



NELLEN NEWS



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Company Law

Root and branch reforms

New companies legislation aimed at modernising English company law is in the process of being drafted. The legislation will build on the proposals contained in the White Paper 'Modernising Company Law' issued last year. The White Paper set out proposals for the most radical transformation of English company law in 150 years.

The main thrust of the reforms is to make the administration of companies far simpler by clarifying or abolishing some of the more arcane areas - areas which have been particularly fruitful for company lawyers. The highlights of the changes include:

- Abolition of the requirement to have an 'authorised share capital'
- Removal of the prohibition on private companies giving financial assistance for the acquisition of their own shares
- Introduction of a solvency statement by the directors as an alternative to the present requirement for a court's approval for a capital reduction
- Revision and codification of the distribution rules to clarify what constitutes a 'distribution'
- The Memorandum and Articles of Association will no longer exist and will be replaced by a single 'constitution'
- All companies will have unlimited capacity (unless they choose to restrict their own capacity)
- Directors' duties (which are currently established by common law) are to be codified

Venture Capital

Recent transactions

- **Bodas Limited** the retailer and brand-owner of Bodas underwear was represented by NELLEN on its issue of convertible preference shares to investors. NELLEN prepared the circular to shareholders and advised on a range of issues including the terms of the Subscription and Investment Agreements, the new Articles of Association and the Warrant Instrument.
- The AIM quoted HR software company **OneClickHR Plc** was represented by NELLEN in connection with an investment by Herald GP Ventures Limited of Unsecured Loan Stock 2005/7, the issue of warrants and the circular to shareholders.

Company Law

Directors' transactions

A recent case has highlighted the strict disclosure and approval requirements relating to transactions between a company and its directors – requirements which came back to haunt a director nine years after the original transaction.

In *JJ Harrison (Properties) Limited v Harrison* the facts were as follows. Mr Harrison, a director of JJ Harrison (Properties) Limited, agreed to buy a property from his company. The company had previously applied for planning permission in relation to the property - this application had been refused. But Mr Harrison had, prior to his purchase of the property, lodged a further application which he failed to disclose, or the fact that circumstances had arisen that made the second application more likely to succeed. A valuation of the property had been carried out prior to the sale, and the valuer had, in a side letter, stated that the property would be significantly more valuable if planning permission was obtained. Mr Harrison also failed to disclose the existence of the side letter. The property was sold to Mr Harrison, planning permission was subsequently received, and he resold the property for a substantial profit.

Mr Harrison's failure to disclose all relevant information meant that the shareholders had not given their *informed consent* to the transaction and their approval was therefore invalid. In the ensuing litigation, the company succeeded in claiming an entitlement to the unlawful profits made by Mr Harrison.



Enterprise Management Schemes

3,200 and growing

We have been told by the Inland Revenue that as at the end of January 2003 more than 3,200 companies had set up Enterprise Management Incentive Share Schemes.

The popularity of EMI schemes is understandable particularly as the qualification criteria have been extended to include companies with up to £30 million of gross assets and the unlimited number of employees who can now participate (subject only to a limit on individual allocations of £100,000 per employee).

EMIs were given an additional impetus last year with the acceleration of taper relief on the sale of employee owned shares (see the article headed 'Capital Gains Tax taper relief'). Because the taper relief clock begins ticking from the date of the *grant* of the EMI option and not from the date of *exercise* of the option, the effective rate of capital gains tax of 10% applies to gains made on the sale of optioned shares where the option had been *granted* two or more years before.

Capital Gains Tax Taper relief

An important change to capital gains tax taper relief took place last year which reduced the effective capital gains tax rate to 10% for individuals and trustees who sell 'business assets' held for more than two whole years.

Taper relief was introduced in 1998 as a replacement for indexation allowances. Whilst indexation involved an uplift on the base cost of assets, taper relief reduces the percentage of the gain chargeable to capital gains tax. After two complete years only 25% of the gain on a business asset is chargeable, which equates to an effective CGT rate of 10%.

Broadly, business assets include all shares in unlisted trading companies (this includes trading companies listed on AIM) and shares in listed trading companies provided the shareholder is an employee or an investor holding at least 5% of the voting rights of the listed trading company. Taper relief also applies to non-business assets, but the taper period is calculated over a period of 10 years, after which time the effective rate of CGT is reduced to 24%.

The acceleration of taper relief will confer a significant benefit on employees and investors realising gains on shares in unlisted trading companies.

Client Profile: REL Consultancy Group

REL Consultancy Group is the world's leading international management consultancy specialising in working capital management for multinational companies. Its client list reads like a who's who of the corporate world and includes giants such as IBM, Sony, GlaxoSmithKline, Ford, BP and General Electric.

Founded by Christopher Bielenberg in 1975 and headquartered in London, REL is a truly global company with 8 offices in the US, Europe and Asia. Most of its management consultants are either shareholders or optionholders (or both) following the REL Employee Benefit Trust's purchase of a large minority shareholding from its venture capital investors (see box).

As companies' earnings have slowed in the last couple of years, working capital management has become an

substantial. REL cites an example of a major US IT company for whom working capital was improved by \$6 billion over a three to four year period releasing cash for more efficient uses elsewhere.

Total working capital management

REL's objectives are threefold: to reduce a client's costs, improve its cash flows and increase its service quality.

To achieve these objectives, REL looks in depth at all three components of working capital: debtors, inventory and creditors. It follows a holistic approach recognising the interrelationship between one function and another - for example, a debtor problem might not stem simply from an inefficient collectibles

Operational improvements

According to the REL canon, working capital management is more than mere financial efficiency – the drivers of working capital management are also operational in nature leading to operational improvements and customer satisfaction. Shipment is a case in point. A reduction in the number of shipments going out late can not only reduce inventory levels but also improve customer satisfaction. Judging by REL's recent survey of the top 1,000 European companies, there are huge improvements still to be made. (visit: www.relconsult.com)

'REL focuses on the various 'levers' that make up the three components of working capital'



even more vital tool by which CFOs can release cash from their businesses. The need for further improvement is urgent, however. In a recent survey REL conducted amongst the top 1,000 European companies and published recently in the Financial Times, REL estimated that €650 billion was still tied up in poorly performing companies leading to an estimated loss of €65 billion based on a 10% cost of capital.

The benefits, therefore, of efficient working capital management can be

department but from some underlying operational reason such as disputes over supply of defective or poorly specified products.

Its processes focus on the various 'levers' that make up the three components of working capital. In relation to the inventory component it will look at levers including order flow, forecasting accuracy, lead times and outsourcing. By adjusting these levers, REL is able to make significant improvements in efficiencies.

NELLEN advised REL Consultancy Group Limited on the establishment and funding of an Employee Benefit Trust (EBT), the vehicle set up to acquire a large minority shareholding in REL from its venture capital investors. The shares are progressively being made available to employees through a variety of share schemes. We advised on the offer to the VCs, the circular to shareholders, the share reorganisation, the share schemes and the related corporate issues.

Strangulation by Regulation

Directors' remuneration reports

Quoted companies often complain they are overwhelmed by regulatory compliance. The situation became worse late last year with the adoption of the Directors' Remuneration Report Regulations 2002, a piece of legislation intended to bring directors' remuneration packages even more into the full glare of publicity.

Under the new regulations, the directors must prepare a directors' remuneration report containing:

- information on individual directors' remuneration packages
- justification for any compensation packages given in the preceding year
- details of any remuneration consultants used

- membership of the remuneration committee
- a statement of the company's future policy on directors' pay
- a performance graph providing information on the company's performance in comparison with the appropriate share market index

Listed companies are required to put an ordinary resolution approving the remuneration report to shareholders at each AGM (although the outcome of this resolution is only advisory).

The new regulations will have effect in respect of companies' financial years ending on or after 31 December 2002.

Employment

Employees binding a company

Most companies' procedures require important contracts either to be authorised by the board or to be signed by a duly authorised director.

Companies need to take care, therefore, not inadvertently to give actual or implied authority to employees to bind the company. If they do, they might find that an employee has committed the company to a deal the board would never have approved.

This happened in the recent case of *SMC Electronics Limited v Akhter Computers Limited* where Akhter Computers Limited was unable to extricate itself from an unfavourable contract which had been signed by one of its employees. The employee concerned had signed a contract with SMC Electronics which entitled SMC to half the profits on business it introduced to Akhter Computers. The business involved the sale of power supply units (PSUs).

It was held that Akhter Computers Limited was bound by the onerous contract which the employee had signed because the employee had both actual and implied authority - his job title was 'Director PSU Sales' (though the employee was not a director), his contract of employment required the employee to perform 'such duties as may be reasonably associated with [his] job title', and entering into commission agreements was incidental to his duties as a 'director' of PSU sales.



New Hires

- **Andrew Milner-White** graduated from the University of Otago in Dunedin, New Zealand with LLB (Hons). Andrew was admitted as a barrister and solicitor in New Zealand following which he spent two years as an assistant solicitor at Chapman Tripp, one of New Zealand's largest commercial law firms. He joined NELLEN as an assistant in October 2002 specialising in corporate/commercial work and employee participation structures. Andrew is a keen singer and is interested in theatre.
- **Lucy Pierce** joined NELLEN as office manager in August 2002. After three years reading French and Spanish at the University of Birmingham, Lucy worked at Michael Page and NetGlobal, both recruitment consultancies. Lucy is responsible for all the office administration and systems as well as the accounting function.