litigation advice

Property guarantees - taking more than a pound of flesh?

Many directors and owners of companies will have been asked, at some point, to provide a guarantee for their company to a potential landlord. This is particularly the case for new or small companies, but has become increasingly prevalent with some high profile 'household name' tenant failures.

Before agreeing to guarantee, it is important to consider the potential personal liabilities that might be incurred and to look at other ways of providing security to a landlord.

Most company owners will have set up their company with limited liability because they didn't want to assume personal risk or liability; by giving a guarantee, that protection can be eroded. Standard guarantee clauses in leases will require the person standing as guarantor not only to make good any losses suffered by the landlord if the tenant fails to pay rent or observe its other tenant covenants - the most obvious and onerous ones being the obligation to repair the property, comply with statutes and pay insurance rent and/or service charge – but also to take a new lease direct from the landlord if either the lease is forfeited or is disclaimed by a liquidator. That new lease would be on the same terms as the original and for the length of term remaining. As such, the guarantee could be very onerous indeed. Many leases will also provide that the landlord can choose to make the guarantor pay rent for the property until it is re-let instead of taking a new lease.

In recent years, however, landlords have taken the view that if the company tenant is in difficulty, it is likely that the person standing behind it will also be struggling, and so they ask for a rent deposit or a bank guarantee – sometimes in addition to a personal guarantee, or sometimes instead of it. That gives the landlord a pot of money he can access quickly and easily in the event of tenant default. It may not cover all losses suffered by the landlord, but it should go a long way towards doing so. Supplying the rent deposit will be a cash flow issue for the tenant company, but provided it doesn't default under the lease, it should earn interest on the deposit.

If the company wants to take over an existing lease – which may well allow the landlord to require a guarantor on any lease assignment - it may be preferable to take an underlease from the existing tenant because the landlord may have fewer controls and less ability to insist on a guarantor. Every transaction, however, will depend on the precise terms of the relevant lease.

One final point to remember is that many leases say that if a guarantor dies, is declared bankrupt or goes into liquidation, the tenant must notify the landlord and provide an alternative guarantor. If that obligation is not met, the landlord has a right to forfeit the lease. For small and medium size businesses there may be no one else prepared to stand as guarantor, in which case this type of clause would cause real difficulty. This is just one of the areas upon which we would advise and look to amend during negotiation.

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Forthcoming events

Employment breakfasts

Across all offices during May. For more details or to register your free place email seminars@birkettlong.co.uk or visit www.birkettlong.co.uk/events

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For Business

DIRECTORS' RESPONSIBILITIES AND LIABILITIES

Directors - do you understand your responsibilities?

Being a director of a company gives rise to a number of responsibilities – and not all directors are aware of the extent of these. Here is a summary of the key areas:

Directors' powers
Directors should check whether there are restrictions on specific powers. They could be restrained from acting by shareholders and held liable for any loss suffered by the company.

Care, skill and diligence
Directors are not expected to be experts in the company's business unless appointed as such, but they are expected to show expertise in the area of management for which they are responsible. Ignoring advice or not seeking advice can make the director liable for the consequences.

Acting in good faith
In a sense, directors are like trustees. They must act in the best interests of the company, the employees and the community/environment. Directors must not allow duties and personal interests to conflict.

Penalties
Directors in breach of their duties are liable to dismissal. The company or shareholders can apply for an injunction to prevent them acting, sue for damages, and require an account of profits or the return of property.

Contracts between directors and company
It is a statutory requirement that directors disclose the nature of their interest in any transaction involving their company.

Disclosure
There are numerous provisions governing what must be disclosed in company accounts.

Liability to outsiders
Normally directors cannot incur liability to third parties unless they voluntarily undertake such liability. However, there are exceptions!

Insolvency
Directors must have sufficient information to assess the company's financial position. If circumstances indicate that an insolvent liquidation is likely, directors must take every step to minimise potential loss to creditors or they may be personally liable for company debts.

Self protection
Directors should attend regular board meetings where proper financial and other reports should be presented. They must understand, or have explained to them, the financial information presented. Those meetings must be minuted and disagreements to actions recorded.

This article only touches upon these complex subjects. For full information about directors' responsibilities within your own business please contact Tracey Dickens.

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Head of the commercial department, Peter Allen, comments on this newsletter's theme of directors' responsibilites:

"A limited liability company is often used to protect individuals from personal liability. However there are many ways in which directors of companies can become personally liable. Directors owe statutory duties to the company; they can also become liable in various ways to third parties. In uncertain times directors need to be careful not to become personally liable unintentionally. In this edition of For Business we look at some of the potential pitfalls for directors and how they can be avoided. I hope it helps you."

HMRC crackdown - directors be aware

Tax avoidance is a highly topical and political issue at the moment. It seems to feature in the news on a near daily basis, particularly as we move closer towards May's general election.

The latest high-profile drive by the Government and HMRC can, in part, be traced back to last summer when the Finance Act 2014 became law.

The Act created new powers designed to target individuals and companies that have taken advantage of tax avoidance/tax mitigation schemes. HMRC now has the power to look back over the ten years prior to the legislation becoming law and issue demands for payments 'on account' pending determination of whether or not the tax scheme is lawful. After an initial wave of these so-called 'Accelerated Payment Notices' being sent out in 2014, thousands more are expected to be dispatched in 2015. The Notices could, in certain instances, amount to millions of pounds and as such are likely to threaten some companies with insolvency.

A number of celebrities have been hung out to dry by the media for taking advantage of 'tax loopholes', provoking the response by David Cameron last year that it was "morally wrong". But wherever the blame lies, over in the corporate arena, companies which face huge demands from HMRC are going to find themselves in significant difficulty, which equally could create problems for their directors personally.

Birkett Long's insolvency law team has already seen directors whose companies will be unable to pay the impending demands and therefore are now technically insolvent. There are far-reaching effects for directors, management, employees, customers, suppliers and shareholders if a business fails. The directors of the business will need timely advice on the best way forward in these situations, be it a corporate rescue or restructure, a pre-pack administration or, in many instances, a voluntary liquidation.

The team has been able to guide the directors of these companies through the legal minefield, making sure they do not fall foul of issues that could create personal liability – meaning their own assets could be attacked – such as wrongful trading, misfeasance or preferences (where a company makes payments to some creditors ahead of others) as well as minimising or eliminating the risk of directors disqualification proceedings.

They have also assisted such directors in the setting up of their new businesses, providing advice on whether and how they can trade with the same or a similar name to the old company, as well as advising on the acquisition of the assets of the old company from the liquidator.

Kevin Sullivan is a partner specialising in contentious insolvency and is recognised in the legal directory, Chambers UK, as a 'key individual' in this area of work. Kevin acts for business clients and insolvency practitioners, and is particularly experienced in successfully defending directors facing proceedings under the Company Directors Disqualification Act 1986. He holds the Certificate of Proficiency in Insolvency and is a member of the Association of Business Recovery Professionals, R3.

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Bare essentials

Directors - are you employees?

A common preliminary argument in employment tribunal litigation is over working status; that is to say, whether someone is an employee and therefore able to benefit from all the enforceable rights that exist in English law for that category of worker, or whether someone is not. This can affect those doing casual work on minimum wage, but also those near the top of the pay scale, or those involved in the management of a business.

The legal status of a director is one of office-holder, who owes statutory and common law duties to their company, but a director can be an employee or self-employed. Executive directors tend to be employees of the company, while non-executive directors tend to be self-employed, although employment status in any given case will depend on circumstances.

Status may come into play for a director who has been dismissed (and wants to claim unfair dismissal) or who seeks recovery of certain sums from the Secretary of State after the insolvency of the company, on the basis of having been employed there. The legal distinction on status is determined by whether there is a mutual obligation on the company and the director to offer and accept work beyond the duties required of a director. Also, if a director works full-time for the company and is paid a salary they are likely to be held to be an employee. By contrast, a director who takes a degree of financial risk by receiving fees from time to time, depending on the company's performance, is more likely to be held to be self-employed.

Directors - are you employees? (continued)

A further factor is whether a director has a controlling shareholding in the company; although a controlling shareholder could block a decision to dismiss themselves or amend their terms of employment, this fact does not by itself mean that a controlling shareholder cannot also be an employee.

In the recent case of Stack v Ajar-Tec, the company had three shareholders, all of whom were directors. Mr Stack was one of them and had no written employment contract but did have other business interests. Whilst he had for three years devoted approximately 80% of his time on the company's business, he had never been paid a salary, and had never pursued one or complained about it. There was also no provision in the company accounts to pay him.

However, the tribunal nonetheless found that Mr Stack was also an employee of the company. There was an express agreement that Mr Stack would do work for the company and, given the way the three directors dealt with each other in order to give business reality to the transaction and enforceable obligations between the parties, an implied term that he would eventually get paid for it. Thus he was free to pursue his complaint of constructive unfair dismissal and unauthorised deductions from wages in an employment tribunal.

The decision on this case was reversed twice to demonstrate that difficulties with status exist at both ends of the management chain.

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