

Company concerns

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The incompetent director: failing to make enquiries

A recent High Court case has shown that non-executive directors remain under the spotlight in the aftermath of the Higgs Review on corporate governance. Directors are increasingly being brought to account for corporate failings and need to remain vigilant.

In the High Court case of *The Secretary of State for Trade and Industry v (1) C Swan, (2) V Reddy, (3) B Ritchie, (4) B North and (5) Ian Stewart*, the executive chairman and the non-executive deputy chairman were disqualified from acting as company directors for failing to deal properly with serious allegations of financial irregularities in a Company which subsequently became insolvent.

The facts of the case are as follows: C Swan was a director and chairman of a listed company. He was also a director of a number of subsidiary companies. B North was a non-executive director and deputy chairman of the same listed company. As chairman of the company's audit and remuneration committee, B North was made aware of a range of allegations of serious financial and accounting impropriety and irregularity. These included allegations that there was a £20 million under-declaration of indebtedness in the group accounts, that the group was operating in reality in breach of its banking covenants and that the auditors had not been told all relevant information. Having heard these allegations and having had only one 40 minute meeting with one of those alleged to have been responsible, B North failed to carry out any further investigation or discuss the allegations with anyone else.

One of the practices within the listed company group which allowed such debt to remain hidden was "cheque-kiting". Cheque-kiting is where matching cheques are issued to companies of the same group in order to increase artificially the companies' cash positions because a payer's account is only debited once a cheque has been cleared whereas a payee's account is credited immediately. One of the principal purposes of this practice at this particular company was to create the impression that the Group was operating within its banking facilities.

The High Court disqualified both B North and C Swan. Although B North was unaware of the cheque kiting itself, the Court found that his lack of competence related to a failure to react to his knowledge of the accounting irregularities with sufficient vigilance and that such conduct fell short of what was expected from a director of his experience. B North was disqualified from acting as a director for three years. C Swan failed to make any

Have you thought about using a Limited Liability Partnership?

An LLP can be used as a vehicle for any business (including investments and joint ventures) that is conducted with a view to making a profit. An LLP has numerous attractive features which may make it a suitable alternative to a company or a partnership. We have highlighted some of the most usual reasons for choosing an LLP below.

An LLP for business

- 1. Distinct legal personality** - Unlike a partnership an LLP has distinct legal personality which means the LLP can enter into contracts in its own name. This can save significant legal costs and management time as contracts, and in particular leases, do not have to be assigned to continuing members on the departure of a member as can often be the case with a partnership.
- 2. Capital contribution and limited liability** - There is no requirement that an LLP's members contribute capital, though most LLPs will require some capital contribution. Members of an LLP benefit from limited liability similar to that of members of a limited company. Providing the members' agreement is drafted correctly, on a winding up, members will (save in exceptional circumstances) not be liable for the LLP's liabilities in excess of their agreed capital contribution (if any).
- 3. Taxation** - The UK tax treatment of LLPs carrying on a trade or profession is essentially the same as that applicable to partnerships. The LLP itself is not subject to tax. The LLP's profits and gains are taxed only in the hands of its members. This avoids any double taxation similar to that which can arise for shareholders of limited liability companies i.e. where profits are taxed and dividends paid out of those taxed profits are taxed again in the hands of the company's members.

A further tax advantage is that, like partnerships, LLPs do not pay employer's national insurance contributions in respect of their members. The tax reliefs that are available to partners are also generally available to members of an LLP carrying on a trade or profession.

4. Flexibility - Aside from its tax transparency and limited liability, the most commercially appealing aspect of an LLP is the ability of the members to structure it in virtually any manner they wish. Some areas of flexibility that are of particular interest are:

- no capital requirement;
- different classes of member may be created to reflect different voting rights, profit share and capital contribution.
- members' agreements can be drafted to resemble a company's articles of association;
- profit share need bear no relationship to ownership, capital contribution or time spent working for the LPP;
- membership shares/interests may be transferable by agreement.

LLPs should have a properly drafted members' agreement. This is essentially a cross between a company's articles of association and a shareholders' agreement.

- 5. Confidentiality** - whilst the disclosure requirements of an LLP are broadly similar to those of a private limited company, there is no requirement for an LLP's members' agreement to be filed with Companies House in the same way that a company must file its articles of association.
- 6. Group structure** - unlike a partnership an LLP can easily form part of a company or LLP group structure as a subsidiary or wholly owned subsidiary.

An LLP for investments and joint ventures

The advantages highlighted above, in particular flexibility, tax transparency, corporate nature and distinct legal personality, mean that LLPs are ideal vehicles for investments (including collective investment schemes) and joint ventures.

However, there is anti avoidance legislation that prevents members of an investment or property investment LLP benefiting from the loan interest relief that is available to members who borrow to contribute capital to a trading or professional LLP.

Tax election deadline extended

From 2005, consolidated (group) accounts of listed companies must be drawn up using International Accounting Standards (IAS). The deadline for companies not using IAS or the new UK GAAP equivalent to elect for convertible and asset-linked securities to be taxed as if the company was using the new standards has been extended in the Finance (No. 2) Act 2005 to 31 December 2005.

Stop Press

The Legal 500 2005 edition

Fox Williams has been ranked in the top tier of law firms for M&A: Smaller deals and Partnership law in this year's edition of the Legal 500. Below are the entries for these two categories from the new 2005 edition.

M&A

Clinching major deals for top names in the technology and fashion industries reinforces Fox Williams' excellence in M&A. Tina Williams advised the shareholders of long-term client Karen Millen on its £120m sale to Icelandic group Baugur. Since advising on the merger establishing Addleshaw Goddard, Williams also acted for Kirkpatrick & Lockhart LLP on its 2004 merger with Nicholson Graham & Jones. Mark Tasker is valued by clients for avoiding 'the usual "shades of grey" advice and making firm recommendations.'

Partnership

Fox Williams maintains its impressive standing in partnership law. Competitors have recognised the firm's ability to win business and the practice is acknowledged as the choice counsel to law firms on their partnership issues. The team is headed by the immensely experienced Tina Williams, while senior partner Ronnie Fox continues to win praise for his hands-on involvement. Such is Fox Williams' standing that it was brought in to advise on Kirkpatrick & Lockhart Nicholson Graham LLP's merger and LLP conversion. The firm's extensive expertise in employment law for employers and employees is another important factor. Consultant Anne Coles also receives accolades.

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