Legal and regulatory update

Compiled and written by Bird & Bird
an international law firm which specialises in advising clients in:

Information technology
Intellectual property
E-commerce
Communications
Pharmaceuticals and biosciences
Sport
Media
Banking and financial services

This section is intended to be a synopsis of recent legal developments and is not intended to be exhaustive. If any issue referred to in this section is to be relied upon, specific advice should be sought. Please contact:

John Wilkinson
Bird & Bird
90 Fetter Lane
London EC4A 1JP

Tel: +44 (0)20 7415 6000
Fax: +44 (0)20 7415 6111

Legal and regulatory update

Regulatory

Stem cell research

In the UK the rules under the Human Fertilisation and Embryology Act 1990 have been relaxed, amidst considerable controversy, in a measure aimed at facilitating stem cell research. This has been achieved by a Statutory Instrument made under the 1990 Act, The Human Fertilisation and Embryology (Research Purposes) Regulations 2000, which permits the Authority established under the 1990 Act, the Human Fertilisation and Embryology Authority, for the first time to issue licences authorising bringing about the creation of embryos *in vitro*, and keeping or using embryos, for the purposes of:

- increasing knowledge about the development of embryos;
- increasing knowledge about serious disease;
- enabling any such knowledge to be applied in developing treatments for serious disease.

Previously the only purposes for which licences could be granted to create embryos *in vitro*, and to keeping or using embryos, had been:

- promoting advances in the treatment of infertility;
- increasing knowledge about the causes of congenital disease;
- increasing knowledge about the causes of miscarriages;
- developing more effective techniques of contraception;
- developing methods for detecting the presence of gene or chromosome abnormalities in embryos before implantation.

The controversy over the new rules came to a head in an unsuccessful attempt in the House of Lords on 22nd January, 2001, to block the Statutory Instrument. However, according to press reports, the Human Fertilisation and Embryology Authority will defer issuing any licences under its new powers until after the hearing of a legal challenge to the new Rules, mounted by ProLife Alliance, a pressure group.

Personal data protection

Data Protection Act

The European Commission and the US Department of Commerce have agreed a mechanism (the 'Safe Harbor' principles) whereby European organisations may transfer personal data to US bodies.

The Data Protection Directive (implemented in the UK by the Data Protection Act 1998, which came into force on 1st March, 2000) prohibits the transfer of personal data to countries outside the European Economic Area that do not offer adequate (ie European) protection for personal data. Significantly, the European Commission had indicated that the USA was not considered adequate. Companies registered under the safe harbor scheme will be considered adequate.

Companies that register under the safe harbor scheme are obliged to comply with the safe harbor principles, as supplemented by a series of frequently asked questions (FAQs) which address the needs of particular industry sectors. One FAQ relates specifically to the application of data protection to the pharmaceutical sector. In order to register for safe harbor, an organisation must adhere to a privacy programme, such as one offered by Trust-E or BBOnline, or it must develop its own privacy programme. Secondly, the organisation must declare its compliance publicly, by registering with the Department of Commerce. Failure to comply with this publicly declared privacy policy will be actionable by the Federal Trade Commission as a deceptive or

misleading trade practice. Individuals may also be entitled to seek compensation for breach of the safe harbor principles.

Safe harbor is not proving attractive; in the three months that the scheme has been operational, only eighteen US companies have registered. This means that European organisations wishing to transfer personal data to the US will still have to look for alternative ways of doing this.

Health and Social Care Bill

Clause 59 of this Bill will, if enacted, allow the Secretary of State for Health to introduce draconian regulations prohibiting or restricting the use of information which is 'to any extent' derived from patient information – even if the patient is not identifiable from the data. The Clause also enables the Secretary of State to include provisions in the terms of service for GPs and pharmacists which prohibit them from disclosing patient information and which introduce criminal offences for breach of any of these provisions.

At the end of 1999 in the *Source Informatics* case, the Court of Appeal ruled that the Department of Health could not restrict the use of anonymous patient information. The Department of Health briefing on Clause 59 makes it clear that the legislation is specifically designed to overturn the *Source* judgment. The briefing note also hints that the Department of Health may use the legislation as justification for charging for access to patient data.

As drafted, Clause 59 is extremely wide ranging. It could affect not only medical informatics companies, such as Source, but also the research and marketing activities of pharmaceutical companies themselves.

Clinical Trials Directive

The Clinical Trials Directive has now, after negotiations between the European Parliament and the Council of Ministers, completed on 15th December, 2000, its passage through the European Community legislature, although the final agreed text has not yet been published. The Directive, which was first submitted by the Commission in 1997, mandates a time limit for ethics committee opinions and regulatory approval or refusals of new clinical trials – generally 60 days, but less for regulatory approvals if 'in compliance with current practice'. This time limit can also be extended by up to 120 days for trials involving gene therapy and genetically modified organisms where consultation is required, and indefinitely where the trial involves xenogenic gene therapy.

Regulatory data protection

The issue of 'essential similarity' is set to be further reviewed by the European Court of Justice (ECJ) in a reference from the English Court of Appeal in *R v Licensing Authority on the application of Novartis*.

As previously noted (Vol. 7, No. 1, pp. 80–81) the High Court had, on 30th March, 2000, supported the Medicines Control Agency's decision to grant Sangstat UK's applications under the abridged hybrid procedure for marketing authorisations for Sangcya oral solution and for Acceptine oral solution, and had refused to make a reference to the ECJ. The ECJ's previous decision in Case C-368/96 *Generics* had concerned normal abridged applications under Article 4.8(a)(iii) of Directive 65/65 and not, as here, hybrid ones in which reliance was placed also on the proviso to Article 4.8(a). On appeal from this the Court of Appeal, after a hearing on 13th and 14th November, 2000, has decided to make no ruling other than to refer to the ECJ various questions concerning the issues of essential similarity and the issues that arise on the abridged hybrid procedure.

Reimbursement

In the UK the Fourth Report to Parliament on the functioning of the Pharmaceutical Price Regulation Scheme (PPRS) was published in December 2000.

This report is the first to comment on the operation of the new (1999) PPRS scheme that has been in effect from 1st October, 1999. The three previous reports have

covered the previous (1993) scheme. The scheme is a voluntary, non-statutory scheme that indirectly controls the prices of branded prescription medicines to the National Health Service (NHS) in the UK by regulating the profits that companies can make on these sales. Thus it does not cover generic medicines sold to the NHS nor branded products available without prescription. The report notes that the price reduction at the outset of the 1999 Scheme (namely an enforced reduction in prices by 4.5%, achieved either by price cuts across the board, by modulation, or by cash repayment) was 'delivered satisfactorily, delivering full year savings to the NHS of around £200 million'. It goes on to note that 'at the same time it has been possible to retain the freedom of pricing for new products, improve allowances for research and development, and retain a non-intrusive approach to the industry'. The report provides details of the operation of the scheme, aggregated data derived from returns under the scheme, price comparisons with other countries in Europe, and a discussion of constituent elements in the growth of NHS medicines expenditure.

Meanwhile the European Commission has instituted proceedings in the ECJ against Austria (Case C-424/99) and Finland (Case C-229/00) for failure to fully implement the Price Transparency Directive 89/105/EEC.

Intellectual property

Second medical use patent claims

Several recent judgments of the English and Dutch Courts have concerned patent claims to medical uses, and in particular to second medical uses, including *American Home Products v Novartis* and *Lilly-ICOS v Pfizer* (Vol. 7, No. 2, pp. 173–5), although none of these has involved any challenge to the principle behind such claims. The House of Lords has now rejected a petition for leave to appeal from the judgment of the English Court of Appeal in the only recent case in which the principle had been questioned, *Bristol-Myers Squibb v Baker Norton & Napro.*

In *Bristol-Myers Squibb v Baker Norton & Napro,* the English Court of Appeal, on 23rd May, 2000, upheld the decision (of Jacob J. reported as [1999] RPC 253) holding invalid a claim to:

> Use of taxol and sufficient medications to prevent severe anaphylactic reactions, for manufacturing a medicamentation for simultaneous, separate or sequential application for the administration of from 135 mg/m^2 up to 175 mg/m^2 taxol over a period of about 3 hours or less as a means of treating cancer and simultaneously reducing neutropenia.

As in the lower court, such claim was held to lack novelty over an oral disclosure at a presentation attended by about 500 persons. The presentation had disclosed all features of this claim, other than that the cancer was actually (ie successfully) treated and the reduction of neutropenia. The associated period of treatment was one of a number of possibilities. The claim was construed to mean 'suitable for treating cancer' so that a submission based on the first omitted feature failed. The court held that in use the monitoring of neutropenia would be standard practice and so this second feature omitted from the presentation could not confer novelty. As to obviousness (if the claim did possess novelty) the use of taxol in the way claimed had been one of trial arms disclosed in the presentation and there could be no invention in carrying out trials in a way disclosed in the lecture.

However, each of the three judges in the Court of Appeal went further than Jacob J. in giving a judgment holding that the claim was not one of the so-called 'Swiss type' (which, if it were, ought to be upheld in conformity with *EPO Decision G* 5/83, *EISAI*, OJEPO 1985, 64; and *John Wyeth and Schering's Applications*, [1985] RPC 545), but a disguised method of treatment claim as no medicament as such would be prepared except perhaps by the doctor administering the claimed drug combination in the stated dosage and for the stated treatment period. Thus, the claim was no more than a discovery of a method of medical treatment and hence to such extent unpatentable.

In Europe such second medical use claims have been developed in case law before the Boards of Appeal of the European Patent Office, and sanctioned by national courts, as, unlike claims to the first medical use, they lack express sanction in the European Patent Convention. This is now set to change as a result of decisions made at the Diplomatic Conference on the Revision of the European Patent Convention, which took place in Munich from 20th to 29th November, 2000. Among many other changes to the Convention that were agreed (but which will however come into force only once ratified by a sufficient number of European Patent Convention (EPC) member states) was one to Article 54 EPC. This would introduce new wording to make it clear that second and subsequent medical uses are patentable without recourse to 'Swiss type' claim wording such as 'use of product X in the manufacture of a medicament for the treatment of Y'. Thus, as is at present the case with a first medical use (for a compound previously known but not known to have utility as a medicine), second and subsequent medical uses (for compounds previously known to have utility as a medicine but for a different indication) could be claimed as 'product X for use in the treatment of Y'.

Community patent and related matters

The European Commission's Proposal for a Council Regulation on the Community patent is still being widely debated. The Regulation was due to be reviewed at the Council of Ministers' Intellectual Property Working Party on 6th February, 2001. The two areas of greatest controversy addressed by the Regulation are those of translation and litigation. Ironically, however, the higher profile accorded to these issues and the wider and more public recognition of the shortcomings of the present system implicit in the Regulation have rejuvenated attempts to improve the present system for obtaining, validating and litigating patents via the European Patent Office, and it is here where significant developments have taken place recently.

To this end two Intergovernmental Conferences (the first in Paris in June 1999 and the second in London in October 2000) have been held. The Paris Conference appointed two working parties to study this subject. The first working party was asked to study ways of reducing by 50 per cent the translation-related costs in obtaining and validating European patents and it produced an Agreement that was approved by the London Conference. Under the Agreement, to be signed only by those countries so willing, signatory countries having English, French or German as a national official language would no longer require any translations of the entire specification of the patent under Article 65 of the EPC. Those signatory countries not having one of these three languages as a national official language would have to nominate one of English, French and German and then no longer require translations of the entire specification in that language into a national official language. However, these countries could still require (and no doubt will require) translations of the claims of the patent into a national official language irrespective of whether the claims are in English, French or German.

At the London Conference, eight countries (the UK, Denmark, Germany, Liechtenstein, Monaco, the Netherlands, Switzerland and Sweden) signed the Agreement. Others are planning to do so, but the position of France is critical. Under Article 6, the Agreement comes into force on the first day of the fourth month after the deposit of the last instrument of ratification or accession by eight contracting states to the EPC, including the three states in which most European patents took effect in 1999. The latter three are Germany, the UK and France, so since eight countries have already signed, the Agreement will come into force soon after France signs, if it does so.

The second working party was charged with:

- studying under what conditions the principle of arbitration in litigation relating to infringement and validity of European patents might be acknowledged

by EPC member countries;
- defining the terms under which a common entity can be established and financed and from which a national jurisdiction can obtain advice on any litigation relating to the validity and infringement of European patents;
- preparing a draft text for an optional protocol to the EPC (now known as the European Patent Litigation Protocol or EPLP) which would commit signatory countries to an integrated judicial system, including harmonised rules of procedure and at least a common court of appeal, for litigation concerning European patents.

While the Working Party has considered all these topics, it has spent most of its time on the third. At the London Conference, it was given a new mandate whereby it has until the end of 2001 to produce an optional agreement in treaty language on the settlement of litigation concerning European patents, dealing with both the second and third topics. It remains to be seen how this will progress as against the parallel Community developments on the Regulation.

Supplementary Protection Certificates

Two references are currently before the ECJ on this subject. One is *BASF* (Case C-258/99), in which, on 30th November, 2000, the Advocate General delivered his opinion, recommending that 'where, by means of a new process, a plant protection product is obtained which contains a smaller proportion of unavoidable impurities than an existing plant protection product with the same active component, the two products are one and the same for the purposes of the Regulation'. This would prevent patentees seeking SPCs in respect of purer material by treating such purer material as a new product. The other reference is in *AB Hassle v Ratiopharm* (Case C-127/00), as to whether the 'first authorisation to place on the market in the Community' includes marketing authorisations which, because of local pricing and reimbursement laws, could not, without more result in a product, actually be placed on the market. The relevance of this is that although marketing authorisations had been granted in France and Luxembourg before the German cut-off date of 1st December, 1998, for the SPC Regulation to apply to products already on the market such marketing authorisations did not permit sales to take place.

Parallel imports

Bayer has successfully appealed to the Court of First Instance (CFI) of the European Court of Justice against the decision of the European Commission late in 1995 to levy on it a fine of ECU3m for infringing Article 81(1) of the EC Treaty by attempting to restrict parallel imports of the cardiovascular drug Adalat. The decision annulling the Commission decision, given on 26th October, 2000, has itself now been appealed by the Commission and by the German parallel traders' association, the BAI.

Prices for the Bayer product varied considerably from member state to member state. The prices in the UK, the largest market, were considerably higher than in Spain and France and so Spanish and French wholesalers ordered larger quantities than required to supply their domestic markets, and exported the surplus to other member states, including the UK.

Bayer refused to supply French and Spanish wholesalers with the quantities of the Bayer product that they ordered. In Spain, Bayer set up a computerised system for identifying parallel exporters, while in France exporting wholesalers were recorded on handwritten lists. Wholesalers tried a number of methods to obtain larger quantities, such as spreading orders among agencies, and placing orders through wholesalers not subject to monitoring. When one was found to be exporting, Bayer France and Bayer Spain penalised it by imposing successive reductions in the volumes supplied.

The Commission found that the practices were part of an arrangement under Article 81 that restricted competition, holding that

an export ban effectively formed part of the continuous commercial relations between Bayer and the wholesalers, and the wholesalers had shown by their conduct that they accepted the ban.

The Commission's finding was appealed to the CFI, which in an interim order suspended the fine pending its final determination of the appeal. Such final determination took place on 26th October, 2000, when the CFI annulled the Commission decision. However, the decision of the CFI does not represent a vindication of the policies said by the Commission to have been adopted by Bayer, but rather a criticism of the nature of the legal assessment undertaken by the Commission. Such assessment had been defective in finding there to be a 'common intention' between Bayer and the wholesalers. Without this there was no agreement between them within the meaning of Article 81.

Although unilateral conduct could fall within Article 82 (abuse of a dominant position), this was not in issue in this case. The CFI observed:

> provided he does so without abusing a dominant position, and there is no concurrence of wills between him and his wholesalers, a manufacturer may adopt the supply policy which he considers necessary, even if, by the very nature of its aim, for example, to hinder parallel imports, the implementation of that policy may entail restrictions on competition and affect trade between Member States.

Several other cases proceeding in the ECJ also concern parallel imports: Case C-172/00 *Ferring v Eurim-Pharm* raises similar issues concerning the impact of regulatory law constraints on parallel imports to those addressed in Case C-94/98 *R v MCA ex parte Rhone-Poulenc Rorer* in which the ECJ gave judgment on 16th December, 1999.

On the trade mark side, having only recently given judgment in the rebranding parallel imports case of Case C-379/97 *Pharmacia & Upjohn v Paranova*, the ECJ now has yet another opportunity to revisit its parallel imports case law in relation to repackaging in two new cases referred to it. One is Case C-443/99 *Merck, Sharp & Dohme v Paranova* from Denmark. The other is Case C-143/00 *Glaxo & ors v Dowelhurst & anr* from England, in which the following questions have been submitted to the ECJ:

1. Can a trade mark proprietor stop or hinder the importation from one member state to another and subsequent marketing or promotion of its own goods where such activities cause no, or no substantial, harm to the specific subject matter of its trade mark rights?
2. Is the answer to 1 any different if the use of the mark is not necessary?
3. Is the answer to 2 any different as between advertising and repackaging?
4. What does 'necessary' mean?
5. If the repackaging is not necessary and does not harm the specific subject matter of the trade mark right, is it abusive conduct and a disguised restriction on trade to enable the proprietor to stop the parallel imports using national trade mark rights?
6. Does the parallel importer have to give advanced notice?
7. If the answer to 6 is yes, will failure to give notice entitle the proprietor to restrain the importation or further commercialisation of those goods even though there is no prejudice caused to the specific subject matter of the trade mark rights?
8. If the answer to 7 is yes, does the requirement apply to all uses of the trade mark and how should notice be given?
9. Can a national court order an injunction, damages, etc. at the suit of the trade mark proprietor where to do so will impede the free movement of goods but is not for the purpose of preventing harm to the specific subject matter of the trade mark rights?

Finally, in T-153/00 *Spain Pharma SA v Commission* the applicant seeks a declaration that the Commission has wrongly failed to act on a complaint submitted by the applicant against a number of companies in the Merck group alleging the setting up of obstacles to the operation of the parallel market in medicinal products.

Competition law

The new Commission Regulations on the application of Article 81(3) of the EC Treaty to categories of research and development agreements and to specialisation agreements ('block exemptions') were published on 29th November, 2000, and apply from 1st January, 2001. However, the previous block exemptions for research and development agreements and for specialisation agreements will continue to apply to agreements already in force on 31st December, 2000, until 30th June, 2002. These new block exemptions have been complemented by a Commission Notice published on 6th January, 2001, providing guidelines on the application of Article 81(3) of the EC Treaty to horizontal cooperation agreements, which has replaced the 1968 Notice on certain types of cooperation agreement and the 1993 Notice on the assessment of cooperative joint ventures. Taken together with the recent Commission Regulation on the application of Article 81(3) of the EC Treaty to categories of vertical agreements (the vertical agreements block exemption) and its accompanying Commission Notice providing guidelines on the application of Article 81(3) of the EC Treaty to vertical agreements, this effects a major restructuring of Community competition law.

Company/commercial law

Legislation

Consultation Paper 81 (Financial Services Authority) January 2001 – Proposed Changes to the Listing Rules – Chapter 20 – (Comments to be received by 16th March, 2001)

The Financial Services Authority ('FSA') has issued a consultation paper in relation to various aspects of the Listing Rules including those rules restricting the listing of biotechnology companies currently set out in Chapter 20.

Background

The FSA has decided to review certain aspects of Chapter 20 of the Listing Rules that are applicable to scientific research-based companies. Currently companies may be admitted to the stock exchange under Chapter 20 only if they meet the conditions for listing set out in this chapter. These conditions include the need for a three year trading record (although the company does not need to have earned revenue throughout this period). Further conditions relate to market capitalisation, size of fund raising and the pre-flotation involvement of sophisticated investors. In addition, under Chapter 20, the company must currently be able to demonstrate that it has 'achieved significant commercial milestones in its development'. Chapter 20 then lists certain milestones, such as (in the case of companies whose activities are mainly the research and development of pharmaceutical products) having at least two drugs in clinical trial under internationally accepted regulatory scrutiny. The FSA is concerned that the milestones may no longer be appropriate indicators of the stage of development for many potential Chapter 20 companies.

The FSA has suggested that the requirement to satisfy at least one of the predetermined commercial milestones should be removed, thus allowing applicants to demonstrate the maturity of that business by explaining the milestones that are appropriate to their particular area of scientific research activity through detailed disclosure in the listing particulars.

The FSA also proposes to introduce specific disclosure requirements for class 1 acquisitions involving another scientific research-based company. These disclosures should include:

- the information required under paragraphs 20.9 and 20.10 of the Listing Rules focusing on the nature of the products, the subject of the transaction and their stage of development (including details of any validations);
- an expert's report (equivalent to the

report required for a new applicant) covering the products that are the subject of the transaction in the case of the acquisition of an unlisted company or products from such a company;
- the impact of the transaction on the current and future funding requirements of the group and details of how the development of any acquired products is to be funded. Where a class 1 transaction occurs within 12 months of admission, the estimate of funding requirements under paragraph 20.8(c) must be stated from the date of the transaction; and
- any risk factors.

Comment The proposed relaxation of the Listing Rules should encourage more biotechnology companies to list on the Stock Exchange and in so doing will make it easier for new companies to raise cash. The FSA has attempted to strike a balance to ensure that the remaining requirements for disclosure will create sufficient safeguards to ensure that private investors are not misled into assuming listed companies are more developed than they actually are.

AIM rules change – revised AIM rules

Background

The Stock Exchange has been working on a revision of the Alternative Investment Market (AIM) rules to provide further clarity to the existing rules and to make them more international in flavour and Internet friendly. The proposed changes were issued for market consultation in November 2000, following which revised rules were brought into effect on 12th, February, 2001. A brief summary of the major rule changes is given below.

- **Principles of disclosure:** the rules now prohibit AIM companies from disseminating information that is false, misleading or materially incomplete.
- **Profit forecasts, estimates and projection:** the nominated adviser will be responsible for confirming that any statement issued by a company about the forecast of its profits has been issued only after due and careful consideration by the AIM company. Separate confirmation from accountants will no longer be required.
- **Disclosure of price-sensitive information:** a clearer rule regarding price-sensitive information has been introduced. An AIM company must notify the Company Announcements Office, without delay, of any new developments (that are not public knowledge) concerning a change in its financial condition, its sphere of activity, the performance of its business, its expectation of its performance and that, if made public, would be likely to lead to a substantial movement in the price of its AIM securities.
- **Lock-ins:** for new businesses that do not have a main business activity that has been revenue earning for two years. The AIM rules now state that shareholders (excluding shareholders that fall in categories such as those authorised to conduct investment business), with more than 10 per cent of a class of securities admitted to AIM, will be subject to a lock-in arrangement.
- **Reverse take-overs:** there will no longer be a suspension on the day of the EGM and shareholders will be sent a full admission document with the notice of the EGM.
- **Use of websites:** documents sent to shareholders by AIM companies can now be made available to the public generally on a website rather than in hard copy only (as is the present case).
- **Directors' dealings:** new controls have been introduced on directors' dealings and those of certain employees. A new concept of 'applicable employees' will be introduced where all employees with 1 per cent or more of an AIM company's securities will be required to disclose their dealings.
- **Half yearly report:** half yearly reports should be issued within three months rather than four months from the end of the relevant period and will be required for every six months from the date of the

financial information in the company's admission document.
- **Settlement:** all companies, not just those incorporated in the UK, must be eligible for electronic settlement.

The Limited Liability Partnerships Act 2000 – commencement date 6th April, 2001

It will be possible to incorporate a limited liability partnership (LLP) from 6th April, 2001. The Limited Liability Partnerships Act 2000 received the Royal Assent on 20th July, 2000. Although the detailed secondary legislation dealing with the regulation of LLPs has not yet been finalised, the Chancellor of the Exchequer announced in the Pre-Budget Report on 8th November, 2000, that the commencement date for registration of LLPs will be 6th April, 2001.

Case law

Joint venture partnership: Khan v Miah & others (2000)

References [2000] 1 WLR 2123; [2001] 1 All ER20

The House of Lords has held that there is no rule of law that states that parties to a joint venture do not become partners until trading actually commences, but rather that they will become partners when they embark on the business activity that is the subject of the joint venture.

Facts

The respondents and the appellant had agreed to open a restaurant with the appellant providing most of the initial capital. The parties had taken a number of steps in preparation for trading, including opening a partnership account in the names of the appellant and the third respondent. However, difficulties, which included the appellant's discovery that the freehold of the proposed venue had been conveyed into the third respondent's sole name, caused the relationship to break down. Consequently, before the restaurant opened, the partnership (which was a partnership at will) was determined.

Decision

The House of Lords held that the preparations were all part of the joint venture and formed part of the business that the parties had agreed to conduct together. There is no rule of law that the parties to a joint venture do not become partners until actual trading commences. Those who agree to carry on a business activity become partners when they actually embark on the activity in question.

Director's duty: MacPherson and another v European Strategic Bureau Limited (2000)

References: LTL/31/7/2000; TLR 5/9/2000

The Court of Appeal has held that the directors of a company who caused a company to enter into an agreement providing for payments out of its assets to certain creditors (including themselves) were in breach of duty to the company.

This decision follows the authority that the powers of management of directors are to be exercised for the benefit of the company and not for their own benefit (*In re Lee, Behrens and Co Ltd [1932] 2 Ch 46*). One of the tests is whether or not a transaction is entered into for the benefit of and to promote the prosperity of the company. In this case, the court held that the agreement was not for the benefit of the company because it amounted to an informal winding up and was an attempted distribution of the assets of the company without making proper provision for all of the company's auditors.

Director's disclosure of interest in contract: Craven Textile Engineers Ltd v Batley Football Club (2000)

References: LTL 7/7/2000

The Court of Appeal has held that the courts do not have a general discretion to do what

seems fair and just in all the circumstances where a director is in breach of his duty to disclose his interest in a contract under section 317 of the Companies Act 1985 (CA 1985).

Facts

H was a director of the claimant company (CTE) and was a former director of a football club (the Club). The claimant sought payment of certain unpaid invoices for work done and goods supplied to the Club during the period when H was a director of the Club.

Decision

The court held that H was in breach of section 317 of the CA 1985 and noted that although section 317 does not set out the consequences of a breach, the authorities show that, in the event of a breach, the relevant contract is voidable (*Guinness plc v Saunders [1990] 2 AC 663*). However, at common law the courts will only permit a company to avoid the contract if the parties can be restored to their original position. In this case, that was not possible as the goods and services had already been supplied. The claimant was therefore entitled to payment of the invoices. The court did not have a general discretion to do what seemed fair and just in all the circumstances.

Sale of beneficial interest in shares: Hilary Scotto v Doreen May Petch and Levin and 11 others re Sedgefield Steeplechase Company (1927) Limited (2000)

References: LTL 21/12/2000

The Court of Appeal recently held that an agreement by shareholders in the Company to sell the equitable interest in their respective shareholdings did not activate the pre-emption provisions in the Company's Articles of Association.

Facts

S and the respondents were, between them, the holders of the entire issued share capital of a company called Sedgefield Steeplechase Company (1927) Limited. The Articles of the company contained rights of pre-emption, which required a member who intends to transfer shares to give notice of his intention in writing to the Board who might then offer the shares to the other members. In 1998 an offer was made by the twelfth respondent (NR) to buy all the shares in the company. One of the shareholders (S) holding 21.13 per cent of the issued share capital refused to sell. NR nevertheless entered into agreements with the respondents by which the respondents agreed:

- to sell the equitable interest and their respective shareholdings to NR;
- against payment of a price to deliver a declaration of trust in favour of NR by which the respondents withhold and deal with the shares as directed by NR so that the respondents cannot be required to transfer or otherwise deal with the shares in any way which would contravene the pre-emption rights contained in the Articles; and
- at the request of NR to requisition an extraordinary general meeting of the company for the purpose of passing a special resolution to delete the pre-emption rights in the Articles.

Decision

The Court of Appeal held that the sale agreements were qualified in such a way that they did not give NR the right to call upon the shareholders to do anything that was inconsistent with the subsisting pre-emption rights in favour of S so as to require them to serve a transfer notice upon her. The intention to transfer the shares conditional upon the deletion of the pre-emption rights was not an intention that created an immediate obligation to give a notice and was not inconsistent with an intention to comply at the appropriate moment with the subsisting provisions of the Articles.