Commercial Law UPDATE

Omitted Takings Affect Share Valuation, Rules Court

A recent case on company valuation may well end up being of great interest to HM Revenue and Customs (HMRC) as well as the two directors involved. It concerned a company which operated a restaurant. When the directors fell out, in order to enable one director to buy out the other's shareholding, the company shares had to be valued.

The problem that arose was that the valuer, quite sensibly, based the valuation on the company's profit as per its statutory accounts. The director being bought out took issue with the valuation on the basis that the disclosed accounts had been artificially suppressed by excluding some of the takings from the financial records.

She claimed that some of the takings were only recorded as 'handwritten takings', and that their inclusion was necessary to form an accurate picture of the company's profitability. These arguments were rejected by the judge and the director appealed to the Court of Appeal.

The Court upheld her challenge and overturned the valuation, concluding that the handwritten takings formed part of the company's 'books and records' and that the valuer, by failing to take them into consideration, had failed to place a fair value on her shareholding. It was not enough to argue that a willing buyer would have been found at the price indicated by the expert's valuation, but 'the price to be determined is the price which a willing buyer and a willing seller in the actual position of these parties would have arrived at. A willing seller would clearly have put forward the handwritten takings as reflecting the actual takings of the business, on the basis that the trading accounts used for tax purposes were understated...'

It would be surprising indeed if the outcome of this decision were not an HMRC enquiry into the business, as a failure to record all takings would almost certainly have resulted in a lower VAT and Corporation Tax yield than would otherwise have been the case.

Given the penalties and interest charges that can result from such an enquiry, this may well turn out to be a Pyrrhic victory. For advice on how to negotiate the dissolution of any business relationship, contact us.

New Cross-Border Insolvency Regime

The European Parliament has at long last approved a system by which insolvencies involving companies that trade in different EU states will be dealt with in a more uniform way.

The need for a trans-national process is evident from the fact that it is estimated that a quarter of firms facing insolvency in the EU have creditors in other EU states.

The aim is to 'throw a lifeline' to struggling companies by avoiding complex legal proceedings and to 'prevent people from exploiting differences between national laws'.

The new rules will apply to all EU member states, which will have two years before most of the provisions come into effect in which to ensure compliance.

For advice on any insolvency issue, contact us.

Contracts Mean What They Say, Not What They Don't

A High Court case concerning an agreement to supply cupcakes has underlined the legal principle that contracts are generally taken to mean what they say and that extrinsic evidence cannot normally be used to assist in their interpretation.

The dispute started with a simple contract for one company to manufacture and supply cupcakes to another company. The former argued that the contract precluded the latter from making cupcakes of its own and required it to place minimum annual orders worth £600,000.

When the second company did not adhere to these stipulations, the manufacturer sued its client, alleging breach of contract.

In striking out the company's breach of contract claim, however, the Court noted that its interpretation of the agreement involved adding words which were not there and would do 'extreme violence' to the natural and ordinary meaning of the wording in fact employed.

There was nothing ambiguous about the agreement and it was thus impermissible to take into account extraneous evidence regarding the parties' alleged intentions. The Court could detect no mistake in the drafting of the contract and it was not possible to argue that it did not make commercial common sense.

For advice on the negotiation or interpretation of any contract, contact us.

Liability Limitation Valid, Rules Court

When a loss is caused to one party by another, the party suffering the loss will often seek redress (damages) from the person or organisation that caused it. The process is relatively straightforward when one person or organisation is responsible for the loss, but what happens when it occurs as a result of the actions of two or more others?

In this circumstance, the law allows the person who has suffered the loss to sue any responsible party for the whole sum. It is then up to the person being sued to take their own action(s) against the others involved and they must then work out their relative liabilities between them.

Such circumstances occur fairly frequently in the construction industry, especially as insolvencies among contractors are relatively common. Where a contractor is insolvent, the sensible litigation strategy may well be to sue only the solvent organisations involved. In order to limit the potential losses that can result in such circumstances, 'net contribution clauses' (NCCs) are common. An NCC limits the liability of a party to a contract to the loss which it is reasonable to ascribe to them bearing in mind the liabilities of the others involved.

In a recent case, it was argued that such clauses are not effective in law, because they vitiate the principle of joint and several liability.

The case concerned a construction contract worth nearly £300,000 which involved considerable 'below ground' work on a house. The couple who owned the house found that there were considerable damp problems after the work had been completed. The work was done by a building firm under the supervision of an architectural firm.

The result was litigation against the architects only, because the builder was by then insolvent. The architects relied on an NCC to limit their liability and the argument over its effectiveness went all the way to the Court of Appeal. Essentially, the owners argued that consumer legislation prevented the limitation of their rights in the way the NCC purported to do.

The Court ruled that the wording of the NCC was clear and enforceable. It caused no imbalance between the respective rights of the couple who commissioned the work (and who had made the ultimate decision about which builder to use) and those who carried it out. Furthermore, other measures, such as the use of a performance bond, could have been put in place to limit the owners' risk.

For assistance in the negotiation of a building contract that protects your rights to the maximum possible extent, contact us.

Title Transfer Ineffective Against Enfranchisement Notice

When tenants apply under the Leasehold Reform, Housing and Urban Development Act 1993 for the right to buy the freehold of the property in which they live, one method of defeating the application which does not work is to transfer the property out of the owner's name (so that required notices are improperly delivered) and then back again.

This ploy was attempted recently, but the freeholder came to grief when the Upper Tribunal of the Lands Chamber ruled that the notices were still enforceable against him when he had temporarily transferred the title to the property concerned to his wife.

We can advise you on any aspect of property law.

Kit Kat Shape Not a Trade Mark?

The law of intellectual property is seldom simple or without surprises.

In 2014, the High Court decided that the 'corrugated' shape of the Kit Kat chocolate bar, whilst unremarkable in itself, had acquired a 'distinctive character' by way of use over time and hence could be registered as a trade mark by the Nestlé company in the product group that includes chocolate goods of all kinds.

The Court concluded that consumers associate the distinctive shape of the product with the Kit Kat brand. The effect of such a decision would be that other chocolate manufacturers would not be allowed to market confectionery the same shape as the Kit Kat bar.

The decision was opposed by Cadbury and the matter was referred to the Court of Justice of the European Union (CJEU).

The CJEU ruled that a trade mark can only be registered if the applicant can demonstrate that the average consumer of its products would 'perceive the goods or services designated exclusively by the mark applied for, as opposed to any other mark which might also be present, as originating from a particular company'. In other words, Nestlé would have to show that the shape of the product alone was sufficient to identify it, without the use of the brand name or any other trade mark.

The practical effect of this decision is that it sets the hurdle very high for applications for registration of trade marks based on the shape of goods sold. The case will now return to the High Court for determination.

Contact us for advice on all aspects of intellectual property protection.

Entering Into a Partnership? Get it in Writing!

Business partners who failed to define their working relationship in writing – instead reaching agreements orally over bottles of red wine in a pub – paid the price when a dispute over money erupted and made its way to the Court of Appeal.

Partner A had joined partner B in her professional practice and had contributed capital to the firm's account. On his retirement, partner A sought the return of those sums. Partner B denied that it had ever been agreed that he would be entitled to the contents of his capital account on his departure.

No agreement as to their partnership, or the terms of partner A's retirement, had been put into writing or executed. However, in ruling in partner A's favour, a judge found that a contract had been agreed, partly orally and partly by conduct, to the effect that he would be entitled to recoup his capital investment on leaving the firm.

In rejecting partner B's challenge to that decision, the Court of Appeal noted that the judge had had the benefit of hearing the witnesses and ruled that his findings of fact could

not be faulted. His conclusions were strongly supported by such documentary evidence as was available. In reaching its decision, the Court expressed surprise that two professional people had not formalised their agreements in writing and had chosen to litigate the matter rather than resolve their differences through mediation or arbitration.

The moral of the story is that in any partnership, company, LLP or other business organisation, you should have a clear written agreement as to what will happen in the event that the business ceases or those involved decide to part company with one another. Failing to do so is in all too many cases a false economy.

We can advise you on your individual circumstances.

BYOD Data Risk Complacency Revealed

Leading anti-virus supplier Kaspersky has carried out a survey which revealed that among small and medium-sized businesses there is a very considerable degree of complacency about the risks of losing sensitive data.

Two thirds of respondents admitted that they held sensitive business data on their personal data devices (laptops, mobile phones or pad devices), yet more than half of these did not take precautions to keep such data secure.

The practical effects of data loss can be considerable. Not only can business-sensitive data in the wrong hands lead to economic losses, but losses of data covered by the Data Protection Act 1998 can also lead to a considerable fine by the Information Commissioner's Office (ICO).

If you allow staff to use their own devices to hold such data or provide them with portable devices, having a strict data protection policy and enforcing it is imperative.

The ICO has produced comprehensive guidance, entitled 'Bring your own device (BYOD)', to help data controllers comply with their duties in this respect. This can be found on the ICO website www.ico.org.uk/.

We can advise you on the law, and the employment and other policies you should put in place to minimise the risk of data loss to your business.

Phased Building Plan Falls Foul of VAT Law

Although VAT as a tax is based on quite tightly worded rules, it certainly has its pitfalls, especially in the property arena.

In a recent case, a university was left facing a large VAT bill when it decided to go ahead with a new building for its chemistry department, to be constructed in two phases. The first phase was completed in 2004. The second phase was not commenced until 2011, after additional funding had been obtained. The original plan involved the construction of a wall that was easy to remove, allowing the second phase of the construction to be simplified.

The university contended that the second phase of the construction should be zero-rated for VAT, as had been the first phase, being the construction of a building for a relevant charitable purpose. Zero-rating of construction projects is important for universities as they normally cannot recover VAT on the expenses they incur.

However, HM Revenue and Customs rejected this assertion, because the relevant section of the VAT regulations does not provide for zero-rating of 'any enlargement of, or extension to, an existing building'.

Although the Tribunal accepted that phased construction was in the original plan and that of necessity such developments often need to be undertaken on a piecemeal basis, on the facts there was no doubt that the second phase was an enlargement or extension of an existing building and, accordingly, it could not be zero-rated.

This case illustrates the wisdom of considering carefully the VAT implications of any proposed property development at the outset. We can advise you on the tax and other aspects of your planned developments.

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