
Examiner's report 2009

266 0021 Company law Zone A

Introduction

The examination covered a range of questions from the Company law syllabus, which enabled students to illustrate their knowledge and understanding of company law.

General remarks

As in previous years, the pattern continued of some students answering problem questions relatively well, but struggling to produce good answers to the essay questions. The main reason for this was that in some essay answers, students did not attempt to answer the particular essay question asked, but instead wrote down everything they had learned about a particular area or produced a pre-prepared answer on a topic. These answers are unlikely to gain many marks as they are not attempts at answering the specific question.

Specific comments on questions

Question 1

Where company law is concerned, clarity and certainty are always more important than justice.'

Discuss.

- a) This statement requires students to discuss the issue of clarity and certainty in company law.
- b) It is probably true that judges favour clarity and certainty in key areas of company law such as the objects, the articles of association and the rule in *Hoss v Harbottle*. However, company law also contains statutory minority protection provisions that are designed to introduce more of a concept of justice over certainty.
- c) In answering this question, students should weigh up the evidence of certainty against the instances of statutory intervention and come to a conclusion about this statement.

Question 2

The expression “interests of the company” provides no guide for resolving disputes amongst shareholders, or between shareholders and other stakeholders.’

Discuss.

This question requires students to address one of the central issues in directors’ duties.

In answering this question students must address the statement and discuss the way in which the judges in the case law constructed something of a compromise on the question of what the interests of the company were.

The Report of the Second Savoy Hotel Investigation must be discussed as well as the reform process that led to the codification of this duty in s.172 CA 2006.

Question 3

It no longer makes sense to talk of UK company law in the singular. We now have two quite different bodies of company law, one for the public company and one for the private company.

Discuss.

- a) This question requires students to address the history of having one-size-fits-all company law and the reform of that position.
- b) One of the findings of the Company Law Review Steering Group (CLRSG) was that company law had largely failed to meet the needs of smaller companies. The result of this finding was that the Company Act (CA) 2006 should aim to make things easier for smaller companies as they are the main consumers of company law. Students should make clear their view on this question, and give reasons for it.
- c) Students should discuss the way in which public and private companies are now treated differently in the CA 2006.

Question 4

It is so clear that non-executive directors make an essential contribution to good corporate governance that the law should be changed to require all listed companies to have a majority of such directors on their boards.’

Discuss.

- a) This question requires students to address the combined code produced by the corporate governance committees and adopted by the London Stock Exchange. The central focus of the combined code has been the role of the non-executive director (NED). Again, in answering this question students need to address their answer specifically to the statement and to explain why they agree or disagree.

To do this, students should go through the background to the code and critique the recommendations of various corporate governance committees, as adopted by the London Stock Exchange.

- b) This statement is controversial as NEDs have not been an unqualified success. The Higgs Report should be discussed here as well as the role of the NED as originally conceived by the Cadbury committee.

Students should discuss the critical point of the code's success – or otherwise – by drawing on the Higgs Report and the various recent corporate governance standards.

- c) Additionally, the failure of NEDs in the various scandals in the UK and the USA should also be discussed.

Question 5

In 2000 Peter, Fred and Wendy set up Runner Ltd to manufacture and supply clothing. They are the only directors and each holds 20% of the shares in the company. The rest of the shares are held by some 40 investors who have largely remained passive while Peter, Fred and Wendy run the business very successfully. Peter is also on the board of directors of Trim Ltd, a major competitor of Runner Ltd. Fred is the director responsible for new products and has developed a new dress fabric which is stain proof and does not need washing. However, when he presents his new fabric to the board, the others are unimpressed and refuse to introduce it into the company's product line. Fred has subsequently announced that he is leaving the company to set up his own company to develop products for the new fabric. Peter has approached Fred privately to see if he would be interested in developing the fabric with Trim Ltd instead.

The other shareholders have become aware of all the issues relating to Fred's departure. Advise them as to how they might protect the interests of Runner Ltd in this situation.

- a) This question concerns the director's fiduciary duty of loyalty.
- b) Students should discuss the duty of loyalty owed by Peter and Fred by first setting out the general position (Re Smith and Fawcett Ltd.).
- c) Having done this, students should discuss the position of directors on competing boards and compare the directors' conduct to key cases such as Cook and Deeks, Regal Hastings and IDC and Cooley.

Question 6

Iris was dismissed as the Managing director of Knock Down Motors Ltd in June 2006. She has since initiated a court action claiming compensation from Knock Down Motors arising from her dismissal. Knock Down Motors has not replied to any correspondence relating to the claim. Iris has also discovered the following: that Knock Down Motors has paid off its trade creditors and has ceased to trade; that Leaf Ltd, the parent company of Knock Down Motors, has removed the remaining assets of Knock Down Motors into Leaf; that the directors of Knock Down and Leaf are the same people; and that Leaf is having financial difficulties.

Discuss the veil-lifting issues raised by this situation.

- a) This question requires students to demonstrate their knowledge of veil-lifting issues.
- b) In answering this question students need to address the key impact that the principle in *Salomon* has on the issue, i.e. the parent has no liability. However, sometimes the judiciary have intervened and lifted the veil. Students will have noted from the reading that from

the 1960s until the 1990s there was little consistency in the way the senior judiciary approached difficult cases where veil-lifting was an option. In 1985 the Court of Appeal in *Re a Company* (1985) could draw on cases such as *Wallersteiner* to argue that the court can use its power to pierce the corporate veil if it is necessary to achieve justice, irrespective of the legal efficacy of the corporate structure under consideration. Equally, four years later, the Court of Appeal in *National Dock Labour Board* could draw on cases such as *Woolfsen* to argue for a strict interpretation of the *Salomon* principle. In short, there was little consistency or certainty in a very important area of company law.

- c) However, since *Adams* the courts have allowed the veil to be lifted in only three situations – single economic entity, mere façade and agent. Students should go through the relevance of each here.
- d) Students should go into detail on the *Creasy* case, which has strong similarities to the facts of this question, and then analyse this set of facts with particular emphasis on *Adams* and *Ord* (which overruled *Creasy*).

Question 7

Staple Ltd was a company set up many years ago to manufacture roof tiles. Its objects clause simply states it is to manufacture roof tiles and other related roofing products. The articles of association also state that the board of directors must seek shareholder authorization for any lending above £50,000. Pat has recently been appointed managing director and wishes to expand the business by building a new factory to extend the company's product range to include the manufacture of bricks. Pat intends to finance the new factory with a bank loan of £500,000.

Richard is a shareholder in Staple Ltd and is concerned about the legality of Pat's plans. Advise him as to the capacity issues raised in this situation.

- a) This question requires students to address the issue of *ultra vires* in the corporate context.
- b) The company has an objects clause which confers power to manufacture roof tiles and other related roofing products. Students should discuss the central problem of the limits placed on a company by its objects clause.
- c) The objects clause issue is not straightforward here and students should spend some time discussing whether the proposed change is within the objects clause. If it is, then fine; if it is not, then students should discuss the statutory saving provisions and their impact here.
- d) Students should also discuss the potential breach of the articles represented by the loan and its effect here.

Question 8

Freshers Ltd was incorporated in 1985 by Madge. In 2005, when the company was worth approximately £5 million, Madge died. She left the whole of the share capital of the company to her 16-year-old son, Paul. Paul was appointed a director of the company. He attended one board meeting in 2005, but found it difficult to follow the discussions there due to his lack of experience and knowledge about the company. He has not attended any board meeting since.

Six months ago Robert, Freshers' managing director, approached Paul. He told Paul that Freshers needed some 'short term' finance, and asked Paul to lend the company £100,000. Paul agreed to do so. To secure the loan, Paul was given a floating charge over all of the company's property. Four months ago, Paul told Charlie, one of the company's suppliers, that he could personally assure him that Freshers was perfectly solvent. Based on that assurance, Charlie supplied another £30,000 worth of stock to the company on credit. Paul has just discovered that the company has been in severe financial difficulties for many months. A board meeting has been called for next week at which Robert will argue that the company should mortgage its factory premises to raise more money so it can 'trade its way out of its difficulties'.

Paul seeks your advice about any personal liability he might face.

- a) This question requires students to demonstrate their knowledge of directors' duties and wrongful and fraudulent trading.
- b) Students must consider the liability of Paul for breach of his duty of skill and care due to his inexperience and actions, and discuss the implication of Robert's actions and the board's potential actions for wrongful and fraudulent trading liability.