IMPORTANT NOTICE

When reading these answers, please note that they are not intended to be viewed as a definitive “model” answer, as in many instances there are several possible answers/approaches to a question. These answers indicate a range of appropriate content that could have been provided in answer to the questions. They may be a different length or format to the answers expected from candidates in the examination.

EXAMINER’S GENERAL COMMENTS

- The performance of the candidates on this paper was very similar to the November 2008 sitting and resulted in a comparable pass rate. Many of the points made below have been made before but continue to be relevant.

- Those candidates who did not do well in Section A of the paper tended to fail it overall. Many candidates continue to pass because of their performance in Section A, even though they do poorly in Section B.

- The weaker candidates are often very weak. It is still the case that the weaker scripts frequently lack any relevant law or authority. For some candidates, their preparation or understanding of what is required for this examination paper is wholly inadequate.

- In the Section A questions, a significant number of candidates continue to write lengthy answers and give too much background information instead of focusing on the question set.

- The Section B answers continue to be characterised by a general inability to identify the legal issues. Instead, many candidates simply write all they know but are unable to apply the law to the facts.

- There were some very competent and informed answers. As always, the scripts of the better candidates were characterised by:

  (i) good identification of the legal issues;
  (ii) an ability to explain and apply the law;
  (iii) a good knowledge of the cases;
  (iv) an appropriate answer length; and
  (v) good structure, presentation and written communication skills.
1. (a) **Explain what is meant by the term, ‘the veil of incorporation’.** (4 marks)

**SUGGESTED ANSWER**

Upon incorporation and from the date in its certificate of incorporation, a company acquires its own legal personality. The company is at law a different person from its promoters, directors and shareholders. This was established in *Salomon v A Salomon & Co Ltd* [1897].

A metaphor used by the courts to illustrate this separation is the ‘veil of incorporation’. This ‘veil’ is said to be drawn over the company emphasising that it is a different person from its promoters, directors and shareholders. The result is that a company is treated, for most purposes, in the same way as a natural person so that, for example, it can own property and sue and be sued.

**EXAMINER’S COMMENTS**

Most candidates were able to explain this term with reference to decided cases. However, a good number wrote long answers and went on to discuss the cases on lifting of the veil, instead of confining their answers to what the veil of incorporation means.

(b) **What statutory protection is offered to a third party who enters into a contract with a person purporting to act on behalf of a company which is not yet formed?** (4 marks)

**SUGGESTED ANSWER**

A contract with a person purporting to act on behalf of a company not yet formed is called a pre-incorporation contract.

Statutory protection is given to the third party by virtue of s36C(1) CA 1985 (or s51 CA 2006 which comes into force in October 2009). This provides that the contract is treated as having been made with the person purporting to act on behalf of the unformed company or as agent for it, and he is personally liable on the contract accordingly. This is subject to any express agreement to the contrary. *Phonogram v Lane* [1982].

**EXAMINER’S COMMENTS**

The main problem with the answers for this question was a lack of focus on the question set. The weaker candidates did not know the relevant statutory provision and instead wrote about how a promoter may avoid liability under a pre-incorporation contract. This was irrelevant material and no credit is awarded for such material.
(c) **What are ‘bonus shares’?**

**(4 marks)**

**SUGGESTED ANSWER**

Profits shown in a company’s account which is treated as profit can be transferred to capital accounts and this is known as ‘capitalization’. One way of doing this is to transfer the profits to a share capital account and then to treat the profits as paid up new shares which are issued to the existing members as ‘bonus shares’. As they are treated as being paid up there is no separate payment made for them by the members.

Under Article 110 of Table A, a decision to issue bonus shares is taken by the directors on the authority of an ordinary resolution.

Bonus shares are issued to the members in proportion to their existing holdings, for example, one bonus share for every five shares owned.

**EXAMINER’S COMMENTS**

There were some very good answers to this question and most candidates knew the essential characteristics of bonus shares.

(d) **Why may a company wish to reduce its share capital?**

**(4 marks)**

**SUGGESTED ANSWER**

A company may reduce its share capital in any way, 641(1) CA 2006. For example, in *Carruth v Imperial Chemicals Industries Ltd* [1937], a capital reduction to reduce the nominal value of one class of the company’s shares so as to reflect the price at which the shares were being traded on the Stock Exchange.

Section 641(4) goes on to give some particular examples of why a company may wish to reduce its share capital. These are:

- to extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;
- to cancel any paid-up share capital that is lost or unrepresented by available assets; or
- to repay any paid-up share capital in excess of the company’s wants.

**EXAMINER’S COMMENTS**

The answers to this question produced some very mixed responses. The main problem was that candidates did not answer the question. Instead of concentrating on why a company may wish to reduce its share capital, too many answers contained lengthy accounts on the procedure for reducing share capital, which was irrelevant. There was also some confusion with s121 CA 1985 (s617 CA 2006) as a number of answers simply contained an explanation of how a company may generally alter its share capital without focusing on reductions.
(e) For the purposes of the offence of insider dealing, explain what is meant by ‘inside information’. (4 marks)

**SUGGESTED ANSWER**

Inside information is dealt with in s56 of the Criminal Justice Act 1993. It does not define inside information but sets the criteria which must be satisfied.

Inside information is information which:

(i) relates to particular securities, or to a particular issuer of securities, or to particular issuers of securities and not to securities generally, or to issuers of securities generally. Securities include shares and an issuer relates to a company;

(ii) is specific or precise;

(iii) has not been made public; and

(iv) if made public, would be likely to have a significant effect on the share price.

**EXAMINER’S COMMENTS**

Most candidates were able to explain the concept of inside information but only a few were able to identify the relevant criteria in s56 of the Criminal Justice Act 1993.

(f) What is a ‘written shareholders’ resolution’, and when may a written resolution not be used? (4 marks)

**SUGGESTED ANSWER**

Written shareholder resolutions are dealt with in ss288-230 CA 2006. Only private companies can pass such written resolutions.

A written shareholders’ resolution is a resolution that is passed either with a simple majority or a special majority. There is no longer a requirement for unanimity. So, the CA 2006 introduces the concept of ordinary and special written resolutions. A written shareholders’ resolution does not require the company to hold a meeting to pass the resolution. A member must signify his agreement to the resolution but this does not necessarily have to be done by signing the resolution.

A written shareholders’ resolution cannot be used to remove a director or an auditor.

**EXAMINER’S COMMENTS**

This question was answered reasonably well. Some candidates failed to appreciate that the previous requirement for such resolutions to be unanimous has been removed by the CA 2006. Weaker candidates confused written shareholders’ resolutions with shareholder agreements and referred to Russell v Northern Bank Development Corporation [1992]. Shareholder agreements are contracts, not resolutions of the company.
(g) **Explain the legal requirements relating to the age and number of directors in both public and private companies.** (4 marks)

**SUGGESTED ANSWER**

The CA 2006 removes the previous restriction on the appointment of directors over the age of 70 in public companies, unless approved by the company in general meeting, with special notice. There is now, therefore, no maximum age limit to be a director but s157 CA 2006 introduced a minimum age of 16.

A public company is required to have at least two directors, and a private company, one. All companies must have at least one director who is a natural person, ss 154-155 CA 2006.

**EXAMINER’S COMMENTS**

Very few candidates made all of the above points and there were a wide range of numbers and ages suggested in the answers. It should be noted that the CA 2006 reduces the required number of members in a public company to one; the number of required directors remains at two.

(h) **Directors are under a duty to exercise independent judgment. What does this mean?** (4 marks)

**SUGGESTED ANSWER**

The duty to exercise independent judgment is contained in s173 CA 2006.

This is a codification of the previous position which prevented directors from fettering their future discretion by agreeing to act in a particular way. Section 173(2) provides that there is no breach of this duty if directors are acting in accordance with an agreement entered into by the company that restricts the future exercise of discretion by its directors, or if they act in a way authorised by the company’s constitution.

An example of a breach of this duty would be a contract between a director and a third party as to how a particular discretion conferred by the articles will be exercised, see *Kregor v Hollins* [1913]. Where, however, the board is able to show that an arrangement would benefit the company there will be no breach. In *Fulham Football Club Ltd v Cabra Estates plc* [1994], it was held that there was no breach of duty when the directors of Fulham agreed to support the planning application of their landlords, Cabra, to redevelop their football ground rather than those of the local authority. In return for their support, Cabra paid the football club a substantial fee. This arrangement would benefit the company.

**EXAMINER’S COMMENTS**

A number of answers confused this duty with that in s174 CA 2006 relating to the duty to exercise reasonable skill and care but, on the whole, this question was well answered. The weaker candidates wrote all they knew on all of the duties of a director.
(i) Why do floating charge holders frequently include a ‘negative pledge’ clause in the charge?  

**SUGGESTED ANSWER**

In terms of priority, a later fixed charge has priority over an earlier floating charge, assuming proper registration of both charges. See *Re Castell and Brown Ltd* [1988].

To protect themselves against a later fixed charge, floating charge holders sometimes insert a ‘negative pledge’ in their charge. This prohibits the creation of subsequent charges ranking equally with or having priority to their charge. A subsequent charge holder will only be bound if they have actual notice. See *Wilson v Kelland* [1911].

**EXAMINER’S COMMENTS**

This was another question that produced some lengthy answers which lacked the necessary focus on the actual question set. It was not necessary to describe the characteristics of a floating charge and how they differ from a fixed charge, except in relation to priority. Such answers attracted little, if any, credit.

(j) Identify four circumstances in which a company may be wound up by the court.  

**SUGGESTED ANSWER**

Section 122 IA 1986 lists eight circumstances:

(i) If the company has passed a special resolution to wind up the company.
(ii) If a public company has not been issued with a trading certificate and more than one has expired since its registration.
(iii) If it is an old public company within the meaning of the Consequential Provisions Act.
(iv) If the company does not commence business within a year from its incorporation or suspends its business for a whole year.
(v) If the number of members in a public company falls below 2.
(vi) If the company is unable to pay its debts.
(vii) If a moratorium for the company under s1A comes to an end and there is in place no voluntary arrangement in relation to the company.
(viii) If the court is of the opinion it is just and equitable to do so.

**EXAMINER’S COMMENTS**

This question was answered reasonably well. The key to answering this question was to focus only on when a court can wind up a company. Some of the answers contained lengthy accounts on the different types of winding up and compared compulsory winding with members’ and creditors’ winding up, which was not needed.
SECTION B
(Answer THREE questions from this section)

2. The business of Alpha Ltd ('the company') is that of a property developer. Alan, Cherry and Basil are the only directors and shareholders of the company, each owning 100 shares. In addition, Alan has been appointed as Managing Director. The Articles of Association of the company contain the following clauses:

(a) in the event of a resolution being proposed at a general meeting of the company for the removal from office of a director, any shares held by that director shall carry the right to three votes per share;

(b) James shall be the Company Secretary;

(c) the Managing Director, Alan, shall have the power to veto any board decision relating to the purchase or acquisition of any property.

At a recent board meeting, Alan tried to exercise his veto after the board decided to purchase a warehouse, but Basil and Cherry ignored Alan’s veto. They then called a general meeting which passed a resolution ratifying the decision of the board. Basil and Cherry are also considering calling another general meeting to remove Alan as a director. James acted as the Company Secretary, but has since been removed.

REQUIRED

Advise Alan and James as to whether they can rely on any of the above Articles of Association. (20 marks)

SUGGESTED ANSWER

Every company is required to have Articles of Association which is a constitutional document of the company setting out the internal rules of how the company is to be run and managed. When the relevant provisions of the CA 2006 come into force (on 1 October 2009), the Articles of Association will obtain a much greater significance as provisions that were previously in the memorandum will be treated as provisions in the company’s Articles.

Under s14 CA 1985 (s33 CA 2006), the Articles of Association have contractual effect. They are treated as having being notionally signed by each member of the company so that there is a contract between the company and the members to observe all the provisions.

Clause (a)

Under s168 CA 2006, members can remove a director at any time by the passing of an ordinary resolution, not withstanding any agreement between the company and the director.
In order to circumvent this provision, it is possible to attach weighted votes to the shares of a director whom it is proposed to remove. This is the purpose of clause (a). When the resolution is voted upon, Alan will have 300 votes as against the 200 of Basil and Cherry with the result that s168 cannot be relied on to remove Alan. Judicial validity for this type of clause was given in the case of *Bushell v Faith* (1970). An argument that the clause infringed what was the equivalent of s168 was rejected by the House of Lords; an ordinary resolution is still needed but the parties are free to agree on what weighting is to be attached to the votes. Furthermore, if Parliament had intended to prevent such clauses it would have done so in the wording of the section.

Alan can rely on clause (a).

Clause (b)

The Articles of Association only bind the company and its members if the claimant is trying to rely on an article that affects him in his capacity as a member, *Hickman v Kent or Romney Marsh Sheepbreeders’ Association* [1915]. An outsider cannot rely on the articles as a contract against the company, *Eley v Positive Government Security Life Assurance Co Ltd* (1876). As James is an outsider, and not a member, he will not be able to rely on the articles. He will have to establish an extrinsic contract outside the Articles if he is to have any remedy but he will not be able to rely on them as the sole basis of a contract to be the company secretary. See *Re New British Iron & Co Ltd* [1898].

Clause (c)

Alan’s power to exercise a veto at board meetings is given to him in his capacity as a director and in this capacity he will be considered as an outsider and beyond the protection of s14 CA 1985 (s33 CA 2006). In *Beattie v E & F Beattie Ltd* [1938], a director was unable to rely on an arbitration clause in the Articles when he was sued for failing to account for company money in his capacity as a director: the fact that he was also a member made no difference.

The facts, however, are similar to the earlier House of Lords decision in *Salmon v Quin & Axtens Ltd* [1909]. In this case, the managing director was able to rely on a veto given to him in the articles and he successfully sought an injunction preventing the company from acting on the resolutions. It has been suggested that the case can be reconciled with *Hickman*, (which requires the claimant to be affected in his capacity as a member), as long as the member specifically pleads his case in his capacity as a member that he has the right to have the articles observed. However, despite its House of Lords status, this case is not easy to reconcile with the weight of authorities which would not allow Alan’s claim as he is an outsider. Another way of explaining the decision, however, is that by failing to observe the articles and then ratifying that failure by an ordinary resolution, Basil and Cherry effectively altered the Articles by a simple majority instead of the required special resolution under s9 CA 1985 (s21 CA 2006).

On the way the authorities currently stand, it is unclear whether Alan can rely on clause (c) but a failure to observe the Articles would give him a claim for unfairly prejudicial conduct under s994 CA 2006, see *O’Neill v Phillips* [1999].
EXAMINER’S COMMENTS

This was the most popular Section B question. The main weakness in the answers was that candidates did not spot the question was about the s33 contract. The classic cases in this area of the law were generally not well known. This question produced some very brief responses. Some candidates simply resorted to copying out the relevant clauses in the question. Repeating the facts of the question attracts no credit and is a very poor examination technique which creates a poor impression.

3. Compare the statutory remedy for ‘unfairly prejudicial conduct’ with the new statutory ‘derivative action’ as a means of protecting minority shareholders. Provide examples, with reference to decided cases, of where the respective remedies might be appropriate. (20 marks)

SUGGESTED ANSWER

The unfairly prejudicial conduct remedy (UPC) is contained in s994 CA 2006. Derivative actions were previously governed by the common law but they are now dealt with in Part 11 CA 2006, ss260-264.

Unfairly prejudicial conduct (UPC)

A member must show that the affairs of the company are being, or have been, conducted in a manner that is unfairly prejudicial to the interests of some part of, or all the members of the company, including at least himself.

The proper approach to the section is now to be found, however, in O’Neill v Phillips (1999). Essentially, to invoke the section, Lord Hoffmann stated that there must be some breach of the terms upon which it has been agreed the company should be run. This may either be a breach of the constitution in that the articles are not being observed or, if the articles are being observed, a breach of some wider equitable consideration upon which the petitioner can base his claim. An example of the latter would be an understanding that the petitioner has the right to participate in the management of the company.

The section has been very useful as a means of protecting minority shareholders in quasi partnership type companies. The range of conduct that has been held to come within the section is very wide and can be illustrated by such cases as:

Re Harmer Ltd [1958] – running a company in an autocratic manner and ignoring the views of other shareholders and directors;

Re London School of Electronics [1986] – diverting company business to another company formed for the purpose;

Re a Company [1986] – removal of a director in a quasi-partnership type company;

Re Sam Weller & Sons Ltd [1990] – failure to declare an adequate dividend; and
Re Macro Ipswich Ltd [1994] – gross mismanagement of the company.

The section has not helped petitioners in public companies. See Re Tottenham Hotspur plc [1994]. Nor has it helped petitioners who simply want to exit the company at will, and require the respondents to purchase their shares without being able to show any fault on the part of the respondents. See Phoenix Office Supplies v Larvin [2003]. Petitioners must also show that they are not the cause of their problems but there is no ‘clean hands’ requirement. Where there is an existing remedy in the articles, or the petitioner has refused an offer, which is unlikely to be bettered after a court action, a petition will usually be struck out. Finally, the time and costs of an action may be considered to be a severe limit to the section.

If UPC is proved, the remedies in the form of court orders are contained in s996 CA 2006. The court can order any remedy it thinks fit but the usual remedy is a share purchase order. The shares will normally be valued pro rata, without any discount being applied to reflect the minority shareholding Re Bird Precision Bellows (1985).

Derivative actions

Derivative actions are now dealt with in ss260-264 CA 2006. A derivative action is defined as one brought by a member of the company in respect of a cause of action vested in the company and who is seeking relief on behalf of the company, s260(1). As the action is commenced on behalf of the company, any remedy in a derivative action goes to the company itself and not to the claimant.

A derivative action may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The action may be against the director or another person (or both). This allows an action against a third party if they assist the director in the breach or knowingly receives trust property from a director, s260(3).

The scope of a derivative action is wider than the previous law as it includes breaches of directors’ duties, even if the breach does not result in a benefit to the director. See Pavlides v Jenson [1956] cf Daniels v Daniels [1978]. Also, the new statutory derivative action no longer requires proof of fraud or wrongdoer control.

Under s261, the claimant must obtain the permission of the court to continue a derivative action. This involves a two stage procedure. First, the claimant must establish a prima facie case on the basis of the claimant’s evidence only. If a prima facie case is not made out, then the claim will be dismissed. If a prima facie case is made out, then the second stage will take place and the court proceeds to a full permission hearing.

Where the company itself has commenced a derivative action but has not prosecuted the claim diligently, a member can apply to continue the action, see s262. Similarly, where a member has commenced an action another member can apply to continue with it, see s264.

Section s263 deals with whether the court should grant permission for the claim to continue. Permission must be refused where:
(i) a person promoting the success of the company under s172, would not seek to continue the claim; and
(ii) the act or omission complained about has been authorised or subsequently ratified by the company.

Where these factors do not apply, the court has a discretion to allow the claim to continue having particular regard to the factors mentioned in s263(3). They are:

(i) whether the member is acting in good faith (for an example under the previous common law, see Barret v Duckett [1995] and Nurcombe v Nurcombe [1985]);
(ii) the importance that a person acting to promote the success of the company under s172 would give to continuing the claim;
(iii) whether the act or omission complained about is likely to be authorised or ratified by the company;
(iv) whether the company has decided not to pursue the claim; and
(v) whether a member could pursue a personal action rather than one on behalf of the company.

Section 264(4) states that the court shall also have particular regard to the views of the members of the company who have no personal interest, direct or indirect, in the matter. This again reflects the previous common position in Smith v Croft (No 2) [1988], in which the court required the ‘majority within the minority’ to consent to the derivative action. Section 263(3) lists a number of factors to be taken into account by the court and they reflect some of the common law decisions.

The remedies for a derivative action are not statutory but based on the common law. Under s994 CA the remedies are statutory and are personal in nature, although the company can order any remedy it thinks fit.

In s994 actions, legal aid is available but it is not for derivative actions. The court can, however, order the company to indemnify the claimant in a derivative action, provided a reasonable board of directors would have commenced the action. See Wallersteiner v Moir (No 2) [1975] and Smith v Croft (No 2) [1988].

Derivative actions will now be available for breaches of directors’ duties in situations where previously a s994 action would have been commenced. It remains to be seen whether claimants will rely on derivative actions and whether the procedural hurdles will limit their number. Petitioners in plc have not fared well in s994 cases and a derivative action for them may be preferable.

EXAMINER’S COMMENTS

This was the least popular question. It was not handled very well by those who attempted it. Few candidates were able to write about the new statutory derivative action and some answers just discussed the unfairly prejudicial remedy. The just and equitable winding up jurisdiction and the case of Ebrahimi v Westbourne Galleries Ltd [1973] decision was sometimes confused with the s994 remedy and derivative actions and discussed at length by the weaker candidates. The question did not require a discussion of this material and it attracted no credit.
4. Coal plc is a mining company, whose main business consists of open cast mining. It has Articles of Association that are in the form of Table A. The board of directors includes Elisa, Michael and Carl.

At a recent board meeting, the directors considered an offer from Land Corp plc to sell land adjoining one of Coal plc’s mining sites for £550,000. The board of Coal plc decided that the company should not accept the offer as it doubted whether it could raise the finance needed to buy the land. Elisa then formed her own company, Ore Ltd, which purchased the land for £550,000. At the same meeting, the directors discussed a proposed contract with Geo plc, which is being considered to survey a plot of land recently purchased by Coal plc. Michael owns 10% of the shares in Geo plc, but did not reveal his interest at the board meeting.

Carl has an arrangement with Driller plc whereby he receives a 10% commission for all orders placed with it by Coal plc. Six months ago, Coal plc purchased some drilling equipment from Driller plc for £100,000, for which Carl was paid £10,000 commission.

The shareholders of Coal plc have discovered these facts, and they have passed an ordinary resolution directing the board of directors to commence legal proceedings against Elisa, Michael and Carl.

REQUIRED

Discuss the legal issues arising out of the above facts. (20 marks)

SUGGESTED ANSWER

This question raises issues relating to directors’ duties and the appropriate organ to commence litigation in the company’s name. The duties of a director were codified in the CA 2006.

Under s172, a director is under an overriding duty to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so, he must have particular regard to a list of non-exhaustive factors listed in the section. These include the likely consequences of any decision in the long-term, the interests of the company’s employees, the need to foster business relationships, the impact on the community and environment, the desirability of maintaining a reputation for high business standards, and the need to act fairly as between the members of the company. All three directors may be in breach of this duty together with the other duties listed below.

Elisa

The relevant duty to consider here is that contained in s175 CA 2006. It states that: ‘A director of a company 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.’
This duty applies in particular to the exploitation of any property, information and opportunity. It is immaterial that the company itself could not take advantage of it, s175(2). This reflects the common law in which cases such as *Regal (Hastings) Ltd v Gulliver* [1942] and more recently in *Bhullar v Bhullar* [2003] make it clear that it is irrelevant that the company could not or would not benefit from the property, information or opportunity.

The purchase by Elisa of the land is a breach of this duty and it makes no difference that she has formed a company to take the benefit of the opportunity. See *CMS Dolphin Ltd v Simonet* [2002]. Commonwealth authorities have taken a relaxed approach in situations similar to that which Elisa finds herself (see *Peso Silver Mines Ltd v Cropper* (1966) and *Queensland Mines Ltd v Hudson* (1978)). The duty in English law, however, is very strict but is not breached if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest, s175(4).

The codification of this duty was intended by the government to change the law and so s175(5)(a) states that the duty is not infringed if the matter has been authorised by the directors. Under s175, there is a change in emphasis which now imposes a positive duty on directors to avoid a conflict from arising and so this requires prior board authorisation. As the company is a plc, authorisation by the directors is possible only if this is provided for in its constitution, s175(5). This will have required Coal plc to have changed its articles and there is no mention of this in the question. The director cannot count towards the quorum at the meeting nor can he vote on the matter, s175(6).

Section 180(4) preserves the current position of allowing companies in their articles to permit certain types of conflict of interest. This appears to say that there will be no breach of s175 where directors are able to rely on any relieving provisions in the Articles. The extent to which relieving provisions are allowed is limited to those which have previously been lawful. The relevant articles in Table A are 85 & 94. Again, this requires Elisa to have disclosed the nature and extent of her material interest in the matter. The position is not so straightforward, however, as Art 85 was ‘previously lawful’ following judicial approval given in *Movitex Ltd v Bulfield* [1988]. This was given on the basis that the previous no conflict duty was held to be a ‘disability’ rather than a duty and so did not breach s309A CA 1985, which prohibited provisions in the Articles which excused directors from breaches of ‘duty’. Section 175 is now, however, expressed as a ‘duty’ and so it is doubtful whether Movitex survives the Act.

Michael

The proposed contract with Geo plc is governed by s177 CA 2006. Under this section, if a director has a direct or indirect interest in a proposed contract with the company, he has a duty to declare both the nature and extent of his interest to the other directors. This can be done either at a board meeting or by notice in writing or by giving a general notice. See s177(2).

The declaration by Michael must only be made before the company enters into the transaction or arrangement with Geo plc and this may be sometime after the contract is first considered. See s177(4). So there would not appear to be an immediate breach by Michael as long as he declares it sometime before it is entered into.
A declaration is not required when a director is not aware of the interest or of the contract, or if it cannot reasonably be regarded as likely to give rise to a conflict of interest. A declaration need also not be made if the interest is known by the other directors.

The duty in s177 is also subject to the provisions in the company’s articles and again s180(4) CA 2006, as explained above in relation to Elisa, will apply.

Carl

By receiving a commission from Driller plc, Carl may be in breach of s176, the duty not to accept benefits from third parties by reason of being a director or doing anything as a director. The duty is not breached if the commission cannot reasonably be regarded as likely to give rise to conflict of interest. It is to be noted that there is no provision for such benefits to be authorised by the board. This duty reflects the previous common law position as illustrated by cases such as Boston Deep Sea Fishing & Ice Co v Ansell (1888). Carl will have to account to the company for any benefit received from Driller plc.

Any breaches of duty by Elisa, Carl and Mike are capable of ratification by the members under s239 CA 2006. The relevant director cannot use their votes as shareholder in the ratification process but the director can attend, count towards the quorum and take part in the proceedings. This reverses the previous law that directors could use their vote as shareholders to ratify their breach as directors. See North West Transportation Ltd v Beatty (1877). On the facts, ratification is not possible as the majority have passed a resolution directing the directors to take action.

The shareholders’ resolution

Article 70 of Table A provides that the business of the company shall be managed by the company. This includes litigating in the name of the company. The shareholders cannot interfere in the management of the company by an ordinary resolution. See Automatic Self Cleaning Co v Cunningham [1906] in which an ordinary resolution directing the directors to sell the whole assets of the company was held to be ineffective. In Breckland Group Holdings Ltd v London and Suffolk Properties Ltd [1989] it was held that the shareholders could not authorise legal proceedings by passing an ordinary resolution. In Mitchell & Hobbs (UK) v Mills [1996] even a managing director with a 66% shareholding was held not to have the authority to commence legal proceedings; only the board could do this.

Article 70, however, states that the powers of the directors are subject to directions by the shareholders if they pass a special resolution.

EXAMINER’S COMMENTS

Question 4 was another popular question but produced some of the most disappointing answers. There was a general lack of knowledge about the new statutory duties and some candidates answered the question without mentioning them at all. They clearly did not appreciate the changes made in this area by the CA 2006. The cases were, generally, not well known. Many answers suffered from being far too general without
any knowledge of the substantive law. Simply saying ‘there is a conflict’ or ‘he should disclose his interest’ is inadequate. Candidates must state the law, refer to authority and then apply this to the facts of the question.

5. Bravo plc is a non-listed public company. It has three directors, Tom, Vic, and Will, who are the only shareholders of the company. Bravo plc requires additional finance, and is proposing to issue a block of ordinary shares to Chris. The shares have a nominal value of £2, and Chris has agreed to pay £2.20 per share, although he will only partly pay for them at the rate of 25 pence per share. The company did not make a profit during its previous financial year, but the directors wish to recommend that a dividend be declared at its next general meeting.

REQUIRED

Advise Tom, Vic and Will on the following matters:

(a) the legal issues relating to the proposed issue of shares to Chris, and payment for them;

(7 marks)

SUGGESTED ANSWER

Chris has agreed to pay £2.20 per share. As the shares have a nominal value of £2.00, this will create a share premium of 20 pence per share. A premium is the difference between the nominal, or the ‘par’ value of shares, and their sale price.

The premium is treated as if it were share capital and under s130 CA 1985 a sum equal to the value of the premium must be transferred to a share premium account. The money in this account can only be used to:

(i) pay up unissued shares which are allotted to members as fully paid up bonus shares;
(ii) write off the company’s preliminary expenses; and
(iii) write off expenses, commission paid or discount allowed on the issue of shares or debentures.

The shares issued to Chris are to be partly paid for at the rate of 20 pence per share. This is not permitted as it will infringe ss101 CA 1985. This provision states that if a public company issues partly paid shares, at least one-quarter of the nominal value must be paid on or before allotment unless they are being issued in pursuance of an employees’ share scheme.

A breach of the section will require Chris to pay the amount of the deficiency plus interest at 5% per annum. In addition, the company and any officer in default (the directors) commit an offence triable either way. A company that has issued partly paid shares has the right to call for the remainder to be paid at any time.
(b) the pre-emption rules that will apply to the issue; (7 marks)

**SUGGESTED ANSWER**

The company will have to consider the pre-emption rules in ss89-95 CA 1985. A right of pre-emption is a right of first refusal. The basic rule is that when a company issues new shares it has to offer them first of all to the existing members in proportion to their existing holdings. This ensures that existing shareholder’s rights are not diluted.

A public company can exclude them by passing a special resolution under s95(2) CA 1985.

The pre-emption rules apply to ‘equity securities’ and this means ordinary shares. In addition, the rules only apply if the shares are paid for wholly in cash and so it is possible to avoid the rules either by issuing preference shares or paying for the shares wholly or partly with a non-cash asset.

An offer to the existing members must remain open for at least 21 days. An allotment of shares in contravention of the pre-emption rights does not invalidate the allotment but the directors are liable to compensate those shareholders to whom the shares should have been offered.

(c) any potential liability for the payment of the dividend. (6 marks)

**SUGGESTED ANSWER**

A company can only pay a dividend if it has profits available for the purpose within s830(2) CA 2006. The profits available are:

‘its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made’.

It is important to note that losses in previous years are carried forward and must be set off against any profits. The company has not made a profit during its last financial year and so it will be necessary to enquire whether any profits from previous years have been carried forward to wipe out the loss that the company made last year.

Even if the company has profits left over form previous years, as it is a public company it will have to satisfy an additional requirement in s831 CA 2006, known as the net asset test. A public company may only pay a dividend if ‘the amount of its net assets is not less than the aggregate of its called up share capital and undistributable reserves and if, and to the extent that, the distribution does not reduce the amount of those assets to less than the aggregate.’ This complex formula requires, in effect, for public companies, unlike private companies, to depreciate fixed assets against profits which they have made before paying a dividend.

If the company pays an unlawful dividend, the directors who authorised the unlawful payment are liable to repay the money to the company. See *Precision Dippings Ltd v*
**EXAMINER’S COMMENTS**

Question 5 was not very popular. It required candidates to have a good knowledge and understanding of the rules. Most candidates were able to make very general statements but were unable to back them up with authority and cases. Part (c) caused the most difficulty and a lot of candidates simply did not address the issue of liability at all.

6. George has been appointed as liquidator of Betprop Ltd (‘the company’), which is in compulsory liquidation and carries on business as a food wholesaler. A winding-up petition was presented by Nita, an employee of the company, on 1 February 2009, and a liquidation order was made on 1 March. Nita is owed £3,000 in unpaid wages.

There are two directors of the company, Molly and Graham, who are also its only shareholders. No accounts have been filed for the last two years, and the drift towards insolvency began in early 2008. In February 2008, in order to raise much needed finance, the company borrowed £70,000 from Premfin plc, who charged an interest rate of 35% per annum.

In December 2008, Molly and Graham decided that the company should give Jerry, one of its customers, a Christmas hamper in the hope that this would encourage him to place an order with Betprop Ltd. At the same time, they took delivery of some food containers from Alpha plc, supplied on Alpha’s standard form contract which provides that the containers are subject to a reservation of title clause.

**REQUIRED**

(a) Explain the difference between a compulsory and voluntary liquidation, and how each is commenced.  

**SUGGESTED ANSWER**

A compulsory winding up is commenced on the date the petition is presented to the court following which a winding order may be granted. The petition is usually presented by a creditor or a member of the company. A voluntary winding up commences with the passing of the relevant members’ resolution specified in s84 IA 1986. It will be a creditors’ voluntary liquidation unless the resolution is followed by a declaration of solvency by the directors, in which case it will be a creditors’ voluntary liquidation. The commencement date is important because it is the date from which the liquidator can look back and examine, and possibly set aside, pre-liquidation transactions. Nita is a creditor who is owed more than £750 and she is, therefore, entitled to present a winding up petition, subject to serving a statutory demand and the debt remaining
unpaid for a period of three weeks. She is also treated as a preferential creditor. In these circumstances a company is unable to pay its debts within the meaning of s123 IA 1986.

In a compulsory liquidation, the liquidator will normally be appointed by the creditors but in a voluntary liquidation, he will be appointed either by the members (if members’ voluntary liquidation) or the creditors (if a creditors voluntary liquidation).

(b) **Advise the liquidator on the legal issues arising out of the above facts.**  
*(10 marks)*

**SUGGESTED ANSWER**

The function of the liquidator is to secure that the assets of the company are got in, realised, and then the proceeds distributed to the company’s creditors, s143 IA 1986.

The £70,000 loan from Premfin plc may be challenged by the liquidator on the basis that it is an extortionate credit transaction due to the interest rate of 35% per annum. The relevant provision is contained in s244 IA 1986 and the liquidator can look back for up to 3 years. The credit agreement with Premfin plc is clearly within this time limit. The credit agreement will be extortionate if either the payments are grossly exorbitant or it grossly contravenes ordinary principles of fair dealing. The court must, however, take into account the risk to the company providing the credit. A court can set aside the agreement in whole or in part, or vary the terms.

The Christmas hamper to Jerry raises the possibility of it being a transaction at an undervalue contrary to s238 CA 1985, as no consideration is provided for the property of the company. The liquidator can look back for up to two years. The liquidator must establish that the company was unable to pay its debts at the time of the transaction. The transaction will not be at an undervalue if it was entered into in good faith for the purpose of carrying on the business and in the reasonable belief that it would benefit the company. The hamper may fall within this exception as Molly and Graham believed that it could result in Jerry placing an order.

The drift towards insolvency since early 2008 raises the possibility of wrongful trading proceeding under s214 IA 1986, which can only be commenced by a liquidator. This is where the business of the company is carried on at a time when the directors knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation. The court may order the directors to make a contribution towards the assets of the company unless they took every step with a view to minimising further losses to creditors after they realised that there was no reasonable prospect of avoiding liquidation. See *Re Produce Marketing Consortium Ltd* [1989]. Wrongful trading seems likely as there were no accounts by which the directors could assess the company’s solvency. Failure to file accounts may also lead to a disqualification order.

The containers were supplied under a retention of title clause and this means that the property in the goods will not pass to the company until they have been paid for. Unless the company had paid for the containers they will not be available to the liquidator to realise and must be returned to the supplier. *See Aluminium Industrie Vassenn v Romalpa* [1976].
(c) How and when will the company be dissolved? (5 marks)

SUGGESTED ANSWER

In a compulsory liquidation, after its affairs are completely wound up, the liquidator sends a notice to the Registrar of Companies that the final meeting of creditors has been held and that he has vacated office.

The notice is registered and the company is then normally dissolved at the end of the period of three months from the date of registration unless some interested party makes an application to the Secretary of State for the date to be extended.

When the company is dissolved it ceases to exist.

EXAMINER’S COMMENTS

This question was a very popular question and produced the best quality answers. Most candidates understood the difference between the types of winding up and were able to discuss the setting aside provisions. There was, however, the usual confusion between the role of a liquidator and that of an administrator or administrative receiver.