



## Editorial

There have been a number of developments in company and employment law over the last few months which have a much wider impact than had originally been expected.

We have produced this newsletter to summarise the potential impact of a number of these. Two of them, social networking and diversity in the Board Room, have been the subject of extensive press comments. Two others in relation to the question of appointing nominees to the Board of joint venture companies and the impact of the potential break up of group relationships have been less widely reported.

We hope that you find these articles of interest.

## Employment Case Update: X v Mid Sussex Citizens Advice Bureau

Employment Partner Sarah Rushton examines the latest cases. Please scroll down for previous reports.

### **X v MID SUSSEX CITIZENS ADVICE BUREAU**

The Big Society, apparently aimed at fostering a culture of volunteerism, was a central plank of the Tory manifesto. Looking at the issue cynically, it could be said to be about saving money at a time when swingeing cuts are being made. If people are willing to provide their services for free, then you need not pay others to do the job. After all, volunteers are cheap, dispensable and less trouble than employees, aren't they? Well, maybe not.

The issues surrounding the legal status of a volunteer are complex and it is important for those engaging volunteers to make sure that they get the relationship right. Charities may come unstuck if their volunteers are able to show that they are in fact employees or workers.

In a genuine volunteer arrangement, there will be no 'mutuality of obligation' between the volunteer and the organisation to which they are providing their services. The volunteer should be free to provide their services as and when they see fit and there should be no expectation on the part of the charity. Any agreement between the volunteer and the organisation needs to be carefully worded to ensure that a contract of employment is not inadvertently created.

In order to be consistent with volunteer status, it is important that volunteers are not paid for their time. If they are paid expenses then these should be genuine out-of-pocket expenses rather than a flat rate allowance. Any expenses over and above this may be regarded as income for tax or benefit claim purposes. In some cases it may even be viewed as a wage (see for example *Migrant Advisory Services v Chaudri EAT*).

The inability to create an obligation on the part of the volunteer or to pay them can be problematic. Joanna Kennedy, chief executive of the charity Z2K, points out: 'Sometimes I would love to be able to pay volunteers for their work, as then there would be a clear mutuality of obligation which would mean we could ask for more regular attendance and reliability. We value and respect our volunteers but need to take care that we do not inadvertently create an employer/employee relationship.'

The issue is an important one. Volunteers do not have protection from unfair dismissal nor are they entitled to the national minimum wage. It would also appear that a genuine volunteer has no protection against discrimination in *X v Mid Sussex Citizens Advice Bureau and others* [2011] EWCA Civ 28. In January The Court of Appeal held that a CAB volunteer could not pursue a claim under the Disability Discrimination Act 1995. She had no contract nor was the arrangement one which determined to whom employment should be offered. Although the case related to disability discrimination, its principles are equally applicable to all other areas of discrimination.

Clearly no one would expect the vast majority of those engaging volunteers to discriminate against them or to dismiss them for no reason, but in an increasingly litigious society a number of charities have expressed relief that the courts have confirmed that discrimination rules do not apply.

However, for those organisations which are both responsible and risk averse, it is worth remembering that the cases in relation to volunteers arose primarily because the individuals concerned thought that they were being treated unfairly. As Joanna Kennedy observes: 'If the relationship is handled correctly then there is mutual benefit in that volunteers find the work personally rewarding and learn useful new skills. In return the organisation is able to do far more work than it would be able to do using only paid staff. Charities need their volunteers and our volunteers learn important life skills from being involved with us. Treat your volunteers properly and your organisation will reap the rewards.'

## **HASHMAN v MILTON PARK**

In *Hashman v Milton Park (Dorset) Ltd t/a Orchard Park ET 3105555/2009*.) Mr H was engaged as a gardener by Orchard Park and dismissed 6 months later.

Mr H a life long animal rights campaigner complained that he was dismissed because the majority shareholders in Orchard Park (who were apparently supporters and members a Hunt) discovered his opposition to fox hunting.

Orchard Park argued that he was dismissed for economic reasons and that besides, his anti fox hunting beliefs, could not amount to a protected "Philosophical belief" under the Employment Equality (Religion or Belief) Regulations 2003 ("the Regulations").

The Regulations prohibited discrimination in the workplace on grounds of religion or belief. The definition of "Belief" included any "religious or philosophical belief". The Equality Act 2010 which replaced the Regulations, includes substantially the same definition of belief.

An employment tribunal held that a general belief in the sanctity of life which included a strongly held belief in anti-fox hunting, constituted a "philosophical belief" for the purposes of the Regulations. There will therefore be a further hearing to see if Mr H suffered discrimination (and so is entitled to compensation) as a consequence of that belief.

The Employment Judge observed that not every one who was anti fox hunting would necessarily hold a 'philosophical belief' for the purposes of the legislation and that the case was very much determined on its own facts.

**Sarah Rushton** is a Partner in the employment department. If you would like to contact her about any of the issues raised in this article please phone 020 7465 7300 or email [srushton@phb.co.uk](mailto:srushton@phb.co.uk)

## Social Networking: the good, the bad and the ugly

**Jonathan Gatward**, partner in our company commercial department, considers the issues surrounding social networking sites.

### Power and Problems

Social networking sites (SNS) are one of the greatest success stories of the internet age. Daily the spread of their influence grows as more sites appear and more users log-on. To provide a snapshot of their popularity LinkedIn, the professional networking site, has 100 million users and Facebook has 750 million users who spend over 700 billion minutes per month on its site.

For businesses SNS represent both opportunities and potential problems. For small businesses with minimal advertising budgets they offer an effective, free marketing tool. For other businesses they can represent a drain on employee productivity as staff waste time at their desk surreptitiously checking their online profile. However, all businesses whatever their size or sector, which have employees that use SNS, are at risk of security lapses. These can cause reputational damage, potential litigation by clients and make companies an easy target for corporate espionage.

### Word of Mouth the SNS Way

Figures published by Marketing Week (13 June 2011) show that 41% of UK companies are using SNS to win new business and that UK companies as a whole are devoting approximately a third of their marketing budgets towards SNS campaigns. The potential of these ready made networks are enormous. For instance successful viral ad campaigns can generate enormous amounts of publicity. To give one example Old Spice's viral video campaign the "Man Your Man Could Smell Like" has been viewed in excess of 20 million times.

However, marketing experts warn against rushing into this new medium without first developing a coherent strategy. Set out below are a few key pointers to help shape your company's approach.

- Monitor SNS sites to establish whether your company is already being talked about. People use SNS to vent their frustrations about companies but also to tell friends and contacts about good products and services. If people are talking about your business then knowing what they are saying will help you to target your approach appropriately and sensitively.
- Ensure that your online approach is consistent with your general marketing strategy and that SNS material is "on message".
- Make sure that you have the time and resources to keep updating your profile and keep things fresh so users keep returning.
- Increasing numbers of people are using mobile devices so ensure that your websites and campaigns are smartphone optimised.
- Consider carefully which SNS are appropriate to your company. If you want greater interaction with your customers then consider Twitter where one in two users post content daily, by comparison only one in ten Facebook users post content daily.

- Consider what your aim is in using SNS, do you plan to use it as a sales channel, a customer services forum or more as an online notice board updating users about new products and promotions.
- Remember that unlike conventional advertising you don't have a captive audience and SNS users are just one click away from a more interesting screen so try to make content entertaining as well as informative.

### **A Hackers Dream**

SNS are easy to sign up to as all you need is an e-mail address and internet access. This is part of their appeal but also one of the main issues with their usage. There is no authentication of new members so just about anybody can join which makes these networks extremely insecure. Set out below are the key issues to be aware of.

### **Impersonation**

This can involve individuals, companies or brands and even those with no existing SNS profile can fall victim. As a stunt two researchers created a fake profile for Marcus Ranum who is a well known expert on computer security. All it took was a photo and some basic information available about him online to create an account on LinkedIn and within 12 hours he had 42 connections. The dangers in this are obvious, severe reputational damage to an individual or the company they represent could be caused, or confidential business information could be extracted from a connection, all without the victim's knowledge. Abuses can be reported and fake accounts will be deactivated by the service provider but by then the damage could already be done.

### **Idle Talk**

SNS makes the user feel that they are amongst a cosy circle of friends but given that the average user on Facebook has 130 "friends" and the information they post might also be available for the view of their friends' friends this is a somewhat misleading impression. The most common issue is an employee posting derogatory comments about their place of work. Often when the employer gets word of it the employee is fired such as the case of the, now notorious, disgruntled Argos worker in Wokingham. However, by then the negative impression of the employer has already been disseminated. Client confidentiality lapses can also occur. For instance the employees of Genesis HealthCare System in Ohio violated the rules on patient confidentiality by discussing patients and mentioning their room numbers online. As well as being very unprofessional, a client might sue for damages if there has been a breach of the confidentiality owed to them.

There is evidently much naivety in the manner that people use SNS and this is open to exploitation by unscrupulous individuals. The European Network and Information Security Agency (ENISA) published a paper highlighting the burgeoning threat of "social engineering attacks" using SNS (ENISA Position Paper No. 1, October 2007). This is a strategy adopted by hackers to bypass security and access confidential corporate information. There is no technological sophistication in this method as the hackers are targeting a company's weakest security link - their employees. Commonly attacks of this kind will involve the hacker joining an online community which can have very low security settings and then using the insider information available there to build up a picture of the company. As an experiment, Abhilash Sonwane (VP of Product Management and Technology for Cyberoam) gathered information on 20 companies using SNS as the resource. Amongst other disclosures, 14 companies disclosed the whole company profile of their organizations including information about employee and business demographics and customers and 8 of the organisations disclosed confidential information such as financial details and announcements about departures in senior management before they were public knowledge.

Hackers may use the information gleaned from these attacks in any number of ways: theft of information about products still in the R&D stage; spying on potential acquisitions, sales and new deals; extracting information in order to hack into corporate networks and cause damage; blackmailing employees; or even accessing physical assets of the company. For such an unsophisticated attack the damage to a company may be extremely high.

## **Malware and Rogue Applications**

The computer security provider, Symantec, warned in its annual threat report that SNS are increasingly being targeted by cyber criminals. In particular, Facebook, Twitter and Google's mobile operating system (Android) are vulnerable to malicious software downloads. Weblinks within SNS encourage users to enter sites that contain malware and rogue applications and what many people don't realise is that you can infect your computer simply by visiting a rogue website. A survey by Sophos, another computer security provider, found that of those SNS users questioned, 40% had been sent malware such as worms, 67% had been spammed and 43% had been subject to phishing attacks, all via SNS. Using these methods cyber criminals collect personal information about an individual or a company which they then use to extract further information or money from the victim.

The potential scale of the problem is demonstrated by the "onMouseOver" Twitter worm, labelled by Sophos as the largest SNS security incident of 2010. This episode was caused by cross-site scripting (XSS) which is the practice of placing code from an untrusted website into another one. In this case, users submitted javascript code as plain text into a Tweet that could be executed in the browser of another user. Pop-up boxes with text appeared when someone hovered over a link in a Tweet. This was developed further by the addition of a code that caused people to retweet the original Tweet without their knowledge. The scale and speed at which the problem developed was astonishing and high profile victims included Sarah Brown and the press secretary to Barack Obama.

## **A Silver Bullet**

Unfortunately, as ENISA concluded in its paper, there is no silver bullet for identifying an attack before it leads to serious damage. The best policy is prevention and ENISA recommends that employers increase employee awareness about their vulnerability in this area and establish a security policy. Many firms block employee access to SNS. However, given that employees are still likely to use SNS at home and reveal details about their professional lives, this isn't really solving the problem and tactics such as this can be seen as heavy handed by employees.

There are a number of precedent security policies that can be downloaded from the internet but the policy must be tailored to fit your company. Below are the main considerations that any company needs to bear in mind when drafting its policy.

- What is the company's overall strategy - is this purely an exercise in damage limitation or does the company want to promote the responsible use of SNS recognising that the networks these create can add value to the company.
- In the context of your company's working environment is the use of SNS by employees likely to impact on their productivity - if the answer is yes you may wish to consider an outright ban (bearing in mind that this could impact negatively on employee morale) or suggest what the company deems to be acceptable use i.e. SNS can only be accessed during lunch breaks.
- How do you wish to define SNS - SNS can encompass a wide range of sites including those that you might not immediately place in the SNS category such as web forums and blogs. Also new sites are constantly appearing so the wording of your policy should be sufficiently broad to include future as well as current SNS.
- Do you want employees to keep the company name out of their interactions - if the answer is yes then state clearly that employees are not permitted to list the name of the company on any of their SNS and must never register with an SNS using a work e-mail address or set up a blog using a work e-mail address. You also need to be aware that making a distinction between social and professional SNS might not be effective as somebody can easily make the link between the social and professional profiles of an individual.
- You need to identify the information you want kept out of the public domain. This should certainly include any information in respect of which the company is bound by confidentiality undertakings i.e. confidential information about clients, patients etc. However, you may also wish to include information as to the company's clients and business partners as well as all other information that is commercially sensitive such as financial information, product development or research information, intellectual property, potential deals and so forth.

- More generally you may need to remind employees to comply with the law (for example copyright legislation) and the contractual terms of service when using an SNS. They also need to be aware of the dangers of malware and, if accessing SNS from work computers is permitted, then prohibiting the downloading of software or applications might be a sensible precaution.
- Finally you need to state what the consequences are likely to be of any breach of the code i.e. formal disciplinary action and the potential for severe breaches to culminate in the termination of an individual's employment.

A robust security policy is helpful but only effective if employees actually read it and comply with it. Therefore taking the time to educate employees about the real dangers that face your business through inappropriate use of SNS is vital. There are insurance policies available to cover damage caused by attacks of this nature and in some cases litigation might be appropriate. However, it may be impossible to identify the perpetrators as a clever cyber criminal will have no difficulty concealing their real identity in what some are labelling the "SNS Wild West".

## The Case for Diversity in the Boardroom

Company Commercial partner **Max Hudson** considers the case for diversity in the boardroom.

In 2010 standing amidst a sea of black dinner jackets in an awards ceremony for the private equity industry I found myself wondering "where are all the women?" The issue of whether there should be active steps to address this disparity has become a major issue for businesses. The purpose of this article is to look at the statistics and arguments being put forward. The facts and figures derive from third party information.

The dearth of females in board level roles is not peculiar to private equity: step into any board room in the country and you will note that these are predominantly male domains. The figures are clear: FTSE 100 boards - 12.5% women; FTSE 100 executive directorships - 5.5%; FTSE 250 boards - 7.8%. The picture is similar on the boards of the major banks: Barclays - 15%, Standard Chartered - 13% and Royal Bank of Scotland and Lloyds Banking Group only 10% women.

The reasons behind this imbalance are complex and controversial but governments around the world are taking note as strong views are put forward that this inequality damages economic growth. Lord Davies of Abersoch's government commissioned report "Women on Boards" published in February 2011 drew on research concluding not only that companies with more balanced boards demonstrate far better operational and share price performance but that female board members seem to cut risk. To take one example, having a female director on the board statistically reduces a company's chances of going into liquidation by 20%. A key proponent of the view that the presence of women in the board room lowers risk is Michel Barnier, Europe's internal markets commissioner. In an interview with the "Guardian" newspaper speaking about his proposal that mandatory quotas should dictate the number of female directors on the boards of banks, he said balanced boards are vital to prevent the "group think" mentality that has "been far too prevalent in the past, with the disastrous consequences we have all witnessed".

So what will this mean for the future composition of Britain's board rooms? In the UK two developments have followed the proposals in Lord Davies' report. First, the executive search community has published a voluntary code of conduct which seeks to improve board room diversity by opening up the recruitment process to more women and to suitably qualified candidates who lack board room experience thereby making recruitment for directorships less of a closed club. Secondly, the Financial Reporting Council (FRC) is in the process of consulting on the possible introduction of a provision in the UK Corporate Governance Code requiring that listed companies establish a policy on board room diversity. The FRC

published the responses of over seventy different organisations this month. They represented a range of views particularly with respect to how prescriptive the code should be in its approach.

Meanwhile in Europe the European Commission is introducing regulation and a directive to implement the Basel III reforms, known as CRD IV. CRD IV which will regulate financial institutions requires, amongst other prudential measures, institutions to put in place "a policy promoting gender, age, geographical, educational and professional diversity on the management body". In a separate move the European Commission has also asked publicly listed EU companies to sign a pledge to increase the number of women on their boards to 30% by 2015 and 40% by 2020. Currently these measures are voluntary but on 8 March 2012 the Commission will analyse whether self-regulation has worked and consider further steps. Quota systems have their critics and fears that pushing reform through will create a two tier system of management with a predominantly male core making the decisions, whilst female directors occupy non-executive positions, may not be without foundation. However, with Norway as the pioneer of the quota system followed closely by France, the Netherlands and Spain, legislators may well pursue this route if self-regulation does not meet their expectations.

This is definitely an issue to watch over the coming months and publicly listed companies and financial institutions should review their boards and their recruitment policies to check that they are paying more than lip service to the need for diversity.

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## Subsidiary & Holding Companies: impact of *Enviroco v Farstad*

Company Commercial Partner **Max Hudson** looks at the definition of 'subsidiary' in the wake of *Enviroco Limited v Farstad Supply A/S*.

### INTRODUCTION

The terms "subsidiary" and "holding company" are frequently defined by reference to section 1159 of the Companies Act 2006 or section 736(1) of the Companies Act 1985 (the former drafted to reflect the latter) which set out that a company is the "subsidiary" of its "holding company" if the holding company:

- holds a majority of the voting rights in it; or
- is a member of it and has the right to appoint or remove a majority of its board; or
- is a member of it and (under an agreement with other members) controls a majority of the voting rights in it.

A "member" is any person that is entered into a company's register of members.

This definition seems to cover most conventional holding company/subsidiary relationships. However, the Court of Appeal's decision in *Enviroco Limited v Farstad Supply A/S* ([2009] EWCA Civ 1399), which the court itself criticised as an "uncommercial" outcome, uncovered a weakness in its application. In this case a company was deemed not to be a subsidiary of its holding company on the basis that the holding company had pledged its shares in its subsidiary to a bank by a Scottish "deed of pledge" under which the bank became the registered holder of the shares. The equivalent in England would be a legal charge.

## **IMPLICATIONS**

In most cases a holding company will hold the majority of the voting rights in its subsidiary and therefore will rely on the first part of the above definition. However, in cases where the holding company only controls the voting rights or board appointments and the legal title of the shares has been transferred to a nominee, the relationship between holding company and subsidiary for the purposes of the definition has been broken.

To put this into context, such cases will be rare given that it is unusual to transfer legal title to perfect security in English corporate transactions where equitable mortgages or charges are more common. However, in those rare cases where these circumstances do arise, the implications, some of which are set out below, are myriad.

### **Contractual issues**

- Change of control provisions could be triggered.
- Rights to intra-group assignments might cease for the detached subsidiary.
- As was the case in *Enviroco Limited v Farstad Supply A/S*, the detached subsidiary may no longer be able to benefit from group indemnity clauses.

### **Banking and finance issues**

- Potential breach of financial covenants.
- Potential breach of change of control representations and warranties.
- As a result of either of the above or any similar such provision an event of default could be triggered.

### **Tax issues**

- VAT group rules use the Companies Act definition of subsidiary so a detached subsidiary would fall outside the group for VAT purposes.

### **Employment issues**

- Potential repercussions for employee share option plans where their scope has been defined by reference to a group and the Companies Act definitions have been used. (Often this is not the case as the definitions from the relevant tax legislation tend to be favoured).

### **Commercial real estate issues**

- A detached subsidiary may no longer be able to rely upon provisions which allow the tenant to share premises with, or sub-let premises to, a group company.

### **Other considerations**

- Does the subsidiary that has become detached from its natural holding company become by default a subsidiary of another entity, for example a bank?
- Could this judgment be exploited as a loophole? By registering the holding company's shares in the name of a nominee might it then be possible to circumvent provisions such as section 136 Companies Act 2006, which prohibits a subsidiary from being a member of its holding company, or section 197 Companies Act 2006, which requires members' approval before a loan can be made by a company to its holding company.

## **PRACTICALITIES**

The logical conclusion to be drawn from the above is that careful consideration should be given as to how "subsidiary" and "holding company" are defined in any contract. It has been suggested that it may be preferable to define these terms by reference to the definitions of "subsidiary undertaking" and "parent undertaking" in section 1162 of the Companies Act 2006, which includes a provision allowing the parent/subsidiary relationship to exist even if the parent company's shares in the subsidiary are held by another party acting on behalf of the parent company.

However, there may be some uncertainty here too and a possible issue with other (non-corporate) undertakings being unintentionally included. To err on the side of caution it is probably better either to use

the section 1159 definition, where possible, but to add an additional clause that specifically covers situations where the legal title has been transferred to a third party for security purposes or to put in place other precautionary arrangements to ensure the group relationship is not broken.

If you would like further advice on the above issues, please speak to your usual contact at this firm. Alternatively contact **Max Hudson** on 0207 465 4300 [mhudson@phb.co.uk](mailto:mhudson@phb.co.uk)

## Nominated Directors: some recent issues

**Max Hudson** examines some of the recent issues that have arisen concerning nominated directors.

### JOINT VENTURES

When parties enter into joint ventures, or make a significant investment in another company, the investor will often seek to protect itself by nominating either a trusted individual or someone regarded as "independent" to the Board of the target company. A recent case has highlighted the problems which can emerge for all the parties involved, including the individual handed the particular chalice.

### Recent Decision

The recent Court of Appeal decision in *Hawkes v Cuddy & Others* (2009 EWCA CIV 291) has demonstrated the problems that can arise where there is no clear mechanism or procedure in place for dealing with the conflict of interest which may arise between an investor and the target company. In this particular case, which involved what were in every sense the competing interests of Welsh rugby football clubs, the documentation referred to general objectives rather than specific procedures. This meant that there was an argument as to whether the appointed directors duties were primarily to the instructor appointing him or to the company in question. The Court of Appeal found that, in this case, the basic duty was to the company to the Board of which the nominee had been appointed not to the person appointing him. This might have given rise to further conflicts if the appointor had been the employee of another party.

### The Problems

The clear message as a result of the case is that it is essential for the investor, the target company and the person appointed to identify between themselves where the problems lie, including:-

- the focus of the investment and what role the appointee is expected to play
- where conflicts may arise
- what information may be confidential to each of the companies involved
- what separate duties arise under the contract of employment of the appointee, or the existing terms of engagement if the appointee is also a member of other corporate boards involved in the joint venture
- any other business interests of the appointee if he is appointed by virtue of his "professional" status or as an independent expert
- whether any other fiduciary duty is involved, for example the position of a trustee in relation to a trust corporation.

Having identified the areas of conflict, it is then appropriate to take advantage of the provisions of the Companies Act 2006 which permit conflicts of interest to be addressed by:

- each of the companies involved going through the appropriate corporate procedures, including members' approval if that is of assistance
- the adoption of appropriate provisions in the Articles of Association of each of these companies involved containing provisions for dealing with the conflicts of interest, and procedures adopted in line

with those set out in Section 175(4) where the matter has been authorised by the directors and the relevant company's constitution does not invalidate that authorisation.

## **PROCEDURES**

It is in everyone's interest to have the procedures set up at the outset. The consequences of any breach of the general duties, which includes addressing conflicts of interest, are that the director in question may be held liable by the company to which he owed that duty. The appointee should check which, if any, directors' and officers' insurance policy may protect him.

In some cases an agreement may provide that an individual has a right to attend at a board meeting but without a specific appointment as a director. The issue any "observer" needs to note in such cases is that, under the provisions of company law, "a director is a director by whatever name called". If, therefore, that observer takes an active role in the relevant discussions, then there is a danger that the individual is treated as a director for the purposes of liability and consequently will need to consider his own position. This is particularly the case in relation to the new statutory duties to act in good faith in the way most likely to promote the success of the company on whose board he is sitting.

The need for a clear set of procedures and appropriate guidance is greater than ever before, and specialist advice is essential at the outset.

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