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BREAKING THE GLASS: THE UK'S PLANS FOR GREATER CORPORATE TRANSPARENCY

Following the G8 summit held on 17 and 18 June of this year, the UK Government has recently announced its commitment to improving corporate transparency and boosting public confidence in the financial sector. In particular, the Government has expressed a desire to:

1. Improve the accountability of directors.
2. Address opaque corporate ownership structures by requiring companies to obtain and keep information regarding their ownership and control.

With these aims in mind, on 15 July 2013, the Department for Business, Innovation and Skills (BIS) published a discussion paper entitled "Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business", which puts forward a number of proposals aimed at improving transparency in the ownership and control of companies in the UK and strengthening the law surrounding the disqualification of directors. The paper is open for comment until 16 September 2013, following which the Government will publish its findings and introduce enabling legislation.

This article provides an overview of the key proposals considered in the discussion paper and some commentary on their likely impact.

Improving the accountability of directors

1. Compensating creditors

In the interests of combating what the Government regards as reckless corporate behaviour in the years preceding the financial crisis, the discussion paper proposes that creditors be allowed to receive compensation for the fraudulent or reckless behaviour of corporate directors. Various methods for achieving this aim are considered in the consultation paper, including granting liquidators the statutory right to sell or assign fraudulent and wrongful trading actions to creditors or third parties and giving administrators the right to bring civil claims for fraudulent or wrongful trading. The discussion paper also asks

whether courts should be permitted to make a compensatory award against a director simultaneously to making a disqualification order so that creditors have better recourse to funds.

Financial liability for reckless directors already exists in some jurisdictions. For instance, in the US, directors of telecommunications company WorldCom paid approximately US$18 million to investors following the company's bankruptcy in the early 2000s.

2. New statutory directors' duties for key sectors

As a means of encouraging responsible corporate governance, the paper proposes amending directors' statutory duties currently contained in the Companies Act 2006 for certain key sectors, such as banking. Under the new system, directors of banks would have a primary duty to promote financial stability over and above the interests of their shareholders.

This proposal follows on from recommendations made in June 2013 by the Parliamentary Commission on Banking Standards, according to which the UK Corporate Governance Code should be amended to require the directors of large banks to prioritise the "safety and soundness" of the bank over the interests of shareholders.

3. Disqualification of directors

The current rules governing the disqualification of directors are examined in detail in the discussion paper. In particular, the paper suggests the following reforms:

- Amending the Company Directors Disqualification Act 1986 (CDDA) to allow additional factors to be taken into account by the court in determining whether to disqualify a director and the period of disqualification. At present, the court must consider the factors specified in Schedule 1 of the CDDA, which include factors such as misfeasance or breach of fiduciary duty and the extent of the director's responsibility for causing the company to become insolvent. The additional factors suggested by BIS in the discussion paper include material breaches of sector regulation; the identity and nature of the creditors concerned, including consideration of whether they are vulnerable, and the scale of the loss they have suffered; the social impact; and the director's track record in terms of previous failures.
- Placing a limit on the number of failures a director is permitted to incur, after which point there is a presumption that a director is unfit to act as such and should be disqualified.
- Extending the time limit for disqualification proceedings in insolvency from two years to five years, or another period, or abolishing the time limit altogether. This measure is designed to accommodate the more complex insolvency cases.
- Requiring disqualified directors to undergo "bounce-back" education or training to teach them how to run a successful company. Directors would be required to bear the cost of attending such an education programme or training. Successful completion of the programme may lead to a reduction in their period of disqualification. The paper also considers whether completing such training should be a prerequisite for any director wishing to seek the leave of the court to manage a company while disqualified.
- Preventing an individual who is disqualified, convicted of a criminal offence or restricted in connection with managing a company overseas from being a director of a UK incorporated company.
- Amending the CDDA to allow sector regulators to disqualify directors in any sector.

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NICK HUTTON

4. Improving insolvency system

The paper expresses concerns over the transparency of pre-pack administrations. A pre-pack occurs where negotiations for the sale of a company's business and assets are undertaken prior to administration. The sale is then executed when the administrator is appointed or shortly thereafter. BIS considers that pre-packs have a tendency to result in businesses being sold at under value, notably to previous owners or connected persons with little or no open market valuation. In order to combat this perceived lack of transparency, BIS has launched an independent review into pre-pack administrations. The review will specifically examine whether pre-packs provide value for creditors and encourage growth. The review is expected to conclude in early 2014.

BIS has also announced plans for an independent review of insolvency practitioners' (IPs) fees. The aim of the review is help unsecured creditors (or even debtors) exert more effective control over fees. The complaints procedure for those dissatisfied with the actions of an IP is also set to be reformed.

Addressing opaque corporate structures

1. Central registry of beneficial ownership

The discussion paper points out that the corporate structure can be abused to facilitate criminal activity such as money laundering or tax evasion. Part of the solution to this problem is thought to lie in increased corporate transparency. With this aim in mind, the consultation paper proposes the creation of a central registry of the beneficial owners of all UK incorporated companies. Under BIS's proposals, "beneficial owner" would be defined as any individual holding an interest in over 25% of the shares or voting rights of a company on an aggregated basis. Shareholdings of individuals acting in concert would also be aggregated. The definition of "beneficial owner" would cover any individual otherwise controlling the way in which a company is run.

BIS envisages that the registry would be maintained by Companies House, however, companies would be placed under an obligation to provide information in respect of the names and addresses of beneficial owners, and details of the shares in which they are interested. It is envisaged that these details would be provided to Companies House upon incorporation and then on a periodic basis. Further, section 1112 of the Companies Act 2006 would apply in respect of information provided by a company to Companies House. It would therefore be an offence to provide false or misleading information knowingly or recklessly.

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The discussion paper is seeking feedback on whether the central register should be made publicly available or whether access should be restricted to certain law enforcement and tax authorities and other regulated entities.

2. Identifying corporate beneficial ownership

The discussion paper also proposes that Part 22 of the Companies Act 2006 ("Information about interests in a company's shares") be extended so that it applies to all companies (at present it only applies to public companies). To ensure that this information is obtained, the paper considers imposing a requirement on companies to identify any beneficial owner or persons acting together and holding more than 25% of the company's shares or voting rights. If the company is not able to identify

a beneficial owner for any reason, the paper proposes giving companies the option of applying to court for assistance in this regard. The paper suggests that companies should be required to notify Companies House if they make an application to the court in these circumstances.

3. Ban on bearer shares

The discussion paper proposes banning the creation of new bearer shares (that is, shares which belong to whoever holds the physical share warrant). Such shares are seen as reducing the transparency of ownership as legal ownership may be transferred without the need to change ownership details on the register of members. The paper also proposes setting a time limit within which existing bearer shares should be converted into ordinary registered shares.

4. Reforming nominee directors

While the paper acknowledges that nominee directors can be used in legitimate commercial scenarios, it points out that they can also be used as a means of masking the true owners of companies. Accordingly, the paper proposes a number of different options regarding the use of nominee directors. The options include improving awareness of directors' duties amongst nominee directors and creating a requirement that nominee directors disclose both their status and who they act for to Companies House, breach of which would result in automatic disqualification from acting as a director.

5. Abolishing corporate directors

Corporate directors are often incorporated offshore in jurisdictions with minimal public reporting requirements. As such, they are seen to result in complex corporate ownership structures which hide the beneficial owners' real identity. In the interests of promoting transparency, the consultation paper proposes a blanket prohibition on corporate directors.

The CBI also believes that the proposed reforms to directors' disqualification regulations are excessive and unnecessary given that there are already tough criminal sanctions in place for directors who engage in fraudulent behaviour.

Breaking the glass or creating an extra layer?

Although the broad drive to improve openness and transparency in business is to be welcomed, it is questionable whether the proposals would achieve their desired effect. If enacted in their present form, the reforms may simply create an extra layer of undesirable red tape. For instance, the creation of a central register of beneficial owners could be a bureaucratic headache for a significant number of UK companies. Since only companies listed on the London Stock Exchange's Main Market will be exempt from the requirement, every other UK registered company and LLP would be forced to undergo the painful task of identifying year after year all those individuals who exercise some control over their companies. This could be a costly and time-consuming exercise for companies and LLPs.

Further, at present the proposals are only UK-wide, although it is hoped that other countries, in particular G8 countries, will follow the UK in adopting similar measures. If the UK is the first country to adopt full corporate transparency, there is a risk that it might suffer a competitive disadvantage. The UK's offshore centres in particular may see their clients leave for countries such as Hong Kong and Singapore which are under less pressure to meet corporate openness requirements.

The reforms have come under fire from the Confederation of British Industry (CBI) on the grounds that they do not provide a proportionate response to the problem of promoting responsible capitalism. Katja Hall, CBI Chief Policy Director, has criticised the proposed reforms to directors' duties on the basis that requiring directors in the banking sector to single out and prioritise "safety and soundness" of the bank over and above other important directors' duties will lead to an inconsistent and piecemeal approach to directors' duties across the UK economy.

The CBI also believes that the proposed reforms to directors' disqualification regulations are excessive and unnecessary given that there are already tough criminal sanctions in place for directors who engage in fraudulent behaviour. The existing rules also provide for clawback pay from individuals if they are found to have mis-managed a company. As such, the CBI believes the focus should be on enforcing laws which already exist rather than on introducing a whole new set of procedures.

Conclusion: watch this space

The Government's proposals are still in early stages and, as with all proposed legislation, the devil will be in the detail of the final version. The Government's current plan is to introduce the reforms before the end of the current Parliament, which is likely to be some time in early 2015. However, given that the results of the consultation process will need to be collected and considered, it seems unlikely that the Government's plans will become a reality. As 2015 draws nearer, the focus of the Government's attention will shift to election campaigning. The proposals are therefore unlikely to get the attention they need to make it onto the statute books before the next election. For the moment, although it is a question of watching this space, it seems there is a long way to go before the reforms will make their mark on the UK's corporate landscape.

For further information, please contact Nick Hutton, Partner, on +44 (0)20 7264 8254 or nick.hutton@hfw.com, or Alexis Kyriakoulis, Partner, on +44 (0)20 7264 8782 or alexis.kyriakoulis@hfw.com, or your usual HFW contact. Research conducted by Tessa Huzarski, Trainee.

For further information, please also contact:

Alistair Mackie
London Partner and Head of Corporate
T: +44 (0)20 7264 8212
alistair.mackie@hfw.com

James Lewis
London Partner
T: +44 (0)20 7264 8322
james.lewis@hfw.com

Robert Follie
Paris Partner
T: +33 1 44 94 40 50
robert.follie@hfw.com

Alexia Kleonakos
Piraeus Partner
T: +30 2 104 293 978
alexia.kleonakos@hfw.com

Rula Dajani Abuljebain
Dubai Partner
T: +971 4 423 0502
rula.dajaniabuljebain@hfw.com

Henry Fung
Hong Kong/Shanghai Partner
T: +852 3983 7777/+86 21 2080 1000
henry.fung@hfw.com

Brian Gordon
Singapore Partner
T: +65 6305 9533
brian.gordon@hfw.com

Aaron Jordan
Melbourne Partner
T: +61 (0)3 8601 4535
aaron.jordan@hfw.com

James Donoghue
Perth Partner
T: +61 (0)8 9422 4705
james.donoghue@hfw.com

Lawyers for international commerce

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
United Kingdom
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888

hfw.com

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