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# For Business

WHEN THINGS GO WRONG

Head of the commercial department, Peter Allen, comments ....

Things go wrong in life and in business. However, there are often options that can prevent things going wrong in the first place, or which can be taken after the event to mitigate what has happened.

In this edition of For Business we consider four situations and look at what you might do in each of these to protect your business. We examine break clauses in leases, shareholders' disputes, an employee taking client information and director's disqualification.

In all these situations it pays to take early legal advice to reduce the risks to you and your business.

## Breaking bad!

**Commercial leases often give the tenant a 'break right' to end the lease early on service of a written notice. The tenant's right to break is often dependant on the tenant meeting various conditions set out in the lease, one of the most common being a requirement for the tenant to give 'vacant possession' at the break date. This can be a fertile ground for disputes as landlords look for reasons to challenge the validity of break notices, particularly where it may be difficult for them to find a new tenant at the same rent.**

Landlords and tenants alike should be aware of a recent case in which the court had to decide whether a tenant's failure to remove internal partitioning (erected with the landlord's consent to create separate offices within the open-plan space), meant that vacant possession had not been given.

The case turned upon whether the partitions amounted to a 'tenant's fixture', which the tenant was not required under the lease to remove. The court noted the demountable nature of the partitioning, which had been connected only to non-structural parts of the premises by screw-fixings and which it therefore viewed as temporary in nature, and decided that it was not a 'fixture'.

The question then became whether the existence of the partitions substantially prevented or interfered with the landlord's ability to use and enjoy the premises. The court decided that they did, and therefore found that vacant possession had not been given and that the lease had not therefore been effectively broken. The tenant became liable for the rent for the remainder of the lease term.

The lesson for any tenant considering exercising a break right is to seek early advice about what needs to be done to ensure that the break is effective. It may be possible to agree specific points with the landlord, such as whether partitions need to be removed, but, in the absence of clear agreement, a tenant should not take chances. To do so could risk having to pay rent for the remainder of the lease term - whether occupying the building or not!

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# Directors' disqualifications

## An overview and the latest statistics

The law is strict on misconduct relating to directors. Kevin Sullivan explains recent changes to legislation and how directors need to be clear on the circumstances that might lead to an allegation of misconduct should their company fail.

**What is 'misconduct'?**

When a company goes into liquidation, administration or administrative receivership, the insolvency practitioner (IP) appointed to deal with the failed business has a statutory duty to investigate the company's affairs and conduct of its directors, including any shadow directors. The sort of misconduct that usually attracts attention includes:

- Non-payment of Crown debts (i.e. taxes) and/or treating the Crown differently – typically, but not exclusively, for a period of more than twelve months and where the sums involved represent more than 50% of all sums due to creditors
- Concealing assets
- Unexplained deficiency in the accounts
- Transactions personally benefitting directors
- Overvaluing assets
- Dishonoured cheques
- Preferential payments to creditors or guarantors
- Taking deposits whilst failing to supply goods or services
- Transactions at an undervalue
- Wrongful or fraudulent trading
- Any breach of a legislative obligation or another obligation which applies to the directors

**The penalties**

From 6 April 2016 IPs are obliged, within three months of the company's demise, to submit their findings about conduct of the directors and shadow directors (including any holding such a position in the previous three years) to the Secretary of State. This is irrespective of whether misconduct has taken place. Should misconduct be identified, further investigations are triggered, which, in turn, could lead to proceedings under the Company Directors Disqualification Act 1986. The Secretary of State now has three years from when the company entered formal insolvency to commence proceedings.

Findings of misconduct can lead to lengthy disqualification. A person can be disqualified from acting as a director of a company or in any way, directly or indirectly, being concerned or taking part in the promotion, formation or management of a company, without the court's permission, for a period of between two and fifteen years.

# Confidential!

## A new way to protect that sensitive information

When employees, directors, partners or shareholders leave a business there is often a worry that they will try to take their clients with them. Often restrictive covenants will be in place to try to prevent this. However, they are not always effective, and the business would have to incur legal costs in order to enforce those restrictive covenants in civil proceedings.

Where there are no restrictive covenants or they are ineffective, it might be argued that the person has wrongly taken confidential information. This is often uncertain and again, civil court proceedings may be required to establish the facts. However, there may be another way.

Data relating to clients and customers held by a business in any format is protected by the Data Protection Act. In a recent case, an employee who was about to leave his employer, sent details of 957 clients to his personal email address. Sending himself that information breached Section 55 of the Data Protection Act 1998. Criminal proceedings were brought, he was prosecuted, found guilty and fined.

The threat of a criminal record is likely to make anyone think twice before taking information to which they have no right.

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To avoid lengthy and costly court proceedings, it may be possible for the director to offer an undertaking not to be a director of a company for an agreed period and this has the same legal effect as a disqualification order made by the court. However, this is accompanied by a schedule detailing the unfit conduct that is published on the Insolvency Service website, which can sometimes attract media attention.

In addition, the Secretary of State – but not a creditor or IP – now has the power to apply to the court to seek a compensation order where:

- a disqualification order has been made or a disqualification undertaking given;
- the person was disqualified on or after 1 October 2015; and
- that person's conduct has caused loss to one or more creditors of the insolvent company

The court may order compensation to be paid to the Secretary of State for one or more creditors, or classes of creditor, or to be paid as a general contribution to the assets of the estate. The disqualified person may give an equivalent undertaking instead.

**Consequences and ripple effect**

The consequences of breaching a disqualification order or undertaking are the same – a fine, imprisonment for up to two years, or both. There may also be personal liability for company debts where the director has continued to act whilst disqualified. Further, anyone involved in management of the company may be similarly liable for those debts if they act or are willing to act on instructions given without the court's permission by a person whom they know to be a disqualified individual or undischarged bankrupt.

Aside from the potentially detrimental effect on an individual's health, a costs order could be made if proceedings are unsuccessfully defended – and this, ultimately, could lead to personal bankruptcy.

So, the potential consequences of disqualification proceedings are massive – not just for the director but also for their family. And effects can ripple further; for example, if that individual has set up a new venture since the insolvency of the company in question, its employees may be at risk of losing their jobs.

# Disqualifications on the rise

## Figures from the Insolvency Service

Following a couple of years where numbers have remained static, the latest figures from the Insolvency Service (published mid-August 2016) suggest a small rise in the total number of disqualifications.

Unsurprisingly, the economic downturn in 2008 caused a spike that was not seen until 2010/11, when there were 1,453 disqualifications, but since then numbers have slowly dropped, levelling out at 1,210 in both 2014/15 and 2015/16. The latest statistics also reveal that there may be an increase in disqualifications in more serious cases – those that merit bans of between 5-10 years and 10-15 years.

At Birkett Long LLP we have considerable expertise in acting for directors facing disqualification proceedings. We have experience of several cases that collapsed before they came to trial, with the director receiving a substantial contribution towards their costs. We have also successfully negotiated disqualification undertakings in appropriate cases.

Should you find yourself facing disqualification proceedings, we may be able to help – and, as is always the case, the sooner you seek advice the better. For help and advice contact Kevin Sullivan.

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# shareholder disputes

## Reducing the impact

**A key fact that is often overlooked in relation to ownership of shares in a limited company is that without a shareholders' agreement no shareholder can be forced to sell their shares, other than as a consequence of a court order (and do you really want a judge dictating the terms of any settlement?). Therefore, unless the shareholders have put an agreement in place shares will remain with a shareholder and can also be passed on to others upon their death (do you really want to be in business with your business partner's family?).**

In the case of a limited company, the Articles of Association provide a basic agreement, but for most off-the-shelf companies this is not appropriate for a situation where there is more than one shareholder, and does not provide a guaranteed exit solution if one party wishes to leave or a dispute arises.

As with any relationship, shareholders can end up wanting to go in different directions, their circumstances may change (due to health or family matters), or they may become disgruntled with operating arrangements such that the relationship needs to move on or has broken down. This is always a potential risk and when entering into such a relationship it is wise to agree an exit strategy to address these and other scenarios. This also enables shareholders to consider and address arrangements arising from that: for example, if a shareholder is to be bought out, how will that be paid for? You can then consider instalment arrangements and putting key man and life insurance policies in place to assist.

Shareholders can also agree what is and is not acceptable, and therefore have greater control over what is expected from the shareholders. This means that if a shareholder breaches those expectations, there is an agreed recourse enabling the parties to move on without having to seek the assistance of the courts to resolve the issue; ensuring less disruption to the business of the company.

A shareholders' agreement drawn up between the parties at the outset can provide for the main eventualities that are likely to arise, and map out a course to be followed when a given issue arises. Its aim is to help prevent unnecessary disputes and provide a watertight mechanism for parties to leave and sell their interest in the business, having a pre-determined mechanism to determine the value of such interest and means of payment.

It is sensible to draw up an agreement at the start, but it is never too late to get an agreement put in place. Certainly, if you are bringing in new shareholders, or the shareholding levels are changing, that is a good time to enter into a formal agreement. The business team at Birkett Long will be happy to advise you on what is right for your business.

To book a face to face, Facetime or Skype meeting to discuss your requirements please contact Tracey Dickens.

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