



→ Business Recovery & Insolvency Newsletter

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Herzogenaurach in Germany is known as ‘the town of bent necks’. It is a town split into footwear factions. For years locals would glance down one’s shoes before starting a conversation.

The small town is home to two sporting dynasties and one of the most infamous family feuds in corporate history. Back in the 1940s an argument between brothers Rudolf and Adolf Dassler gave rise to two rival sportswear companies: Puma and Adidas situated on either side of the town’s river.

The split spawned decades of fierce business rivalry, split a town in two and led to the establishment of two of the best-recognised sporting brands in the world.

No one knows how it started.

A few weeks ago, after more than 60 years of enmity, Puma and Adidas chose to call a truce.

The employees shook hands in Herzogenaurach and played a football match, the first joint activity since the Dassler brothers fell out.

Our experience could have helped the Dassler brothers if we had been around at the time.

Could we have made a difference? We would like to think so.

In this edition we wish you to have a taste of the depth of talent and experience that exists at Geldards LLP.

We have German lawyers and German speakers in-house (indeed we invite you to read the ‘Festschrift’ article by David Griffiths), we have trained mediators, we have experience in family businesses and unfair prejudice applications (see our experience in the Hawkes v Cuddy case. You will note we even like sport!)





So could we have made a difference? Well possibly not, as Rudolf Dassler was arrested by American forces in the 1940s and sent to a prisoner of war camp. He was convinced it was Adi, his brother, who had turned him in.

Herzogenaurach gossip also came up with more salacious theories, not least that Adolf had slept with Rudolf's wife and Rudolf had fathered Adolf's son.

We also like to think we are not hubristic; we are lawyers not miracle workers!



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→ Family Businesses

Family businesses are extremely important to the UK economy.

A report¹ estimated that family businesses account for:

- 42% of private sector employment;
- 38% of GDP in the private sector;
- £47 billion per annum in taxes; and
- 3 million employees.

The DTI (make that BERR, sorry BIS) also publishes an annual survey of small firms. 70% that are family owned were first generation, while 20% are second generation and the remaining 10% had been owned by the family for three generations or more.

What happens to the businesses that fail? Are they sold off?

The high failure rate of family businesses is often due to family rivalries and bitter feuds.

These occur notoriously often in third and fourth-generation businesses, where there are a myriad of cousins, some directly involved in the business and others wanting a share of the money.

As with any family there is squabbling, in-fighting

and jealousy. How does one maintain family business harmony?

Family participation as managers and/or owners of a business can present unique problems because the dynamics of the family system and of the business are not in balance. The personal interest of the family member and the well being of the business may be in conflict.

When a family business is basically owned and operated by one person (usual in first generation) that person does the necessary balancing between personal life and the business automatically. The governance structure is simple and informal.

The lack of alignment becomes more apparent in future generations when for example one family member with shares may want to sell the business to maximise the return, but another, who is an owner and also a manager, may want to keep the business because it is their job and they want the family business to be passed onto future generations.

The conflict can be managed by appropriate governance structures being put in place, such as share pre-emption rights, the involvement of non-executive directors or devising a family charter.

Management and ownership succession planning is vital. We would much rather be involved in helping a family agree a policy in the Articles of Association, a shareholders' agreement or a family charter than handling a board room dispute.





There are a many financial mechanisms for handling family business succession and every family is different. However one thing is the same: planning, planning, planning!

At the risk of distorting a well known expression, in the context of a family business, to fail to plan is to plan to fail.

[1] Institute for Family Business by Capital Economics
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→ Duties Of Non-Executive Directors

Non-executive directors (NEDs) who are appointed for a particular purpose need to ensure that they do not allow themselves to breach their statutory duties to the company to which they have been appointed.

In particular they must ensure that they do not allow external considerations to cloud their judgment in how they conduct themselves as director. If they do there could be unpleasant and expensive consequences.

Statutory duties

The duties of all company directors have recently been codified in sections 171 to 177 of the Companies Act 2006 ("the Act").

In summary they are:

- **171** To act within powers;
- **172** To promote the success of the company;
- **173** To exercise independent judgment;
- **174** To exercise reasonable care, skill and diligence;
- **175** To avoid conflicts of interest;

- **176** Not to accept benefits from third parties; and
- **177** To declare interests in proposed transactions or arrangements.

Prior to the Act those duties were enshrined in case law.

Difficulties can arise when a director has other interests which may cause tension with their duties to the company of which they are a director. In particular directors must not allow themselves to be influenced by, for instance, their interests as a shareholder of the company.

In many cases what is good for the company will of course be good for its shareholders. There are statutory safeguards in relation to directors voting on matters where they have an interest (section 175).

Conflicts of interest can also arise where a director has other directorships, particularly in circumstances where two companies having a common director are entering into a transaction. They can also arise where a director is appointed as a NED.

NEDs are particularly common in joint venture companies, where the directors of the joint venture company are nominated by the respective parties entering into the joint venture.

Clearly the parties to the joint venture will have certain expectations of their nominee by virtue of their nomination. The role of the nominee director is in many ways similar to the role of a NED.





Unfair prejudice

Breach of duty is often relevant in relation to allegations of unfair prejudice. Under section 994 of the Act (previously section 459 of the Companies Act 1985) it is necessary to show that:

- The company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of the members generally or of some part of its members (including [the petitioner]); or
- That an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

If it is established that a company is being run in a way that is unfairly prejudicial to one or all of its members then the Court, under its supervisory jurisdiction in relation to all matters pertaining to companies, can make various orders designed to remedy the unfairness.

Remedies under section 996 of the Act can include:

- regulating the conduct of the company's affairs in the future;
- prohibiting or compelling any action or proposed action by the company;
- requiring the company to litigate (to enforce rights of the company which its directors would not otherwise have caused it to enforce);
- alteration of the company's written constitution; or
- ordering the purchase of a member's shares, combined with their removal as a director.

Alternatively the court can order that the company be liquidated, ultimately bringing its existence to an end.

Hawkes -v- Cuddy

One of the first reported decisions under section 994 was Hawkes -v- Cuddy, an acrimonious dispute having major implications for the Ospreys professional rugby team in Wales. Ospreys is one of only four regional professional rugby teams in Wales. Geldards acted for Mr Cuddy. The company behind the Ospreys was called Neath-Swansea Ospreys Limited ("Ospreys").

The company at the centre of the litigation, Neath Rugby Limited ("Neath"), was a 50% owner of Ospreys in conjunction with Swansea RFC. Mr Cuddy was Neath's nominee director at Ospreys and a major cause of the club's success both on and off the field.

The petitioner (Mr Hawkes) made allegations including forgery and the taking of secret profits, as well as unfair prejudice. His primary complaint was that when Mr Cuddy was acting as a director of Ospreys, he was failing to represent the interests of Neath, putting him in breach of his duties to Neath.

Mr Hawkes' petition sought the removal of Mr Cuddy as a director of Neath and the sale of his shares to Mr Hawkes. That would have had serious consequences for the future of the Ospreys and repercussions across Welsh rugby.

In essence Mr Hawkes sought to argue that Mr Cuddy was conducting the affairs of Ospreys in a way that was unfairly prejudicial, not because of what Mr Cuddy was doing in his capacity as a director of Ospreys, but rather in his conduct as a director of Neath. He argued that the dual roles were such that certain conduct in respect of one amounted to conduct in respect of the other.

The court did not accept Mr Hawkes' allegations of unfair prejudice. It confirmed the long established principle that a director owes duties to the company of which he is a director, regardless of his perceived obligations or loyalties to his nominee (Neath). Nevertheless the affairs of one company could also amount to the affairs of another company under section 994.





However, there was no evidence that Mr Cuddy was in breach of his duties to Neath by virtue of his conduct as a director of Ospreys. Consequently Neath was not being run in a way that was unfairly prejudicial to its members i.e. Mr Hawkes.

Mr Cuddy was substantially successful in the proceedings. The trial judge (Mr. Justice Lewison) ordered a restructure of the board of directors of both Neath and Ospreys, giving Mr Hawkes his own say at board level rather than through Mr Cuddy and thereby securing the future of Ospreys as a team. That was exactly what Mr Cuddy had previously offered to do. The Court of Appeal upheld that order.

The decision confirms that nominee directors must not be swayed by their appointor. They are above all directors and must ensure that they act in the best interests of their company (under section 172), regardless of their loyalties to their appointor or indeed the expectations that their nominee may have. If they do that then their conduct will be beyond reproach.

The same is true of NEDs.

Insolvency

Past conduct of all directors of an insolvent company will be scrutinised by a liquidator.

If it transpires that any director failed to act in accordance with their statutory duties as set out in sections 171 to 177 of the Act and that the resulting breach of duty caused loss to the company (thereby exacerbating the consequences of insolvency for the company's creditors) then the liquidator may be able to bring a claim of misfeasance against the director personally.

Under section 212 of the Insolvency Act 1986 the court has wide powers to order a director to pay damages to remedy the harm done to creditors resulting from their

misfeasance.

Those damages could be a very substantial amount of money, depending upon the size of the loss arising from the act of misfeasance.

Furthermore, a liquidator is obliged to report on the conduct of directors. That will include nominee directors and NEDs. That report is considered for the purposes of deciding whether or not the conduct of any of the directors gives grounds for disqualification under the Company Directors Disqualification Act 1986.

Misfeasance will certainly be a factor in that disqualification decision. Under that legislation a director can be disqualified from being a director of any company for between 2 and 15 years.

Our Experience

Paul Hopkins and Liz Bray from Geldards' Cardiff office acted for Michael and Simone Cuddy, the eventual victors in the litigation.



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→ The Failed Leader - Why Do CEOs Crash And Burn?

*“The fault, dear Brutus, is not in our stars,
But in ourselves...”*

Shakespeare: Julius Caesar Act I scene 2

Most of us admire success. It is uplifting to read the biographies of men and women who have excelled in the many fields of human endeavour.

Failure is at the same time concerning and fascinating for us. We search for explanations. Some person or persons must be responsible and we seek to allocate blame.

Not many of us are quick to find fault in ourselves. Amongst the many business men and women I have met in the course of my job as a solicitor, only a minority had a degree of insight or awareness of the causes of the commercial failures with which they were connected.

According to them, it was largely the fault of others: the economy, stupid; the weak pound; the market that just disappeared. And latterly: the profligate banks and the breakdown of regulatory control.

The purpose of my article is not to explore this “otherness” but focus instead on the individuals responsible for the management of businesses that failed or who conspicuously strayed from the straight and narrow.

My methodology is to take the case of CEOs who failed and see if there is a common thread by going through

some biographical details and behavioural characteristics. Here I think it is important to be realistic and not too ambitious.

For example, two of the CEOs had no formal training or qualifications for their respective businesses and two were professional standard squash players, but I doubt whether these common factors on their own lead to any great insights.

I shall identify the CEOs as A, B, C, D, E, F, G and H. I then propose to share my views of what went wrong and what might have been done better.

To make it more interesting I shall make the cases anonymous and leave it to the reader to identify the CEOs concerned. (Tip: a few of the individuals A to H aren't really CEOs as we would understand it but certainly had comparable positions of authority). Also, one letter contains the identity of two CEOs.

Send your answers to me at david.griffiths@geldards.com before 6 January 2010 and the three best responses will receive a bottle of champagne.

Email me anyway and after that date I will send you the correct answers and full details.

*“Tragedie is to seyn a certeyn storie,
As olde bookes maken us memorie,
Of hym that stood in greet prosperitee,
And is yfallen out of heigh degree
Into myserie, and endeth wrecchedly.”*

Chaucer: Prologue to the Monk's Tale





A

Born into the lower echelons of the aristocracy, 'A' advanced himself through the system to become Minister of Finance. The finances of the State were in a ruinous condition as a result of mismanagement of fiscal revenue and meeting the cost of continuous warfare with neighbouring countries.

He succeeded in turning round the fortunes of the State by honouring existing governmental contracts, including pledging his personal credit and effecting a revaluation of the currency.

He also succeeded in creating a tidy amount of cash on the side which he applied in ambitious building projects. The finest architects of the time were engaged in their construction and design.

'A' assumed (wrongly) that the autocratic head of state (AHOS) would appreciate the construction and a big party was thrown for AHOS. This caused AHOS to become jealous and lead to the inevitable downfall of 'A', who received a term of life imprisonment after a show trial, the initial sentence being increased by the personal intervention of AHOS.

His successor had better luck and his particular style of economic management gave rise to a neologism which is current today. The successor also was able to put together a tidy sum on the side but did not make the mistake of flaunting it and so lived to enjoy it.

B

Sent away to boarding school as a child, 'B' learned that:

"It teaches you to be independent. It also teaches you

not to show emotions."

When he first started work he was often late and had little idea of how the business worked. A first class sportsman he was able to combine being CEO and captaining his county cricket club as well as being a keen five a side football player.

Sport also informed his business life when he stated:

"There is a finite life in being a chief executive. It is rather like being a football manager. Very few people get to choose the timing of their leaving".

'B' left the business not at his own timing when it rapidly imploded. His parting words were:

"I hugely love this company. I'd love to be a part of rebuilding it, if asked to."

To date, no one has asked.

C

'C' enjoyed a rapid rise to success as an accountant becoming a partner in a big 4 practice before his thirtieth birthday.

His first major achievement was in the administration of a huge cross border bank failure where he was responsible for a team of 1,000 people. Partly as a result of his efforts creditors received a dividend of more than 50p in the pound.

Five years later, 'C' switched jobs and was soon promoted to CEO. He embarked on a ruthless and successful acquisition trail. Assets of the business quadrupled in value and profits soared.





In his personal life he was known to be able to recite all 6 verses of 'American Pie' by Don McLean.

It would be fair comment to say that 'C's' interpersonal skills were not strong. A former chief executive of one of the subsidiaries described his manner as:

"facetious and withering - a classical psychological bully."

He would hold a management meeting each morning for his top executives which would last for anything up to an hour and which became known as "morning beatings."

Another senior executive recounted that such meetings:

"were never about enlightening anyone about anything."

It is a reasonable inference that at such meetings non-enlightenment was two-way traffic, i.e. why speak and draw attention to yourself and risk humiliation?

In the ensuing collapse 'C' received a generous severance package and subsequently agreed to commute some of the benefits. Shareholders are still counting the cost.

D

'D' was a phenomenally successful manager.

He had increased annual profits over forty fold in a period of thirteen years and the share price of the company had multiplied twenty fold. He made a lot of people rich beyond their wildest dreams: shareholders, employees and of course himself.

Success, however, came at a price.

Nicknamed 'the Gorilla', he was the classic exponent of the command and control style of management. He would inspire in his senior management both great loyalty and fear. One commentator described how:

*"Those closest to him slaved like courtiers to a medieval monarch, second guessing his moods and predilections, fretting over minute details of his schedule down to the flower arrangements and insulating him from trouble - **from almost anything he might not want to hear**" (my emphasis).*

Intriguingly, 'D' had great premonition and prescience concerning the fate that would overtake not just his own industry but the capital markets.

At the annual meeting of the World Economic Forum in January 2007 he observed that:

"This could be the year when the markets crack".

He was wrong only on the timing. The markets cracked the year after.

In his management 'D' became increasingly isolated from the coal face, being fed carefully vetted information from his own inner circle. He would happily deliver perorations to customers but seldom spent time listening to investors.

The collapse of the business of which he was CEO has not come easy for 'D'. He has publicly stated that the world is not yet ready to hear his side of the story.

They (not quite clear who) are:

"looking for someone to dump on right now, and that's me."

No doubt the time will come for him to tell his story.

E

Biographical details of 'E' are somewhat sparse, which is understandable given his necessarily short tenure of office.

One of his first actions after being appointed CEO was





to insist in a fit of pique that his PA not only change his name to 'Miss' but undergo surgery to effect a sex change.

His sycophantic board members would agree with him on almost everything and saluted his identification of Mitsubishi as the capital of Japan as a stroke of genius.

It was only when the non-execs learned that he had been dipping employees in varnish and using them as office furniture that patience finally ran out.

His severance package included a lump sum payment of \$ 100 million, the corporate jet, perpetual benefits and a salary of \$1 million per year.

F

Described as a classic example of the leader who hung on for too long, he was surrounded by weak people who tended to agree with him. He was eventually pushed out by those whom he (wrongly) believed were his most loyal supporters. As a result he failed to produce a worthy successor.

A great leader, he failed to recognise the effect of his personality on those surrounding him. This manifested itself in a tendency to 'shoot the messenger' bearing bad news so that bad news stopped reaching him with the inevitable consequence.

This leader had a background in retail. (Tip: I use the convention of the masculine including the feminine and the singular the plural etc.)

G

'G' succeeded in his early twenties to running the family business which in present day values was producing a sum in excess of £50 million a year.

The fifth holder of an aristocratic title, the first holder had distinguished himself by great military and political successes. By the end of his twenties, the family fortune

had been largely dissipated.

'G' had, however, enjoyed modest success as a dancer even if not quite of the Strictly Come Dancing variety.

He died a bankrupt aged 30 in Monte Carlo. The family fortunes never recovered.

H

Faced with criticism from a non-executive director as to a proposed merger, this CEO refused to give any proper answers to the objections raised, went red in the face and shortly afterwards left the room stating that he could not be expected to deal with "amateurs".

A few years later, and joined by a corporate finance expert, 'H' embarked on a policy of spending the company's cash, selling the cash cows, borrowing heavily and buying manufacturing companies at the top of the market.

The crash came shortly afterwards when the company had to be bailed out by its banks and new management. The shares in the company became effectively valueless causing loss to thousands of small shareholders.

"The purposes in the human mind are like deep water, But the intelligent will draw them out..."

Proverbs 20:5

So what went wrong in the curious cases of A, B, C, D, E, F, G and H?

Is there a sort of psychological 'smoking gun' we can point to, perhaps a dominating and domineering father





figure or a childhood loss which commits the subject to a fruitless and futile search for compensation?

Given infinite resources, skilled psychologists and therapists and the willingness of the subjects to submit themselves to the process (difficult where some of them are sadly no longer with us) no doubt some answers would emerge.

Not having that luxury, what follows therefore are some reflections on what went wrong in the absence of fully documented case histories.

Absence of feedback

Here it is not just a question of the unwillingness of the CEO to receive feedback but crucially the unwillingness of those closest to him to give it. In many of the cases above the reaction of the CEO was to shoot the messenger of bad news.

As the bearer of bad news why run the risk of humiliation, facing the bad temper of the CEO and even risking dismissal? It is much easier even if no less culpable to filter out the bad news and feed through only what the recipient wants to hear.

Research carried out in the US by Jackman and Strober¹ reveals that only half of the managers sampled had ever asked for feedback².

A number of reasons for this pattern of avoidance were given such as:

- Re-awakening of feelings of childhood dependence;
- Denial and procrastination (i.e. an unwillingness to explore what is wrong);
- Comparison with others will show others in a more positive light; and

→ Self sabotage where the subject looks for ways to make the expected negatives real.

For example, we don't wish to hurt other people's feelings; we don't wish to become separated from the group; we need to keep our job; look what happens to whistleblowers. The unwillingness both to receive and give feedback is part of the bigger picture of our unwillingness too tell the truth. In this area, cognitive justifications abound.

We conveniently overlook the fact that taken to its conclusion the absence of truth or rather the unwillingness to say it leads to the death march and the extermination camp.

Over optimism

In a commercial context this means being overly or naively optimistic about current undertakings and prospects. It is also known as the overconfidence effect³.

Over optimism is based on our own selective perception of reality. We tend to seek out those facts and matters which support our own views and discount heavily those which do not. As a litigation lawyer and mediator it is a bias I know only too well.

I should of course point out that over optimism is not in itself a bad thing. In many areas of business and life you are likely to get along much better with a tendency to over optimism rather than pessimism and you are more likely to end up happier. Treat yourself to a copy of Professor Seligman's book *Authentic Happiness*⁴ and a modest dose of Positive Psychology and you will see what I mean.

In many situations however, over optimism is misplaced. To take an obvious example: would you prefer the pilot to carry out a second check that the wings of the plane had fully de-iced or would you rather not have the 20 minute delay and run the risk?⁵





Loss aversion

This refers to the human tendency to take only few risks to make a small gain as opposed to taking bigger risks to avoid losses.

It is this condition which stops us from selling our loss-making stocks and shares because rather than focussing on the current price and the present prospects of the stock in question we remain fixated on the original and higher price paid.

In the words of the authors of a recent publication:

*“Unrealistic optimism is a pervasive feature of human life; it characterizes most people in most social categories. When they overestimate their personal immunity from harm, people may fail to take sensible preventive steps”.*⁶

Why?

*“People hate losses. Roughly speaking, losing something makes you twice as miserable as gaining the same thing makes you happy”.*⁷

There were not a few chances for subjects ‘A’ to ‘H’ to bail out before the inevitable.

What a delicious irony for the sacked whistleblower of HBOS to tell the Treasury Select Committee that he had already warned management years earlier that the business was embarked on activities which were speculative and likely to lead to losses.⁸

Less recently, even professional analysts and investors chose to ignore the warning signs from Enron and deleted or filtered worrying information.⁹

It is not necessary, however, to go back to Enron. The last two years have produced numerous cases of eye-watering ineptitude and incompetence.

Because of their high profiles, the respective falls from

grace of A to H were spectacular. And yet their failings were only too human and not a special privilege of their exalted position.

In other words, there are lessons to be learned by all of us.



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[1] 2003: Fear of Feedback. Harvard Business Review





[2] See also Rogers, J: Coaching Skills (2nd Edition) 2008. Oxford University Press.

[3] See Wikipedia entry: 'Over Confidence Effect' (accessed 22 November 2009).

[4] Seligman, M.E.P: Authentic Happiness. Using the New Positive Psychology to Realize Your Potential for Lasting Fulfillment. Reprint 2006. Nicholas Brealey Publishing.

[5] In the context of corporate governance see Iris H-Y Chiu Company Lawyer 2008: The role of securities disclosure regulation in investor protection relating to corporate insolvency: some observations on the US, EU and UK regulatory frameworks.

[6] Thaler, R.J and Sunstein C.R: Nudge. Improving decisions about health, wealth and happiness. 2009. Penguin Books, page 36. See also Kahneman D. and Tversky A. (eds.) Choices, Values and Frames. Cambridge University Press, Cambridge 2003 at page 414.

[7] Op cit p.36.

[8] This Is London Article: 'They Were Still In Denial, All The Way To The Precipice' - www.thisislondon.co.uk

[9] Coffee J.C: Gatekeepers: The Role of the Professions in Corporate Governance. 2006. Clarendon Press. Oxford





→ Lexi Holdings PLC (In Administration) v Luqman [2009] EWCA Civ 117

The Court of Appeal held that two inactive non-executive directors ('NEDs') were liable for losses suffered by the company as a result of a massive fraud perpetrated by its managing director.

Facts

Lexi was in the business of providing bridging finance to people looking to acquire property. Shaïd Luqman ("Shaïd") was the MD. His fellow directors were his two sisters, Monuza Luqman ("M") and Zaurian Luqman ("Z"), who was also the sole shareholder, and three other individuals who were unconnected to the family.

Waheed Luqman ("W"), Shaïd's brother, was a de facto director. Both Z and M were non-executive directors, or 'NEDs'.

Shaïd had prior convictions for dishonesty and had been imprisoned in the 1990s. This was known to the family but not to the other directors. Between October 2002 and November 2006 Lexi was financed initially by Barclays, then by Barclays on behalf of a syndicate of banks who provided revolving credit facilities of various amounts.

During this period, Shaïd misappropriated approximately £60 million including payments made to W, Z, M, his father and a number of other companies controlled by Shaïd. On 5 October 2006 Lexi was placed into administration.

Lexi's administrators caused Lexi to commence proceedings to recover the missing funds from Shaïd, W,

Z and M. There have been numerous applications and hearings resulting in a number of freezing orders, unless orders and the imprisonment of Shaïd for contempt of court.

Judgment was entered against Shaïd after he was debarred from defending the action for failure to comply with various court orders.

Lexi's application for summary judgment against W succeeded in the sum of £41 million plus interest on the basis that he was found to be sufficiently involved in the improper conduct of Shaïd as to be taken to have permitted or authorised it. His appeal failed and W declared himself bankrupt.

In the summary judgment application against M and Z, Mr Justice Briggs concluded that

"By reason of their total inactivity while directors [M and Z] breached the fiduciary and common law duties of care which they owed to Lexi... and are liable to [Lexi] in damages and/or to compensate [Lexi] in equity in respect of any losses caused by such breaches of duty arising out of the transactions..."

He allowed the issue of causation to go to full trial.

At trial Mr Justice Briggs concluded that the two sisters were liable for the misappropriated funds paid to themselves but not for the fraudulent payments paid to other family members.

Mr Justice Briggs decided that even if M and Z had complied with their duties and had notified the other directors of Shaïd's previous criminal convictions, the bank would not have acted any differently and the





outcome would have been the same.

There was no causation between M and Z's acts and the loss suffered. Lexi appealed.

The Court of Appeal allowed the appeal and declared the sisters were liable for the full amount of misappropriated payments. M and Z had failed to discharge their directors' duties as they had not challenged Shaid about a fictitious director's loan account.

By not informing their fellow directors, the two sisters allowed Shaid's dishonesty to continue on a large scale and permitted misapplications of funds.

If a director should have done something in accordance with his duties to the company, then he will be liable for the consequences of not doing it.

The court approached causation on the basis that a company should be placed in the position that it would have been in had the director performed his duties rigorously, disregarding the possibility that he may have been discouraged from doing so by the defaulting director or others.

Comment

Directors will not be exempt from liability if they simply sit back and allow a fellow director to breach his or her duties when they know (or ought to know) of the breach. This is the case even if a director is a NED.

Directors must ensure that they maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties. The court will not accept as an excuse for non-compliance with directors' duties the reason that those duties have been delegated to a fellow director.

A proper degree of delegation and division of responsibility between members of a board of directors is allowed and is often necessary. However, total abrogation of responsibility is not.

Similarly, a director who allows himself to be dominated by a defaulting director is also likely to be in breach of

duty. Shaid, the villain in Lexi, was described in the High Court as being:

"a persuasive, sophisticated, charming and highly intelligent liar".

NEDs are not directly involved in the day-to-day operations of the business. This means that they are likely to have less access to information than executive directors and may as a result be less able to exert influence.

However, lack of information is not a defence for failing to monitor the actions of other directors or scrutinising the accounts of the business and asking appropriate questions.

We have previous experience of suing a "puppet" officer of a company who had numerous corporate directorships and was based in Switzerland.

He would happily sign off instructions causing payments of the Company's money to all and sundry for which Lighman J. had no hesitation in making him personally liable: **Re. Transocean Equipment Manufacturing and Trading Limited** [2005] EWHC 2603 (Ch).



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→ The Walker Review - Corporate Governance Reforms

The Government announced on 26 November 2009 that it will move quickly to implement the reforms of bank pay and governance proposed by Sir David Walker.

The final version of the report can be read visiting:
www.hm-treasury.gov.uk/govt_walker_reforms.htm

On 16 July 2009 HM Treasury published a consultative review by Sir David Walker on corporate governance in UK banks and other financial industry entities (BOFIs).

The review was undertaken at the request of the Prime Minister following the banking crisis and incorporates many recommendations by the Institute of Chartered Secretaries and Administrators from their report 'Boardroom Behaviours'.

While many of the recommendations relate to "banker's bonuses" there are many other corporate governance recommendations that can be drawn. The recommendations include the following:

Board size, composition and qualification

Non-executive directors (or 'NEDs') should have sufficient knowledge and understating of the business that they contribute to the board and that NEDs on BOFI's be provided with dedicated support.

NEDs on BOFI boards will also be expected to commit more time than has been normal in the past (with a suggested minimum commitment of 30 to 36 days). This has already led to many NEDs resigning from boards.

The FSA should give closer attention to overall board

balance in relation to risk strategy and should take into account not only the relevant experience of directors and their other qualities.

Functioning of the board and evaluation of performance

NEDs should be ready, able and encouraged to challenge strategy.

The chairman, who should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position, should be expected to commit a substantial proportion of their time.

There are also recommendations as to the role of institutional shareholders and the governance of risk, as well as the more publicised recommendations as to remuneration.



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→ Festschrift Article On The Cross-Border Insolvency Regulations 2006

A 'Festschrift' is a legal tradition in Germany used to celebrate the career of a distinguished professional.

Hans Peter Runkel is a leading light in the German insolvency world. He turned 70 earlier this year. For his birthday more than 30 leading lights of the insolvency profession were invited to contribute to a bound volume of articles all relating to insolvency law that were presented to him at his party.

Three of those contributors were our own David Griffiths, Professor Adrian Walters and Anton Smith.

Our offering was on the subject of the Cross-Border Insolvency Regulations 2006 and how that legislation can now be used by an overseas officeholder to seek a mandatory stay of legal proceedings against the insolvent debtor and its assets in this jurisdiction.

A copy of the article (which is written in English) is available to read by referring back to the electronic newsletter. Go to the 'Festschrift' article & download the PDF from the link provided at the bottom of the page.

