



Welcome to the Autumn 2009 edition of Business Law. In this issue we focus on a number of recession issues which have become increasingly relevant in today's economic downturn. We outline the importance of directors' duties, especially in times of financial difficulty and the increasing use of pre-packs in the sale of insolvent companies. We deal with redundancy and restructure and suggest some ways in which the law can help you get your bills paid and protect your company's brand.

I hope the articles in this edition suggest ways in which you can survive and indeed prosper in these difficult times. As ever, I would be delighted to hear your feedback. If you would like any advice on the issues covered in this newsletter, please contact the author of the relevant article.

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Directors' duties - points to consider if in financial difficulties

The Companies Act 2006 provides that a director's primary duty is to promote the success of the company for the benefit of its shareholders' members' as a whole (s. 172(1)). However, where the company is in financial difficulties and is likely to become insolvent, the directors must also have regard to the interests of the company's creditors. The Insolvency Act 1986 (IA 1986) contains various concepts such as fraudulent or wrongful trading, which, if applicable, qualify a director's primary duty.

To give some clarity to the expression 'financial difficulties', there are two broad tests of insolvency. A company is typically insolvent if either its liabilities (including its contingent and prospective liabilities) exceed its assets (the 'balance sheet test'), or it is unable to meet its liabilities as they fall due (the 'cash flow test'). Even where a company is solvent but there is a significant risk that the company will become insolvent, it is not safe for its directors to ignore the interests of creditors. In such a case, the directors must balance the interests of shareholders and creditors, depending on the effect their actions will have on each class of interested parties.

Wrongful trading

A director will be liable for wrongful trading if, before the commencement of a winding up, the director knew, or ought to have known, that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and the director then failed to take every step that a reasonably diligent person would have taken to minimise the potential loss to the company's creditors.

Section 214 of the IA 1986 allows a liquidator, in the course of winding up the company, to make a civil claim against a

director personally for 'wrongful trading'. If the court finds that the director is liable for wrongful trading, the director could be ordered to contribute to the company's assets for an amount that the court thinks proper.

Fraudulent trading

Section 213 of the IA 1986 provides that a company is trading fraudulently if it is carrying on a business with the intent to defraud creditors. There is a civil liability and the court can order any person concerned

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'If on-line retailing is so user-friendly then why is the high street still here?'



Click v Brick

The use of the internet and e-retailing has undeniably been a spectacular growth area in recent years. Due to the cross-border nature of the internet the phenomenon has spread, with on-line shopping now considered a serious alternative to the high street. This has led some to debate whether there is any need for the bricks and mortar retail units of old and whether the growth of on-line retail will be the final nail in the coffin for the high street shop.

Convenience/accessibility

When looking at the success of many on-line retailers the key advantage that they have over the high street is convenience and accessibility. We are no longer constrained by shop opening hours which more often than not don't fit in with the 9-5 of our jobs. People need to be able to shop when it suits them and with more demands than ever on our time the internet is invaluable; no strict opening hours, no waiting in line and you can browse for as long as you need. A last minute birthday present can be ordered at midnight safe in the knowledge that it will arrive the next day and a short break can be booked at 3am. The internet never closes.

Shopping from the comfort of your own home also allows the consumer to avoid the actual journey to the shops. Queuing and paying for car parking also becomes a thing of the past.

Usability

The average family has more access to the internet than 15 years ago. Most households now own at least one computer with the householders themselves more computer literate than ever before. IT courses at schools and colleges have helped to make the internet more accessible and user-friendly and we are now seeing a generation who are at ease with computers and the internet having used them growing-up. As well as education, social networking sites such as Facebook, Myspace and Bebo have helped to create a culture where the internet is seen as an integral part of everyday life rather than something that is difficult to navigate.

Price comparisons

The amount of information that consumers can find on the internet is also a draw. They can not only compare prices easily without traipsing from shop to shop to see the most up to date deals. Often retailers are able to put their best deals on the internet and the well informed consumer will always check the on-line price before purchasing in store. Consumers can also read customer reviews and see ratings on-line. This is most useful when purchasing one off items such as electrical equipment, which are likely to be more expensive.

Social experience

If on-line retailing is so user-friendly then why is the high street still here (even in its recently decimated form)? Shopping for many people isn't just a practical exercise in buying something that is needed, but is a social one too. The same cannot be said for logging on to a computer by yourself. Whether you are shopping with a friend or asking the sales assistant's opinion, the internet cannot substitute the interaction which people get from the high street. Many young women in particular find that shopping is integral to their social lives and shopping is seen as an event rather than a practical activity.

Sensory experience

Many people like to try before they buy; trying on the new dress that they have seen, ascertaining whether the new mobile phone they want to buy is as light-weight as they'd like. Consumers can't do this when shopping on-line and the enjoyment that people get from actually

interacting with the product shouldn't be underestimated. This is so essential to some consumers that although they will purchase online (often finding a more favourable deal), that will only be after having looked at the product in-store.

Security

Security has always been a buzzword when talking about the internet and, whilst security has undoubtedly improved, it is not fail safe. There is still a sense of suspicion amongst some consumers who are not keen to provide personal details when shopping online.

Conclusion

The retail sector is facing tough times, in order to survive and indeed thrive once the market is more settled, the prudent retailer will be looking to multi-channel retailing. In order to move forward and attract differing consumers e-retailing should work alongside the high street, a fact borne out by one of our clients who stressed that the burgeoning success of his e-retail operation was heavily reliant on his high street outlets to drive traffic to his website.

So, rather than click versus brick, should those looking for a bigger market share really be concentrating on a sales and marketing strategy that focuses on click plus brick? We think so.

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'Control is the key to maintaining a strong brand.'

Are you making the most of the value of your company's intellectual property?

In the current climate, some company assets are falling in value particularly those traditional ones like buildings and other property. On the other hand the value of your company's intellectual property (IP) rights may have risen. Companies appear to be less willing to allocate budget to research and development projects and on the other hand there are infringers out there in the market place eager to make money on the back of your company's brand, invention or creation.

How protected is your company's brand, your creation, your invention?

Here are four things you can do to 'tidy up' what might increasingly become one of your business' key assets, its IP:

- 1 If you don't already have one, register a trade mark. A trade mark functions as a badge of origin helping consumers to distinguish the products and services of one trader from those of another.
- 2 Obtain a patent for a new or improved product or process. This gives the patentee (you) the exclusive right for a period, to prevent others from making, using or selling the invention without permission.
- 3 Apply for a registered design which protects the appearance of the whole or part of a product.
- 4 Manage your business' copyright in an ordered and systematic way. Copyright protects a wide variety of original works including those embodied in books, photographs, paintings, plans, sculpture, music, drama records, films, videos, architecture, computer software, broadcasts and typographical arrangements of published works. Copyright also protects literary, dramatic, musical or artistic works which are computer generated. Appoint

somebody centrally within your organisation to whom dated works are posted and logged, preferably on a computer hard drive.

Go further and appoint an individual within your organisation that deals with all IP so that rights are managed centrally and that person can build up expertise in that area.

There are other unregistered rights that are already in existence within your company. Make sure these are owned by the company or that the company has the requisite licence to use them. Control is the key to maintaining a strong brand. Be quick to react to those who might be infringing your intellectual property rights. A quick analysis of your rights, the type of infringement and a brief letter can prevent your rights being diluted and trampled over and is fairly inexpensive to undertake.

[A brief look by us and a summary of what rights your company has and how to protect them might put your company in a better position to raise security. For more information on our intellectual property team and the services it provides, please visit \[www.thomaseggar.com/business/commercial-advice/intellectual-property\]\(http://www.thomaseggar.com/business/commercial-advice/intellectual-property\) or contact Richard Hastings on 023 8083 1216 or \[richard.hastings@thomaseggar.com\]\(mailto:richard.hastings@thomaseggar.com\)](#)

Newsbrief

Problems getting your bills paid - the law can help

In the current market conditions one of the most significant issues for business is the late payment of invoices.

The Late Payment of Commercial Debt (Interest) Act 1998 ('the Act') makes provision for recovery of interest and compensation on commercial debts which are unpaid on the date the invoice falls due, or 30 days after the date of the invoice, whichever is the later. The legislation provides that the interest rate payable should be 8% above base rate but to simplify claims the rate is fixed for six month periods at the rates in force on the preceding 31 December to 1 June. The current rate is therefore 8.5%.

Key points when delivering invoices

- Make sure you make a clear claim for the sums due and where appropriate set out the various items charged.
- Provide supporting documentation where necessary or when requested.

Key points when receiving invoices

- Check invoices upon receipt and pay any sums that are irrefutably due.
- If there is a genuine dispute as to the amount claimed in an invoice, give clear notice and request an explanation.
- Withholding payment of the full balance will leave you exposed to interest and compensation under the Act.
- Further withholding payment leaves you exposed to the real danger of court and/or insolvency proceedings especially bearing in mind current market conditions. Creditors are more likely to initiate legal proceedings sooner than in the past and when a balance of £750 or more is undisputed and is outstanding, a petition to wind up a company may be presented.

'The price paid is often low and does not create sufficient funds for even a modest dividend to unsecured creditors.'

Pre-pack and phoenix - what's the problem?

The first question for most people looking at this article will be - what is a pre-pack and what is a phoenix?

When a company becomes insolvent it is sometimes the case that immediately following its demise the business and assets are sold to a new company, which rises phoenix like from the ashes, all very glamorous. However, what is not glamorous is that the creditors of the old company are left behind and the new company seemingly carries on as before, free from its historic debts. This is all the more galling when the new company and old company have the same directors and shareholders. In broad terms this is called a phoenix.

A pre-pack is a variation on the phoenix. In a pre-pack the sale of the old business and assets are agreed with an insolvency practitioner prior to his appointment, so that on the day of his appointment the sale of the business takes place. This is ordinarily through a new style administration.

The price paid is often low and does not create sufficient funds for even a modest dividend to unsecured creditors. The creditors have no real opportunity to challenge the decision to sell and only become aware of it after the event.

This is all perfectly legal. The main proviso is that a proper market value is paid for the business and assets.

The pre-pack and the phoenix have been part of corporate life ever since there have been limited liability companies. However, they come into sharper focus in times of recession. Additionally the ease with which a pre-pack may be undertaken using the relatively new administration procedure has alarmed some creditors. (I say new, it came into effect in September 2003).

Creditors are right to feel alarmed. But are they right when they call for this abuse to be outlawed completely?

The question is - are pre-packs necessary? If they are the only way to extract value from the old company then I would say yes but they may not be the first choice. The first choice would be to trade the insolvent company in administration and market the business over a reasonable period to test the market and get the best price for it. However, this first choice is very often not an option. Examples of barriers to trading include:

- Insufficient funds for trading.
- Inability to trade economically in administration.
- Regulatory difficulties.

In all too many cases trading is impractical. Therefore the company needs to cease trading as soon as possible and the assets disposed of. If a pre-packed going concern sale can deliver a better price for the business as some goodwill is preserved, savings in jobs, preservation of a tenant for the landlord and a healthy business going forward then there is the open question - why not?

The answer to that is often creditor unease, as discussed above.

The Department for Business, Innovation and Skills recognises that if conditions are appropriate a pre-pack can be advantageous to all parties and the best way of extracting value from a dire situation.

In order to allay creditor unease the regulators of insolvency practitioners have introduced a Statement of Insolvency Practice (SIP 16) setting out how a pre-pack must be conducted. SIP 16 is wide ranging and rigorous. Some commentators feel too rigorous.

While SIP 16 is welcome if it promotes good practice and creditor confidence, I feel it is aimed at the wrong, soft, target.



It is not insolvency practitioners who trade insolvent businesses and then buy them back. It is not insolvency practitioners who seek to avoid their creditors using pre-packs. It is directors.



Directors who fail to manage their company's affairs in accordance with the standards set down in the Companies Act 2006 are the culprits here. Regulate them I hear you say.

Well they already are regulated, in this context. We have:

- The Company Directors Disqualification Act 1986.
- Wrongful trading.
- Preference and undervalue claims.
- General breach of duty claims.
- Prohibition on the re-use of company names.

Directors can be sued personally and disqualified from acting as directors if there is evidence of misconduct. Ultimately they can even be imprisoned.

The problem for me is that these sanctions are too rarely used or not targeted to maximum effect.

It is much easier to regulate the professional than catch and punish the real culprits. It seems more likely to me that an insolvency practitioner will be sanctioned for breaching SIP 16 than a director sued or disqualified for his conduct in the matter.

Finally, part of the problem stems from a lack of awareness of directors' duties, particularly in the small to medium sized company. There is no licensing or training of directors. Anybody can set up a limited company and trade it with the privilege of limited liability. This simply has to change.

Personally I would like to see a simple training regime requiring directors to attend a one day course before becoming a director and thereafter a further course every two to three years. If they fail to attend the course then Companies House should refuse their form 288s. Additionally, lenders and creditors might require evidence that a director's appointment was valid by specific reference to attending the course before extending credit. Attendance could be a matter of public record and available at Companies House and with credit reference agencies.

Will it ever happen? I suspect not - but I can always dream.

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Newsbrief

Inaugural Digital Dinner

Professor Dame Wendy Hall, one of the world's leading computer scientists and Professor of Computer Science at the University of Southampton, was special guest and key note speaker at the South's first Digital Dinner on 11 June 2009, hosted by Thomas Eggar LLP, in conjunction with Business Southampton.

It has really only been the last 10 years in which the Web phenomenon has taken off, and Dame Wendy considered why and how, what she dubbed, the 'world wide wait' had exploded into the vital global information system it is today.

Richard Hastings, also taking questions from the floor, agreed with Dame Wendy that the future of the web lay in 'linked data'; a revolution in data interaction allowing users to interact with documents on the Web in such a way that a user could, not only find out where an answer to a question was located, but actually be given an answer back!

Although not as simple as flicking the 'off switch', they conceded that making the Web unusable could essentially do the same thing; restrictive legislation, net neutrality and potential monopoly rights were serious issues with potentially damaging effects on the concepts of free use under which the Web was originally designed.

The pair considered the argument that the Web compounded the recent financial crisis. Although arguably the answer maybe 'yes', when dealing with such complex financial structures, the Web itself should not take all the blame. Unprecedented personal interaction with the Web via social networking and data sharing illustrate a bright present and an even brighter future for the Web.

'There is no doubt that the environment is far tougher now than it was a year ago..'

UK TMT: views from the sector

So how are businesses shaping up in the current environment, and how has this changed in the last twelve months? Paul Anthony, partner and Head of Technology, Media and Telecoms (TMT) at BDO Stoy Hayward's Southampton office looks at the latest findings.

BDO Stoy Hayward recently conducted a research project with CFO Europe Research Services to examine the risks and opportunities of the downturn for the TMT sector. It has been fascinating to be able to see how the views of the sector have changed in comparison to this time last year.

Access to funding

Perhaps unsurprisingly, the number of TMT businesses who feel they have access to funding for their business to operate effectively has more than halved year-on-year. In 2009, only 38 per cent of TMT businesses said it was easy to get access to new funding in comparison to 73 per cent in 2008. In addition, the number who found it difficult to get access to funding more than doubled to 30 per cent (up from 14 per cent last year).

This is a real concern. We are hearing increasing levels of frustration being expressed by TMT businesses as financiers say to them 'meet your growth forecasts and we'll support you with additional finance'. These dynamic, innovative businesses need the additional capital to meet their growth forecasts and so this is just creating a chicken and egg situation. As the economic environment remains tough over the coming months, the situation is likely to become increasingly difficult and many businesses may feel that funding has dried up completely.

Scaling back

Many survey respondents have scaled back their capital raising plans - 55 per cent said this year that they are not looking to raise capital externally, up from 17 per cent last year. For those who are looking for capital, we have seen a major shift in source - in 2008 59 per cent of TMT businesses were looking to investment banks, private equity and the capital markets for finance; this has fallen to 14 per cent this year. Instead, the number of businesses looking for

straightforward bank loans has almost doubled from 9 per cent to 17 per cent.

These results are clearly a reflection of the difficult environment that TMT businesses are experiencing and suggest that companies have to scale back their long term plans in view of the current economic situation. TMT businesses have found themselves in an ironic situation as the banks, particularly those who have been nationalised, are being encouraged (if not pressurised) to lend. However, there is a perception amongst businesses that obtaining bank funding has become a very protracted and expensive process. If companies continue to believe access to funding has dried up then only those in desperation will be approaching the banks, and the banks will see fewer high quality lending opportunities. It's a vicious circle and poses a real risk that investment in research and development, the lifeblood of many TMT businesses, will dry up, stalling UK innovation.

Innovation led growth

Interestingly, there has been a significant shift in how TMT businesses plan to grow. We are expecting to see an increase in strategic partnerships, with more businesses willing to collaborate in order to succeed. Last year, growth was all about acquisition, but a year on, innovation is the preferred route, combined with stretching existing products and services into new markets.

Our survey found 80 per cent of respondents were not planning to cut research and development expenditure. With funding in short supply, collaboration and strategic partnerships are a natural strategy as businesses seek to maintain their research and development activity. Collaboration brings not only cost savings from asset sharing and product synergies, but also a broader skill base upon which to build innovation.



Outlook

There is no doubt that the environment is far tougher now than it was a year ago - many more companies are forecasting a decline in revenues in 2009. As the economic crisis subsides, and with innovation as they key strategy for most, companies can expect a fiercely competitive market place.

However, strong growth is still forecast in the medium term. Over 60 per cent of senior executives surveyed are confident that their companies can meet their



Dealing with redundancy and restructure

In this current economic climate, redundancies and other cost-saving measures are increasingly important considerations for many employers.

Sadly, many businesses are finding that redundancies are now a reality. Employers are also conscious that what is already a difficult process can be made more challenging – and expensive – as a result of the legal rights that employees enjoy, and the increasing knowledge of employment rights amongst the workforce.

If redundancies are unavoidable, there is at least one recent change to be grateful for as the much-maligned Statutory Dispute Resolution Procedures were repealed on 6 April 2009. These were a trap for the unwary and could often land well-meaning employers in legal difficulties. Interestingly, the replacement regime – under the ACAS Code of Practice on Discipline and Grievance – does not apply to redundancy situations at all. This significantly reduces the complexity of carrying out redundancy processes, but there are still some legal hoops to jump through.

Employers must still take care to ensure that any redundancies are carried out in a fair manner. This will include consideration of issues of selection, suitable alternative employment and considering ways to avoid redundancy. Failure to carry out a fair procedure can render the dismissal unfair, leading to an award of up to £66,000 so it is always prudent to take specific advice in advance.

Employees with more than two years' service are entitled to a statutory redundancy payment calculated on the basis of a week's pay (capped at £350) per year of service, adjusted for age. Many employers pay enhanced redundancy payments, however.

The redundancy process, whilst less complicated than previously, is still relatively convoluted, and it does contain potential pitfalls for the employer.

That said many employers in the current recession are looking at alternatives to redundancy. The benefits of these can allow

talent to be retained in the workforce, and costs savings to be achieved, without the unpleasantness and cost, in financial and emotional terms, of a redundancy process.

These can include:

Pay freezes In the absence of a contractual right to an annual pay increase, these can be an effective and simple way to save costs.

Sabbaticals Many employers are now offering employees a sabbatical on significantly reduced (or no) pay. It is very important to ensure that appropriate terms are agreed for any such sabbatical (for example salary, conditions of return etc). Some employers require the employee to do certain things during the sabbatical – such as voluntary work, or offer financial encouragement for the employee to do so. It is particularly important to ensure that the arrangements are clear, comprehensive and understood by all parties.

Reducing hours and/or pay Many employers have sought their employees' agreement to reduce hours en masse – for instance particular categories of the workforce agreeing to work four days a week for 85% of salary. Again agreeing appropriate terms is key here.

Layoff/short time working These are generally temporary measures and there are strict statutory rules governing them and the interaction with the entitlement to redundancy payments. Generally, there needs to be a contractual right to impose lay-off.

Flexible working Many employers consider other ways to reduce costs and retain talent, such as home-working, flexible contracts and job-share arrangements. Each of these can provide benefits but in each case care needs to be taken to ensure that appropriate terms are put in place to safeguard the employer and the employee.

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revenue growth targets for the next three years. But whilst this medium term outlook for TMT companies is fairly robust, it will not be without casualties.



BDO Stoy Hayward

If you would like to more information on the survey or the issues discussed in this article, please contact Paul Anthony on 023 8088 1700 or paul.anthony@bdo.co.uk

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(not just a director) to make a contribution to the insolvent company's assets. Fraudulent trading is also a criminal offence.

Misfeasance

A liquidator can also hold liable directors and anyone else responsible for the misapplication of company property, or who have been guilty of misfeasance or have caused loss to the company through a breach of a fiduciary or other duty in relation to the company (section 212 of the IA 1986). Those duties could include matters such as a director's involvement in the company entering into an undervalue transaction or granting a preference.

Undervalue transactions

A company enters into a transaction with a person at an undervalue if the company makes a gift to that person or if the value of the consideration for the transaction is significantly less than the value of the consideration provided by the company. There is a 'good faith' saving in the IA 1986 for transactions that might otherwise be held to be undervalue transactions - namely if the court is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

Preferences

A company gives a preference to a person if that person is one of the company's creditors, a guarantor or a surety of its debts and the company does anything which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position the person would have been in if that thing had not been done.

Again, there is a restriction in the IA 1986, namely that a court will not make an order that there has been a preference unless the company which has given the preference was 'influenced by a desire' to improve that particular creditor's position in the event of an insolvent liquidation.

The Court has extensive powers if it finds that the company has entered into

an undervalue transaction or has given a preference. These powers include requiring any property transferred as part of the transaction or in connection with the giving of the preference to be re-vested in the company, the transaction to be set aside and requiring any person who received any benefits from the company to repay those benefits.

Disqualification of directors

A finding of fraudulent or wrongful trading would also be relevant to the possible application of the Company Directors Disqualification Act 1986 (CDDA 1986) and is almost certain to lead to the disqualification of a director. Under the CDDA 1986, the court has the power to disqualify directors from acting as such, or being involved with the management of a company, for a specified period of time, the minimum period being two years.

The grounds for making disqualification orders under the CDDA 1986 include where the court is satisfied that the director's conduct makes him "unfit to be concerned in the management of a company". Case law suggests that in considering whether to make a disqualification order, the court will look to see whether there has been dishonest conduct, whereas ordinary commercial misjudgements would not be enough to justify disqualification.

Practical considerations

- Directors should monitor the financial position of their company carefully and regularly review the management accounts. If concerned about the company's solvency, seek early advice from a specialist who can advise about the viability of the company and how to proceed.
- Hold regular board meetings and keep appropriate minutes. It is important to ensure that as much up-to-date financial information as possible is available to the meeting, and that those meetings, and the decisions made at the meetings, are fully documented. Be aware that the directors' conduct will be scrutinised later in the event of insolvency.
- Avoid taking on any further credit other than in the ordinary course of

business. To minimise the risk of a successful claim being made against the directors for wrongful trading or other potential areas of liability, the directors should take action to ensure that as far as possible no further debts are incurred by the company.

- Avoid vulnerable transactions. Any transactions entered into by the company at this point could, depending on the facts, be vulnerable to later challenge by a liquidator on the basis either that they were made at an undervalue or that they were preferences.

If you are interested in finding out more about directors' duties, please call a member of our Corporate Commercial Practice Group on 0870 160 1300.

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