England

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1. Introduction

1.1 Admissibility of cash pooling agreements

English law provides no express or implied prohibitions on the creation or implementation of cash pooling agreements.

1.2 Types of cash pooling agreement

English law gives considerable freedom of contract, and cash pooling agreements can be constructed as physical pooling or notional pooling.

(a) Physical cash pooling

Accounts are opened by the master account holder and the group companies at a bank. A sweep mechanism is agreed whereby, on a regular basis (often daily at a set time), credit balances then held by the group companies are swept into a master account. The sweep can be either arranged to sweep all credit balances (zero balancing) or set at specific levels (target balancing, which can also be capable of variation from time to time). Accounts held by group companies which are then in debit receive transfers of funds from the master account to reduce or clear the overdraft. Such arrangements give rise to inter-company debts between the relevant group company and the master account holder. Service or other fees may be levied. Interest is generally credited by the bank to the master account and may from there be paid down to group companies, usually proportionately.

(b) Notional cash pooling

Accounts are opened by the master account holder and the group companies at a bank. The bank and the group companies agree that the credit and debit balances of each relevant account be notionally consolidated, and interest (and sometimes fees) are paid or charged on the net balance from time to time. To give effect to this, a master account is established to which the consolidated interest is debited or credited. The bank may agree to act on the instructions of the master account holder in the distribution of interest credited to the master account. Save for the crediting or debiting of interest and sometimes fees, usually to the master account alone, the accounts are operated by the group companies as their own accounts under their own control and no physical sweep takes place.

(c) Common features

Commonly, the bank requires each participant to indemnify the bank, and/or to provide a guarantee to like effect, against any other participant's default (eg, if a participant becomes insolvent while its balance is in debit), though such liability may be limited to amounts standing to the credit of that participant's own account. The bank is usually given express authority to apply credits of any company against debits of any other (netting and set-off rights). While technically, in the context of a notional cash pooling agreement at least, it may be argued that the need for such indemnities or cross-guarantees should be limited to any fees or interest payable to the bank where there are insufficient funds in the master account, it is rare to see the indemnities or guarantees so limited.

English law has no general restriction or maximum limits as to the amount that may be guaranteed, though a guarantor company's constitution documents will need to be checked and consideration given to whether it is appropriate that shareholder resolutions be passed in addition.

Cash pooling agreements can operate in a multi-currency environment. In such circumstances the various accounts are usually pooled by currency and a master account established for each currency. Foreign exchange controls may operate from time to time or in relation to particular currencies which may need to be taken into account.

Under English law, the relationship between a bank and its customer is one of debtor/creditor.

Almost invariably the relationships created between the master account holder and each group company in a physical cash pooling agreement would be analysed as debtor/creditor relationships as well, but the position should be analysed (and drafted for) in each case.

In a notional cash pooling agreement, there is no physical sweep mechanism, but the arrangements will result in interest and possibly fees being received or incurred by the master account holder at the expense of (or possibly to the benefit of) participant companies. As between themselves, the participants and master account holder should determine how the resulting benefits and costs are attributed and accounted for.

Generally in this chapter, it is assumed that all companies party to the relevant cash pooling agreement are members of the same group of companies, and that the relevant agreement is governed by English law. No account is taken of the judicial, administrative and legislative variations encountered in Scotland and Northern Ireland.

1.3 Legal requirements from various perspectives

Cash pooling arrangements are not identified as such by rules of law relating specifically to them in company, banking, insolvency, regulatory or tax law.

However, numerous different legal principles can come into play in the context of any cash pooling agreement and the most significant of these are touched on below.

(a) Company law

Although there are no specific requirements in English company law with respect to cash pooling agreements, such agreements constitute a bundle of contractual rights and obligations, the principal elements of which are that a participant will in all probability be lending and borrowing moneys and guaranteeing the obligations of other (group) companies. Each participant company's directors should take into account the relevant general legal and regulatory requirements before the company enters into such arrangements. These include the following.

Directors' duties: the Companies Act 2006 contains a codified statement of the general duties of directors.

English law makes no distinction between executive and non-executive directors. It does, however, recognise, and generally attach liability to, shadow directors (persons in accordance with whose directions or instructions the directors of the company are accustomed to act) in the same way as to other directors. In addition, *de facto* directors (ie, persons who are treated by the company and its directors as directors, but whose particulars have not been filed with the English Companies Registry) will be treated in the same way. English law does not recognise the concept of a supervisory director and English companies have a single board: the board of directors.

The Companies Act contains seven statutory duties which are owed by the directors to the company (Section 170(1) and following). In general terms, only the company can enforce these duties, although, in certain limited circumstances, the shareholders may bring an action (known as a derivative action) against directors who are in breach. (In a liquidation, the company will be represented by the insolvency practitioner and these duties may be enforced by the insolvency practitioner on behalf of the company; there are also provisions under the Insolvency Act 1986 enabling a liquidator to pursue directors for misfeasance and breach of duty.) There are seven duties under the Companies Act.

First, a director must act in accordance with the company's constitution and must exercise his powers only for their proper purpose. There are protections for a third party dealing with a company in good faith: the power of the directors to bind the company (or authorise others to do so) is deemed not to be limited by the company's constitution. Moreover, a third party is not bound to enquire whether there are any limitations on the power of the directors. These protections do not, however, affect any liability incurred by the directors by reason of exceeding their powers.

Second, a director must act in the way which he considers, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders (which are also called members) as a whole. In so doing, the director must have regard (among other matters) to:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;

- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between the members of the company.

The duty is subject to any enactment or rule of law requiring directors in certain circumstances to consider or act in the interests of the creditors of the company and, accordingly, the duty is displaced when the company is insolvent, and may be modified by an obligation to have regard to the interests of creditors as the company nears insolvency.

Third, a director must exercise independent judgment. The duty will not be infringed by a director acting in accordance with an agreement entered into by the company that restricts the future exercise of the directors' discretion or in a way authorised by the company's constitution.

Fourth, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with both:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of the director in relation to the company; and
- the general knowledge, skill and experience that the director actually has.

Fifth, a director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The disinterested directors of the company may, however, authorise the conflict by director authorisation, provided that certain conditions are met. The conflict may also be authorised by shareholder authorisation. In the context of a cash pooling agreement, where the participants are a group of companies, the likelihood is that there will be some common directors. Directors should ensure that their determinations as to any particular company within the cash pooling agreement are by reference to the position of that company alone.

Sixth, a director must not accept any benefit from a third party which is conferred because of him being a director, or him doing or not doing anything as a director.

Lastly, a director has a duty to declare any interest in a proposed transaction or arrangement with the company.

Maintenance of capital: English law imposes capital maintenance rules on English companies. The rules contain a number of restrictions on public companies not likely to be relevant for cash pooling agreements, but they regulate for all companies – whether public or private – the circumstances in which dividends or distributions may be paid. A company (whether public or private) may make distributions to its members only out of distributable profits (defined and circumscribed in the Companies Act). Additional requirements apply to distributions by a public company (ie, a company which is named as a public limited company or has plc in its name, which does not necessarily betoken that its shares are publicly listed or traded on any recognised exchange): the amount of its net assets must be not less than the aggregate of its called-up share capital and its undistributable reserves, and the distribution must not reduce the amount of its net assets to less than that aggregate sum. A distribution made in contravention of the rules is unlawful. Consequently, parties to a cash pooling agreement where moneys are passing between group companies will want to ensure that the status of these transmissions (and their categorisation, which is usually as creating, or constituting repayment of, intra-group loans) is clear so that they are not construed as potentially unlawful distributions.

Corporate governance, risk management, internal control and reporting requirements: companies (whether incorporated in the United Kingdom or elsewhere) which have a premium listing of equity shares on the Main Market of the London Stock Exchange (ie, the form of listing with more stringent requirements than those applicable to the standard listing on this market) are subject to the 'comply or explain' regime of the UK Corporate Governance Code. The code contains principles of good governance relating to a number of areas, including (in Section C) principles relating to risk management and internal control. The Listing Rules (LR 9.8.6R and LR 9.8.7R) require companies covered by the code to state, in their annual financial reports, whether they have complied with the code and, if not, to explain their reasons for non-compliance. Directors of the relevant category of companies considering entering into a cash pooling agreement should consider the impact of the requirements of the code. The code does not apply to companies with a standard listing of equity shares on the Main Market of the London Stock Exchange or to companies traded on any of the other London exchanges, such as AIM, although these rules are currently under review.

Formalities: cash pooling agreements are contractual arrangements and English law requires, in order for there to be a valid contract, that there be offer, acceptance, consideration and an intention to create legal relations. Cash pooling agreements will usually include guarantees, and guarantees are required under Section 4 of the Statute of Frauds 1677 to be made in writing and signed by or on behalf of the guarantor. The Companies Act also legislates for the manner in which contracts or deeds (as the case may be) are executed.[1] Although not a statutory requirement, guarantees (and indemnities too) are often entered into as deeds. More stringent

1 Deeds differ from contracts mainly in that contracts may be oral (though some types of contract are required to be in writing, such as guarantees), and require, in order to be binding:
- an offer;
- acceptance of that offer;
- that a *quid pro quo*, or consideration, pass from the promisee; and
- the intention to create legal relations.

Where made in writing, the form of execution requires little in the way of formality. Deeds, by contrast, can bind parties without there being an offer, or acceptance, or the passing of consideration. Deeds must be in writing, must make clear that a deed is intended, and must be validly executed and delivered; the execution formalities are thus greater than for any type of contract. Some documents must be made by way of deed, such as land transfers and powers of attorney.

signatory requirements will apply than for a simple contract, but the use of a deed will avoid any questions regarding the presence or (from the perspective of legal formalities only) sufficiency of consideration. It is important to check whether a company's memorandum and articles of association restrict the company from entering into a guarantee or indemnity and, if they do, they will need to be amended by a shareholders' resolution. In any event, for the protection of the directors of the company giving the guarantee and indemnity, as well as for the benefit of the counterparty, a shareholders' resolution approving the arrangements should be passed. Unless the arrangements give rise to the creation of security, however, there should be no public registry registration requirements. (Banks' rights of set-off would not generally be regarded or framed as security rights requiring registration, even were such rights to constitute security, registration at the English Companies Registry would not be likely to be required by virtue of Regulation 4 of the Financial Collateral Arrangements Regulations (No 2) 2003 and Regulation 4 of the Financial Collateral Arrangements Regulations 2013. Some practitioners do, as a matter of practice, register at Companies House security that is a financial collateral arrangement, however.)

(b) General contract law

Cash pooling agreements drafted under English law may rely on protective provisions (depending on the perspective of the person drafting – usually the bank's lawyer – and often completed and agreed by the customers without the benefit of legal input) designed to protect the bank. As previously noted, participants may be required to provide guarantees and indemnities, but banks may also include rights of set-off (to bolster bank rights of set-off, a special right recognised as a matter of common law), and flawed asset clauses (clauses which provide that title to a particular right or asset is conditional in some way – for example, that a depositor has no right to its deposit back unless certain liabilities have been discharged).

(c) Insolvency law

The main circumstance where a cash pooling agreement is likely to be reviewed, or possibly challenged, is in the context of the insolvency of one or more parties to it.

English insolvency law – basics and applicable legislation: English insolvency law (excluding laws relating specifically to special categories of company such as banks and insurance undertakings) is encompassed in the following legislation (and, in the context of cross-border matters, in the following order of precedence):

- the EU Insolvency Regulation (1346/2000);
- the Cross-Border Insolvency Regulations 2006 (which represent the UK enactment of the United Nations' Commission for International Trade Law Model Law on Cross-Border Insolvency); and
- the Insolvency Act.

In a purely domestic (English) context, the Insolvency Act is the principal relevant legislation. The EU Insolvency Regulation and the Cross-Border Insolvency

Regulations are important in a cross-border context and are dealt with below in that context.

In addition to the statutory regime, over the years the English courts have developed extra-statutory (common law) principles of comity, whereby English courts will assist foreign courts and their officers, and in the context of insolvency, principles of modified universality. Modified universality recognises the benefit in one insolvency process and law governing the entire insolvency of any given entity while at the same time it gives courts in each jurisdiction certain discretion in relation to local procedures and the interests of local creditors. Where none of the EU Insolvency Regulation, the Cross-Border Insolvency Regulations or the Insolvency Act provides assistance, foreign insolvency officials may consider asking for assistance under these common law principles.

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