

Commercial Contracts: Defining a Group Company

Background

The Supreme Court decision in *Enviroco Limited v Farstad Supply A/S* [2011] UKSC 16 highlights the need for care when defining group companies in commercial contracts.

In this case, Asco UK Limited chartered an oil-rig supply vessel from Farstad. The charter document provided that Farstad would indemnify Asco and its affiliates against liabilities. The charter defined affiliates to include “any subsidiary of Asco UK, or any company which is also a subsidiary of a company that Asco UK is a subsidiary of”. Both Enviroco and Asco UK were subsidiaries of Asco Plc. Subsidiary was expressly defined as having the same meaning as in section 736 of the Companies Act 1985 (CA 1985).

In this edition:

- Commercial Contracts: Defining Group Companies
- Discrimination in the provision of goods and services
- Owing money to the tax man for failing to tell him you didn't owe him money in the first place!
- Annual Returns



After the charter was signed, Asco Plc charged the shares they had in Enviroco to the Bank of Scotland under a Scottish Deed of Pledge, which required the shares to be registered in the name of the bank. As a result, Asco Plc was no longer the registered holder of the shares in Enviroco.

A fire on the vessel resulted in severe damage and Enviroco sought to invoke the indemnity from Farstad.

The Issues

The courts had to decide whether Enviroco could rely on the indemnity. In order to do so they would have to be classed as a subsidiary of Asco Plc under section 736 CA 1985.

Section 736 of the CA 1985 (now reproduced in section 1159 of the CA 2006), states:

continued overleaf

company commercial

“A company is a “subsidiary” of another company, its “holding company,” if that other company –

- (a) Hold a majority of the voting rights in it, or
- (b) Is a member of it and has the right to appoint or remove a majority of its board of directors, or
- (c) Is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it, or if it is a subsidiary of a company which is itself a subsidiary of that other company.”

As Asco Plc was not a majority shareholder in Enviroco, holding only 50% of the shares, section 736 (1)(a) of the act did not apply. Section 736 (1) (b) did not apply on the facts either.

Enviroco could only claim to be a subsidiary of Asco Plc within section 736 (1)(c). Enviroco therefore had to establish it was a “member” under section 22(2) of the CA 1985 (and now section 112(2) CA 2006), which defines a member as “a person who agrees to become a member of the company, and whose name is entered on its register of members”.

Enviroco argued they could rely on section 736A (7)(b) CA 1985 which provided:

“Rights attached to shares held by way of security shall be treated as held by the person providing the security...where the shares are held in connection with the granting of

loans as part of the normal business activities apart from the right to exercise them for the purpose of preserving the value of the security or of realising it, the rights are exercisable only in his interests.”

Enviroco argued that one of the rights attaching to shares was membership and so as the provider of the security, Asco Plc retained the right of membership and consequently Enviroco was a subsidiary of Asco Plc.

Decision

Applying the strict statutory meaning of section 736 CA 1985, the Court of Appeal overturned the High Court decision and held that by pledging their share to the Bank of Scotland, Enviroco was no longer a subsidiary and thus could not enforce the indemnity. The decision was confirmed by the Supreme Court.

Legal Implications

Although the decision relates to section 736 of CA 1985, the definitions are broadly the same as section 1159 of the CA 2006, and consequently two drafting implications have arisen following the case.

- Firstly, the decision means that where a holding company states they control the majority voting rights in the subsidiary as opposed to holding them, it could lead to the de-grouping of the subsidiary company. De-grouping could also occur where the holding company pledges the shares in the subsidiary by way of a legal mortgage or transfers the shares in the subsidiary to a nominee so that they are no longer registered

as a member.

- Secondly, it means that a Limited Liability Partnership may not automatically be included within the definition of a subsidiary company in section 1159 of the CA 2006, as the 2001 Regulations which supplemented the Limited Liability Partnerships Act 2000 and applied definitions of holding company and subsidiary from the CA 1985 to LLP's, were repealed with the final implementation of the CA 2006. The legislation replacing the Regulations does not apply the definitions within the CA 2006 to LLP's and therefore it is unclear whether LLP's technically fall within the definition of a subsidiary company.

It is worthy of note that as parent subsidiary relationships exist because the parent company holds the majority of the voting rights in the subsidiary, and consequently whilst the case is significant its practical impact may be limited. Additionally, in England, banks usually take an equitable mortgage over a company's shares as opposed to a legal mortgage which transfers the shares into the bank's name.

Notwithstanding the above, companies can avoid these potential difficulties by ensuring that when drafting a contract they define 'Group' as widely as possible and make it clear that in instances where ownership of shares has been transferred to a third party as security, the original parent company still remains a member of the subsidiary.

Discrimination in the provision of goods and services

This checklist sets out the duties your business owes to members of the public when you provide them with goods, services or facilities. Since 1 October 2010, these rules have been set out in the Equality Act 2010.

Who is a service provider?

A service provider is any person who provides services, goods or facilities to members of the public, whether or not for payment. A service provider is responsible for the acts of their employees and agents.

What are services, goods and facilities?

The meaning of the words “services, goods or facilities” are not defined by the Equality Act 2010 and are likely to be interpreted widely by the courts. They can include:

- Access to any place members of the public are permitted to enter (for example, pubs or restaurants).
- Accommodation in a hotel, boarding house or other similar establishment.
- Facilities for education (including privately run nursery schools or pre-schools).
- Facilities for entertainment, recreation or refreshment (for example, cinemas or theatres).
- The services of any profession or trade.

What are the protected characteristics?

Members of the public who access



your goods, services or facilities are protected on the basis of certain characteristics. They are protected both when requesting a service, good or facility and during the course of being provided with it. Protected characteristics under the EA 2010 are applicable to the provision of:

- sex;
- race;
- gender reassignment;
- disability;
- sexual orientation;
- pregnancy and maternity; and
- religion or belief.

The provisions on age discrimination in the provision of goods and services are not yet in force as the Government is still consulting on these – with them due to come into force in April 2012.

The anti-discrimination rules vary according to the protected characteristic.

What is prohibited?

■ **Direct discrimination.** You must not treat a person less favourably than someone else on the basis of a protected characteristic. For

example, a nightclub charges a higher price of entry to a man where the service provided to a woman is otherwise exactly the same.

■ **Indirect discrimination.** You must not apply a general policy or procedure which would particularly disadvantage a group of people with a protected characteristic. For example, a shop decides to apply a “no hats or headwear” rule to customers. If this rule is applied uniformly to all customers, Sikhs, Jews and Rastafarians who may cover their heads as part of their religion will be disadvantaged. Unless the shop can objectively justify the provision it will be unlawful.

■ **Harassment.** Harassment is unwanted conduct relating to a protected characteristic or of a sexual nature that has the purpose or effect of violating a member of the public’s dignity or creating a hostile, degrading, humiliating or offensive environment for that individual.

■ **Victimisation.** You must not treat someone less favourably because they have:

- complained about discrimination;
- helped someone else complain; or
- done anything to uphold their own or someone else’s rights under discrimination law.

■ **Discrimination arising from disability.** You must not treat a disabled person less favourably because of something arising from

or in consequence of their disability, where you cannot show that such treatment is objectively justified.

■ **Failure to make reasonable adjustments.** You have a duty to make reasonable adjustments irrespective of whether you currently have disabled customers. If you have not already done so, you should review how accessible your services are. Examples of steps it may be reasonable to take include:

- a solicitors' firm lending a tape recorder to a disabled client who cannot communicate in writing or is unable to travel to

the firm's office, so they can dictate their instructions; or

- providing bills in alternative formats (such as Braille or large print).

Fines for breaching discrimination law

Many claims for compensation are limited to injury to feelings as no other financial losses have been incurred as a result of the discriminatory act. However, irrespective of the level of awards for injury to feelings, damage to your reputation may be irreparable.



Owing money to the tax man for failing to tell him that you didn't owe him money in the first place!

Everyone loves the taxman....

It comes to the end of the financial year and you look at your finances and establish that you have no tax to pay. You sit back and relax confident that you don't have to submit any tax document. Right? Wrong!

Whether you believe you have tax to pay or not you may (depending on your employment status) still have to submit a self assessment tax return. Failure to do so, even if you don't owe any tax, could see you faced with a fine of up to £1600.

HMRC have brought in stricter and more onerous penalties for people who fail to submit a return when required to do so. The penalties increase depending on how late the return is, but can exceed £1600 if you are over 12 months late filing your return.

HMRC will no longer cancel fines if it becomes apparent that no tax is due - therefore you could find yourself owing the Government money for failing to tell them that no tax is due!



Annual Returns

Companies Act 2006 (Annual Returns) Regulations 2011 ('Regulations').

The Companies Act 2006 (Annual Returns) Regulations came into effect on 1st October 2011 and apply to annual returns made up to or after this date.

Every company in England and Wales is required to submit an annual return to Companies House once a year. The annual return acts as a snapshot of the board and shareholders of the company.

The format of the annual return was overhauled as part of the new provisions introduced in the Companies Act 2006. The Regulations put forward certain amendments to the requirements a company has to comply with as part of the annual return, with particular focus on shareholdings, member information and the structure by which a company classifies its principal business activities. The amendments include the following main points:

- The Regulations remove the requirement for the company to state whether it was a traded company at any time during the period of the return.
- A requirement has been added stating that the company must provide details in the return of whether shares were admitted to trading on a relevant market during the return period (e.g. AIM, OFEX), or on a non UK market. Where shares were admitted to trading the company must also state in the annual return whether it was an issuer and DTR5 applied.
- Where the company's shares were traded on any relevant market or non UK market during the period of the return, the company will not be required to disclose the name of every member.
- Companies whose shares were not traded on a relevant market for the whole of the annual return period or which are not covered by DTR5, will only need to disclose details of significant shareholders as at the date of the annual return (being holders of at least five per cent of the issued shares of any class).
- Where a company classifies its principal business activities, the 2007 edition of the UK Standard Industrial Classification of Economic Activities will be used, as opposed to the 2003 edition. In addition to this there will be codes for dormant companies, non-trading and residents' property management companies.

The Regulations were introduced as part of the Government's aim to reduce red tape for business. For the majority of companies, this will reduce the amount of information required for the annual return, albeit very slightly.

If you would like to discuss how Magrath LLP's company secretarial service can help your business, please contact us at companycommercial@magrath.co.uk

David Little
Partner
david.little@magrath.co.uk
0207 317 6728

Abigail Priest
Solicitor
abigail.priest@magrath.co.uk
0207 317 6768

Magrath LLP solicitors 66/67 Newman Street London W1T 3EQ
tel 020 7495 3003 fax 020 7317 6766 www.magrath.co.uk

This newsletter is for information purposes only. The information and opinions expressed in this document do not constitute legal advice and should not be regarded as a substitute for legal advice. For further information on our legal services please see above.

© Magrath LLP Solicitors 2011