which a mandatory bid must be made for the remainder of the shares of the company to be acquired once a certain number of shares in that company has been obtained. These matters will be considered in more detail later.

(c) Insider dealing

The Code deals with insider trading in quoted companies and the Takeover Panel can publish reprimands in respect of those who deal inside. These are extra-legal sanctions, the Criminal Justice Act 1993 providing for criminal sanctions. The contribution in this field made by the Financial Services and Markets Act 2000 on market abuse under the control of the Financial Services Authority has already been noted (see Chapter 13).

See p. 259

(d) Misleading profit forecasts

Directors and other officers of companies do, from time to time, make public statements as to the future profits of companies which are misleading. The Panel has been active in this area in requiring the publication of corrections of misleading statements.

In addition, when a forecast of profit before taxation appears in a document addressed to shareholders, there must be included forecasts of taxation, extraordinary items and minority interests.

(e) Tactics of directors

The directors of the company to be acquired have in the past used tactics to frustrate the bid and retain control. The Panel takes action on the basis of the Code's general principle 7 which states:

> At no time after a bona fide offer has been communicated to the board of the offeree company or after the board of the offeree company has reason to believe that a bona fide offer might be imminent may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits.

In the past, directors' tactics used to frustrate a bid have often consisted of the issue of additional shares to a company or person(s) who would not accept the bid, without consulting the shareholders of the victim company as to whether this tactic of the directors was acceptable. Obviously general principle 7 would apply to such a situation but now the 2006 Act provides, as we have seen, that the authority of the company is required before the allotment of certain securities by the directors (see Chapter 11). This is reinforced by Rule 21 which carries a similar provision regarding the issue of shares but extends to the making of other contracts otherwise than in the ordinary course of business.

See p. 226

However, there are some situations where general principle 7 and Rule 21 would be the only sanction, for example where the directors lease off the company's property to put it beyond the control of the bidder so that he does not continue with his bid. If we assume that company B, our victim company, owns the freehold of a large block of flats which a bidder for company B wishes to demolish in order to develop the site, then if the directors of B were to lease out the block of flats for, say, 99 years, thus preventing the bidder, even if he were successful, from demolishing the premises for that period so that he did not proceed with his bid, then such a tactic would, unless approved by ordinary resolution of the members, infringe general principle 7 and Rule 21 and the 'proper purpose' rule and could be the basis of a complaint to the Panel and action by it to prevent infringement of the Code.

Statutory Authority of the Panel and the City Code

The Panel is an independent body, established in 1968, whose main functions are to issue and administer the City Code (sometimes referred to as the Code or the Takeover Code) and to supervise and regulate takeovers and other matters to which the Code applies in accordance with the rules set out in the Code. It has been designated as the supervisory authority to carry out certain regulatory functions in relation to takeovers pursuant to the Directive on Takeover Bids (2004/25/EC) (the 'Directive'). Its statutory functions are set out in and under ss 942 to 963 of CA 2006. Rules are set out in the Code. Further information relating to the Panel and the Code can be found on the Panel's website at www.thetakeoverpanel.org.uk.

In addition, the membership of the Panel covers a wide range of services within the City and therefore a flagrant flouting of the Code could lead to problems in addition to the loss of the Stock Exchange market for purchase and sale of securities. The Code is issued on the authority of the Takeover Panel.

Membership of the Panel

The chairman, deputy chairmen and certain members of the Panel used to be appointed by the Governor of the Bank of England under earlier editions of the Code, reflecting the historical reality of how the self-regulatory process was initiated. However, the Governor no longer has a formal role in the Panel's composition, rather these individuals are appointed by the Panel itself. In addition, its membership comprises individuals nominated by the following bodies, all of which are committed to support its activities:

The Association of British Insurers;
The Association of Investment Trust Companies;
The Association of Private Client Investment Managers and Stockbrokers;
The British Bankers' Association;
The Confederation of British Industry;
The Institute of Chartered Accountants in England and Wales;
The London Investment Banking Association (with separate representation for its Corporate Finance Committee and Securities Trading Committee);
The National Association of Pension Funds;
The Investment Management Association;
London Investment Banking Association Securities Trading Committee.

Each of the bodies listed above may also nominate designated alternates.

In addition, the Panel publishes reprimands which may even appear in the professional press. The publication of this sort of information should have some effect upon practitioners for publication leads to knowledge by their colleagues that they have transgressed the ethics of the Code. Published public reprimands are rare because of the devastating effect such statements may have on companies operating within the financial sector.

It is the nature and purpose of the City Code to ensure that shareholders are treated fairly and are not denied an opportunity to decide on the merits of a takeover. In particular, shareholders of the same class must be afforded equivalent treatment by an offeror under the City Code. The City Code however is not concerned with the financial or commercial advantages or disadvantages of a takeover which are matters for the company and its shareholders. Additionally, competition policy is outside of its remit.

CA 2006, s 952 allows the Panel to impose sanctions on a person who breaches the rules. These sanctions can be enforced by the Panel seeking enforcement by the court pursuant to s 955, CA 2006. Hearings and appeals (including the establishment of an independent Takeover Appeal Board) are provided for in s 951, CA 2006.

Judicial review

In ***R* v *Panel on Takeovers*** [1987] 1 All ER 564 the Court of Appeal decided that, having regard to the public consequences of non-compliance with the Code, e.g. that a bid by one company for another could be declared invalid if the procedures of the Code were infringed, an application to the High Court to consider a Panel ruling by way of judicial review would be available in an appropriate case. The courts are not, however, anxious to intervene because judicial review of a Panel decision introduces an element of delay which is undesirable in the takeover situation.

All that now remains is to consider some of the major steps in a takeover bid and see how the various rules of the Code affect the position. In addition, we must give special consideration to the duties of directors in takeovers since this is not only the greatest area of practical problems but is also most likely to be required for examination purposes.

In all situations company A is attempting to acquire company B.

Secrecy during negotiations: insider dealing

See p. 259

The relevant provisions, which are set out in Rules 2 and 4, are designed to prevent insider dealing and they are *extra-legal* in their operation. The *legal* provisions, under which insider dealing may, in certain circumstances, be a criminal offence punishable by a fine and/or imprisonment, are set out in the Criminal Justice Act 1993 (see Chapter 13).

There are, as we have seen, additional *civil* sanctions for market abuse in the Financial Services and Markets Act 2000 that are administered by the Financial Services Authority.

Rule 2, which is concerned with keeping bids secret before public announcement, states: 'The vital importance of absolute secrecy before an announcement must be emphasised.'

Rule 4, which is concerned with dealings before and during the offer, requires all persons who have confidential price-sensitive information concerning an offer or contemplated offer to treat it as secret and not pass it on to anyone else unless it is necessary to do so, as where it is part of a person's work to pass it on as, for example, by one member of an audit team to another as part of the audit function.

Additionally, there must not be dealings in securities of the offeree or the offeror company by persons (other than the offeror) who have price-sensitive information prior to the announcement of an approach by a bidder, or an actual bid, or of the termination of negotiations. Dealing is allowed in the shares of the offeror company where the bid will not significantly affect the value of the offeror's shares, which may often be the case. It is the shares of the offeree company which are most likely to be affected by a bid.

If those involved in the negotiations feel that secrecy cannot be maintained, they should ask the Stock Exchange for a temporary halt in dealings.

Failure to comply with Rules 2 and 4 may result in a reprimand from the Panel which may be published.

The rules of the Code are now preventive and information suggesting that insider dealing has taken place which might be revealed by dealings on the Stock Exchange would be passed by the Stock Exchange and by the Panel to the Financial Services Authority for investigation.

Offer document and response of offeree board

The rules derive from section J (consisting of Rules 23–27) of the City Code. It is worth referring again to the general object of the detailed contents of the offer document and any documents issued by the offeree board which is stated in Rule 23.

More important than the contents of the offer document is what an individual shareholder can do if he is misled by the contents of the offer document. While accepting that this branch of the law is not well developed, the judgment of Brightman J in ***Gething* v *Kilner*** [1972] 1 WLR 337 would seem to justify the following statement:

> If an offer document or a recommendation circulated by the directors of the offeree company contains a false or misleading statement made knowingly, or presumably, if such a document omits information known to the persons issuing it which the law or good practice requires it to contain, any shareholder of the class to whom the bid is addressed may apply to the court for an injunction to restrain the offeror from proceeding with the bid or declaring it unconditional.

Partial offers and mandatory offers

In this connection a knowledge of Rule 36 (partial offers) and Rule 9 (mandatory offers) is of importance. However, before considering the rules relating to partial offers which can result in a bidder obtaining control of a company 'on the cheap', as it were, the nature of a partial bid should be understood. If we take three shareholders of the target company and their holdings to be Mr A (100 shares), Mr B (50 shares), and Mr C (40 shares), then a 50 per cent partial bid will involve, for example, an offer to take 50 of A's shares, 25 of B's shares, and 20 of C's. When this sort of bid is being contemplated, Rule 36 must be followed. Under the rule the Panel's consent is required for any partial offer.

In addition, the following subrules of Rule 36 should be noted.

In the case of an offer which would result in the offeror holding shares carrying less than 30 per cent of the voting rights of a company, consent will normally be granted (Rule 36.1).

Any offer which would result in the offeror holding shares carrying 30 per cent or more of the voting rights of a company must normally be conditional, not only on the relevant number of acceptances being received, but also on approval of the offer, normally signified by means of a separate box on the Form of Acceptance and Transfer, being given by shareholders holding 50 per cent of the voting rights not held by the offeror and persons acting in concert with it. This requirement may on occasion be waived if over 50 per cent of all voting rights of the offeree company are held by the shareholder (Rule 36.5).

Where an offer is made for a company with more than one class of equity share capital which would result in the offeror holding shares carrying 30 per cent or more of the voting rights, a comparable offer must be made for each class (Rule 36.8).

In connection with mandatory offers, the following subrules of Rules 2 and 9 should be noted.

Mandatory offers

A mandatory bid must be made unless the Panel gives its consent:

- by a person who acquires whether by a series of transactions over a period of time or not shares which taken together with shares held or acquired by persons acting in concert with him carry 30 per cent or more of the voting rights of the company;
- by a person who together with people acting in concert with him holds not less than 30 per cent but not more than 50 per cent of the voting rights of a company if there is *any increase at all* in the percentage level of that holding.

Previously in such situations a person or a group acting in concert could acquire in any 12-month period additional shares carrying up to 1 per cent of the voting rights without making a general offer for the company. The change was made following criticism of the ability of a person or concert party to achieve control over a period of time without making a formal bid as where the holding was, say, 48 per cent and the 1 per cent acquisitions eventually brought over 50 per cent and thereby basic control.

The second rule is to deal with persons who have made a bid that has failed to achieve control but which has left the bidder with, say, a 35 per cent holding. Although the City Code consists of extra-legal rules, the High Court applied the 30 per cent mandatory bid rule in effect by the decision in ***Philip Morris Products Inc*** v ***Rothmans International Enterprises Ltd (No 2)*** (2000) *The Times*, 10 August.

Immediately upon an acquisition of shares which gives rise to an obligation to make an offer under this rule, the offeror shall make an announcement of its offer giving the information required by the Code. The announcement of an offer under this rule should include confirmation by a financial adviser or other appropriate independent party that resources are available to the offeror sufficient to satisfy full acceptance of the offer (Rule 2.5(c)).

An important exception to the requirement to make a mandatory bid occurs when there is a rescue operation. If company B is in financial difficulties but company A is willing to invest in the share capital of B in order to save it, then if A takes an issue of shares in B which gives A, say, 35 per cent of the share capital of B, the Panel will consider waiving the mandatory bid requirement for the rest of B's shares.

Except with the consent of the Panel, no nominee of the offeror or persons acting in concert with it shall be appointed to the board of the offeree company, nor shall the offeror and persons acting in concert with it transfer, or exercise the votes attaching to, any shares in the offeree company, until the offer document has been posted (Rule 9.7).

The Code defines 'acting in concert' as follows: 'Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate, through the acquisition by any of them of shares in a company, to obtain or consolidate control of that company.'

Then follows a list of persons who will be presumed to be persons acting in concert with others in the same category unless the contrary is established. These include a company, its parent, subsidiaries, and fellow-subsidiaries, and their associated companies.

For this purpose, ownership or control of 20 per cent or more of the equity share capital of the company will be regarded as a test of associated company status. Other persons presumed to be acting in concert are a company with any of its directors (together with their close relatives and related trusts); a company with any of its pension funds; a person with any investment company, unit trust or other funds whose investments such person manages on a discretionary basis; a financial adviser with his client where the financial adviser has shares in the client company; and finally, directors of a company which is subject to an offer or where the directors have reason to believe a bona fide offer for their company may be imminent.

It should be noted that although an interest of under 30 per cent does not constitute control in the Takeover Panel's eyes, the Office of Fair Trading may take the view that it could constitute a merger giving the Office of Fair Trading power to make a reference to the Competition Commission with a view to preventing the takeover going ahead if it is thought by the Competition Commission to be undesirable in the public interest. The relevant provisions are contained in the Competition Act 1998 and the Enterprise Act 2002.

Compulsory acquisition

CA 2006, s 979 (formerly CA 1985, s 429) is a section which can be used but only by a corporate bidder who has made a bid to acquire compulsorily the shares of a small minority who have not accepted the offer. The provisions of the section are as follows:

(a) Where A already has not more than 10 per cent of B or no holdings in B at all, then if 90 per cent of B's shareholders, or other shareholders, have accepted the offer within four months A may within two months after the reaching of the 90 per cent threshold serve a notice on dissentients that it intends to acquire their shares. The dissentients have six weeks from the date on which the notice was given to appeal to the court. If there is no appeal or the court does not order otherwise, A acquires the shares.
(b) Where A has more than 10 per cent of B, then under s 979 of the 2006 Act, three-quarters in number and 90 per cent in value of B's other shareholders must accept within four months of the offer.

The court will seldom interfere if the offer is fair but will not allow the section to be used for improper purposes such as the expulsion of a minority.

Re Bugle Press Ltd [1960] 3 All ER 791

Holders of 90 per cent of the shares in a company formed a new company which made an offer for the shares of the old company. As was to be expected, 90 per cent of the shareholders accepted the offer and the new company then served notice on the holder of the other 10 per cent of the shares stating that it wished to purchase his holding.

Held – by the Court of Appeal – that in substance the new company was the same as the majority shareholders, and the scheme was in effect an expropriation of the minority interest. 'What the section is directed to is a case where there is a scheme or contract for the acquisition of a company, its amalgamation, re-organisation or the like, and where the offeror is independent of the shareholders in the transferor company, or at least independent of that part or fraction of them from which the 90 per cent is to be derived.' *Per* Evershed MR.

The High Court (affirmed by the Court of Appeal) has ruled that CA 2006, s 979 allows a bidder who holds 90 per cent in value of the shares in the victim following a bid to compulsorily acquire the shares of the remaining members even though they did not receive the offer documents.

In Re Joseph Holt plc Winpar Holdings Ltd* v *Joseph Holt Group plc [2000] 97 (44) LSG 44. Appeal case available at www.lawtel.com, under Case Law-CO100109

In March 2000, Inhoco 1849 plc, now the Joseph Holt Group plc, announced that it was making an offer to acquire all the issued share capital of Joseph Holt plc. The offer document was sent to most of Joseph Holt plc's existing shareholders, and an advertisement was placed in the London edition of the *Financial Times*. The offer document was not sent to shareholders whose addresses were in Australia, Canada, Japan or the USA because complying with the securities laws of those countries was difficult and costly.

By April 2000, Joseph Holt Group plc had received acceptances which, together with the shares it already held, amounted to over 90 per cent in value of Joseph Holt plc.

Notices of compulsory acquisition under s 429(1) were sent to the remaining shareholders. Once notices are sent, the bidder is entitled to, and must, acquire the outstanding shareholdings under s 430(2).

A s 429(1) notice was sent to Winpar Holdings Ltd in Australia. The company objected on the ground that the notice was invalid since it had not received the offer documents.

The High Court ruled (later affirmed by the Court of Appeal) that the offer was to acquire all the shares as required by s 428. The fact that the offer was not communicated to a particular shareholder was not fatal to the offer and the subsequent proceedings under s 429(1). For the compulsory acquisition procedure to apply, it was necessary only that an offer for all the shares was made: it was not necessary that such an offer was received by or known to a particular shareholder. The offer made by Joseph Holt Group related to Winpar's shares, even though Winpar was not aware of it. The offer documentation was a general and not a limited process, and in addition the offer did not exclude the shares of those resident in Australia. The s 429(1) notice to Winpar was therefore valid and the compulsory purchase procedure applied to its shares.

Comment

Transfer of the acquired shares is effected by an instrument of transfer executed on behalf of the shareholder by a person appointed by the offeror (CA 2006, s 981).

Reverse acquisition

This is a takeover method used by a private company to go public without undertaking all the regulatory hurdles that going public usually requires. The private company acquires majority ownership in a publicly listed company that has no assets or liabilities (called a shell), changes the company's name, and installs its management and board of directors.

Directors' duties in a takeover by general offer

Suppose that in a bid situation the directors bargain for additional payments to themselves, what can the other shareholders do?

Apart from the provisions of the City Code, if the directors of B retire from office 'golden handshakes' are covered by the Companies Acts and such sums are held in trust for those shareholders who sold their shares as a result of the offer, if the payments were not disclosed and approved by ordinary resolution of the members.

If they do not retire, the Companies Acts do not apply and additional payments made to directors are not recoverable. Thus if no change is made in the directorship but, for example, the board are paid £100,000 to persuade them to recommend the offer to the other shareholders, or are paid an increased price for their shares because they hold a large block, it seems there can be no recovery under the Acts.

It will be apparent, therefore, that there are situations in which the directors, in connection with a takeover bid, may receive additional payments without being liable to account for them under the statute.

The Code also applies and provides that unless the Panel consents the offeror, or persons acting in concert, may not make arrangements to deal or buy or sell shares of the offeree company during an offer or when one is in contemplation, if those arrangements have attached to them favourable conditions not being extended to all shareholders.

The City Code and the supervision of the Panel should in most cases prevent this occurring in the case of public companies but it could still occur in the case of private ones where in fact some of the worst abuses have occurred in the past. Where a private company is concerned or, in the case of a public company if the Panel is not effective, the most hopeful line, in terms of getting the money back from the directors, is to allege a breach of their fiduciary duties towards the company. The general equitable principle exemplified in ***Regal (Hastings) Ltd*** v ***Gulliver***, 1942 (see Chapter 19) could apply. However, the action is not straightforward because the wrong covered in that case is basically one to the company and payments made to directors to secure favourable recommendation to the shareholders in a bid situation seem merely to be a payment to them in their capacity as directors, no corporate action being involved, though the extra money received is, of course, an undisclosed benefit or profit from office and is recoverable by the company on the basis of a breach of fiduciary duty.

See p. 379

However, it is somewhat futile to allow the company to recover in cases where those who are really wronged are the other shareholders who have sold. The Companies Act provides that moneys paid as a result of retirement are held on trust for the shareholders but the judge-made equitable rules as seen in the ***Regal*** case do not necessarily extend to shareholders. Presumably, the s 175 CA 2006 which codifies the duties of a director to avoid conflicts of interest such as misuse of corporate opportunities for personal gain might now replace the general equitable principle stated in ***Regal***.

Dealings in shares during offer period

Another problem which can arise if the directors have been offered incentives to recommend a bid is that the bid price for the shares may be lower than it should be. Where this is so, the offeror company (A) may, in order to enhance its chances of successful control, purchase shares in B on the market at a price higher than the bid price.

Since it is not desirable to fetter the market in shares, Rule 8.1 of the Code provides that dealings in relevant securities by the parties to a takeover and by any associates, for their own account, or the account of discretionary investment clients, must be disclosed daily to the Stock Exchange (Company Announcements Office), the Panel and the press (discretionary) not later than 12 noon on the business day following the date of the transaction. Such disclosures must state the total of all relevant securities of any offeror or the offeree company purchased or sold on any day during the offer period, in the market or otherwise, and the prices paid or received.

In this connection, Rule 6.2 provides that if the offeror or persons acting in concert purchase securities during the offer period at above the offer price, then it shall increase its offer to not less than the highest price paid for the securities so acquired. Rule 7.1 provides that an announcement of any such purchase and the consequent increased offer must be made immediately.

The Code provides that a person with a significant commercial interest in the outcome of an offer should not, without the consent of the Panel, deal in the shares of an offeror or an offeree company during an offer period.

Recent amendments and developments

The Code was amended on 14 January 2008 to cover transactions implemented by way of a scheme including the addition of a new Appendix 7 to the Code explaining how the provisions of the Code apply to schemes (and listing those which do not apply where a scheme is used). Rule 26 of the Code (documents on display) was amended on 25 January 2010 (among other things) to provide that all documents required by that Rule to be put on display should also be available for inspection on a website.

On 1 July 2009, legislation was put in place in Jersey, Guernsey and the Isle of Man, putting the Takeover Panel's regulation of takeovers and mergers of companies registered in those jurisdictions on a statutory footing. As a result, the Takeover Panel now has powers and duties in the Channel Islands and the Isle of Man equivalent to those imposed on and granted to it in the UK by the Companies Acts 2006.

Two important changes were made to the Code's disclosure rules which came into effect on 19 April 2010: (a) first, to require that a person subject to the Code's disclosure regime (including a person with a gross long interest of 1 per cent or more in any relevant securities of any party to an offer, other than a cash offeror) should disclose his long interests and short positions in relevant securities of an offeree company by no later than the tenth business day after the commencement of the offer period (and, in the case of a securities exchange offer, in relevant securities of the offeror by no later than the tenth business day after the announcement that first identifies it as an offeror), regardless of whether he has dealt in the relevant securities of the party concerned (the 'opening position disclosure' requirement); and (b) secondly, to require that a person who has a gross long interest of 1 per cent or more in any relevant securities of a party to an offer (other than a cash offeror) should disclose any dealing by him in any relevant securities of any party to the offer (other than a cash offeror) – i.e. not only dealings in relevant securities of the party to the offer in which he has a gross long interest of 1 per cent or more; and also that any person making a disclosure under the Code should disclose details of all his long interests and short positions in relevant securities of all parties to the offer (other than a cash offeror) – i.e. not only the party to the offer in whose relevant securities the dealing occurred (the 'extended composite disclosure' requirement).

Essay questions

1 In order to raise additional finance Devonia Trust plc, a holding company, intends to make a rights issue. Its subsidiaries have their own classes of share capital with different voting and dividend rights. With a view to simplifying the capital structure of the group it is proposed to exchange all the subsidiary companies' shares held by minority shareholders for ordinary shares in the holding company itself.

Advise Devonia Trust plc as to how its objective could be achieved, the steps necessary to be taken and the implications of any such scheme. (*University of Plymouth*)

2 Write notes on TWO of the following:

(a) promoters;

(b) redeemable shares;

(c) disqualification of directors;

(d) schemes of arrangement. (*The Institute of Chartered Secretaries and Administrators*)

3 Zed Ltd wish to acquire the undertaking of a company which is in members' voluntary liquidation but still trading. Zed Ltd cannot afford cash for the purchase and suggest they should issue their own shares to the value required. How can this suggestion be implemented?
(*The Institute of Chartered Accountants in England and Wales*)

4 Beefy Farm Ltd was incorporated in 2005. Its articles of association appointed Peter and Richard as directors for life. The objects clause of the company's memorandum of association provided that the company should carry on the business of beef breeding with any other activities reasonably incidental thereto. The objects clause included a power to borrow money and a provision that no object or power should be deemed subsidiary to any other.

In November 2005 Beefy Farm Ltd unexpectedly received what appeared to be an attractive proposition from an Italian company to manufacture their ice cream under licence. The Italian company encouraged them to use the farm's milk in the manufacture. Beefy Farm Ltd borrowed £100,000 from National Bank plc to get started with the new business but subsequently refused to repay it on the ground that the loan was *ultra vires*.

(a) Advise National Bank plc on their legal position.

AND

(b) How far, if at all, would your answer to (a) differ if the bank had a copy of Beefy Farm Ltd's memorandum of association at the time of lending the money?

AND

(c) How far, if at all, would your answer to (a) differ if Richard alone negotiated the loan agreement and Peter knew nothing about it? (*Glasgow Caledonian University*)

5 B Ltd held a general meeting including the following alterations to the articles which were duly passed:

(a) 'a member shall, upon the request of the board, transfer his shares to a person nominated by the board';

(b) 'a director shall vacate office upon the written request of all other directors';

(c) 'upon the death of a director his/her shares shall be forthwith registered in the name of his/her spouse or other next of kin notwithstanding any testamentary disposition to the contrary';

(d) 'a member wishing to sell his shares shall inform the directors who shall buy them at a fair valuation made by the auditors'.

Henry has been a director for five years and was appointed by the articles. He has no service contract, but the articles appointed him for life. He has been asked to resign under (b) above.

John, who holds 1,000 shares, and is also a shareholder in a rival company with which he now trades (having formerly traded with B Ltd), has been requested under (a) above to transfer his shares to Alice, the daughter of one of the directors.

Sally is executor of Jim, a deceased director who by his will bequeathed his shares to his daughter Lyn. The board has refused to transfer his shares to Lyn saying they have been registered under (c) above in the name of Rebecca, Jim's widow, from whom he had been separated but not divorced for 40 years.

Vera has informed the board that she wishes to sell her shares, but two months have elapsed and the board has taken no action at all.

Advise Henry, John, Sally and Vera of any legal remedies which may be open to them.

(*Kingston University*)

Test your knowledge

Four alternative answers are given. Select ONE only. Circle the answer which you consider to be correct. Check your answers by referring back to the information given in the chapter and against the answers at the back of the book.

1 Thames plc is in financial difficulties and wants its debenture holders to exchange their debentures for shares in order to get rid of the requirement to pay interest on the debentures. How should Thames proceed?

- **A** Under s 110 of the Insolvency Act 1986.
- **B** Under s 895 of the Companies Act 2006.
- **C** By a reduction of capital.
- **D** By unilaterally altering the terms of issue of the debentures.

2 Developer plc wishes to take over Hotels Ltd in order to develop the sites on which various hotels belonging to Hotels Ltd stand as supermarkets. Developer's bid is likely to be accepted by a majority of Hotels' shareholders. The directors of Hotels Ltd have sold the various hotels to a subsidiary of Hotels Ltd and taken a lease back off them. The lease restricts the use of the various premises to the hotel business. Developer has now withdrawn its bid. What is the position of the directors of Hotels Ltd?

- **A** They are only in breach of the 'proper purpose rule'.
- **B** They are not in breach of any fiduciary duty.
- **C** They are in breach of the 'proper purpose rule' and the City Code.
- **D** They are liable for breach of warranty of authority.

3 Tay plc is to make a bid for shares in Uncle plc. If the bid is successful it will result in Tay holding 20 per cent of the shares in Uncle. What is the position under the City Code?

- **A** The Panel must consent and will normally do so.
- **B** There is no need for the Panel to be involved.
- **C** The Panel must consent and is unlikely to do so.
- **D** The City Code does not allow this sort of bid.

4 Toys plc is in financial difficulties. Cycles plc is prepared to inject new capital into Toys, which when completed will leave Cycles with 35 per cent of the share capital of Toys. What is the position under the City Code?

- **A** Cycles is required to make a bid for the rest of Toys' shares.
- **B** The City Code provides for rescue bids to go through without recourse to the Panel.
- **C** The City Code is not concerned with rescue bids.
- **D** The Panel may in the case of a rescue bid waive the normal requirements for a mandatory bid.

5 Fred, a financier, has made a personal bid for the equity shares of Brick plc. He has acquired 92 per cent of the shares in Brick and intends to compulsorily acquire the rest. What is the legal position?

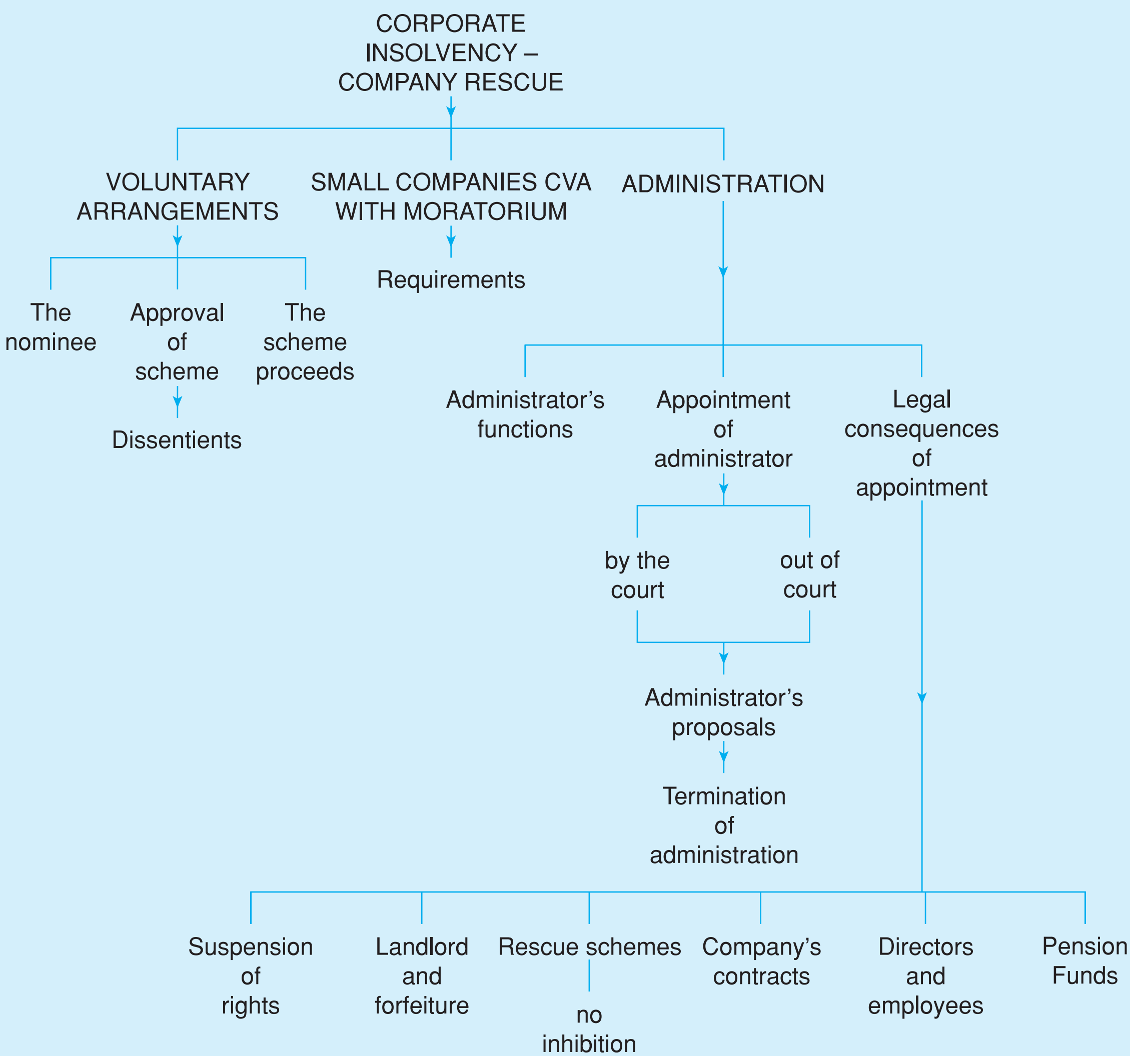
- **A** Fred will be able compulsorily to acquire the shares under the Companies Act 2006.
- **B** Fred cannot compulsorily acquire the shares under the Companies Act 2006 because he did not get 95 per cent.
- **C** There are no legal provisions which allow compulsory acquisition.
- **D** The compulsory acquisition provisions of the Companies Act 2006 do not apply in this situation.

6 Before incorporation of a company called Alfredo Ltd its promoter, Mostyn, made a contract on behalf of the company. Who will be liable if the contract is not performed by Alfredo Ltd?

- **A** Alfredo Ltd.
- **B** Mostyn.
- **C** The directors of Alfredo Ltd.
- **D** The shareholders of Alfredo Ltd.

Answers to test your knowledge questions appear on p. 617.

25 Corporate insolvency – company rescue



In this chapter we shall consider those aspects of insolvency law which are designed to rescue the company and prevent winding-up.

Voluntary arrangements

Sections 1 to 7 of the Insolvency Act 1986 provide for a type of voluntary arrangement which is concerned to prevent a company from being wound up. In general terms, a CVA is a contract made between the company and its creditors. The contract freezes the existing debts at an agreed date. The company carries on trading and pays a monthly amount into the CVA over an agreed period, usually of three to five years. The CVA allows the company to go on trading but enables the creditors to receive at least a part of their debt.

When interpreting the terms of a CVA contract, courts generally opt for an interpretation that supports the CVA. However, a court may adopt an approach that may not be convenient for the supervisors if that is the proper interpretation of what the parties agreed. See, for instance, ***In Re Energy Holdings (No.3) Ltd (In Liquidation)*** [2010] EWHC 788 (Ch) in which the court held that the supervisors must apply the terms of the CVA and thus not leave the creditor's claim in limbo and lacking an effective right of appeal. Here the supervisors' excessive delay from leaving these claims unadjudicated cost them dearly! They were ordered to pay both sides' costs of the applications on an indemnity basis.

The company's directors can initiate formal proposals for a voluntary arrangement at any time and the company need not actually be insolvent though it often will be, or at any rate close to it. Once a winding-up begins or an administration order is made (see below), the directors can no longer initiate a scheme, though the initiative may come in such a case from the liquidator or the administrator.

In fact, in general terms a voluntary arrangement will be much more likely to succeed if it is put forward by an administrator after an administration order has been made since as we shall see the suspension of creditors' rights which occurs in an administration will give the administrator/nominee (see below) a better chance to put together a fully considered scheme.

The proposals will be similar to those which must be referred to the court under Part 26 of the Companies Act 2006, e.g. creditors agreeing to take, say, 50 pence in the pound. The Insolvency Act 1986 provides a simpler approach to the 2006 Act, though that section remains available for major reconstructions for which it is more appropriate.

In this regard, the High Court has approved as a voluntary arrangement a proposal by a company to pay nil pence in the pound to its preferential and other unsecured creditors (see ***IRC*** v ***Adams and Partners Ltd*** [1999] 2 BCLC 730). Creditor approval was given to the scheme because it gave a better return to the Bank of Scotland plc which held a fixed and floating charge over the assets. The Revenue, as a preferential creditor, challenged the arrangement on the basis that it was not an arrangement permitted by the 1986 Act but its claim failed. The Revenue might have fared better if it had brought a claim under s 6 of the 1986 Act on the basis that the arrangement was 'unfairly prejudicial' to it. However, such a claim must be brought within 28 days of the results of the creditors' meeting being reported to the court and the Revenue had left it too late for this. The Revenue could only challenge it on the basis that it was an arrangement of a type not permitted by the Act, and on this contention the Revenue failed.

The nominee

The directors must appoint a nominee, though in an administration or liquidation the administrator or liquidator will act as nominee. The nominee must be an authorised licensed insolvency practitioner.

Certain professional bodies recognised by the Secretary of State for Business, Innovation and Skills (Secretary of State) may authorise their members to act as insolvency practitioners. The bodies currently recognised for England and Wales are: The Chartered Association of Certified Accountants, The Insolvency Practitioners' Association, The Institute of Chartered Accountants in England and Wales, and The Law Society. Persons not authorised by a professional body may apply to the Secretary of State for authorisation. The relevant professional association is the Insolvency Practitioners Association.

In this connection, s 4 of the Insolvency Act 2000 authorises persons other than licensed insolvency practitioners (IPs) to act as nominees or supervisors of company (or individual) voluntary arrangements, provided that such persons are members of bodies that are recognised by the Secretary of State. The change seems designed to let in members of bodies such as the R3, the Association of Business Recovery Professionals, and other turnaround specialists and maybe to provide more competition in the market where there are only some 1,200 IPs at present taking appointments.

The nominee will investigate the scheme and report to the court, within 28 days after he is given notice of the proposed scheme, as to whether the scheme is likely to be viable so that meetings of members and creditors should be called to approve it. If the nominee is already an administrator or liquidator, there is no need to report to the court. Unless the court orders otherwise, where a report is made to it, the nominee will order meetings of creditors and members to be called to consider the proposals for a voluntary arrangement and to approve it.

In order to assist him with his report, he is entitled to a statement of affairs from the directors. Where a nominee is required to report to the court, he must state in his report whether in his opinion the proposed company voluntary arrangement (CVA) has a reasonable prospect of being approved and implemented (Insolvency Act 2000, Sch 2). As we have seen, such a report is not necessary where the nominee is an administrator or liquidator.

Approval of scheme: by members and creditors

Approval requires a simple majority in value of the members voting in person or by proxy (or by written resolution) and a three-quarters majority in value of creditors voting in person or by proxy at a creditors' meeting. Every creditor of the company of whose claim and address the nominee is aware is entitled to attend.

A resolution will fail if at the creditors' meeting more than half in value of the creditors who are not connected with the company, i.e. who are not director creditors or directors' relatives who are creditors, vote against it.

If the meetings approve the arrangement, it becomes binding on all ordinary creditors, but not on preferred or secured creditors, unless they agree, who can pursue their claims against the company.

In ***Re Cancol Ltd*** [1996] 1 BCLC 100 the High Court decided that a person who was entitled to a future or contingently payable debt such as future payments of rent to fall due under an existing lease was a 'creditor' for the purposes of insolvency legislation and was bound by a company voluntary arrangement approved at a meeting of creditors of which he had notice and at which he was entitled to vote.

The approval of the scheme is reported to the court which may discharge an administration order or a winding-up order.

The decision in ***Re Cancol*** (1996) is now reinforced by the Insolvency Act 2000 which provides that a CVA will bind all of the company's creditors, including unknown creditors, who are then able to claim from the company only the dividends they would have received if they had come to light after the CVA had been completed. Such creditors may also make an application to the court on the ground that their interests are unfairly prejudiced by the voluntary arrangement that is approved (see Sch 2, paras 6 and 7). Preferential creditors retain their priority, of course, and secured creditors will rely on their security unless they have consented to surrender it to the company and become ordinary creditors when the above provisions of the IA 2000 will apply if, for example, they fail to attend a meeting and vote even where no notice was given.

It is an offence under the IA 2000 for an officer of a company to try to obtain approval of the members or creditors to a proposed CVA by making a false representation or fraudulently doing or failing to do anything (Sch 2, paras 8 and 12). The nominee or supervisor is required under para 10 of Sch 2 to report suspected offences to the Secretary of State. The Secretary of State is granted powers to investigate such suspected offences (para 10).

Dissentients

Dissenting members and creditors may apply to the court to set aside the scheme on the grounds of unfair prejudice or material irregularity. This must be done within 28 days of the nominee reporting the approval of the scheme to the court. The time limit cannot be extended.

The High Court considered the phrase 'material irregularity' in ***In re Trident Fashions plc*** [2004] *The Times*, 23 April. The application was brought against the company's three joint administrators and the company which employed them. The material irregularity relied on was the failure by one of the administrators to disclose to the meeting the existence of certain offers to purchase the company. It appeared that at the meeting the administrator concerned mentioned only one formal offer without saying that there had been two other offers as well. The judge concluded from this that there had been a relevant irregularity. However, the decision of the Court of Appeal in ***Cadbury Schweppes plc* v *Somji*** [2001] 1 WLR 615 had to be looked at. It laid down a test in this sort of case which was that if the truth had been told at the meeting it would be likely to have made a material difference to the way in which the creditors would have assessed the terms of the proposed voluntary arrangement: was there a substantial chance that the creditors would not have approved the arrangement? The fact that the meeting might have been adjourned for a few days was not enough. The judge said that in the circumstances it was unlikely that the meeting would have been adjourned but even if it had been adjourned for a few days there was no real prospect that it would have affected the approval of the voluntary arrangement. On the matter of omission of material at the meeting the court could interfere with the arrangement only if the omission was one which no reasonable practitioner would have made. The creditors' application was dismissed.

Approval by creditors only

A decision by the creditors' meeting to approve a proposed CVA will prevail where this conflicts with the decision made by a meeting of the company, subject to the right of a member to challenge this on an application to the court (Insolvency Act 2000, Sch 2, para 5).

If the scheme proceeds

If the scheme proceeds beyond the above stages, the nominee becomes the supervisor and implements the scheme. At any stage in the implementation of the scheme, and as it proceeds, the creditors can challenge the supervisor's decisions in front of the court and, equally, the supervisor may ask the court for directions.

Subsequent liquidation

In ***Re Arthur Rathbone Kitchens Ltd*** [1997] 2 BCLC 280 the High Court ruled that s 84 of the Insolvency Act 1986 (circumstances in which a company may be wound up voluntarily) allowed members of the company to resolve that the company be wound up voluntarily even though the directors had proposed an approved voluntary arrangement that was still in progress or capable of fulfilment or not, even though this might mean that the members had broken the terms of the arrangement.

Here the decision of the High Court in ***Re Brelec Installations Ltd*** (2000) *The Times*, 18 April, is of interest. BI had entered into a 'trading out' voluntary arrangement whereby regular payments of a set amount were paid to the supervisors over a fixed period. Some six months later the company failed to pay its debts as they fell due and later went into liquidation. The issue between the supervisors and liquidator was the monies paid by the company to the supervisors prior to the liquidation. Was it available to the supervisors or the liquidator? The court ruled in favour of the supervisors. It was not appropriate to scrutinise the company's trading to determine when default first occurred so as to pinpoint the date from which payments to the supervisors were to be regarded as held for the benefit of the company rather than for the arrangement. The monies received by the supervisors prior to the liquidation remained subject to the trusts of the voluntary arrangement.

The High Court also ruled in ***Re Kudos Glass Ltd (in liquidation)*** [2001] 1 BCLC 390 that sums held by the supervisor of a creditors' voluntary arrangement are in the event of a compulsory winding-up order made in regard to a non-CVA debt held by the supervisor on trust solely for the CVA creditors. The court ruled that if the petitioner had been the supervisor or a CVA creditor, it would have found that the petitioner had elected to end the scheme and the funds would be transferred to the liquidator.

Small companies: a CVA with a moratorium option

The following provisions of the Insolvency Act 2000 are relevant. Section 1 introduces Sch 1 to the Act, which makes the option of applying for a short moratorium of 28 days available to a small company where its directors intend to put a proposal to the company's creditors for a company voluntary arrangement.

Small companies are not obliged to use this procedure but can proceed under the standard procedure if they wish.

Eligible companies

To be eligible a company must satisfy *two* or more of the conditions for being a small company within s 247(3) of the CA 1985 (repealed and replaced by Companies Act 2006, ss 382 and 465 consolidating). Certain other companies that are involved in financial markets where the modifications to former law are designed to ensure that financial markets continue to function in the event of the insolvency of one of the participants are also included. Those ineligible are companies that are subject to formal insolvency proceedings, as where a winding-up is in progress, or where in the previous 12 months a moratorium has failed.

Nominee's statement

Directors who want a moratorium must provide information to the nominee as follows:

- a document setting out the terms of the proposed CVA;
- a document giving details of the company's assets, debts and other liabilities, together with any other information that the nominee may request.

Given that the nominee considers that the proposal has a reasonable prospect of success in terms of being approved and implemented and that sufficient funding is available and that meetings of the company and creditors should be held, he must provide the directors with a statement to that effect. In reaching conclusions, the nominee may rely on the information provided by the directors unless he has reason to believe it may be inaccurate.

Documents to be submitted to the court

In order to obtain a moratorium, the directors must file certain documents with the court. These are set out in Sch 1, para 7 and include the terms of the proposed CVA and a statement of the company's affairs.

Duration of moratorium

Schedule 1, para 8 deals with this and provides that the moratorium will come into force when the documents referred to above are filed with the court. The maximum initial moratorium is 28 days. This period can be extended or reduced by order of the Secretary of State. A meeting of the company and creditors held within the initial period may decide to extend the moratorium by up to a further two months. The Secretary of State may by order increase or decrease that period of two months. The moratorium may be brought to an end by a decision of the meetings of creditors and company to approve a CVA. Alternatively, it may be brought to an end:

- by the court;
- by the nominee's withdrawal of his consent to act;
- by a decision of meetings of creditors and the company other than to approve a CVA;
- at the end of the 28-day minimum period if *both* of the first meetings of the company and creditors have not taken place;
- if there is no decision of the above meetings to extend it.

Notification of the beginning of the moratorium

The directors have a duty to inform the nominee that a moratorium has come into force. When a moratorium comes into force and when it ends, the nominee must advertise that fact and notify the Registrar of Companies and the company. When the moratorium comes into force, he must also notify any creditor who has petitioned for a winding-up and, when it ends, any creditor of whose claim he is aware.

Effect of moratorium on creditors

Except for an 'excepted petition', i.e. a petition by the Secretary of State that winding-up is in the public interest under s 124A of the IA 1986, no petition to wind up the company can be commenced nor can any other insolvency proceedings. No steps may be taken to enforce any security over the company's property or repossess any goods in the company's possession under any hire-purchase agreement, nor can any other proceedings, execution or other legal process be commenced or continued, or distraint, e.g. by a landlord, be levied. No meeting of the company may be held or requisitioned without the consent of the nominee or of the court.

Winding-up petitions presented prior to the moratorium are stayed during the period but not 'public policy' petitions which continue unaffected.

Section 127 of the IA 1986 rendering void dispositions of the company's property after presentation of a winding-up petition does not apply.

Securities given during the moratorium

These are unenforceable unless given with reasonable grounds that they would benefit the company.

Company invoices

All invoices and orders and letters where the name of the company appears must give the name of the nominee and state that a moratorium is in force. The officers of the company commit an offence if this provision is breached in the absence of reasonable excuse.

Obtaining credit

During the moratorium the company may not obtain credit to the value of £250 or more without first telling the person giving the credit that a moratorium is in force. This includes payments in advance for the supply of goods and services. There are criminal penalties on the company's officers for breach.

Disposals and payments

While the moratorium is in force the company may only dispose of any of its property or pay a debt that existed at the start of the moratorium if there are reasonable grounds for believing that it will benefit the company and the moratorium committee gives approval. If there is no committee, approval must be given by the nominee. There is nothing to prevent the sale of property in the ordinary course of business as where, for example, a farming supplies company sells a tractor as part of its retail trade. Again, officers of the company commit an offence on breach.

Disposal of charged property

The Schedule allows the disposal by the company during the moratorium of charged property and any goods in its possession under an HP agreement, provided the holder of the security or the owner agrees. The holder of a fixed charge and the owner of goods on HP are entitled to have the proceeds of sale applied to repayment of the loan or debt but the holder of a floating charge retains a charge of equal priority to his original charge over the proceeds of the sale or disposal of the charged property.

Monitoring of company's activities

The Schedule imposes a duty on the nominee to monitor the company's affairs during the moratorium in order to form a judgment as to the viability of a CVA and the company's ability to carry on during the moratorium. The directors have a duty to provide the nominee with information.

Withdrawal of consent to act by nominee

The Schedule provides that a nominee may withdraw his consent to act if:

- he considers that the CVA proposal (or modifications communicated to him) no longer has a reasonable prospect of being approved or implemented; or
- he considers that the company has insufficient funds now and during the moratorium to enable it to continue in business throughout the moratorium; or
- he becomes aware that on the date of filing the company was not eligible for a moratorium; or
- the directors are not providing him with relevant information on request.

On withdrawal of the nominee's consent, the moratorium ends. The above are the only grounds on which the nominee may withdraw his consent and he must give notice to various parties, i.e. the court, the Registrar of Companies, the company and creditors of whom he is aware. He commits an offence by not doing so.

Challenging the nominee's actions

Any creditor, director or member of the company or any other person affected by the moratorium who is not satisfied by any decision or act of the nominee may apply to the court for relief. The court may confirm, reverse or modify any such decision or act and give directions to the nominee or make any order it sees fit either during or after the moratorium.

Where the acts of the nominee have caused the company loss and the company appears not to be taking any action, creditors may apply to the court which, if it thinks that the acts of the nominee were unreasonable, may order the company to make a claim against the nominee or authorise a creditor to do so.

Replacement of the nominee by the court

Where it is, for example, impracticable or inappropriate for the nominee to continue, the court may direct that the nominee be replaced by a qualified person who consents.

Summoning of meetings and their conduct

Schedule 1, paras 27 and 28 deal with this and provide, among other things, that the nominee may call meetings of creditors and of the company whenever he sees fit.

These meetings decide whether or not to approve the proposed CVA with or without modification. These modifications may not affect the rights of secured creditors or preferential creditors unless they consent.

Moratorium committee

In a case where the moratorium is extended, there is provision for the setting up of a moratorium committee to exercise functions conferred on it by the meetings referred to above. The meetings must approve an estimate of the committee expenses.

Members and creditors: conflicting decisions

If the decisions of the members and creditors are conflicting, the decision of the creditors prevails but a member may apply to the court for an order that the members' decision should prevail.

Effect of the CVA

The CVA, when approved, binds all creditors of the company including unknown creditors. That includes those creditors who, having followed the insolvency rules, were not served with notice of the relevant meeting(s). Such persons can apply to the court on the grounds of unfair prejudice and the court may, for example, revoke or suspend the approval of the CVA. Otherwise, these creditors are entitled to the dividends payable under the arrangement only. On approval of the CVA, the nominee becomes the supervisor.

Challenge of directors' actions during the moratorium

Any member or creditor can apply to the court for relief on the grounds that the directors are acting in a way unfairly prejudicial to the interests of creditors or members. The court may make an order regulating matters or bring the moratorium to an end. This form of action applies in relation to the acts of directors during the moratorium. The application may be made during or after the moratorium. If made afterwards, the court's order will be to regulate matters and obviously not to bring the moratorium to an end.

Offences by officers of the company

The Schedule provides that if during the 12 months prior to the start of the moratorium an officer of the company has committed certain acts, e.g. fraudulently removed the company's property worth £500 or more or falsified the company's records in relation to its property, he commits an offence, as does an officer who so acts during the moratorium.

It is also an offence for an officer of the company to try to obtain a moratorium or an extension of it by making false statements or fraudulently doing or not doing anything.

Void provisions in floating charge documents

Schedule 1 provides that any provision in a floating charge is invalid if the charge is to crystallise (and therefore become a fixed charge) on the obtaining of, or any action to obtain, a moratorium.

The remainder of the Schedule makes consequential amendments to various parts of the IA 1986, e.g. so that suppliers of gas, water and electricity are not permitted to require a nominee to pay outstanding debts for supply as a condition for supply during the moratorium. There is also a provision that the relevant date for determining preferential claims is the date on which the moratorium comes into force.

Trading with companies that are in a CVA

It is not unusual for creditors to carry on trading with a CVA company. Any new debts will not be covered by the CVA and become, in effect, new liabilities of the CVA company. There are, of course, some concerns about a continuation of trade since, if the company cannot meet its CVA requirements, it will almost certainly be forced into liquidation and the new liabilities, if not paid, may not be met. Set out below are some precautions that a creditor can take in such circumstances:

- where goods are supplied a retention of title clause could be used in the contract of supply to ensure that the seller retains ownership of the goods until they are paid for and if they are still in stock;
- the contract of sale could require cash on delivery;
- an attempt should be made to obtain personal guarantees of the new liabilities from the directors;
- ascertain from the CVA supervisor whether or not the company is up to date with its payments under the CVA;
- it is obviously not wise to carry on trading on the old terms; the terms of trade should be renegotiated.