

---

# Examiner's report 2009

## 266 0021 Company law Zone B

---

### 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

**'Section 172 of the Companies Act 2006 represents a clear and welcome acknowledgement that the interests of a company's shareholders cannot be allowed to triumph over the interests of other "stakeholders" in the company.'**

**Discuss.**

- a) This question requires students to address one of the central issues in directors' duties.
- b) 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.
- c) In addressing this question the reform process that led to the codification of this duty in s.172 Company Act (CA) 2006 and its impact should be discussed in detail.

## Question 2

**Discuss whether company law should always 'think small first'.**

- a) This provocative question addresses one of the findings of the Company Law Review Steering Group (CLRSG) that company law should be tailored to smaller companies as they are the main consumers of company law. It requires students to give their view on the focus of company law. Note: students should make clear their views on this question, giving reasons for having this view.
- b) Students should go through the reason why the CLRSG felt the need to emphasise small companies, and give some examples of how company law is already aimed at small companies and where it fails them, if indeed it does.
- c) Whether students agree or disagree with the statement set out in the question, the critical point should be made that although small companies make up the majority of companies, large companies are economically more important. If that is the case, should they not have a greater claim to be the focus of company law or are there countervailing reasons for the focus on small companies' needs?

## Question 3

**'The Combined Code on corporate governance has been a great success.'**

**Discuss.**

- a) In this question students are again asked to discuss a provocative statement and apply their knowledge of the combined code to it. Again, in answering the question students need to address their answer specifically to the statement and to explain why they agree or disagree.
- b) To do this students should go through the background to the code and critique the recommendations of the various corporate governance committees as adopted by the London Stock Exchange.
- c) Lastly, they should discuss the critical point of its success or otherwise by drawing on the Higgs report and the various recent corporate governance scandals.

## Question 4

**'The new statutory derivative action is an unnecessary addition to company law.'**

**Discuss.**

- a) This question requires students to discuss the need or otherwise for a statutory derivative action.
- b) Students should discuss the common law position in *Foss v Harbottle* and the reasons why the judiciary may have made derivative action so difficult.
- c) Students should also discuss the problems this caused for shareholders and the reasons why the CLRSG felt reform was necessary, and give their opinion as to whether the CA 2006 derivative action reform will be a success.

### Question 5

Simon and Rebecca are former employees of Rubber plc, an international energy company based in London. They were recruited to work as scientists at Rubber plc 10 years ago and, although originally based in London, they spent most of the 10 years working in mines in various countries in Africa. Having recently retired because of ill health and returned to London, they have discovered that their health problems are related to exposure to dangerous substances in the course of their employment. Having checked their employment contracts, they have found that they were employed in Africa by Rubber (South Africa) Ltd, a wholly owned subsidiary of Rubber plc, which has subsequently gone into insolvent liquidation. They have also discovered that Rubber plc is directly responsible for the safety policy of all its subsidiaries and that a number of directors of the two companies were the same people.

Discuss the veil-lifting issues that arise in the above 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. You will have noted from your reading that from the 1960s until the 1990s there was little consistency in the way in which 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 *Woolfson* 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 must go into detail on the cases of *Lubbe*, *Connolly* and *Williams*, which have similarities here.

### Question 6

Sam has been acting as managing director of Earthways Ltd for two years, although he has in fact never been properly appointed a director of the company. The company has an objects clause which states that the company shall manufacture and sell organic products. Its articles of association say that the remuneration of any director shall be settled by the company's shareholders in general meeting, by ordinary resolution.

Sales of the company's products have declined in recent months and Sam decides that drastic action is needed. He agrees with Grizzle and Bone Pies plc to manufacture a range of non-organic pies for them. The contract is initially for six months, but Sam expects to renew it when it expires. It is also decided that Dave, a non-executive director of the company, should take on a full-time position as a sales director, to explore the opportunities for selling other, non-organic, products. Sam decides the company will give Dave a three-year employment contract, at £60,000 per year, which Dave accepts.

**Josh, a minority shareholder in Earthways, has just discovered the foregoing. He seeks your advice whether either he, or the company itself, might challenge the salary payable to Dave, and the contract with Grizzle and Bone Pies (including its renewal).**

**Advise Josh.**

- a) This question requires students to address the issue of *ultra vires* in the corporate context.
- b) The company has an objects clause which states that the company shall manufacture and sell organic products. Discuss the central problem of the limits placed on a company by its objects clause.
- c) The objects clause issue is straightforward here and Sam's actions will result in a number of *ultra vires* acts. The statutory saving provisions and their impact should also be discussed here.
- d) Students should discuss also the potential breach of the articles represented by the three year employment contract and its effect.
- e) Students should also discuss the issue of Sam's appointment in terms of ostensible authority.

#### **Question 7**

**Until two years ago, Alan and Bernie were the only directors of Zennon Ltd. They each owned 50% of the company's shares. Catherine, who had worked for the company for 10 years, was offered a well-paid job with a competitor of Zennon. To persuade Catherine not to accept that offer, Alan and Bernie each transferred to Catherine 10% of the company's shares. They also appointed Catherine a director of the company, and altered the company's articles to state that Catherine would be entitled to remain a director of Zennon for so long as she was a shareholder. Finally, it was also agreed that, if Alan or Bernie wished to sell their shares, they would offer them first to Catherine (although the articles were never altered to reflect this last agreement).**

**Alan and Bernie now wish to retire from the company and sell their shares. Xerxes has made Alan and Bernie a very generous offer for their shares, which Alan and Bernie wish to accept. They are prepared to call a shareholders' meeting to pass whatever resolutions may be necessary to enable them to sell their shares to Xerxes. Xerxes has made it clear that if he takes over Zennon, he will immediately remove Catherine as a director of the company.**

**Catherine seeks your advice as to whether she can:**

- (a) prevent Alan and Bernie selling their shares to Xerxes; and**
- (b) prevent her removal as a director in the event of Xerxes taking over Zennon.**

**Advise Catherine.**

- a) This question is about minority protection issues in a 'quasi partnership' or 'close' company.
- b) Catherine cannot stop Alan and Bernie selling their shares using the constitution of the company, but she could attempt either to have the company wound up under section 122 (1) (g) or use s.994 CA 2006 (formerly s.459) to get a remedy.

- c) However, s.994 presents some problems for Catherine as, while she might be able to show that her interests have been prejudiced, she may not be able to show that unfairness has occurred (O'Neil and Philips) as their agreement was never formalised.
- d) S.122 (1) requires a complex argument that the company was a partnership and the understanding that formed the basis of the company has broken down (Ebrahimi).
- e) Whether Catherine can be removed after the takeover will depend on how the alteration of the article was embedded. If Xerxes can simply remove the article then she can be removed, but if the article protects removal by, for example, providing Catherine with weighted voting rights on any vote to remove it, then she will be protected.

### Question 8

**Steve is a director of Egrit Plc, and owns 10% of the company's shares. The company hopes to secure a large contract from Power Plc. If it does, it will need some new machinery. Steve and his wife, Belinda, own all the shares of Toolit Ltd, a company that sells such machinery. Toolit offers to sell Egrit the machinery it will need for £200,000. Egrit's board considers this offer. Steve speaks strongly in favour of it and the board agrees to purchase the machinery from Toolit.**

**When Charles, a minority shareholder in Egrit, subsequently discovers this, he objects strongly. He claims the price paid to Toolit was too high. In response, the board of Egrit calls a shareholders' meeting, which approves the purchase from Toolit and also agrees to 'ratify any breach of duty by the directors'. Steve votes in favour of both resolutions. Egrit has now learnt that it has failed to get the contract from Power Plc, and no longer needs the machinery bought from Toolit. Egrit has been advised that the resale value of the machinery is only £120,000.**

**Advise Charles whether:**

- (a) the company would have any recourse against Toolit, Steve or Belinda in respect of the contract with Toolit;**
- (b) he (Charles) could bring a derivative action against Steve, or any other director of Egrit, in respect of the foregoing events.**
  - a) This question concerns the director's fiduciary duty of loyalty and the derivative action.
  - b) Students should discuss the duty of loyalty owed by directors by first setting out the general position (Re Smith and Fawcett Ltd).
  - c) Having done that, they should compare the directors' conduct to key cases such as Cook and Deeks, Regal Hastings and IDC and Cooley.
  - d) Students should then discuss the possibility of Charles bringing a derivative action.