Business Law Newsletter

Professional Contract Drafting for Business

Spring -'24 Edition

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Editorial

Imagine, your boss asks you on a Monday morning to come up with a name and a neat acronym for an exchange to help shareholders in private companies to sell their shares to other investors, what would you choose?

PSM- Private Share Market?
PEE- Private Equity Exchange?
ERE- Equity Release Exchange?
ETH- Equity Trade Hub?

Surely, any of those might get your boss interested. But no, the actual name that some bright spark has come up with is PISCES- Private Intermittent Securities and Capital Exchange System, also known as the ITV- the Intermittent Trading Venue. Honestly, who makes up this stuff?

Thankfully, not everything hangs on a name and the idea behind PISCES / ITV is an innovative response for investors in illiquid private company shares, as our item on the ITV explains.

The issue of raising money for private companies is a hot topic, so here are some arguments on both sides of the equity (shareholder investment) vs debt (bank borrowing) discussion:

Debt Financing:

Advantages:

1. Maintain Control: When you borrow money through debt financing, you retain full ownership and control of your business. Unlike equity financing, you don't have to share profits or decision-making authority with shareholders.

2. Predictable Repayment Obligations: With debt financing, you have a clear repayment schedule, including principal and interest payments. This predictability can help with budgeting and cash flow management, as you know exactly how much you owe and when payments are due.

3. Tax Benefits: In many cases, the interest paid on business loans is tax-deductible, which can result in significant savings for your business.

4. Credit History: Responsibly managing debt can help establish and improve your business's credit history. This can be beneficial when seeking future financing opportunities or negotiating better terms with lenders.

Disadvantages:

1. Financial Risk: Taking on debt introduces financial risk, especially if your business experiences a downturn or struggles to generate sufficient cash flow to meet repayment obligations.

2. Interest Costs: While interest payments may be tax-deductible, they still represent a financial burden on your business. High-interest rates or unfavourable loan terms can increase the overall cost of borrowing and reduce your profitability.

3. Security: Lenders usually require collateral to secure loans, especially for small businesses without an established track record or strong credit history. Personal guarantees are often required, meaning that your assets (house, bank deposits and investments) are at risk.

4. Inflexibility: Debt financing typically involves fixed repayment terms, which can limit your ability to adapt to changing market conditions or invest in new opportunities. High debt levels may also constrain future borrowing capacity.

Equity Financing:

Advantages:

1. Cost: Unlike debt financing, equity financing does generally come with a fixed cost to bring in the funds. Investors buy shares in exchange for an ownership stake in your business, and their returns are typically linked to the company's performance.

2. Shared Risk: Equity investors share, pro rata to their investment, the financial risk of the business. If the business fails, investors may lose their investment, but they are not entitled to repayment like debt holders. This can provide some relief for cash-strapped SMEs, especially during challenging times.

3. Access to Expertise and Networks: Equity investors often bring more than just their money capital to the table. They can provide valuable industry expertise, strategic guidance, and access to networks that can help grow your business and open doors to new opportunities.

4. Cash Flow: Equity financing allows businesses to access funding for growth initiatives without taking straining cash flow. This can be particularly advantageous for start-ups or high-growth SMEs with ambitious expansion plans.

Disadvantages:

1. Control: Selling shares usually means relinquishing a portion of ownership and decision-making authority in your business. Depending on the terms on which shares are issued, investors may have a direct say in major business decisions, which may conflict with your views.

2. New investment: bringing in new investors or taking on some working capital debt can prove problematic if existing shareholders are not in favour of such a move.

3. Valuation Challenges: Negotiating the valuation of your business can be challenging, especially for start-ups or early-stage SMEs with limited financial history or tangible assets. Setting the valuation too high may deter potential investors, while undervaluing your business could result in giving away too much equity.

4. Confidentiality: Sharing ownership of your business with investors may mean they get access to sensitive commercial information about your business, products, or intellectual property, increasing the risk of leaks or breaches that could harm your competitive advantage

Debt and equity financing have their pros and cons, and the optimal choice depends on factors such as your business's financial situation, growth objectives, risk tolerance, and long-term strategy.

Many SMEs use a combination of debt and equity financing to strike the right balance between leveraging external capital and preserving ownership control.

Jeremy Cama, Editor

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AI Corner

THE AI REGULATION BILL

The UK Artificial Intelligence (AI) regulation Bill has completed its second reading in the House of Lords. The general debate on all aspects of the Bill took place on 22 March 2024. The Bill will now move on to the committee stage which will involve a line by line examination of the Bill once that is scheduled.

What are the main objectives of the AI Bill (*according to ADOBE AI Assistant as endorsed by the Contracts-Direct editorial team*)?

Creation of the AI Authority: The bill mandates the creation of a body called the AI Authority, which will have various functions including ensuring that relevant regulators consider AI, coordinating a review of relevant legislation, monitoring risks arising from AI, and promoting interoperability with international regulatory frameworks.

Regulatory Principles: The AI Authority must have regard to certain principles, including the need for safety, transparency, fairness, accountability, and redress in the regulation of AI. Businesses developing, deploying, or using AI are required to be transparent, test AI thoroughly, comply with applicable laws, and ensure inclusivity and non-discrimination.

Regulatory Sandboxes: The AI Authority is required to collaborate with relevant regulators to establish regulatory sandboxes for AI. These sandboxes allow businesses to test innovative propositions in the market with real consumers, providing support in identifying consumer protection safeguards and requiring tests to have clear objectives and be conducted on a small scale.

AI Responsible Officers: The bill mandates that any business developing, deploying, or using AI must have a designated AI officer. The AI officer's duties include ensuring the safe, ethical, unbiased, and non-discriminatory use of AI by the business and ensuring that data used in AI technology is unbiased.

Transparency, IP Obligations, and Labelling: The bill requires that persons involved in training AI supply a record of all third-party data and intellectual property used in that training to the AI Authority. It also mandates that businesses developing, deploying, or using AI provide clear health warnings, labelling, and opportunities for informed consent to customers. Additionally, independent third parties accredited by the AI Authority must be allowed to audit the processes and systems of such businesses.

Sounds good, but, as it is a private members' Bill, there is a chance that the Government will not want to adopt it and make it law, with or without amendment.

Business Tips for Spring

VAT: Evaluate if the recent increase in the VAT registration threshold to £90,000 provides an opportunity for your SME to grow without the VAT burden initially. However, be mindful of crossing the threshold in the future.

Growth Guarantee Scheme: Explore financing options like the newly renamed Growth Guarantee Scheme, which provides government-backed loans of up to £2 million for SMEs in Great Britain.

National Insurance: Leverage the reduced National Insurance contributions, which can save self-employed individuals an average of £650 annually when combined with the abolished Class 2 NI. This increases cash flow for SMEs.

Allowable Training Costs: Find out if you could claim the cost of training as an allowable business expense if you are a self-employed individual- The government has published new guidance around the tax deductibility of training costs.

AI use policy: Develop AI guidelines and policies to ensure responsible and transparent use of AI in your business. Take a look at how to develop AI use policy.

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Companies

COMPANIES HOUSE CHANGES

Increase in fees

From 1st May 2024, fees across a range of services provided by Companies House will increase- see the full list here.

Filing accounts

Two changes of note are that:

1. Over the next 2-3 years, company accounts will have to be filed by software only and perhaps the more important one is

2. Small and micro-entity companies will need to file their profit and loss accounts. The detail of what they will need to include will be set out in secondary legislation. Small

companies that do not qualify as micro entities will also need to file a directors' report- read more about this change here.

TAKING AN EMPLOYER'S CLIENT LIST

A recent English High Court decision imposed damages of £38k or loss of profit on a former employee in favour of his former employer for passing off, damage to reputation and breach of confidence. The case is a useful reminder that anyone setting up a new business should be careful in how they promote the business so as not to infringe the rights and entitlements of a third party, especially a former employer.

The claimant (Cosmopolitan), a recruitment agency specialising in gardening services, filed claims of breach of confidence and passing off, against its ex-employee, Mr Ludley and the newco GreenScape which was incorporated by Ludley just before the expiration of his employment. (GreenScape also specialised in recruitment within the garden services industry).

In the months leading up to Ludley's resignation in June 2021, Ludley used a MailChimp account to secure various proprietary Cosmopolitan documents and spreadsheets containing financial data, lists of over 500 live and target clients, as well as information regarding historic and planned advertising and promotional campaigns.

Days after Ludley's employment terminated, he sent an email to the 500-strong contact list informing recipients that Cosmopolitan (already a trading name for PSN Recruitment) would be changing its name to GreenScape. He stated that the reason for this change was that:

> '*We never liked the name "Cosmopolitan Recruitment". It sounds like a cocktail, has no connection with what we do, and it's difficult to use on the telephone.*
>
> *So, as we are more likely to have a pint and we work exclusively in the Landscaping and Gardens sector we felt that GreenScape was a much better alternative.*'

Ludley went on to ask the recipients of the email to use the new GreenScape email address instead for all future Cosmopolitan correspondence and Ludley proceeded to conduct business with these clients.

When Cosmopolitan became aware of the misrepresentation, they acted immediately and wrote to Ludley who responded, it later came to light, by installing 'Erasure' software to destroy all evidence of the misappropriated data and deleting the MailChimp account used to secure Cosmopolitan's data.

The court agreed with Cosmopolitan's claims and found that Ludely's actions amounted to passing off and a breach of confidence, both in equity and in contract

The decision highlights that behaving improperly in starting up a new business can have serious and costly consequences. Employees owe contractual and implied duties of good faith / fidelity concerning confidential information. Read more about the case here

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COMPANIES HOUSE TACKLES FRAUD

The first measures under the Economic Crime and Corporate Transparency Act 2023 (ECCT Act) came into force on Monday 4 March 2024.

Changes introduced include:

- ✓ greater powers to query information and request supporting evidence.
- ✓ stronger checks on company names.
- ✓ new rules for registered office addresses (all companies must have an appropriate address at all times - they will not be able to use a PO Box as their registered office address).
- ✓ a requirement for all companies to supply a registered email address.
- ✓ a requirement for subscribers to confirm they're forming a company for a lawful purpose when they incorporate, and for a company to confirm its intended future activities will be lawful on its confirmation statement.
- ✓ greater powers to tackle and remove factually inaccurate information.
- ✓ the ability to share data with other government departments and law enforcement agencies.

ECONOMIC CRIME AND CORPORATE TRANSPARENCY ACT 2023

The Home Office has published eight factsheets giving details of the different measures contained in the Economic Crime and Corporate Transparency Act 2023 (ECCTA 2023).

The overarching factsheet has highlighted some of the reforms introduced by the ECCTA 2023, including reforms to Companies House, reforms to prevent the abuse of limited partnerships, additional powers to seize and recover suspected criminal cryptoassets, reforms to give businesses more confidence to share information in order to tackle money laundering and other economic crime, and new intelligence gathering powers for law enforcement and removal of nugatory burdens on business.

The factsheet has also highlighted additional measures to strengthen ECCTA 2023 during passage, including a failure to prevent fraud offence and amendments to tackle Strategic Lawsuits Against Public Participation (SLAPPs).

Government Factsheets

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INTERMITTENT TRADING VENUE

The ITV, announced in the summer of 2023 by the Chancellor, will function as a platform that facilitates trading in eligible private companies' shares.

During specific, pre-determined trading windows, new and existing shareholders will be able to transact through an auction process.

The ITV is trying to bridge the gap between listed public markets and private companies by giving certain private companies access to capital markets without requiring them to formally float on a stock market and expose themselves to the volatility of public markets.

As the ITV is aimed at pre-IPO companies, it is not going to be for everyone, but it has the potential to give investors in private companies a route to greater liquidity in their shares (i.e. an exit route).

As proposed, the ITV will have 12 auctions a year- one in each month- and will be on an "opt-in" basis, meaning eligible companies can decided which auctions to join in.

The monthly auctions will be done using the London Stock Exchange's auction infrastructure.

Eligible companies will only be able to trade existing issued shares and will not be permitted to issue new shares via the ITV. Criteria for companies to trade on the ITV are awaited.

Although it is not yet known when the ITV will launch, the Treasury has launched a consultation on the ITV, which closes on 17th April.

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Employment

FLEXIBLE WORKING

From 6th April 2024, all employees have a day-one right to request flexible working from their employers.

What is flexible working and how is it applied for?

An employee can request a change to the number of hours they work, when they start or finish work, the days they work, and where they work.

Employees need to make what is called "a statutory application" to their employer, the essential components of the application are:

1. The date of the request
2. A statement that this is a statutory request for flexible working
3. Details of how the employee wants to work flexibly and when they want to start
4. A statement saying if and when they've made a previous application - include the date of the previous request

The employer must discuss the request with the employee before it can refuse it and make a decision within 2 months, or longer if agreed. In refusing a request, the employer must provide the business reasons for its decision.

There are 8 "permitted business reasons" that an employer may reject a flexible working request:

1. Burden of additional costs.
2. Detrimental effect on ability to meet customer demand.
3. Inability to reorganise work among existing staff.
4. Inability to recruit additional staff.

5. Detrimental impact on quality.
6. Detrimental impact on performance.
7. Insufficiency of work during the periods you propose to work.
8. Planned structural changes.

An employee may complain to an employment tribunal if they disagree with the employer's decision and may make 2 flexible working requests in any 12 month period.
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Spring Budget

On Wednesday, 6 March, Chancellor Jeremy Hunt delivered the Spring Budget 2024. This was accompanied by a full fiscal statement from the Office for Budget Responsibility (OBR).

Here is a summary of the main announcements and what they mean for your business.

TAX CHANGES

The new tax year started on 6th April, and with that here's what you need to know for the tax year 2024/25 (c/o Simply Business):

- ✓ Personal allowance rates
- ✓ Income tax brackets
- ✓ National Insurance reforms
- ✓ National minimum wage rates
- ✓ Dividend tax changes
- ✓ Making Tax Digital
- ✓ Business rates
- ✓ Working tax credits

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