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## PAPER F4

**CORPORATE AND  
BUSINESS LAW  
(ENGLISH)**

**FOR EXAMS IN 2010**

# ACCA

## PAPER F4

### CORPORATE AND BUSINESS LAW (ENGLISH)

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**In this January 2010 edition**

- We discuss the **best strategies** for revising and taking your ACCA exams
- We show you how to be **well prepared** for your exam
- We give you **lots of great guidance** on tackling questions
- We show you how you can **build your own exams**
- We provide you with **three** mock exams including the **December 2009 exam**
- We provide the **ACCA examiner's answers** as well as our own to the June and December 2009 exams as an additional revision aid

Our **i-Pass** product also supports this paper.

FOR EXAMS IN 2010

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# Question index

The headings in this checklist/index indicate the main topics of questions, but questions may cover several different topics.

Questions set under the old syllabus 2.2 paper are included because their style and content reflect the F4 exam. Some questions have been amended to reflect the current exam format.

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		Question	Answer

## Part A: Essential elements of the legal system

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4	Contemporary sources of law (12/08)	10	18	3	33
5	Precedent	10	18	3	35
6	Precedent; terms (6/09)	10	18	4	37
7	Legal terms (2.2 6/05)	10	18	4	38
8	Common law and legislation (6/08)	10	18	4	40
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10	Sources of law and the Human Rights Act 1998	10	18	4	44

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14	Offers and invitations to treat I (2.2 6/04)	10	18	6	50
15	Offers and invitations to treat II (6/08)	10	18	6	51
16	Acceptance and revocation of offer (2.2 6/03)	10	18	6	53
17	Ace Ltd (2.2 6/07 amended)	10	18	6	55
18	Car filters (Pilot Paper)	10	18	7	56
19	Presumption and rebuttal (2.2 12/05)	10	18	7	57
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22	Consideration (6/09)	10	18	8	62
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25	Types of term I (Pilot Paper)	10	18	8	67
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30	Arti (6/09)	10	18	9	75
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			Question	Answer
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33 Remoteness and measure of damages (2.2 6/04)	10	18	10	81
34 Roger and Lulu	10	18	10	83
35 Remoteness of damage (12/07)	10	18	10	84
36 Duty of care (Pilot Paper)	10	18	11	85
37 Standard of care (6/08)	10	18	11	86
38 Causality and remoteness	10	18	11	87
39 Defences (12/08)	10	18	11	88
40 Accountants4U	10	18	11	90

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41 Employed v self-employed (6/08)	10	18	12	91
42 Employment contracts (2.2 Pilot Paper)	10	18	12	93
43 Common law duties (2.2 6/02)	10	18	12	94
44 Redundancy (Pilot Paper and 6/09)	10	18	12	96
45 Constructive and unfair dismissal (12/07)	10	18	12	98
46 Constructive and fair dismissal (12/08)	10	18	12	100
47 Grace and Fawn Ltd (2.2 12/02 amended)	10	18	13	102
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50 Unlimited and limited partnerships	10	18	14	106
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52 Clare, Dan and Eve (6/08)	10	18	14	109
53 Partnership liability	10	18	15	111
54 Partnership v company (2.2 12/01 amended)	10	18	15	112
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57 Separate personality (6/08)	10	18	15	116
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Marks	Time allocation Mins	Page number	
		Question	Answer

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68 Capital terms I (2.2 12/03 amended)	10	18	18	132
69 Shares and debentures (6/08)	10	18	18	133
70 Capital terms II (12/08)	10	18	18	135
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77 Resolutions (12/08)	10	18	21	146
78 Meetings (Pilot Paper)	10	18	21	148
79 Company secretary (2.2 Pilot Paper and 6/05)	10	18	21	149
80 Implied authority and company secretary (2.2 6/07)	10	18	21	150
81 Appointment and removal (2.2 12/03)	10	18	21	151
82 Statutory grounds for disqualifying directors (6/09)	10	18	22	152
83 Statutory duties	10	18	22	154
84 Promoting success (12/08)	10	18	22	155
85 Powers and duties of directors (2.2 6/03)	10	18	22	156
86 Helen (2.2 12/03 amended)	10	18	22	158
87 Directors (6/08)	10	18	22	159
88 Auditors I (2.2 6/03)	10	18	23	161
89 Auditors II (12/07)	10	18	23	163
90 Katch Ltd (12/07)	10	18	23	165
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93 Compulsory winding up	10	18	24	170
94 Lazy Days	10	18	24	171
95 Earl (12/07)	10	18	24	172

Marks	Time allocation Mins	Page number	
		Question	Answer

## Part H: Governance and ethical issues relating to business

96	Directors and corporate governance (Pilot Paper)	10	18	25	173
97	Huge plc (Pilot Paper)	10	18	25	175
98	Sid and Vic (6/08)	10	18	25	176
99	Wrongful trading (2.2 12/05)	10	18	25	178
100	Push Ltd (2.2 6/07 amended)	10	18	26	179
101	Money laundering (2.2 12/05)	10	18	26	180
102	Greg (6/09)	10	18	26	181

### Mock exam 1

Questions 103 to 112

### Mock exam 2

Questions 113 to 122

### Mock exam 3 (December 2009)

Questions 123 to 132

### Planning your question practice

Our guidance from page xxii shows you how to organise your question practice, either by attempting questions from each syllabus area or **by building your own exams** – tackling questions as a series of practice exams.

### ACCA examiner's answers

The ACCA examiner's answers to questions marked '**Pilot paper**', '**12/07**', '**6/08**' or '**12/08**' can be found on the BPP website at the following link:

[www.bpp.com/acca/examiner-solutions](http://www.bpp.com/acca/examiner-solutions)

### Additional question guidance

Additional guidance to certain questions can be found on the BPP website at the following link:

[www.bpp.com/acca/extra-question-guidance](http://www.bpp.com/acca/extra-question-guidance)



# Using your BPP Learning Media products

This Kit gives you the question practice and guidance you need in the exam. Our other products can also help you pass:

- **Learning to Learn Accountancy** gives further valuable advice on revision
- **Passcards** provide you with clear topic summaries and exam tips
- **Success CDs** help you revise on the move
- **i-Pass CDs** offer tests of knowledge against the clock

You can purchase these products by visiting [www.bpp.com/mybpp](http://www.bpp.com/mybpp).

You can view demonstrations of i-Learn and i-Pass products by visiting [www.bpp.com/acca/study-materials/#ilearn](http://www.bpp.com/acca/study-materials/#ilearn). Scroll down the page until you find the sections for i-Learn and i-Pass and click on the appropriate 'View demo' button.

# Topic index

Listed below are the key Paper F4 syllabus topics and the numbers of the questions in this Kit covering those topics.

If you need to concentrate your practice and revision on certain topics or if you want to attempt all available questions that refer to a particular subject, you will find this index useful.

Syllabus topic	Question numbers
Acceptance	11, 12, 13, 16, 17, 18
Administration	94
Agent's authority	49
Articles of association	62, 63, 64, Mock exam 2: Q9
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Court system	2, 3, 5
Criminal activity in companies	97-102, Mock exam 1: Q7, Mock exam 3: Q10
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Debentures	69, 76
Defences to negligence	39
Delegated legislation	9, Mock exam 2: Q1
Directors' appointment and removal	81, 82
Directors' duties and powers	83-85, Mock exam 1: Q9, Mock exam 3: Q9
Directors' role	85, 87
Dismissal from employment	43-48, Mock exam 1: Q8, Mock exam 2: Q4
Disqualification of directors	82
Dividends	75
Duty of care	36, 37, 40, Mock exam 1: Q5, Mock exam 2: Q6
Employers' duties	43
Employment contract	42, Mock exam 3: Q7
Exclusion clauses	27, 28, Mock exam 2: Q8

Syllabus topic	Question numbers
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Human rights law	10, Mock exam 1: Q1
Insider dealing	97, 98, 102, Mock exam 1: Q7
Intention to create legal relations	19-21
Interpretation of statute	Mock exam 1: Q1
Invitation to treat	11-15, 18
Issue of shares	67
Legal personality	57, 58
Legislation	4, 7, 8, 9, 10, Mock exam 3: Q1
Limited liability	54, 56, 66, Mock exam 2: Q10, Mock exam 3: Q5
Liquidation	92, 93, 95, Mock exam 2: Q7
Meetings	78, Mock exam 1: Q6
Memorandum of association	Mock exam 2: Q9
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Registering a company	58, 59
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Remoteness of damage (contract)	33
Remoteness of damage (tort)	35, Mock exam 1: Q5
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Secretary	79, 80
Share capital	67-71, 75, Mock exam 2: Q10
Sources of law	4, 8, 10
Statute law	4, 8, 10
Terms of a contract	25, 26, Mock exam 2: Q2
Tort	34-40, Mock exam 1: Q5, Mock exam 2: Q6
Types of company	56, 66 Mock exam 2: Q5
Types of director	85, 87, 96
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Syllabus topic	Question numbers
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Unfair dismissal	45, 46, 48, Mock exam 2: Q4
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Winding up	92, 93, Mock exam 2: Q7, Mock exam 3: Q6
Wrongful dismissal	48
Wrongful trading	99, 100

# Using your BPP Learning Media Practice and Revision Kit

## Tackling revision and the exam

You can significantly improve your chances of passing by tackling revision and the exam in the right ways. Our advice is based on feedback from ACCA examiners.

- We look at the dos and don'ts of revising for, and taking, ACCA exams
- We focus on Paper F4; we discuss revising the syllabus, what to do (and what not to do) in the exam, how to approach different types of question and ways of obtaining easy marks

## Selecting questions

We provide signposts to help you plan your revision.

- A full **question index**
- A **topic index** listing all the questions that cover key topics, so that you can locate the questions that provide practice on these topics, and see the different ways in which they might be examined
- **BPP's question plan** highlighting the most important questions and explaining why you should attempt them
- **Build your own exams**, showing how you can practise questions in a series of exams

## Making the most of question practice

At BPP Learning Media we realise that you need more than just questions and model answers to get the most from your question practice.

- Our **Top tips** included for certain questions provide essential advice on tackling questions, presenting answers and the key points that answers need to include
- We show you how you can pick up **Easy marks** on some questions, as we know that picking up all readily available marks often can make the difference between passing and failing
- We include **marking guides** to show you what the examiner rewards
- We include **examiners' comments** to show you where students struggled or performed well in the actual exam
- We refer to the **2009 BPP Study Text** (for exams in 2010) for detailed coverage of the topics covered in questions
- In a bank at the end of this Kit we include the **examiner's answers** to the June and December 2009 papers. Used in conjunction with our answers they provide an indication of all possible points that could be made, issues that could be covered and approaches to adopt.

## Attempting mock exams

There are three mock exams that provide practice at coping with the pressures of the exam day. We strongly recommend that you attempt them under exam conditions. **Mock exams 1 and 2** reflect the question styles and syllabus coverage of the exam; **Mock exam 3** is the December 2009 paper.

# Revising F4

## General exam support from BPP Learning Media

BPP Learning Media is committed to giving you the best possible support in your quest for exam success. With this in mind, we have produced **guidance** on how to revise and techniques you can apply to **improve your chances of passing** the exam. This guidance can be found on the BPP Learning Media web site at the following link:

[www.bpp.com/acca/examtips/Revising-for-ACCA-exams.doc](http://www.bpp.com/acca/examtips/Revising-for-ACCA-exams.doc)

A paper copy of this guidance is available by emailing [learningmedia@bpp.com](mailto:learningmedia@bpp.com)

## Topics to revise

Although the examiner, David Kelly, sets challenging questions, the styles of question he uses are now familiar because he has been the law examiner for many years. He has also provided very detailed suggested answers, which show all the detail required to score very highly indeed.

As with most examiners, David Kelly has warned against question-spotting and trying to predict the topics that will be included in the exam. He has on occasions examined the same topic in two successive sittings. He regards few areas as off-limits, and all of the major areas of the syllabus can and have been tested.

The exam consists of ten compulsory questions. You must therefore revise the syllabus fully, even omitting one topic area could potentially cause you to fail the exam.

The examiner expects you to show your basic knowledge in the seven knowledge-based questions he will set in each exam, but you will be rewarded for showing that you have thought about the way the law operates. Marks can be given for critical insights into the way the law works in practice as opposed to regurgitating standard chunks of text. The three scenario-based questions will require you to **identify** the legal issues, **state** the law, **apply** and **conclude**. You should practise this ISAC approach when attempting such questions as it will give your answer balance and demonstrates logical thought and application.

There are certain topics that were examined particularly frequently and thoroughly under the old syllabus and we have seen this continue under the new syllabus:

- Operation of the English legal system (courts, precedent, sources of law)
- Contract formation, contents, breach and remedies
- Employment law (duties and dismissal)
- Company formation and constitution
- The duties, powers and role of Directors
- Share capital
- Company administration and liquidation
- Insider dealing and money laundering

Negligence and corporate governance are relatively new syllabus areas which you should consider highly examinable.

## Question practice

You should use the Passcards and any brief notes you have to revise the syllabus, but you mustn't spend all your revision time passively reading. **Question practice is vital**; doing as many questions as you can in full will help develop your ability to analyse scenarios and produce relevant discussion and recommendations. The question plan on page xxii tells you what questions to cover so that you can choose questions covering a variety of syllabus areas.

# Passing the F4 exam

## Displaying the right qualities

The examiner will expect you to display the following qualities.

Qualities required	
<b>Read and answer the question set</b>	If, for instance, the question asks you to set out the ways in which agency can be formed, do not waste time describing the different types of authority that an agent has, or the rights of the agent. You'll score nothing. In fact, as time goes on, ACCA law questions are becoming more and more focused – so watch out!
<b>Knowledge of the law</b>	70% of the marks available in this paper are for showing that you have knowledge of the relevant law. All knowledge-based questions ask for basic knowledge of very specific topics.
<b>Application of the law</b>	30% of the marks are available for the scenario questions. These require application of law to the analysis of scenarios. This sounds more complicated than it is. Usually the scenario relates directly to the law and is generally quite easy to answer. Sketching the relationship between parties in the scenario will help you understand it.
<b>Communication</b>	<p>There are few if any numbers in law exams, and this is a problem for some students. It shouldn't be. Being an accountant is as much about knowledge and the communication of knowledge as it is about numbers and what they represent. If you're nervous about not having the comfort blanket of numbers in the exam, it's particularly important that you practise:</p> <ul style="list-style-type: none"><li>• Reading law questions so that you identify exactly what it is the examiner is seeking</li><li>• Planning law answers so that you get all your points into them, in a logical order (this helps you to be accurate and comprehensive)</li><li>• Writing law answers so that you feel confident in your ability to get your knowledge across effectively. Get someone else to read your answers and then give you feedback on whether the answers are communicating clearly.</li></ul>

## Avoiding weaknesses

David Kelly has emphasised the importance of good exam technique and setting out answers clearly. He has mentioned that the following shortcomings should be avoided:

- Unclear question labelling, it is sometimes difficult for the marker to actually recognise which question is being answered
- Not starting each question on a new page
- Not using both sides of the paper, thus leading to bulkier scripts
- Using additional booklets to no great effect, by simply repeating information
- Producing long general essay answers to problem questions which contain little information relating to the specific issues raised in the question

## Using the reading time

The ACCA allows you 15 minutes reading time for Fundamentals papers F4-F9 and all Professional level papers. How you use this time is up to you, but here are some possible options:

- Speed read through the question paper, jotting down any ideas that come to you about any of the questions
- Decide the order which you're likely to tackle questions (see below)
- Spend the remainder of reading time reading the question(s) you'll do first in detail, analysing scenarios, jotting down plans (any plans written on the question paper should be reproduced in the answer booklet)
- When you start writing, get straight on with the questions you've planned in detail

## Choosing the order to tackle the questions

As all ten questions are compulsory, it is important for you to decide which order to attempt them. Since each question carries equal marks you may prefer to attempt the questions that you are more confident about first. This means you will build up marks early on giving you a solid base to tackle the harder questions later. However do not spend too long on the questions you are confident about as you need to spend an equal amount of time on them all. You cannot pass the exam answering three or four questions well and the rest poorly.

An alternative strategy is to answer all questions in strict order. You could use the time saved choosing the order by starting to plan your answers. You may prefer to use this method if you find yourself spending too long on your favourite questions as it forces you to spend an equal time on each before moving on.

## Tackling questions

You'll improve your chances by following a step-by-step approach to answering questions such as the following.

### Step 1 Read the requirement

Identify the knowledge areas being tested and see precisely what the examiner wants you to do. This will help you focus on what's important, especially if there is a scenario. Identify and make sure you understand the action verbs in the requirement. These are mostly 'explain', (which means: make clear and intelligible or state the meaning of). In scenario questions you may be asked to 'analyse' (which means examine in detail the structure of) or 'advise' (which means: to 'inform' or 'notify').

### Step 2 Check the mark allocation

This shows the depth of answer anticipated and you should use it to allocate time across parts of the question and decide where to slot in knowledge to avoid repeating yourself.

### Step 3 Read scenarios carefully

Identify which information is relevant to each part. Read the scenario and jot down key points on the page: who's who, the key issues at stake, the alternatives open to the parties for resolving any dispute (eg damages, rectification etc), and conclusion.

### Step 4 Plan your answer

Consider the number and priority of points you will make. Use the ISAC approach when answering scenario questions.

- **Identify** the legal issues
- **State** the relevant law
- **Apply** the law
- **Conclude** with justification

### Step 5 Write your answer

Stick carefully to the time allocation for each question, and for each part of each question.



## Gaining the easy marks

Most marks in this paper are available for setting out the legal rules that apply to each topic. These are 'easy marks' – if you know the rules! In the scenario questions, there are often easy marks available for identifying who is who, stating the key issues and reaching a reasoned conclusion.

To get these 'easy' marks:

- Make sure that you plan gaining these marks as a priority. Try to identify them as you read the questions and write them down
- State the law clearly, in as simple language as you can (you're not a lawyer standing up in a courtroom: you need to impress the examiner with your knowledge of the law, not with fancy 'legalese'). Learn as many basic definitions as you can.

# Exam information

## The exam paper

### Format of the exam

10 compulsory questions of 10 marks each  
Three questions will involve a short scenario

*Number of  
marks*  
100  

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100

Time allowed: 3 hours

The examination will comprise of questions drawn across all syllabus areas. The scenario questions will normally require you to analyse a situation from a legal point of view and give advice.

### December 2009

- 1 Interpreting statutes
- 2 Postal rule and privity of contract
- 3 Damages
- 4 Auditors' duty of care
- 5 Companies and limited liability
- 6 Winding up and administration
- 7 Duties of employers and employees
- 8 Exclusion clauses
- 9 Directors' liability
- 10 Fraudulent and wrongful trading

This exam is included in this kit as Mock Exam 3.

*Question in this kit*

### June 2009

- |    |  |     |
|----|--|-----|
| 1  | Judicial precedent – terms                 | 6   |
| 2  | Consideration                              | 22  |
| 3  | Representations, express and implied terms | 26  |
| 4  | Company names and 'passing off'            | 65  |
| 5  | Capital maintenance and reducing capital   | 71  |
| 6  | Director disqualification under CDDA 1986  | 82  |
| 7  | Redundancy                                 | 44  |
| 8  | Anticipatory breach of contract            | 30  |
| 9  | Directors' duties                          | 91  |
| 10 | Insider dealing and money laundering       | 102 |

#### Examiner's comments

As usual, this paper was made up of ten compulsory questions, each of ten marks, although many of them were subdivided into distinct parts. This format seems to have settled down and to meet with candidates' approval from the way they tackle it. However, it is a matter of some concern that a significant number of candidates are not completing, or even attempting, all ten questions. This does not appear to be an issue of time-management but lack of knowledge, which might reflect a failed effort of candidates to question spot. This point has been made in the past, but it clearly has to be repeated for every session: if you do not do all the questions you greatly reduce your chances of passing the exam. The syllabus is wide, but you have to cover it all; question/area spotting is a dangerous game to play. All questions were done very well by a number of candidates across the board; although the reverse of that is equally true in that all questions were done inadequately by a number of candidates across the board.

## December 2008

1	Sources of law	4
2	Anticipatory breach of contract	29
3	Contributory negligence and <i>volenti non fit injuria</i>	39
4	Share capital	70
5	Ordinary, special and written resolutions	77
6	Duty to promote the success of the company	84
7	Fair and constructive dismissal	46
8	Contract formation	11
9	Amending articles of association	64
10	Partnership liability	51

### Examiner's comments

This paper gave rise to the worst level of performance from candidates for a number of years. A couple of the questions required a subtlety of approach that was beyond the ability of students at this level (question 9 being the cited example), however there were many marks available for basic knowledge and indeed question 9 could have been passed well, without the need for the subtly provided in the model answer. This was due to the lack of legal knowledge exhibited by candidates. Even in question such as number eight, in which most candidates achieved a reasonable mark, it was noticeable the extent to which candidates simply did not support their analysis with the legal authority of, in this instance, cases. However markers commented that this lack of legal authority was a shortcoming throughout the paper.

Question in this kit

## June 2008

1	Common law and legislation	8
2	Offer and invitation to treat	15
3	Standard of care	37
4	Separate legal personality	57
5	Ordinary and preferences shares, debentures	69
6	Types of director	87
7	Employment and self-employment	41
8	Contract law remedies for breach	31
9	Partnership liability	52
10	Insider dealing	98

### Examiner's comments

The main reason for any inadequate performance in the paper was a complete lack of knowledge on the part of the candidates. The questions provided ample opportunity for candidates to demonstrate both knowledge and understanding. Some candidates clearly find 10 compulsory questions challenging and try to question spot, which, as a general rule, has disastrous consequences. However, the format of the paper suits the stronger candidate.

## December 2007

1	Criminal and civil law	2
2	Privity of contract and intention to create legal relations	21
3	Tort and remoteness of damage	35
4	Memorandum of association	
5	Dividend rules	75
6	Constructive and unfair dismissal	45
7	Company auditors	89
8	Offer and acceptance	13
9	Liquidation and capital	95
10	Authority of agents and managing directors	90

Please note that question 4 is not included in this kit because the subject matter is now out of date.

### Examiner's comments

This is the first report on an examination conducted under the new syllabus and format. The change in format seems to have been less problematic than the change in syllabus with most candidates answering all of the questions, although it has to be said with various degrees of success. Some candidates are treating the three problem/application questions at the end of the paper in the same way as they dealt with the previous 20 mark problem questions, with the effect that the candidates are spending too much time dealing with these questions to the detriment of their general performance. This appears to be a particular concern with candidates who start their papers with the problem questions. Candidates should be made aware that these questions are worth no more than the other questions and they should be encouraged to manage their time better in making sure they have sufficient time to deal with all the questions equally well. It is always surprising the extent to which students will pursue marginal marks at the end of an answer rather than turn their attention to the easier marks to be had by answering a new question.

As for the syllabus change, the introduction of tort law appears to have completely passed by the majority of candidates, who insisted in answering the tort question as if it were a contract question.

## Pilot paper

1	Delegated legislation	9
2	Terms, conditions, warranties and innominate terms	25
3	Duty of care	36
4	Registering a public limited company	59
5	Annual, general and class meetings	78
6	Corporate governance and executive/non-executive directors	96
7	Redundancy rules	44
8	Offer and acceptance	18
9	Shareholders' liability	73
10	Insider dealing	97

## Analysis of past papers

The table below provides details of when each element of the syllabus has been examined and the question number and section in which each element appeared.

Covered in Text chapter		Dec 2009	June 2009	Dec 2008	June 2008	Dec 2007	Pilot Paper
	<b>ESSENTIAL ELEMENTS OF THE LEGAL SYSTEM</b>						
1	The English legal system					1	
2	Sources of English law	1	1	1	1		1
3	Human rights						
	<b>THE LAW OF OBLIGATIONS</b>						
4, 5	Formation of contracts	2	2	8	2	2, 8	8
6	Terms of contract	8	3				2
7	Breach of contract	3	8	2	8		
8	Torts			3	3	3	3
9	Professional negligence	4					
	<b>EMPLOYMENT LAW</b>						
10	Employment contract	7			7		
11	Dismissal and redundancy		7	7		6	7
	<b>THE FORMATION AND CONSTITUTION OF BUSINESS ORGANISATIONS</b>						
12	Agency law						
13	Organisations and legal personality	5		10	4,9		
14	Company formation						4
15	Constitution of a company		4	9		4	
	<b>CAPITAL AND THE FINANCING OF COMPANIES</b>						
16	Share capital			4	5		9
17	Borrowing and loan capital				5		
18	Capital maintenance and dividend law		5			5	
	<b>MANAGEMENT, ADMINISTRATION AND REGULATION OF COMPANIES</b>						
19	Company directors and other company officers	9	6,9	6	6	7, 10	
20	Company meetings and resolutions			5			5
	<b>LEGAL IMPLICATIONS OF COMPANIES IN DIFFICULTY OR IN CRISIS</b>						
21	Insolvency and administration	6				9	
	<b>GOVERNANCE AND ETHICAL ISSUES RELATING TO BUSINESS</b>						
22	Corporate governance						6
23	Fraudulent behaviour	10	10		10		10

## Useful websites

The websites below provide additional sources of information of relevance to your studies of *Corporate and Business Law*.

- [www.accaglobal.com](http://www.accaglobal.com)  
ACCA's website. The students' section of the website is invaluable for detailed information about the qualification, past issues of Student Accountant (including technical articles) and even interviews with the examiners.
- [www.bpp.com](http://www.bpp.com)  
Our website provides information about BPP products and services, with a link to the ACCA website.
- [www.ft.com](http://www.ft.com)  
This website provides information about current international business. You can search for information and articles on specific industry groups as well as individual companies.
- [www.lawreports.co.uk](http://www.lawreports.co.uk)  
The Incorporated Council of Law Reporting
- [www.lawrights.co.uk](http://www.lawrights.co.uk)  
Source of free legal information
- [www.lawsociety.org.uk](http://www.lawsociety.org.uk)  
Law Society
- [www.bbc.co.uk](http://www.bbc.co.uk)  
The website of the BBC carries general business information as well as programme-related content.

## The Supreme Court for the United Kingdom

The **Constitutional Reform Act 2005** has severed the link between the **legislative** and **judicial** functions of the House of Lords. A **Supreme Court** for the United Kingdom has been established and it opened for business at the start of the legal year in October 2009. It consists of **12 judges** known as '*Justices of the Supreme Court*' and its members include a **President** and a **Deputy President**.

Its **role** is to take over the House of Lords' appellate function – in other words to hear civil and criminal case appeals. However, the House of Lords continues with its existing **legislative role**.

To avoid confusion in answers to questions in this kit, the House of Lords is referred to where that institution decided a particular case. Future decisions made by the Supreme Court will be noted as such.

# Planning your question practice

We have already stressed that question practice should be right at the centre of your revision. Whilst you will spend some time looking at your notes and Paper F4 Passcards, you should spend the majority of your revision time practising questions.

We recommend two ways in which you can practise questions.

- Use **BPP Learning Media's question plan** to work systematically through the syllabus and attempt key and other questions on a section-by-section basis
- **Build your own exams** – attempt questions as a series of practice exams

These ways are suggestions and simply following them is no guarantee of success. You or your college may prefer an alternative but equally valid approach.

## BPP Learning Media's question plan

The BPP Learning Media plan below requires you to devote a **minimum of 25 hours** to revision of Paper F4. Any time you can spend over and above this should only increase your chances of success.

- Step 1**     **Review your notes** and the chapter summaries in the Paper F4 **Passcards** for each section of the syllabus.
- Step 2**     **Answer the key questions** for that section. These questions have boxes round the question number in the table below and you should answer them in full. Even if you are short of time you must attempt these questions if you want to pass the exam. You should complete your answers without referring to our solutions.
- Step 3**     **Attempt the other questions** in that section. For some questions we have suggested that you prepare **answer plans or do the calculations** rather than full solutions. Planning an answer means that you should spend about 40% of the time allowance for the questions brainstorming the question and drawing up a list of points to be included in the answer.
- Step 4**     Attempt **Mock exams 1, 2 and 3** under strict exam conditions.

Syllabus section	2009 Passcards chapters	Questions in this Kit	Comments	Done <input checked="" type="checkbox"/>
<b>Revision period 1</b> <i>English legal system</i>				
Types of law and the court system	1	1	These concepts could easily be examined, spend some time planning out an answer to them.	<input type="checkbox"/>
		2	A good question, thoroughly testing knowledge of the English courts.	<input type="checkbox"/>
Sources of law	2	4, 5, 6	These questions cover the key areas of sources of law and precedent. Questions could easily be set requiring their explanation and their advantages and disadvantages.	<input type="checkbox"/>
Delegated legislation	2	9	Students often find this topic difficult. Make a good attempt at this Pilot Paper question.	<input type="checkbox"/>
Human Rights Act	3	10	Questions on the Human Rights Act may not come up often, but when they do they could be similar to this.	<input type="checkbox"/>
<b>Revision period 2</b> <i>Formation of contract</i>				
Contract formation	4, 5	13, 15, 16, 19, 21	These questions comprehensively cover the issue of contract formation. They look at offer, acceptance and intention to create legal relations. Try at least four of them in full and plan a fifth.	<input type="checkbox"/>
Consideration	5	22, 24	Consideration is likely to feature quite frequently in the exam as it is central to contract law. Attempt these questions as they are good practice for this tricky area.	<input type="checkbox"/>
<b>Revision period 3</b> <i>Terms of contract and breach</i>				
Terms of a contract	6	25	This Pilot Paper question covers the key issues in relation to the content of contracts. A similar question could easily come up and the examiner would expect you to earn high marks on it.	<input type="checkbox"/>
Exclusion clauses	6	27, 28	Question 27 is a useful example of a question on exclusion clauses as it covers most of the main areas. Question 28 illustrates the type of scenario question that could be set on this area of law.	<input type="checkbox"/>
Breach	7	29	This question makes you think about breach, which is likely to be examined quite frequently. Do this question in full.	<input type="checkbox"/>
Damages	7	30, 32, 33	Exams may include questions on damages alone and remedies generally. Remoteness of damage and the measure of damages are other popular areas. Practising these questions will prepare you well.	<input type="checkbox"/>



Syllabus section	2009 Passcards chapters	Questions in this Kit	Comments	Done <input checked="" type="checkbox"/>
<b>Revision period 4</b> <i>Tort and negligence</i>				
Negligence	8	35, 36, 37, 39	These questions are a good test of remoteness of damage, duty of care and causality which are key areas of negligence.	<input type="checkbox"/>
Professional negligence	8,9	40	Professional negligence is a key new topic in this syllabus and so you need to be aware of the main issues.	<input type="checkbox"/>
<b>Revision period 5</b> <i>Employment law</i>				
Employees or independent contractors	10	41	This June 2008 question covers this important practical issue and explores the importance of the distinction.	<input type="checkbox"/>
Employment contracts	10	42, 43	These questions quickly deal with employment contracts and duties of employers.	
Redundancy	11	44 47	The examiner included a specific question on redundancy in the Pilot Paper and examined it again in June 2009, so it is clearly important. It could appear as either a scenario or knowledge-based question.	<input type="checkbox"/>
Dismissal	11	45, 46, 48	Unfair, wrongful and constructive dismissal are all key terms so make sure that you know the difference between them. Try these questions in full.	<input type="checkbox"/>
<b>Revision period 6</b> <i>Agency and business associations</i>				
Agents	12	49	Questions on agency are likely to cover authority as this is the main area where disputes occur. This question covers all types of authority.	<input type="checkbox"/>
Partnership	13	50, 51, 52, 53 55	Questions on partnership can take various forms. They may test your understanding of authority and liability of partners or how they may be terminated. These questions cover them all.	<input type="checkbox"/>
Incorporation	13	54, 57	The advantages and disadvantages of incorporation are also very popular with the examiner. Question 54 is a very good example from the previous syllabus. The veil of incorporation is also important and is covered in Question 57 from June 2008.	<input type="checkbox"/>

Syllabus section	2009 Passcards chapters	Questions in this Kit	Comments	Done <input checked="" type="checkbox"/>
<b>Revision period 7</b>				
<i>Company formation</i>				
Company formation	14	<input type="text" value="61"/>	An excellent question on promoters and preincorporation contracts.	<input type="checkbox"/>
		<input type="text" value="59"/>	This Pilot Paper question focuses particularly on plcs, but as you know, ltd companies are very similar except for the trading certificate requirement. This subject matter is very popular with the examiner, and was examined a number of times under the old syllabus.	<input type="checkbox"/>
Types of company	13,14	56	The examiner may set questions that test your knowledge of quite basic terms, such as this one on types of company. Plan an answer by jotting down the key points that you would make.	<input type="checkbox"/>
Company constitution	15	<input type="text" value="62, 63"/>	These questions are typical of the questions the examiner has set before and are therefore good practice. They require you to have a good knowledge of the documents of a company's constitution. You might find scenario questions in company law draw on knowledge of what is contained in an objects clause and the articles in general, so it is important to work on your knowledge of them.	<input type="checkbox"/>
Company names	15	<input type="text" value="65"/>	This is a good question and it requires a quite detailed knowledge of the law. If this is an area you struggle with, work through this question in full.	<input type="checkbox"/>
Company registers and records	14	<input type="text" value="60"/>	You may be set a similar question on this syllabus area as there are not many ways the examiner could test it. Have a good attempt at it and revisit any registers or records you omit.	
<b>Revision period 8</b>				
<i>Company finance</i>				
Shares	16	<input type="text" value="67, 69, 70, 71, 72"/>	Make sure that you get the basics right in these questions as if they come up in the exam you should expect to score highly. Question 72 covers all you need to know about class rights and will prepare you well for a topic students always struggle with.	<input type="checkbox"/>
Dividends	18	<input type="text" value="75"/>	Dividends can be examined in isolation or as part of a larger question. They are important, but can be complex, so have a good attempt at this question.	<input type="checkbox"/>
Debentures and charges	17	<input type="text" value="76"/>	You should be able to answer a knowledge-based question on loan capital well. You may find an exam question asking you to compare and contrast shares and debentures as sources of capital.	<input type="checkbox"/>

Syllabus section	2009 Passcards chapters	Questions in this Kit	Comments	Done <input checked="" type="checkbox"/>
<b>Revision period 9</b> <i>Company administration</i>				
Resolutions	20	<input type="checkbox"/> 77	It is vital to know all about resolutions. They may be relevant in a scenario question where shareholders are taking various actions or in an explain question such as this. You should aim to get full marks as you just need to repeat text book knowledge.	<input type="checkbox"/>
Meetings	20	<input type="checkbox"/> 78	This is a good example of the type of knowledge-based question you may see on meetings.	<input type="checkbox"/>
<b>Revision period 10</b> <i>Company management</i>				
Company secretary	19	<input type="checkbox"/> 79	You must be prepared to answer questions like this comprehensively. An identical question was set in the Pilot Paper and June 2005 exam, under the old syllabus.	<input type="checkbox"/>
Auditors	19	88, 89	The rules on auditors are quite straightforward. Put your knowledge to the test by producing answer plans.	
Directors	19	<input type="checkbox"/> 81, 82, 83, 85, 87, 90, 91	These questions comprehensively cover all aspects of directors and are extremely good practice for the type of company law question you should expect in the exam.	<input type="checkbox"/>
<b>Revision period 11</b> <i>Winding up</i>				
Compulsory winding up	21	<input type="checkbox"/> 93	Winding up is an area which might seem daunting, but easy marks can be gained. Work through this in full.	<input type="checkbox"/>
Voluntary winding up	21	<input type="checkbox"/> 92, 95	Question 95 gives good practice of the skills needed to answer scenario questions in this area. It is quite a difficult question, so take your time.	<input type="checkbox"/>
Administration	21	<input type="checkbox"/> 94	Administration may seem like a strange concept, but just remember that it is an attempt to save the company – not another form of liquidation. This section is probably about as hard as questions will get in this area so it is good preparation for the exam.	<input type="checkbox"/>
<b>Revision period 12</b> <i>Governance and ethical issues</i>				
Corporate governance	22	<input type="checkbox"/> 96	Governance can be examined in many ways. This question focuses on the basics and links into the duties of directors.	<input type="checkbox"/>
Criminal offences	23	<input type="checkbox"/> 98, 100, 101, 102	These questions cover the key criminal offences that you must understand. Produce quality answers for them all.	<input type="checkbox"/>

# Build your own exams

Having revised your notes and the BPP Passcards, you can attempt the questions in the Kit as a series of practice exams. You can organise the questions in the following ways.

- Either you can attempt complete past exam papers; recent papers are listed below:

	<i>Pilot paper Question in kit</i>	<i>December 07 Question in Kit</i>	<i>June 08 Question in kit</i>	<i>December 2008 Question in kit</i>	<i>June 2009 Question in kit</i>
1	9	2	8	4	6
2	25	21	15	29	22
3	36	35	37	39	26
4	59	63*	57	70	65
5	78	75	69	77	71
6	96	45	87	84	82
7	44	89	41	46	44
8	18	13	31	11	30
9	73	95	52	64	91
10	97	90	98	51	102

\* Note. Question 4 from the December 2007 exam is not included in this kit as it is out of date under the Companies Act 2006. Question 63 should be attempted instead as a suitable replacement.

- Or you can make up practice exams, either yourself or using the suggestions we have listed below.

	<i>Practice Exam</i>					
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>
1	2	3	4	6	8	9
2	15	19	22	26	27	29
3	35	36	37	38	39	21
4	50	57	53	65	59	49
5	70	72	75	76	69	67
6	77	83	84	89	80	93
7	41	44	46	42	43	45
8	64	51	58	52	90	91
9	31	30	28	24	20	13
10	97	98	100	86	94	102



# Questions

### **ACCA examiner's answers**

Remember that you can access the ACCA examiner's solutions to questions marked '**Pilot paper**', '**12/07**', '**6/08**' and '**12/08**' on the BPP website using the following link:

[www.bpp.com/acca/examiner-solutions](http://www.bpp.com/acca/examiner-solutions)

### **Additional question guidance**

Remember that you can find additional guidance to certain questions on the BPP website using the following link:

[www.bpp.com/acca/extra-question-guidance](http://www.bpp.com/acca/extra-question-guidance)

## ESSENTIAL ELEMENTS OF THE LEGAL SYSTEM

Questions 1 to 10 cover the essential elements of the legal system, the subject of Part A of the BPP Study Text for Paper F4.

### 1 Types of law

**18 mins**

- (a) Define law

**(1 mark)**

Briefly explain the following types of law.

- (b) Common law and equity

**(3 marks)**

- (c) Civil law

**(3 marks)**

- (d) Criminal law

**(3 marks)**

**(Total = 10 marks)**

### 2 Legal system and courts (12/07)

**18 mins**

- (a) In relation to the English legal system distinguish between the following:

- (i) Criminal law

**(5 marks)**

- (ii) Civil law

- (b) Explain the jurisdiction of the courts dealing with criminal and civil law.

**(5 marks)**

**(Total = 10 marks)**

### 3 Civil courts and tracks (2.2 12/02)

**18 mins**

- (a) Briefly describe the main civil courts in the English legal system.

**(6 marks)**

- (b) Explain the three track system for allocating cases between courts.

**(4 marks)**

**(Total = 10 marks)**

### 4 Contemporary sources of law (12/08)

**18 mins**

In relation to the English legal system, explain the main sources of contemporary law.

**(10 marks)**

### 5 Precedent

**18 mins**

- (a) Explain the doctrine of precedent within the English legal system

**(2 marks)**

- (b) Explain the hierarchy of the courts within the English legal system in relation to the operation of precedent.

**(3 marks)**

- (c) Discuss the relative advantages and disadvantages of the doctrine of precedent.

**(5 marks)**

**(Total = 10 marks)**



## 6 Precedent; terms (6/09)

18 mins

Explain and distinguish between the following terms in relation to the doctrine of precedent in the English legal system:

- (a) *Ratio decidendi* and *obiter dictum* (4 marks)
- (b) Binding precedent and persuasive precedent. (6 marks)

(Total = 10 marks)

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## 7 Legal terms (2.2 6/05)

18 mins

Explain the distinction between the following terms in relation to the doctrine of precedent in the English legal system:

- (a) *Ratio decidendi* and *obiter dictum* (5 marks)
- (b) Reversing, overruling and distinguishing (5 marks)

(Total = 10 marks)

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## 8 Common law and legislation (6/08)

18 mins

In relation to the English legal system explain the following sources of law:

- (a) Common law (6 marks)
- (b) Legislation (4 marks)

(Total = 10 marks)

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## 9 Delegated legislation (Pilot Paper)

18 mins

Explain the meaning and effect of delegated legislation, and evaluate its advantages and disadvantages, and how it is controlled by both Parliament and the courts. (10 marks)

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## 10 Sources of law and the Human Rights Act 1998

18 mins

In relation to sources of English law, explain:

- (a) Case law (common law) (4 marks)
- (b) Statute (legislation) (3 marks)
- (c) In what ways has the Human Rights Act 1998 had an impact on UK law? (3 marks)

(Total = 10 marks)

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## THE LAW OF OBLIGATIONS

Questions 11 to 40 cover the law of obligations, the subject of Part B of the BPP Study Text for Paper F4.

### 11 Alvin (12/08)

18 mins

Alvin runs a business selling expensive cars. Last Monday he mistakenly placed a notice on one car indicating that it was for sale for £5,000 when in fact its real price was £25,000. Bert later noticed the sign and, recognising what a bargain it was, immediately indicated to Alvin that he accepted the offer and would take the car for the indicated amount. Alvin, however, told Bert that there had been a mistake and that the true price of the car was £25,000. Bert insisted that he was entitled to get the car at the lower price, and when Alvin would not give it to him at that price Bert said that he would sue Alvin.

After Bert had left, Alvin changed the price on the car to £25,000 and subsequently Cat came in and said she would like to buy the car, but that she would have to arrange finance.

On Tuesday Del came by and offered Alvin the full £25,000 cash there and then and Alvin sold it to him.

*Required*

Advise Alvin, Bert, Cat and Del as to their rights and liabilities in the law of contract.

(10 marks)

### 12 Ann's art (2.2 12/01 amended)

18 mins

On Friday 10 December the following notice is placed in the window of Ann's art gallery: '2 copies of a very rare Blake print – £15,000 each'. Chas and Dave are very keen to acquire the prints but think that the price is too high. They each offer Ann £12,000 for a copy but she refuses to sell the prints at that price, although she says she will accept £13,500. She also says she will keep her offer to them open until 12 o'clock on the following Monday, 13 December, if they each pay her £100. Chas and Dave agree and each hands over £100. On the Saturday before the deadline Chas and Dave have to leave the country on business but before they do so each posts a letter stating that he agrees to buy one of the prints at the agreed price of £13,500. Chas's letter arrives at 9.30 on the Monday morning but Dave's letter is delayed and arrives on the morning of Tuesday 14 December. In any event Ann had already sold both prints to Eve on Saturday 11 December for a total price of £30,000.

*Required*

Advise Ann on whether or not she has an enforceable contract with Chas and Dave. Your answer should focus on whether an offer was made and if it was accepted.

(10 marks)

### 13 Ali (12/07)

18 mins

Ali is an antique dealer and one Saturday in November 20X7 he put a vase in the window of his shop with a sign which stated 'exceptional piece of 19th century pottery – on offer for £500'.

Ben happened to notice the vase as he walked past the shop and thought he would like to have it. Unfortunately, as he was late for an important meeting, he could not go into the shop to buy it, but as soon as his meeting was finished he wrote to Ali agreeing to buy the vase for the stated price of £500. The letter was posted at 11:30 am.

Later on the same day, Chet visited Ali's shop and said he would like the vase but was only willing to pay £400 for it. Ali replied that he would accept £450 for the vase, but Chet insisted that he was only willing to pay £400 and left the shop. However, on his journey home Chet realised that £450 was actually a very good price for the vase and he immediately wrote to Ali agreeing to buy it for that price. His letter was posted at 12:30 pm.

Just before closing time at 5 pm. Di came into Ali's shop and she also offered £400 for the vase. This time Ali agreed to sell the vase at that price and Di promised to return the following Monday with the money.

On the Monday morning Ali received both of the letters from Ben and Chet before Di could arrive to pay and collect the vase.

*Required*

From the point of view of the law of contract advise Ali as to his legal relations with Ben, Chet and Di. (10 marks)

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## **14 Offers and invitations to treat I (2.2 6/04)**

**18 mins**

In relation to contract law distinguish between offer and invitation to treat and explain why it is important to make such a distinction. (10 marks)

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## **15 Offers and invitations to treat II (6/08)**

**18 mins**

In relation to contract law explain the meaning and effect of:

- (a) An offer (4 marks)
- (b) An invitation to treat (6 marks)

(Total = 10 marks)

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## **16 Acceptance and revocation of offer (2.2 6/03)**

**18 mins**

Explain in relation to the law of contract:

- (a) The rules relating to acceptance of an offer (5 marks)
- (b) The rules relating to revocation of an offer (5 marks)

(Total = 10 marks)

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## **17 Ace Ltd (2.2 6/07 amended)**

**18 mins**

Ace Ltd had been having difficulties in developing software for its new internet service Brag.com. As the time for delivering the service, 1 May 20X7, approached, Ace Ltd placed the following notice in the January edition of its company journal:

‘£10,000 reward to any employee who can design a solution to the Brag problem before 1 April.’

The journal was distributed to all employees of Ace Ltd.

Cid, a self employed computer expert, who was married to an employee of Ace Ltd, read the journal and thought that he could solve the problem so started work on it.

Ed, a computer software expert employed by Ace Ltd, but not involved with the Brag.com project, saw the advert and decided to work on it in his own time after reading the journal.

However, before anyone could solve the problem, Ace Ltd decided to cancel the Brag.com project and placed a note in the March edition of its journal cancelling the reward for overcoming the Brag.com problems.

*Required*

Analyse the scenario from the perspective of contract law and advise Cid and Ed, each of whom managed to solve the Brag.com problem after the cancellation of the reward but before the original deadline. (10 marks)

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## 18 Car filters (Pilot Paper)

18 mins

Al operates a small business manufacturing specialist engine filters. In January he placed an advertisement in a car trade magazine stating that he would supply filters at £60 per filter, but would consider a reduction in the price for substantial orders. He received a letter from Bash Cars plc requesting his terms of supply for 1,000 filters. Al replied, offering to supply the filters at a cost of £50 each. Bash Cars plc responded to Al's letter stating that they accepted his offer but that they would only pay £45 per filter. Al wrote back to Bash Cars plc stating that he would supply the filters but only at the original price of £50. When Al's letter arrived, the purchasing director of Bash Cars plc did not notice the alteration of the price and ordered the 1,000 filters from Al, which he supplied.

*Required*

Analyse the situation from the perspective of contract law and in particular advise Al what price he is entitled to claim from Bash Cars plc. (10 marks)

## 19 Presumption and rebuttal (2.2 12/05)

18 mins

In relation to the intention to create contractual relations explain:

- (a) The meaning of the terms 'presumption' and 'rebuttal'. (2 marks)
- (b) How presumption and rebuttal operate in the context of:
  - (i) domestic and social agreements (4 marks)
  - (ii) business agreements (4 marks)

(Total = 10 marks)

## 20 Alan's intention (2.2 12/04 amended)

18 mins

Alan is a qualified accountant. Last year he agreed with his father Ben, who owns a small manufacturing business, that he would prepare his tax return for him for a fee of £500. Alan did the accountancy work and Ben submitted the accounts to the tax authorities. Ben now refuses to pay Alan, saying that it is not right for a son to charge his father for doing him a favour.

Two years ago Alan separated from his wife Cath. As part of the written agreement between them, Alan agreed to pay Cath £1,000 per month in order to maintain her and their daughter Dawn. The money also had to be used to pay off the mortgage on the house that Alan and Cath jointly owned. Alan promised that when the mortgage was paid off he would transfer his share of the property to Cath. Now, however, although the mortgage has been paid off, Alan refuses to transfer his title in the house to Cath.

*Required*

Briefly analyse the above situation from the point of view of contract law and advise Alan whether:

- (a) Alan can require Ben to pay him for his accountancy work
- (b) Cath can require Alan to transfer his part of the house to her (10 marks)

## 21 Privity and intention (12/07)

18 mins

In relation to the law of contract explain the meaning and effect of:

- (a) The doctrine of privity (6 marks)
- (b) The intention to create legal relations (4 marks)

(Total = 10 marks)

## 22 Consideration (6/09)

18 mins

In relation to the law of contract:

- (a) Define and explain consideration (3 marks)
- (b) Explain the following statements regarding consideration:
  - (i) consideration must be sufficient but does not have to be adequate (3 marks)
  - (ii) past consideration is not good consideration (4 marks)

(Total = 10 marks)

## 23 Forms of consideration (2.2 12/02)

18 mins

- (a) Define consideration as it is understood in English contract law. (3 marks)
- (b) Explain and distinguish between the following terms:
  - (i) executory consideration (2 marks)
  - (ii) executed consideration (2 marks)
  - (iii) past consideration (3 marks)

(Total = 10 marks)

## 24 Paying Adam (2.2 6/03 amended)

18 mins

Adam, who operates an accountancy practice, charges £1,000 per year for producing business accounts for tax purposes. Unfortunately he has had some difficulty in recovering his fees from two clients as follows.

- 1 Bob, a car mechanic, told Adam that he could only raise cash to pay half of his fees but that he would service Adam's car for the coming year. Adam reluctantly agreed to this proposal.
- 2 Dawn, a not very successful musician, also told Adam that she could only pay half the money she owed him as she needed to use the other half to finance her new record. Once again Adam agreed to accept the half payment. Dawn's record subsequently became a major hit and she made £100,000 profit from it.

Adam himself is now in financial difficulty and needs cash to pay his own tax bill.

*Required*

Advise Adam whether he can recover any of the outstanding money from the above clients. (10 marks)

## 25 Types of term I (Pilot Paper)

18 mins

In relation to the contents of a contract explain the following:

- (a) Terms (2 marks)
- (b) Conditions (3 marks)
- (c) Warranties (3 marks)
- (d) Innominate terms (2 marks)

(Total = 10 marks)

## 26 Types of term II (6/09)

18 mins

In relation to the law of contract, distinguish between and explain the effect of:

- (a) A term and a mere representation; (3 marks)
- (b) Express and implied terms, paying particular regard to the circumstances under which terms may be implied in contracts. (7 marks)

(Total = 10 marks)

## 27 Exclusion clauses (2.2 6/02)

18 mins

- (a) Explain the meaning of exclusion clauses, also known as exemption clauses, in contract law. (2 marks)
- (b) How are such clauses controlled:
  - (i) at common law (4 marks)
  - (ii) by statute? (4 marks)

(Total = 10 marks)

## 28 Seller Ltd and Transport Ltd

18 mins

Seller Ltd had used the services of Transport Ltd for a number of years. On this occasion, the managing director of Seller Ltd telephoned the offices of Transport Ltd and arranged for the transportation of some expensive machinery to a customer. Transport Ltd confirmed the order by sending a notice to this effect. Unfortunately, due to driver error, the vehicle carrying Seller Ltd's equipment crashed and the equipment was badly damaged. Transport Ltd has advised Seller Ltd that it intends to rely on the following clause:

'Transport Ltd will not accept any liability for loss or damage caused to customers' property during transportation, no matter how the loss or damage was caused. Customers are advised to take out their own insurance.'

Transport Ltd has pointed out that the clause appears in a notice prominently displayed outside the entrance to the company's offices, and is reproduced on the back of all invoices, receipts and confirmation of order notices issued by the company.

*Required*

Advise Seller Ltd whether Transport Ltd will be able to use the clause to avoid liability for the damaged goods.

Your answer should focus on the following areas.

- (a) Can the exclusion clause be incorporated into the contract between Seller Ltd and Transport Ltd? (6 marks)
- (b) How does statute law restrict such clauses? (2 marks)
- (c) Has Transport Ltd breached its contract with Seller Ltd? (2 marks)

(Total = 10 marks)

## 29 Breach of contract (12/08)

18 mins

In relation to the law of contract, explain what is meant by breach of contract, paying attention to anticipatory breach. (10 marks)

## 30 Arti (6/09)

18 mins

In January 20X8 Arti entered in a contractual agreement with Bee Ltd to write a study manual for an international accountancy body's award. The manual was to cover the period from September 20X8 till June 20X9, and it was a term of the contract that the text be supplied by 31 June 20X8 so that it could be printed in time for September. By 30 May, Arti had not yet started on the text and indeed he had written to Bee Ltd stating that he was too busy to write the text.

Bee Ltd was extremely perturbed by the news, especially as it had acquired the contract to supply all of the accountancy body's study manuals and had already incurred extensive preliminary expenses in relation to the publication of the new manual.

*Required*

In the context of the law of contract, advise Bee Ltd whether they can take any action against Arti. (10 marks)

## 31 Astride's wall (6/08)

18 mins

Astride entered into a contract with Bild Ltd to construct a wall around the garden of a house she had just purchased. The wall was to be three metres high to block out a view of a rubbish tip. The wall was due to be finished in May and Astride entered into another contract with Chris to landscape the garden starting on 1 June.

Bild Ltd finished the wall on 25 May. However when Astride came to examine it for the first time she found that it was only 2.5 metres high and that the rubbish tip was still visible from the top of her garden.

On 1 June, Chris informed Astride that he was too busy to landscape her garden and that she would have to get someone else to do it. The only person available, however, will charge Astride £500 more than Chris had agreed for doing the work.

*Required*

Analyse the scenario from the perspective of the law of contract, advising Astride:

- (a) Whether she can require Bild Ltd to reconstruct the garden wall in order to make it the agreed height, and if not, what alternative action is available to her. (5 marks)
- (b) Whether she can require Chris to undertake the work on the garden, and if not, what alternative action is available to her. (5 marks)

(Total = 10 marks)

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## 32 Remedies for breach (2.2 12/02 and 12/04)

18 mins

State and explain the remedies available for breach of contract.

(10 marks)

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## 33 Remoteness and measure of damages (2.2 6/04)

18 mins

In the law of contract describe the rules relating to:

- (a) Remoteness of damage (5 marks)
- (b) The measure of damages (5 marks)

(Total = 10 marks)

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## 34 Roger and Lulu

18 mins

Roger is a keen boxer. He has been successful in many fights but recently took part in a fight in which he lost to Jack. The fight took place under the necessary safety regulations and was stopped before Roger was beaten too badly. However, soon after the fight it was clear that he had received severe brain damage and now has difficulty talking.

Lulu used a public toilet at her local train station. Unfortunately the lock was defective and she was stuck inside. In a hurry she attempted to climb out of the window (despite a warning notice not to) and fell to the ground outside injuring her head.

*Required*

Assuming the fight organisers and the train station have breached their duty of care, do they have any defences that will limit or eliminate their liability for the injuries caused to Roger and Lulu? (10 marks)

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## 35 Remoteness of damage (12/07)

18 mins

In relation to the law of tort explain the concept of 'remoteness of damage'.

(10 marks)

## 36 Duty of care (Pilot Paper)

18 mins

In relation to the tort of negligence explain the meaning of 'duty of care'.

(10 marks)

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## 37 Standard of care (6/08)

18 mins

In relation to the tort of negligence explain the standard of care owed by one person to another.

(10 marks)

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## 38 Causality and remoteness

18 mins

In terms of the tort of negligence, briefly explain:

- (a) Causality and the 'but for' test (4 marks)
- (b) The circumstances that may break the chain of causality (6 marks)

(Total = 10 marks)

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## 39 Defences (12/08)

18 mins

In relation to defences in the tort of negligence, explain the meaning of:

- (a) Contributory negligence (5 marks)
- (b) *Volenti non fit injuria* (consent) (5 marks)

(Total = 10 marks)

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## 40 Accountants4U

18 mins

Sally is the audit partner of Accountants4U and regularly advises on takeovers. She was asked to speak at a board meeting of GWZ Ltd which was planning a takeover of THT Ltd (a client of Sally's) as the latest audit report showed very good profits. During the meeting she said that she absolutely stood by the results of THT Ltd which she had signed off.

The takeover went ahead, but soon after GWZ Ltd found that THT Ltd was in fact close to insolvency rather than being profitable. It is now looking to sue Accountants4U for negligence.

Advise Sally as to whether or not her firm would be liable for a claim of negligence brought by GWZ Ltd.

(10 marks)

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## EMPLOYMENT LAW

Questions 41 to 48 cover employment law, the subject of Part C of the BPP Study Text for Paper F4.

### 41 Employed v self-employed (6/08)

**18 mins**

In relation to employment law:

- (a) Explain why it is important to distinguish between contracts of service and contracts for services. **(4 marks)**
- (b) State how the courts decide whether someone is an employee or is self-employed. **(6 marks)**

**(Total = 10 marks)**

### 42 Employment contracts (2.2 Pilot Paper)

**18 mins**

In relation to employment law:

- (a) Describe how the courts distinguish between contracts of service and contracts for services **(7 marks)**
- (b) Explain the importance of the distinction **(3 marks)**

**(Total = 10 marks)**

### 43 Common law duties (2.2 6/02)

**18 mins**

Explain in the context of employment law:

- (a) The common law duties imposed on employers **(6 marks)**
- (b) Constructive dismissal **(4 marks)**

**(Total = 10 marks)**

### 44 Redundancy (Pilot Paper and 6/09)

**18 mins**

In relation to employment law, explain the meaning of redundancy and the rules that govern it.

**(10 marks)**

### 45 Constructive and unfair dismissal (12/07)

**18 mins**

In relation to employment law explain:

- (a) The meaning of 'constructive dismissal' **(5 marks)**
- (b) The remedies available in relation to a successful claim for unfair dismissal **(5 marks)**

**(Total = 10 marks)**

### 46 Constructive and unfair dismissal (12/08)

**18 mins**

In relation to employment law, explain:

- (a) The grounds upon which dismissal may be fair **(5 marks)**
- (b) The meaning and effect of constructive dismissal **(5 marks)**

**(Total = 10 marks)**

## 47 Grace and Fawn Ltd (2.2 12/02 amended)

18 mins

Fawn Ltd manufactures clothes and used to sell them through its own retail shop. Grace, who is 33 years old, was employed by Fawn Ltd for three years as manager of the shop. Grace has been told that her services are no longer required as Fawn Ltd has decided to close its store and concentrate solely on manufacturing. Grace has also been told that she will not receive any recompense for her job loss.

*Required*

Advise Grace as to the likelihood of her successfully claiming for redundancy.

(10 marks)

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## 48 Impact College (2.2 12/05 amended)

18 mins

Impact College Ltd provides private tuition. The college is managed by Jack, who also has responsibility for personnel matters. The College has lost a considerable number of its clients in recent years and the decision has been taken to reduce the staff numbers by ten. Fred, Gale and Hilda are amongst the 60 lecturers currently employed by Impact College Ltd. They have all worked for Impact College for the past six years. Fred has been the staff trade union representative for the past three years and has had several confrontations with Jack as to the working conditions of the college's employees. Gale has been off work twice in the past four years on maternity leave, to Jack's stated annoyance, and is pregnant once again. Last year Hilda reported the college for breaching health and safety requirements and the college was fined a substantial amount of money. It has transpired that Fred, Gale and Hilda are amongst the ten members of staff to be selected for dismissal by the college and they all suspect that Jack has pursued a personal vendetta against them.

*Required*

Advise Fred, Gale and Hilda as to what action they can take against their employer.

(10 marks)

**Note.** You are not required to discuss redundancy.

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## THE FORMATION AND CONSTITUTION OF BUSINESS ORGANISATIONS

Questions 49 to 66 cover the formation and constitution of business organisations, the subject of Part D of the BPP Study Text for Paper F4.

### 49 Types of authority (2.2 12/01)

**18 mins**

Explain the meaning of the following terms with regard to the law of agency:

- (a) Express authority (3 marks)
- (b) Implied authority (3 marks)
- (c) Ostensible/apparent authority. (4 marks)

**(Total = 10 marks)**

### 50 Unlimited and limited partnerships

**18 mins**

- (a) Briefly discuss what an unlimited partnership is. (4 marks)
- (b) What is meant by 'apparent authority' in the context of partnership law? (3 marks)
- (c) What are the main requirements of a limited liability partnership with regard to formation and publicity of information? (3 marks)

**(Total = 10 marks)**

### 51 Ham, Sam and Tam (12/08)

**18 mins**

Ham, Sam and Tam formed a partnership to run a petrol station. The partnership agreement expressly stated that the partnership business was to be limited exclusively to the sale of petrol.

In January 20X8 Sam received £10,000 from the partnership's bank drawn on its overdraft facility. He told the bank that the money was to finance a short-term partnership debt but in fact he used the money to pay for a round the world cruise. In February Tam entered into a £15,000 contract on behalf of the partnership to buy some used cars, which he hoped to sell from the garage forecourt. In March the partnership's bank refused to honour its cheque for the payment of its monthly petrol account, on the basis that there were no funds in its account and it had reached its overdraft facility.

*Required*

Advise Ham, Sam and Tam as to their various rights and liabilities in relation to partnership law. **(10 marks)**

### 52 Clare, Dan and Eve (6/08)

**18 mins**

Clare, Dan and Eve formed a partnership 10 years ago, although Clare was a sleeping partner and never had anything to do with running the business. Last year Dan retired from the partnership. Eve has subsequently entered into two large contracts. The first one was with a longstanding customer Greg, who had dealt with the partnership for some five years. The second contract was with a new customer Hugh. Both believed that Dan was still a partner in the business. Both contracts have gone badly wrong leaving the partnership owing £50,000 to both Greg and Hugh. Unfortunately the business assets will only cover the first £50,000 of the debt.

*Required*

Explain the potential liabilities of Clare, Dan, and Eve for the partnership debts. **(10 marks)**

## 53 Partnership liability

18 mins

Describe the liability of partners for partnership debts in a:

- (a) Traditional partnership (2 marks)
- (b) Limited partnership (4 marks)
- (c) Limited liability partnership (4 marks)

(Total = 10 marks)

## 54 Partnership v company (2.2 12/01 amended)

18 mins

Consider the advantages of the registered company as against the partnership as a form of business organisation.

(10 marks)

## 55 Termination of partnerships (2.2 12/02)

18 mins

Detail the grounds upon which a partnership can be terminated.

(10 marks)

## 56 Types of company (2.2 6/02)

18 mins

Distinguish between:

- (a) Unlimited companies (3 marks)
- (b) Companies limited by guarantee (3 marks)
- (c) Companies limited by shares (4 marks)

(Total = 10 marks)

## 57 Separate personality (6/08)

18 mins

In the context of company law explain:

- (a) The doctrine of separate personality and its consequences (6 marks)
- (b) The circumstances under which separate personality will be ignored (4 marks)

(Total = 10 marks)

## 58 Mick's company (2.2 12/05 amended)

18 mins

Mick has operated a house building business as a sole trader for a number of years. Now his accountant has recommended that he should consider registering as a company in order to gain the benefits of separate personality. He is unclear as to what is meant by this and seeks advice on how he would go about registering.

*Required*

- (a) Explain the concept of corporate personality (5 marks)
- (b) Detail the procedures and the documentation required to register a private limited company (5 marks)

(Total = 10 marks)

## 59 Public companies (Pilot Paper)

18 mins

State the documents necessary and the procedure to be followed in registering a public limited company and enabling it to start trading.

(10 marks)

## 60 Company registers and accounting records (2.2 6/02 amended)

**18 mins**

- (a) List and explain the purpose of the various registers that have to be kept by a company. (5 marks)
- (b) Describe the accounting records that have to be maintained by a company. (5 marks)

**(Total = 10 marks)**

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## 61 Eden plc (2.2 6/05 amended)

**18 mins**

Don was instrumental in forming Eden plc, which was registered and received its trading certificate in December 20X4. It has subsequently come to the attention of the board of directors that the following events had taken place prior to the incorporation of the company:

- (a) Don entered into a contract in the company's name to buy computer equipment, which the board of directors do not wish to honour.
- (b) Don entered into a contract in the company's name to develop a particular patent, which the board of directors of Eden wish to pursue but in relation to which the other party does not wish to proceed.
- (c) Don entered into an agreement with Fad Ltd for business equipment. The agreement was made 'subject to adoption by Eden plc' but now Eden plc does not wish to pursue the agreement.

*Required*

Analyse the situation from the perspective of the law relating to company promoters and in particular advise the parties involved in the transactions detailed. **(10 marks)**

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## 62 Objects clause (2.2 6/05 amended)

**18 mins**

In relation to the company's constitution explain:

- (a) The extent of a company's objects (3 marks)
- (b) The meaning and effect of the doctrine of *ultra vires* (7 marks)

**(Total = 10 marks)**

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## 63 Articles (2.2 6/04 amended)

**18 mins**

Explain the meaning and effect of a company's articles of association, paying particular attention to the following issues.

- (a) The nature of model articles of association (2 marks)
- (b) The effect of the articles on both members and non-members (4 marks)
- (c) The procedure for altering the articles of association (4 marks)

**(Total = 10 marks)**

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## 64 Fred (12/08)

18 mins

Fred is a member of Glad Ltd, a small publishing company, holding 100 of its 500 shares; the other 400 shares are held by four other members.

It has recently become apparent that Fred has set up a rival business to Glad Ltd and the other members have decided that he should be expelled from the company.

To that end they propose to alter the articles of association to include a new power to 'require any member to transfer their shares for fair value to the other members upon the passing of a resolution so to do'.

*Required*

Advise the parties concerned whether or not the proposed change to the articles is legally enforceable and whether or not it can be used to force Fred to sell his shares. **(10 marks)**

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## 65 Company names (6/09)

18 mins

In relation to company law, explain:

- (a) The limitations on the use of company names; **(4 marks)**
- (b) The tort of 'passing off'; **(4 marks)**
- (c) The role of the company names adjudicators under the Companies Act 2006. **(2 marks)**

**(Total = 10 marks)**

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## 66 Various terms (2.2 6/06)

18 mins

Explain the meaning and consequence of the following terms when found at the end of the names of business organisations:

- (a) LLP **(3 marks)**
- (b) Ltd **(3 marks)**
- (c) plc **(4 marks)**

**(Total = 10 marks)**

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## CAPITAL AND THE FINANCING OF COMPANIES

Questions 67 to 76 cover capital and the financing of companies, the subject of Part E of the BPP Study Text for Paper F4.

### 67 Issue and premium (2.2 12/01)

18 mins

With regard to payment for shares explain the meaning and effect of the following:

- (a) Issuing shares at a discount (6 marks)
- (b) The share premium account (4 marks)

(Total = 10 marks)

### 68 Capital terms I (2.2 12/03 amended)

18 mins

In relation to a company's shares explain the following.

- (a) Nominal value (2 marks)
- (b) Market value (2 marks)
- (c) Issued capital (3 marks)
- (d) Paid up capital (3 marks)

(Total = 10 marks)

### 69 Shares and debentures (6/08)

18 mins

In relation to company law explain the meaning of the following:

- (a) Ordinary shares (3 marks)
- (b) Preference shares (3 marks)
- (c) Debentures (4 marks)

(Total = 10 marks)

### 70 Capital terms II (12/08)

18 mins

In relation to a company's shares, explain the following:

- (a) The statement of capital and initial shareholdings (4 marks)
- (b) Authorised minimum issued capital in a public company (2 marks)
- (c) Paid-up capital (2 marks)
- (d) The difference between nominal value and market value (2 marks)

(Total = 10 marks)

### 71 Capital maintenance and reducing share capital (6/09)

18 mins

In relation to company law, explain:

- (a) The doctrine of capital maintenance; (4 marks)
- (b) The circumstances under which both a private and a public company can reduce its capital and the procedure to be followed. (6 marks)

(Total = 10 marks)

## 72 Class rights (2.2 12/02)

18 mins

In company law:

- (a) Explain the meaning of class rights in relation to company shares providing examples of such rights (6 marks)
  - (b) State how such rights can be altered (4 marks)
- (Total = 10 marks)

## 73 Flop Ltd (Pilot Paper)

18 mins

Flop Ltd was in financial difficulties. In January, in order to raise capital, it issued 10,000 £1 shares to Gus, but only asked him to pay 75 pence per share at the time of issue. The directors of Flop Ltd intended asking Gus for the other 25 pence per share at a later date. However, in June it realised that it needed even more than the £2,500 it could raise from Gus's existing shareholding. So in order to persuade Gus to provide the needed money Flop Ltd told him that if he bought a further 10,000 shares he would only have to pay a total of 50 pence for each £1 share, and it would write off the money owed on the original share purchase.

Gus agreed to this, but the injection of cash did not save Flop Ltd and in December it went into insolvent liquidation, owing a considerable amount of money.

*Required*

Explain any potential liability that Gus might have on the shares he holds in Flop Ltd. (10 marks)

## 74 Lux Ltd (2.2 6/07 amended)

18 mins

In 20X5 two newspaper companies, Kudos Ltd and Lux Ltd, entered into negotiations in an attempt to safeguard their independent positions. As a result, an agreement was reached and a contractual document drawn up to the effect that:

- (i) Kudos Ltd was to purchase 15% of Lux Ltd's ordinary share capital and 20% of its preference shares, which carry a preferred dividend of 10%
- (ii) Mat, the current deputy editor of Kudos Ltd's paper, was to be appointed as the editor of Lux Ltd's paper, with a contract of employment for five years at a salary of £50,000 per year

Following the agreement the articles of Lux Ltd were altered so as to accommodate all of the above terms.

The majority of the board of directors of Lux Ltd have become disenchanted with their link with Kudos Ltd and want to agree terms for a link with another paper, News Ltd. In order to facilitate this new allegiance they propose:

- (a) To remove Mat from his position as editor of the Lux paper
- (b) To reduce the dividend on all preference shares to 5%

*Required*

Advise the directors of Lux Ltd generally as to the nature of class rights and in particular as to the legality of, and procedure for, pursuing their proposals. (10 marks)

## 75 Dividends (12/07)

18 mins

In relation to the rules governing the payment of company dividends explain:

- (a) How dividends may be properly funded (4 marks)
- (b) The rules which apply to public limited companies (3 marks)
- (c) The consequences of any dividend being paid in breach of those rules (3 marks)

(Total = 10 marks)



## 76 Debentures and charges (2.2 6/04)

18 mins

In relation to companies' loan capital explain the following terms.

- (a) Debenture (3 marks)
- (b) Fixed charge (3 marks)
- (c) Floating charge (4 marks)

(Total = 10 marks)

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## MANAGEMENT, ADMINISTRATION AND REGULATION OF COMPANIES

Questions 77 to 91 cover management, administration and regulation of companies, the subject of Part F of the BPP Study Text for Paper F4.

### 77 Resolutions (12/08)

18 mins

In relation to private companies, explain the meaning of, and the procedure for passing, the following:

- (a) An ordinary and a special resolution (5 marks)
- (b) A written resolution (5 marks)

(Total = 10 marks)

### 78 Meetings (Pilot Paper)

18 mins

In relation to company law explain and distinguish between the following:

- (a) Annual general meeting (5 marks)
- (b) Other general meetings (2 marks)
- (c) Class meeting (3 marks)

(Total = 10 marks)

### 79 Company secretary (2.2 Pilot paper and 6/05)

18 mins

Explain the rules relating to the appointment, duties and powers of a company secretary in a public limited company.

(10 marks)

### 80 Implied authority and company secretary (2.2 6/07)

18 mins

In relation to the law of agency:

- (a) Explain the meaning of implied authority (6 marks)
- (b) Explain the extent of the implied authority of a company secretary (4 marks)

(Total = 10 marks)

### 81 Appointment and removal (2.2 12/03)

18 mins

In company law explain:

- (a) How a director of a company may be appointed (3 marks)
- (b) How a director may be removed from his position (7 marks)

(Total = 10 marks)

## 82 Statutory grounds for disqualifying directors (6/09) 18 mins

Explain the grounds upon which a person may be disqualified under the Company Directors Disqualification Act 1986. (10 marks)

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## 83 Statutory duties 18 mins

Briefly explain any five of the statutory duties owed by directors to their companies. (10 marks)

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## 84 Promoting success (12/08) 18 mins

In relation to the Companies Act, 2006, explain the duty of directors to promote the success of the company, and to whom such a duty is owed. (10 marks)

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## 85 Powers and duties of directors (2.2 6/03) 18 mins

In relation to company law:

- (a) Explain briefly the common law powers and duties of directors (6 marks)
- (b) Distinguish between:
  - (i) Executive directors
  - (ii) Non-executive directors (4 marks)

(Total = 10 marks)

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## 86 Helen (2.2 12/03 amended) 18 mins

Helen is a director of Industria plc, but she also carries out her own business as a wholesale supplier of specialist metals under the name of Jet Ltd.

Last year Industria plc entered into a contract to buy a large consignment of metal from Jet Ltd. Helen attended the board meeting that approved the contract and voted in favour of it, without revealing any link with Jet Ltd. The contract price was considerably above the market price and Jet Ltd and Helen made a considerable profit from it.

Nevertheless the previous year has been a particularly good year for Industria plc and it was revealed at a board meeting on 25 March that it had made larger than expected profits.

*Required*

Analyse the situation explaining any potential liability that Helen may have in relation to the sale of the metal to Industria plc by Jet Ltd. (10 marks)

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## 87 Directors (6/08) 18 mins

In relation to company law distinguish between:

- (a) Executive directors (4 marks)
- (b) Non-executive directors (3 marks)
- (c) Shadow directors (3 marks)

(Total = 10 marks)

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## 88 Auditors I (2.2 6/03)

18 mins

Explain the role of public company auditors paying particular regard to their appointment, removal, rights and duties. (10 marks)

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## 89 Auditors II (12/07)

18 mins

In the context of corporate governance explain the role of the external company auditors, paying particular regard to the following issues:

- (a) Their qualifications
- (b) Their powers
- (c) Their duties

(10 marks)

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## 90 Katch Ltd (12/07)

18 mins

Katch Ltd is a small private company. Although there are three members of its board of directors, the actual day-to-day running of the business is left to one of them, Len, who simply reports back to the board on the business he has transacted. Len refers to himself as the managing director of Katch Ltd, although he has never been officially appointed as such.

Six months ago Len entered into a contract on Katch Ltd's behalf with Mo to produce some advertising material for the company. However Katch Ltd did not wish to proceed with the advertising campaign and the board of directors have refused to pay Mo, claiming that Len did not have the necessary authority to enter into the contract with him.

*Required*

Analyse the situation with regard to the authority of Len to make contracts on behalf of Katch Ltd, and in particular advise whether or not Katch Ltd is liable to Mo.

(10 marks)

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## 91 Clean Ltd (6/09)

18 mins

Clean Ltd was established some five years ago to manufacture industrial solvents and cleaning solutions, and Des was appointed managing director.

The company's main contract was with Dank plc a large industrial conglomerate.

In the course of its research activity, Clean Ltd's scientists developed a new super glue. Des was very keen to pursue the manufacture of the glue but the board of directors overruled him and decided that the company should stick to its core business.

The managing director of Dank plc is a friend of Des's and has told him that Dank plc will not be renewing its contract with Clean Ltd as he is not happy with its performance. He also told Des that he would be happy to continue to deal with him, if only he was not linked to Clean Ltd.

Following that discussion Des resigned from his position as managing director of Clean Ltd and set up his own company, Flush Ltd which later entered into a contract with Dank plc to replace Clean Ltd. Flush Ltd also manufactures the new glue discovered by Clean Ltd's scientists, which has proved to be very profitable.

*Required*

In the context of company law, advise the board of Clean Ltd as to whether they can take any action against Des or Flush Ltd. (10 marks)

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## LEGAL IMPLICATIONS OF COMPANIES IN DIFFICULTY OR IN CRISIS

Questions 92 to 95 cover the legal implications of companies in difficulty or in crisis, the subject of Part G of the BPP Study Text for Paper F4.

### 92 Liquidation (2.2 12/04 amended)

18 mins

In the context of company liquidation:

- (a) State and explain the two main grounds under which a company may be wound up under Section 122 of the Insolvency Act 1986. (5 marks)
- (b) What are the distinguishing characteristics of a creditors' voluntary winding up? (5 marks)

(Total = 10 marks)

### 93 Compulsory winding up

18 mins

What is the immediate legal effect of an order of the court for the compulsory winding up of a company?

(10 marks)

### 94 Lazy Days

18 mins

Lazy Days Ltd is a coach tour company. It recently leased a fleet of five brand new 'Executive style' coaches ahead of an anticipated increase in business. The coaches cost a total of £20,000 a month to lease, and on top of this, the business also has to pay its overheads including staff costs – a total of £15,000 per month. The increase in business did not materialise and Lazy Days is only generating £28,000 of revenue per month. The trips are going out on average 50% full of passengers.

Noelle, the Finance director is increasingly concerned about the situation and has called a meeting of the board of directors to discuss the situation and the possibility of putting the business into administration.

Advise Noelle of:

- (a) The purpose and effect of an administration order (3 marks)
- (b) The procedure to be followed when applying for administration (5 marks)
- (c) Whether or not it is likely that an administration order would be granted for Lazy Days Ltd (2 marks)

(Total = 10 marks)

### 95 Earl (12/07)

18 mins

Earl has been employed by Flash Ltd for the past 20 years. During that time he has also invested in the company in the form of shares and debentures. Earl owns 5,000 ordinary shares in Flash Ltd. The shares are of £1 nominal value and are paid up to the extent of 75%. The debentures, to the value of £5,000, are secured by a fixed charge against the land on which Flash Ltd's factory is built.

In April it was announced that Flash Ltd was going into immediate insolvent liquidation, owing considerable amounts of money to trade creditors. As a result of the suddenness of the decision to liquidate the company, none of the employees received their last month's wages. In Earl's case this amounted to £2,000.

*Required*

Advise Earl as to his rights and liabilities in relation to Flash Ltd in regard to:

- (a) His unpaid wages (3 marks)
- (b) His shareholding (3 marks)
- (c) His debentures (4 marks)

(Total = 10 marks)

## GOVERNANCE AND ETHICAL ISSUES RELATING TO BUSINESS

Questions 96 to 102 cover governance and ethical issues relating to business, the subject of Part H of the BPP Study Text for Paper F4.

### 96 Directors and corporate governance (Pilot Paper) 18 mins

- (a) Explain briefly what is meant by 'corporate governance'. (4 marks)
- (b) Within the context of corporate governance examine the role of, and relationship between, executive directors and non-executive directors. (6 marks)

(Total = 10 marks)

### 97 Huge plc (Pilot Paper) 18 mins

In January the board of directors of Huge plc decided to make a takeover bid for Large plc. After the decision was taken, but before it is announced, the following chain of events occurs:

- (i) Slye, a director of Huge plc, buys shares in Large plc
- (ii) Slye tells his friend Mate about the likelihood of the takeover and Mate buys shares in Large plc
- (iii) at a dinner party Slye, without actually telling him about the takeover proposal, advises his brother Tim to buy shares in Large plc and Tim does so

*Required*

Consider the legal position of Slye, Mate and Tim under the law relating to insider dealing. (10 marks)

### 98 Sid and Vic (6/08) 18 mins

Sid is a director of two listed public companies in which he has substantial shareholdings: Trend plc and Umber plc. The annual reports of both Trend plc and Umber plc have just been drawn up although not yet disclosed. They show that Trend plc has made a surprisingly big loss and that Umber plc has made an equally surprising big profit. On the basis of this information Sid sold his shares in Trend plc and bought shares in Umber plc. He also advised his brother to buy shares in Umber plc.

Vic who is also a shareholder in both companies sold a significant number of shares in Umber plc only the day before its annual report was published.

*Required*

- (a) Analyse the above scenario from the perspective of the law relating to insider dealing (8 marks)
- (b) In particular advise Vic as to his position (2 marks)

(Total = 10 marks)

### 99 Wrongful trading (2.2 12/05) 18 mins

Explain the meaning and effect of 'wrongful trading' under s.214 of the Insolvency Act 1986. (10 marks)

## 100 Push Ltd (2.2 6/07 amended)

18 mins

Three years ago Norm, a wealthy retired accountant, agreed to become a director of his son Owen's company, Push Ltd, which had been established three years previously. Owen told Norm that he only wanted his name amongst the directors in order to give Push Ltd increased credibility. Norm never actually took part in the management of the company and never attended any company meetings. Norm has now learned that Push Ltd is insolvent and owes considerable debts. Owen has confessed to Norm that he had deliberately hidden the fact that Push Ltd has been insolvent and carried on trading for the past two years, in which time Push Ltd's debts have increased from £50,000 to £300,000.

*Required*

Advise Norm in regard to the following:

- (a) Any potential liability on behalf of himself or Owen for fraudulent trading under s213 of the Insolvency Act 1986 (5 marks)
- (b) Any potential liability of himself or Owen for wrongful trading under s214 of the Insolvency Act 1986 (5 marks)

(Total = 10 marks)

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## 101 Money laundering (2.2 12/05)

18 mins

- (a) Explain the term 'money laundering' and how such activity is conducted. (5 marks)
- (b) Explain how the Proceeds of Crime Act 2002 seeks to control money laundering. (5 marks)

(Total = 10 marks)

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## 102 Greg (6/09)

18 mins

Greg is a member of the board of directors of Huge plc. He also controls a private limited company Imp Ltd through which he operates a management consultancy business. He also owns all the shares in Jet Ltd through which he conducts an investment business.

When Greg learns that Huge plc is going to make a take-over bid for Kop plc he arranges for Jet Ltd to buy a large number of shares in Kop plc on the London Stock Exchange on which it makes a large profit when it sells them after the takeover bid is announced. He then arranges for Jet Ltd to transfer the profit to Imp Ltd as the charge for supposed consultancy work. The money is then transferred to Greg through the declaration of dividends by Imp Ltd.

*Required*

Analyse the above conduct from the perspective of criminal law paying particular attention to the issues of:

- (a) Insider dealing; and (5 marks)
- (b) Money laundering. (5 marks)

(Total = 10 marks)

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# Answers



### **ACCA examiner's answers**

Remember that you can access the ACCA examiner's solutions to questions marked '**Pilot paper**', '**12/07**', '**6/08**' and '**12/08**' on the BPP website using the following link:

[www.bpp.com/acca/examiner-solutions](http://www.bpp.com/acca/examiner-solutions)

### **Additional question guidance**

Remember that you can find additional guidance to certain questions on the BPP website using the following link:

[www.bpp.com/acca/extra-question-guidance](http://www.bpp.com/acca/extra-question-guidance)

# 1 Types of law

**Text Reference.** Chapter 1

**Top tips.** Do not go into too much detail about each type of law – remember there are only three marks available for each. Writing too much will not earn you extra marks and will cost you valuable time.

**Easy marks.** A brief definition and explanation of each type of law will earn you enough marks to pass.

- (a) Law is a **formal control mechanism**. It provides a structure for dealing with and resolving disputes that may arise, as well as providing some deterrent to those wishing to disrupt social order.

- (b) **Common law**

**Common law** developed in England during the period following the Norman Conquest. It was made by judges who travelled around the country to keep the King's peace and made law by **amalgamating local customary laws** into one 'law of the land'. Today, the concept of **precedent** continues as this key feature of common law is what distinguishes it from other legal systems.

**Remedies** under common law are monetary, and are known as **damages**.

## **Equity**

Common law does not provide justice to the wronged person if monetary compensation is **not a suitable remedy**. For example, where a person needs to **stop** another person's behaviour or to force them to **act** as they agreed to, **equity** provides remedies to achieve this and other non-monetary resolutions.

**Equity** developed two or three hundred years after common law as a system to resolve such disputes and to therefore introduce **fairness** into the legal system.

- (c) **Civil law**

**Civil law** exists to regulate disputes over the rights and obligations of persons dealing with each other and seeks to compensate injured parties.

It is therefore a form of **private law** (between individuals) and there is no concept of punishment. The object is to **compensate** the wronged person for the damage they suffered. Where civil cases go to court, the case must be proved on the balance of probability. The object is to convince the court that it is more probable than not that the assertions of the wronged person are true. However, both parties may choose to settle the dispute out of court should they wish.

- (d) **Criminal law**

In **criminal cases**, the state prosecutes the wrongdoer for a crime that they have committed. A crime is conduct that is prohibited by the law.

It is therefore a form of **public law** (between the State and individuals). The State is the prosecutor because it is the community as a whole which suffers as a result of the law being broken. Persons guilty of crime may be **punished** by fines payable to the State, imprisonment, or a community-based punishment. In a criminal trial, the burden of proof to convict the accused rests with the prosecution, which must prove its case beyond reasonable doubt.

In the UK, the police take the initial decision to **prosecute**, but this is then reviewed by the Crown Prosecution Service. However, some prosecutions are started by the Director of Public Prosecutions, who is the head of the Crown Prosecution Service.

## 2 Legal system and courts

**Text reference.** Chapter 1

**Top tips.** It is very easy to write too much when answering this question. You will only have about 9 minutes to answer Part (a) and the same period of time for Part (b) so ensure your answer sticks strictly to the facts. It may help you to quickly list a selection of facts for each part before writing your answer so you do not become distracted and begin to waffle.

**Easy marks.** Stating the nature of criminal and civil law in Part (a) and remembering the appeals procedure for each court system in Part (b).

**Examiner's comments.** There was often an attempt to consider certain relevant factors such as criminal proceedings are brought by the state and civil proceedings by the individual and the aim of criminal proceedings is to punish by fines or imprisonment while civil proceedings aim to compensate by way of damages. Also there was some mention of the different standards of proof. A small number noted the different methods of citation and the fact that different courts are involved. The outcome was that many candidates produced a reasonable response. Some candidates thought that the death penalty was still carried out in England.

### Marking scheme

	Marks
(a) A thorough to comprehensive explanation of the difference between the two types of law.	3–5
Ranging from some but little knowledge down to no understanding at all of the differences.	0–2
(b) Full explanation of both court systems.	4–5
Some explanation of the courts in both systems.	2–3
Little or no knowledge of either court system or, at the higher end of this grade, some knowledge of one of the systems.	0–1

#### (a) (i) Criminal law

A **crime** is conduct prohibited by the law. In a **criminal case** the State is the prosecutor because it is the community as a whole which suffers as a result of the law being broken. Persons guilty of crime may be punished by **fines** payable to the State, **imprisonment**, or a **community-based** punishment. Criminal cases are usually referred to as *R v Jones*. The prosecution is brought in the name of the Crown against the alleged wrongdoer, the **accused**. In a criminal trial, the **burden of proof** to convict the accused rests with the **prosecution**, which must prove its case **beyond reasonable doubt**.

#### (ii) Civil law

**Civil law** exists to **regulate disputes** over the **rights** and **obligations** of persons dealing with each other, and seeks to compensate injured parties. It is a form of **private law** and covers areas such as tort, contract and employment law. In civil proceedings, the case must be proved on the **balance of probability**, the object is to convince the court that it is more probable than not that a person's assertions are true. There is no concept of **punishment**, and **compensation** is paid to the wronged person. Both parties may choose to **settle** the dispute **out of court** should they wish.

Terminology in civil cases is different from that in criminal cases. The **claimant** sues the **defendant**. A civil case would therefore be referred to as, for example, *Smith v Megacorp plc*.

It is not an act or event which creates the distinction between criminal and civil law, but the **legal consequences**. A single event might give rise to both criminal and civil proceedings.

(b) **Jurisdiction of criminal courts**

All criminal cases begin in **magistrates' courts** where the case is introduced into the system. Certain types of offence are known as **indictable offences**; these are serious offences and can only be heard in a Crown Court. Other, less serious **summary offences** are heard summarily in the magistrates' court. Where an offence falls in between the two it can be **'triable either way'**: this means the defendant will have the choice to be tried by the magistrate or at the Crown Court in front of a **jury**.

Where the decision in a **criminal case** is appealed against, a court further up the hierarchy will hear it.

**Appeals** from magistrates' courts are either to the **Crown Court** or the **Queen's Bench Division** of the **High Court**. Appeals can be by way of **'case stated'**, in other words the law was misinterpreted by the magistrate.

**Appeals** against **conviction** or **sentence** from the **Crown Court** are heard at the **Court of Appeal** and this may in turn be appealed to the **Supreme Court for the United Kingdom**. Case stated appeals from the Crown Court are made to QBD.

**Jurisdiction of civil courts**

The nature of the case and the size of the claim will determine which court hears a civil case. **County courts** deal with almost every kind of civil case that is **small** or which are deemed to be **'Fast Track'** cases. The case is heard by a Circuit Judge assisted by District Judges.

**Complicated cases** or those which are deemed to be **'Multi Track'** cases are heard at the **High Court**. The **Queen's Bench Division** hears cases of **contract** and **tort**. The **Family Division** hears cases involving **children** and **matrimonial** issues such as divorce. The **Chancery Division** hears cases concerning **trusts**, **bankruptcy** and **corporate** matters.

**Appeals** are to the **Civil Division** of the **Court of Appeal** and are heard by three judges who will decide the outcome by a majority. As with criminal cases, a further appeal to the **Supreme Court for the United Kingdom** may be permitted.

## 3 Civil courts and tracks

**Text reference.** Chapter 1.

**Top tips.** Before you start a question like this it is worth drawing a rough diagram of the civil court system to use as a plan. This will help to ensure that you don't forget any of the courts involved. Notice that part (b) asks you specifically about the track system for allocating cases, so there is no need to go into detail about that in part (a). Keep to the civil courts in this question: you will gain no marks for discussing the criminal courts.

**Easy marks.** Stating and describing each court.

### Marking scheme

		Marks
(a)	Magistrates court	1
	County Court (with examples)	2
	High Court (3 divisions)	1½
	Court of Appeal	1
	Supreme Court for the United Kingdom	½
		6
(b)	County Court and High Court	1
	Small claims track	1
	Fast track	1
	Multi track	1
		4
		10

- (a) The courts in the English Legal System which have a **civil jurisdiction** are as follows.

### **Magistrates' court**

The **magistrates' court** is mainly a criminal court, but it also has original jurisdiction in a number of civil cases, particularly family proceedings. It hears many domestic issues such as proceedings for the financial provision for parties to a marriage and children, the custody or supervision of children and guardianship, and adoption orders. It will also hear claims for recovery of unpaid local authority charges and council tax.

### **County court**

The **county court** only hears civil cases, but deals with virtually every type of civil matter arising within the geographical area which it serves. In some types of case, its jurisdiction is concurrent with that of the High Court. The main limits to its jurisdiction are financial. It is involved in hearing the following:

- Actions in **contract** and **tort**
- **Equitable matters** concerning trusts, mortgages and partnership dissolution
- Disputes concerning **land**
- Undefended **matrimonial** cases
- **Probate** matters
- **Miscellaneous** matters conferred by various statutes, for example, the Consumer Credit Act 1974
- Some **bankruptcy**, company **winding-up** and **admiralty** cases.

### **High Court**

The **High Court** also deals with civil cases at first instance. It is divided into three sections.

- The **Queen's Bench Division** deals with common law matters, such as contract and tort. It also includes a Commercial court and an Admiralty Court (to deal with shipping cases). A Divisional Court of the QBD has an appellate jurisdiction on cases from magistrates' courts and tribunals.
- The **Chancery Division** of the High Court deals with equity matters such as trusts, mortgages, bankruptcy, taxation, probate and partnerships. It also has a special Companies Court which deals with liquidations and other company proceedings, and a Patents Court.
- The **Family Division** of the High Court deals with matrimonial cases, family property and proceedings relating to children. The Family Division also has a limited appellate function in that it hears some appeals on domestic matters from the Magistrates' Courts.

### **Appeal courts**

The civil courts which have an exclusively **appellate jurisdiction** are the **Civil Division of the Court of Appeal** and the **Supreme Court for the United Kingdom**.

### **Court of Appeal**

The **Court of Appeal** hears appeals from the High Court, county courts and several special tribunals. It reviews the evidence and the legal opinions and makes its decisions based on them. Cases are heard by three judges sitting together (known as Lord Justices of Appeal).

### **Supreme Court for the United Kingdom**

The **Supreme Court for the United Kingdom** is the highest court of appeal in the English legal system. Cases are heard by Justices of the Supreme Court. The court hears appeals from the Court of Appeal and also appeals from the High Court, under the 'leapfrog procedure' where leave to appeal is granted.

- (b) The **Civil Procedure Rules** introduced a three track system for the allocation of civil cases. Generally speaking, county courts hear small claims and fast track cases and the High Court hears multi-track cases.

### **Small claims track**

Under the **small claims track**, cases are heard where the claim is for **less than £5,000**. If the claim is for more than the stated amount, the parties may still elect to use the small claims track, subject to the court's approval. The small claims track is intended to permit litigants to conduct their case in person if they so wish as the procedure is less formal, cheaper and quicker than court proceedings. The arbitrator is usually the district judge or may be appointed by the parties.

### Fast track

Cases **under £25,000** may be allocated to the '**fast track**'. This is a strictly limited procedure, designed to enable cases to be brought to trial within a short but reasonable timescale. Costs are fixed and hearings are designed to last no longer than one day.

### Multi track

Finally, the **multi track** approach is intended to provide a new and more flexible regime for the handling of claims **over £15,000** in value. These are the cases that tend to be more complex. An initial 'case management conference' will be held to encourage the parties to settle the dispute or to consider the merits of alternative dispute resolution. The trial judge sets a budget and a final timetable for the trial.

Claimants of cases between £15,000 and £25,000 have the choice of using the fast or multi track, although judges may insist complex cases are heard using the multi track.

## 4 Contemporary sources of law

**Text reference.** Chapter 2.

**Top tips.** Take a minute or two at the start of the question to clarify in your own mind what points you need to include. Ensure your answer refers to the 'contemporary' sources of law rather than historical ones.

**Easy marks.** Make sure that you include and explain each source in your answer. Don't just state what they are: explain them too.

**Examiner's comments.** This question required the candidates to consider the various sources of contemporary United Kingdom law. The better answers displayed a competent understanding of what was required. There was firstly, a reference to legislation being formulated by Parliament, along with the process involved. Many answers continued with a rather detailed coverage of delegated legislation- examples, advantages and disadvantages. On precedent the good answers explained the nature of judicial precedent including the legal rule on which a judicial decision is based – ratio decidendi comparing that with other statements of law which do not form the basis of the decision -obiter dicta. However most coverage concerned the hierarchy of authority as a factor in determining the importance of a precedent.

On the debit side a number of responses concentrated either on legislation more usually delegated legislation or precedent, which limited the possible marks available. A noticeable number of answers considered the historical sources – common law and equity but managed some marks if this involved an account of case law. It is maybe that some candidates, especially the overseas ones, were not familiar with the word 'contemporary'.

The third contemporary source of law is of course EU Law but only a few candidates made a reasonable attempt to explain its role and many who mentioned it showed some confusion with the European Convention on Human Rights.

### Marking scheme

In order to get full marks candidates must deal well with each of the three areas and not confine themselves to an extended treatment of only one, or two of them. Also the question asks for a consideration of the main sources of contemporary law. It would be inappropriate, therefore, to present an extended treatment of the role of custom as a source of law, to the exclusion of a more detailed treatment of the other sources. The following marking scheme details the way in which marks would be allocated in relation to this question.

Each major part would be notionally allocated 3 marks, with the additional mark for a particularly good treatment of one of the sources or reference to some other source.

8–10 marks: Thorough treatment of the three major sources with perhaps reference to other sources such as custom or perhaps the role of the Law Commission, although the latter is certainly not necessary.

5–7 marks: Thorough treatment of two of the sources, or a less complete treatment of the three.

2–4 marks: Some understanding but lacking in detail. Perhaps unbalanced answer, focusing on only one aspect of the question and ignoring the others.

0–1 mark: Shows little understanding of the subject matter of the question.

## Sources of English law

There are **three main sources of English law**, namely **legislation** (statute), **case law** and **custom**. Broadly speaking, legislation is made by the legislature in Parliament and case law is 'made' and developed in the courts. Therefore, as both of these sources create law today, they can be considered contemporary. However, local customs, which developed historically and have generally existed for a very long time, are not considered to be contemporary.

### Legislation

**Statute law** is made by **Parliament**. Parliament may make law as it sees fit – it may repeal earlier statutes, overrule case law developed in the courts or make law in new areas previously unregulated. The validity of an Act of Parliament cannot be questioned (*Cheney v Conn 1968*). This principle of Parliamentary sovereignty has been reduced somewhat by the UK's membership of the European Union which requires its laws to be brought into line with the EU's treaties and directives. Additionally, the Human Rights Act 1998 requires new laws to be compatible with the European Convention on Human Rights.

### Additional material

The paragraph below is not vital for your answer. We have included it for the sake of completeness. It would probably only be worth 1 mark if included in your answer.

A proposal for legislation is first aired in a **Green Paper**. After comments are received, a **White Paper** is issued. This is then put into draft form as a **Bill** and introduced into the House of Commons or the House of Lords. Once a Bill has passed through the necessary stages in one House, it is introduced into the other House. In each, the successive stages are the **first reading** (publication only), **second reading** (debate), **Committee stage** (examination by a Standing Committee), **report stage** (approval by the full House) and **third reading** (final approval). Finally, a Bill receives the **Royal Assent** prior to becoming an Act of Parliament.

Statute law may be '**fresh**' **legislation** or it may be a **consolidation of existing statutes** and their amendments, for example the Companies Act 2006. It may also be a codification of existing statutory and case law, for example the Sale of Goods Act 1979.

The courts are **bound to apply** relevant statute law and cannot choose to disregard or rewrite it. Whatever the nature of the legislation, the role of judges to **interpret and apply it** is the same. Judicial interpretation might be needed because of ambiguity in drafting or uncertainty as to whether a particular set of facts are within the scope of a statute, or where unforeseeable developments have occurred since the statute was passed.

The **complexity** of much modern legislation means that, in many instances, there is a **great deal of detail** which cannot conveniently be included in an Act. Therefore, legislation often gives power to a minister or public body, such as a local authority, to make laws for specified purposes in the form of statutory instruments, bye-laws and Rules of Court. Such **delegated legislation** has the same legal force and effect as the empowering Act itself.

### Case law

Case law is law which is made in the **courts** according to the rules of **common law and equity**. Both common law and equity are the product of decisions in the courts made by judges who interpret and apply previous cases based on a principle of consistency, the doctrine of *stare decisis* or **binding precedent**.

This doctrine provides that once a principle of law has been decided in court, it becomes a precedent which, generally speaking, **binds the lower courts in cases with materially the same facts**. If the facts of the case are not materially the same as those of the relevant precedent, the precedent may be 'distinguished' and not followed.

In order to be a binding precedent, a decision must be based on a **proposition of law** and not a question of fact. It must **form part of the ratio decidendi** of the case; this is 'any rule of law expressly or impliedly treated by the judge as a necessary step in reaching his conclusion, having regard to the line of reasoning adopted by him, or a necessary part of his direction to the jury' (Cross).



Statements which announce **legal principle** but **do not form part of the ratio decidendi** and statements which are based on **hypothetical facts** are not precedents but are *obiter dicta* and of persuasive authority only.

Whether the doctrine of binding precedent applies depends on the **status of the court** dealing with the case and that of the court which delivered the 'precedent' judgment. There is a **hierarchy of courts** with the lower courts being bound to follow the decisions of the higher courts. Therefore, for example, magistrates' courts and county courts are bound by decisions of the High Court, the Court of Appeal and the Supreme Court for the United Kingdom.

## 5 Precedent

**Text reference.** Chapter 2.

**Top tips.** Allocate your time to all parts of the question carefully. Notice that part (c) asks you about the advantages and disadvantages of binding precedent, so you do not need to include those in part (a).

**Easy marks.** Include a mention of all of the courts in the structure to maximise the breadth of your answer. In part (c) be sure to discuss both the advantages and disadvantages, as there will be marks for both. You can't earn marks if you don't address the specific issues asked for.

### Marking scheme

This question requires candidates to explain the doctrine of precedent, the hierarchical structure of the English court system and the operation of the doctrine of precedent. It is essential that all aspects of the question be dealt with.

- 6-10 marks    A good to full explanation of the doctrine of precedent together with a description of the position and relationship of the various courts within the hierarchy will result in full marks. The more full the explanation and the more detailed the description, the higher will be the marks awarded.
- 0-5 marks    Unbalanced answer, perhaps lacking in detail in relation to the court structure or the operation of precedent. A mere diagram of the court structure will gain no more than 2 marks at most.

#### (a) Binding precedent

The doctrine of **binding precedent**, or *stare decisis*, is essential to the English legal system. It provides that in determining any case, where the facts of the case are materially the same as in a previous case heard by a superior (or sometimes equal) court, then the court will be bound by any proposition of law which formed part of the *ratio decidendi* of that previous case. The purpose of the doctrine is to provide **coherency**, **consistency** and, therefore, **predictability** and **fairness** in the development of case law.

#### **Ratio decidendi and obiter dicta**

Only a **proposition of law**, as opposed to a statement of fact, will be binding. The *ratio decidendi* of a case has been defined as 'any rule of law, express or implied, treated by a judge as a necessary step in reaching his conclusion, having regard to the line of reasoning adopted by him, or a necessary part of his direction to the jury' (Cross). The *ratio decidendi* is often difficult to identify and should be contrasted with *obiter dicta*; these might be propositions of law which do not form part of the basis for the decision, or statements based on hypothetical facts rather than the actual facts before the court. *Obiter dicta* are of persuasive authority only and do not bind later courts.

#### (b) The **hierarchy of the courts** is as follows.

##### **Magistrates', County and Crown Courts**

Decisions of the **Magistrates' Courts** and **County Courts** do not constitute precedent and are therefore not binding on any court, but each of these courts is bound by decisions of the High Court, Court of Appeal and the Supreme Court for the United Kingdom. The **Crown Court** is also bound by the superior courts and its decisions are of persuasive authority only.



## High Court

A decision of the **High Court** (an individual judge) binds all lower courts, but does not bind another High Court judge. However, it is of persuasive authority and tends to be followed in practice. A decision of a **Divisional Court of the High Court** binds any other divisional court as well as a judge sitting alone. A Divisional Court decision usually binds another divisional Court, although in rare circumstances it may have regard to the exceptions available to the Court of Appeal arising from the *Bristol Aeroplane* case.

## Court of Appeal

The **Court of Appeal's** decisions are binding on all English courts (except the Supreme Court for the United Kingdom). The Court is normally bound by its own previous majority and unanimous decisions, by those of its predecessors and by those of the Supreme Court for the United Kingdom.

## Supreme Court for the United Kingdom

The **Supreme Court for the United Kingdom** stands at the apex of the English judicial system. Its decisions are binding on all other English courts. It generally regards itself as bound by its own earlier decisions but it reserves the right to depart from its own precedents in exceptional cases, although this discretion is rarely exercised.

- (c) There are a number of widely accepted **advantages** to the doctrine of binding precedent.

### Certainty

The doctrine helps to ensure certainty, fairness and predictability of decisions. The need for costly and time-consuming litigation can be avoided where the facts of a case are so materially similar to those of a previous case that the outcome can be foretold. The doctrine also gives guidance to judges and leads to consistency in decisions from different judges in different courts and in different parts of the country.

### Clarity

Since only propositions of law forming part of the ratio decidendi of a case constitute binding precedent, it should be the case that the doctrine gives rise to a healthy source of statements of legal principle that can helpfully and clearly be applied to new cases generally. This leads to a saving of time for all concerned, in that cases do not need to be put before the courts and argued again.

### Flexibility

The doctrine allows the law to grow and be developed in accordance with changing needs and circumstances of society and allows a much more flexible judge-made law than Parliament-enacted legislation.

### Practicality

Another advantage of the doctrine of judicial precedent sometimes put forward is that it has its roots in tried and tested cases and not in theory, as is often the case with new legislation. As a result, there should perhaps be less uncertainty and misunderstanding in its application.

A number of **disadvantages** can also be identified.

### Inflexibility

It can be argued that with certainty comes rigidity, inflexibility and undesirable decisions being reached because judges are obliged to apply earlier decisions. This makes the law more complicated especially where judges are clearly at pains to avoid being bound by a precedent which would cause such a result.

### Lack of clarity

There may also be a lack of clarity. Although possibly not strictly a 'disadvantage' of the doctrine, the criticism is sometimes made that these propositions of law are often not clear enough and there may appear to be conflicting propositions in the same judgment or discrepancies between propositions reached in more than one case.

### Uncertainty

There can also be uncertainty, because there are only a finite number of precedents available and so it is often not possible to predict exactly how a court may decide a particular case.

### Unconstitutional

It may also be argued that the doctrine is unconstitutional. It is sometimes said that the flexibility given to unelected judges is too great as it effectively allows them to make law not just to apply law.

### Complexity

The disadvantage of the level of detail often contained in judgments is that the bulk of material makes subsequent reading, digesting and application of judges' decisions unnecessarily difficult and complicated. The distinguishing of cases can also become more tenuous the more detail is included.

## 6 Precedent; terms

**Text reference.** Chapters 1 and 2.

**Top tips.** Make it easy for the marker to award you marks by using a separate paragraph to explain each type of precedent – give each paragraph a header too.

**Easy marks.** Defining each type of precedent.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to consider the doctrine of precedent and in particular to explain particular terms operative within that doctrine. On the whole it was done fairly well. However the greatest shortcoming was in relation to the lack of information about the hierarchy of the courts within the English legal system and the implications this has for the doctrine of precedent.

### Marking scheme

This question requires candidates to consider the doctrine of precedent and in particular to explain particular terms operative within that doctrine.

- |     |           |  |
|-----|-----------|--|
| (a) | 3–4 marks | A thorough, to complete answer, explaining the meaning of the two terms.                                   |
|     | 0–2 marks | A less than complete answer, probably unbalanced, focusing only on one of the terms, or lacking in detail. |
| (b) | 4–6 marks | Thorough treatment of the topic. Clearly explaining the meaning of the two types of precedent.             |
|     | 2–3 marks | Less thorough answer, but showing a reasonable understanding of the topic of precedent.                    |
|     | 0–1 mark  | Weak answer, perhaps showing some knowledge but little understanding of the topic generally.               |

#### (a) Judgements

A judgement in a case will start with a description of the facts and probably a review of earlier precedents. The judge will then make **statements of law applicable to the legal problems** raised by the material facts. Statements are classed as either **ratio decidendi** or **obiter dicta**.

#### Ratio decidendi

Statements, which if used as the **basis for the decision**, are known as the **ratio decidendi** of the case. This is the vital element that **binds future judges**.

### Obiter dicta

Statements made by a judge which are said 'by the way' are known as **obiter dicta**. They **do not form part of the ratio decidendi** and are not binding in future cases as they are merely persuasive.

There are **two types** of obiter dicta:

- A judge's statements of **legal principle** that do not form the basis of the decision.
- A judge's statements that are not based on the material facts, but on **hypothetical facts**.

It is not always easy to distinguish the **ratio decidendi and obiter dicta**. In decisions of appeal courts, where there are several separate judgements, the members of the court may reach the same conclusion but give different reasons. Many judges indicate in their speeches which comments are 'ratio' and which are 'obiter'.

### (b) Judicial precedent

Case law in England is based on the system of judicial precedent which states that **principles of English law do not become inoperative through the lapse of time**. Precedent, or the principle of consistency, is expressed in the maxim **stare decisis**, which means 'to stand by a decision'. In any later case to which a legal principle is relevant, the same principle should (subject to certain exceptions) be applied.

#### Court hierarchy

The **court system** in the UK is split into those courts which deal with **civil law** cases and those which deal with **common law cases**. Cases begin in Courts of First instance, which in civil cases is usually the **County Court** and the **Magistrate's Court** in the criminal system. Decisions of these courts can be appealed to courts higher up in the hierarchy which include the relevant division of the **High Court** and **Court of Appeal**. The final appeal court in the UK is the **Supreme Court for the United Kingdom**.

Decisions of the courts in the hierarchy create two types of judicial precedent, **binding** and **persuasive**.

#### Binding precedent

**Binding precedent** means that a judge is bound to apply a decision from an earlier case to the facts of the case before them, provided, among other conditions, there is no material difference between the current case and the previous case which created the 'binding' precedent.

#### Persuasive precedent

Apart from binding precedents, reported conclusions of any court may be treated as **persuasive precedents** in future cases. Persuasive precedents may be, but need not be, followed in a later case. This is because a court of higher status is free to disregard the verdict of a court of lower status.

Where an earlier decision was made by a lower court, a judge can **overrule** that earlier verdict if they disagree with the lower court's statement of the law. **The outcome of the earlier judgement remains the same, but will not be followed in future.**

If the decision of a lower court is appealed to a higher one, the higher court may **reverse** the decision if they feel the lower court has wrongly interpreted the law. **When a decision is reversed through appeal, the higher court is usually also overruling the lower court's statement of the law.**

## 7 Legal terms

**Text reference.** Chapter 2.

**Top tips.** Notice that the question asks you to explain the **distinction** between the terms stated. That means trying to highlight the differences between them, so you should stress for example that the *ratio* is central to a case decision, while the *obiter* is peripheral.

**Easy marks.** In this 10 mark question there must be at least one mark for defining the meaning of each of the five terms specifically mentioned and in part (a) probably another mark or mark and a half each for further explanation of the definition. So five easy marks are available just for addressing each of the terms.

**Examiner's comments.** The question was neither popular nor well-done. The examiner was surprised by this as the doctrine of precedent is central to the English legal system. Many answers in part (a) only provided a translation of the two Latin terms and did not expand upon them and explain their different effects. Answers to part (b) tended to be unsatisfactory, as few candidates could explain that reversing relates to decisions and over-ruling relates to *ratios*.

This question requires candidates to consider the doctrine of precedent and in particular to explain particular terms operative within that doctrine.

- |     |           |   |
|-----|-----------|---|
| (a) | 3–5 marks | A thorough, to complete answer, explaining the meaning of the two terms.  |
|     | 0–2 marks | A less than complete answer, probably unbalanced, focusing only on one of the terms, or lacking in detail.        |
| (b) | 3–5 marks | A thorough answer demonstrating a clear understanding of the three terms.   |
|     | 0–2 marks | A less than complete answer, probably unbalanced, focusing only on one or two of the terms, or lacking in detail. |

(a) **Binding precedent**

The doctrine of **binding precedent**, or *stare decisis*, provides that in determining any case, where the facts of the case are materially the same as in a previous case heard by a superior (or sometimes equal) court, then the court will be bound by any proposition of law which formed part of the *ratio decidendi* of that previous case.

In practice, the doctrine means that decisions of the Magistrates' and County Courts are not binding on anyone but they are bound by decisions of the High Court, Court of Appeal and the Supreme Court for the United Kingdom.

The purpose of the doctrine is to provide coherency, consistency and, therefore, predictability and fairness in the development of case law. A comprehensive, consistent and objective system of reporting of cases is necessary for the doctrine to operate, as this enables lawyers to have access to previous relevant cases.

**Ratio decidendi**

Only a **proposition of law**, as opposed to a statement of fact, will be binding. The *ratio decidendi* of a case has been defined as 'any rule of law, express or implied, treated by a judge as a necessary step in reaching his conclusion, having regard to the line of reasoning adopted by him, or a necessary part of his direction to the jury' (Cross).

**Obiter dictum**

The *ratio decidendi* is often difficult to identify and should be contrasted with *obiter dicta* which might be propositions of law which do not form part of the basis for the decision or statements based on hypothetical facts rather than the actual facts before the court. *Obiter dicta* are of **persuasive authority** only and do not bind later courts. This means that they may be taken into account, but need not necessarily be followed.

**Differences**

It is not always easy to **distinguish** between the *ratio decidendi* and the *obiter dicta*. Judges do not always make clear in their comments whether a particular statement or conclusion is 'ratio' or 'obiter'. Indeed, in a case heard by more than one judge, each judge may provide a different *ratio decidendi* in support of a common decision.

(b) **Precedent**

When a case is decided, the **principle underlying that decision becomes a precedent**. In later cases, judges will look to that precedent and may be bound to make their decisions in accordance with the doctrine of judicial precedent. In certain circumstances, however, a judge may not wish to follow an earlier decision and it may be open to them to reverse, overrule or distinguish the precedent.

**Reversing**

Once a decision has been reached in a case by the court of first instance (the court where the case was originally heard), the party against whom the court's finding is reached may decide, or be given leave, to appeal against the decision. If the appellate court decides that the original decision was incorrect, it is said to

'reverse' the original decision. The original decision cannot subsequently form a precedent. For example, where the Court of Appeal reverses a decision of the High Court, the first decision cannot be a precedent but the reversed decision becomes one instead.

### Overruling

Following the example given above; if the first decision (by the High Court) had been reached by following precedent, then in reversing that decision, the Court of Appeal also '**overrules**' that earlier precedent which formed the *ratio decidendi*. It can be seen that overruling involves an earlier case, rather than a case which is the subject of an appeal. Higher courts may overrule the decisions of lower courts, depriving those earlier decisions of their precedent status.

When a decision is overruled, the **law is changed with retrospective effect**. Judges are usually cautious before overruling a long-standing precedent, but this is sometimes necessary, for example where what is acceptable within a particular society changes.

### Distinguishing

For a precedent to be followed, the facts of the previous case and the case under consideration must be materially the same. To the extent that there are significant differences in the material facts between the two cases, the previous case may be '**distinguished**' and therefore not followed.

## 8 Common law and legislation

**Text reference.** Chapters 1 and 2.

**Top tips.** This is a very straightforward question that requires you to explain two sources of English law. The answer below provides far more detail than you would be expected to produce in the exam, and is designed to cover a wide range of possible answers.

Before writing your answer to each part, quickly list all of the points that you need to make. Aim for one point per mark. This will enable you to write your answer quickly and keep it focused on the question in hand.

According to the examiner's model answer for part (a), you would also gain marks if you explained some advantages and disadvantages of common law - although this was not specifically asked for in the question.

In part (b), you would also gain marks if you explained the rules of statutory interpretation – again not specifically required by the question.

**Easy marks.** This question is a gift. There is no reason not to score very highly as you just need to repeat textbook knowledge.

**Examiner's comments.** This question dealt with a central aspect of the English legal system. It was divided into two parts with part (a) referring to the common law and part (b) referring to legislation. As has been the case for a number of years candidates did not do particularly well in this question which is surprising given that the first question is always on aspects of the legal system. Of concern was the fact that a number of candidates simply did not do this question.

### Marking scheme

- |     |           |   |
|-----|-----------|---|
| (a) | 4–6 marks | Good explanation of the common law. Examples used to highlight answers. |
|     | 2–3 marks | Sound understanding but perhaps no examples.                            |
|     | 0–1 marks | Little knowledge only about the topic.                                  |
| (b) | 3–4 marks | Good awareness of the meaning and effect of legislation.                |
|     | 0–2 marks | Limited knowledge only about the topic.                                 |

(a) **Common law**

**Common law** is the earliest element of the English legal system. It is a system of rigid rules laid down by the **Royal Courts** following the Norman Conquest. The 'law of the land' was created by **judges** who travelled around the country keeping the King's peace. By applying and amalgamating **local customary laws**, a body of legal rules common to the whole country was created.

The doctrine of **judicial precedent** underpins the common law and English law generally. A key principle is that **legal principles do not become inoperative through the lapse of time**. This doctrine means that a judge is bound to apply a decision from an earlier case to the facts of the case before him. This is provided that there is no material difference between the cases and that the previous case created a '**binding**' **precedent**.

When making a judgement, a judge will make various statements. These statements are either classed as **ratio decidendi** or **obiter dicta**. Judgements start with a description of the facts of the case and probably a review of earlier precedents. The judge will then make **statements of law applicable to the legal problems** raised by the material facts. The facts which are used **as the basis for the decision are known as the ratio decidendi**. This is the **vital element that binds future judges**.

However, if there are significant differences between the earlier and current cases, the court may **distinguish the earlier case on the facts** and thereby **avoid following it as a precedent**.

**Obiter dicta** means something said 'by the way' and does not bind future judges, but it may have persuasive authority. There are two types of obiter; firstly, statements of **legal principle** that do not form the basis of the decision and secondly, statements that are not based on the material facts, but on **hypothetical facts**.

**Remedies** under common law are **monetary**, and are known as **damages**.

(b) **Legislation**

Whilst the judiciary is responsible for the creation of common law, **Parliament** is responsible for **statute law** and therefore it is the supreme source of law in the UK. Statute law is usually made in areas so **complicated** or **unique** that suitable common law alternatives are unlikely, or would take an unacceptable length of time to develop. Company law is one example of an area of law created by statute.

In addition to making new law, Parliament may make the law clearer by passing **codifying** statutes. These put case law on a statutory basis (such as the Sale of Goods Act 1979). It may also pass **consolidating** statutes that incorporate an original statute and its successive amendments into a single piece of legislation (such as the Employment Rights Act 1996 or the Companies Act 2006).

A proposal for legislation can be brought by the Government, a backbench MP, or a peer. A Government bill may be aired in public in a **Government Green** or **White Paper** and may be introduced into either the House of Commons or the House of Lords. When it has passed through various stages in one House it must then go through the same stages in the other House.

**Delegated legislation**

Powers may be given to a minister, or public body such as a local authority, to make **subordinate or delegated legislation**. Delegated legislation has the same force of law as statute but it is often used where the law is highly technical (requiring expert input) or where it is too time-consuming for Parliament to go into enough detail.

As delegated legislation is often created by unelected individuals or bodies there are controls over it. It may have to be approved by an **affirmative resolution** of Parliament and/or be **laid** before Parliament for 40 days before it takes effect.

There are standing **Scrutiny Committees** of both Houses whose duty it is to examine delegated legislation from a technical point of view and they may raise objections if necessary. However they have no authority to object to its nature or content.

Delegated legislation may be **challenged** in the courts. Firstly, on the grounds that Parliament exceeded its authority to delegate and has acted *ultra vires*, or secondly, that the legislation has been made without due compliance with the correct procedure.

The **Human Rights Act 1998 (HRA)** gives courts power to **strike out** any delegated legislation that runs contrary to the HRA.

## 9 Delegated legislation

**Text reference.** Chapter 2.

**Top tips.** Notice that this question effectively asks you four separate things: (i) the meaning of delegated legislation, (ii) its effect, (iii) its advantages and disadvantages and (iv) how it is controlled by Parliament and the courts. It is important that you acknowledge all four of these requirements and make sure that you attempt them.

**Easy marks.** The easy marks for this question spring from the point made above, ie that you must attempt all the requirements that the question specifically asks for.

### Marking scheme

#### Marks

- |      |   |
|------|---|
| 6–10 | A thorough answer which explains the meaning of delegated legislation and how it is introduced. The perceived advantages and disadvantages should be considered and all aspects of control should be mentioned. For full marks reference should be made to the Human Rights Act 1998. |
| 0–5  | A less complete answer, perhaps lacking in detail or unbalanced in that it does not deal with some aspects of the question.   |

#### Meaning of delegated legislation

In the UK, it is **Parliament** which has sole power to create new legislation. However, the complexity of much modern legislation means that, in many instances, there is a great deal of detail which cannot conveniently be included in an Act of Parliament. The time available to Parliament is limited and the volume of legislation that is required to regulate a complex modern society is extremely high.

Therefore, much modern legislation contains sections allowing for the full scope of legal rules to be completed by Parliament's delegates who are normally ministers, government commissions or local authorities. The legislation is often enabling in nature, which means that it sets out the broad objectives and purpose of the Act, leaving the detail to be delegated to individuals or bodies outside Parliament. Therefore, **delegated legislation is law made by some subordinate person, body or authority to whom Parliament has delegated its legislative powers.**

#### Effect of delegated legislation

The effect of delegated legislation can be as wide as Parliament sees fit. Delegated legislation is usually encountered in one of a number of specific forms.

- **Statutory instruments:** Most often, these laws take the form of statutory instruments, made by government ministers to whom enabling legislation has delegated the relevant powers.
- **Bye-laws:** These are made by local authorities and apply within a specific locality.
- **Rules of Court:** these may be made by the judiciary to control court procedure.
- **Professional rules:** Parliament also gives powers to various professional bodies, such as the ACCA, in connection with the regulation by the professional body of the conduct of its members.
- **Orders in Council:** these contain rules which are often laid down by the Privy Council.

#### Advantages of delegated legislation

Delegated legislation can be extremely effective, but it also has drawbacks. The principal advantages, which make it an effective form of legislation, are as follows:

#### Volume of work

Without delegated legislation, Parliament would be overwhelmed by the **volume of work**. Delegated legislation therefore enables Parliament to concentrate on the broader principles of the legislative framework, rather than getting bogged down in details.



## Speed

The use of delegated legislation enables new laws to be passed much more **quickly**, especially advantageous in times of **emergency**.

## Expertise

The subject of new legislation is often highly detailed, **technical and complex**. It therefore makes sense for the exact content and wording to be arrived at by consultation with professional, commercial or industrial groups outside parliament who have the relevant **expertise**.

## Tider primary legislation

It also means that the **primary legislation is more concise** because the details are left to other delegated legislation documentation.

## Flexibility

Delegation leads to **greater flexibility**, because regulations can be altered later without the need to revert to Parliament.

## Disadvantages of delegated legislation

There is also some disadvantage inherent in passing legislative powers into the hands of persons outside Parliament itself.

## Volume

The **volume of delegated legislation** means that it can become difficult for Parliament (and others) to keep track of the effect of the legislation that it has enabled.

## Unconstitutional

Although Parliament is ultimately responsible for the legislation that is in force, it is likely that much of the detail has actually been drafted and finalised by individual ministers or by civil servants. Since civil servants are **unelected**, the degree to which law-making powers should be delegated to them is a matter for some debate.

It is therefore important that delegated legislation is **properly controlled** and that control is exercised by the courts and by Parliament.

## Control over delegated legislation

### Ultra vires

The power to make delegated legislation is conferred by the enabling Act of Parliament and this also defines the extent of that power. A statutory instrument may be **challenged** in the courts on the grounds that it is **ultra vires** – in other words that it exceeds the prescribed limits or that it has been made without due compliance with the correct procedure. In this way they may be said to exercise some degree of control over it.

## Human Rights Act 1998

The **Human Rights Act 1998**, implementing the European Convention on Human Rights, introduced an additional check on delegated legislation. In any proceedings in which a court determines whether a provision of primary legislation is compatible with a Convention right, **the court may declare the provision incompatible with the Convention right** but cannot declare it invalid. However, in any proceedings in which a court determines whether a provision of delegated legislation, is compatible with a Convention right, it may declare the delegated legislation itself to be invalid and therefore of no effect.

## Parliament

Parliament can also exercise some control over delegated legislation. This is achieved by means of providing for statutory instruments to be **laid before Parliament for 40 days** before they take effect and for members to propose (within forty days) a resolution of veto if there are objections. Alternatively, some regulations must be affirmatively approved by Parliament before they take effect. In addition, there are standing committees ('Scrutiny Committees') of both Houses of Parliament whose duty it is to examine statutory instruments with a view to raising objections if necessary (usually on the grounds that the instrument is obscure, expensive or retrospective).



# 10 Sources of English law and the Human Rights Act 1998

**Text reference.** Chapters 1, 2 and 3.

**Top tips.** You should note that there are three requirements for part (a). Not only are you asked about the main provisions of the Human Rights Act, but also who is bound by the Act and who it is intended to protect. Don't fall into the trap of omitting one of the parts and thereby denying yourself the credit available.

On the assumption that there is a mark available for each of who is bound and who is protected in part (a) there are then five marks for the provisions of the Human Rights Act. You should aim to produce at least five points, for a mark each, and there may be extra credit for elaborating on them.

Part (b) is a good opportunity to demonstrate your wider reading. Stay up to date with developments in this area.

**Easy marks.** Stating the main provisions of the Human Rights Act 1998.

## (a) Case law (common law)

**Common law** is the earliest element of the English legal system. It is a system of rigid rules laid down by the **Royal Courts** following the Norman Conquest. The 'law of the land' was created by **judges** who travelled around the country keeping the King's peace. By applying and amalgamating **local customary laws**, a body of legal rules common to the whole country was created.

The doctrine of **judicial precedent** underpins the common law and English law generally. A key principle is that **legal principles do not become inoperative through the lapse of time**. This doctrine means that a judge is bound to apply a decision from an earlier case to the facts of the case before him. This is provided that there is no material difference between the cases and that the previous case created a '**binding**' **precedent**.

When making a judgement, a judge will make various statements. These statements are either classed as **ratio decidendi** or **obiter dicta**. Judgements start with a description of the facts of the case and probably a review of earlier precedents. The judge will then make **statements of law applicable to the legal problems** raised by the material facts. The facts which are used **as the basis for the decision are known as the ratio decidendi**. This is the **vital element that binds future judges**.

However, if there are significant differences between the earlier and current cases, the court may **distinguish the earlier case on the facts** and thereby **avoid following it as a precedent**.

**Obiter dicta** means something said 'by the way' and does not bind future judges, but it may have persuasive authority. There are two types of obiter; firstly, statements of **legal principle** that do not form the basis of the decision and secondly, statements that are not based on the material facts, but on **hypothetical facts**.

**Remedies** under common law are **monetary**, and are known as **damages**.

## (b) Statute (legislation)

Whilst the judiciary is responsible for the creation of common law, **Parliament** is responsible for **statute law** and therefore it is the supreme source of law in the UK. Statute law is usually made in areas so **complicated** or **unique** that suitable common law alternatives are unlikely, or would take an unacceptable length of time to develop. Company law is one example of an area of law created by statute.

In addition to making new law, Parliament may make the law clearer by passing **codifying** statutes. These put case law on a statutory basis (such as the Sale of Goods Act 1979). It may also pass **consolidating** statutes that incorporate an original statute and its successive amendments into a single piece of legislation (such as the Employment Rights Act 1996 or the Companies Act 2006).

A proposal for legislation can be brought by the Government, a backbench MP, or a peer. A Government bill may be aired in public in a **Government Green** or **White Paper** and may be introduced into either the House of Commons or the House of Lords. When it has passed through various stages in one House it must then go through the same stages in the other House.

## (c) Impact of the Human Rights Act 1998 on UK law

The main impact of the Human Rights Act on UK law is that UK courts are now required to **interpret** UK law in a way that is **compatible** with the Convention.

## Existing legislation

**Existing legislation** must be **interpreted** in a way that is **compatible with convention rights**, meaning that the courts must take into account the previous decisions of the **European Court of Human Rights**. If a court feels that a provision of primary legislation (ie an Act of Parliament) is incompatible with the Convention it can make a declaration of incompatibility. It is then up to the Government to take action to remedy the incompatibility.

Areas in which the **human rights legislation** has already affected UK law include the following:

- Courts are now to decide the minimum sentence for convicted murderers sentenced to life imprisonment, rather than the Home Secretary
- The limitation on defendants in rape cases to questioning the victims has been removed following *R v A (2001)*.

## 11 Alvin

**Text reference.** Chapter 4.

**Top tips.** The answer to this question looks straightforward, and indeed it is. However, you cannot earn enough marks to pass by rushing straight into a conclusion – make sure you follow the correct approach. **Identify** the legal issues, **state** the law, **apply** the law and then **conclude**. This will ensure you cover the material in enough depth to pass.

**Easy marks.** This is a very simple question and you should have no trouble passing it by stating and applying the basic principles of contract formation.

**Examiner's comments.** Answers broke the question down into a statement of relevant law and then applying that law to the three customers – Bert, Cat and Del. Credit was given for a brief statement of the key essentials for a valid contract, and then the distinction between an offer and an invitation to treat. The vast majority of students rightly identified that Alvin's notice was in fact an invitation to treat, correctly citing or describing the case of *Fisher v Bell*. However, in applying the law to the scenario, many candidates jumped straight into dealing with each customer as though Alvin's notice was an offer and therefore Alvin was the offeror. Some of these students then went on to reach the correct conclusions – that Bert and Cat had no right to sue Alvin as no contract had been made.

Generally speaking, marks were gained by dealing with Bert since that is when candidates went into detail about Alvin's offer being an invitation to treat, to which Bert responded by making an offer, which Alvin was at liberty to accept or reject. Some students became confused at this stage by saying that Alvin could revoke his offer of £5,000 as long as it was before Bert's acceptance; whereas some candidates kept on track by treating the notice as an invitation to treat which was not capable of acceptance. Therefore Alvin was free to change the price on the notice.

Cat's scenario was more problematic for candidates. Many candidates did not specifically identify the issue concerning the option contract, which would have obliged Alvin to honour any promise he makes to keep the offer open if Cat had paid some consideration for him to do so. The reason for this is that a promise to keep an offer open is only binding where there is a separate contract to this effect. However many candidates did cover the issue of Cat's failure to give consideration so credit was given accordingly. Most students also correctly identified that Alvin did not, in any case, expressly accept Cat's offer. Some candidates raised the issue of counter-offer, but the question was not inviting a discussion of counter-offer.

Del's scenario was a simple case of legally enforceable contract being entered into, with Del being the offeror and Alvin being the offeree. For some reason, many candidates just simply restated the facts given in the question rather than actually concluding that a contract had been reached because the essentials for a contract were all present.

This question asks candidates to analyse the scenario provided in the light of the rules relating to the formation of a contract. In particular it requires an examination of the distinction between offer and invitation to treat, and the operation of option contracts.

8–10 marks: A thorough treatment of all of the rules relating to the formation of contracts together with a clear and correct application of those rules to the problem scenario. Cases will be expected to be provided at this level.

5–7 marks: Good analysis and case support, although perhaps limited in appreciation.

3–4 marks: Recognition of the areas covered by the question, but lacking in detail.

0–2 marks: Very weak answers which might recognise what the question is about but show no ability to analyse or answer the problem as set out.

### Alvin and Bert

#### Issue

Alvin has been threatened with legal action by Bert for not selling him the car when Bert apparently accepted Alvin's offer. The issue appears to be whether or not a valid offer was made by Alvin in the first place.

#### Relevant law

For a contract to be valid there must be an **offer** made by the offeror and **acceptance** from the offeree. An offer is a definite promise to be bound on specific terms. It does not have to be made to a particular person and may be made to a class of persons or to the world at large.

**Statements that initiate negotiations** are not offers but are known as **invitations to treat**. They are not capable of being accepted and therefore cannot form a legally binding agreement.

According to Bert, a contract was formed when he accepted Alvin's **offer**, which he believes was made by the **price notice** that Alvin attached to the car. It must therefore be considered whether or not the price notice is a **valid offer** or an **invitation to treat**.

In *Fisher v Bell 1961* it was held that an article for sale with a **price attached** to it is not a valid offer but an invitation to treat.

#### Application of law and conclusion

Alvin's price notice cannot be considered a valid offer. Legally, Bert made an offer when he 'accepted' to purchase the car for £5,000. As Alvin did not accept this offer, there is no contract between Alvin and Bert and Alvin **cannot be sued** for not selling Bert the car.

### Alvin and Cat

#### Issue

Cat offered to purchase the car at full price but required Alvin to wait until she could arrange finance. Alvin subsequently sold the car for cash to Del. The issue here is whether or not Alvin could revoke the contract with Cat in order to sell the car to Del.

#### Relevant law

An offeror may **revoke** their offer at any time before acceptance, *Payne v Cave 1789*. Even if they undertake to keep their offer open for a specified time, they may nonetheless revoke it within that time. This is unless a **separate contract** exists under which the offeror has agreed to keep it open. However, Alvin is not the offeror in this case because the price notice is just an invitation to treat. Therefore revocation does not apply.

### Application of law and conclusion

The question is therefore whether or not Alvin and Cat formed a separate contract by which Alvin agreed to wait for Cat to arrange finance to purchase the car. Such contracts are known as **option contracts** and are formed in the same way as any other contract. From the facts of the case, it does not appear that such a contract was formed as **Cat did not provide any consideration** in return for Alvin keeping the offer open. Therefore Alvin was free to revoke the contract which he did by selling the car to Del, and so no contract exists between Alvin and Cat.

### Alvin and Del

A valid contract was formed between Alvin and Del. Del **offered the full price** to Alvin who accepted it. Del provided **cash payment** as **consideration**, in return for the car provided by Del.

## 12 Ann's art

**Text reference.** Chapter 4.

**Top tips.** This scenario question is typical of the type of question you must expect the exam. It requires you to analyse the scenario and apply principles of contract law to it. You must not expect there to be one simple and obvious answer to a question like this. Comparing this situation to case law you are aware of will help you identify what is most likely to be the case here.

Imagine the process (say) Dave's solicitor will go through – analysing case law, trying to build up his own case. He would compare the facts to *Carlill v Carbolic Smokeball Co*, etc ... so must you. In this instance you must consider the scenario from each person's point of view (Ann, Chas, Dave, Eve). What case would each try to build? Each point raised would be relevant in this answer.

You will probably find it useful, as we have in our answer, to consider the various elements of contract separately: agreement (offer and acceptance), consideration, intention (if relevant ... in this commercial situation it is a fair assumption that the parties intended legal relations and it does not merit being mentioned).

**Easy marks.** As with the previous question, the only easy marks are for stating the basic rules and definitions – learn them!

### Marking scheme

	Marks
Agreement	1
Offer	2
Invitations to treat	2
Acceptance	2
Postal rule	2
Conclusion	1
	<u>10</u>

### Agreement

For an agreement to constitute a valid and binding contract, it must comprise a valid **acceptance** of a valid **offer** made with the **intention of creating legal relations** and being supported by valid **consideration**.

### Offer

An offer is a definite promise to be bound on specific terms. It must be certain in its terms (*Gunthing v Lynn*) and can be made to a particular person or to a class of persons, in which case it is only open for those persons to whom the offer is made to accept it.

However, an offer can be made to the **world at large** (*Carlill v Carbolic Smoke Ball Co*) in which case anyone can accept it. It must be more than a mere supply of information (*Harvey v Facey*) or statement of intention (*Harris v Nickerson*).

### Invitation to treat

An invitation to treat, on the other hand, is an indication that a person is prepared to receive offers with a view to entering into a binding contract. It is generally accepted that goods displayed in a shop window give rise to an invitation to treat rather than an offer (*Fisher v Bell*).

### Ann

The notice in Ann's window is therefore almost certainly an invitation to treat and an offer was made in response to this invitation to treat when Chas and Dave offer £12,000 for the prints.

### Acceptance

Acceptance must be an **unqualified agreement** to the terms of the offer and must not introduce new terms (in which case it is a counter offer). Similarly, a purported acceptance which is actually a request for further information or one which is made 'subject to contract' will not constitute valid acceptance.

Acceptance of an offer may be by express words or be inferred from conduct (*Brogden v Metropolitan Rly Co*). It may only be made by a person authorised to do so, usually the offeree or their authorised agent.

### Ann

Ann is entitled to accept or reject Chas's and Dave's offers and she rejects them, but at the same time makes a **counter-offer** that she will sell the prints for £13,500 each. Likewise, Chas and Dave are free to accept or reject this counter offer which destroys the original offer of £12,000 (*Hyde v Wrench*).

The arrangements whereby Ann agrees to keep the offers open until noon on Monday amount to separate option agreements supported by consideration in Chas and Dave each paying £100. These collateral contracts are binding on both parties. The offer to sell at £13,500 has still to be accepted in order to make the main contract of sale binding also.

### Communication of acceptance

Generally speaking, **acceptance must be communicated to the offeror** before it can be effective, unless the offeror expressly waives the need for communication (as in *Carlill's* case). The offeror may stipulate the sole means of communication in which case only compliance with their terms will suffice.

If the offeror specifies a means of communication but does not make it absolutely compulsory, then acceptance by another means which is equally expeditious and does not disadvantage the offeror in any way will be sufficient (*Yates Building Co v R J Pulleyn and Sons (York)*).

### The postal rule

Communication of acceptance by post is subject to the **postal rule** established in *Adams v Lindsell*. This provides that where the use of the post is in the contemplation of both parties and the acceptance is correctly addressed and stamped and is actually put in the post, then **acceptance will be valid and effective once posted** and it is irrelevant whether the offeror actually receives the letter.

There is no need for the offer to specifically state that acceptance must be communicated by post – whether this was in the **contemplation of the parties** may be deduced from the circumstances. Clearly if it is evident that the parties did not intend the postal rule to apply then the rule will be excluded.

### Ann

In this case, **Ann does not stipulate the means by which acceptance of her offer is to be communicated**. It can be argued, however, that since the parties so far have communicated face to face, it was to be expected that Chas and Dave would again visit the shop by Monday if they wished to purchase the prints at £13,500 a piece.

In the case of Chas, his acceptance arrives within the stipulated time in any event and an enforceable contract for sale exists from this point. It is submitted that Dave, however, has not entered into an enforceable contract for sale with Ann because his acceptance has not been communicated by noon on Monday and the postal rule was not in the reasonable contemplation of the parties.

# 13 Ali

**Text reference.** Chapters 4 and 5

**Top tips.** Answering this question is very simple if you read it carefully. Questions such as this typically include three issues for you to spot and advise on. When you **identify** an issue you need to **state** the relevant law in your answer, **apply** it to the scenario and **conclude**. Answers to scenario questions may therefore be shorter than other questions since marks are awarded for application.

**Easy marks.** Identifying and stating the law on window displays, counter-offers and executory consideration.

**Examiner's comments.** The question tended to be done reasonably well with most candidates achieving a pass mark on the basis of their recognition of the law involved in the scenario and their application of that law.

## Marking scheme

	Marks
A thorough analysis of the scenario focusing on the appropriate rules of law and applying them accurately. It is extremely likely that cases will be cited in support of the analysis and/or application.	8–10
A clear understanding of the general law but perhaps lacking in detail or unbalanced in only dealing with some issues.	5–7
Some, but limited, understanding of the law or completely lacking in application.	2–4
Little or no knowledge of the relevant law.	0–1

## Issues

The **issues in the scenario** concerning Ali, Ben, Chet and Di are in regard to **contractual offer** and **acceptance**, the elements that forms a **valid agreement**, and **consideration**.

## Advertisements

An **advertisement** in a shop window is considered in law to be an **invitation to treat**, so the seller is under no obligation to sell the product. An offer is legally a definite promise to be bound on specific terms; it was held in *Fisher v Bell 1961* that having goods in a window did not amount to offering them for sale.

## Acceptance

Acceptance must be an **unqualified agreement to the terms of the offer**. A purported acceptance which introduces any new terms is a counter-offer, which has the effect of terminating the original offer: *Hyde v Wrench 1840*.

## Consideration

**Executory consideration is a promise given for a promise.** It can be defined as 'that which is to take place at some future time'. For instance, consideration for the delivery of goods is executory if it is a promise to pay at a future date. The consideration in support of each promise is the other promise, not a performed act, but it is valid consideration nonetheless.

Applying the law to the scenario we can determine the following:

## Ben

Ali's advertisement is an invitation to treat, not an offer, therefore Ben cannot accept it as such. Ben's letter however is legally an offer to Ali to buy the vase. Therefore Ben has no contract to buy the vase.

## Chet

Chet made an offer to buy the vase from Ali for £400 which Ali did not accept. By introducing new terms (a price of £450) Ali made a counter-offer to Chet. Chet rejected this offer and therefore made no agreement to buy the vase from Ali. Subsequently he could not then accept a counter-offer that he has already rejected and therefore he has no contract to buy the vase.

## Di

Di made a valid offer to Ali to buy the vase for £400 which was accepted. Di's promise to pay Ali and Ali's promise to provide the vase to Di on Monday are both executory consideration, which is valid to support a contract. Therefore Di has a contract to buy the vase from Ali which will be valid unless and until she fails to pay for the vase on Monday. In that event Ali will be free to sell the vase to Ben, Chet or anyone else.

# 14 Offers and invitations to treat I

**Text reference.** Chapter 4.

**Top tips.** It is important to notice in this question that you must explain what offers and invitations to treat are **and** also explain why it is important to be able to distinguish between the two.

**Easy marks.** Explain what an offer is and back it up with some cases. Set out the situations where an invitation to treat can arise and make sure that you give some cases as examples. Don't forget to try to explain the importance of the distinction.

**Examiner's comments.** This was the most popular question on this paper and was generally well done and there was good use of cases. Some candidates fell into the trap of writing all they knew about offers, without relating it to a comparison with invitations to treat.

## Marking scheme

This question is a very straightforward question with little room for ambiguity.

6-10 marks    A thorough, to complete answer detailing what is meant by the two terms and distinguishing them clearly. It is most likely that case examples will be provided.

0-5 marks    A limited understanding, or a lack of clarity as to the distinction between the two concepts.

## Offers

In the law of contract, an **offer is a definite promise to another to be bound on specific terms**. It is a promise which is capable of acceptance so as to form a binding contract. It cannot be in vague terms, for example a promise to buy a horse if it is 'lucky' (*Gunthing v Lynn 1831*). An offer can be made to an individual, a class of persons or to the world at large and it can be accepted by the conduct of the offeree (*Carlill v Carbolic Smoke Ball Co 1893*).

Once an offer has been accepted, a binding contract is created. Either party (the offeror, who made the offer) or the offeree (who accepted the offer) may legally enforce the promise of the other.

## Supply of information

A mere **supply of information** is not an offer, because there is no intention to be bound. For example, stating the minimum price that one would consider if a sale were to be agreed does not constitute an offer (*Harvey v Facey 1893*).

## Statement of intention

Similarly, a mere **statement of intention**, for example, that an event such as an auction is to take place, is not the same as an offer (*Harris v Nickerson 1873*). Only an offer made with the intention that it shall become binding when accepted may be accepted so as to form a binding contract.



## Invitation to treat

An **invitation to treat**, on the other hand, is an indication that someone is prepared to receive offers with the view to forming a binding contract. In the usual example, when a person displays goods for sale, they are not making an offer but are inviting other persons to make them an offer to buy the goods which they can then choose whether or not to accept. There is no binding contract until this offer is made and, in turn, accepted.

## Differences

Case law has established a number of accepted principles which apply to determine whether a statement is an offer or merely an invitation to treat:

### Advertisements

As a general rule an **advertisement** is not of itself an offer capable of acceptance but is usually regarded as an attempt to induce offers and therefore is an invitation to treat (*Partridge v Crittenden 1968*).

In limited circumstances, an advertisement may constitute an offer as in *Carlill v Carbolic Smoke Ball Co 1893*, where the words of the advertisement were held to be an offer to the **world at large**, capable of being **accepted by anyone** fulfilling the necessary conditions;

### Price lists

Similarly, the circulation of a **price list** constitutes an invitation to treat (*Grainger v Gough 1896*). It would not make sense if a seller was obliged to sell to everyone who wished to acquire goods on the basis of a price list – the law effectively protects the seller from buyers who may not be creditworthy and from the situation where stock is limited.

### Exhibitions of goods for sale in a self-service shop

In *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) 1952*, the chemists exhibited various goods on self-service shelves. It was held that this was not an offer, but an invitation to treat. Customers took up the invitation by taking the goods to the cash point, thereby making an offer to buy which was accepted by the shopkeeper on accepting payment.

### Display of goods in a shop window

In *Fisher v Bell 1961*, a shopkeeper was prosecuted for **offering for sale** an offensive weapon by exhibiting a flick knife in their shop window. It was held that the display of an article in a shop window was in no sense an offer for sale, but constituted an invitation to treat.

## Invitations for tenders

An **invitation to tender** does not amount to an offer to contract with the party offering the lowest price. Rather, the tender itself is the offer which the person who issued the invitation to tender is then free to accept or reject.

## Auction sales

An **auctioneer's request for bids** is not a definite offer to sell to the highest bidder but an invitation to treat. The bid itself is the offer, which the auctioneer is then free to accept or reject (*Payne v Cave 1789*).

## Conclusion

Clearly the distinction is important since whether one party's words or actions **constitute an offer** or merely an invitation to treat determines whether a **contract is made** from the other party's response.

# 15 Offers and invitation to treat II

**Text reference.** Chapter 4

**Top tips.** This question requires the repetition of textbook knowledge on two of the basic principles of contract law. The examiner often sets questions, like this, where parts (a) and (b) are related. Make sure your answer to part (a) does not cover the material required in part (b). Note how the answer makes reference to case law where appropriate.

**Easy marks.** Defining offer, invitations to treat, and the use of examples and cases.



**Examiner's comments.** ... the best answers defined offer in positive terms and went on to consider several of the many issues that could have been properly raised in relation to it. They then went on to deal with invitation to treat as a distinct issue in part (b). These best answers invariably provided case authorities or examples in support of their explanations.

### Marking scheme

This question in two parts requires candidates to explain the meaning of offer and invitation to treat within the common law.

(a) Carries 4 marks as follows:

3–4 marks Thorough to complete explanation of the meaning of offer. It is expected that cases will be cited in support, although examples will be acceptable.

1–2 marks Some but limited knowledge of the topic. Perhaps uncertain as to meaning or lacking in detailed explanation or authority.

0 marks No understanding whatsoever.

(b) Carries 6 marks.

4–6 marks Thorough to complete explanation of the meaning of invitation to treat. It is expected that cases will be cited in support, although examples will be acceptable.

2–3 marks Some but limited knowledge of the topic. Perhaps uncertain as to meaning or lacking in detailed explanation or authority.

0–1 marks Very little or no understanding whatsoever.

(a) **Offer**

The first **essential element** in the formation of a binding contract is **agreement**. This is usually evidenced by **offer** and **acceptance**. Offers are made by an offeror to an offeree and are **definite promises to be bound on specific terms**.

They may be **express** or **implied statements** of the terms on which the maker is prepared to be **contractually bound** if it is accepted unconditionally. Therefore, if accepted, offers result in legally binding contracts. Statements that are too vague are not offers, *Gunthing v Lynn 1831*.

Offers may be made to **one person**, to a **class of persons** or to the **world at large** (*Carlill v Carbolic Smoke Ball Co 1893*), and only the person or one of the persons to whom it is made may accept it.

Not all statements are offers, even if they appear or purport to be. True offers must be **distinguished** from a mere **supply of information** and from **statements of intention**.

An example of a **supply of information** can be found in the case of *Harvey v Facey 1961*. In this case, a telegram stating the minimum price an individual would accept for a property was held not to be an offer.

**Statements of intention** are also not classed as offers. An example is the advertising of an event such as an auction. Potential buyers may not sue the auctioneer if the auction does not take place, *Harris v Nickerson 1873*.

(b) **Invitations to treat**

An **invitation to treat** can be defined as 'an indication that a person is prepared to receive offers with a view to entering into a binding contract'

**Invitations to treat** are **not capable of acceptance** and therefore cannot form a valid agreement. Those who make them are not obliged to accept any offers that result from them. In legal terms, the person who receives an invitation treat becomes an offeror if they respond to the invitation. The maker of the invitation to treat becomes an offeree.

## Examples of invitations to treat include

### Auction sales

Offers are made by bidders stating the price at which they are prepared to buy and acceptance takes place by the fall of the auctioneer's hammer, *Payne v Cave 1789*

**Advertisements** (for example, price lists or newspaper advertisements)

An advertisement of goods for sale is usually an attempt to induce offers, *Partridge v Crittenden 1968*.

### Displaying goods for sale

Displaying goods in a shop window (*Fisher v Bell 1961*) or on the open shelves of a self-service shop or advertising goods for sale, is normally an invitation to treat, *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) 1952*.

### An invitation for tenders

A **tender** is an estimate submitted in response to a prior request. When a person tenders for a contract they are making an offer to the person who has advertised a contract as being available. An invitation for tenders does not generally amount to an offer to contract with the person quoting the lowest price, except where the person inviting tenders actually makes it clear that they are making an offer.

## 16 Acceptance and revocation of offer

**Text reference.** Chapter 4.

**Top tips.** Each part of this question is worth five marks, which means that you can only spend nine minutes on them. Don't give in to the temptation to over-run on part (a) and therefore not leaving yourself enough time to do justice to part (b), which is equally straightforward. The examiner will not allow you to score over the mark allocation on one part of a question even if you devote all your time to it and produce a brilliant answer.

**Easy marks.** Get the easy marks by writing the rules on acceptance and revocation down, and if possible citing a case or quoting an illustration in support.

**Examiner's comments.** This was the most popular question in the entire exam. The main criticism of candidates was that some produced irrelevant material, for example on invitations to treat, therefore wasting their time.

### Marking scheme

This question requires an explanation of the rules relating to the acceptance and revocation of offers in contract law. Marks will not be transferred between parts.

- |     |           |  |
|-----|-----------|--|
| (a) | 3-5 marks | A good to complete answer dealing with most if not all of the issues relating to acceptance of offers                    |
|     | 0-2 marks | A less detailed answer, perhaps recognising what the question relates to but lacking in detailed knowledge of the rules. |
| (b) | 3-5 marks | A good to complete answer dealing with most if not all of the issues relating to revocation of offers                    |
|     | 0-2 marks | A less detailed answer, perhaps recognising what the question relates to but lacking in detailed knowledge of the rules  |

#### (a) Acceptance

Valid acceptance of a valid offer is one of the essentials of a contract.

An acceptance must be an **unqualified agreement** that corresponds to the terms of the offer. If a purported acceptance in fact introduces new terms then it is a 'counter-offer' (which might then be accepted by the original offeror) and not an acceptance. Therefore in *Hyde v Wrench 1840*, where an offer was made to sell land for £1,000 and the claimant made a counter-offer of £950 but later sought to accept the original offer, it was held that the claimant's counter-offer had terminated the original offer.

### Method of acceptance

The acceptance may be by express words or be inferred from conduct (*Brogden v Metropolitan Rly Co 1877*). In a unilateral contract (as in *Carlill v Carbolic Smoke Ball Co 1893*), **performance of the act** required by the offer or advertisement constitutes acceptance. There must be some act on the part of the offeree since **passive inaction or silence is not capable of constituting acceptance** (*Felthouse v Bindley 1862*).

### Request for information

A response to an offer which is actually a **request for further information** will not constitute acceptance. Acceptance made 'subject to contract' will not amount to a valid acceptance until the proposed formal contract has been signed.

### Communications

Acceptance of an offer may only be made by a **person authorised to do so**, usually the offeree or their authorised agent. Generally speaking, acceptance must be **communicated to** the offeror before it can be effective, unless the offeror expressly waives the need for communication (as in *Carlill's case*). The offeror may stipulate the sole means of communication in which case only compliance with their terms will suffice. If the offeror specifies a means of communication but does not make it absolutely compulsory, then acceptance by another means which is equally expeditious and does not disadvantage the offeror in any way will be sufficient (*Yates Building Co v R J Pulleyn and Sons (York) 1975*).

### Postal rule

Communication of acceptance by post is subject to the **postal rule** established in *Adams v Lindsell 1818*. This provides that where the use of the post is in the contemplation of both parties and the acceptance is correctly addressed and stamped and is actually put in the post, then acceptance will be valid and effective once posted and it is irrelevant whether the offeror actually receives the letter.

There is no need for the offer to specifically state that acceptance must be communicated by post – whether this was in the contemplation of the parties may be deduced from the circumstances. For example if the offer was itself made by post (*Household Fire and Carriage Accident Insurance Co v Grant 1879*).

Clearly if it is evident that the parties did not intend the postal rule to apply then the rule will be excluded (*Holwell Securities v Hughes 1974*).

### (b) Revocation

The offeror may 'revoke' (or cancel) the offer **at any time prior to acceptance** (*Payne v Cave 1789*) unless by a separate option agreement, they agreed to keep the offer open for a certain period of time (*Routledge v Grant 1828*). Once accepted, an offer cannot be revoked. Equally, once an offer has been revoked, it is no longer available for acceptance.

### Method of revocation

Revocation may be made by an express statement to that effect or may be **implied** from an act of the offeror indicating that the offer is no longer in force (for example sale of the goods to a third party).

### Communication

Whatever form it takes, it is essential that the revocation is **communicated to the offeree** in order to be effective. Revocation of an offer may be communicated by the offeror or by any third party who is a sufficiently reliable informant (*Dickinson v Dodds 1876*).

### Postal rule

While a **postal acceptance of an offer** is usually effective from the time of posting, a postal revocation of an offer does not take effect until **received by the offeree** (ie communicated to the offeree). Therefore, where a letter of revocation crosses in the post with a letter of acceptance, a legally binding contract will have been formed from the time the letter of acceptance was posted (*Byrne v van Tienhoven 1880*).

Where an offer is intended to be accepted by conduct (a unilateral contract), it has been held that the offer cannot be revoked once the offeree has begun to perform the necessary act required to accept the contract (*Errington v Errington 1952*).

# 17 Ace Ltd

**Text reference.** Chapter 4

**Top tips.** As with all scenario questions, the correct approach is to **Identify** the area of law, **State** the relevant law, **Apply** the law and **Conclude**. Ensure you always follow this method.

Explaining the *Carlill* case is important to demonstrate an understanding of how the law works, but you could have explained the law without reference to this case.

**Easy marks.** Defining offer and acceptance and stating relevant cases to support your answer present you with an easy source of marks. If you knew the case law well then your application to the facts in this question should have been straightforward.

## Issue

Cid and Ed wish to claim the £10,000 reward but Ace Ltd will seek to counter this claim on the grounds that no contract was formed (there was a **lack of offer and acceptance**).

## Offer

An offer is a **definite promise** to be bound on **specific terms**. It can be an express or implied statement of the terms on which the maker is prepared to be contractually bound. It does not have to be made to a particular person; it may be made to a class of persons or to the world at large.

## Acceptance

Acceptance is a positive act by a person to whom an offer has been made which brings a binding contract into effect. Contracts usually come into **effect** once the offeree has **accepted** the terms presented to them. This is the point of no return; after acceptance, the offeror **cannot revoke** their offer and both parties will be **bound** by the terms that they have agreed.

## Case law

*Carlill v Carbolic Smoke Ball Co 1893* is considered the **key case** on offer and acceptance and it is relevant to Cid and Ed's situation.

In this case the manufacturers of a medicinal product (a smoke ball) advertised that if the smoke ball was used as directed and the person using it caught influenza, they would pay them £100. To show that they were serious, the manufacturer deposited £1,000 in a bank account to be used for any claims arising. The claimant used the smoke ball as instructed and subsequently caught influenza.

The case is important as it established several points of law. First **offers do not need to be addressed to a particular person** but can be made to the whole world. Secondly mere '**sales puff**', which consumers are not expected to take seriously, can **become an offer** when the offeror makes some indication that it **should be taken seriously** – in this case the deposit of £1,000 into the bank. Thirdly **acceptance does not need to be communicated to the offeror** in cases such as this. Acceptance will result from a person following the terms of the offer (in this case using the smoke ball).

The *Carlill* case is an example of a **unilateral contract**, in other words a contract where the terms of the offer are fulfilled by the actions of the offeree. As acceptance is not necessarily communicated to the offeror; they are subject to slightly different rules than bi-lateral contracts, the most pertinent difference being on revocation of an offer.

Usually an offeror may **revoke** their offer at **any time before acceptance**: *Routledge v Grant 1828*. However this is not the case in **unilateral contracts** and **revocation is not possible** once the offeree has begun to **perform** the task specified in the offer: *Errington v Errington 1953*.

## Ace Ltd

Ace Ltd will attempt to **deny the existence of a contract** on the following grounds:

- That the offer in the journal **should not be taken seriously**
- That the offer was **not validly accepted** by Cid and Ed
- That the offer was **validly revoked**

Whilst not quite the same as the *Carlill* case as there is no reward, the offer in the journal could quite easily be argued to be serious since it was made in an **employee journal** and employees should **reasonably expect** the journal's contents to be serious. That the offer was not validly accepted would be dismissed on the facts contained in the *Carlill* case. Notification of acceptance is not required; **performance of the task is enough**. Valid revocation would be dismissed as a unilateral contract was made and therefore **revocation is not possible** once performance has commenced, as per *Errington v Errington (1953)*.

### Cid

Ace Ltd will claim that the offer was not made to Cid. The terms of the offer clearly state that it is open to **employees of Ace Ltd only** and therefore in this respect the facts differ from that of the *Carlill* case. Offers can be made to the world at large but where they are addressed to a specific group of people then only those within that group can accept them. Therefore Cid has no claim on the reward.

### Ed

Ed is an employee and therefore **included in the terms of the offer**. As mentioned above, Ace Ltd is **not permitted to revoke** the offer and therefore since he solved the problem before the deadline he is entitled to the reward.

## 18 Car filters

**Text reference.** Chapter 4.

**Top tips.** Questions such as this can seem complicated as there are many events occurring. Keep a clear head and try to draw a timeline with the types of events and the order in which they occur. This will help you follow the story and decide what events are offers, counter offers and acceptance.

**Easy marks.** Stating the law on offer and acceptance.

### Marking scheme

#### Marks

8–10	A complete answer, highlighting and dealing with all of the issues presented in the problem scenario. It is most likely that cases will be referred to, and they will be credited.
5–7	An accurate recognition of the problems inherent in the question, together with an attempt to apply the appropriate legal rules to the situation.
2–4	An ability to recognise some, although not all, of the key issues and suggest appropriate legal responses to them. A recognition of the area of law but no attempt to apply that law.
0–1	Very weak answer showing no, or very little, understanding of the question.

**Valid acceptance** of a valid offer is one of the essentials of a contract.

### Offer

An **offer is a definite promise to another to be bound on specific terms**. It is a promise which is capable of acceptance so as to form a binding contract. It cannot be in its vague terms, for example a promise to buy a horse if it is 'lucky' (*Gunthing v Lynn 1831*). An offer can be made to an individual, a class of persons or to the world at large and it can be accepted by the conduct of the offeree (*Carlill v Carbolic Smoke Ball Co 1893*).

Once an offer has been accepted, a **binding contract** is created. Either party (the offeror, who made the offer or the offeree, who accepted the offer) may legally enforce the promise of the other.

### Supply of information

A mere **supply of information** is not an offer, because there is no intention to be bound. For example, stating the minimum price that one would consider if a sale were to be agreed does not constitute an offer (*Harvey v Facey 1893*).

### Statement of intention

Similarly, a mere **statement of intention**, for example, that an event such as an auction is to take place, is not the same as an offer (*Harris v Nickerson 1873*). Only an offer made with the intention that it shall become binding when accepted may be accepted so as to form a binding contract.

### Invitation to treat

An **invitation to treat**, on the other hand, is an indication that someone is prepared to receive offers with the view to forming a binding contract. In the usual example, when a person displays goods for sale, they are not making an offer but are inviting another person to make them an offer to buy the goods which they can then choose whether or not to accept. There is no binding contract until this offer is made and, in turn, accepted.

### Advertisement

Therefore, an **advertisement** for the sale of goods is treated as an attempt to induce offers (*Partridge v Crittenden*, where an advert in a magazine was held to be an invitation to treat and not an offer).

### Acceptance

The acceptance of an offer must be an **unqualified agreement** to the terms of the offer. If it in fact introduces new terms then it is a counter-offer (which might then be accepted by the original offeror) and not an acceptance. Therefore, in *Hyde v Wrench 1840*, where an offer was made to sell land for £1,000 and the claimant made a counter offer of £950 but later sought to accept the original offer, it was held that the claimant's counter offer had terminated the original offer.

### AI

Applying this to AI's situation it is clear that AI's **advertisement** is an invitation to treat and the first letter from Bash Cars plc requesting terms was a **request for information** and therefore neither constituted an offer.

The first offer was the letter by AI stating that he offered to sell the filters at £50. Bash Cars could have accepted this offer, but replied with a **counter offer** (as it changed the price to £45). This counter offer destroys AI's offer. AI replied with his own counter offer when he restated his terms and Bash Cars was free to reject this offer, but instead sent in an order for 1,000 filters which constituted **acceptance** of AI's counter offer.

Therefore AI and Bash Cars plc have entered into a **binding contract** for AI to supply 1,000 filters at £50.

## 19 Presumption and rebuttal

**Text reference.** Chapter 5.

**Top tips.** At first glance, this looks quite a difficult question. However if you take just a minute to think about it, you will see that it is not so intimidating and covers quite an easy area of law. Always make sure that you actively consider each question in the paper when you are choosing which ones to do, as seemingly difficult questions can often be quite easy, and vice versa.

**Easy marks.** This question looks quite intimidating and daunting because it contains some real legal jargon: 'presumption' and 'rebuttal'. However, all it is asking you is when it is presumed that there is intention to create legal relations, and when it is not, and what can cause those presumptions to be rebutted, or overridden. There will be easy marks available for quoting the relevant cases (which should be familiar).

**Examiner's comments.** Many candidates could not specifically explain the terms, as required by part (a) of the question, but almost explained them by default in part (b), where they were able to set out what they knew of these situations. This indicates that candidates memorise answers to questions but cannot then cope with the questions if they are set in a different order from that expected.

8-10 marks	Thorough treatment of the two contexts with appropriate use of cases.
5-7 marks	Good treatment of one of the contexts but less complete treatment of the other.
0-4 marks	Very unbalanced answer, focusing on only one aspect of the question and ignoring the other, or one which shows little understanding of the subject matter of the question and simply cites a number of cases in an unstructured way.

### (a) **Presumption**

In a legal context, a **presumption** is an assumption of fact accepted by the courts until disproved. The court is entitled to assume a fact to be true until such time as there is a greater weight of evidence which disproves the presumption.

#### **Rebuttal**

If the presumption is disproved or outweighed, it is said to be rebutted. A witness can present facts to persuade the judge that the presumption is not true. For example, an accused person is presumed innocent until proven guilty. The presumption of innocence is rebuttable.

### (b) **Intention**

No agreement can constitute a contract unless there is evidence, express or implied, of the **intention** of the parties that their agreement should give rise to legally binding obligations. The parties may make an **express statement** in making an agreement, that it is or it is not intended to create legal relations (*Rose & Frank v Crompton 1925*) but this is unusual. Usually courts must interpret the agreement which the parties have made by objective criteria and legally rebuttable presumptions, depending on the relationship of the parties.

#### **Presumption**

There are **two basic presumptions**, the first relating to **family and social arrangements** and the second relating to **commercial agreements**. Both presumptions may be **rebutted** by evidence to the contrary.

#### (i) **Family and social arrangements**

**Domestic agreements** are generally regarded as **informal** rather than contractual, unless the facts indicate otherwise. At one time, it was firmly considered that in an agreement made in a domestic context there was no implied intention to create legal relations if none had been expressed. Therefore an agreement by a husband to pay an allowance to his wife during his absence abroad was not legally binding (*Balfour v Balfour 1919*). Similarly, in *Jones v Padavatton 1969*, a mother promised her daughter a monthly allowance if the daughter would return to England to study law. The daughter did so and the mother refused to pay the allowance. It was held that there was no intention to create legal relations and that the agreement was not therefore legally binding.

The presumption is, however, **rebuttable** and the courts may decide that there is an intention to create legal relations in an agreement between husband and wife, especially if they are no longer **living together** or if there is **other evidence** that legal relations were intended. For example, the agreement being formally drawn up and signed (*Merritt v Merritt 1970*). Also, where the agreement relates to **property matters**, it is perhaps more likely that the courts will infer an intention to create legal relations.

In other relationships, such as those involving **relatives** or **friends**, the presumption is more likely to be rebutted where there is a **'mutuality in the arrangements'** amounting to a joint enterprise. For example where persons jointly enter a competition (*Simpkins v Pays 1955*). In this case, a woman, her granddaughter and a paying lodger took part in a weekly competition in a newspaper, which they entered in the grandmother's name. One week they won £750 and the lodger was denied a third share. It was held that there was a mutuality of agreement and that this was not a 'friendly adventure' but a contract and enforceable.



(ii) **Commercial arrangements**

In **commercial agreements**, the courts will normally infer that there is **an intention to create legal relations** unless there is evidence to the contrary.

In *Edwards v Skyways 1964* an agreement entered into to make an '**ex-gratia**' payment as part of a larger negotiation was held to be legally binding. In *Carlill v Carbolic Smoke Ball Co 1893*, the manufacturer argued – unsuccessfully – that their offer to pay a sum of money to any user of their medicine (who was not protected by it) was a mere '**puff**' not intended to create a legally binding agreement. The court held that their assurance that they had deposited money in a bank account to meet claims was evidence of an intention to create legal relations.

Some commercial agreements may be described by the parties as '**binding in honour only**'. This amounts to an express denial of intention to create legal relations and is effective to rebut the presumption (*Jones v Vernon Pools 1938*).

As mentioned above, in *Rose and Frank v Crompton 1923*, a statement that the arrangement was not subject to legal jurisdiction was held to be effective. '**Letters of comfort**' given to creditors of subsidiary companies are presumed to be statements of present intentions only and are not legally binding (*Kleinwort Benson Ltd v Malaysia Mining Corp Bhd 1989*).

## 20 Alan's intention

**Text reference.** Chapter 5.

**Top tips.** Read the question carefully at least twice. It contains two mini scenarios and you must address each of them. The question tries to help you to appreciate this, by asking you two specific questions, but it does not give you a mark allocation for the separate parts. In each of the scenarios, make sure that you:

- **Identify** the issue
- **State** the law
- **Apply** the law
- **Conclude** and advise the parties concerned

**Easy marks.** You can gain easy marks in this question by identifying the legal issues for each of the problems. That demonstrates to the examiner that you can recognise the law. Then try to illustrate your answer by reference to similar cases. Don't forget to advise the parties concerned on the basis of the points that you have made.

### Marking scheme

This question requires candidates to analyse a situation from the perspective of contract law. In particular it requires an understanding, explanation and application of the law relating to the need for an intention to create legal relations in the creation of contractual relations. Marks will be allocated as follows.

- |            |   |
|------------|---|
| 9-10 marks | Thorough explanation of the law relating to intention to create legal relations relevant to the scenario, with case authorities or examples. Good and accurate application of the law to the particular issues raised in the problem. |
| 7-8 marks  | Good treatment of the topic but perhaps not dealing with all the issues raised or lacking in some knowledge or application. Perhaps lacking balance.  |
| 5-6 marks  | Lacking in detail in some or all aspects or lacking in application  |
| 0-4 marks  | Some but little knowledge of the topic with little appropriate action   |



## Contracts

A **contract** is a **legally binding agreement** resulting from the **valid acceptance** of a **valid offer** supported by **consideration**. In addition, no agreement can constitute a contract unless there is evidence, express or implied, of the intention of the parties that their agreement should give rise to legally binding obligations.

The parties may make an **express statement** in making an agreement, that it is or it is not intended to create legal relations. In one leading case, a written agreement stated that the agreement itself was 'not subject to legal jurisdiction' (*Rose & Frank v Crompton 1925*) and that statement was legally effective.

However, in many cases, the parties do not express any intention and in those circumstances the **courts** must **interpret the agreement** which the parties have made by objective criteria and legal rebuttable presumptions, depending on the relationship of the parties.

There are **two basic presumptions**, the first relating to **family and social arrangements** and the second relating to **commercial agreements**. Both presumptions may be rebutted by evidence to the contrary.

### Domestic and social agreements

**Domestic agreements** are generally regarded as **informal** rather than contractual, unless the facts indicate otherwise. Therefore an agreement by a husband to pay an allowance to his wife during his absence abroad was not legally binding (*Balfour v Balfour 1919*).

The **presumption** is, however, **rebuttable** and the courts may decide that there is an intention to create legal relations in an agreement between husband and wife, especially if they are no longer living together and/or if there is other evidence that legal relations were intended. For example, where the agreement is formally drawn up and signed (*Merritt v Merritt 1970*). Also, where the agreement relates to property matters, it is perhaps more likely that the courts will infer an intention to create legal relations.

### Business agreements

In **commercial agreements**, the **courts** will normally infer that there **is an intention to create legal relations** unless there is evidence to the contrary. In *Edwards v Skyways 1964* an agreement entered into to make an 'ex-gratia' payment as part of a larger negotiation was held to be legally binding. In *Carlill v Carbolic Smoke Ball Co 1893*, the manufacturer argued, unsuccessfully, that their offer to pay a sum of money to any user of their medicine (who was not protected by it) was a mere 'puff' not intended to create a legally binding agreement. The court held that their assurance that they had deposited money in a bank account to meet claims was evidence of an intention to create legal relations.

Some commercial agreements may be described by the parties as '**binding in honour only**'. This amounts to an express denial of intention to create legal relations and is effective to rebut the presumption (*Jones v Vernon Pools 1938*). As mentioned above, in *Rose and Frank v Crompton 1923*, a statement that the arrangement was not subject to legal jurisdiction was held to be effective.

Applying the above principles to the facts of the scenario, the following may be observed.

#### (a) Alan and Ben

Alan and Ben are son and father and so it may be thought that the presumption that this is a '**domestic and social**' arrangement, involving family relations, should apply. However, it is clear from the facts of the case that there is an intention to enter into a business relationship with an expectation of consideration on both sides. It is likely that a court would find that Ben should pay for the work.

#### (b) Cath

The presumption in arrangements between **husband and wife**, as evidenced by the Balfour case, is that there is no intention to enter into legal relations. However, the case in the scenario involves a situation which resembles the *Merritt case*, in that the husband and wife are separating and the agreement is contained in a signed document. It is likely that a court would find that Cath could enforce the agreement against Alan.

## 21 Privity and intention

**Text reference.** Chapter 5

**Top tips.** Privity of contract and intention to create legal relations are two areas of law which may seem complicated when really they are not. When thinking of privity think private - third parties have few rights to sue on contracts they are not party to. When explaining intention remember that social agreements are not usually legally binding, and that commercial contracts are binding unless the contrary is proved.

**Easy marks.** Stating the nature of privity in Part (a) and the two rebuttable presumptions in Part (b).

**Examiner's comments.** On the whole the question was reasonably well answered. Part (b) was answered better than part (a). In respect of the former, many candidates were able to give a full account of the relevant principles and provide case authorities in support of their explanations. In contrast, whilst many candidates could state the basic principle of privity and some could cite the case of *Dunlop v Selfridge* to explain it, their knowledge of the exceptions to the rule left much to be desired. A surprising number knew very little and indeed many confused privity with the unrelated concept of privacy.

### Marking scheme

	Marks
A thorough understanding of both topics demonstrated by references to cases or examples.	8–10
A clear understanding of both topics but perhaps lacking in detail.	5–7
Alternatively, an unbalanced answer showing good understanding of one part but less in the other.	
Some, but limited, understanding of both topics, or clear understanding of only one of the topics.	2–4
Little or no knowledge of either of the topics	0–1

#### (a) Privity of contract

The term '**privity of contract**' is a general rule which means that only a person who is a party to a contract has enforceable rights or obligations under it. **Third parties** generally have no right to sue on a contract: *Dunlop v Selfridge* 1915. If a party to a contract imposes a condition for the benefit of a third party or obtains a promise of a benefit for a third party, then that party (not the third party) can usually enforce it. However damages cannot be recovered on the third party's behalf, since a claimant can only recover damages for a loss they have suffered.

#### Exceptions

There are some **exceptions** to the rule that third parties cannot enforce a contract.

#### Where the contract has been validly assigned to the third party

Benefit from a contract can be re-assigned from the original beneficiary to a third party if the assignment is in writing, if it transfers the same or no more benefits to the new beneficiary and if it has the consent of the other party.

#### Where they act in another capacity

In *Beswick v Beswick* 1968 a widow was able to sue in her capacity as administrator of her late husband's estate rather than purely as his wife.

### Where the contract is a collateral contract

In *Shanklin Pier v Detel Products Ltd 1951* the owners of a pier were able to sue the suppliers of paint used by contractors to paint the pier. The paint supplier confirmed to the contractors that the paint was suitable for the job but this did not turn out to be true. The pier owners were able to sue the paint suppliers, even though they were not party to the contract for the sale of the paint, as they were party to the collateral contract between them and the contractors responsible for painting the pier.

### Where there is foreseeable loss to a third party

In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd 1994* a third party was in the contemplation of both parties at the time the contract was made. As it was reasonably foreseeable that the third party may suffer a loss as a result of breach of contract the claimants successfully sued contractors for poor workmanship on behalf of the third party.

#### (b) Intention to create legal relations

The law recognises that only certain contracts are intended to have **legal effect**. If every agreement made was legally binding then the courts would be overrun by litigation.

Where there is no express statement as to whether or not legal relations are intended, the courts apply one of two **rebuttable presumptions** to a case.

- **Social, domestic and family arrangements** are not usually intended to be *binding*: *Balfour v Balfour 1919*
- **Commercial agreements** are usually intended by the parties involved to be legally binding: *Edwards v Skyways Ltd 1964*

The word '**presumption**' means it is assumed that something is the case, for example it is presumed that social arrangements are not deemed to be legally binding. '**Rebuttable**' means that the presumption can in some cases be refuted.

For example in *Merritt v Merritt 1970* a **domestic case** between husband and wife was deemed to involve a legally binding agreement because that is what the facts and circumstances suggested. In *Rose and Frank v Crompton 1923* a **commercial agreement** was found not to be legally binding since the contract explicitly stated this was so.

## 22 Consideration

**Text reference.** Chapter 5.

**Top tips.** It is important to allocate your time correctly to the different parts of the question. The last part is worth 40% of the whole, so devote enough time to it.

**Easy marks.** This is a very straightforward question, and the easy marks lie in the cases that you can cite in support of the definitions and explanations that you provide. In the definition of consideration in part (a) try to quote the cases that give the textbook definitions. Make sure that you address all of the parts of the question: don't forget to deal with both adequacy and sufficiency in part (b).

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to examine some of the essential principles relating to the doctrine of consideration in relation to the law of contract.

Part (a) required an explanation of consideration and on the whole it was done very well, with the majority of candidates either giving quotations from appropriate cases or providing examples of consideration.

Part (b) was divided into two separate elements. Part (i) focused on the meaning of and difference between sufficiency and adequacy. By and large candidates were much clearer as regards the issue of adequacy and only a relative few were able to give a clear or detailed explanation of the requirement relating to sufficiency. Part (ii) on past consideration was done fairly well and most candidates were able to cite *McArdle*. However, only a few went further to consider the exceptions to the general rule as set out in such cases as *Lampleigh*.

(a) **Consideration**

**Consideration** is an **essential element of all binding contracts**, except those made by deed. This is based on the idea that the contractual promise should not be gratuitous but should have an element of bargain about it, even though the courts will not weigh up the relative values of each party's promise or act. Broadly speaking, the doctrine of consideration provides that one party must know that they have bought **the other party's promise**, either by performing some act of their own or by offering a promise of their own.

Consideration has been defined as follows: 'an **act** or **forbearance** of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable' (*Dunlop v Selfridge 1915*). An alternative definition was given in *Currie v Misa 1875*: 'A valuable consideration in the sense of the law may consist either in some **right, interest, profit** or **benefit** accruing to one party, or some **forbearance, detriment, loss** or **responsibility** given, suffered or undertaken by the other.'

**Types of consideration**

Consideration may validly be **executed** or **executory** but cannot be past. **Executed consideration** is a performed, or executed, act in return for a promise. **Executory consideration** is a promise given for a promise (and will be valid before either party performs their promise). Both executed and executory consideration are provided at the time when the promise is given.

Consideration must '**move from the promisee**' which means that the price of a promise **must be paid by the person who seeks to enforce the promise**, ie the promisee (*Tweddle v Atkinson 1861*). The promisor need not receive any benefit from the promisee.

(b) (i) **Adequacy**

The fact that consideration need not be **adequate** means that it does not have to be of a value appropriate to the promise. The courts will not seek to weigh up the comparative values of the promises, nor will they provide a remedy for someone who simply makes a poor bargain.

In *Chappell & Co v Nestle Co 1959*, chocolate wrappers were held to be good consideration because they were identifiable even though they had no economic value. A nominal rent is sufficient consideration even if it is inadequate as rent in the open market (*Thomas v Thomas 1842*).

**Sufficiency**

If consideration is to be **sufficient**, it must be more than the contracting parties were legally obliged to do in any event. For example in *Glasbrook Bros. v Glamorgan County Council*, the policing of a football match was considered to be sufficient consideration to expect payment as more police were supplied than would normally be the case.

**Other considerations**

**Additional incentives** from the promisee to encourage performance of existing contractual or statutory obligations are not sufficient consideration (*Stilk v Myrick 1809*). However, in *Williams v Roffey Bros & Nicholls (Contractors) Ltd 1990*, where the promise to pay extra was given to avoid liability under a penalty clause, the courts held that the mutual benefit derived was sufficient to constitute valid consideration.

(ii) **Past consideration**

Subject to some exceptions, anything which has already been done when the promise is made is '**past consideration**' and is not sufficient (*Re McArdle 1951*). Where one party to an existing contract makes a further promise, even if it is directly related to the previous bargain, it will be held to have been made on past consideration (*Roscorla v Thomas 1842*).

There are some exceptions where **past consideration will suffice** to make the promise enforceable:

- Under s27 **Bills of Exchange Act 1882**, past consideration is sufficient to create liability on a bill of exchange;
- Where a request for services is made, it may be **implied** that the person requesting them was also promising to pay for them. Where that person promises a specific reward after the services have been performed, that promise will be treated as fixing the amount promised rather than as a new promise (*Lampleigh v Braithwait 1615*). The court will need to be satisfied, however, that both parties have assumed, during their negotiations, that the services being requested would have to be paid for (*Re Casey's Patents, Stewart v Casey 1892*).

## 23 Forms of consideration

**Text reference.** Chapter 5.

**Top tips.** It is important to notice the mark allocation in this type of question, as there are four separate parts and it is all too easy to overrun on one of them, limiting the time available on the others.

**Easy marks.** Defining consideration in part (a), and explaining the three types of consideration in part (b).

**Examiner's comments.** This was the most popular question on the paper. Candidates tended to score higher marks where they gave definitions, cases or examples. Some candidates were confused between executory and executed consideration, and in part (b)(ii) some just cited *Re McArdle* without explaining the legal principle.

### Marking scheme

		Marks
(a)	Price of the other person's promise (or similar explanation)	1
	Cases or examples	<u>2</u>
		3
(b)	<i>Executory consideration</i>	
	A promise for a promise	1
	Example	<u>1</u>
		2
	<i>Executed consideration</i>	
	Definition and example	2
	<i>Past consideration</i>	
	Explanation	1
	Cases or example	1
	Exceptions to the rule	<u>1</u>
		<u>3</u>
		<u>10</u>

### (a) Consideration

**Consideration**, like a valid offer and acceptance and an intention to create legal relations, is an essential element of all binding contracts, except those made by deed. This is based on the idea that the contractual promise should not be gratuitous but should have an element of bargain about it, even though the court will not concern itself with the fairness of the bargain made. Broadly speaking, the doctrine of consideration provides that one party must know that they have bought **the other party's promise**, either by performing some act of their own or by offering a promise of their own.

In *Dunlop v Selfridge*, consideration was defined as follows: 'an act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable'. An alternative definition was given in *Currie v Misa*. 'A valuable consideration in the sense of the law may consist either in some **right, interest, profit or benefit** accruing to one party, or some **forbearance, detriment, loss or responsibility** given, suffered or undertaken by the other.'

### Adequacy and sufficiency

Consideration must be **sufficient but it need not be adequate**. That is to say that it does not have to be of a value appropriate to the promise. The courts will not seek to weigh up the comparative values of the promises, nor will they provide a remedy for someone who simply makes a poor bargain. In *Chappell & Co v Nestle Co*, chocolate wrappers were held to be good consideration because they were identifiable even though they had no economic value to Nestle.

- (b) It is often said that consideration may validly be **executed or executory but cannot be past**. Both executed and executory consideration are provided at the time when the promise is given.
- (i) **Executory consideration** is a promise given for a promise (and will be valid before either party performs their promise). Therefore, the consideration in support of each promise is the other party's promise rather than a performed act. If one party agrees to pay for goods which the other party agrees to deliver, that constitutes sufficient consideration so that if either party withdraws without the other's consent, that is breach of contract.
  - (ii) **Executed consideration** is a performed, or executed, act in return for a promise. Therefore, in reward cases, for example, a promise to pay a reward when an act is done becomes enforceable only when that act is performed.
  - (iii) Subject to some exceptions, anything which has already been done when the promise is made is '**past consideration**' and is not enforceable (*Re McArdle*). Where one party to an existing contract makes a further promise, even if it is directly related to the previous bargain, it will be held to have been made on past consideration (*Roscorla v Thomas*).

There are, however, some **exceptions** where past consideration will suffice to make the promise enforceable, including:

#### Bills of Exchange Act 1882

Under s 27 bills of Exchange Act 1882, past consideration is sufficient to create liability on a bill of exchange; and

#### Request for Services

Where a request for services is made, it may be implied that the person requesting them was also promising to pay for them. In which case, where that person promises a specific reward after the services have been performed, that promise will be treated as fixing the amount promised rather than as a new promise (*Lampleigh v Braithwait*). The courts will need to be satisfied, however, that both parties must have assumed, during their negotiations, that the services requested would be paid for (*Re Casey's Patents*).

## 24 Paying Adam

**Text reference.** Chapter 5.

**Top tips.** In a complex scenario question like this one it is important that you follow our suggested procedure:

- **Identify** the issue
- **State** the law
- **Apply** the law
- **Conclude** on the given scenario

You can either do this separately for each part of the question, or you can do it in the way our answer does, by discussing all of the aspects of the law first and then applying it to the specific parts of the question.

**Easy marks.** Get the easy marks by making sure that you tackle each of the situations outlined in the question. Try to explain the legal principle and to quote at least one case in support of each.

This question asks candidates to analyse the problem scenario in terms of the rules relating to the waiver of existing contractual rights generally and it also requires an explanation of the doctrine of promissory estoppel.

- 9-10 marks    A thorough to complete understanding of the legal issues in the question together with a clear analysis of the problem scenario and a correct application of the law to it.
- 7-8 marks    Good understanding of the law and supporting analysis and application.
- 5-6 marks    Some, if limited, knowledge of the law. Perhaps lacking in analysis and application.
- 0-4 marks    Little understanding of the legal issues arising from the question.

### Issue

This question covers the **doctrine of consideration**, and specifically whether it is possible for consideration in a contract to be different from that originally agreed.

### Consideration

One of the essential elements of a contract is **consideration** except where a contract is made by deed. One of the consequences of this principle is that, if an additional promise is made by one party to a contract, that additional promise must equally be supported by consideration. It does not matter whether this is a promise to do more than under the original contract or to do less, ie a waiver of some kind.

### Forbearance

Two of the best-known definitions of consideration both include reference to the concept of **forbearance** and make it clear that the courts consider that **forbearance** (eg to pursue part of a debt) can amount to consideration. If a party to a contract agrees to waive their right to a part of a debt, it is clear under the general principles of contract law that this promise must itself be supported by consideration.

In *Foakes v Beer 1884*, the defendant had obtained judgement against the claimant for a debt. By written agreement, the defendant agreed to accept payment by instalments of the sum due, with no mention being made of interest which was also due. The claimant paid off this amount and the defendant then claimed the interest as well, arguing that their written agreement did not prevent them from claiming the interest as this promise was not supported by consideration. It was held that they were indeed entitled to the debt with interest, as the claimant had provided no consideration for any waiver of rights.

There are, however, exceptions to the rule that the debtor must give consideration if the waiver is to be binding that are relevant to Adam's situation.

- If the debtor offers and the creditor accepts **anything to which the creditor is not already entitled**, the extra thing will be sufficient consideration for the waiver. This may be for example, goods instead of cash (*Anon 1495*) or payment before the date payment is due (*Pinnel's case 1602*).
- The principle of **promissory estoppel** may prevent the creditor from retracting their promise with retrospective effect. This doctrine of equitable or promissory estoppel was developed in *Central London Property Trust v High Trees House 1947* to provide a more general safeguard to the promisee against the risk that the promisor may withdraw their waiver.

### Promissory estoppel

The doctrine applies when a person **promises** (without consideration) **not to enforce** in full their existing rights and intending that the promisee shall act on the promise by altering their position in reliance on it. If the promisee does act on the promise the promisor is **estopped** from withdrawing the promise. In some circumstances however they may, on giving reasonable notice of their intention, restore the original position for the future. In other words the doctrine may operate to suspend rights which may be enforced once again if reasonable notice has been given.



The doctrine only applies to a **promise freely given** (*D & C Builders v Rees 1966*). In this case, claimants were forced to accept lower sums because of financial difficulties of which the creditor was aware. It also only applies to a promise to waive existing rights and it is a 'shield not a sword', which means that the doctrine does not create new causes of action where none existed before (*Combe v Combe 1951*).

Applying these principles to the facts of the case involving Adam, the following conclusions are suggested:

#### Bob

In Bob's case, Adam agreed to accept servicing of his car as a payment in kind. He may not recover any further sum from Bob (*Anon 1495*). Consideration need not be '**adequate**' at law but must be **sufficient** so the question of whether servicing of the car is valuable enough is not relevant.

#### Dawn

Prima facie, Adam's agreement to accept only half of the debt appears to be unsupported by consideration and therefore Adam may still claim the remaining amount. However, Dawn may claim he cannot do so because of the doctrine of **promissory estoppel**, since she acted on the strength of his waiver by spending the remaining debt money on her record.

If Adam can show that he did not accept part payment voluntarily or that she took advantage of his financial difficulty (it is not clear what level of difficulty he was experiencing at this time), he may be entitled to recover following *D and C Builders v Rees*. Alternatively, it may be argued that following the success of her record, her reliance on the waiver was not to her detriment and it would be inequitable to allow her to avoid her obligations. The circumstances are not such that it would be unjust to allow Adam to enforce his legal rights (*Combe v Combe 1951*).

## 25 Types of term I

**Text reference.** Chapter 6.

**Top tips.** Notice the mark allocation to the four parts of the question and make sure that you give them each the appropriate amount of time. At 1.8 minutes a mark, you should spend about 5½ minutes on a 3 mark section and about 3½ minutes on a 2 mark section. Do not be tempted to over-run as you will then lose the chance to do well on the other parts of the question.

Our answer to part (d) is far longer than you would be expected to produce in the exam but covers the subject comprehensively for revision purposes.

**Easy marks.** Make sure that you attempt each of the parts of the question in order to get the easy marks available for the definitions and the illustrative cases. Don't forget the easy marks for explaining the effects of breach of the different types of terms.

### Marking scheme

#### Marks

- |      |   |
|------|---|
| 8–10 | Thorough explanation of the meaning of terms generally together with an explanation of the three categories of terms with reference to appropriate cases or examples.       |
| 5–7  | Reasonable treatment of terms generally and one or even two of the types of terms, or a less complete treatment of all the elements.  |
| 0–4  | Very unbalanced answer, focusing on only one aspect of the question and ignoring the others, or one which shows little understanding of the subject matter of the question. |



(a) **Terms**

**Contractual terms** are statements or promises which are incorporated into a contract. The contracting parties are contractually bound to observe and perform contractual terms and in the event of breach, the injured party's remedies will depend on whether the term is classified as a **condition** or a **warranty**.

(b) **Conditions**

A **condition** is a vital term of the contract which goes right to the heart of the contract, breach of which allows the innocent party to treat the agreement as **terminated and sue for damages**. Alternatively, they may elect to affirm the contract, in which case they can still sue for damages for any loss but must continue with their own obligations.

In the leading case of *Poussard v Spiers 1876* it was held that failure by an opera singer to appear on the opening night of a series of performances amounted to breach of a condition and the producer had been entitled to treat the contract for the remaining performances as discharged.

(c) **Warranties**

A **warranty** is a subsidiary contractual term which is less fundamental and breach of it gives only a **right to damages**, not to treat the contract as discharged. If a party to the contract attempts to repudiate the contract following a breach of warranty, this will amount to a wrongful repudiation. This would therefore make the party initially in breach open to a claim for breach of contract.

In contrast to the *Poussard* case, above, the case of *Bettini v Gye 1876* involved an opera singer who was booked to arrive six days before the first performance in order to attend rehearsals. He arrived three days before the first performance and it was held that this was a breach of a warranty. The defendants were not entitled to treat the contract as discharged and were ordered to compensate the claimant, whose services they had refused to accept.

(d) **Innominate terms**

In the absence of any express provision describing the contractual term as a condition or warranty (or any statutory provision which implies certain conditions and warranties), the court will seek to construe what was the **intention of the parties at the time of the contract**. It is this intention which will be used to decide whether the broken term is to be a condition or warranty (*Bunge Corporation v Tradax SA 1981*).

Where the intention is not clear, then the term is described as an **innominate term** and must be interpreted in the light of the actual effect of the breach. If the effect of the breach is to deprive the injured party of 'substantially the whole benefit of the contract' then the term will be treated as a condition giving rise to a right to treat the contract as repudiated and sue for damages. If the effect of the breach is not so severe, the injured party's rights will be the same as for breach of an express warranty.

In the case of *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisa Kaisha Ltd 1962*, a term that provided for the claimants to supply a ship which was 'in every way fitted for ordinary cargo service' was held to be innominate as it could not automatically be construed as either a condition or a warranty. The court held that the effect of the breach of this innominate term (the ship was not available for 7 out of 24 months) was insufficient to be regarded as breach of condition and did not justify terminating the contract.

## 26 Types of term II

**Text reference.** Chapter 6.

**Top tips.** It is important that you clearly distinguish between the two legal terms in each part – make sure the marker knows you are aware of the differences!

**Easy marks.** Defining each of the four terms.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to consider the law relating to terms in contracts. Part (a) specifically required the candidate to distinguish between terms and mere representations while part (b) required them to explain the difference between express and implied terms in contracts.

Part (a) tended to be answered fairly well and most candidates were able to distinguish between terms and representations, although some candidates spent too much time in developing extended answers on the various types of terms.

Part (b) was also fairly well answered and most candidates were aware of the various sources of implied terms and their effects. Perhaps not surprisingly less detail was provided about express terms.

### Marking scheme

- |     |           |  |
|-----|-----------|--|
| (a) | 2–3 marks | A good explanation of the distinction between terms and representations. No reference to misrepresentation is needed.  |
|     | 0–1 mark  | Very little knowledge of the meaning of the concepts.  |
| (b) | 5–7 marks | Thorough treatment of the topic. Clearly distinguishing between the two types of terms and explaining most, if not all of the ways in which terms may be implied into contracts. |
|     | 2–4 marks | Less thorough answer, but showing a reasonable understanding of the topic.   |
|     | 0–1 mark  | Weak answer, perhaps showing some knowledge but little understanding of the topic generally.   |

#### (a) Terms and representations

**Contractual terms** are statements or promises which are incorporated into a contract. The contracting parties are contractually bound to observe and perform contractual terms and in the event of breach, the injured party's remedies will depend on whether the term is classified as a **condition** (vital to the contract) or a **warranty** (subsidiary to the main purpose of the contract).

A **representation** is something which induces the formation of a contract but which does not become a **term** of the contract. The importance of the distinction is that different remedies are available depending on whether a term is broken or a representation turns out to be untrue. If the statement is made by a person with **special knowledge** it is more likely to be treated as a contract term (*Dick Bentley Productions v Arnold Smith Motors 1965*).

#### (b) Express and implied terms

An **express term** may be defined as any term which has been included by the parties. It may be written or oral. The court will ascertain as a question of fact whether any oral statement constitutes a term of the contract or simply a representation. However, if a contract exists and contains all necessary terms to make it an effective contract, generally speaking oral evidence will not be admitted in order to add to, vary or contradict any of the written terms. An apparently binding legal agreement must be **complete and certain in its terms** to be a valid contract (*Scammell v Ouston 1941*).

##### Implied terms

An **implied term** is one which is deemed to form part of a contract even though not expressly stated by the parties, whether orally or in writing. Terms may be implied by the courts, (as necessary to give effect to the parties' presumed intentions), by statute, or in accordance with relevant trade practices. Implied terms can normally be excluded or varied by the parties save where this is prevented by relevant statutory provisions.

##### Court

The usual reason for a **court** to imply a term in a contract is in order to **give business efficacy** to that contract. In such cases the term which is implied will be one which, it appears to the court, the parties inadvertently omitted or which is so obvious that it goes without saying and it can be assumed that the parties simply took it for granted that such a term would apply. The courts will be keen to prevent the failure of an otherwise sound contract and to implement the manifest intention of the parties (*The Moorcock 1889*). The courts have also established a number of implied terms into employment contracts concerning employers' and employees' duties.

## Statute

Terms will be **implied by statute** where that is the expressed intention of the legislation, for example under the **Sale of Goods Act 1979**, terms are implied as to the vendor's title and the description and quality of the goods in a contract for the sale of goods.

## Custom and practice

The parties may be considered to have entered into a contract **subject to a custom or practice of their trade**. In *Hutton v Warren 1836*, the defendant landlord gave the claimant, a tenant farmer, notice to quit the farm but insisted that the tenant should continue to farm the land during the period of notice. The tenant asked for 'a fair allowance' for seeds and labour from which they received no benefit (as they left before harvest time). It was held that by custom they were bound to farm the land until the end of the tenancy, but they were also entitled to a fair allowance for seeds and labour. However, any express term overrides a term which might be implied by custom (*Les Affreteurs v Walford 1919*).

# 27 Exclusion clauses

**Text reference.** Chapter 6.

**Top tips.** It is important to spend a little time planning before embarking on this question, especially for part (b). You need to clarify in your own mind the differences between statutory and common law control of exclusion clauses, so that you can produce a logical and well-structured answer.

**Easy marks.** There are few easy marks unless you know all the rules on exclusion clauses. The easiest marks are to define exclusion clauses and state their aim.

**Examiner's comments.** Candidates did not pay heed to the mark allocations for the different parts of this question, and did not equate their efforts in relation to the marks indicated for each part of the question. Candidates tended to score better marks on parts (a) and (b)(i) and seemed happier dealing with the common law rather than the statutory points. The Unfair Contract Terms Act and the Unfair Terms in Consumer Contracts Regulations were essential for a full discussion of this area of the law.

## Marking scheme

			Marks
(a)	Definition	1	
	Aim of law is to protect the weaker party	<u>1</u>	
			2
(b)	(i) Proper incorporation into contract	1	
	If document signed	$\frac{1}{2}$	
	Effect of misrepresentation	$\frac{1}{2}$	
	Cases ( $\frac{1}{2}$ each)	1	
	Contra proferentem rule	<u>1</u>	
			4
	(ii) Unfair Contract Terms Act	1	
	No exclusion for death or injury	1	
	Other examples of terms	1	
	Unfair Terms in Consumer Contracts Regulations	<u>1</u>	
			<u>4</u>
			<u>10</u>

(a) **Exclusion clauses**

An exclusion clause, or exemption clause, can be defined as '**a clause in a contract which purports to exclude liability altogether or to restrict it by limiting damages or by imposing other onerous conditions**'. As a general principle of contract law, the courts will not usually interfere where two parties negotiate a contract from positions of comparable bargaining strength. However, the law will seek to **protect a weaker party**, for example in the case of standard term contracts put forward by the party in the stronger bargaining position. The validity of exclusion clauses is governed by the common law, the Unfair Contract Terms Act 1977 and a number of other statutory regulations.

(b) (i) **Control by common law**

The **common law** provides that an exclusion clause must be properly incorporated into a contract, or in a document which is an integral part of the contract, before it can be effective (*Chapelton v Barry UDC*). Provided this is the case, a term cannot usually be disputed if the **document has been signed**, even if the signatory could not read the terms (*L'Estrange v Graucob*), unless the party putting forward the document gives a misleading explanation of the term's effects (*Curtis v Chemical Cleaning Co*).

**Unsigned contracts**

In the case of an **unsigned contract**, then it must be shown either that the party affected actually **knew of the clause** or that the person seeking to rely on the exemption clause has taken reasonable steps to bring the existence of the clause to the attention of the other party at the time of or before the contract was made. Therefore, sign on a hotel room wall was not incorporated into the contract between hotel and client since it was not seen until after the contract was made (*Olley v Marlborough Court*).

**Nature of the liability**

The court will have regard to the **nature of the liability** which is being excluded when deciding whether a clause has been effectively incorporated. If the terms are particularly unusual or wide, a more prominent notice may be necessary (*Thornton v Shoe Lane Parking Ltd*).

**Prior notice**

**Prior notice** of the terms is not necessary, however, where the parties have had previous consistent dealings and the documents used previously contained similar terms (even if the claimant has never read them (*Spurling v Bradshaw*)).

**Previous dealings**

Where there have been **previous dealings**, but not on a consistent basis, then the party to be bound by the term must be sufficiently aware of it at the time of making the latest contract (*Hollier v Rambler Motors*). A particularly unusual or onerous term must be highlighted if it is to be incorporated into the contract (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*).

**Interpretation**

At common law, under the *contra proferentem* rule, the courts **interpret exclusion clauses strictly** and in favour of the weaker party. They presume that the clause is not intended to defeat the main purpose of the contract. A general exemption will not be interpreted so as to cover negligence (*Hollier v Rambler Motors*) unless to do so is the only means by which the clause is given meaning (*Alderslade v Hendon Laundry*).

(ii) **Control by statute**

The scope of the common law in governing exclusion clauses has been significantly curtailed by extensive **statutory provisions**. The main statutory limitations on exclusion clauses are contained in the **Unfair Contract Terms Act 1977**. The Act applies to clauses inserted into most agreements by commercial concerns or businesses and provides that some clauses shall be void and some valid only as far as they are reasonable.

### Personal injury and death

Liability for **personal injury** or **death** due to negligence may never be excluded (s 2(1)). An exemption for loss due to negligence in other circumstances will be valid only insofar as it is reasonable (s 2). 'Negligence' covers breach of contractual obligations of skill and care and the common law duty of skill and care.

### Reasonableness

**Reasonableness** is to be considered with reference to the factors in s 11 and s 2. The court will consider the relative strength of the parties' bargaining power, whether an inducement was offered to the customer, whether the customer knew or ought to have known of the exemption clause and whether compliance with the contract's terms was practicable (Sch 2).

### Burden of proof

The **burden of proof** lies with the person relying on the clause and the court will consider the factors outlined above in reaching a decision. This will be a matter of fact.

### Sale of goods

A term in a **guarantee of goods** which excludes or limits liability for loss or damage caused by a defect of the goods in consumer use (s 5) will be void, as will a clause in any contract for the sale of goods which excludes the condition that the seller has a right to sell the goods (s 6). Likewise a clause which purports to exclude or limit liability for breach of the conditions relating to **description, quality, fitness or sample** (ss 6 and 7) will be **void** in a consumer contract and subject to the reasonableness test in a non-consumer contract.

### Unfair terms in consumer contracts

In addition to UCTA, the **Unfair Terms in Consumer Contracts Regulations 1999** apply to consumer contracts for the supply of goods and services and to terms which have not been individually negotiated. An **unfair term** is any term which causes a **significant imbalance** in the parties' rights and obligations under the contract to the detriment of the consumer. The courts will have regard to similar factors as those under UCTA and whether the supplier dealt fairly and equitably with the consumer.

## 28 Seller Ltd and Transport Ltd

**Text reference.** Chapter 6.

**Top tips.** This is quite a straightforward problem if you have revised this area thoroughly. A lack of technical knowledge will cost you marks. There is plenty of case law on the topic and you should refer to it.

**Easy marks.** Remembering and stating relevant cases to support your answer.

### Marking scheme

	Marks
Incorporation of the clause	
– By signature	1
– Notice/nature	2
– Course of dealings	3
Statute law restrictions	2
Conclusion	2
	<u>10</u>

(a) **Incorporation of exclusion clauses**

There are three ways in which exclusion clauses can be incorporated into contracts: by **signature**, by **notice** and by a **course of dealing**.

**Signature**

The terms may be incorporated into the contract by the **signature** of the other party on a document bearing the terms. The signatory is taken to know of the terms, even if they could not read them (*L'Estrange v Graucob*).

**Notice**

With regard to incorporation by **notice**, it must be shown that the person seeking to rely on the exclusion clause has taken reasonable steps to bring the existence of the clause to the attention of the other party **at the time the contract was made**. Only in limited circumstances will the courts allow the incorporation of a term after the contract has been made. Therefore a sign on a hotel room wall was not incorporated into the contract between hotel and client since it was not seen until after the contract was made (*Olley v Marlborough Court*).

**Nature of the liability**

The court will have regard to the **nature of the liability** which is being excluded when deciding whether a clause has been effectively incorporated. If the terms are particularly unusual or wide, a more prominent notice may be necessary (*Thornton v Shoe Lane Parking Ltd* where a notice excluding liability for injury in an automatic car park was not sufficiently displayed or referred to at the time the contract was made).

**Course of dealing**

Where the parties deal frequently in **transactions of a similar nature** and on the **same terms**, the courts are ready to hold that the exclusion clause has been incorporated into the latest agreement by virtue of its being present in the previous dealings, even if the claimant had never read it. The position is not as straightforward where the previous dealings have not been on a consistent basis (eg *Hollier v Rambler Motors* which concerned a consumer contract).

**Seller Ltd**

In the case of Seller and Transport, the court will consider each of these tests. There is no evidence that Transport's exclusion clause has been incorporated by **signature**. With regard to incorporation by **notice**, it seems that visitors to Transport's premises will be made aware of the clause by virtue of the 'notice prominently displayed'. However as the order was placed by telephone, it is unlikely that Transport can use this in its defence. Equally, the notice provided with the confirmation of order is provided **too late** to be incorporated into the contract, as the contract has already been concluded by this stage. Following *Olley v Marlborough Court*, this precludes incorporation of the clause by notice to the other party.

The court will also consider the fact that there have been **previous dealings** between the parties and will need to determine whether unspecified dealings over 'a number of years' are enough to constitute a regular and consistent course of dealing. In *Hollier v Rambler Motors* a course of dealing which amounted to 3 or 4 transactions over 5 years was held not to be sufficient. On the facts given it is not possible to conclude on this point.

(b) **Statute**

Statute law imposes some very important restrictions on the use of exclusion clauses. The **Unfair Contract Terms Act 1977**, which applies to clauses covering business liability, divides these clauses into two types; those which are **void** and those which are valid only as far as they are **reasonable**.

(c) **Conclusion**

There has been a breach of contract by Transport Ltd, involving failure to exercise its implied duty of reasonable skill and care in supplying a service under the **Supply of Goods and Services Act 1982**. An exclusion for loss due to negligence in other circumstances, in a business contract such as this one, will be valid only insofar as it is reasonable (s 2 of the 1977 Act).

In deciding **reasonableness**, the court will consider the relative strength of the parties' **bargaining power**, whether an **inducement** was offered to the customer, whether the customer **knew** or ought to have **known** of the **exclusion clause** and whether **compliance** with the contract's terms was **practicable** (Sch 2 of the 1977 Act).

## 29 Breach of contract

**Text reference.** Chapter 7.

**Top tips.** Be careful to read the question carefully as you are not just required to give a general explanation of breach of contract. Your answer must pay particular attention to anticipatory breach.

**Easy marks.** Defining breach of contract and anticipatory breach.

**Examiner's comments.** This question required candidates to show understanding of what is meant by breach of contract paying particular attention to anticipatory breach. On the whole the question was answered well. Many candidates were able to explain breach and the consequences according to the status of the term broken – either warranty, condition or innominate term, although some candidates did take this as an opportunity to answer a question on terms rather than breach. In this question it is pleasing to note that explanations were very often supported by accurate references to relevant case law.

Anticipatory breach was dealt with equally well on the whole, with many candidates drawing the distinction between express/implied anticipatory breach. Once again the relevant case law was cited in support of the explanations.

However, in spite of the question generally being well done there was considerable room for improvement, not just in terms of being better prepared to answer the question but also in terms of examination technique. Too many candidates spent an inordinate amount of time and effort in producing an introduction to their answer by explaining in considerable detail the essential elements of legally binding contracts, when in fact the question assumed the existence of the same. Such an approach not only wasted valuable time but also produced unfocused answers that gained fewer marks than they might otherwise have gained had they limited their time and effort to the essential matter of the question.

### Marking scheme

This question requires candidates to show understanding of what is meant by anticipatory breach. In demonstrating such understanding candidates should mention the consequences of such a breach of contract, but answers should not focus too much on remedies.

8–10 marks: A thorough explanation of the concept of breach providing cases or examples by way of explanation.

5–7 marks: A clear understanding of what is meant by breach but perhaps lacking in the detail expected of the very best answers.

2–4 marks: Some understanding of the breach, but confused or lacking in explanation as to meaning or effect.

0–1 mark: No real understanding of the meaning of the term.

### Breach of contract

A party is said to be in **breach of contract** where, without lawful excuse, they do not perform their contractual obligations precisely.

A person sometimes has a lawful excuse not to perform contractual obligations, if:

- Performance is **impossible**, perhaps because of some unforeseeable event.
- They have tendered performance but this has been **rejected**.
- The **other party** has made it **impossible** for them to perform.
- The contract has been discharged through **frustration**.
- The parties have by **agreement** permitted **non-performance**.



Breach of contract gives rise to a **secondary obligation to pay damages** to the other party. However, the primary obligation to perform the contract's terms remains, unless the party in default has **repudiated** the contract. This may be before performance is due, or before it has been completed, and repudiation has been accepted by the injured party.

### Anticipatory breach

**Anticipatory breach** occurs before the time of performance arrives and can occur in two ways.

#### Explicit (express) anticipatory breach

This is where one party **declares in advance** that they will not perform their side of the bargain when the time for performance arrives. For example, in *Hochster v De La Tour 1853*, an agreement to act as a courier from 1<sup>st</sup> June was cancelled by letter on 11<sup>th</sup> May. The court held that action for breach of contract could commence straight away rather than waiting for actual breach on 1<sup>st</sup> June as there had been express anticipatory breach.

#### Implicit (implied) anticipatory breach

This is where some **action** occurs which makes **future performance impossible**. For example, in *Omnium D'Enterprises v Sutherland 1919* an agreement was reached whereby a ship was let between two parties. The ship was actually sold before the contract could be carried out and this action was held to be repudiation of the contract.

### Remedies

As a **consequence** of anticipatory breach, the wronged party may **treat the contract as discharged** and **sue for damages immediately**, or **continue with their obligations until actual breach occurs**. Their claim for **damages** will then depend upon what they have **actually lost**. For example, in *White & Carter (Councils) v McGregor 1961* there was a contract to supply adverts on litter bins. Before the claimant performed their side of the bargain, the defendant wrote to cancel the contract. However, the claimant continued to provide the adverts anyway and then sued the defendants to claim the agreed price. This was upheld by the court.

## 30 Arti

**Text reference.** Chapter 7.

**Top tips.** Although the solution to this question may seem obvious, don't make the mistake of leaping straight into the conclusion – most of the marks are for explaining the law, not for the conclusion.

**Easy marks.** Stating the law on breach of contract and the various remedies.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to analyse a problem scenario from the perspective of contract law and apply the appropriate legal rules, specifically relating to anticipatory breach of contract and the remedies subsequent to any such action.

On the whole the question was dealt with fairly well, with the majority of candidates recognising that the issue involved anticipatory breach and providing appropriate case authority to support their analysis. A number, however, spent a largely wasted time considering the distinction between conditions and warranties and citing the cases in that area. This would appear to be the follow on from question 3, which raised the issue of terms. A smaller group suggested that there was no real problem in any case as Arti might still produce the material, so they didn't write anything about the law relating to the problem scenario.

The remedies issue was done less well, with the majority failing to pursue it with the necessary detail and a surprising minority suggesting that specific performance could be awarded.



This question requires candidates to analyse a problem scenario from the perspective of contract law and apply the appropriate legal rules.

- 8–10 marks Clear analysis of the problem scenario – recognition of the contract law issues raised and a convincing application of the legal principles to the facts. Appropriate case authorities are likely to be cited.
- 6–7 marks Sound analysis of the problem – recognition of the major principles involved and a fair attempt at applying them.  
Perhaps sound in knowledge but lacking in analysis and application.
- 3–5 marks Unbalanced answer perhaps showing some appropriate knowledge but weak in analysis or application.
- 0–2 marks Very weak answer showing little analysis, appropriate knowledge or application.

### Issue

From the facts it is clear that there is a contract between Arti and Bee Ltd for Arti to write a study manual that will be ready by 30 June 20X8. As of 31 May 20X8, Arti had not commenced work on the study text, he has also written to Bee Ltd stating that he is too busy to write it. The issue at hand is the apparent breach of contract by Arti, and Bee Ltd needs to know what remedies are available to it.

### The law

A party is said to be in **breach of contract** where, without lawful excuse, they do not perform their contractual obligations precisely. Breach of contract often occurs at the time the contract is performed. However in Arti's case, breach has occurred before the date of performance.

Where a party breaks a condition of the contract by declaring in advance that they will not perform it, the other party may treat this as **anticipatory breach**. This allows them to either treat the contract as discharged immediately (*Hochster v De La Tour 1853*), or allow the contract to continue until there is an actual breach (*White & Carter (Councils) v McGregor 1961*).

If the innocent party elects to treat the contract as still in force, they may continue their preparations for performance and **recover the agreed price** for their services. Any claim for damages will be assessed on the basis of what the claimant has really lost.

### Remedies

Two remedies for breach of contract which may be relevant are specific performance and damages.

#### Specific performance

This involves the party in breach being compelled to perform their obligations by the court. No compensation is paid to the injured party – the benefit to them is that the contract is fulfilled. This remedy is not available in employment contracts or contracts for personal services.

#### Damages

Damages is a remedy which is available where any contract is breached. It is a monetary payment from the party in breach to the innocent party. However, a party can only be sued for damages if the loss **arises naturally from the breach in a manner which the parties may reasonably be supposed to have contemplated, in making the contract, as the probable result of the breach of it** (*Hadley v Baxendale 1854*).

As a general rule, the amount awarded as damages is what is needed to **put the claimant in the position they would have achieved if the contract had been performed**. Punishing the party in breach is not the aim. Loss of profit can be claimed if it is deemed normal (*Victoria Laundry (Windsor) v Newman Industries 1949*). Preliminary expenses can also be claimed if they are in the ordinary course of business and not excessive (*Anglia Television Ltd v Reed 1972*).

In assessing the amount of damages it is assumed that the claimant will take any reasonable steps to reduce or **mitigate** their loss (*Payzu Ltd v Saunders 1919*). The burden of proof is on the defendant to show that the claimant failed to take a reasonable opportunity of mitigation. However, this does not appear necessary in cases of anticipatory breach, as the *White and Carter* case allows the injured party to continue to make preparations as if the other party will fulfil the contract.

The injured party is not required to take **discreditable** or **risky measures** to reduce their loss since these are not 'reasonable'.

### Application and conclusion

Applying the law to the facts it would appear that Arti is in **anticipatory breach** of his contract with Bee Ltd.

Bee Ltd has the option to **continue** as if the contract will be performed and claim damages when Arti fails to supply the study text, or it may treat the contract as **discharged** and seek a remedy immediately.

Bee Ltd may wish to force Arti to fulfil his part of the deal since time is running out for them to find another author who can write the material at short notice. This unfortunately is not an option as **specific performance** is not a remedy in contracts for personal service.

If another author is sought in mitigation then Arti would be liable for any damages where the **cost of the new author** is greater than what Bee Ltd would have paid Arti. Arti would be liable for any extra author costs.

If no author can be found then Bee Ltd could claim **loss of profit** as a consequence of it not being able to supply the text to the accountancy body but only if the profit is normal profit. Arti would not be liable for profits which are outside what was expected when the contract was signed. Bee Ltd could also claim its **preliminary expenses** which appear to be reasonable in the circumstances.

## 31 Astride's wall

**Text reference.** Chapter 7

**Top tips.** Contract law questions are often based on one issue – in this case breach of contract and remedies. Don't waste time discussing formation of contracts as it is not relevant and you will not earn any marks. If you applied the ISAC approach to this question then you would not have made this mistake (I = identify the issue).

**Easy marks.** Setting out the basic principles of law relevant to the issues in the question.

**Examiner's comments.** Overall, candidates acknowledged that there had been a breach of contract and displayed a good understanding of the various remedies available and the better answers recognised that the estimation of damages in relation to construction contracts was difficult. A sound understanding of relevant case law was displayed with many candidates referring to Ruxley Electronics and Construction Ltd v Forsyth (1995) and acknowledging that the cost of remedying defects has to be proportionate to the difference between the services ordered and those supplied.

### Marking scheme

This question requires candidates to analyse a situation from the perspective of contract law. In particular it requires an understanding, explanation and application of the law relating to the remedies available for breach of contract. Marks will be allocated as follows:

- |            |   |
|------------|---|
| 8–10 marks | Full and thorough explanation of the law relating to remedies for breach of contract, with case authorities or examples. Good and accurate application of the law to the particular issues raised in the problem. |
| 5–7 marks  | Good treatment of the topic but perhaps not dealing with all the issues raised or lacking in some knowledge or application. Perhaps lacking balance.  |
| 3–4 marks  | Lacking in detail in some or all aspects or lacking in application.   |
| 0–2 marks  | Some but little knowledge of the topic with little appropriate application.   |

Astride has made legally enforceable contracts with Bild Ltd and Chris so the issue appears to be **breach of contract** and what **remedies** are available to her.

### **Breach of contract**

Breach of contract may occur **before** the time of performance (**anticipatory breach**) or at the time of performance (**repudiatory breach**). Astride's dispute with Bild Ltd is therefore repudiatory breach; her dispute with Chris is anticipatory breach.

**Repudiatory breach** allows the injured party to either seek a remedy or affirm the contract. Astride is clearly not going to affirm the contract so she will seek a remedy.

Where **anticipatory breach** occurs, the injured party has a choice. They can either treat the contract as repudiated immediately and seek a remedy (*Hochster v De La Tour 1853*), or continue with their preparations for the contract and sue the defendant for the full amount of their losses (*White & Carter (Councils) v McGregor 1961*).

### **Remedies**

One common law and one equitable remedy have been identified as potentially relevant to the situation.

#### **Common law remedy – Damages**

Under **common law**, a breach of contract automatically gives the right of monetary compensation (damages) to the injured party. **Damages** are intended to restore them to the same position they would have been in if the contract had been performed. Payment of damages is subject to two tests; **remoteness of damage** and **measure of damages**.

#### **Remoteness of damage**

Under the **remoteness of damage** test, losses must be **natural consequences** of the breach. As this is obviously the case in Astride's dispute with Bild Ltd and Chris, it will not be discussed any further. The key issue to the case is the measure of damages.

#### **Measure of damage**

The **measure of damage** is what is required to compensate for the loss incurred. It is not intended that the injured party should profit from a claim. Damages may be awarded for financial and non-financial loss.

Building contract disputes are particularly difficult to resolve. Problems can occur if the work is not up to a **particular standard** or does not meet a **certain specification**. The usual measure of damages is the cost of rectifying the work. However, where the **cost** of such work is **out of proportion** with the **benefit** to the claimant, compensation will be granted instead. This is the difference between the value of the work done and what was contracted.

This was highlighted in *Ruxley Electronics and Construction Ltd v Forsyth 1995* where a swimming pool was constructed slightly shallower than was agreed. Correcting the defect required demolishing the shallower (but otherwise perfectly serviceable) pool and constructing a new one. The court held that the cost of such remedial work was disproportionate to its benefit and that loss of value based damages should be paid.

Where a building contractor **fails to perform** the work, damages will be awarded which represent the cost of another party performing the work instead.

#### **Equitable remedy – specific performance**

The court may at its **discretion** give an equitable remedy by ordering the defendant to perform their part of the contract instead of letting them 'buy themselves out of it' by paying damages for breach.

The order will **not** be made if it would require performance over a period of time and the court could not ensure that the defendant complied fully with the order. Therefore specific performance is not ordered for contracts of **employment** or **personal service** nor usually for building contracts.

Applying the law to Astride's case.

- (a) **Specific performance** is not available as a remedy in building contracts therefore Astride can only claim **damages**. Her case is different to the *Ruxley* case as all that is required is for the wall height to be increased to the contracted height. The court will award her damages for this **extra cost**.
- (b) Astride cannot get an order of specific performance against Chris but she has the choice to sue for **damages** either before, or at the time of performance. In either case she will be awarded damages to cover the **additional cost** of another person performing the work (£500).

## 32 Remedies for breach

**Text reference.** Chapter 7.

**Top tips.** Before you start to write, take a minute or two to run through the different remedies for breach of contract in your head. Do not restrict yourself purely to damages.

**Easy marks.** For each remedy that you discuss make sure that you cite a case or an illustration in support.

**Examiner's comments.** This was a very popular question and was answered well by most candidates. However some students restricted themselves to damages and no matter how good their answers, they could not earn full marks. Some candidates fell into the trap of discussing breach of contract and anticipatory breach, neither of which was relevant to this question. This could have been a result of students rote learning the answers to past papers and then not appreciating that the question was actually a little different.

### Marking scheme

This question requires candidates to examine the various remedies that may be available to innocent parties when they suffer as a consequence of a breach of contract.

- 8-10 marks Thorough to complete answers, showing a detailed understanding of all or certainly most of the remedies available, perhaps with examples or cases.
- 5-7 marks A clear understanding of the topic perhaps lacking in detail.
- 2-4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the various remedies.
- 0-1 marks Little or no knowledge of the topic.

### Breach of contract

A party is said to be in **breach of contract** where they **fail to perform their contractual obligations fully and precisely** without lawful excuse. Breach of contract always gives rise to an obligation to **compensate** the other party for losses sustained. In certain cases, the breach may also entitle the innocent party to treat the contract as discharged.

The **remedies** available are as follows:

#### Damages

Damages are a **common law remedy** primarily intended to restore the person who has suffered loss to the same position they would have been in had the contract been performed. Where there is no contractual provision for liquidated damages, the courts will determine the damages payable with reference to the following factors:

- The remoteness of damage
- The measure of damages

## Remoteness of damages

With regard to **remoteness**, the courts consider how far down the chain of cause and effect the consequences of breach should be traced before they become so remote that no compensation should be awarded in respect of them.

Under the rule in *Hadley v Baxendale 1854*, damages may be awarded in respect of losses which **arise naturally**, according to the **usual course** of things or which arise in a manner which the parties may **reasonably be deemed to have contemplated** as the probable result of breach of contract.

If the resulting loss is of an **unusual type**, that is, outside the natural course of events, it may be claimed only if the defendant was aware of the unusual circumstances which might give rise to that abnormal loss (*Victoria Laundry v Newman Industries 1949*).

## Measure of damage

In assessing the **measure of damages**, it should be noted that damages are intended to **restore** the wronged party to the position they would have been in if the contract had been performed but not to put them in a better or more profitable position nor to be punitive. Measurement of financial loss is usually made with reference to the available market rule.

## Action for the price

If the breach of contract is one party's **failure to pay the contractually agreed sum**, the other party should bring a personal action for the price against the party in breach. This is subject to the proviso that the property in the goods has passed to them unless the price has been agreed to be paid on a specific date (s49 SGA 1979).

## Quantum meruit

A 'quantum meruit' award may be sought as an **alternative to damages** where, for example, one party has already performed part of their obligations and the other party then repudiates the contract. Provided the injured party elects to treat the contract as terminated, they may claim a reasonable sum in respect of the work done (*De Bernardy v Harding 1853*). A quantum meruit award, unlike damages which is a compensatory award, is a restitutory award and aims to restore the claimant to the position they would have been in if the contract had never been made.

## Specific performance

An order of specific performance is an **equitable remedy** and is an order to the party in breach to **perform their part of the contract**. It is at the discretion of the court and will only be awarded where damages would not be an adequate remedy. It will not be awarded where performance would be required over a period of time and the court could not properly supervise the performance. For example in a contract for employment or personal services or building contracts.

## Injunction

An injunction, like specific performance, is an **equitable remedy** at the discretion of the court. The court can require the defendant to **observe terms** in the contract which are in substance negative restraints. The court may award an injunction in cases where specific performance would be refused. For example in a contract of personal service (*Warner Bros Pictures Inc v Nelson 1937*, *Metropolitan Electricity Supply Co v Ginder 1901*). An injunction will not be granted merely to restrain the defendant from acts inconsistent with their positive obligations (*Whitwood Chemical Co v Hardman 1891*).

## Rescission

Rescission entails **setting the contract aside** as if it had never been made. Rescission is an equitable remedy which seeks to ensure that the parties should be restored to their position before the contract was made. The right to rescind is lost where:

- The misled person affirms the contract after discovering the true facts
- The parties can no longer be restored to their original positions
- The rights of third parties would be prejudiced by rescission
- So much time has elapsed that allowing rescission would be inequitable.

## 33 Remoteness and measure of damages

**Text reference.** Chapter 7.

**Top tips.** This questions asks you to 'describe the rules'. Spend a minute or two when you start the question clarifying in your own mind what the rules are and jot them down so that you don't miss anything out. Then decide in what order to present them in your answer. Make sure that you divide your time on this question equally between the two parts.

**Easy marks.** As you discuss each rule make sure that you support your point with a decided case, and if you can't remember a case try to make up an example or illustration which will add authority to your answer.

**Examiner's comments.** Some candidates were confused as to the difference between remoteness and measure of damages and could not produce separate answers for parts (a) and (b). The examiner noted that some candidates who did badly on this question did reasonably well on their other questions, indicating that they had insufficient knowledge to tackle all questions competently. Candidates should make sure that they have adequate knowledge across the syllabus.

### Marking scheme

This questions is divided into two parts, each worth 5 marks each. Each part should be marked independently on its own merits although candidates may well run the two parts together.

6-10 marks    The best answers will provide a clear explanation of the test for deciding remoteness of damage and the various rules relating to fixing the amount of damages to be paid and reference will be made to cases.

0-5 marks    Weaker answers may show little understanding of the rules. Alternatively they may be unbalanced or deal only with one aspect of the question.

### Damages

Damages are a **common law remedy** primarily intended to restore the person who has suffered loss to the same position they would have been in **had the contract been performed**. Where there is no contractual provision for liquidated damages, the courts will determine the damages payable with reference to the following factors: the remoteness of damage and the measure of damages.

#### (a) Remoteness of damage

Damages for breach of contract will not be awarded to the extent that they are considered too remote. In considering remoteness, the court is asking how far down the **sequence of cause and effect** the consequences should be traced before they become so indirect or remote that they should not be compensated for.

In contract, the **remoteness of damage test** (otherwise known as the rule in *Hadley v Baxendale*) is in two parts. It provides:

- That damages may be awarded only in respect of losses which **arise naturally**, according to the usual course of things, from the breach or in a manner which the parties may reasonably be deemed to have contemplated as the probable result of breach of contract.
- That if the resulting loss is of an **unusual type**, that is, outside the natural course of events, it may be claimed only if the defendant had **actual or constructive knowledge** of the unusual circumstances which might give rise to that abnormal loss.



## Defendant's knowledge

Both parts of the rule are concerned with **what the defendant must have known**. Under the first head of the rule, they are **deemed to accept any normal consequence** which any other person might expect. Under the second head, if the consequence of breach is abnormal, or not what one would ordinarily expect, they are liable only if, in making the contract, they **knew of the special circumstances** from which the abnormal consequence of breach could arise.

In *Victoria Laundry v Newman Industries 1949*, the defendant was in breach of contract for failing to deliver goods on time. As a result, the claimant lost profits on **regular contracts** and on abnormally lucrative contracts which would have been performed had the goods been delivered on time. It was held that damages for loss of the normal profits were recoverable, but not for the **abnormal profits** since the defendant had no knowledge of these special contracts. The second head of the rule was not satisfied in respect of these lost profits.

In *The Heron II 1969* on the other hand, the defendant was held liable for damages when they failed to deliver a cargo of sugar on time and the claimant lost potential profits on resale due to a drop in the market value of sugar during the period of delay. The defendant argued that they were unaware that the claimant intended to sell the cargo immediately. The court held that it is a matter of **common knowledge** that commodities fluctuate in value, which means that delay can cause loss and that the defendant should reasonably have expected that the claimant intended to resell the cargo.

## (b) Measure of damages

Damages are intended to restore the wronged party to the position they would have been in if the contract had been performed but **not to put them in a better or more profitable position**. This is sometimes referred to as protecting the **expectation interest** of the claimant. The claimant's expectation loss may be defined as the loss of what the claimant would have received had the contract been properly performed.

A claimant may alternatively seek to have their **reliance interest** protected; this refers to the position they would have been in had they not relied on the contract. Because they compensate for wasted expenditure, damages for reliance loss cannot be awarded if they would put the claimant in a better position than they would attain under protection of their expectation interest.

## Market rule

**Measurement of financial loss** may be made with reference to the **available market rule**. If a buyer refuses to take delivery of goods which they have contracted to buy, and the seller sues for loss of profit on the transaction, the existence of a market in which there is an excess of supply over demand will lead to a successful claim (*Thompson Ltd v Robinson (Gunmaker) Ltd 1955*). Whereas if there is an excess of demand over supply, only nominal damages will be payable (*Charter v Sullivan 1957*). Damages will be awarded only in respect of reasonably foreseeable loss, which is not too remote (*Hadley v Baxendale 1854*).

## Financial loss

**Financial loss** is usually based on the actual loss suffered, although some types of non-financial loss are recoverable (*Jarvis v Swan Tours 1973*).

## Mitigation

The claimant must, however, take reasonable steps to **mitigate** their loss. This means that they must take reasonable steps to put themselves in as good a position as if the contract had been performed. For example, where goods are not delivered the buyer must take steps to buy the same goods from elsewhere as cheaply as possible (*Payzu v Saunders 1919*).

## Liquidated damages

The parties to a contract may seek to avoid complicated calculations of loss and disputes as to damages by providing a formula for the calculation of damages in the contract itself. For example a daily rate of payment in the event of late completion or late delivery of goods. A **liquidated damages** clause will be upheld by the court in the event of breach provided it is a genuine attempt to anticipate the appropriate level of damages (*Ford Motor Co (England) Ltd v Armstrong 1915*).

## Penalty clauses

Any term which amounts to a **penalty clause** will be void. In determining whether the clause in question is a penalty clause or a liquidated damages provision the courts will look to see if the clause represents a genuine pre-estimate of loss (*Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd 1915*). If so, the clause will be upheld, even if the actual loss is greater or smaller.

## 34 Roger and Lulu

**Text reference.** Chapter 8

**Top tips.** Maximise your marks by identifying the issues, stating the relevant law and then applying it to the scenario.

**Easy marks.** There are few easy marks unless you revised this area of law well. Stating what contributory negligence and *volenti non fit injuria* are will earn you some basic marks.

There are two defences to a claim in **negligence**, **contributory negligence** and ***volenti non fit injuria***.

### Contributory negligence

**Contributory negligence** does not exonerate the guilty party from their negligence completely, but their liability to pay compensation may be reduced by the courts if the injured party is proved to have contributed to the loss they suffered in some way.

In the case of *Sayers v Harlow UDC 1958*, a lady was injured while trying to climb out of a public toilet cubicle which had a defective lock. The court held that she had **contributed** to her injuries by the method by which she had tried to climb out.

Courts will **reduce damages** awarded to the claimant on a percentage basis which is just and reasonable. This is typically in the range of 10% to 75%, however it is possible to reduce the claim by up to 100%.

### Volenti non fit injuria

**Volenti non fit injuria** is the voluntary acceptance of the risk of injury. This defence is available to the defendant where both parties have **expressly consented** to the risk (such as on waiver forms signed by those taking part in dangerous sports), or it may be implied by the conduct of the claimant. This could be the case, for example, where it is reasonable for the parties to expect a high degree of risk and to accept it.

This defence will **exonerate** the party that caused the injuries from a liability in negligence as the injured party accepted the risk when they undertook the activity.

### Roger and Lulu

Whilst it is not clear that Roger and Jack **expressly agreed** to the risk, it is reasonable for them to expect and accept it. Roger has taken part in many fights so he cannot argue that he was not aware of the risk – therefore Jack and the organisers are likely to be exonerated from any liability under negligence for the injuries caused to Roger. The only exception to this could be if Jack had gone beyond the rules, or continued to punch after the bell.

Lulu's case is very similar to the case of *Sayers v Harlow* mentioned above. If she had heeded the warning notice then she would **not have** received the injuries that she did. Therefore the court is likely to find that she contributed to her own injuries and will reduce her claim against the train station accordingly. This does not exonerate the train station from liability but merely reduces the damages owed to Lulu because of her own actions.



## 35 Remoteness of damage

**Text reference.** Chapter 8

**Top tips.** Do not dump everything you know about negligence when answering this question! It is explicitly about remoteness of damage so keep your answer focused on this area.

**Easy marks.** Stating the basic rules on remoteness of damage.

**Examiner's comments.** The vast majority of candidates simply ignored the reference to tort and answered the question on the basis of contract law and consequently got very few if indeed any marks, depending on whether they gave a sufficiently general explanation of remoteness that could be applied to tort. Even those candidates who did recognise that the question related to tort rather than contract still tended to produce overly general answers, treating the questions as an invitation to write all they knew about tort law. That being said of the very few answers that managed to achieve pass marks, some did provide sound answers.

### Marking scheme

	Marks
A thorough understanding of the issues involved. It is likely that the best answers will focus on the cases, although examples might be used.	8–10
A clear understanding of the topics but perhaps lacking in detail.	5–7
Some, but limited, understanding of the issue, perhaps not referring to any cases to support the explanation.	2–4
Little or no knowledge of the topic.	0–1

### Remoteness of damage

Even where it is proved that a **defendant's negligence** caused damage to a claimant, a **negligence claim** can still **fail** if the damage caused is '**too remote**'. This rule, which is comparable to remoteness of damage in contract cases, is important as it **restricts a defendant's liability** for damage to those losses which they should **reasonably have foreseen**. It would be unfair for a party to be held liable for **damage** which, although they may have caused it, was unforeseeable and therefore in theory impossible to prevent.

The **test of reasonable foresight** developed out of *The Wagon Mound 1961*. Liability is limited to **damage** that a **reasonable man could have foreseen**. This does not mean the exact event must be foreseeable in detail, just that the eventual outcome is foreseeable.

### Case law

In the case of *The Wagon Mound 1961* a ship was taking on oil in Sydney harbour. Oil was spilled onto the water and it drifted to a wharf 200 yards away where welding equipment was in use. The owner of the wharf carried on working because they were advised that the sparks were unlikely to set fire to furnace oil. Safety precautions were taken. A spark fell onto a piece of cotton waste floating in the oil, thereby starting a fire which damaged the wharf. The owners of the wharf sued the charterers of the *Wagon Mound*. The court decided that the claim must fail. Pollution was the foreseeable risk: fire was not.

The test has since developed further. In *Jolley v London Borough of Sutton 2000* it was held that the remoteness test can be passed if some **harm is foreseeable** even if the exact nature of the injuries could not be. In this case the defendants should have removed a boat which had been dumped two years previously. A teenage boy was injured while attempting to repair it. The court decided that even though the precise incident was not foreseeable, the authority should have foreseen that some harm could be caused since they knew children regularly played on the abandoned boat.

Invariably it is **up to the court** concerned to decide what damage is foreseeable given all the **circumstances** and **facts** available to it.

## 36 Duty of care

**Text reference.** Chapter 8

**Top tips.** This question is more detailed than it first appears. To earn the marks you must be able to recall the three cases in this area otherwise your answer will not be complete.

**Easy marks.** There are few easy marks unless you know the cases. If you know them, quoting the decisions will earn you good marks quickly.

### Marking scheme

#### Marks

8–10	Thorough explanation of the meaning of duty of care with appropriate references to cases.
5–7	Reasonable duty of care but perhaps lacking in detail or cases authority.
0–4	Very unbalanced answer, lacking in detailed understanding.

#### Duty of care

Duty of care is central to the tort of **negligence** as to succeed in a claim the claimant must prove that:

- The defendant had a **duty of care** to avoid causing injury, damage or loss
- There was a **breach** of that duty by the defendant
- In consequence the claimant **suffered** injury, damage or loss

#### Case law

In the landmark case of *Donoghue v Stevenson 1932*, the House of Lords ruled that a person might owe a duty of care to another with whom they had **no** contractual relationship at all.

In this case, the claimant purchased a bottle of **ginger beer** for consumption by another person. This other person drank part of the contents, which contained the remains of a decomposed snail, and became ill. The manufacturer argued that as there was no contract between themselves and the person who drank the ginger beer, they owed them no duty of care and so was not liable.

The House of Lords refuted this and laid down the general principle that **every person** owes a duty of care to his 'neighbour', to 'persons so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected'.

The courts generally decide whether a duty is owed on a case by case basis, with each new case setting a precedent based on its own particular facts.

#### Two-stage test

For any **duty of care** to exist, it was stated in *Anns v Merton London Borough Council (1977)* that two stages must be tested:

- Is there **sufficient proximity** between the parties, such that the harm suffered was reasonably foreseeable?
- **Should the duty be restricted** or limited for reasons of economic, social or public policy?

#### Caparo

However this has been further refined in the case of *Caparo Industries plc v Dickman (1990)* which established a three stage test for establishing a duty of care that still stands:

- Was the harm **reasonably foreseeable**?
- Was there a **relationship of proximity** between the parties?
- Considering the circumstances, is it **fair, just and reasonable** to impose a duty of care?

By meeting this test, a claimant will have established that they are owed a duty of care by the defendant.

## 37 Standard of care

**Text reference.** Chapter 8

**Top tips.** There are not many knowledge-based questions that can be written on the standard of care in the tort of negligence and this one covers just about everything. Note how the answer is broken down into short paragraphs with headers. This makes it easier for markers to award you marks as points stand out clearly.

**Easy marks.** Stating that individuals have a duty to act as a reasonable man would and the six factors used in deciding whether a duty of care has been breached.

**Examiner's comments.** The majority of candidates did not answer the question asked and produced general explanation of the law of tort or the duty of care, rather than the specific issue of standard of care.

### Marking scheme

This question requires candidates to explain the standard of care owed by one person to another in relation to the tort of negligence.

- |            |   |
|------------|---|
| 8–10 marks | Full understanding and explanation of the topic. It is likely that cases will be cited as authority although examples will be acceptable as an alternative. |
| 5–7 marks  | Lacking in detail in some or all aspects of the topic. Unbalanced answer that only focuses on some particular issues.                                       |
| 3–4 marks  | Some, but little, knowledge of the topic.   |
| 0–2 marks  | Little if any knowledge of the topic.   |

### Duty of care

To succeed in an action for **negligence** the claimant must prove that; the defendant had a **duty of care** to avoid causing injury, damage or loss, there was a **breach of that duty** by the defendant and in **consequence** the claimant suffered **injury, damage or loss**.

The **standard of reasonable care** requires that the person concerned should do what a **reasonable man** would do. This also means the reasonable **employer**, or the reasonable **adviser**.

The following factors should be considered when deciding if a duty of care has been breached.

### Probability of injury

It is presumed that a reasonable man takes **greater precautions** when the risk of injury is high. Therefore when the risk is higher the defendant must do more to meet their duty. In *Glasgow Corporation v Taylor 1992* a local authority was held to be negligent when children ate poisonous berries in a park. A warning notice was not considered to be sufficient to protect children.

### Seriousness of the risk

The young, old or disabled may be prone to more serious injury than a fit able-bodied person. The '**egg-shell skull**' rule means that you must take your victim as they are. Where the risk to the vulnerable is high, the level of care required is raised. In *Paris v Stepney Borough Council 1951* an employer was found to owe a higher standard of care to an employee who only had one eye when the other eye was blinded at work.

### Practicality and cost

It is not always reasonable to ensure all possible precautions are taken. Where the **cost** or **disruption** caused to eliminate the danger far **exceeds the risk** of it occurring it is likely that defendants will be found not to have breached their duty if they do not implement them.

In *Latimer v AEC Ltd 1952* an employer was held not liable for an injury to an employee who slipped over at work. The factory was flooded and the employer did all they could to make the floor safe using sawdust. However, not all the floor could be protected and the employee was injured on one of the few areas not treated. The only other option, closing the factory, would have outweighed the risk to the employees.

### Common practice and custom

Where an individual can prove their actions were in line with **common practice** or **custom** it is likely that they would have met their duty of care. This is unless the common practice itself is found to be negligent.

### Social benefit

Where an action is of **some benefit** to society, defendants may be **protected** from liability even if their actions create risk. For example, a fire engine that speeds to a major disaster provides a social benefit that may outweigh the greater risk to the public.

### Professions and skill

Persons who hold themselves out to possess a particular skill should be judged on what a **reasonable person possessing the same skill** would do in the situation rather than that of a reasonable man. Professions are able to set their own standards of care for their members to meet and therefore members should be judged against these standards rather than those laid down by the courts.

### Res ipsa loquitur

In some circumstances the claimant may argue that the **facts speak for themselves** (*res ipsa loquitur*). Want of care being the only possible explanation for what happened, negligence on the part of the defendant must be presumed.

The claimant must demonstrate, firstly, that the thing which caused the injury was under the **management and control** of the defendant. Secondly they must prove that the accident would not have occurred if the defendant used **proper care**. In *Mahon v Osborne 1939* a surgeon was required to prove that leaving a swab inside a patient after an operation was not negligent.

Where **res ipsa loquitur** is established, the standard of care and its breach becomes irrelevant, the defendant is automatically liable unless they can prove they were not negligent.

## 38 Causality and remoteness

**Text reference.** Chapter 8

**Top tips.** Keep to the subject matter of the question. Any answers that venture into remoteness of damage will not attract high marks.

**Easy marks.** Stating the circumstances that will break the chain of causality.

### (a) Causality and the 'But for' test

Liability for negligence will only be proved if the claimant can show that a **chain of events** occurred that began with the defendant's negligent action and that resulted directly with the damage caused to the claimant. This concept is known as **causality**.

To satisfy the requirement that harm must be caused by another's actions, the 'But for' test is applied. The claimant must prove that **'but for'** the other's actions they would not have suffered damage. Therefore claimants are unable to claim for any harm that would have happened to them anyway irrespective of the defendant's actions.

This concept is illustrated in the case of *Barnett v Chelsea and Kensington HMC (1969)*. In this case a casualty doctor sent a patient home without treatment. The patient died of arsenic poisoning. The court held that the doctor was negligent, but the negligent action did not cause the death – the patient would have died anyway, therefore there is no chain of causality.

(b) **Circumstances that break the chain of causality**

**Multiple causes**

Where an injury has a **number of possible causes** including the negligent action, the chain of causality will be broken where the negligent act is not the most likely to have caused the injury. For example in *Wilsher v Essex AHA (1988)*, a claimant could not prove that a doctor's negligence was the most likely out of six causes to have caused blindness in a baby.

**Novus actus interveniens**

Courts will only impart liability where there is a chain of events that are a probable result of the defendant's actions. Defendants will not be liable for damage when the chain of events is broken. There are **three types** of intervening act that will break the chain of causation.

**Act of the claimant**

The actions of the claimant themselves may break the chain of causation. The rule is that where the act is reasonable and in the ordinary course of things an act by the claimant will not break the chain. In *McKew v Holland, Hannen and Cubbitts (Scotland) Ltd (1969)*, a worker who was prone to falls could not claim for negligence as they did not seek assistance when negotiating a flight of stairs.

**Act of a third party**

Where a third party intervenes in the course of events the defendant will normally only be liable for damage until the intervention.

**Natural events**

Natural events that are unforeseeable will break the chain of causality. By their nature, they are unforeseeable circumstances that the defendant could not avoid. However, a foreseeable event will not break the chain.

## 39 Defences

**Text reference.** Chapter 8

**Top tips.** This is a straightforward question, but to pass it you must ensure your answer is complete and contains sufficient examples that show how the defences are applied in practice. Your opening paragraph should explain what tort is. This was not asked for directly in the question but is required to give context to the rest of your answer.

**Easy marks.** There are few easy marks unless you revised this area of law well. Your definitions of contributory negligence and *volenti non fit injuria* will earn you the basic marks.

**Examiner's comments.** This question required candidates to explain the concepts of contributory negligence and consent. Answers required focussed on the reduction to damages and the defences to negligence respectively. As in previous sittings, questions on this area proved extremely difficult for candidates to answer.

Answers varied in standard although on the whole, this question was answered very unsatisfactorily. It was apparent that candidates were not comfortable with this area of law. They tended to either write hardly anything at all, or wrote everything they knew on the area starting with the neighbour principle, regularly citing *Donoghue v Stevenson* and going on to write in detail about the consequences of negligent advice. *Hedley Byrne v Heller* featured very frequently in answers. There was also discussion of remoteness of damage and the quantum of damages, which would be awarded in cases of personal injury.

There were some focussed answers which correctly analysed the principles in the question and some sound examples of case law were produced. However, answers such as these were very few in number. Candidates need to realise that there are different elements to the law of tort, just like there are with the law of contract. A complete knowledge regurgitation of every bit of law on the area will not suffice and will not be awarded decent marks. More practice is needed in this area. That said the area is still relatively new and answers were slightly improved from those at the last sitting.

- 8–10 marks: Thorough explanation of the meaning and effect of both elements of the question. Cases or examples will be expected to gain full marks.
- 5–7 marks: Reasonable explanation of both concepts but perhaps lacking in detail or cases authority.
- 3–4 marks: Some but limited knowledge of both elements or only dealing with one of them.
- 0–2 marks: Very unbalanced answer, lacking in detailed understanding.

### Tort

Tort is different from other legal wrongs. Firstly, it is **not a breach of contract**, where the obligation which is alleged to have been breached arose under an agreement between two parties. Secondly, it is **not a crime**, where the object of the proceedings is to punish the offender rather than to compensate the victim.

Instead, torts **are civil wrongs** and the person wronged **sues in a civil court** for **compensation** or an **injunction**. The claimant's claim generally is that they have suffered a loss, such as personal injury, at the hands of the defendant who should pay them damages.

No **previous transaction** or **contractual relationship** need exist between the parties. Claims are based on the principle that people owe **duties of care** to each another. A **liability** will exist if it is proved that a **duty of care** is **breached**, that the **breach caused the damage** suffered by the claimant, and that the **damage is not too remote**.

However, two defences are available to a defendant who would otherwise be liable under tort. These are **contributory negligence** and **volenti non fit injuria**.

#### (a) Contributory negligence

**Contributory negligence** does not exonerate the guilty party completely, but their **liability** to pay compensation may be **reduced** by the courts if the injured party is proved to have contributed to their loss or damage.

In *Sayers v Harlow UDC 1958*, a lady was injured whilst trying to climb out of a public toilet cubicle which had a defective lock. The court held that she had **contributed** to her injuries by the method she had tried to climb out.

Courts will **reduce damages** awarded to the claimant on a percentage basis which is just and reasonable. This is typically in the range of 10% to 75%, however it is possible to reduce the claim by up to 100%.

#### (b) Volenti non fit injuria

**Volenti non fit injuria** is the voluntary acceptance of the risk of injury. This defence is available to the defendant where both parties have **expressly consented** to the risk (such as on waiver forms signed by those taking part in dangerous sports), or it may be implied by the conduct of the claimant. This could be the case, for example, where the injured party was involved in stealing and joyriding a car which crashes.

In *ICI v Shatwell 1965* the two injured parties disregarded safety instructions whilst handling detonators. It was upheld that their reckless action was enough to establish acceptance of the risk of injury.

This defence will **exonerate** the party that caused the injuries from a liability in negligence as the injured party accepted the risk when they undertook the activity.

# 40 Accountants4U

**Text Reference.** Chapter 9

**Top tips.** Remember, in scenario questions such as this the key is to **identify** the law at issue, **state** the law, **apply** the law and form a **conclusion**.

**Easy marks.** Setting out the requirements for liability not only forms a solid base for your answer, but will also attract some easy marks for demonstrating knowledge.

## Liability

Accountants4U would be liable to GWZ Ltd for **negligence** if GWZ Ltd can prove:

- Accountants4U **owed** them a **duty of care**
- It **breached** that **duty of care**
- As a **natural consequence** of the breach they suffered **damage**

## Duty of care

In the case of *Caparo Industries plc v Dickman (1990)* it was decided that auditors owe a duty of care to the shareholders of a company in respect of their audit work. This duty does not extend to the world at large or to shareholders increasing their stakes in the company.

This means that GWZ Ltd is not owed any duty in respect of its reliance on the accounts for making its investment decision. However, the company could argue that a '**special relationship**' had been established. Firstly, since Accountants4U provided information in the knowledge that GWZ was contemplating an investment and secondly, that GWZ would rely on the information provided by the senior partner when deciding whether or not to proceed.

Similar facts occurred in *ADT Ltd v BDO Binder Hamlyn (1995)*. In this case, similar comments were made by an audit partner in respect of a proposed takeover. The court decided that the auditors assumed responsibility for the comments made and held that a duty was owed.

It is therefore **likely** that **GWZ Ltd is owed a duty of care by Accountants4U**.

## Breach of duty

Where auditors provide information that is to be used in important business transactions, a higher standard of care is required, *Morgan Crucible Co plc v Hill Samuel Bank Ltd and others (1990)*. On the facts of the case it is likely that Accountants4U will be found to have breached this duty as they did not carry out any extra work to support the advice given by Sally.

## Causality

It is clear that the negligent advice caused the loss to GWZ Ltd – had they been advised that the figures were inaccurate then it is unlikely that the takeover would have gone ahead.

## Defences

*Volenti non fit injuria* does not apply in this case and the actions of GWZ Ltd seem reasonable in the circumstances. Therefore Accountants4U would not have a defence to a claim against them.

## Conclusion

On the facts of the case and that of *ADT Ltd v BDO Binder Hamlyn*, it is likely that GWZ Ltd could recover damages from Accountants4U for the loss they suffered.



## 41 Employed v self-employed

**Text reference.** Chapter 10

**Top tips.** You may be tempted to 'waffle' if you are not quite sure what to write when answering this question. Avoid this at all costs. If you are really stuck then a shorter answer containing everything that you know is almost certainly better than a longer answer that has been spun out. Save your time for a question that you are happier with.

**Easy marks.** This is a difficult question as you may struggle to come up with enough facts to answer it. This said, you could obtain several marks quickly by distinguishing between contracts of and for service and giving some examples of the consequences of being an employee or independent contractor. Stating the three tests would also earn you a mark or two.

**Examiner's comments.** ... this was clearly a topic that many candidates had prepared for well. On the whole this question was well done and in some instances done very well indeed, with the well prepared candidates providing good case authority to support their explanations. Of those who did not do well in their answers, the major shortcoming was a tendency to focus just on one of the tests and not to consider the others.

### Marking scheme

This question asks candidates to explain the common law rules used to distinguish contracts of service from contracts for services.

8–10 marks A thorough treatment of all of the rules, perhaps placing them in their historical context but certainly providing case support and providing a good application of the law to the scenario.

5–7 marks Good analysis and case support, although perhaps limited in appreciation.

2–4 marks Recognition of the areas covered by the question, but lacking in detailed analysis.

0–2 marks Little or no analysis or knowledge of the subject of the question.

#### (a) **Contracts of service and for services**

A general rule is that an employee is someone who is employed under a **contract of service**, for example, a person working as an administrator for a large insurance company. An independent contractor is someone who works under a **contract for services**, for example, a plumber whom you hire to do some work in your home.

It is important to distinguish between them as each has **different rules** concerning the legal rights and obligations of the person concerned.

Examples of the different rules include:

##### **Employment protection**

Employment law confers protection and benefits upon employees under a contract of service, for example regarding unfair dismissal and notice periods. Such protection is not available to independent contractors.

##### **Liability**

Employers are generally vicariously liable for tortious acts of employees, committed in the course of employment. Independent contractors are liable for their own actions.

##### **Taxation**

Employees pay tax and national insurance through the PAYE scheme via their employers. Independent contractors are taxed differently and must administer it themselves.



(b) **The courts**

In practice, the distinction between employees and independent contractors depends on many factors. The **courts** will primarily look at the **reality of the situation** rather than accept the form of the arrangement on face value.

Initially, they will look at the **relationship** between the parties and any **agreement** between them. Where the 'employee's' status is still unclear, a series of tests will be applied; the **control, integration and economic reality (multiple)** tests.

**The control test**

The court will consider whether the employer has **control** over the way in which the employee performs their duties. Where it appears that the 'employer' may control how the 'employee's' duties are performed, then they will be treated as an employee; *Mersey Docks & Harbour Board v Coggins & Griffiths (Liverpool)* 1947.

**The integration test**

The courts consider whether the employee is so skilled that they cannot be controlled in the performance of their duties. Lack of control indicates that an 'employee' is **not integrated** into the employer's organisation, and is therefore not employed. In *Cassidy v Ministry of Health* 1951 a doctor was held to be an employee as they were selected for a particular task and integrated into the organisation to perform certain surgical operations. If patients had the right to choose the doctor, this would indicate that the doctor was not so integrated and they would have been treated as an independent contractor.

The control and integration tests are important, but **no longer decisive** in determining whether a person is an employee.

**The economic reality (multiple) test**

Courts now focus on whether the 'employee' was **working on their own account** and this requires numerous factors to be considered.

In *Ready Mixed Concrete (South East) v Ministry of Pensions & National Insurance* 1968 it was held that a contract of service existed where:

- There is **agreement** from the worker that they will provide work for their master in exchange for remuneration.
- The worker agrees either expressly or impliedly that their master can exercise **control** over their performance.
- There are other **factors** included in the contract that make it **consistent** with a contract for service.

**Other factors** that can be considered include:

- Does the 'employee' use their **own tools and equipment** or does the 'employer' provide them?
- Does the 'employer' have the power to **select or appoint** its 'employees', and may they dismiss them?
- **Payment of salary** is a fair indication of there being a contract of employment.
- **Working for a number of different people** is not necessarily a sign of being an independent contractor. A number of assignments may be construed as 'a series of employments'.

The decision whether to classify an individual as an employee or not is also influenced by **policy considerations**. For example, an employment tribunal might regard a person as an employee for the purpose of unfair dismissal despite the fact that the tax authorities treated them as self-employed.

## 42 Employment contracts

**Text reference.** Chapter 10.

**Top tips.** Be careful to follow the breakdown of the available marks and focus on part (a) when structuring your answer. Reference to each of the three tests should be supported by a case example.

**Easy marks.** Explaining the three tests for employment status and the reasons why the distinction is important should be lodged firmly in your memory by now and will earn you good marks if you can repeat them.

### Marking scheme

		Marks
(a)	Brief definition of employee	½
	Brief definition of independent contractor	½
	Control test	1
	Example or case	1
	Integration test	1
	Example or case	1
	Economic reality test	1
	Example or case	1
		<hr/>
		7
(b)	Reasons for distinction (1 mark each; max. 3)	3
		<hr/>
		10

### (a) Contracts of service and for services

An **employee** is someone employed by an employer under the terms of a formal contract of employment (a '**contract of service**').

An **independent contractor** is a self-employed person who contracts to provide services for another party (a '**contract for services**') but who does not enter into a contract of employment. Sometimes the distinction between the two is very obvious – such as where the employer deducts PAYE and NI from the worker's gross pay – but often it is not. The expressed intentions of the parties will not necessarily be conclusive (*Ferguson v John Dawson & Partners*).

#### The distinction

The courts will look at the **reality of the situation** rather than at the expressed intentions of the parties. The courts have generally applied one or more of three tests – of **control**, **integration** and **economic reality**.

#### Control test

The **control test** asks whether the employer has control over the way in which the employee performs their duties. In the past, this has been quite a good indication of the existence of an employee relationship, but working practices are changing. The control test is less definitive now, at a time where many employees have a degree of skill which makes the relationship difficult to define.

#### Integration test

The **integration test** was developed to overcome this difficulty, and applies where the employee has such a degree of skill that they cannot be 'controlled' in the performance of their duties. Applying this test, the court asks whether they became an **integral part of the employer's business organisation**, or did their work remain outside of and merely accessory to it? Therefore, in *Cassidy v Ministry of Health*, it was held that a skilled surgeon was the employee of the Ministry of Health since, although the Ministry could not possibly control the doctor in their medical work, it (not the patient) had selected them and integrated them into the organisation.

### Economic reality

The **economic reality** or '**multiple**' test is a further development and asks whether the employee is **working on their own account**. Here the court will consider all relevant factors including the employer's right to appoint and dismiss, the basis on which payment is made, whether tax and NI is deducted, who provides the tools and equipment, the number of 'employers' (*Ready Mixed Concrete (South East) v Ministry of Pensions and NI*). The courts will also consider whether the employee is entitled to delegate all their obligations (in which case there is no contract of employment), whether they are restricted in their place of work, whether they are obliged to work and whether holidays and hours of work are agreed (*O'Kelly v Trusthouse Forte plc*).

### (b) Reasons for the distinction

There are several reasons why the distinction between a contract of service and a contract for services is important:

#### Protection

Legislation may offer **employment protection** to employees under a contract of service but not to the self-employed. This provides for minimum periods of notice, remedies for unfair dismissal and for redundancy payments;

#### Social security

The **contribution rates** payable under social security legislation differ as between the employed and the self-employed, and there are also differences in entitlement to benefits and statutory sick pay;

#### Tax

Deductions must be made by an employer for **income tax** under Schedule E from the salary paid to employees under a contract of service. Whereas the self-employed are taxed under Schedule D and are directly responsible to HM Revenue and Customs for all due deductions;

#### Liability

The employer may be **vicariously liable for tortious acts** committed by their employees during the course of their employment, but such liability is severely restricted in the case of a contract for services;

#### Liquidation rights

Should the employer go into liquidation or become bankrupt, the employee under a contract of service has **preferential rights as a creditor** for payment of outstanding salary and redundancy payments, up to certain limits;

#### Other rights and duties

The **implied rights and duties** which apply in the employer/employee relationship under a contract of service would not apply to the same degree to a contract for services;

#### VAT

An independent sub-contractor may have to **register their business for VAT** purposes and charge VAT on services supplied.

## 43 Common law duties

**Text reference.** Chapters 10 and 11.

**Top tips.** Notice in this question that it is asking for the common law duties of the employer, not the employer's duties in general. Make sure that you don't waste your time by listing all of the duties you can think of from whatever source: focus your answer on what the question requires.

**Easy marks.** Stating the duties of employee and employer.

**Examiner's comments.** Answers to this question were disappointing. Many candidates could only produce two common law duties at most, and many fell into the trap of describing statutory duties instead. In general, part (a) was better answered than part (b) as many candidates had little knowledge of constructive dismissal and confused it with redundancy.

		Marks
(a)	Overriding duty is mutual trust and confidence	1
	Reasonable care for safety	1
	Reasonable rate of remuneration if not agreed	1
	Duty to provide work (discuss)	2
	Breach enables employee to treat contract as discharged	1
		<hr/>
		6
(b)	Repudiation of a vital term	1
	Employer liable for breach; maybe unfair dismissal	1
	Three conditions for employee to show	1
	Examples of type of breach	1
		<hr/>
		4
		<hr/>
		10

(a) **Employer's duties**

The **duties owed by an employer** to their employee will be as set out **expressly in the contract of employment** and, in the absence of relevant express terms, **as implied by common law and statute**. The overriding duty of the employer at common law is a duty of mutual trust and confidence. Neither the employer nor the employee should act in a manner which could damage such mutual respect. In addition, the common law implies several other terms into the contract of employment, all of which are fundamental to the relationship.

**Reasonable care**

First, the employer has a duty to take **reasonable care for the safety** of the worker. Therefore, they must provide competent staff, safe premises and equipment and a 'safe system of work'. The employer could be liable in negligence if this is not done.

**Remuneration**

In the unlikely circumstances of there being no agreement as to remuneration, the rate of **remuneration** must be reasonable. However, statute largely governs the method and rate of payment (including the Equal Pay Act 1970 and the National Minimum Wage Act 1998).

**Provide work**

In certain circumstances, the common law will imply **a duty to provide work**. Employees protected include those paid on a piecework or commission basis and those whose earning power and reputation is founded on active occupation, for example actors and journalists. If there is in fact no work available, the duty will not be breached as long as the employee continues to receive remuneration, unless the employee is skilled and needs relevant work in order to prevent the skills falling into disuse. If an employee properly incurs expenses or losses in the performance of their duties, the employer has a common law duty to reimburse them.

Breach of such common law duty may entitle the employee to treat the contract as discharged and/or to claim damages for breach of contract.

(b) **Constructive dismissal**

**Constructive dismissal** takes place where the employer **repudiates some vital term of the employment contract** and, despite willingness to continue the employment, the employee resigns because of it. No notice of termination is served on either party. In such cases, the employer is liable for breach of contract. Provided the breach is sufficiently serious, the employee may still make a claim for unfair dismissal (s.136 ERA).

## Proof

The **employee must show** that the **employer has committed a serious breach of contract**, that they left because of it and that they have not waived the breach, thereby affirming the contract. If the employee waits for too long before resigning, for example, they may be taken to have accepted the breach and waived their rights in respect of it. However, delaying for a reasonable period while finding alternative employment may be acceptable.

## Case law

The **breach must be serious and amount to a repudiatory breach** (*Western Excavating (ECC) Ltd v Sharp*). Unilaterally imposing a complete change in the employee's duties or reducing the employee's pay have been held to be sufficiently serious to entitle the employee to claim breach of contract and claim for constructive dismissal (*Ford v Milthorn Toleman Ltd* and *Industrial Rubber Products v Gillon*). Similarly, a failure to provide a suitable working environment (*Waltons and Morse v Dorrington*) and a failure to follow the prescribed disciplinary procedure (*Post Office v Strange*) have also been held to be sufficient grounds for a constructive dismissal.

# 44 Redundancy

**Text reference.** Chapter 11.

**Top tips.** Although the requirement of this question is set out in just one sentence, you must notice that there are actually two requirements: explain the meaning redundancy (what it is) and explain the rules which govern it. You must try to address both issues.

**Easy marks.** Setting out what redundancy is and the compensation available to qualifying employees.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to explain the meaning of the term redundancy and the legal rules relating to it.

The question enabled candidates who knew the law on redundancy to perform well since there are marks available for a large number of legal points/range of relevant legal information e.g. the definition of redundancy; the meaning of 'dismissal'; qualification; the effect of offers of alternative employment and trial periods; remedies and so on. Candidates who could clearly and accurately state these points with reference to some case-law examples scored well.

Candidates also were able to score by referring to the collective provisions on trade union consultation and particularly if they were able to identify the relationship of the individual redundancy payment with individual claims for unfair dismissal arising out of unfair selection.

Many candidates were able to accurately state the basic rules and some to describe the relationship with other rules such as dismissal and trade union consultation.

However, there were common basic errors in that candidates were unable to correctly state e.g. the length of the qualifying periods or time limits for claims. Others seemed unable to comprehend the distinction between a claim for a redundancy payment and other claims (e.g. common law for wrongful dismissal) or statutory (notice entitlement and unfair dismissal).

Thus some scripts made no distinction between the statutory rules on notice and those on redundancy. A significant number seemed to have no awareness that unfair dismissal and redundancy provide separate remedies e.g. some stated that an employee would only be redundant if the selection was unfair, or that an employee would be redundant if they e.g. lacked qualification or competence for the job. The remedy, it seems to some, for redundancy is re-instatement, re-engagement or an award of £60,000. Others thought that the employee could claim 'damages' for loss of earnings. In other cases redundancy was described as a wrongful dismissal.

### Marks

This question requires candidates to explain redundancy and the legal rules relating to it.

8–10	Thorough to complete answers, showing a detailed understanding of the concept of redundancy, the rules for calculating payment and probably making references to the legislation.
5–7	A clear understanding of the topic, but perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in the other.
2–4	Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the topic.
0–1	Little or no knowledge of the topic.

### Redundancy

The law relating to **redundancy** is set out in the **Employment Rights Act 1996**. A dismissal is treated as caused by redundancy where the only or main reason for the dismissal is that:

- The employer has **ceased** or **intends to cease** carrying on the business in which the employee has been employed or at the local establishment where the employee has been employed
- The **requirements of that business** for employees to carry on the work done by the employee have **ceased** or **diminished**.

### The business

The businesses of **associated employers** are usually **treated as one business** for this purpose. If the employee's contract requires them to work at places other than their present place of employment, and the employer under the terms of the contract requires them to move to a different place of work because there is no longer work at their present place of employment, that is not a case of redundancy.

### Job loss

In considering whether the **requirements of the business** for staff have diminished, it is the **overall position** which must be considered. If for example A's job is abolished and A is moved into B's job and B is dismissed, that is a case of redundancy although B's job continues. If the employer reorganises their business or alters their methods so that the same work has to be done by different means which are beyond the capacity of the employee, that is not redundancy. The test is whether the job still exists (*North Riding Garages v Butterwick 1967* and *Vaux and Associated Breweries v Ward 1969*).

### Alternative employment

The employer may offer a redundant employee **alternative employment** for the future. If the employee then **unreasonably refuses** the offer, they lose their entitlement to redundancy pay. The offer need not be in writing but must be made before the end of the old employment, to take effect within not more than four weeks after it will end. The offer must be of alternative employment in the **same capacity**, at the **same place** and on the **same terms and conditions** as the **previous employment**. If it differs in any such respect, it must be suitable employment in relation to the employee. The alternative employment must not be perceived as being lower in status (*Cambridge District Co-operative Society v Russell 1993*). These matters are questions of fact.

### Trial period

The employee is entitled to a **4 week trial period** in the alternative employment and if either party terminates the new contract during this trial period, it is treated as a case of redundancy at the expiry date of the old employment. If the employee accepts and continues in the new employment, their service is treated as continuing from the old employment.

## Redundancy payment

An employee has a right to a **redundancy payment** if they are dismissed because of redundancy. The employee must show that they were dismissed. It is then for the employer to rebut the presumption that they were dismissed for redundancy. An employee is not entitled to redundancy pay if they resign voluntarily or if they accept suitable alternative employment or if they are dismissed for misconduct.

The employee must **qualify** for redundancy by:

- Having been **continuously employed** for **at least two years**,
- Having been **dismissed** (or laid off or put on short time),
- The **reason** for their **dismissal being redundancy**.

**Redundancy pay** is calculated as follows:

- 1.5 weeks pay for each such year of employment consisting wholly of weeks in which the employee was aged 40 or more;
- 1 week's pay for each such year consisting wholly of weeks in which they were aged between 22 and 40;
- 0.5 week's pay for each year where they were aged between 18 and 22.
- A week's pay (subject to a statutory maximum, currently set at £350 per week) is taken as pay of the final week of employment.

**Disputes** are heard by an **employment tribunal** and, on appeal, by the **Employment Appeal Tribunal**. The employer is expected to act reasonably and to follow the ACAS Code of Practice on Disciplinary Practice and procedures in Employment.

## 45 Constructive and unfair dismissal

**Text reference.** Chapter 11

**Top tips.** Part (a) is a good opportunity to explain the law on constructive dismissal by using case law. If you can state the points of law from at least four cases then you will be well on your way to a good answer. If you got stuck in Part (b) try to think in terms of the real world. If you were unfairly dismissed what remedies would you want? Your job back? Compensation?

**Easy marks.** Describing constructive dismissal in Part (a) and listing the remedies for unfair dismissal in Part (b).

**Examiner's comments.** There were still candidates who appeared not to recognise any distinction between wrongful and unfair dismissal or between unfair dismissal or redundancy or between unfair dismissal and rights to minimum periods of notice. For these candidates, such errors appeared on both parts of the question. In relation to part (b) especially, some simply listed broad and unspecific grounds for dismissal - fighting, pregnancy, discrimination with no reference at all to the question being asked. Part (b) did not ask for the test of fairness of the dismissal, but for an explanation of the remedies.

### Marking scheme

	Marks
(a) Requires candidates to explain what is meant by constructive dismissal.	
A clear concise explanation perhaps citing cases or examples.	4–5
A clear understanding, but perhaps lacking authority or examples.	2–3
Unbalanced, or may not deal with all of the required aspects of the topic. Alternatively the answer will demonstrate very little understanding of what is actually meant by constructive dismissal.	0–1
(b) Thorough to complete answers, showing a detailed understanding of all or certainly most of the remedies available.	4–5
A clear understanding of the remedies, but perhaps lacking in detail.	2–3
Little or no knowledge of the topic.	0–1



(a) **Constructive dismissal**

**Constructive dismissal** occurs where the **employee terminates** their **employment contract** either with or without notice **due to the behaviour of their employer**. Outwardly the employer will often appear willing to continue the employment, but through their actions they **repudiate some essential term** of the contract. If the effect of this repudiation is that the employee resigns then the employer is potentially liable for breach of contract as a result of constructive dismissal.

**Case law**

Examples of breaches of contract which have led to claims of constructive dismissal include **reduction in pay** (*Industrial Rubber Products v Gillon* (1977)), **a complete change in the nature of the job** (*Ford v Milthorn Toleman Ltd* 1980), **failure to follow the prescribed disciplinary procedure** (*Post Office v Strange* 1981), **failure to provide a suitable working environment** (*Waltons and Morse v Dorrington* 1997) and **failure to implement a proper procedure** (*WA Goold (Pearmak) Ltd v McConnell & Another* 1995).

**Breach of contract**

To establish constructive dismissal, the **employee** must show that their employer has committed a serious breach of contract (a repudiatory breach), that they left because of the breach and that they did not 'waive' the breach, thereby affirming the contract.

**Conduct**

Courts will therefore look carefully at the **conduct of both parties** involved in a constructive dismissal claim. In *Western Excavating (ECC) Ltd v Sharp* 1978 the employee was suspended without pay for misconduct. This caused them financial difficulties, and so they applied for an advance against holiday pay but was refused. They then left and claimed for constructive dismissal. In this case the court found that the employer had not repudiated the contract and so there had been no dismissal.

(b) **Remedies for unfair dismissal**

Remedies for a successful claim for unfair dismissal include **reinstatement**, **re-engagement** and **compensation**.

**Reinstatement**

**Reinstatement** is return to the same job without any break of continuity by order of the employment tribunal.

**Re-engagement**

**Re-engagement** occurs when the employment tribunal orders that the employee is given new employment with the employer on terms specified in the order.

When deciding whether to exercise powers of **reinstatement** and **re-engagement**, the tribunal must take into account whether the complainant wishes to return to work for their employer and whether it is practicable and just for the employer to comply. **Such orders are in fact very infrequent**.

**Compensation**

If the tribunal does not order reinstatement or re-engagement the tribunal may award **compensation**, which may be made in three stages.

- **Basic award**

A **basic award** calculated as follows. Those aged 41 and over receive one and a half weeks' pay (up to a maximum of £350 gross per week) for each year of service up to a maximum of 20 years. In other age groups the same provisions apply, except that the 22-40 age group receives one week's pay per year and the under 22 age group receives half a week's pay.

- **Compensatory award**

A **compensatory award** (taking account of the basic award) for any additional loss of earnings, expenses and benefits on common law principles of damages for breach of contract. This is limited to £66,200 by the Employment Rights Act 1996.



- **Punitive award**

If the employer does not comply with an order for reinstatement or re-engagement and does not show that it was impracticable to do so a **punitive additional award** is made of between 26 and 52 weeks' pay (again subject to the £350 per week maximum).

- **Reduced award**

The employment tribunal may reduce the amount of the award if the employee **contributed** in some way to their own dismissal, if they **unreasonably refused** an offer of reinstatement, or if it is **just and equitable** to reduce the basic award by reason of some matter which occurred before dismissal.

## 46 Constructive and fair dismissal

**Text reference.** Chapter 11.

**Top tips.** Read this question carefully. For example in part (a), it would be easy to discuss unfair reasons for dismissal by mistake.

**Easy marks.** Defining fair and constructive dismissal.

**Examiner's comments.** This question was one of the few, it has to be said, where candidates performed most satisfactorily. Sound answers to (a) precisely identified the statutory grounds covering fair dismissal under Employment Rights Act 1996, viz. capability or qualification, misconduct, redundancy, breach of statutory provision and other substantial reasons. The very best also referred to dismissal upon retirement. All too frequently, however, candidates listed a range of possible fair dismissal scenarios without tying them into the statutory headings, e.g. theft, fraud, violence, making secret profits, failing professional qualifications, absenteeism and a range of other possibilities. Many of these overlapped and could have been cited as instances of one of the general headings. Marks awarded depended on the comprehensive nature of these instances, but a number merely cited examples of misconduct and consequently did not gain the level of marks available.

The answers to part (b) were well done. Many candidates were able to adequately define constructive dismissal and to offer one or two case examples.

*Simmos v Dowty Seals Ltd* (1978) was often referred to. The best answers went on to discuss the contractual basis of constructive dismissal, citing *Western Excavating v Sharp* (1978) and went on to mention possible remedies.

Some answers completely misinterpreted the concept of constructive dismissal, often portraying it as an extra weapon in the employer's armoury in the defence of an unfair dismissal claim. A number of candidates adequately defined constructive dismissal but appeared to believe that it only related to redundancy dismissals.

### Marking scheme

This question relating to issues in employment law is divided into two parts and the marks will be allocated equally.

- (a) Requires candidates to explain the provisions of the Employment Rights Act 1996 relating to the statutory grounds covering fair dismissal.
- 3–5 marks: A good explanation of the grounds upon which dismissal may be fair.
- 0–2 marks: Some awareness of the area but lacking in detailed knowledge.
- (b) 3–5 marks: Candidates must show an understanding of what is meant by constructive dismissal, perhaps citing cases or examples.
- 0–2 marks: Unbalanced, or may not deal with all of the required aspects of the topic. Alternatively the answer will demonstrate very little understanding of what is actually meant by constructive dismissal.

(a) **Fair grounds for dismissal**

Under the **Employment Rights Act 1996**, employers wishing to justify the dismissal of an employee as fair must prove their **principal reason** relates to:

**Capability or qualifications of the employee**

**Capability** is assessed by reference to skills, aptitude, health or any other physical or mental quality.

**Qualification** means any academic or technical qualifications relevant to the position that the employee holds': s 98(3). In addition to the lack of capability or qualification, employers must also show that they acted reasonably before dismissing the employee.

**Conduct**

To dismiss on grounds of **misconduct**, the employer must prove that the employee's actions can be categorised as **gross misconduct**, which justifies summary dismissal on the first occasion, rather than **ordinary misconduct**, which is not usually sufficient grounds for dismissal unless it is persistent. Gross misconduct may include theft or drunkenness at work.

**Redundancy**

Redundancy is always a fair reason for dismissal providing it fulfils the **legal criteria** for redundancy and the employee was **fairly selected** for it.

**Legal prohibition or restriction**

Dismissal on the grounds of a **statutory prohibition** or **restriction** that prevents the employee from **lawfully working** in the position which they are employed for is a fair reason for dismissal. For example, where a doctor is struck off the relevant professional register and so is ineligible to practise.

**Some other substantial reason which justifies dismissal**

The category of **other substantial reason** permits the employer to rely on some factor which is unusual and likely to affect them adversely. For example, an employer has justified dismissal where:

- The employee was married to one of their competitors.
- The employee refused to accept a reorganisation. For example, a change of shift working made in the interests of the business and with the agreement of a large majority of other employees.

(b) **Constructive dismissal**

**Constructive dismissal** occurs where the **employee terminates** their **employment contract** either with or without notice **due to the behaviour of their employer**. Outwardly the employer will often appear willing to continue the employment, but through their actions they **repudiate some essential term** of the contract. If the effect of this repudiation is that the employee resigns then the employer is potentially liable for breach of contract as a result of constructive dismissal.

Examples of breaches of contract which have lead to claims of constructive dismissal include; **reduction in pay** (*Industrial Rubber Products v Gillon* (1977)), **a complete change in the nature of the job** (*Ford v Milthorn Toleman Ltd* 1980), **failure to follow the prescribed disciplinary procedure** (*Post Office v Strange* 1981), **failure to provide a suitable working environment** (*Waltons and Morse v Dorrington* 1997) and **failure to implement a proper procedure** (*WA Goold (Pearmak) Ltd v McConnell & Another* 1995).

To **establish constructive dismissal**, the **employee** must show that their employer has committed a **serious breach of contract** (a repudiatory breach), that they left because of the breach and that they did not 'waive' the breach, thereby affirming the contract.

Courts will therefore look carefully at the **conduct of both parties** involved in a constructive dismissal claim. In *Western Excavating (ECC) Ltd v Sharp* 1978 the employee was suspended without pay for misconduct. This caused them financial difficulties, and so they applied for an advance against holiday pay but they were refused. They then left and claimed for constructive dismissal. In this case the court found that the employer had not repudiated the contract and so there had been no dismissal.

## 47 Grace and Fawn Ltd

**Text reference.** Chapter 11.

**Top tips.** Even in relatively short questions like this, follow our suggested approach: **identify** the issue, **state** the law, **apply** the law and **conclude**.

**Easy marks.** Stating the criteria for redundancy and calculating redundancy pay would earn you pass marks.

### Marking scheme

	Marks
Redundancy	
Criteria for redundancy	3
Qualification for redundancy pay	2
Calculation of redundancy pay	2
Redundancy selection procedure	2
Grace qualifies for redundancy	1
	<u>10</u>

### Redundancy

The law relating to redundancy is found in the Employment Rights Act 1996.

#### Qualifying employee

A **qualifying employee** has a right to a redundancy payment (as compensation) in the event that they are dismissed because of redundancy, that is (s 139) 'where the only or main reason for the dismissal is that:

- The employer has **ceased or intends to cease** carrying on the business in which the employee has been employed or at the local establishment where the employee has been employed or
- The **requirements of that business** for employees to carry on the work done by the employee have **ceased or diminished**'.

If the employer requires the employee to move to a **different place of work** and that is within the terms of the contract of employment, then there is no redundancy.

#### Dismissal

The onus is on the employee to show that they were **dismissed** and then on the employer to show that the dismissal was for some reason other than redundancy.

The employee must show that they were dismissed in one of the following ways:

- Dismissal by the **employer bringing the contract** to an end, with or without notice;
- Dismissal where a **fixed term contract ends** and is not renewed (although protection may be lost if the contract is for more than one year's duration);
- When the **conduct of the employer is sufficiently serious** that it amounts to a repudiation of the employment contract and the employee resigns as a result, lawfully terminating the contract without notice by reason of the employer's conduct. If the employee is dismissed for misconduct, they will not be entitled to a redundancy payment (*Sanders v Neale*). Similarly if they resign voluntarily there is no entitlement.

#### Alternative employment

The employer may choose to offer a redundant employee **alternative employment** (s 141). If the employee unreasonably refuses the offer, they lose their entitlement to a redundancy payment. Broadly speaking, the alternative employment must be in the **same capacity**, at the **same place** and on the **same terms and conditions** as the old employment. It should not be perceived as being lower in status (*Cambridge District Co-operative Society v Ruse 1993*).

An employee **qualifies** for redundancy pay if (s 109) they have been **continually employed for 2 years** or more.

## Redundancy pay

**Redundancy pay** is calculated as follows: 1.5 weeks pay for each complete year of employment during which the employee was aged 40 or more, 1 week's pay for each year where they were aged between 22 and 40 and 0.5 week's pay for each year where they were aged between 18 and 22. A week's pay is capped at £350.

The entitlement to a redundancy payment is lost if the **employee does not claim** a payment within **6 months** of the relevant date (such as the expiry of the dismissal notice). If the employer disputes their claim, the employee should refer it to an Employment Tribunal. A right of appeal lies to the Employment Appeals Tribunal.

## Selection

The employer should have a **redundancy selection procedure** which conforms to good industrial relations practice (*Williams v Compair Maxam Ltd*). They should give as much warning as possible of impending redundancies, consult with the relevant trade union, make the selection fairly and consider whether offers of alternative employment can be made. Protective awards may be made against an employer who fails to consult trade unions or to give notice of impending redundancies to the government.

# 48 Impact College

**Text reference.** Chapter 11.

**Top tips.** When reading through the question, make sure that you pick up all the details that might be relevant to your answer. For example, you are told that all the staff members have been employed for six years, so you do not need to discuss factors such as the time requirements for actions for unfair dismissal

**Easy marks.** Make sure that you advise Fred, Gale and Hilda, as required by the question, but do not omit to discuss the situation with regard to the other seven members of staff, who do not have the specific circumstances of the other three.

## Marking scheme

8-10 marks	A full and detailed treatment of all elements of the question.
6-7 marks	Less complete answer, or lacking in some detail. Perhaps slightly unbalanced in not dealing with all of the elements of the question.
4-5 marks	Unbalanced answers evidencing knowledge of only some of the elements in the question, or lacking of detail in relation to the answers provided.
0-3 marks	Very unbalanced to the extent of dealing with only one or two of the elements, or evidencing little or no knowledge of any aspect of the question.

## Unfair grounds for dismissal

The three named employees should be advised that as well as redundancy there might be other avenues open to them. Some grounds put forward for dismissal will be automatically unfair, as follows:

### Pregnancy

Regardless of the length of service, a dismissal on grounds of **pregnancy** or a pregnancy-related illness, or any matter related to **childbirth**;

### Trade Union

A dismissal on the grounds of an employee's actual or proposed membership of an independent **trade union** or their taking part at an appropriate time in the activities of such a trade union or their refusal to be a member of a trade union is unfair. However, it is fair to dismiss employees involved in an unofficial strike, lockout or other industrial action.

### Spent conviction

An employee dismissed on the basis of a **conviction** which is actually spent under the Rehabilitation of Offenders Act 1974;

### Health and Safety

Where an employee takes steps to carry out **health and safety related activities** as requested by their employer or brings health and safety risks or dangers to the employer's attention or where they leave work reasonably believing themselves to be in danger;

### Enforcing statutory rights

Where an employee takes action against an employer to **enforce statutory rights and duties** and the employer dismisses them as a result (s.104 ERA).

### Fred, Gale and Hilda

Fred, Gale and Hilda will seek to show that their dismissals are **unfair** under the above categories and Impact College will seek to establish that the reason for their dismissal was simply redundancy as in the case of the other seven employees.

### Remedies

An employee must apply to the employment tribunal with a claim for unfair dismissal within 3 months of the dismissal. Where unfair dismissal is shown, three remedies are available:

- **Reinstatement** to the same job without any break in the continuity of employment (s.114 ERA);
- **Re-engagement** in a different but comparable and suitable job with the same employer or their successor or associate;
- **Compensation**.

### Compensation

**Compensation** is the most usual award and the only relevant remedy in this case. This consists of a **basic award**, based on an employee's weekly wage (subject to a statutory maximum) and their age. There may also be a **compensatory award** for additional losses of earnings, expenses and benefits, calculated on ordinary common law principles of damages for breach of contract (also subject to a statutory maximum).

In addition, a **punitive award** may be made if the employer has failed to comply with a reinstatement or re-engagement order or if the reason for dismissal was unlawful discrimination.

The tribunal may **reduce** the amount of any **compensation** if the **employee contributed in any way to their dismissal**, or if they unreasonably refuse an offer of reinstatement or if it is just and equitable to do so on some other ground relating to the time prior to dismissal.

## 49 Types of authority

**Text reference.** Chapter 12.

**Top tips.** This was another reasonably straightforward 'explain' requirement, although some students find the authority of the agent a tricky area.

Even if you had scored full marks on part (a), you would have failed the question if you had not been able to answer parts (b) and (c).

This illustrates the importance of reading through and getting to grips with the key terms and definitions given in the Study Text. You can then build on your understanding of these by seeing the law in practice – in the case examples given in the Text.

**Easy marks.** Defining the types of authority.

**Examiner's comments.** Candidates generally did not do well on this question, possibly because agency was a new topic in the syllabus at the time the question was set. However many candidates did not seem to have grasped the essential principles, especially of implied authority.

Many candidates failed to answer part (c) of the question despite the fact that it was worth 4 marks. The candidates who did attempt part (c) often repeated material that they already produced for part (a).

### Marking scheme

		Marks
(a)	Definition of express authority	1
	Depends on terms of agency agreement	1
	Breach of warranty of authority	1
		<u>3</u>
(b)	Implied incidental authority	1
	Implied customary authority	1
	Implied usual authority	1
		<u>3</u>
(c)	Explanation	1
	Case or example	1
	Agency by estoppel requirements	2
		<u>4</u>
		<u>10</u>

### Authority of an agent

As a general rule, in order to be valid and binding on the principal and third party, a contract entered into by an agent must be entered into within the bounds of the agent's authority. However, that authority need not be express for the contract entered into by the agent to bind the principal. It may be implied actual authority or apparent authority.

#### (a) Express authority

**Express authority** is the extent of authority which it is agreed (between the principal and agent) the agent shall have to enter into contracts on the principal's behalf. The precise scope and extent of 'express actual authority' will depend on the construction of the written document in which the appointment or conferring of authority is contained or on the evidence supporting an oral giving of actual express authority. If the **agent** acts outside their express authority, they will be **liable** to the **principal** for breach of contract and to the **third party** for breach of warranty of authority.

#### (b) Implied authority

Actual authority may be implied rather than express:

- **'Implied incidental authority'** will be deemed to exist where it is reasonable to suppose that the principal also gave the agent authority to enter into transactions which are necessarily incidental or subordinate to the matter of the express authority. For example, the authority to advertise goods when the agent is expressly authorised to sell them.
- **'Implied customary authority'** is that which an agent shall be deemed to have by reason of their operating in a particular market or business, for example an estate agent may have implied authority to show potential buyers round a house.
- **'Implied usual authority'** is that which an agent shall be deemed to have by reason of their occupying a particular position or engaging in a particular trade.

In cases of **implied actual authority**, the **third party** who contracts with the agent is entitled to assume that the agent has implied authority unless they know to the contrary.

In *Watteau v Fenwick*, the principal was held to be bound by a contract entered into by their agent with implied usual authority (as a hotel manager, they bought cigars on credit) even though the third party did not know that the agent, as the other contracting party, was the agent of the principal. As between the agent and the principal, however, the agent is not entitled to contravene the principal's express authority or instructions by claiming implied authority.

(c) **Apparent authority**

'**Apparent**' or '**ostensible**' **authority** is that which the **principal represents** to other parties they have given their agent. Although matters of apparent authority and implied usual authority often appear to be co-extensive, it is the conduct of the principal which creates apparent authority. It also arises where the principal is aware that an agent is claiming to be their appointed agent and yet does nothing to correct that impression. In either case, the principal will be bound by the actions of the ostensible agent.

In *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*, a company was bound by the acts of one of its directors who acted like a managing director even though they had not been appointed formally to that position. By its mere acquiescence, the company had led the third party to believe that they were the managing director and the third party had relied on that impression.

**Pre-existing relationships**

There need not be a pre-existing agency relationship. Apparent or ostensible authority (or 'agency by estoppel') requires a **representation which is relied upon** thereby causing an alteration in the position of the representee. The representation may be express or implied from previous dealings or implied from conduct.

**Revocation**

Where the principal has **subsequently revoked** an agent's authority, they will continue to be bound by acts entered into by that agent within their former authority with third parties who dealt with them previously, until they inform those third parties that the agent is no longer so authorised (*Willis Faber and Co Ltd v Joyce*).

**Representation**

The **representation** must be made either by the **principal** or by **another agent** acting on their behalf (*Armagas Ltd v Mundogas SA, The Ocean Frost*) but not by the agent claiming to have the authority. It must be one of fact and not of law and it must be made to the third party. If the third party knew that the agent had no authority or did not believe them to have, they cannot claim **agency by estoppel**. Unless the alteration of position also causes damage or detriment, any damages awarded will be nominal although, strictly speaking, it is not necessary to show that reliance resulted in such damage or detriment.

## 50 Unlimited and limited partnerships

**Text reference.** Chapter 13.

**Top tips.** This is a straightforward factual question and is nicely broken down so that you should be able to gain good marks on each part. Notice that part (c) is asking specifically about limited liability partnerships, so you should restrict your answer to consideration of those.

**Easy marks.** There is half a mark available for each valid point in part (a). Try to think of a range of ideas to demonstrate the breadth of your knowledge. In part (b) there are two marks for an explanation of apparent authority and a further mark for an example. In part (c) assume a mark and a half for each of the two requirements.



		Marks
(a)	PA 1890 definition	1
	Person	1
	Carrying on a business	1
	View of profit	1
(b)	Definition in PA 1890	1
	Example, case or illustration	1
	Purpose the protection of third parties	1
(c)	Definition	1
	Examples of filing requirements	1
	Examples of publicity	1
		<u>3</u>
		<u>10</u>

(a) **Unlimited partnerships**

Unlimited partnerships are governed by the **Partnership Act 1890**, which defines a partnership as 'the relations which exist between persons carrying on a business with a view of profit.'

**Person**

A person can include a **registered company** as well as **individual** living people. There must be at least **two** parties for partnership to exist.

**Carrying on a business**

Business can include any **form of activity** that must have a beginning and an end. It can consist of a single transaction such as a joint venture.

**View of profit**

The partners must **intend** to make a profit, if they intend to trade just to gain experience there is no partnership: *Davies v Newman 2000*. A partnership will still exist even if losses are made – it is the partners' intention that is key.

(b) **Partners' authority**

Partners in a firm are regarded as having both **actual** and **apparent authority** to bind the firm. Their actual authority is the authority given to them by the partnership agreement to carry out certain acts.

**Apparent authority**

Their **apparent authority** is defined by the Partnership Act 1890. This states that every partner is an agent of the firm and the other partners for the purpose of the business of the partnership. The partner's actions in the **normal course of business**, of a sort that the firm would normally be expected to do, **bind the firm** and the other partners, so that they too are liable to the third party. However, if the partner does not have the authority to make the contract, and the **third party knows that to be the case or does not know or believe them to be a partner**, then the firm will not be bound.

**Example**

For example, X is a partner in a firm that runs a garage buying and selling second hand cars, but the partnership agreement states that the firm is not to trade in new cars. If X enters a contract for the purchase of a new car from a third party who is not aware of the prohibition in the partnership agreement, then the firm as a whole would be bound by that contract, as X had apparent authority to enter into it.

**Purpose**

The **purpose** of the law is the **protection of third parties**, and the nature of the authority often depends on the perception of the third party involved. If the third party genuinely believes that the partner has authority, the firm is likely to be bound by the partner's actions.



(c) **Limited liability partnership**

A **limited liability partnership (LLP)** formed under the Limited Liability Partnership Act 2000 is a corporate body with separate legal personality from its members, but it retains some of the features of a partnership.

In order to be incorporated, the subscribers must **file details** with the Registrar of Companies:

- The **name** of the LLP
- The **location** of its **registered office** (ie England and Wales, Wales or Scotland)
- The **address** of the **registered office**
- The **name** and **address** of **all the members** of the LLP
- Which members are to be **designated members**, who take responsibility for the publicity requirements of the LLP.

The **designated members** of a LLP are required to:

- **File notices** with the Registrar of Companies, for example when a member leaves
- **Sign and file accounts**
- **Appoint auditors** if appropriate

## 51 Ham, Sam and Tam

**Text reference.** Chapter 13.

**Top tips.** You need to consider the authority of partners and the liability they have for the firm's debts. Avoid the temptation in to discuss all you know about agency law – keep your answer focused on partnerships.

**Easy marks.** Stating the basic rule of partnership authority.

**Examiner's comments.** This question required candidates to consider key issues relating to the powers, authority and liability of partners. Candidates were required to exhibit a thorough knowledge of partnership law together with the ability to analyse the problems contained in the question and apply the law accurately. While there were many decent answers to the question, with candidates demonstrating a reasonable understanding of partnership law, once again it has to be said that some candidates simply did not recognise the issues involved in the problem scenario. As has been said a small number of candidates appeared to take the fact that the business of the partnership was limited to the sale of petrol as an indication that it was a limited partnership and produced answers explaining that business form. Others presented general answers on the different possible partnership forms without making any real attempt to deal with the question, a clear indication that they prepared an answer and were going to reproduce it whether it was relevant or not.

### Marking scheme

This question refers to key issues relating to the powers, authority and liability of partners.

8–10 marks: Candidates will exhibit a thorough knowledge of partnership law together with the ability to analyse the problems contained in the question.

5–7 marks: Candidates will exhibit a sound knowledge of partnership law together with the ability to recognise the issues contained in the question. Knowledge may be less detailed or analysis less focused.

3–4 marks: Identification of some of the central issues in the question and an attempt to apply the appropriate law. Towards the bottom of this range of marks there will be major shortcomings in analysis or application of law.

0–2 marks: Very weak answers which might recognise what the question is about but show no ability to analyse or answer the problem as set out.

## Issue

Ham, Sam and Tam have set up in partnership together. They have a partnership agreement and debts in the name of the partnership amounting to over £25,000.

### Partners' relationships with third parties

**Each partner is the agent of the firm** and when a third party contracts with a partner, they contract with all the partners.

There are **exceptions** to this third party principle. One is that the partners are bound to an act which a partner has carried out in the normal course of business, unless the partner acting had **no authority** to do so, **and the third party was aware** that the partner did not have authority to do so.

Another exception is that if one partner **pledges the credit of the firm** for a **purpose apparently not connected with the firm's business**, the firm is not bound unless the partner is specifically authorised to undertake that transaction.

However, as a general rule, the **firm** (that is, all the individual partners) is **liable** to third parties for actions of a partner where they have **apparent** or **actual** authority.

### The bank loan

Sam has taken money from the **firm's bank account** to use for a personal holiday. However, as a partner, and in the absence of any specific mention to the contrary in the agreement, **he has authority** to withdraw money from the bank account.

His action has therefore **incurred a debt** to a third party that is owed by all three partners, not just himself, and if he cannot repay the money to the bank, the bank is entitled to **sue the other partners** for the balance.

### The debt for the cars

Tam has entered into a **contract to buy cars** in the name of the partnership. The **partnership agreement** specifies that the partnership should **only sell petrol**, so Tam does not have authority to undertake this contract.

However, the **third party** is not privy to the partnership agreement so is not aware that the contract is beyond the scope of the partnership. Tam has **apparent authority** to undertake the contract on behalf of the other partners.

However, as the trade of the partners is to **sell petrol**, it is possible that this contract might fall into the other exception to the authority rule, because the sale of cars is **not connected** to their business. It is a moot point whether selling cars is connected to selling petrol and a court might well rule that the two were connected, in which case, all three partners would be liable for this debt. This was the decision in *Mercantile Credit v Garrod (1962)*.

### The debt for the petrol

Purchasing petrol is a **normal** part of business for this partnership. Whoever made the contract would have had **authority** to do so and bound the other partners to the contract. They are all liable for the petrol bill.

## 52 Clare, Dan and Eve

**Text reference.** Chapter 13

**Top tips.** This question requires you to advise three people who have slightly different circumstances. It is often quicker to answer such questions by taking each person in turn and applying the ISAC approach to each.

**Easy marks.** There are few easy marks here. If you know partnership law well, the easiest marks are in its application to the scenario.

**Examiner's comments.** On the whole the majority of candidates recognised the specific underlying issues within the general context of partnership law, although the manner in which they applied the law to the issues differed significantly depending on their knowledge of partnership law. The question concerned three distinct characters; Clare, Dan and Eve and most candidates dealt with each in turn although not always appropriately.

This question requires candidates to analyse a problem scenario that raises issues relating mainly to partnerships but which also involves agency law.

- 8–10 marks Clear analysis of the problem scenario – recognition of the issues raised and a convincing application of the legal principles to the facts. Appropriate case authorities may be cited, but are not necessary if the principles are understood.
- 5–7 marks Sound analysis of the problem – recognition of the major principles involved and a fair attempt at applying them. Perhaps sound in knowledge but lacking in analysis and application.
- 3–4 marks Unbalanced answer perhaps showing some appropriate knowledge but weak in analysis or application.
- 0–2 marks Very weak answer showing little analysis, appropriate knowledge or application.

### Assumption

In answering this question it is assumed that Clare, Dan and Eve are involved in a **traditional partnership**. This is because no mention is made of a Limited Partnership under the Limited Partnerships Act 1907 or a Limited Liability Partnership under the Limited Liability Partnerships Act 2000.

Therefore, partners are **jointly liable** for all partnership debts that result from contracts made by other partners which bind the firm.

### Clare

A **sleeping partner** is a common term used to describe a partner who puts capital into the partnership but has no day-to-day involvement in the running of the business. They are distinct from limited partners in limited partnerships as they do not have limited liability.

Clare was unwise not to become involved in the firm as she would have had an equal say in how it was run and maybe could have prevented the financial problems. Unfortunately, as the firm does not have limited liability, she is **fully liable** for the debts of the firm.

### Dan

Partners are liable for debts incurred **during their time** as partners, but when they retire special rules apply.

**Retiring partners** are still liable for any **outstanding debts** incurred while they were a partner, unless creditors agree to **release** them from liability.

They are also **liable** for debts of the firm incurred after their retirement if the creditor knew them to be a partner (before retirement) and has not had **notice** of their retirement.

They are **not liable** for debts incurred with **new customers** after they retire providing the new customer was not aware of them as a partner or they knew them but were also aware of their retirement.

It would appear that **Dan is liable** for the debt with **Greg** as it does not appear that Greg had notice of Dan's retirement, nor did he agree to release him from liability.

**Hugh was aware of Dan's capacity as a partner** so Dan **will be liable** for the debt with Hugh unless Hugh was aware of his retirement.

### Eve

Like the others, Eve is **liable** for the debts of the partnership. The partners have **joint liability**. This usually means that debts are shared equally, but if one partner cannot afford to pay their full share, the others have to make up the shortfall. If Dan is not liable on the debt with Hugh, then this debt will be **shared equally** between Clare and Eve.

## 53 Partnership liability

**Text reference.** Chapter 13

**Top tips.** Part (a) is only worth two marks so do not spend long on it. Ensure your answer clearly states what liability is in each type of partnership.

**Easy marks.** A description of each type of partnership and a statement of liability would be enough to pass this question.

### Marking scheme

		Marks
(a)	Definition of partnership	1
	Jointly liable	1
		2
(b)	Description of limited partnership	1
	One limited, one unlimited partner	1
	Limited partner cannot participate	1
	Limited partner cannot bind the firm	1
		4
(c)	Description of limited liability partnership	1
	Limited liability	1
	Legal status of partnership	1
	Partners' authority	1
		4
		<u>10</u>

#### (a) Traditional partnership

A **traditional partnership** is the relationship which subsists between persons carrying on a business in common with the intention of making a profit (s1 Partnership Act 1890). A partnership does not have a separate legal identity distinct from the partners. One of the consequences of this is that the partners are jointly and severally liable for all debts and liabilities arising under any contracts made which bind the partnership to the full extent of each partner's wealth.

#### (b) Limited partnership

A limited partnership under the **Limited Partnership Act 1907** is also known as a **limited liability partnership**. This type of partnership is very rare today and accounts for less than 1% of all partnerships in the UK. A limited partnership is formed when one or more of the partners invest capital into the business but do not participate in running and managing the business. These partners therefore have limited liability as they can only lose the amount of money that they initially invested into the business.

In a limited partnership, the law states that there must be at least one partner who has unlimited liability (a **general partner**). The general partner has control of the management of the business. However, none of the limited partners is permitted to participate in the management of the business. If they do, their limited liability is lost. A limited partner cannot bind the partnership. Only the general partner can do that.

In order to take advantage of the protection afforded by limited liability, an organisation which constitutes itself as a limited partnership must comply with the requirements of the Limited Partnership Act 1907. In particular, the partnership must be registered at Companies House giving details of the partners and the extent of their liability.

(c) **Limited liability partnerships**

**Limited liability partnerships (LLPs)** are a relatively new form of business structure, following the enactment of the **Limited Liability Partnership Act 2000**. An LLP combines the features of a partnership along with the limited liability and creation of a legal personality more usually associated with limited companies. An LLP is not dissolved on a change of membership. At the end of the life of a partnership, it is wound up rather like a company.

An LLP is a body corporate and therefore an **artificial legal person** with its own property and liabilities, separate from its members. Every member-partner is treated as an agent of the LLP and therefore (usually) has **authority to bind the LLP** by their actions.

Since the LLP is a **separate legal entity** the members are not jointly liable for contracts entered into by the LLP and/or jointly and severally liable for any wrong-doings committed by the LLP. However, members will be liable for their own acts of negligence or wrong-doing much in the same way as company directors are. The rules on fraudulent and wrongful trading apply to an LLP in much the same way as they do to a limited company, as do the Companies Act provisions regarding the disqualification of directors, insolvency and winding up procedures.

LLPs are incorporated by **registration** at **Companies House** and are required to file accounts there. An **incorporation document** to which the initial members have subscribed must be submitted to the **Registrar of Companies**. This document will set out the name of the LLP along with its registered office, the name and address of each member and which members are to be '**designated members**' (who are responsible for compliance with the filing and administrative requirements).

## 54 Partnership v company

**Text reference.** Chapter 13.

**Top tips.** This is a straightforward question on the benefits of incorporation against a partnership. Commit the table in Study Text Chapter 13 to memory and use the points to answer any similar question that may arise in future.

**Easy marks.** Stating the differences will earn you quick marks – remember to use a separate paragraph for each.

### Marking scheme

	Marks
Separate legal personality	1
Contrast with partnership	1
Limited liability	1
Contrast with partnership	1
Perpetual succession	1
Contrast with partnership	1
Transferability of interest	1
Contrast with partnership	1
Capital	1
Security	1
	<u>10</u>

## Advantages of incorporation

There are a number of advantages offered by incorporating the business into a private limited company:

### Legal entity

Probably the most important factor which distinguishes a company from other forms of organisation is that a company is a distinct legal entity separate from its members whereas in a partnership there is no separate legal person as distinct from the partners. This means that the assets and liabilities of the business belong to the company itself.

### Limited liability

If the company becomes insolvent, the shareholders are not liable for the company's debts which belong to the company. They are liable only to the company for that amount, if any, which remains unpaid on their shares. In contrast, a partner is normally jointly and severally liable for all the debts of the firm to the extent of their personal wealth. However, directors of private companies are often required to give personal guarantees to lenders so the distinction is not always so great.

### Perpetual succession

In the case of companies, there is no cessation brought about by a change in the membership, but any change of partners in a partnership (by death, bankruptcy or resignation) operates as a termination of the old partnership and the beginning of a new one. In practice, a partnership agreement will often provide that for so long as there are two or more surviving partners on the death of one partner the partnership shall continue between them. Dissolution of the partnership can be effected by the agreement of the partners or according to the terms of the partnership agreement. A company is 'dissolved' by liquidation.

### Transferability

Subject to any restrictions imposed by the company's constitution, a company member's shares constitute a form of property and are freely transferable. Although a partner can assign their interest, the assignee of it will not as a result become a partner in the partnership (whereas a transferee of a member's shares thereby becomes a member of the company).

### Capital and security

A company may find it easier to raise capital for the expansion of the business than a partnership since the liability of potential investors is limited as described above and a company can borrow by debentures and loan stock. Furthermore, a company can raise capital by providing a fixed or floating charge as security but a partnership cannot provide security by way of a floating charge. There are, for the benefit of shareholders, various rules and regulations, contained in the Companies Act and the company's constitution, which are stringently applied relating to the reduction or distribution of a company's capital whereas in the case of a partnership partners may, by mutual agreement, withdraw capital from the partnership as they wish.

## 55 Termination of partnerships

**Text reference.** Chapter 13.

**Top tips.** Think carefully before attempting a question like this: it requires detailed knowledge of a fairly narrow area of the law on partnership and you must keep your answer focused on the requirement.

**Easy marks.** Stating each ground for termination.

**Examiner's comments.** This was a popular question and was relatively well-answered. The main criticism is that some candidates just listed the grounds as bullet points, and did not explain how the circumstances would arise. Many candidates did not make the point that the dissolution can occur at the volition of either the partners or in some instances the court.

	<b>Marks</b>
Dissolution by agreement of partners	2
Partnership Act 1890 grounds:	
Specific venture/fixed period ends	2
Death or bankruptcy of one of the partners	1
Supervening illegality	1
Notice by a partner	1
By agreement	1
By court order	<u>2</u>
	<u>10</u>

## **Dissolution**

Dissolution is the term used to describe when a **partnership comes to an end**. A partnership can always be dissolved by **agreement** of the partners. In addition the Partnership Act 1890 provides that a partnership will be dissolved in the **following circumstances**.

### **Fixed time/specific venture**

Where the partnership was entered into for a **specific venture or a fixed time period** and that venture or fixed period comes to an end. If in fact the partners decide to continue even after such time, the partnership is thereafter referred to as a 'partnership at will' and like any other partnership can be brought to an end by the partners' wishes.

### **Death or bankruptcy**

On the **death or bankruptcy of one of the partners**. Since a partnership has no separate legal personality but is the relationship that subsists between its partners, it follows that the death or bankruptcy of one of its partners will bring the partnership to an end (this is not the case with partnerships created under the Limited Liability Partnerships Act 2000). In practice, however, a partnership agreement will usually provide for the partnership business to continue under the control of the remaining partners who automatically constitute a new partnership.

### **Illegality**

In the case of **supervening illegality**. Where the business of the partnership becomes illegal, it is automatically dissolved. For example where the outbreak of war means that the partnership is thereafter trading with the enemy or if a solicitor in a partnership fails to renew their practice certificate, as required by law.

### **Notice**

Where one partner gives **notice of dissolution** to the remaining partners, provided the partnership is for an unlimited duration.

### **Agreement**

By **agreement** between the partners that the partnership should be dissolved.

### **Court order**

By order of the **court**. The court may order dissolution of a partnership, for example

- A partner becomes a patient under the **Mental Capacity Act 2005** or otherwise **permanently incapacitated**;
- Where one partner **carries on activities prejudicial to the partnership business** or is **persistently in breach** of the **partnership agreement**;
- Where the **partnership business** can only be **carried on at a loss**; or where it is **just** and **equitable** to do so on any other grounds.

## 56 Types of company

**Text reference.** Chapter 13.

**Top tips.** At first sight this looks like a gift of a question, but do make sure that you write sufficient worthwhile points about each type of company to maximise your mark.

**Easy marks.** Explaining how member liability is different in each type of company.

**Examiner's comments.** Generally answers to this question were satisfactory. Some students wasted time by discussing the subject of company formation, not the subject of this question at all. The issue of unlimited liability caused difficulties to some candidates, and there was confusion with the unlimited liability of the partnership or the sole trader. Some candidates were also confused by companies limited by guarantee, relating them to commercial guarantees.

### Marking scheme

		Marks
(a)	Unlimited company	1
	Can only be private	$\frac{1}{2}$
	No reference to liability in the constitution	$\frac{1}{2}$
	Extent of members' liability	$\frac{1}{2}$
	Advantages	$\frac{1}{2}$
		3
(b)	Limited by guarantee	
	Extent of members' liability	1
	Guarantee between company and members	1
	Examples	1
		3
(c)	Limited by shares	
	Liability established in constitution	2
	Position on winding up	1
	Creditors have no direct claim against members	1
		4
		<u>10</u>

### Companies

The **Companies Act** provides that an incorporated company may have either (a) no limit to the members' liability ('an **unlimited company**'), (b) the liability of its members limited to the amount unpaid on the shares respectively held by them ('a **company limited by shares**'), or (c) the members' liability limited to such amount as the members undertake to contribute to the assets in the event of a winding up ('a **company limited by guarantee**'). The matter of limited liability relates to the liability of the company members and not the company itself. In all cases, the company is a separate legal person with ownership of its assets, debts and other liabilities.

#### (a) Unlimited companies

An **unlimited company** cannot be a public company but must be a **private company**. Such a company's constitution makes no reference to members' liability as there is **no limit to their liability**. In the event of a liquidation, all members can be required to contribute as much as necessary in order to pay the company's debts in full. An unlimited company has the advantages of not being required to file copies of its annual accounts and reports (save in certain cases) and it may purchase its shares from its own members without following any formal processes.

#### (b) Companies limited by guarantee

In a **company limited by guarantee**, each shareholder is liable to contribute to the company the amount specified in the **company's constitution** in the event of the company going into liquidation but not before.



Creditors have no direct claim on members since the guarantee is between the member and the company only.

A company limited by guarantee would be particularly appropriate to **non-commercial activities**, such as a **trade association** or a **charity** where the aim is to balance annual income and expenditure rather than to generate surpluses to be distributed to shareholders. The members' guarantee is really a form of reserve capital.

(c) **Companies limited by shares**

In a **company limited by shares**, the fixed amount of each share will be specified in the company's constitution and that amount fixes the maximum liability of each shareholder which they agree to pay in money or money's worth either in one sum or by instalments. In the event of a winding up, the **members can be required to contribute any part of their stated liability which remains unpaid at that date** but not more. As above, creditors are owed debts by the company and have no claim against the members save in the event of liquidation.

## 57 Separate personality

**Text reference.** Chapter 13

**Top tips.** Notice how the answer is broken down into short paragraphs with headers. Always present your answers this way as it draws the marker's attention to your points and enables them to award you marks quickly and easily.

**Easy marks.** Defining legal personality and explaining its consequences. If you struggled with this you should go over the material in the text and your notes again – it is easily learnt.

**Examiner's comments.** As a whole candidates performed well on this question. However, once again it has to be stated that a significant number of candidates did not even attempt this question on one of the most fundamental principles of company law.

### Marking scheme

This question asks candidates to consider the doctrine of separate personality, one of the key concepts of company law. It also requires some consideration of the occasions when the doctrine will be ignored, and the veil of incorporation pulled aside. This latter part will demand consideration of both statute and common law provisions. The question is divided into two parts to indicate to candidates the weighting they should apply in answering the question, although the answers can be answered as a whole.

(a) Carries 6 marks

- |           |   |
|-----------|---|
| 5–6 marks | A thorough to complete answer explaining the meaning and effect of separate personality. It is likely that cases will be cited as authority although examples will be acceptable as an alternative. |
| 2–4 marks | Some but limited knowledge of the topic. Perhaps uncertain as to meaning or lacking in detailed explanation or authority.   |
| 0–1 mark  | Very little or no understanding whatsoever.   |

(b) Carries 4 marks

- |           |   |
|-----------|---|
| 3–4 marks | A thorough to full explanation detailing the situations under which separate personality will be ignored. |
| 1–2 marks | Some understanding perhaps lacking in explanation or examples of when the doctrine will be ignored.       |
| 0 marks   | No understanding whatsoever.  |

(a) **Legal personality of companies**

**Corporate personality** is a common law principle that grants a company a legal identity, separate from the members who comprise it.

The case of *Salomon v Salomon & Co Ltd 1897* is considered the key case that established the above principle. Salomon ran a non-incorporated business for 30 years but decided to convert it into a limited liability company where he would hold 20,001 shares and his family would hold 6 shares.

After incorporation, the business ran into financial difficulties and went into **liquidation**. Several creditors could not be paid out of the assets of the business and Salomon was taken to court to recover the debts. The claimant argued that since Salomon held most of the shares the business was **still in effect his own** and therefore he was liable for the business' debts.

However, the court held that the **assets** and **liabilities** of the **business** were that of the company as it was a **separate legal entity** in its own right. Therefore Salomon was not liable.

The **consequences of separate legal personality** are:

**Limited liability**

The **company** itself is **liable without limit for its own debts**. If the company buys goods from another company it owes the other company money.

Limited liability is a benefit to members. They own the business, so might be the people whom the creditors logically ask to pay the debts of the company if the company is unable to pay them itself.

Limited liability prevents this by stipulating the **creditors** of a limited company **cannot demand payment of the company's debts** from members of the company.

The only liability members have is to repay any amount unpaid on the nominal value of the shares that they hold.

**Legal capacity**

The company may enter into **agreements** and **contracts** in its own name and **sue** and be **sued** in matters of contract law, criminal law and tort. This means that where the company has suffered damage, it is the only proper claimant to demand compensation. This decision is taken by the members collectively under majority rule. Individual members are not permitted to take action themselves for wrongs suffered by the company.

**Perpetual existence**

Unlike partnerships which dissolve when partners leave or die, companies continue to exist despite changes in membership. Companies cannot die and can only cease when liquidated and removed from the companies register.

**Assets**

All assets transferred to the company become the property of the company. This means that although members collectively own the company, they do not have a direct claim on specific assets. As a result of this, companies may issue fixed and floating charges over their assets - chargeholders are safe in the knowledge that members cannot claim the assets for themselves.

(b) **The veil of incorporation**

Because companies have **separate legal personality** people can look at them and not know who or what owns or runs them. The fact that members are 'hidden' in this way is sometimes referred to as the '**veil of incorporation**'. Literally, the members are 'veiled' from view.

However, under the **circumstances** below, the veil may be lifted and the doctrine of separate legal personality set aside.

**Lifting the veil by statute to enforce the law**

A public company must obtain a **trading certificate** from the Registrar before it may commence trading. Failure to do so leads to **personal liability** of the directors for any loss or damage suffered by a third party resulting from a transaction made in contravention of the trading certificate requirement.

Persons (usually the directors) who are knowingly parties to **fraudulent or wrongful trading** shall be **personally responsible** under civil law for the debts and other liabilities of the company: s 213 and 214 Insolvency Act 1986.

Directors who participate in the management of a company in contravention of an order under the Company Directors Disqualification Act 1986 will be **jointly or severally liable** along with the company for the company's debts.

The Insolvency Act 1986 (s 217) makes it a criminal offence and the directors personally liable where they are a director of a company that goes into insolvent liquidation and they become involved with the directing, managing or promoting of a business which has an **identical name** to the original company, or a **name similar** enough to suggest a connection.

#### Lifting the veil to prevent evasion of obligations

A company may be identified with those who control it, for instance to determine its residency. The courts may also ignore the distinction between a company and its members and directors if the latter use that distinction to **evade** their **existing legal obligations**; *Gilford Motor Co Ltd v Horne 1933*.

In time of war a company is not permitted to trade with '**enemy aliens**'. The courts may draw aside the veil if, despite a company being registered in the UK, it is suspected that it is controlled by aliens.

The veil may also be lifted where directors **ignore** the separate legal personality of two companies and transfer assets from one to the other in disregard of their duties in order to avoid an existing liability *Re H and Others 1996*.

An application to wind up a company on the '**just and equitable**' ground under the Insolvency Act 1986 may involve the court lifting the veil to reveal the company as a **quasi-partnership**. This may happen where the company only has a few members, all of whom are actively involved in its affairs. Typically the individuals have operated contentedly as a company for years but then fall out, and one or more of them seeks to remove the others *Ebrahimi v Westbourne Galleries Ltd 1973*.

#### Lifting the veil in group situations

The principle of the veil of incorporation extends to the holding (parent) company/subsidiary relationship. Although holding companies and subsidiaries are part of a group under company law, they retain their **separate legal personalities**; *Adams v Cape Industries plc 1990*.

## 58 Mick's company

**Text reference.** Chapters 13 and 14.

**Top tips** Do not fall into the trap of devoting your efforts to the part that you think you will be best at, therefore denying or limiting yourself many of the marks available for the question as a whole.

**Easy marks.** This is a very straightforward question and you need to go into as much depth as possible in your answers to maximise the marks available to you. Notice in part (b) that you are asked for both the **procedures** and **documentation** needed to register the company. Notice also that the question is asking you about private limited companies, so you will gain no marks from discussing issues such as trading certificates.

### Marking scheme

- |     |           |  |
|-----|-----------|--|
| (a) | 4-5 marks | A clear explanation of corporate personality with reference to case authority.                       |
|     | 2-3 marks | Some, but limited explanation of the concept, perhaps only reference to Salomon with no explanation. |
|     | 0-1 marks | Very little explanation of the concept.  |

- (b) 4-5 marks A good answer setting out most of the documents required.
- 2-3 marks Some knowledge but lacking in explanation, or perhaps an unbalanced answer focusing on only some of the documents.
- 0-1 marks Very limited knowledge or explanation.
- 

- (a) A legal 'person' possesses **legal rights** and is subject to **legal obligations**. The term 'person' is used to mean both individual human beings (natural persons) and other bodies, including registered companies.

#### **Corporate personality**

A company is **distinct** as a separate legal person from its owners or members and hence a 'veil of incorporation' exists between them. The distinction between a company and its members was clearly set out in *Salomon v Salomon and Co Ltd 1897*.

In this landmark case, the court held that Salomon, although he owned 20,001 out of 20,007 shares in Salomon & Co Ltd, was under **no personal liability** to the failed company or to its creditors. Additionally, the court held that debentures issued to him by the company created a valid security over the company's assets which ranked before the claims of unsecured creditors of the company.

Since then, the distinction has been developed in both case law and statute. In limited circumstances the metaphorical **veil will be lifted by statute or common law** in order to avoid the inequitable consequences of adhering strictly to the rule of law in Salomon's case.

#### **Consequences of separate personality**

As a result of having separate personality, a corporation can enter into **contracts** in its own right and will be liable for breach of contract and may have to pay **damages** or suffer some other remedy awarded against it. Conversely, it may sue on a contract, it being the proper person to bring an action, not the members. The fact that a company has limited legal liability means that the shareholders of the company cannot be required to contribute more than the amount outstanding (if any) on their shares. A company's assets and liabilities are its own, and members do not have an insurable interest.

- (b) **Company registration**

Most companies are formed by **incorporation** under the Companies Act. Under this Act, an application should be completed and the following documents should be prepared and delivered to the Companies Registry to obtain registration of a company and a certificate of incorporation:

#### **Memorandum of association**

The memorandum is a simple document which states that the subscriber(s) wish to form a company and agree to become members of it, each taking at least one share. It is signed by each of them.

#### **Articles of association**

The articles will govern the procedures for the daily running of the company, including the voting rights attached to shares and the calling and conduct of meetings. They only need to be submitted if the company does not need model articles or if the model articles are to be amended.

#### **Statement of proposed officers**

This gives particulars of the company's first directors and secretary with their signed consent to act.

#### **Statement of compliance**

This confirms that the requirements of the Companies Act on company formation have been fully complied with.

#### **Statement of capital and initial shareholdings**

This is required from all companies with share capital. It contains details of the company's share capital and the initial shareholdings of the subscribers.

#### **Fee**

A registration fee, currently £20.

### Certificate of incorporation

Once these have been checked and found to be in order by the Registrar of Companies, a **certificate of incorporation** is issued under the Companies Act. This is conclusive evidence that the formalities of registration have been complied with. Alternatively, a company may be bought 'off the shelf' from an appropriate enterprise which has already incorporated a range of companies for sale. In such cases, the name of the company and the directors will need to be changed (as a minimum).

## 59 Public companies

**Text reference.** Chapter 14.

**Top tips.** This is a straightforward question as it does not require much application of the law. Given that students traditionally tend to find the application questions more difficult, it is a good opportunity to gain much needed marks.

**Easy marks.** Stating and explaining all the required documents that should be sent to Companies House would earn you enough marks to pass this question.

### Marking scheme

#### Marks

8–10	Answers will show a thorough understanding of the registration process, listing the documents required, and will make clear reference to the trading certificate in relation to public companies.
5–7	A sound understanding of the area, although perhaps lacking in detail.
2–4	Some understanding of the area but lacking in detail, perhaps failing to deal with the need for a trading certificate.
0–1	Little or no knowledge of the area.

### Registered companies

A registered company is a commercial concern which is incorporated and registered under the **Companies Act 2006**. A registered company always has a written constitution comprising its **articles of association** and any other **resolutions** or **agreements** that it may make. Any company not registered as a public company is a private company.

#### Registration

To register a new company, s9 requires an **application for registration** must be made and submitted to the Registrar. The application must contain; the company's **proposed name**, the **location** of its **registered office** (England and Wales, Wales, Scotland or Northern Ireland), a statement that the **liability of members** is to be **limited by shares** or **guarantee** and a statement of the **intended address** of the **registered office**.

Additionally, the following documents should be prepared and accompany the application.

- **A memorandum of association.** The memorandum is a simple document which states that the subscriber(s) wish to form a company and agree to become members of it, each taking at least one share. It is signed by each of them.
- **Articles of association.** The articles will govern the procedures for the daily running of the company, including the voting rights attached to shares and the calling and conduct of meetings. They only need to be submitted if the company does not need model articles or if the model articles are to be amended.
- **Statement of proposed officers.** This gives particulars of the company's first directors and secretary with their signed consent to act.

- **Statement of compliance** that the requirements of the Companies Act on company formation have been fully complied with.
- **Statement of capital and initial shareholdings.** This is required from all companies with share capital. It contains details of the company's share capital and the initial shareholdings of the subscribers.
- A registration **fee**, currently £20.

Once these have been checked and found to be in order by the Registrar of Companies, a **certificate of incorporation** is issued. This is conclusive evidence that the formalities of registration have been complied with. Alternatively, a company may be bought 'off the shelf' from an appropriate enterprise which has already incorporated a range of companies for sale. In such cases, the name of the company and the directors will need to be changed (as a minimum).

### Public companies

In addition, to register a **public limited company** the directors must obtain a **trading certificate** by submitting a form signed by a director or secretary to the Registrar of Companies. The submission should include a **statement of compliance** that the nominal value of the **allotted share capital** is at least **£50,000** and details of any **preliminary expenses** and **payments** or **benefits** to **promoters**.

## 60 Company registers and accounting records

**Text reference.** Chapter 14.

**Top tips.** Another straightforward question that does not require application of the law. Jot down all the points you need to make before writing your answer to ensure your answer is complete.

**Easy marks.** Learn all the company registers, if you can state and explain them well you would earn almost enough marks to pass.

### Marking scheme

		Marks
(a)	Register of members	2
	Register of charges	1
	Register of directors	1
	Records of directors' service contracts	1
		<hr/>
		5
(b)	Sufficient to show company's transactions	2
	Daily entries of cash	1
	Record of assets and liabilities	1
	Statement of stocks	1
		<hr/>
		5
		<hr/>
		10

### (a) Company registers

Under the Companies Act, companies are bound to keep a number of **statutory registers** available for public inspection and normally held at the company's registered office.

- A **register of members** containing the name and address of each member and the class to which they belong, the number of shares held by them and the date on which they became and (when appropriate) ceased to be a member;

- A **register of charges** containing details of all fixed and floating charges affecting the company property or undertaking, setting out brief descriptions of property charged, the amount secured and the name of the chargee.
- A **register of directors** containing details of each individual's name and address (usually a service address), nationality, business occupation, and date of birth;
- **Records of service contracts.** Copies or written memoranda of all service contracts for directors, including contracts for services other than as the capacity of director.

(b) **Accounting records**

A company is required to keep accounting records **sufficient to show and explain the company's transactions**, so that it is possible at any time to determine the company's financial position and to ascertain that any balance sheet or profit and loss account complies with the Act.

The records must contain **daily entries of sums paid and received** (describing the nature and source of the transactions), and a **record of assets and liabilities**. Where the company deals in goods, the accounts must also contain **statements of stocktaking** and the stock held at the end of each financial year and **statements of goods bought and sold** (except retail sales).

## 61 Eden plc

**Text reference.** Chapter 14.

**Top tips.** Make sure that you address all three of the issues (with a clear sub-heading for each) and get the easy marks by identifying what the point of law is, eg in part (i) it is the personal liability of promoters etc. Even if you cannot say much about it, identifying the issue will earn you marks.

**Easy marks.** Don't forget to have a go at advising the parties involved in this question. Marks will be available as long as you base your advice on the conclusions you have reached.

### Marking scheme

This question requires candidates to explain the law relating to company promoters. Marks will be allocated as follows:

8-10 marks	Full and thorough explanation of the law relating to promoters with good and accurate application of the law to the particular issues raised in the problem.
6-7 marks	Good treatment of the topic but perhaps not dealing with all the issues raised or lacking in some knowledge or application. Perhaps lacking balance in that it only deals with some of the elements of the question.
4-5 marks	Lacking in detail in some or all aspects or lacking in application.
0-3 marks	Some but little knowledge of the topic with little appropriate application.

### Promoters

In the scenario described, Don has taken on the legal role of '**promoter**' to Eden plc. A promoter is 'one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose' (*Twycross v Grant 1877*).

The term promoter also includes anyone who makes any **business preparations** for the company. They will normally require the company to agree to reimburse their expenses incurred in the promotion and formation once the company has been incorporated.



A solicitor, accountant or other professional who acts in their **professional capacity** in connection with the formation of a company is not a promoter on that basis. Whether someone is a promoter is a question of fact.

(a) **Computer equipment**

The general rule is that a **promoter is personally liable** on any **completed pre-incorporation contract** entered into with a third party. A pre-incorporation contract is a contract purported to be made by a company or its agent at a time before the company has received its certificate of incorporation. Since the company does not exist at the time the contract is made, it cannot be held liable in respect of its terms, nor can it ratify it or enforce it.

The promoter is liable for **damages for breach of warranty of authority** in any pre-incorporation contract where the promoter can be said to have warranted to the other party that the company existed when in fact it did not (*Kelner v Baxter 1860*).

Section 51(1) CA 2006 provides that the person purporting to act for the company shall be **personally liable** on the contract subject to any agreement to the contrary. It was held in *Phonogram Ltd v Lane 1981* that any **agreement to the contrary** must be an **express agreement** and cannot be implied.

It is irrelevant whether the other party knew that the company did not exist or whether the contract is made in the company's name or in the agent's name.

In the situation described involving Don and Eden plc, the **directors are not legally bound** to honour the purported contract with the computer equipment supplier. The supplier will have to take action against Don for breach of contract.

(b) **Patent**

A company may however enter into a **new contract** (a 'novation') on similar terms after incorporation. Mere recognition of the pre-incorporation contract by **performing** it or **accepting** benefits under it is not sufficient to constitute a new contract. However, this new contract will of course require the third party to be willing to enter into it on the same terms.

In the situation described involving Don and Eden plc, there is simply **no contract involving the company**. If the other party does not wish to proceed, the directors will be unable to show any legal obligation for them to do so.

(c) **Equipment**

In order to overcome the difficulties posed by the law relating to pre-incorporation contracts, the promoter might seek to avoid liability by **postponing completion** of the contract until after incorporation of the company or by providing that their liability shall cease as and when the newly incorporated company enters a new contract on identical terms.

In the situation described involving Don and Eden plc, there is **no contract** since Eden plc does not wish to pursue the arrangements with Fad Ltd. Fad Ltd therefore has no cause of action against either Don (since the condition has not been fulfilled and therefore the contract has not come into existence) or the company.

## 62 Objects clause

**Text reference.** Chapter 15.

**Top tips.** Notice the different requirements of the parts of the question. Part (a) is asking just for the extent of the company objects, while part (b) asks for the meaning of *ultra vires* and also its effect. So you must make a positive effort to identify the effect on a company's contracts (and on its directors) if a contract is made that is subject to a restriction within the scope of the objects.

**Easy marks.** Defining what *ultra vires* is.



This question requires candidates to explain the extent of a company's objects clause, and in particular to explain the current operation of the doctrine of *ultra vires*.

- 8–10 marks Thorough to complete answers, showing a detailed understanding of both elements of the question.
- 5–7 marks A clear understanding of the topic, but perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in the other.
- 2–4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the topic.
- 0–1 marks Little or no knowledge of the topic.

### (a) Company objects

A company's **constitution**, and in particular its **articles of association**, contains its **objects**. Under the Companies Act 1985, every company was required to state its objects so defining the **purpose of the company** and its capacity to act. Companies could **not** enter into agreements that were not consistent with their objects.

The **Companies Act 2006** changed matters and now all companies with model articles are **automatically** deemed to have completely **unrestricted objects** and so may enter into any contract so long as it is legal. However companies are permitted to **restrict** their objects by **special resolution**. Therefore should the members wish to prevent directors entering into certain types of contract they can do so.

### (b) Ultra vires

The contractual capacity of a registered company is **defined by its objects clause** and this is usually unrestricted. Any contract entered into which is subject to a restriction under that clause is in theory *ultra vires* (and void). However, given that the validity of a company's acts cannot be questioned on the grounds of it having lacked legal capacity (s.39 CA 2006), the *ultra vires* rule is of very limited effect in so far as third parties are concerned.

#### Internal ultra vires

Internally, the *ultra vires* rule is still relevant. The **directors** owe a duty to act in **accordance** with the company's **constitution** and only to exercise powers for the purposes for which they were conferred. A member can obtain an injunction to restrain the doing of an *ultra vires* act before it is done. However, in the event that the directors are in breach of this duty, the action can be ratified by **special resolution** (and their liability relieved by a separate special resolution).

#### External ultra vires

Externally, s.39 CA 2006 provides that *'the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution'*. Neither the company nor the third party can plead *ultra vires* to escape their obligations and there is no requirement for good faith. Therefore, the *ultra vires* rule has effectively been abolished in relation to acts done between a company and a third party unless the third party acts in bad faith and the directors exceed their authority. Now almost all such acts will be capable of validation at the instance of either party.

S.39 is supported by s.40 which states that *'in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company's constitution.'* This means that providing the **third party** acts in **good faith**, they can **assume that the directors have the authority to bind the company**. Third parties do not need to check the articles for any restrictions.

Any *ultra vires* transaction between a company and a director will be **voidable** at the instance of the company unless ratified or third party rights intervene or where restitution can no longer be made.

## 63 Articles

**Text reference.** Chapter 15.

**Top tips.** Make sure that you give the correct amount of time to the three parts of this question. The two mark section should only be allocated about 3½ minutes. Don't over-run on any one part as that means that you will deny yourself the opportunity for the easy marks on the later parts of the question. Notice that part (b) is effectively asking you two things, as it requires the contractual effect on both members and non-members.

**Easy marks.** When you state a point of law in an answer the easy way to double your marks is to cite a case or two in support. The law on articles includes a lot of straightforward quotable cases, so include as many of them as you can.

**Examiner's comments.** This was a popular question on this paper and it was relatively well done. The worst done part was part (c) where many candidates merely talked about the requirement for a special resolution and did not consider the issue of whether alterations were *bona fide* and in the interests of the company as a whole.

### Marking scheme

- 6-10 marks    Thorough treatment of both the content and effect of articles of association. Answers towards the top end will provide cases to exemplify the operation of the articles and will be rewarded accordingly.
- 0-5 marks    Weak understanding of the articles generally. Perhaps unbalanced in that there is knowledge of some cases but little in other important areas.

#### (a) **Model articles**

A company's articles of association deal mainly with matters affecting the **internal conduct of the company's affairs** including the issue and transfer of shares and class rights, dividends and alterations of capital structure, the convening and conduct of general meetings, the appointment, powers and proceedings of directors and company accounts.

A company may have its own full-length special articles or it may adopt **Model articles**. Model articles are deemed to apply to the extent that the company does not submit its own articles in substitution on registration. The provisions of the Companies Act override a company's articles where they prohibit something which, on the face of it, is permitted by the articles or where the Companies Act require a special procedure to be followed.

#### (b) **Effect of the Articles of Association**

A company's **articles of association**, bind:

- Its members to the company,
- The company to its members, and
- Its members to each other (s.33 CA 2006).

This contractual effect **does not bind the company to third parties** and it applies only to rights and obligations which affect members in their capacity as members (*Hickman v Kent or Romney Marsh Sheepbreeders Association 1915*). Therefore in *Eley v Positive Government Security Life Assurance Co 1876* when Eley, although a member of the company, brought a claim in his capacity as solicitor and not as member, the contractual effect of s.33 could not be relied upon.

The **members are contractually bound** by the articles in their **dealings with one another** as if each had separately agreed to be bound by them (*Rayfield v Hands 1958*). If an outsider enters into a contract with a company which is silent on a particular point but that same point is covered by the articles, then the contract is deemed to incorporate the articles to that extent (*Re New British Iron Co, ex parte Beckwith 1898*). Essentially in such cases the articles operate to supply a missing term in a contract made with the company.

(c) **Altering the Articles of Association**

A company's **articles of association** may be **altered** by the company by passing a **special resolution** to that effect in general meeting. The articles once properly altered are binding on the company and its members in the same way as the original articles.

**Restrictions**

An article **cannot be made unalterable** by declaring it to be unalterable in the articles or by requiring a greater majority vote than 75% or by means of a separate contract under which the company undertakes not to alter it.

An alteration will be void if it **conflicts with the Companies Act**. Equally it will be void if it compels any member to subscribe for additional shares or if the majority who approve it are not acting **bona fide** in what they deem to be the **interests of the company as a whole**.

An alteration **cannot have retrospective effect**. Any alteration which varies class rights must be made according to the correct rights variation procedure. An alteration purporting to give the majority the right to buy the shares of the minority will not be valid (*Brown v British Abrasive Wheel Co 1919*).

In *Greenhalgh v Arderne Cinemas Ltd 1950* the Court of Appeal made it clear that the '**bona fide** for the **benefit of the company as a whole**' test referred to above is a **single test** and also a **subjective test** (ie what did the majority believe?). The company as a whole in this context means the **general body of shareholders**. The test is whether every 'individual hypothetical member' would in the honest opinion of the majority benefit from the alteration (*Greenhalgh's case*).

Provided the purpose is to benefit the company as a whole, the alteration does not become invalid by reason of the **minority suffering special detriment** or some members escaping loss (*Allen v Gold Reefs of West Africa Ltd 1900*).

A company **cannot be prevented** from **altering its articles of association** where such an alteration causes a breach of a contract entered into by the company although it may be liable for damages if that is the result (*Southern Foundries (1926) Ltd v Shirlaw 1940*).

## 64 Fred

**Text reference.** Chapter 15.

**Top tips.** This is a short scenario so it should be easy for you to identify the issue. Make sure you state what it is at the start of your answer. You must then state the relevant law and apply it to Fred's case before coming to a conclusion.

**Easy marks.** Stating the rules of amending the articles of association.

**Examiner's comments.** This question required candidates to examine the law relating to the power of companies to change their articles of association. As the substantive law, either in the statute or case law relating to this area has not been changed this question allowed even those candidates who were unaware of the Companies Act 2006 an opportunity to do well. Unfortunately it was an opportunity not taken by many candidates, as the question tended to be done inadequately. A number of candidates wilfully misinterpreted the question as relating to directors' duties and wasted a lot of time and effort in pursuing that path. The majority of candidates recognised that the issue was about the alteration of articles, and recognised that it required the passing of a special resolution with a 75% majority. However very few were able to explain the tests for deciding whether the alteration could be challenged in court. Even those who were aware of the bona fide '*interest of the company as whole*' test tended not to explain it further, with only a small number considering the situation of the '*hypothetical individual*' member.

As a result although many concluded that the alteration could be challenged in the courts, no legal principle or authority was cited in support, or irrelevant law relating to directors or indeed partnerships was cited.

This question requires candidates to examine the law relating to the power of companies to change their articles of association.

8–10 marks: Candidates will exhibit a thorough knowledge of the relevant law together with the ability to analyse the problems contained in the question.

5–7 marks: Candidates will exhibit a sound knowledge of the relevant law together with the ability to recognise the issues contained in the question. Knowledge may be less detailed or analysis less focused.

3–4 marks: Identification of some of the central issues in the question and an attempt to apply the appropriate law. Towards the bottom of this range of marks there will be major shortcomings in analysis or application of law.

0–2 marks: Very weak answers which might recognise what the question is about but show no ability to analyse or answer the problem as set out.

### Issue

The members of Glad Ltd wish to **amend the company's articles of association** to force Fred to sell them his shares in order to remove him from being a member of the company. The question that must be answered is **can** the articles be amended for this, and if so, will the amendment be **legally binding**?

### Articles of Association

S.33 CA2006 provides that a company's **articles of association bind a company to its members, the members to the company and members to members**. Members are deemed to have separately covenanted with each other and the company to observe the provisions of the articles.

### Altering Articles of Association

**A company's articles of association may be altered by the company by passing a special resolution** to that effect in general meeting. The articles once properly altered are binding on the company and its members in the same way as the original articles.

However, such alterations will be **void** if they compel any member to **subscribe for additional shares** or if the **majority** who approve them are not acting **bona fide** in what they deem to be the **interests of the company as a whole**.

In *Greenhalgh v Arderne Cinemas Ltd 1950* the Court of Appeal made it clear that 'the company as a whole' in this context means the **general body of shareholders**. The test is partly subjective and partly objective, ie whether every 'individual hypothetical member' would in the honest opinion of the majority benefit from the alteration.

Provided the purpose is to benefit the company as a whole, the alteration does not become invalid by reason of the **minority suffering special detriment** or some members escaping loss (*Allen v Gold Reefs of West Africa Ltd 1900*).

### Case law

The following cases are relevant to Fred's situation.

In *Brown v British Abrasive Wheel Co 1919*, the 98% majority was prepared to inject more capital into the company, but only if they could acquire the shares of the 2% minority, who refused to sell. The majority purported to alter the articles to provide for **compulsory acquisition** of the shares on a fair value basis. The minority objected and the alteration was held to be invalid.

In *Sidebottom v Kershaw, Leese & Co Ltd 1920* a new article permitted the acquisition of the shares of minority shareholders who carried on a competing business. The validity of such an alternation was upheld by the court.

However, in *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd 1920* a similar amendment was held to be invalid because it permitted the company to acquire the shares of any member, even if there were no specific grounds to show that it would benefit the company.

## Fred

Following the principles set out above, it appears that a new article that requires the acquisition of a member's shares would be valid if it would be of **benefit to the company**, and this certainly appears to apply in Fred's case (he is in direct competition with Glad Ltd). However, the **resolution actually proposed by Glad Ltd** would allow the company to acquire the shares of **any member** for a fair price. Therefore it is likely to be held as invalid under the facts of the *Dafen* case.

## 65 Company names

**Text reference.** Chapter 15.

**Top tips.** Before you start to write your answer, take a minute to go through in your head and jot down on a piece of paper the main points that you need to make – in parts (a) and (b) this means at least four good company name rules and facts about passing off.

**Easy marks.** Get the basic marks for each part by explaining the importance of a company's name, the tort of passing off and the role of the company names adjudicators.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question, divided into three parts, required candidates to explain the limitations on the use of company names, the tort of 'passing off' and finally the role of the company names adjudicators under the Companies Act 2006.

It has to be said that this question, and in particular part (a) was extremely well done. The great majority of candidates were well able to cite most of the rules governing what names can and can't be used by companies. Part (b) was also done fairly well with many candidates able to cite cases in support of their explanation of the law. Part (c), which introduced the new concept of the company names adjudicator was also done fairly well. It is pleasing to see that candidates are now coming to terms with the 'new' companies legislation.

### Marking scheme

- |     |           |   |
|-----|-----------|---|
| (a) | 3–4 marks | Good explanation of the rules relating to company names.                                      |
|     | 0–2 marks | Some but limited knowledge of the control over company names.                                 |
| (b) | 3–4 marks | Good explanation of the tort of 'passing off' with case authority to support the explanation. |
|     | 0–2 marks | Some but limited knowledge of 'passing off'.  |
| (c) | 2 marks   | Good explanation of the role of the company names adjudicators and why they are necessary.    |
|     | 0–1 mark  | Little if any knowledge of the concept.   |

### (a) Company name

The **name of a company** must be specified in the company's **constitution** and serves to **identify the company**, distinguishing it from any other company. The Registrar of Companies has statutory powers of control over the choice of names in order to ensure that they comply with both statutory and common law restrictions and requirements. These apply both on the initial registration of a company by its promoters and on any subsequent change of name by the company.

### Public and private companies

If the company is a **public company**, the name must end with the words 'public limited company' or 'plc'. If it is a **private limited company**, the name must end with the word 'limited' or 'ltd'. This is except in the case of private companies limited by guarantee and companies licensed before 25 February 1982 where the word 'limited' may be omitted if certain conditions are satisfied. Appropriate Welsh wording may be used by companies having a registered office in Wales.

### Restrictions on names

A company **cannot share the name of any existing company** which appears in the statutory index at the Companies Registry. Nor can a company bear a name which, in the Secretary of State's opinion, is **offensive, sensitive** or constitutes **a criminal offence** or suggests a connection with the **government** or a **local authority**. Words such as 'British' or 'National' will only be permitted if the nature and size of the company is appropriate. A name which suggests some **professional expertise** will be permitted only if that expertise exists in the company and appropriate professional bodies have no objection.

Under the Companies Act 2006, the **Secretary of State** may order a company to change its name where it is the same or 'too like' another on the register.

#### (b) Passing off

Under the common law, a company can be prevented from using its registered name if the use of that name causes the company's goods or services to be confused with those of another company. The court may grant an injunction in a '**passing-off**' tort action brought by that other company and may also force the defendant company to change its name (*Ewing v Buttercup Margarine Co Ltd 1917*).

In this case, a sole trader was prevented from using the business name 'The Buttercup Dairy Co' in the north of England because of confusion with the business in the London area of Buttercup Margarine Co Ltd.

If, however, the two companies' businesses are different, confusion is unlikely to occur, and hence the courts will refuse to grant an injunction: *Dunlop Pneumatic Tyre Co Ltd v Dunlop Motor Co Ltd 1907*

The complaint will also not succeed if the claimant lays claim to the exclusive use of a word which has a general use: *Aerators Ltd v Tollit 1902*.

#### (c) Company Names Adjudicators

Under the Companies Act 2006, companies have the right to appeal to the **Company Names Adjudicators** if they feel that another company's name is too similar. The Adjudicators will look into the case and make a decision which is binding on both parties. This decision may be to **compel a name change** (including in some cases the determination of what the new name will be) or to do nothing. If a party is unhappy with the decision they may appeal it in court.

## 66 Various terms

**Text reference.** Chapter 13.

**Top tips.** Read this sort of question very carefully before launching yourself into the answer. Make sure that you have clearly distinguished between the various terms in your own mind. The examiner noted that in part (c) some candidates thought that plc meant private limited company. This must have been as a result of their not stopping to think properly before they wrote their answer, as private companies had already been covered in part (b).

**Easy marks.** The examiner gave a clear mark allocation in this question, and you should make sure that you stick to it. The two 3 mark sections should take you roughly five minutes each, leaving you eight minutes to do the 4 mark part (c) and check through your whole answer. Don't over-run on these timings, as it is much easier to get the easy marks on the next section of your answer rather than scrabble trying to get the last half mark on the current section.



**Examiner's comments.** This was another very popular question with the majority of candidates attempting it. Usually, it was answered well. The majority observed that the question was in parts and structured their answers accordingly: only a small minority grouped everything together and produced a confused answer.

In part (a) on limited liability partnerships, some candidates based their answers around the 1907 Act and did not mention the 2000 Act, and hence did not score very good marks. Part (b) on private limited companies was generally well-attempted. In part (c) on plcs, a minority of candidates thought that the term stood for private (instead of public) limited companies

### Marking scheme

8-10	Good to complete answer which shows a knowledge of the meaning and effect of the three terms.
5-7	Some basic knowledge of what is meant by the terms, but no real depth of understanding. Perhaps an unbalanced answer that only deals with one or two parts of the question.
0-4	Little knowledge or knowledge of only one of the forms.

#### (a) LLP

LLP stands for **limited liability partnership**. This is a form of partnership created under the **Limited Liability Partnership Act 2000**, which is actually a **corporate body with a separate legal personality**. This differentiates it from a traditional partnership, which has no separate legal personality and in which the partners' liability is unlimited. The limited liability partnership, which is denoted by the suffix LLP, therefore has some of the attributes of a limited company.

To **incorporate** a limited liability partnership, the subscribers must lodge a document with the **Registrar of Companies**. This must include the **name** of the partnership, the **location of its registered office** (eg England and Wales), the **address of the registered office**, the **names and addresses of all the members** of the LLP, the identities of those members who are going to be '**designated**' members and the registration fee. Designated members are responsible for the publicity requirements of the LLP including signing and delivering the accounts.

**Every member of the LLP is an agent of the partnership** and as such, provided the member has authority to act, **the LLP will be bound by its members' acts**. An LLP does not dissolve on a member leaving it, but, like a company, continues in existence. A formal winding up is required if the members decide to dissolve an LLP.

#### (b) Ltd

'Ltd' shows that the business organisation is a limited company, and, in particular, a **private limited company** as opposed to a public limited company. The essential characteristic of a company is the distinction between the corporation and its members (*Salomon v Salomon & Co Ltd 1897*) which means that the company's assets and liabilities are its own and a company can enter into and enforce contracts in its own right. Likewise, a company is liable for breach of contract and may have to pay damages or suffer some other remedy against it.

The significance of the word 'limited' is that the **liability of the company's members is limited to such amount as is unpaid on their shares**. Once shares are fully paid up, the owners of those shares have no further liability in respect of the debts of the company. A company will not cease to exist on a change in its membership.

The **name** of a private limited company must end with the word '**limited**' or '**ltd**', save where a specific exception applies, in order to publicise to parties dealing with the company the fact of its members' limited liability. Appropriate Welsh wording may be used by companies having a registered office in Wales.

(c) **plc**

'plc' denotes a **public limited company** which is also a separate legal entity distinct from its members. As with a private limited company, **the members' liability is limited to the amount outstanding on their shares**. A public company must **state in its constitution that it is a public company** and its **name** must end with the words '**public limited company**' or '**PLC**' or '**plc**' or its Welsh equivalent. A public company is one registered as such under the Companies Act.

Unlike a private company, **a public company can raise capital by offering its shares and debentures to the public**. Only a public company can be listed on the Stock Exchange or other investment exchange. Generally speaking, a public limited company is subject to more stringent accounting and other regulations than a private limited company.

## 67 Issue and premium

**Text reference.** Chapter 18.

**Top tips.** Notice that the requirement in this question falls into two parts. It asks you to explain both 'the meaning' and 'the effect' of the two issues. This should help you build up marks in your answer by making sure that you address both of these requirements. For example, in part (a), to explain the **meaning** of the concept, you really have to answer the question 'discount to what?' In other words, you have to explain that shares have a **nominal value** attached and that they cannot be issued at a discount to that. The basic **effect** of the concept is that if shares are issued at a discount to nominal value, this is illegal. This means that any money due to make the payment up to nominal value could be called in event of liquidation. This is similar to the effect of having partly paid shares.

**Easy marks.** There are no easy marks unless you can explain the various rules that are required.

### Marking scheme

		Marks
(a)	Explanation of nominal value	2
	Protection of creditors needed	1
	Explanation of issue at discount	1
	Valuation of non cash consideration by plcs	1
	Other exceptions	1
		6
(b)	Explanation of share premium	2
	Examples of uses	2
		4
		<u>10</u>

(a) **Issuing shares at a discount**

A company may issue shares within the **authority granted to directors**. Every share has a **nominal value** and **cannot be allotted at a discount** to that value s580. In order to protect the company's creditors, a company must obtain in money or money's worth consideration of a value at least equal to the nominal value of the shares allotted. The **uncalled capital** passes as a debt on a transfer of the shares so that it is payable by the holder at the time payment is demanded (s588).

If shares are allotted at a **discount**, the allottee is still **liable to pay the full nominal value** together with interest at the appropriate rate. The issue of shares at a price which is less than the **market value** (but equal to or more than the nominal value) of existing shares does not contravene the provision.

In the case of **private companies**, shares may be allotted for **inadequate consideration** by the acceptance of **goods or services at an over value**. A blatant and unjustified overvaluation will not, however, be upheld. Any non-cash consideration must be valued in the case of public companies.



It is not a contravention of s580 to issue shares at par but to pay an **underwriting fee** or other **commission** which reduces the net amount received below par value provided the company is permitted to do so by its articles.

(b) **The share premium account**

A company may issue shares for a price in **excess** of the **nominal value** of those shares. The excess is called the '**share premium**' and must be credited to a **share premium account**. Where the shares are issued for a non-cash consideration in excess of the shares' nominal value, the excess should still be credited to the share premium account, since the statutory rule applies to issues of shares 'at a premium whether for cash or otherwise'.

The general rule is that reduction of the share premium account is subject to the same restrictions as reduction of share capital. **No part of the account can be distributed as dividend.**

The account can be used to pay up fully paid shares under a **bonus issue** since this operation simply converts one form of fixed capital into another. It can also be used to pay **issue expenses** and **commission** in respect of a **new share issue**.

Furthermore, the share premium account is included in the '**undistributable reserves**' when determining whether a dividend can lawfully be declared by a public company.

## 68 Capital terms I

**Text reference.** Chapter 16.

**Top tips.** Notice the mark allocations for the four separate parts of this question and make sure that you stick to the associated timings. You should only be spending about 3½ minutes on a 2 mark part.

**Easy marks.** Make sure that in each part of the question you focus on the specific subject of that part, eg issued capital, and explain it in as much depth as you can.

### Marking scheme

This question seeks an explanation of the nominal value of shares and their market value together with an explanation of the two types of share capital listed.

8-10 marks    Thorough explanation of all the elements in the question.

5-7 marks    Thorough treatment of some of the elements, or a less complete treatment of all of them.

0-4 marks    Unbalanced to very unbalanced answer, focusing on only one element and ignoring the others, or one which shows little understanding of the subject matter of the question.

### Shares

A **share** is the **interest** of a **shareholder** in the company measured by a **sum of money**, for the purpose of liability in the first place, and of investment in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se (*Borland's Trustees v Steel Bros & Co Ltd 1901*). It is a transferable form of property carrying rights and obligations.

(a) **Nominal value**

The **nominal value** of a share is the **fixed monetary amount specified** in the **constitution** and does not usually change. The nominal value indicates how much the company raised when the shares were first issued (assuming they were fully paid up) and forms the company's capital which is subsequently used for investment in the operation of the company. For example, a company may issue 100,000 shares at £1 nominal value. If the shares are fully paid, the shareholders will pay a total of £100,000 to the company.

(b) **Market value**

Shares of a public company, once issued, may be traded – publicly or privately – so that the identity of some or all shareholders changes. In trading these shares, the shareholders may, subject to certain constraints, agree a **price for the shares that does not necessarily match the nominal value**. This is known as its **market value**. If the company is performing well and its prospects are good, the market value may be higher than the nominal value. Alternatively, the market value may fall below the nominal value.

(c) **Issued capital**

A company's **issued share capital** is the type, class, number and amount of shares actually held by its shareholders. A company may issue ordinary shares for cash provided it has the **authority** to do so. The authority to issue – or allot – shares is normally given to the directors by the company's articles of association. Alternatively, an ordinary resolution can be passed which gives the directors authority. A company may only allot shares within this authority but need not issue as many shares as it is authorised to.

In the case of a **public limited company**, the **issued share capital must be at least £50,000** of which at least one quarter plus the full amount of any share premium must be paid up.

(c) **Paid-up capital**

**Paid-up capital** is the amount of a company's issued share capital for which the company has actually **received payment** from the shareholders. If a company's shares have a nominal value of £1, it is usual, although not necessary, for the whole amount to be paid immediately. The company may for example request a first payment of 50p per share, in which case the shares are said to be part-paid. Until the full nominal value of the shares is paid, the shareholders will retain liability for the unpaid element. This element is referred to as **uncalled capital**.

## 69 Shares and debentures

**Text reference.** Chapters 16 and 17

**Top tips.** You may be tempted to write more than you need to when answering this question. Remember that only ten marks are on offer for all three parts – that means three or four marks per part. Nothing elaborate is needed, just make enough points in each part and then move on.

The marking scheme indicates that you would be awarded marks for the standard of your overall answer, rather than per part.

**Easy marks.** All marks in this question are easy – you only need to state simple facts about each source of capital.

**Examiner's comments.** The majority of candidates dealt with the question well, indeed it was the best answered question in the paper, but [in] some answers there was a tendency to define [the investments] in terms of each other and hence effectively to repeat information. Surprisingly candidates were less successful at defining the ordinary share, although those who made use of the definition in *Borland's Trustees v Steel* (1901) invariably produced reasonable answers.

### Marking scheme

This question requires candidates to consider the various investment mechanisms available to investors.

- |            |  |
|------------|--|
| 8–10 marks | Full understanding and explanation of the various forms of investment.   |
| 5–7 marks  | Lacking in detail in some or all aspects of the possible investment forms. Unbalanced answer that only focuses on some of the forms. |
| 3–4 marks  | Some, but little, knowledge of the topic.  |
| 0–2 marks  | Little if any knowledge of the topic.  |

(a) **Ordinary shares**

According to the decision in *Borland's Trustee v Steel Bros & Co Ltd 1901* a **share** is; 'the interest of a shareholder in the company measured by a sum of money, for the purpose of a liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se*'.

There are three consequences of this definition.

- The share must be **paid for** ('liability'). The nominal value of the share fixes this liability; it is the base price of the share eg a £1 ordinary share.
- It gives a **proportionate entitlement** to dividends, votes and any return of capital ('interest').
- It is a form of **bargain** ('mutual covenants') between shareholders which underlies such principles as majority control and minority protection.

A share's **nominal value** is its face value. So a £1 ordinary share for instance, has a nominal value of £1. No share can be issued at a value below its nominal value. However, the company may allow shareholders to pay less than the full nominal value when then shares are purchased. Any outstanding liability can be called upon at a later date and this amount represents the shareholder's only liability should the company be liquidated.

Possible drawbacks of ordinary shares include the possibility that no dividends are paid and/or their market value will fall if the company is not profitable.

(b) **Preference shares**

**Preference shares** are regarded as a slightly safer investment than ordinary shares since they carry one or more rights. By default they are deemed to have **identical rights** to ordinary shares. However, a company's articles or resolutions may create differences between them.

Common differences include:

- A **preference share** may carry a **prior right** to receive an **annual dividend of fixed amount**, say a dividend of 6% of the share's nominal value. Dividends are usually **cumulative** – if they are not paid one year they rollover to the next.
- A **preference share does not usually carry a right to vote, or voting is permitted only in specified circumstances**. For example, failure to pay the preference dividend, variation of their rights or a resolution to wind up.
- **Preference shares** may carry a **priority right to return of capital**. Essentially this means that the amount paid up on the preference shares is to be repaid in liquidation **before** anything is repaid to **ordinary shareholders**. However this right has a price. Usually holders of the preference shares are not entitled to share in **surplus assets** when the ordinary share capital has been repaid.

(c) **Debentures**

A **debenture** is the written acknowledgement of a debt by a company, normally containing provisions as to payment of interest and the terms of repayment of capital.

A debenture is usually a printed legal document. There are three main types.

- **Single debentures**. These are one-off debentures issued to individual lenders such as banks in return for a secured loan or overdraft.
- **Debentures issued as a series**. These are used when finance is raised from a number of different lenders who provide different amounts on different dates and the intention is that they should rank equally in their right to repayment.
- **Debenture stock subscribed to by a large number of lenders**. This type of debenture is used when a company wishes to publicly raise funds from a number of lenders at the same time. Only public companies may use this method as it constitutes a prospectus.

Whatever the type of debenture, holders are **creditors** of the company. Unlike shareholders they are entitled to receive **interest payments** even if the company is not profitable.

A debenture may create a **charge** over the company's assets as security for the debt.

**Fixed charges** attach to the asset as soon as the charge is created. If the company disposes of the charged asset it will either **repay the secured debt** out of the proceeds of sale, or **pass the asset over to the purchaser** still subject to the charge.

**Floating charges** attach to the asset on **crystallisation** (specific circumstances which cause a floating charge to convert into a fixed charge), rather than on creation. This means floating charges rank after fixed charges for payment if both types of charge are secured on the same asset. Floating charges are usually secured on assets such as **receivables** or **inventory**.

## 70 Capital terms II

**Text reference.** Chapters 13 and 16.

**Top tips.** Notice the mark allocations for the four separate parts of this question and make sure that you stick to the associated timings. You should only be spending about 3½ minutes on a 2 mark part.

**Easy marks.** Make sure that in each part of the question you focus on the specific subject of that part, eg paid-up capital, and explain it in as much depth as you can.

**Examiner's comments.** This question required an explanation of the different types of share capital listed together with an explanation of the difference between the nominal value of shares and their market value. Given that the examiner had provided an article on this very topic, the inadequate performance in this question gives ground for concern. This was the first question that required an understanding of the provision in the Companies Act 2006 and unfortunately the majority of candidates were simply unaware of the changes introduced by that piece of legislation. As a result part (a) was very inadequately done. Answers also indicated that many candidates still are of the opinion that the memorandum of association is still the most important constitutional document for companies and that it contains the company's 'authorised capital', a concept completely removed by the 2006 Act.

The three other parts of the question were done better, for the simple reason that they did not require any real knowledge of the Companies Act 2006 and any legal regulation required in the answers was not changed by it. On some occasions decent performance in the latter three parts was sufficient to compensate for an inadequate performance in part (a).

### Marking scheme

This question seeks an explanation of the different types of share capital listed together with an explanation of the difference between the nominal value of shares and their market value.

8–10 marks: Thorough explanation of all of the elements in the question.

5–7 marks: Thorough treatment of some of the elements, or a less complete treatment of all of them.

0–4 marks: Unbalanced to very unbalanced answer, focusing on only one element and ignoring the others, or one which shows little understanding of the subject matter of the question.

### Shares

A **share** is **the interest** of a **shareholder** in the company measured by a **sum of money**, for the purpose of liability in the first place, and of investment in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se (*Borland's Trustees v Steel Bros & Co Ltd 1901*). It is a transferable form of property carrying rights and obligations.

(a) **Statement of capital and initial shareholdings**

As part of the process of forming a company, a return known as a **statement of capital and initial shareholdings** is required to be made to the **Registrar of Companies**.

This statement provides a **public record** of the following details in respect of the **share capital** of the company and is **up to date** as of the statement date.

- The **total number** of shares of the company
- The **aggregate nominal value** of the shares
- For each **class of share**, the **prescribed particulars** of any rights attached, the **total number** of shares in the class and the **aggregate nominal value** of shares in the class
- The **amount paid up** and the amount (if any) **unpaid** on each share, either on account of the nominal value of the share or by way of premium.

There should be **sufficient information** to **identify each subscriber** to the Memorandum of Association with the **number, nominal value and class of share** taken by them on **formation** as well as **amounts paid and unpaid** on the **nominal value** and any **share premium**. This information must be provided for **each class of share** the subscriber will hold on formation.

(b) **Authorised minimum issued capital in a public company**

A company's **issued share capital** is the **type, class, number and amount of shares** actually held by its shareholders. In the case of a **public limited company**, the **issued share capital must be at least £50,000** or the prescribed **Euro** equivalent.

(c) **Paid-up capital**

**Paid-up capital** is the amount of a company's **issued share capital** for which the company has actually **received payment** from the shareholders. If a company's shares have a nominal value of £1, it is usual, although not necessary, for the whole amount to be paid immediately. The company may for example request a first payment of 50p per share, in which case the shares are said to be **part-paid**. Until the full nominal value of the shares is paid, the **shareholders will retain liability** for the unpaid element. This element is referred to as **uncalled capital**. Shares in a public company must be one quarter paid up.

(d) **Nominal and market value**

The **nominal value** of a share is the **fixed monetary amount** specified in the constitution and does not usually change.

Shares of a **public company** may be traded on a stock market. As part of the deal, the parties may agree a **price for the shares that does not necessarily match the nominal value**. This is known as its **market value**. For example, if the company is performing well and its prospects are good, the market value may be higher than the nominal value. Alternatively, the market value may fall below the nominal value.

## 71 Capital maintenance and reducing share capital

**Text reference.** Chapter 18.

**Top tips.** The use of examples to illustrate the types of reduction available to companies is a quick and easy method of demonstrating your knowledge.

**Easy marks.** Defining the principle of capital maintenance and stating the three methods of capital reduction will get you the basic marks. However, you need to provide some explanation of the reduction methods and outline the procedure to pass.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** Part (a) required candidates to comment on their understanding of the doctrine of capital maintenance. A majority of candidates correctly identified that the capital should be maintained as a buffer for creditors and should not be used to pay dividends to shareholders. A number of candidates went on to explain that shares should not be issued below nominal value, the rules relating to the payment of dividends and that public companies are required to have £50,000 minimum share capital. A minority of candidates struggled to clearly explain the doctrine and as a result spent a lot of time discussing the different types of shares and debt (fixed and floating charges) for which no marks were awarded.

Part (b) required candidates to discuss when a company may want to reduce its capital and the procedure to be adopted by both public and private companies. A vast majority of candidates correctly identified when a reduction in capital would be appropriate, a few also mentioned share buyback for which credit was given.

With regard to the procedural aspects there appeared to be some confusion. A number correctly distinguished the procedural differences, however, many candidates went off tangent by either writing a substantial amount of text regarding share buyback or a combination of company law points, which were not directly related to the question.

Overall, this was very well attempted question. It appears that candidates are gradually becoming more familiar with the technical aspects of the Companies Act 2006.

### Marking scheme

- (a) 3–4 marks Thorough explanation of the doctrine of capital maintenance perhaps with some examples of its application.  
0–2 marks Some knowledge but lacking in detail.
- (b) 4–6 marks Good to full consideration of the procedure for reducing capital. Reference must be made to the 2006 Act procedure and the difference between public and private companies should be mentioned specifically.  
2–3 marks Some general knowledge but lacking in detail as regards to the process or not mentioning the difference between the two company forms.  
0–1 mark Little or no understanding of the process.

(a) **Capital maintenance**

**Capital maintenance** is a fundamental principle of company law. It states that limited companies should not be allowed to make payments out of capital except in certain limited circumstances. Therefore the Companies Act contains many examples of control upon capital payments. These include provisions restricting dividend payments, and capital reduction schemes. Another rule of capital maintenance is that shares cannot be issued at a discount.

The principle **ensures a minimum amount of capital** is left in the company to protect creditors. However, it is often also in the shareholders' best interests too since it acts as a guard against the business running out of capital and potentially becoming insolvent.

(b) **Reducing share capital**

A limited company is permitted without restriction to cancel **unissued shares** as that change does not alter its financial position. There are three basic methods of reducing **issued share capital** specified in s 641 of the Companies Act 2006.

**Extinguish or reduce liability on partly paid shares**

For example, a company has shares with a nominal value of £1 which are 75p paid up and it chooses to reduce the nominal value to 75p or to a figure between 75p and £1. Nothing is repaid to the shareholders; it is their potential future liability on the shares which is reduced.

### Pay off part of paid-up share capital out of surplus assets

For example, a company has shares with a nominal value of £1 which are fully paid and it chooses to reduce the nominal value from £1 to 70p and repays 30p in the pound to shareholders.

### Cancel paid-up share capital which has been lost or which is no longer represented by available assets

For example, a company has shares with a nominal value of £1 which are fully paid, but its net assets are only worth 50p per share. Therefore it has a debit balance on its reserves and is unable to pay dividends to its shareholders. By reducing the nominal value to 50p per share, it is able to write off the debit balance, and if it is profitable, it can pay dividends to the shareholders immediately without having to wait for future profits to clear the debt.

### Procedure

A limited company may reduce its issued share capital if:

- It has **power** to do so in its articles. If it does not have power in the articles, these may be amended by a **special resolution**.
- It passes a **special resolution**. If the articles have been amended, this is another special resolution.
- It obtains **confirmation** of the reduction **from the court** (public companies only), or makes a **statement of solvency** (private companies only).

### Court approval

When the court receives an application for reduction of capital its **first concern** is the effect of the reduction on the company's ability to pay its debts, that is, that the creditors are protected.

If the reduction is by extinguishing liability or paying off part of paid-up share capital, the court requires that **creditors** shall be **invited** by advertisement to state their objections (if any) to the reduction. Where paid-up share capital is cancelled, the court **may** require an invitation to creditors.

Normally the company persuades the court to dispense with advertising for creditors' objections (which can be commercially damaging to the company). This may be achieved by **paying off the creditors** before application is made to the court, or it may produce to the court a **guarantee**, say from the company's bank, that its existing debts will be paid in full.

The **second** concern of the court, where there is more than one class of share, is whether the reduction is fair in its effect on different classes of shareholder.

If the reduction is, **in the circumstances**, a **variation of class rights** the **consent** of the class must be obtained under the variation of class rights procedure.

Within each class of share it is usual to make a **uniform reduction** of every share by the same amount per share, though this is **not** obligatory.

The court may also be concerned that the **reduction should not confuse or mislead people who may deal with the company in future**. It may insist that the company add 'and reduced' to its name or publish explanations of the reduction.

If the court is satisfied that the reduction is in order, it confirms the reduction by making an order to that effect. A **copy of the court order** and a **statement of capital**, approved by the court, to show the altered share capital is delivered to the Registrar who issues a certificate of registration.

### Solvency statement

A private company need not apply to the court if it supports its special resolution with a solvency statement. A **solvency statement** is a **declaration** by the directors, provided **15 days** in advance of the meeting where the special resolution is to be voted on. It states there is **no ground** to suspect the company is currently **unable** or will be **unlikely to be able** to pay its debts for the next **twelve months**. All possible liabilities must be taken into account and the statement should be in the prescribed form, naming all the directors. Copies of the special resolution and solvency statement must be sent within 15 days of being passed to the Registrar.



## 72 Class rights

**Text reference.** Chapter 16.

**Top tips.** Class rights and their variation are often thought of as a difficult technical subject, but the law is relatively straightforward. Remember the rights of the existing shareholders are paramount and must be protected.

**Easy marks.** Describing what class rights are.

**Examiner's comments.** Most candidates had a reasonable attempt at part (a), although many only discussed voting rights and did not mention rights for return of capital. Part (b) was poorly answered as candidates did not know enough about the statutory provisions for variation of class rights. Candidates did well when explaining minority objection rights.

### Marking scheme

		Marks
(a)	Tend to be decided by Articles	1
	Examples: ordinary and preference shares	1
	Rights to receive dividends	2
	Rights to and return on capital	<u>2</u>
		6
(b)	Special resolution; $\frac{3}{4}$ majority	1
	Rights in articles	1
	Other: 75% majority	1
	Minority objection rights	<u>1</u>
		<u>4</u>
		<u>10</u>

### (a) Class rights

There are no statutory definitions of what particular rights are enjoyed by particular classes of shares. Rather, **class rights are those provided by the company's articles of association** and on the issue of the relevant shares. If no differences between shares are expressly provided then it is assumed that they all carry the same rights. A company may choose to **specify particular rights** and attach them to particular classes of shares. Such rights will deal with matters concerning **dividends, return of capital, voting** and the **right to appoint directors**.

All shares carrying **identical rights** are **grouped together into a class of shares**. The most common instances of different classes are **ordinary shares** and **preference shares** but a company may also have ordinary shares with voting rights and ordinary shares without voting rights, for example. The main difference between ordinary shares and preference shares is the implied right attaching to preference shares to receive an annual dividend of a fixed amount.

### Examples of rights

The **right to receive a preference dividend is deemed to be cumulative unless the contrary is stated**. The preference shareholders cease to be entitled to arrears however, where the company goes into liquidation unless the dividend was declared at the time liquidation commenced or unless there is express provision in the articles or other terms of issue. Preference shareholders are not entitled to participate in any additional dividend over and above their specified rate. In other respects, preference shareholders carry the same rights as ordinary shareholders unless otherwise stated.

The **holders of ordinary shares will be entitled to the surplus profits** once other commitments have been met whereas preference shares carry no such right beyond payment of the fixed dividend.

Similarly, holders of ordinary shares will be entitled to a share of the **surplus assets on a winding up** whereas other types of shareholder will normally only be entitled to a return of their capital.



**Preference shares** will normally be expressed **not to carry voting rights** or only limited voting rights, unlike ordinary shares.

Shareholders may have some class **rights which attach to them as members** even though those rights are not attached to particular classes of shares.

(b) **Variation of class rights**

A **variation of class rights** is an alteration in the position of shareholders with regard to those benefits or duties which they have by virtue of their shares.

**Consent**

The rights vested in the holders of a class of shares can only be varied by the company with the **consent of all the holders** or with such consent of a majority as is prescribed (usually) by the articles.

**Special resolution**

Normally the procedure is that a **special resolution** be passed giving approval for a proposed variation by a three-quarters majority cast either at a separate meeting of a class or by written consent (s 630). If the rights are set by the constitution or otherwise and there is a **variation procedure** laid down then that procedure must be followed.

**Appeal**

Whenever class rights are varied in pursuance of a procedure laid down by the company's constitution, holders of at least **15%** of the issued shares of the relevant class **who have not themselves consented** to or voted in favour of the variation may **apply to the court** within **21 days** of the class consent being given for an order cancelling the variation (s 633).

They must satisfy the court that the variation is '**unfairly prejudicial**' to the class, usually by showing that the majority who voted in favour were seeking some advantage to themselves as members of a different class instead of considering the interests of the class in which they were then voting. The court can either **approve** or **cancel** the variation but cannot modify its terms or give conditional approval.

**Not a variation**

It might be noted that the **subdivision of shares** in one class with the effect of increasing that class's voting strength is not strictly a variation of class rights (*Greenhalgh v Arderne Cinemas Ltd*), even though the effect is prejudicial to members of another class by reducing the value of their rights.

Similarly, **issuing shares of the same class to allottees** who are **not already members** of the class, is not a variation of class rights (*White v Bristol Aeroplane Co Ltd*).

## 73 Flop Ltd

**Text reference.** Chapters 16 and 18.

**Top tips.** This is a very practical question and we shall probably see many more like this in the F4 exams. A careful reading of the question should show you that the first purchase by Gus was within the rules on share capital, as the shares were issued but an amount was left unpaid. As Flop Ltd was in financial difficulties you should then have been alert to the possibility that there was a problem with the second issue. As with all scenario questions you need to be careful to **identify** the issues at stake, then **state** the law applying to those issues, then **apply** the law to the facts of the case and **conclude**.

**Easy marks.** State that companies issue shares of a designated and fixed monetary amount (their nominal value), and that they can be issued at a premium but never at a discount to that nominal value.

## Marks

8–10	A complete answer, highlighting and dealing with all of the issues presented in the problem scenario. It is most likely that cases and statutory provisions will be referred to, and they will be credited.
5–7	An accurate recognition of the problems inherent in the question, together with an attempt to apply the appropriate legal rules to the situation.
2–4	An ability to recognise some, although not all, of the key issues and suggest appropriate legal responses to them. A recognition of the area of law but no attempt to apply that law.
0–1	Very weak answer showing no, or very little, understanding of the question.

## Shares

A **company share** was defined in *Borland's Trustee v Steel Bros and Co Ltd 1901* as the interest of a shareholder in the company measured by a sum of money for the purpose of a liability. This means that the share must be paid for by the shareholder.

### Issued and allotted capital

**Issued and allotted share capital** is the **type, class, number and amount** of the **shares issued and allotted to specific shareholders**, including shares taken on **formation** by the **subscribers to the memorandum**. These totals are divided into shares of fixed nominal amount, a figure such as 50p or £1 which is chosen by the company but which has no direct correlation with either their value to the shareholder or the assets of the company.

Shares may be issued to shareholders in return for the **full nominal value** of each share, in which case it is called '**issued and fully paid**', but the company need not necessarily require full payment immediately for the share, in which case there is an amount left unpaid. This amount remains a **liability** of the shareholder to the company. Once a share is **fully paid**, the shareholder has **no remaining liability** to the company, even if it goes into insolvent liquidation.

### Issue at a discount

The rules on leaving amounts unpaid as a call on shareholders are not contradicted by the rule that every share with a **nominal value may be issued at a premium** to that value **but may not be issued at a discount** to it: s580 and *Ooregum Gold Mining Co of India v Roper 1892*.

Flop Ltd made the **first issue** of shares to Gus at their **nominal value**, that is **without a discount**, although it was prepared to wait for 25% of the issue price to be paid. Furthermore, in allotting shares the company should receive **money or money's worth**; this Flop Ltd did by accepting 75p per share and a promise to pay 25p per share when called on to do so.

A company may resolve to **write off** any unpaid capital but if it subsequently becomes insolvent this resolution is ineffective and the shareholder is still liable.

### Gus

Applying these rules to the scenario, it is clear that Flop Ltd had a **remaining call** on Gus after the first issue for the amount left **unpaid** on his shares, that is £2,500. When a company does **issue shares at a discount to their nominal value** it is effectively saying that the shareholder has a £1 share, say, but only needs to pay 75p in total for it. This is **prohibited**: the shareholder must nonetheless pay the full nominal value plus interest at the appropriate rate. Any person to whom the shareholder transfers the shares and who knew of the underpayment is similarly liable s588.

Applying these rules to the scenario, when it makes the second issue to Gus, Flop Ltd is trying to do so at a 50p discount to their nominal value. This is **disallowed** under s580 and **Gus is still liable** for the balance (10,000 x 50p = £5,000) plus interest.

# 74 Lux Ltd

**Text reference.** Chapters 15 and 16

**Top tips.** The question does not explicitly require a discussion on the articles of association or how minorities can oppose a variation of class rights, but to answer it in sufficient detail you need to discuss these first – make sure that you keep your explanation focussed on the issues in the scenario.

**Easy marks.** Stating the nature of the articles as a contract, the nature of class rights and how each can be amended.

## Articles of Association

A company's **articles**, together with any **resolutions or agreements** that it makes, forms its **constitution**. Under s33 Companies Act 2006 a company's **constitution binds the members to the company, the company to its members and members to other members**. The constitution does **not** bind the company to third parties and it only applies to rights and obligations that affect members **in their capacity as members**: *Eley v Positive Government Security Life Assurance Co 1876*.

## Alteration of articles

All companies have a statutory power to alter their articles by **special resolution**, or in the case of a private company, by **written resolution** with a 75% majority. Therefore the consent of each individual member is not required for alteration of the articles, just the requisite majority.

For an alteration to be valid the majority must **honestly believe** that it is in the **interest of the company** as a whole (a subjective test) and that it would be in the interests of a **hypothetical individual member** (an objective test): *Greenhalgh v Arderne Cinemas Ltd 1950*. Where a person has a **contract** contained in the articles, they cannot obtain an injunction to prevent the articles being altered: *Southern Foundries (1926) Ltd v Shirlaw 1940*.

## Class rights

A company's shares confer certain **rights** on the members who own them. Where only one type of share exists the rights are normally the same, however different types of share will often confer different rights. For example **preference shares** usually entitle the member to a **fixed dividend** with **priority** of payment over ordinary shares and priority over the **repayment of capital** (ahead of ordinary shares) in the event of a winding up. Other class rights may attach regarding voting or the right to remove a director. Any share that has **different rights** from others is grouped with the other shares carrying identical rights to form a **class**.

## Altering class rights

**Alteration** of the rights that attach to a particular class of share requires the **consent of the members** of that class. Members are not entitled to vote on a resolution that affects the rights of a class of share that they do not own.

The **standard procedure** for a variation of class rights is contained in s630 Companies Act 2006. This states that a **special resolution** should be passed by a **three quarters majority** cast either at a **separate meeting** of the class, or by **written consent**. If the company's articles impose any other requirements then these must be followed instead.

## Appeal

Whenever class rights are varied a **minority** of holders of shares of that class may apply to the court to have the variation cancelled. Under s633 Companies Act 2006, the objectors together must:

- Hold **not less than 15%** of the **issued shares** of the class in question
- **Not** themselves have **consented** to or voted in favour of the variation
- **Apply** to the court within **21 days** of the consent being given by the class

The court can either approve the variation as made or cancel it as '**unfairly prejudicial**'. It cannot, however, modify the terms of the variation.

To establish that a variation is 'unfairly prejudicial' to the class, the minority must normally show that the **majority** who voted in favour was seeking **some advantage** to themselves as **members** of a **different class** instead of considering the interests of the class in which they were then voting.

### Removal of Matt from his position of editor of the Lux paper

Matt has a **separate employment contract** that is not affected by changes in the articles. Employment is not a **right of membership** so the articles themselves cannot form a contract of employment between Matt and the company (*Eley v Positive Government Security Life Assurance Co 1876*). If the courts were to establish an **outside contract** with the terms contained within the articles (*Re New British Iron Co, ex parte Beckwith 1898*), Matt **could not prevent** the company from altering its articles and terminating his employment, but he would have the right to sue for breach of contract (*Southern Foundries (1926) Ltd v Shirlaw 1940*).

### Reduction of preference share dividend from 10% to 5%

The **reduction of dividends** is clearly a **variation of a class right** that under the variation procedure requires a **75% majority** by **special or written resolution**. Kudos Ltd is likely to want to prevent this variation but as it only holds 20% of the shares in the class it cannot prevent the variation by itself. However, Kudos Ltd does hold over 15% of the shares in the class so it could **apply to the court** for the variation to be cancelled. As the effect on Kudos Ltd is relatively minor and as it affects all shareholders equally it is likely that the court would uphold the variation.

## 75 Dividends

**Text reference.** Chapter 18.

**Top tips.** This question provides you with a good structure to work with as it could quite easily have been written with one single requirement asking you to explain the rules on dividends, so take advantage of this and organise your answer well. Be quick as you have just about six minutes on each part to get down all your facts. This is no time to waffle so stick to the point!

**Easy marks.** The calculation of distributable profits. Learn it if you don't know it.

**Examiner's comments.** Too many candidates focused their answers on the different type of shares that companies can issue and the order in which the holders of these different types of share receive their dividend. Secondly, and in a similar vein, too many candidates focused on the procedure for declaring dividends rather than on the rules relating to what can actually be paid

### Marking scheme

	Marks
A thorough understanding of law relating to dividends as it applies to both public and private companies. Cases may well be cited and will be credited.	8–10
A clear understanding of the general law but perhaps lacking in detail or unbalanced in only dealing with one of the types of company.	5–7
Some, but limited, understanding of the law.	2–4
Little or no knowledge of the clauses.	0–1

#### (a) Dividends

All companies have the power to **declare dividends**. This is the return given to members for their investment in the company. The directors may authorise the payment of **interim dividends** during the financial year but the **final dividend** must be **approved by the members**, usually by **ordinary resolution** with a simple majority at a public company's AGM or by **written resolution** of private companies. Members cannot declare a dividend themselves or increase the amount of a dividend above that recommended by directors, but they may resolve to take a smaller one.

**Dividends** are usually declared payable on the **paid up amount of share capital** and are usually paid in **cash**. They may however be paid wholly or partly by the distribution of non-cash assets.

### Funding of dividends

The **general rule** applicable to all companies is that **dividends may not be paid out of capital**. The Companies Act 2006 sets out specific rules that must be followed which essentially mean that dividends must be paid out of profits that they have available for that purpose, in other words **distributable profit**.

'**Distributable profit**' is defined in the Companies Act as 'accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made'. Only profits realised at the balance sheet date shall be included in the calculation.

'**Accumulated**' means that any losses of previous years must be included in reckoning the current distributable surplus. In order to be treated as 'realised', a profit or loss must be deemed to be realised in accordance with generally accepted accounting principles prevailing when the accounts are prepared.

#### (b) Public company dividends

In addition to the rules stated above, a **public company** can only make a distribution if its **net assets**, at the time, are **equal** to or **greater** than the **aggregate of its called up share capital and undistributable reserves**. The amount of any dividend cannot exceed such amount as would leave its net assets at not less than that aggregate amount.

**Undistributable reserves** comprise the **share premium account**, the **capital redemption reserve**, the **revaluation reserve** and any reserve which the company is prohibited from distributing by statute or its own constitution. This means that a **public company** can only make a **distribution** from its profits **after depreciating fixed assets**.

#### (c) Consequences of breach of dividend rules

If a dividend is paid otherwise than out of distributable profits the **company**, the **directors** and the **shareholders** may be involved in making good the unlawful distribution.

The directors are held **responsible** since either they recommended to members in general meeting that a dividend should be declared or they declared interim dividends.

The directors may however **honestly** rely on proper accounts which disclose an apparent distributable profit out of which the dividend can properly be paid. They are not liable if it later appears that the assumptions or estimates used in preparing the accounts, although reasonable at the time, were in fact unsound.

The company can **recover from members** an **unlawful dividend** if the **members knew** or had **reasonable grounds** to believe that it was unlawful: s847. If the directors have to make good to the company an unlawful dividend they may claim **indemnity from members** who at the time of receipt knew of the irregularity.

## 76 Debentures and charges

**Text reference.** Chapter 17.

**Top tips.** Keep the three parts of the question separate. Do not be tempted to start discussing charges in part (a) on the nature of debentures, as you will then duplicate your answers for parts (b) and (c).

**Easy marks.** Try to back up the points you make when defining the terms with cases where the definitions were established.

**Examiner's comments.** The question was generally well done and there were few specific criticisms. In part (b) not many candidates could explain why fixed charges cannot be made over stocks, and in part (c) some candidates tended to be a bit too general rather than answering the specific requirement about floating charges.

This question is divided into three distinct parts carrying 3, 3 and 4 marks respectively.

6-10 marks The best candidates will show a full understanding of the nature of loan capital in company law and will be able to explain in clear terms the meaning of each of the three terms.

0-5 marks Weak candidates will either only be able to explain one of the categories or will not be able to explain any of them in a satisfactory manner. There might even be confusion between the various types.

(a) **Debentures**

A **debenture** is a **written acknowledgement of debt**, which may be any document which states the terms on which a company has borrowed money. A debenture may create a **charge** over the company's assets as security for the loan.

A debenture is usually a **formal printed legal document**. A **single debenture** is issued to a single lender but debentures may be issued as **a series to different lenders**. In this case each lender receives a debenture in identical form in respect of their loan and the lenders' rights rank *pari passu* in their right to repayment and in any security given to them. Public companies only may issue debenture stock to members of the public by means of a prospectus.

**Secured debentureholders** may enforce their security by taking possession of the charged assets and selling them (in the case of a legal charge) or appointing a **receiver**. These rights will normally arise from the express provisions of the relevant charge or, in certain circumstances, may be awarded by court order.

(b) **Fixed charges**

A **fixed** or specific **charge attaches** to the relevant asset as soon as the charge is **created**, for example a charge over named property given as security for a loan to the owner of the property. If the company needs to dispose of the charged asset, it will either repay the secured debt out of the sale proceeds so that the charge is discharged or dispose of the asset still subject to the charge.

Any type of charge gives to the holder a **priority claim** to payment of what is owing to them out of the value of the property which is subject to that charge. The ranking of that priority will depend on the types and times of creation of all relevant charges.

**Assets secured**

A **fixed charge** may be legal or equitable and over land or other company assets, from **buildings** and **chattels** to **book debts**. It is **not appropriate** to give a fixed charge against **stock in trade** as the company would then be legally prevented from dealing with it without approval. In the event of default, the chargee can appoint a receiver who may sell the asset charged in order to recover the debt. If the proceeds of sale exceed the debt, the excess goes towards paying off other debts. If they are less, then the debentureholder becomes an unsecured creditor in respect of the amount of debt outstanding.

**Advantages**

The main advantage enjoyed by a holder of a fixed charge as opposed to a floating charge is that a fixed charge confers **immediate rights over identified assets**. It is therefore more certain as to which of the chargor's assets are subject to the charge and gives an immediate right of sale over them.

A fixed charge will **rank in priority** to a floating charge even if it was created after the floating charge since it attaches to the property at the time of creation rather than at the time of crystallisation.

The one exception to this general rule is where a **floating charge** contains an express prohibition on the creation of subsequent fixed charges (**a negative pledge clause**) and a subsequent chargee has actual notice of such prohibition.



(c) **Floating charges**

No particular form of wording is required to create a **floating charge**. Where a charge is created over certain assets but the company retains the right to deal with those assets during the ordinary course of business until the charge **crystallises**, then that charge is a 'floating charge'. On crystallisation, a floating charge is converted into a fixed charge on the assets owned by the company at the time of crystallisation. Crystallisation will occur on the happening of any of the events specified in the charge, such as the **liquidation of the company** or the **cessation of its business**

Whether or not the parties label a charge as 'fixed' or 'floating' will not be conclusive but the general rule will be applied. For example a charge which covers present and future **bank debts**, whatever it is called by the parties, will be floating if the company is allowed to deal with money collected from debtors without notifying the chargee and fixed if the money must be paid to the chargee, for example in reduction of an overdraft (*Siebe Gorman & Co Ltd v Barclays Bank Ltd 1979*).

## 77 Resolutions

**Text reference.** Chapter 20.

**Top tips.** You should be familiar with all the types of resolution a company can pass. This question should therefore hold no fear, as it is an ideal opportunity to earn easy marks.

**Easy marks.** Defining each type of resolution.

**Examiner's comments.** This question required candidates to explain the meaning of and procedure for the passing of (a) an ordinary and a special resolution and (b) a written resolution. Once again although the terms were continued from the previous companies Act, the 2006 Act made significant changes to them.

As a whole, candidates performed well on part (a) with the majority of candidates identifying that resolutions were decisions by members, usually held by a poll or a show of hands at a meeting (either AGM or GM) and that a simple majority is required for the passing of the ordinary resolution and 75% for a special resolution. Some candidates went further and provided examples of when the two types of resolutions would be used. It has to be noted, however, that a number of candidates thought that such decisions were taken by directors rather than members.

Part (b) relating to written resolutions was inadequately answered. Most candidates worked out from the question that this procedure applied only to private companies, but only a few went on to develop their answers. While some candidates were aware that these resolutions were available when such companies did not hold general meetings, some insisted that they were passed at general meetings. As has been said very few candidates were aware of the changes introduced by the 2006 Companies Act.

### Marking scheme

This question requires candidates to consider the way in which resolutions are voted on in companies.

- (a) Requires candidates to explain the rules relating to ordinary and special resolutions.
- 3–5 marks: A good explanation of the difference between the two types of resolution.  
0–2 marks: Some awareness of the area but lacking in detailed knowledge.
- (b) 3–5 marks: Candidates must not only show an understanding of what is meant by a written resolution but also the rules relating to them.  
0–2 marks: Unbalanced, or may not deal with all of the required aspects of the topic. Alternatively the answer will demonstrate very little understanding of what is actually meant by a written resolution.

(a) **Ordinary and special resolutions**

Resolutions voted on at **private company** meetings are either classed as **ordinary** or **special resolutions**.

**Requisitioning resolutions**

The **directors** normally decide which resolutions shall be voted on in a meeting. However, members can also take the initiative to requisition certain resolutions be considered at as well.

In order for **members** to put forward a resolution, they must represent **5% of the voting rights**, or be at least **100 in number** with an average paid up capital of £100 per member and must deliver the resolution to the company at least **6 weeks in advance** of the meeting. They may also request a **statement** of less than 1,000 words regarding the resolution be circulated to all members. Members requisitioning a resolution are **liable** to pay any **incidental expenses** unless the company agrees otherwise.

**Passing ordinary resolutions**

An **ordinary resolution** is one carried by a **simple majority of over 50%** of votes cast. This is in terms of number of hands in the case of a vote on a show of hands or voting rights where a poll is called. A **14 days' notice** period applies to **meetings** where an ordinary resolution is to be considered. Ordinary resolutions are commonly used for **non-contentious issues** such as the approval of a dividend, but are also used on issues such as the removal of a director.

**Passing special resolutions**

A **special resolution** requires a **majority of 75%** or more to pass it and it also requires a **notice period of 14 days**. They are required for a **change of name, reduction of share capital, restriction of the objects or amendments to the articles** and are therefore used where major or contentious decisions need to be made.

**Filing procedure**

A **signed copy** of all **special resolutions** must be **delivered to the Registrar of Companies** for filing, usually within 15 days of their being passed. Also their **text** must be **set out in full in the notice convening the meeting** and they must be described as special resolutions. No such procedure applies in respect of ordinary resolutions.

(b) **Written resolutions**

A **written resolution** is one which may be passed only by a **private company**. They are available to them because **private companies** are **not required** to hold **general meetings** and therefore they are the easiest method to make decisions without having to hold one. They can be used to pass almost any type of decision, **however they cannot be used to remove a director or auditor** from office since both have a right to attend and speak at a meeting where any proposal for removal is to be discussed.

**Procedure**

**Copies** of the resolution must be sent to **all members** eligible to vote as a **hard copy, email** or through a **website**. Alternatively, the **same copy** may be sent to each member in turn. The resolution should be accompanied by a statement informing the member, how to **signify their agreement** to the resolution and the **date** the resolution must be passed by.

The required **majority** to pass the resolution will **depend on the nature of the business** being considered. Where a three quarters majority would have been required if the vote took place in a meeting then the same majority is required for an identical written resolution.

As with **ordinary** and **special resolutions**, **members holding 5%** of the **voting rights** may request a written resolution providing it **would be effective** (not prevented by the articles or law) and is **not defamatory, frivolous or vexatious**. A **statement** containing no more than **1,000 words** on the subject of the resolution may accompany it. Members requisitioning such resolutions are **liable** for **any incidental costs** unless the company decides otherwise.



# 78 Meetings

**Text reference.** Chapter 20.

**Top tips** At first sight this looks a gift of a question, but beware! You can probably rustle up a few marks worth of comment on AGMs, but do you know enough about other general meetings and class meetings? Although you may feel comfortable with the first part of the question, there is a risk that you will score few marks on the other parts unless you are confident with the subject matter.

Our answer to part (b) contains much more detail than you would need for 2 marks. The list of who can call a general meeting is included as a valid answer could have covered them. To get the marks you would have needed to cover the material in the first paragraph and give a couple of examples of who can call a meeting.

**Easy marks.** To make the most of the marks available here, notice the allocation of the marks to each of the three parts of the question and allocate your own time accordingly. You need to go into as much detail as possible on AGMs as that part attracts half of the marks for the question.

## Marking scheme

### Marks

8–10	A good treatment of all three types of meeting, probably, although not necessarily, with reference to statutory provisions
5–7	A sound understanding of this area, although perhaps lacking in detail.
2–4	Some understanding of the area but lacking in detail, perhaps failing to deal with one type of meeting
0–1	Little or no knowledge of the area.

### (a) Annual general meetings

Every **public company** must hold an **annual general meeting** ('AGM') in each calendar year within **six months** of the company's year end. Private companies are not required to hold an AGM. At least **21 days' written notice** must be given for each AGM unless all members entitled to attend agree to shorter notice. The notice must specify the meeting as an AGM.

**Ordinary business** to be transacted at an AGM includes the consideration of the **directors' and auditors' reports** and the **company accounts**, the **election of directors** and **appointment of auditors**, the fixing of **auditors' remuneration** and the **declaration of dividends**. The full text of any proposed resolution concerning special business is set out in the notice which may be provided as a hard copy or electronically.

### (b) General meetings

Other meetings of the company are **general meetings**. A minimum of **14 days' written notice** must be given. The meeting may be called in any of the following ways:

- By the **directors** whenever they see fit;
- By the directors on the **requisition of members** holding at least 10% of the paid up share capital carrying voting rights or (if there is no share capital) 10% of the voting rights, in which case the meeting must be called within 28 days of the requisition being deposited. The required percentage is reduced to 5% for private companies that have not held a meeting for 12 months;
- By the **court**, on the application of a director or member, usually in the case of deadlock (for example where one member of two refuses to attend and so provide a quorum);
- By an **auditor** who gives a statement detailing the circumstances for their **resignation** or other loss of office and requires their explanation to be considered by the company;
- Compulsorily, by the directors of a public company where the **net assets fall to half or less of the amount of its called up share capital** (s656).

(c) **Class meetings**

A **class meeting** may be called by the directors or other competent person or authority for the **holders of one class of shares** to approve a **proposed variation** of the rights attached to those shares. Alternatively under a scheme of arrangement the holders of shares in one class may be divided into separate classes, for whom separate meetings are required, where the scheme proposed affects each group differently.

The **standard general meeting rules** on issuing notices and on voting apply to a class meeting. The quorum for a class meeting is two persons who hold at least one third in nominal value of the issued shares of the class except that a quorum of one is permissible where all the shares are held by one member.

## 79 Company secretary

**Text reference.** Chapter 19.

**Top tips.** The question asks you to outline the rules in three areas. That should help to structure your answer, and you should attempt all three parts. Notice that the question relates to a public limited company and answer it accordingly. Try to focus on a plc.

**Easy marks.** The first thing to notice is that you are asked about the company secretary of a public company, so concentrate your efforts on that. Secondly, make sure that you address the three separately identified requirements of the question, that is (a) appointment, (b) duties and (c) powers.

**Examiner's comments.** This was a popular question and was done well by the majority of candidates. Each part of the requirement was to be allocated three marks, with one additional 'floating' mark available for a very good performance in a particular part.

### Marking scheme

This question is divided into three parts and each part will be allocated three marks with one mark floating in order to allow markers to reward the best performance in any particular part.

8–10 marks Thorough treatment of all three aspects of the question.

5–7 marks Thorough treatment of two aspects of the question or a reasonable, but less than full, treatment of all three aspects.

0–4 marks Unbalanced answer, merely dealing with one part of the question, or demonstrating no real understanding of the nature of the question.

### Appointment

**Every public company must have a secretary** and a sole director shall not also be the company secretary. A corporation can fulfil the role of secretary to a company. A company may also have two or more joint secretaries.

**The directors of a public company must take all reasonable steps to ensure that the secretary is suitably qualified** for the post by their knowledge and experience. A public company secretary may be anyone who:

- Has been a public company secretary for at **least three out of the five years prior to their appointment**
- **Is a member of the ACCA or one of a number of other professional bodies:** ACCA, CIMA, ICAEW, ICAS, ICAI or CIPFA
- Is a **barrister, advocate or solicitor** in the UK
- **Is a person who**, by virtue of holding or having held any other position or being a member of any other body, **appears to the directors to be capable of the post.**

## Duties

The **duties of the secretary** are not defined by the Companies Act but are **laid down by the company's board of directors**, therefore varying according to the size and nature of the company. Generally, the company secretary is seen as the person who is charged with ensuring that the company and its officers comply with statutory and regulatory requirements. More specifically, the secretary's duties will include the following:

- **Convening meetings and making all arrangements incidental to meetings of the Board of Directors.** This will include matters such as issuing the agenda, collating or preparing papers to be submitted to the meeting, attending the meeting, taking minutes of the meeting and communicating decisions of the meeting as appropriate to persons inside and outside the company.
- **Signing forms and returns** as required
- **Maintaining the register of members**, recording transfers of shares and issuing share certificates to members
- Maintaining the **other statutory registers** and ensuring that all necessary **documents, returns and notices** are delivered to the **Registrar of Companies**
- Ensuring that **accounts are kept** in accordance with the requirements of the Companies Act (unless the company has an accountant or a finance department)

## Powers

Under the general principle of the law of agency, a **company secretary may be treated as having apparent authority to bind the company** by their actions on its behalf, unless the company has denied them that authority and the other party has notice of the restriction.

In *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*, the Court of Appeal recognised that it is the normal function of the company secretary to enter into contracts **connected with the administration of a company** (in this case ordering cars from a car hire firm purportedly for the company's business).

# 80 Implied authority and company secretary

**Text reference.** Chapters 12 and 19.

**Top tips.** Not all questions require you to explain the facts of a case, but when you are required to explain an area of law it may be a very good idea to refer to cases in detail. However you would have also scored marks if you illustrated your answer with a hypothetical situation instead.

**Easy marks.** Defining implied authority in Part (a) and remembering the cases in Part (b). There are very few cases on company secretaries so you should try to remember them all.

### (a) Implied authority

Where there is no express authority, authority may be **implied** from the **nature** of an agent's activities or from what is **usual** or **customary** in the **circumstances** or in the person's position. Where a person has implied authority they may enter into contracts on behalf of their principal, binding them to a third party.

As far as **third parties** to contracts made by agents are concerned, they are entitled to assume that the agent has all the usual powers that they would be expected to have. They may also assume that the agent has all the usual authority that goes with their position, unless they are aware of anything to the contrary.

For example, in *Watteau v Fenwick 1893* the owner of a hotel employed the previous owner to manage it. The previous owner was **forbidden to buy cigars** on credit but did so anyway. When the cigar seller was not paid it sued the new owner who argued that they were not bound by the contract, since the manager had no actual authority to make it.

However, it was decided that **purchasing cigars** on credit was within the **usual authority** of a manager of a hotel and therefore the new owner was bound by the contract as the restriction of usual authority had not been communicated to the cigar seller.

All **employees** and **directors** have **different levels of implied authority** that are relevant to their position. For example a managing director has implied authority to enter into commercial contracts.

(b) **Company secretary**

As mentioned in Part (a), all employees and directors have some level of **implied authority** brought about by their position and the company secretary, as an officer of the company, is no different. The powers of the company secretary have historically been very limited, but the common law increasingly recognises that they may be able to act as agents in some circumstances. Specifically, they may enter the company into contracts connected with the **administrative side** of the company: *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd 1971*.

## 81 Appointment and removal

**Text reference.** Chapter 19.

**Top tips.** For part (b) of this question, which is worth 7 marks, make sure that you think through the various possibilities while planning your answer. It is not enough just to talk about removal under S168 CA2006; you must think about the other forms of removal of directors, for example under the terms of the Company Directors Disqualification Act.

**Easy marks.** Maximise the marks you can get for part (a) by discussing all the ways in which a director can be appointed, not just by the members on an ongoing basis. For example, what happens when a company is formed: how are the directors appointed then? What happens if there is a casual vacancy?

**Examiner's comments.** Candidates generally answered part (a) well, although not many were able to discuss appointment to fill a casual vacancy. It was worrying that some candidates thought that directors are elected by their fellow directors. In part (b) a surprising number of candidates did not deal with the s168 procedure or were unsure as to the type of resolution required. A surprising number thought that directors had the power to dismiss other directors.

### Marking scheme

This question requires candidates to explain the ways in which company directors can be appointed and also the ways in which they can be removed from office. Part (a) carries three marks and part (b) carries seven marks reflecting the amount required in each answer.

8-10 marks Thorough explanation of both aspects of the question.

5-7 marks Thorough treatment of one of the elements, or a less complete treatment of both of them.

0-4 marks Unbalanced to very unbalanced answer, focusing on only one element and ignoring the other, or one which shows little understanding of the subject matter of the question.

(a) **Appointment**

The **first directors** of a company will be those named in the particulars delivered to the Registrar of Companies on incorporation. Subsequent directors will be appointed as provided for by the **articles**. Most companies adopt model articles which provides for the co-option of new directors by existing ones and for the election of directors by the company in general meeting.

The directors themselves may fill a **casual vacancy** by co-option, with such an appointee being required to stand at the next election of directors. A company may also elect new directors in general meeting by passing an ordinary resolution to that effect. A director is normally a shareholder in the company but this is not required by law; however the Articles may require that the directors hold shares in the company.

A **public company** must have at least **two directors**, but a **private company** need only have **one**.

(b) **Removal**

A director may **leave office** by removal under **s 168**, by **disqualification**, by **resignation**, by **not offering themselves for re-election**, on **death**, on **dissolution** of the company or in accordance with **provisions of the articles** (for example, for no longer holding the necessary number of qualification shares).

**Model articles** set out a procedure for the **retirement and re-election ('rotation')** of directors whereby, one-half of the directors retire by rotation. Those who have been in office longest since their last election retire, and all retiring directors are eligible for re-election, they shall be deemed to be re-elected unless the meeting decides otherwise.

**S168 CA 2006** provides that a director may be **removed** from office at any time by **ordinary resolution** of which **special notice** (28 days) has been given to the company by the person proposing it. On receipt of the special notice, the company must send a copy to the relevant director who may require that a memorandum of reasonable length be issued to the members. They also have the right to address the meeting at which the resolution is considered.

Section 168 cannot be overridden by the articles or by any service agreement although the articles can provide for **weighted voting rights** (*Bushell v Faith 1969*) or permit an easier procedure, for example a resolution of the board of directors.

Model articles provide that a director must vacate office if they are **disqualified by statute** or become **bankrupt** or enters into an arrangement with their creditors or if they become of **unsound mind** or **resign by written notice** or if they are **absent for three consecutive months** from board meetings **without leave** from the other directors who resolve that they should therefore vacate office.

An **undischarged bankrupt** cannot act as a director nor be concerned directly or indirectly in the management of a company except with leave of the court that adjudged him bankrupt. The Company Directors Disqualification Act (CDDA) provides that a director may be disqualified (for up to 15 years) for persistent **breaches** of companies legislation, **fraudulent or wrongful trading** or **insider dealing**.

A director may **retire** at any time.

## 82 Statutory grounds for disqualifying directors

**Text reference.** Chapter 19.

**Top tips.** If you could not remember the statutory grounds for disqualification, you could have thought about why a court would want to ban a person from acting as a director. In this case, fraud, failing to provide statutory returns, or being generally unfit for the position may have occurred to you.

**Easy marks.** There are no easy marks here unless you know the law. If you did, stating the statutory reasons for disqualification will get you quick and easy marks.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to explain the operation of the Company Directors Disqualification Act 1986. Performance in relation to the question was patchy, with some candidates providing thorough answers, but a large number mistaking the whole import of the question and delivering an answer, either on directors' duties, or the removal of directors, or a mixture of both. Unfortunately these issues overlapped and even then marks had to be awarded generously. Not only did this confusion not allow candidates to do well in this particular question but it indicated an overall confusion about the nature of directors' duties and their control. In the final analysis, if the candidate cannot refer to the appropriate legislation they are not going to get many marks.

This question requires candidates to explain the operation of the Company Directors Disqualification Act 1986.

- 8–10 marks Thorough to complete answers, showing a detailed understanding of the legislation.
- 5–7 marks A clear understanding of the topic, but perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in the other.
- 2–4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the topic.
- 0–1 mark Little or no knowledge of the topic.

### Vacation of office

Directors may be required to **vacate office** because they have been disqualified on grounds dictated by the articles. They may also be disqualified from a wider range of company involvements under the **Company Directors Disqualification Act 1986 (CDDA)**.

### Disqualification under statute

The **Company Directors Disqualification Act 1986** provides that a **court may formally disqualify a person from being a director** or in any way directly or indirectly being concerned or taking part in the promotion, formation or management of a company: s1.

Therefore the terms of the disqualification order are very wide, and include acting as a consultant to a company. The Act, despite its title, is not limited to the disqualification of people who have been directors. Any person may be disqualified if they fall within the following grounds.

#### **Where a person is convicted of an indictable offence in connection with the promotion, formation, management or liquidation of a company or with the receivership or management of a company's property (s 2)**

An indictable offence is an offence which may be tried at a crown court; it is therefore a serious offence. It need not actually have been tried on indictment but if it was the maximum period for which the court can disqualify is fifteen years, compared with only five years if the offence was dealt with summarily (at the magistrates court).

#### **Where it appears that a person has been persistently in default in relation to provisions of company legislation (s 3)**

This legislation requires any return, account or other document to be filed with, delivered or sent or notice of any matter to be given to the Registrar. Three defaults in five years are conclusive evidence of persistent default.

The maximum period of disqualification under this section is five years.

#### **Where it appears that a person has been guilty of fraudulent trading (s 4)**

This means the director has been found guilty of an offence under s993 of the Companies Act 2006. It generally means that they carried on a business with intent to defraud creditors or for any fraudulent purpose. It applies whether or not the company has been, or is in the course of being, wound-up.

The person does not actually have to have been convicted of fraudulent trading. The legislation also applies to anyone who has otherwise been guilty of any fraud in relation to the company or of any breach of their duty as an officer.

The maximum period of disqualification under this section is fifteen years.

#### **Where the Secretary of State acting on a report made by the inspectors or from information or documents obtained under the Companies Act, applies to the court for an order believing it to be expedient in the public interest (s 8)**

If the court is satisfied that the person's conduct in relation to the company makes that person unfit to be concerned in the management of a company, then it may make a disqualification order. Again the maximum period of imprisonment is fifteen years.

### Unfitness (s 6)

A court **must** make a disqualification order where a person has been a director of a company which has at any time become **insolvent** and **their conduct** as a director of that company makes them **unfit to be concerned in the management of a company**. The courts may also take into account their conduct as a director of other companies, whether or not these other companies are insolvent. Directors can be disqualified under this section even if they take no active part in the running of the business.

In such cases the **minimum** period of disqualification is two years – the maximum period is fifteen years.

### Other situations

Other, less common situations (amongst others) where a director can be disqualified include:

- **Where a director was involved in certain competition violations** – (maximum period fifteen years).
- **Where a director of an insolvent company has participated in wrongful trading** - (maximum period fifteen years).

## 83 Statutory duties

**Text reference.** Chapter 19.

**Top tips.** The examiner has asked for a brief explanation of five of the duties. Therefore you must limit the amount of time you spend on each to about three and a half minutes otherwise you will go over the time allocation for the question. You are only required to explain five duties.

**Easy marks.** Stating each duty and the relevant section number.

The Companies Act 2006 introduced **seven statutory duties** that directors must meet.

(1) **Duty to act within powers (s 171)**

This duty requires directors not to exceed the powers given to them by the company. In particular they must only exercise powers for the purpose for which they were conferred.

(2) **Duty to promote the success of the company (s 172)**

The principle of 'enlightened shareholder value' requires directors to act in a way which is most likely to promote the success of the company for the benefit of the members as a whole.

(3) **Duty to exercise independent judgement (s 173)**

Directors must exercise independent judgement. They must not delegate their powers or be swayed by the influence of others.

(4) **Duty to exercise reasonable skill, care and diligence (s 174)**

Directors have a duty to exercise the same standard of care, skill and diligence that would reasonably be expected of a reasonably diligent person with:

- The knowledge, skill and experience which may be reasonably expected of a person in their position and
- The knowledge, skill and experience they actually have.

(5) **Duty to avoid conflicts of interest (s 175)**

The Act suggests a number of circumstances where a director's personal interests may conflict with the company's interests. Directors have a duty to avoid such circumstances.

(6) **Duty not to accept benefits from third parties (s 176)**

This duty prevents directors from accepting benefits from parties outside the company (usually bribes). It supports the duty under s 175 by preventing a potential conflict of interest.



(7) **Duty to declare an interest in proposed transactions or arrangements (s 177)**

Directors must declare the nature and extent of any proposed arrangement or transaction they may be involved in with the company either personally or through a third party. Disclosure may be given by written or general notice or at a board meeting, but must be made to the directors, as disclosure to the members is not sufficient to discharge the duty.

## 84 Promoting success

**Text reference.** Chapter 19.

**Top tips.** Directors' duties were put into a statutory basis under the Companies Act 2006. The duty to promote the success of the company attracted significant press attention, so don't be afraid to bring in any knowledge from your wider reading on this area.

**Easy marks.** There are no easy marks unless you have read and understood the issues surrounding this duty.

**Examiner's comments.** This question required candidates to explain the duty of directors to promote the success of the company and to whom such a duty is owed. This question required specific reference to section 172 of the Companies Act 2006, but only a small minority of candidates appeared to be aware of that Act let alone the detail of section 172. Very few produced satisfactory answers to this question. They were clearly up to speed on the Companies Act 2006 and exhibited a sound knowledge and understanding of directors' duties and, specifically, the duty to promote the success of the company. The others either used the out of date 1985 Act or relied on a general description of directors' duties

### Marking scheme

This question requires candidates to explain the duty of directors to promote the success of the company and to whom such a duty is owed.

8–10 marks: A very good answer revealing a thorough to complete understanding of both elements of the question.

4–7 marks: A good answer but perhaps unfocused or lacking in detail as to the specific duties applied under s.172.

0–3 marks: Weak answer, not fully explaining the law or issues involved.

### Duty to promote the success of the company

An overriding theme of the Companies Act 2006 is the principle that the **purpose of the legal framework** surrounding companies should be **to help companies do business**. Their main purpose is to create wealth for the shareholders.

This theme is evident in the **duty of directors to promote the success of a company** under Section 172 of the Act. During the Act's development, the independent Company Law Review recommended that company law should consider the interests of those who companies are run for. It decided that the new Act should embrace the principle of '**enlightened shareholder value**'.

In essence, this principle means that the law should encourage **longtermism** and **regard for all stakeholders** by directors and that **stakeholder interests** should be **pursued** in an **enlightened** and **inclusive** way.

To achieve this, a duty of directors to act in a way, which, in **good faith**, promotes the success of the company for the benefit of the members as a whole, was created.

### Requirements of the duty

The requirements of this duty are difficult to define and possibly problematic to apply, so the Act provides directors with a **non-exhaustive list** of issues to keep in mind.



When **exercising this duty** directors should consider:

- The **consequences of their decisions** in the long term.
- The **interests of their employees**.
- The need to **develop good relationships** with **customers** and **suppliers**.
- The **impact of the company** on the **local community** and the **environment**.
- The desirability of **maintaining high standards of business conduct** and a **good reputation**.
- The need to **act fairly as between all members** of the company.

The list identifies areas of **particular importance** and **modern day expectations** of **responsible business behaviour**. For example the interests of the company's employees and the impact of the company's operations on the community and the environment.

The **Act does not define** what should be regarded as the **success of a company**. This is down to a director's judgement in good faith. This is important as it ensures that business decisions are for the directors rather than the courts.

No guidance is given for what the **correct course of action** would be where the various s172 **duties are in conflict**. For example a decision to shut down an office may be in the long term best interests of the company but it is certainly not in the interests of the employees affected, nor the local community in which they live. Conflicts such as this are inevitable and could potentially leave directors open to breach of duty claims by a wide range of stakeholders if they do not deal with them carefully.

### To whom the duty is owed

Section 170 of the Act makes it clear that directors owe their duties to the company, **not** the members. This means that the **only company itself can take action against a director** who breaches them. This puts the common law position set out in *Percival v Wright 1902* onto a statutory footing. However, it is possible for a member to bring a derivative claim against the director on behalf of the company.

## 85 Powers and duties of directors

**Text reference.** Chapter 19 and 22.

**Top tips.** Note that the question asked you to cover common law rather than statutory duties. You would receive no marks had you written about statutory duties. Be very careful when reading the requirement.

**Easy marks.** In the light of the mark allocation you need to try to consider six instances of powers and duties and hopefully back them each up with a case in illustration. In part (b) try to make two comments each about executive and non-executive directors.

**Examiner's comments.** Candidates who did not do so well on this question tended to write a general description of the sort of work that directors do, rather than focus on specific powers and duties. In part (b) few candidates could expand on the basic distinction between executive and non executive directors.

### Marking scheme

This question raises issues relating to the important topic of corporate governance. It requires a consideration of the role of directors generally together with an explanation of the distinction between executive or non-executive directors. Six marks are available for part (a) and 2 marks for each of the two elements in part (b).

- |     |           |  |
|-----|-----------|--|
| (a) | 4-6 marks | A clear understanding of the role of the company director in law with an explanation of their role, powers and duties. |
|     | 0-3 marks | Some awareness of the role of the company director but lacking or limited in legal detail.                             |
| (b) | 3-4 marks | A good understanding of both elements of the question  |
|     | 0-2 marks | A limited knowledge of both elements or good knowledge of only one of the elements                                     |

(a) **Directors**

**Every company must have one or more directors to manage its affairs.** A director is someone (whether or not they are given the title of director) who takes part in making decisions affecting the company by attendance at meetings of the board of directors. Directors are given certain powers which they may exercise in the performance of their role and are also obliged to act in accordance with certain duties. Breach of many of the duties of a director can lead to criminal proceedings.

**Powers**

The board of directors of a company is charged with **managing the business of the company**, usually with a view to maximising the company's profits. Powers are conferred on the directors **collectively** and not (generally speaking) upon individual directors. These **powers** are **defined** by the **company's articles** which normally authorise the directors to 'manage the business of the company' and 'to exercise all the powers of the company'.

**Statutory provisions** and any **director's contract of employment** will also be relevant to defining a director's powers and responsibilities. Directors appointed as **managing directors** have apparent authority as agents of the company to enter into business contracts on behalf of the company.

**Restrictions**

There are certain **restrictions** placed on the exercise of the **directors' powers**. They must **report** back to the shareholders on the **company's business** at the annual general meeting or as required by members requisitioning a meeting. In many instances, for example the alteration of the articles or a reduction in the company's capital, a meeting of the shareholders must be called and a **special resolution** passed. Other matters will require the passing of an **ordinary resolution**.

The **members exercise some control** over the directors' powers in the sense that they (usually) are responsible for **appointing directors** and can vote to **remove them from office**. They can also alter the articles in such a way as to re-allocate the powers between the board and the general meeting. However the directors are not agents of the members but derive their powers from the company as a whole.

On the other hand, some matters will be **solely for the directors**, such as a declaration of solvency on a capital reduction or voluntary liquidation and the declaration of an interim dividend. Sometimes the **articles** will **place limits** on the directors' powers, such as in the case of maximum borrowing limits. Furthermore, directors' decisions can be challenged if they exercise their powers for improper purposes or not in what they honestly believe to be the best interests of the company (*Bamford v Bamford*).

**Duties**

There are a number of duties imposed upon company directors by statute and common law, which duties are owed primarily to the company as the **general body of shareholders** rather than to individual shareholders (*Percival v Wright 1902*). Since they make contracts as agents of the company and have control of its property, directors are said to be akin to trustees and therefore owe **fiduciary duties** to the company in the same way as trustees owe fiduciary duties to the trust.

A **fiduciary duty** is a duty imposed as a result of the position of confidence and trust in which one party stands in relation to another and common law examples include:

- Directors must act within the **powers given to them** and must exercise those powers **bona fide** in what they honestly consider to be the **interests of the company** (*Smith v Fawcett*).
- Directors must exercise their powers for a **proper purpose**. Directors' powers are restricted to the purposes for which they were given. If a director exercises their powers for a collateral purpose, the transaction will be invalid unless ratified by the company passing an ordinary resolution to that effect in general meeting (*Howard Smith Ltd v Ampol Petroleum Ltd 1974*).
- Directors must **avoid conflicts of duty and personal interest**, must not obtain any personal advantage from their position as director without the consent of the company (*Regal Hastings v Gulliver 1942*) and must not fetter their discretion by agreeing to vote as some other person directs.

- Directors also have a **common law duty of care and skill** which they owe to the company as the general body of shareholders. A director is expected to show the degree of skill which may reasonably be expected from a person of their knowledge and experience, they are required to attend board meetings when able to do so but they are not required to concern themselves with the company's affairs in between meetings (unless they have undertaken otherwise) and they are entitled to delegate the routine management of the company and its business affairs to the company's management provided that they have no grounds to suspect that they might be dishonest or incompetent (*Re City Equitable Fire Insurance Co Ltd 1925*).

(b) (i) **Executive directors**

An **executive director** is a director who performs a **specific role** in a company under a **service contract** which involves a regular, possibly daily involvement in management. A director may also be an employee (usually a member of management) of their company.

**Directors** who have additional **management duties** as employees may be distinguished by special titles such as '**finance director**'. Such titles (with the exception of 'managing director') do not affect their personal legal position.

(ii) **Non-executive directors**

A **non-executive director**, on the other hand, acts only as a member of the board of directors. Their usual involvement is to attend board meetings. They are not involved in the day to day management of the company. In a public limited company, the role of the non-executive director has become more important in recent years with the increasing emphasis on, and regulation of, **good corporate governance**.

The tasks of the non-executive director include the following:

- To contribute an **independent** view to the board's deliberations;
- To help the board provide the company with effective **leadership**;
- To ensure the continuing **effectiveness of the executive directors and management**;
- To ensure **high standards of financial probity** on the part of the company.

Non-executive and executive directors are subject to the same statutory and fiduciary duties.

## 86 Helen

**Text reference.** Chapter 19.

**Top tips.** Read the question carefully at least twice so that you appreciate exactly what the scenario involves and make a note of the points you need to make before starting to write your answer.

**Easy marks.** For each of the two parts of the question, make sure that you:

- **Identify** the law
- **State** the law
- **Apply** the law
- **Conclude** on the situation in the question

### Marking scheme

This question requires candidates to analyse a problem scenario and explain and apply the law relating to directors' contracts with their companies.

8-10 marks	A good analysis of the scenario with a clear explanation of the law relating to contracts between directors and their companies both at common law and under statute. Cases and/or reference to the Companies Act will be provided.
5-7 marks	Some understanding of the situation but perhaps lacking in detail or reference to the statute.
0-4 marks	Weak answer lacking in knowledge or application, with little or no reference to the Companies Act.

## Directors' duties

Since they make contracts as agents of the company and have control of its property, **directors** are said to be akin to trustees and therefore owe **fiduciary duties** to the company in the same way that trustees owe fiduciary duties to the trust. Therefore a director must act *bona fide* and honestly and not seek any personal advantage. Under the Companies Act 2006 they also owe a number of **statutory duties**.

Under s 175 a director must avoid any **conflict of duty and personal interest** and must not obtain any **personal advantage** from their position as director without the consent of the company. In *Regal Hastings v Gulliver 1942* the directors funded the creation of a subsidiary company in order to purchase two more cinemas. This resulted in profits on a later sale of the company. It was held that they had only made the profits because of their position as directors of the parent company and they were therefore required to account for the profits.

It is not necessary to prove an actual conflict, nor that the company has been **prejudiced** in any way by any such conflict.

A statutory and common law framework exists enabling directors to be interested in contracts with the company but only subject to certain safeguards, the **principal common law condition** being that a director **cannot obtain personal advantage** from their position qua director unless permitted by the company. Without such consent, the contract would be voidable at the instance of the company.

Under s177 of the Act, directors must always disclose the **nature** and **extent of any interest, direct or indirect**, that they have in a **contract** or **proposed contract** with the company.

The disclosure must be made **before** the company enters into the transaction and should be made to the directors by **general** or **written notice** or **verbally** at a board meeting. Disclosure just to the members is not sufficient and should the disclosure become void or out of date then a fresh one should be made.

### Helen

Turning to the case in question, it appears that Helen has not disclosed either her **interest** in Jet Ltd or her interest in this particular contract. Helen will have to account to Industria for any **profit** that she has made on the transaction and she may also be subject to a **fine**. It is irrelevant that Industria plc has in fact made larger than expected profits. Had she dealt honestly with Industria plc by declaring her interest and obtaining company approval, she would have been permitted to retain her profits.

## 87 Directors

**Text reference.** Chapter 19

**Top tips.** This question is not technically difficult, but having to answer three parts may have caused you to spend too long answering it. Watch your time and aim to write for five or six minutes on each part before moving on. Jotting down bullet points as an answer plan is always a good idea as it helps focus the mind on the task in hand and prevents you straying off target.

**Easy marks.** Defining each type of director.

**Examiner's comments.** Most candidates made a reasonable attempt at explaining the role of the executive directors and gave comprehensive explanations about the role they play in the day-to-day management of the company. There was also a reasonable effort shown in tackling part (b) of the question about the role of the NED. Many made good reference to the importance of corporate governance and the need for some sort of 'check' on the powers of the executive directors.

This question raises issues relating to the important topic of corporate governance. It requires a consideration of the role of directors generally together with an explanation of the distinction between executive or non-executive directors and an explanation of the meaning of the term 'shadow director'.

- 8–10 marks Full understanding and explanation of all three elements of the question.
- 5–7 marks Lacking in detail in some or all elements of the question. Unbalanced answer that only focuses on two of the elements.
- 3–4 marks Some, but limited knowledge of the nature of the three elements, or unbalanced in dealing with only one or two aspects of the question.
- 0–2 marks Little if any knowledge of the topic or very unbalanced in its treatment of the question.

### (a) Executive directors

An **executive director** is a director who performs a specific role in a company under a **service contract** which requires a regular, possibly daily, involvement in management.

Such a director may also be an **employee** of the company. This fact may create a potential conflict of interest which in principle a director is required to avoid.

To allow an individual to be both a **director and employee** the articles usually make express provision for it, but prohibit the director from voting at a board meeting on the terms of their own employment.

Directors who have additional management duties as employees may be distinguished by **special titles**, such as 'Finance Director'. However (except in the case of a managing director) **any such title does not affect their personal legal position**.

They have two distinct positions as:

- A **member of the board** of directors; and
- A manager with management responsibilities as an **employee**

### (b) Non-executive directors

A **non-executive director** does not have a function to perform in a company's management but is involved in its governance. They are subject to the same legal duties as executive directors

In **listed companies**, corporate governance codes state that boards of directors are more likely to be fully effective if they comprise both **executive directors** and strong, independent **non-executive directors**.

The **main tasks** of Non-executive directors are as follows:

- **Contribute an independent view** to the board's deliberations
- **Help the board provide** the company with **effective leadership**
- **Ensure the continuing effectiveness** of the **executive directors** and management
- **Ensure high standards of financial probity** on the part of the company

### (c) Shadow directors

According to company law, a **director** is a person who is responsible for the overall direction of the company's affairs. This means any person occupying the position of director, by whatever name they are called. A shadow director has also been defined as any person in accordance with whose instructions the directors are accustomed to act. However this does not include professionals such as accountants or solicitors.

A person might seek to **control** a company as a **director** but **avoid the legal responsibilities of being a director**. The law seeks to prevent this by extending several statutory rules to **shadow directors**. Shadow directors are directors for legal purposes if the board of directors are accustomed to act in **accordance with their directions and instructions**.

An example of a shadow director would be a **major shareholder** who uses their power to **manipulate** the **board of directors**.

Shadow directors are subject to the same legal duties as executive directors.

## 88 Auditors I

**Text reference.** Chapter 19.

**Top tips.** The important thing to notice in this question is that it is asking you for four specific things (appointment, removal, rights and duties), on top of the basic requirement for an explanation of the role of the auditor. The best way to structure your answer would be to have a heading for each of these, so that you can show the marker clearly that you have addressed all of them.

**Easy marks.** Make at least one or two, and hopefully more, points about each of the four topics specifically mentioned in the question

**Examiner's comments.** Most candidates dealt adequately with the appointment, role and duties of auditors, although there was some uncertainty over appointment. The best answers also considered the duty of care of auditors and cited cases such as *Caparo*.

### Marking scheme

This question requires candidates to consider the role of the auditor in relation to companies and the precise way in which this relationship is regulated by company law.

6-10 marks    A thorough understanding of the role of the auditor explaining their rights and duties. Mention will also be made of their qualifications for office and the manner in which they are appointed and may be removed.

0-5 marks    Some knowledge of the role of auditors but lacking in detail or unbalanced in the detail provided.

### Auditors

Every public company is required to appoint auditors. Auditors are appointed to ensure that the **interests of a company's shareholders** are being protected and to make certain **reports to the shareholders**.

The Companies Act 2006 provides that an auditor must be a member of a **recognised supervisory body** and hold an appropriate qualification. Certain types of person are **ineligible** for appointment as a company auditor. These include officers and employees of the company, anyone employed by or in partnership with such a person or anyone who holds such a position in respect of an associated company. An auditor may be an individual or a body corporate or a partnership.

### Appointment

Appointment is usually made in the first instance by the **directors of a new company**. They are appointed to hold office until the conclusion of the first meeting at which the accounts are considered. The directors or the company in general meeting may also appoint an auditor to fill a **casual vacancy**.

In normal circumstances, the **members** appoint the auditors at each general meeting at which the accounts are considered, to hold office until the next such meeting, that is, to audit and report on the accounts to be prepared for that subsequent meeting. If the members fail to appoint auditors at the general meeting at which the accounts are considered, the company must, within 28 days of the meeting, give notice to the **Secretary of State**, who has the power to appoint auditors.



## Removal

An auditor may **resign** by giving notice in writing to the company's registered office. The auditor must deposit at the registered office a **statement** that states that there are **no circumstances** connected to their resignation that should be brought to the attention of the members and creditors. If there are such circumstances then a statement to that effect should be deposited instead. The company must send a copy of the notice of resignation to the Registrar and, if there is a statement of circumstances, a copy of this statement to every member entitled to receive accounts.

If a statement has been circulated, the **auditor** is **entitled to circulate an explanatory statement of reasonable length to the members, requisition a general meeting** to explain the reasons for the resignation and attend and speak at any meeting where the appointment of successors is discussed. Similarly, if an auditor declines to accept reappointment, a statement of circumstances – or that there are none – is required.

An auditor may be **removed from office** before expiry of their appointment by the passing of an **ordinary resolution** in general meeting. **Special notice** is required and members and auditors must be notified. Similarly where an auditor is not re-elected when their term of office expires, special notice must be given of any resolution to appoint different auditors. Special notice means that a copy of the proposed resolution is given to the auditor who has the statutory right to defend themselves by issuing a statement or addressing the meeting in person.

## Duties

The statutory duty of auditors is to **report to the members of the company** on whether the accounts which they have audited

- Give a **true and fair view** of the result for the year and the state of affairs of the company (and, if applicable, the group of companies) and
- Have been **properly prepared** in accordance with the Companies Act.

This report covers the profit and loss account and balance sheet of the company. They must also report on whether the information given in the **directors' report** is **consistent** with the accounts.

In reaching the opinion expressed in these reports, the auditors must form an opinion:

- As to whether **proper accounting records** have been kept,
- Whether proper **returns** adequate for the audit have been received from **branches**,
- Whether the accounts are in **agreement** with the underlying accounting records and
- Whether the company has complied with the requirements of the Companies Act regarding **disclosure of directors' emoluments and other benefits**.

Under the principles of the law of tort, an auditor has a **duty of care**. This duty of care is owed to the company rather than to individual shareholders or potential investors (*Caparo v Dickman 1990*). The duty of care means that an auditor must perform the audit with **reasonable care and skill**. If a breach of the duty of care is shown, the auditor may be sued for damages. Under the Companies Act 2006 auditors have the right to agree with their client a **limitation of liability** for negligence. This should be prepared annually.

## Rights

The auditors are given certain **legal rights** to enable them to carry out their duties:

- A right at all times of **access to the books and records of the company**
- A right to require such **information and explanations** from the company's officers as they consider necessary for the performance of their duties
- A right to **attend any general meetings** of the company and to receive all notices of, and communications relating to, such meetings
- A right to be **heard at general meetings** which they attend on any part of the business that concerns them as auditors
- A right to **receive notice** of any written resolution proposed

## 89 Auditors II

**Text reference.** Chapter 19.

**Top tips.** Don't let the length of this answer put you off. There is a very wide scope for answering this question and therefore the answer reflects almost everything that you could have written. A good answer would have explained at least three or four points in a fair degree of detail for each of the three aspects in the question. An explanation of auditor liability was not explicitly required by the question but it is included here as the examiner's answer covered it and marks would have been awarded if your answer included this material.

**Easy marks.** Listing the rights and duties of auditors in Part (c).

**Examiner's comments.** There was a significant tendency for candidates to overstate the powers of auditors, even to the extent of suggesting that they could take over the running of the company or dismissing the board of directors. Perhaps of more importance in this regard, and certainly from the accountancy point of view, was the almost general tendency to assert that the auditors had to ensure that the accounts provided a true and fair view, rather than the correct approach that the auditors reported on whether the accounts presented actually portrayed a true and fair view. The difference is subtle but important.

### Marking scheme

	Marks
A thorough understanding of the role of the auditor explaining their rights and duties. Mention will also be made of their qualifications for office and the manner in which they are appointed and may be removed.	8–10
A clear understanding of the general law but perhaps lacking in detail or unbalanced in only dealing with some issues.	5–7
Some knowledge of the role of auditors but lacking in detail or unbalanced in the detail provided.	2–4
Little or no knowledge of the topic.	0–1

### Auditors

The general role of **auditors** is to support the concept of **good corporate governance** by providing **independent reports** that confirm or deny the accuracy and reliability of financial information produced by the company. Such reports protect the interests of the shareholders since they involve an independent assessment of the financial controls and results of the company that they have invested in.

All **public companies** must have an auditor but private companies that meet the requirements of the Companies Act Small Companies Regime are exempt from an audit. These companies are often run and owned by the same small group of people and therefore an audit is not required to safeguard their interests.

#### (a) Qualification of auditors

Membership of a **Recognised Supervisory Body** is the main prerequisite for eligibility as an auditor. The Act requires an auditor to hold an '**appropriate qualification**'. This means that they must satisfy **criteria** for appointment as an auditor, such as holding a **recognised qualification**.

Under the Companies Act 2006, a person may be ineligible on the grounds of '**lack of independence**'. This means that a person is ineligible for appointment as a company auditor if for example they are an **officer** or **employee** of the company being audited, or a **partner** or **employee** of such a person.

The legislation does **not** disqualify a shareholder, a debtor, a creditor or a close relative of an officer or employee of the company from being its auditor.



## Appointment and removal of auditors

The **first auditors** are usually appointed by the directors, to hold office until the **first general meeting** at which their appointment is considered. Members usually subsequently appoint auditors, in general meeting with an ordinary resolution. **Subsequent auditors** may not take office until the previous auditor has ceased to hold office. The auditors will hold office from 28 days after the meeting at which accounts are laid until the end of the corresponding period next year (public companies). **Casual vacancies** in the post of auditor are usually filled by either the directors or the members.

**Auditors of private companies** are deemed **automatically re-appointed** unless the auditor was **appointed by the directors**, the **articles require formal re-appointment**, **members holding 5% of the voting rights** serve notice that the auditor should not be re-appointed, a resolution has been passed that prevents re-appointment or the **directors have resolved that auditors should not be appointed** for the forthcoming year as the company is likely to be exempt from audit.

To **leave office** auditors may **resign** their appointment or they may **decline re-appointment**. They may be **removed from office** before the expiry of their appointment by the passing of an **ordinary resolution with special notice** in general meeting or simply by **not being re-appointed** when their term of office expires. **Special notice** must be given of any resolution to appoint auditors who were not appointed on the last occasion of the resolution

### (b) Powers of auditors

#### Statutory rights

The Companies Act provides **statutory rights** for auditors to enable them to carry out their duties.

#### Access to records

Auditors have a right of access at all times to the books, accounts and vouchers of the company: s499(1).

#### Information and explanations

Auditors have a right to require from the company's officers, employees or any other relevant person such information and explanations as they think necessary for the performance of their duties: s499(1)

#### Attendance at/notices of general meetings

Auditors have a right to attend any general meetings of the company and to receive all notices of and communications relating to such meetings which any member of the company is entitled to receive: s502(2)

#### Right to speak at general meetings

Auditors have a right to be heard at general meetings which they attend on any part of the business that concerns them as auditors: s502 (2)

#### Rights in relation to written resolutions

Auditors have a right to receive a copy of any written resolution proposed: s502(1)

### (c) Duties of auditors

The **statutory duty** of auditors is to report to the members whether the accounts give a **true and fair view** and have been properly prepared in accordance with the Companies Act.

They must also **state** whether or not the **directors' report** is **consistent** with the **accounts**. For **quoted companies**, they must **report** to the members on the **auditable** part of the **directors' remuneration report** including whether or not it has been properly prepared in accordance with the Act.

To fulfil their statutory duties, the auditors **must carry out such investigations as are necessary** to form an opinion as to whether:

- **Proper accounting records** have been kept and **proper returns** that are adequate for the audit have been received from branches
- **Accounts** are in **agreement** with the **accounting records**
- **Information** in the **directors' remuneration report** is consistent with the **accounts**.

## Auditors' liability

**Professional negligence** cases such as *Caparo* have resulted in an increase in litigation against auditors for breach of duty and negligence. The **Companies Act 2006** has provisions which permit auditors to agree **limited liability** with their clients.

Under s532 any **agreement** between an auditor and a company that seeks to **indemnify the auditor** for their own negligence, default or breach of duty or trust is **void**. However under s534, an agreement can be made which **limits the auditor's liability** to the company. Such **liability limitation agreements** can only stand for **one financial year** and must therefore be replaced annually.

Liability can only be **limited** to what is **fair and reasonable** having regard to the auditor's responsibilities, their contractual obligations and the professional standards expected of them. Such agreements must be approved by the members and **publicly disclosed** in the **accounts** or **directors' report**.

## 90 Katch Ltd

**Text reference.** Chapters 12 and 19.

**Top tips.** Although you may recognise the facts of the *Freeman & Lockyer* case in the scenario and therefore have a good idea of what the answer is, you must explain all the types of authority so that you can eliminate them. Stating that the company is liable due to the *Freeman* case might be the right answer but it would not earn you enough marks to pass.

**Easy marks.** Quoting the *Hely* and *Freeman* cases and using them to explain implied and apparent authority.

**Examiner's comments.** While the majority of candidates grasped the essence of this question, a fairly substantial minority failed to see what was required and based their answers on topics which were not central to the question.

### Marking scheme

	Marks
A thorough analysis of the scenario focusing on the appropriate rules of law and Applying them accurately. It is extremely likely that cases will be cited in support of the analysis and/or application.	8–10
A clear understanding of the general law but perhaps lacking in detail or unbalanced in only dealing with some issues.	5–7
Some, but limited, understanding of the law or completely lacking in application.	2–4
Little or no knowledge of the relevant law.	0–1

## Directors' powers

The powers of the directors are **defined by the articles**. The directors are usually authorised 'to manage the company's business' and 'to exercise all the powers of the company for any purpose connected with the company's business'. As **agents of the company**, directors may have **express**, **implied** or **apparent** authority to enter the company into binding contracts.

### Express authority

Express authority to enter into a **particular contract** can be granted by the board of directors to one or more of their number. Where such express authority is given, the company will be bound by the agreement.

## Implied authority

Where there is no express authority, authority may be **implied** from the director's position within the company. A company's articles usually provide for one or more directors to be appointed as managing director. **Managing directors** usually have authority to make commercial contracts on behalf of the company and therefore those appointed as such are permitted to exercise this authority as they see fit, their actions binding the company. As far as **third parties** are concerned, they are entitled to assume that a person appointed as managing director has this implied authority unless they know to the contrary.

In *Hely-Hutchinson v Brayhead Ltd 1968* it was held that implied authority can be **extended to directors** who, although **never formally appointed** as managing director, nonetheless act as if they were (they are known as *de facto* managing directors).

## Apparent authority

Where an individual has neither express nor implied authority they may still be able to bind the company in contracts if they have apparent authority. This authority arises where they are **'held out'** by members of the board **as having authority** to enter into contracts. The company will be **estopped** from denying this if a third party acts on the representation.

In *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd 1964* a company carried on a business as a property developer. The articles contained a power to appoint a managing director but this was never done. One of the directors of the company, to the knowledge but without the express authority of the remainder of the board, acted as if they were managing director. They found a purchaser for an estate and also engaged a firm of architects to make a planning application. The company later refused to pay the architect's fees on the grounds that the director had no actual or apparent authority.

The court found the company liable since, by its acquiescence, it had **represented** that the director was a managing director with the authority therefore to enter into contracts that were normal commercial arrangements in that sector, and which the board itself would have been able to enter.

## Len

From the facts of the case it is clear that **Len did not have express authority** from the company to enter into the contract and therefore from this point of view the company is not liable.

As **Len is not a director he cannot have implied authority** to bind the company; the *Hely-Hutchinson* case makes it clear that implied authority can only be extended to directors, not employees.

The circumstances in which Katch Ltd finds itself are very similar to that of the *Freeman & Lockyer* case. **Len has been allowed by the board to act as if he were managing director** and therefore as a third party Mo is entitled to assume that he has the **implied authority** of one. This authority permits him to bind the company in **commercial contracts**, so the company will be bound by the advertising contract entered into by Len. Katch Ltd therefore has a liability to pay Mo or be sued for breach of contract.

# 91 Clean Ltd

**Text reference.** Chapter 19.

**Top tips.** Following the ISAC approach as our solution does gives your answer a ready-made structure and takes you through a logical process to come to your conclusion.

**Easy marks.** Identifying the issue, stating and applying the law, and coming to a reasonable conclusion.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required an analysis of the doctrine of corporate opportunity and the rules relating to directors' duties. It has to be said it was the least popular question on the paper and was not attempted by a considerable minority of candidates, and those who did tackle it, did not do particularly well in it.

There were essentially two core issues in the question, relating to conflict of interest, corporate opportunities and the much less essential corporate personality issue.

The majority of candidates recognised that the question related to directors' duties in some way, but apart from citing those generally, could get no further than that. Very few candidates even considered the corporate opportunities issue, preferring to go down the road of patent law, which is not even part of the syllabus of this paper.

As for the corporate personality issue, although not central to the question a number of candidates saw it as the key issue and spent all their time dealing with that –perhaps it would not be too cynical to suggest that this was in response to their lack of knowledge relating to any other aspect of the question.

### Marking scheme

This question requires a consideration of the statutory duties placed on company directors under the Companies Act 2006.

- 8–10 marks    Thorough to complete answers, showing a detailed understanding of the rules relating to conflict of interest.
- 5–7 marks    A clear understanding of the topic but perhaps lacking in detail or application.
- 2–4 marks    Some knowledge, although perhaps not clearly expressed, or very limited in its application.
- 0–1 mark    Little or no knowledge of the topic.

### Issue

The issue at hand is the actions of Des in setting up a rival company (Flush Ltd) and taking a major customer away from the company of which he was a director (Clean Ltd). Flush Ltd also manufactures a profitable product which Clean Ltd employees discovered.

### The law

The Companies Act 2006 sets out the **principal duties** that directors owe to their company. Many of these duties developed over time through the operation of **common law** and **equity**, or are **fiduciary duties** which have now been codified to make the law clearer and more accessible.

A **fiduciary duty** is imposed upon certain persons because of the position of trust and confidence in which they stand in relation to another.

Broadly speaking directors must be **honest** and **not allow their personal interests to conflict with their duties as directors**. The directors are said to hold a **fiduciary position** since they make contracts as **agents** of the company and have control of its property.

The duties which are relevant to the situation with Des are:

#### Promote the success of the company (s 172)

Under this duty, directors must act in a way which, in **good faith**, promotes the success of the company for the benefit of the members as a whole. However, as it is a new duty created by the Companies Act 2006 it is as yet unclear how it will be interpreted and applied.

#### Avoid conflicts of interest (s 175)

Directors have a **duty to avoid circumstances** where their **personal interests conflict**, or may possibly conflict, **with the company's interests**. This may occur when a director makes personal use of corporate opportunities, information or property belonging to the company, whether or not the company was able to take advantage of them at the time (*Regal (Hastings) Ltd v Gulliver 1942*).

**Directors will not be liable** for a breach of this duty if:

- The **members** of the company **authorised** their actions
- The **situation cannot reasonably be regarded** as likely to give rise to a conflict of interest

- The **actions have been authorised by the other directors**. This only applies if they are genuinely independent from the transaction and:
  - If the company is private - the articles do not restrict such authorisation, or
  - If it is public - the articles expressly permit it.

### **Declare interests in transactions or arrangements (s 177 and 182)**

Directors are required to **disclose to the other directors** the nature and extent of any interest, direct or indirect, that they have in relation to a **proposed transaction or arrangement** with the **company**.

**Disclosure** to the **members** is **not** sufficient to discharge the duty. Directors must declare the **nature** and **extent** of their interest to the **other directors** as well.

Directors also have a statutory obligation to declare any direct or indirect interest in an **existing transaction** entered into by the company.

The case of *Industrial Development Consultants Ltd v Cooley 1972* indicates that a director's duties can also apply after they leave the service of the company that they are a director of.

### **Remedies**

Breach of duty comes under the **civil law** rather than criminal law. Section 170 makes it clear that directors owe their duties to the company, **not** the members. This means that **only the company itself can take action against a director** who breaches them. This usually means the other directors starting proceedings.

#### **Consequences of breach include:**

- **Damages** payable to the company where it has suffered loss.
- **Restoration** of company property
- **Repayment of any profits** made by the director
- **Rescission of contract** (where the director did not disclose an interest)

### **Application and conclusion**

By creating Flush Ltd as a rival to Clean Ltd, Des set up a situation where he has a **conflict of interest**. He has a personal interest in Flush Ltd and a professional duty to Clean Ltd. A further conflict was created where Dank plc sought to move its business from Clean Ltd to Flush Ltd. The result was Clean Ltd losing its major customer.

Des also had a duty to **declare an interest in the proposed transaction** of Dank plc contracting with Flush Ltd rather than Clean Ltd.

**Des is clearly in breach of his duties** under s 175 and 177 of the Companies Act 2006.

Additionally, by creating a rival in Flush Ltd, it could be argued that Des is also in **breach of his duty** under s 172 – **to promote the success of Clean Ltd**. This duty is likely to also be broken by Flush Plc selling the new glue which was developed by Clean Ltd.

Clean Ltd will have suffered loss in two areas. Firstly the loss of Dank plc as its major customer, and secondly loss of profits on the new glue being sold by Flush Ltd. The court could order Des pay Clean Ltd **damages** and **repay any profits** earned by Flush Ltd from Dank plc and on the sale of the glue. He will not be protected by the corporate veil of Flush Ltd as the court will simply lift it.

## **92 Liquidation**

**Text reference.** Chapter 21.

**Top tips.** In part (a) notice that the question asks you to 'state and explain' the grounds. This means that you must say what they are, and then give as much further information as you can. For example, what does 'just and equitable' mean? How does a court decide that a company cannot pay its debts – how much does it have to owe?

In part (b) do not confuse members' and creditors' winding up on one hand and compulsory and voluntary winding up on the other.

**Easy marks.** In questions like this which are very technical, marks are available for just stating the law and require little application. You should be able to pass the question by repeating book knowledge.

**Examiner's comments.** The question was not popular and was very poorly done. The majority of candidates did not actually address the issue of S122, but merely discussed the winding up of companies in general terms. Many candidates only seemed able to address one of the grounds in any depth; this limited mark-earning potential.

### Marking scheme

This question requires candidates to explain the grounds under which a company may be wound up under s 122 of the Insolvency Act 1986.

- |            |  |
|------------|--|
| 8-10 marks | Thorough to complete answers, showing an understanding of all or certainly most of the grounds for winding up.       |
| 5-7 marks  | A clear understanding of the topic, perhaps lacking in detail.   |
| 2-4 marks  | Some knowledge, although perhaps not clearly expressed, or very limited knowledge in its understanding of the topic. |
| 0-1 marks  | Little or no knowledge of the topic.   |

#### (a) Compulsory winding-up

A **compulsory winding-up** is one ordered by the court under s.122 IA on one or more of seven specified grounds. The most important of these grounds are:

- That the company is **unable to pay its debts**; and
- That it is **just and equitable** to wind up the company.

##### Unable to pay its debts

Where a creditor is owed more than **£750** and makes a written demand for payment and the company fails to pay the debt, or offer reasonable security for it, within **three weeks**, the company is deemed unable to pay its debts. The creditor may persuade the court of the company's inability to settle its debts in other ways, for example by proving that the company's assets are less than its liabilities.

##### Just and equitable ground

The **just and equitable** ground is usually relied on by a **member** who is **dissatisfied** with the directors' or controlling shareholders' **management** of the company, provided they can show that no other remedy is available and satisfactory.

A member who is dissatisfied with the directors or controlling shareholders over the management of the company may **petition the court** for a winding up on the basis that to do so is **just and equitable**. Such winding up orders have been made where the **substratum** (the only main object) of the company **no longer exists** (*Re German Date Coffee Co 1882*), where the company was formed for an **illegal or fraudulent purpose**, where there is a **complete deadlock in the management** of the company's affairs (*Re Yenidje Tobacco Co Ltd 1916*) and where the **trust and confidence** between both **directors** and **shareholders** in a small company have **broken down** (*Ebrahimi v Westbourne Galleries Ltd 1973*).

#### (b) Creditors' voluntary winding-up

The winding up is instigated by a **special resolution** of the company in general meeting, by which the company states that it cannot continue to trade because of its liabilities. Private companies may pass a **written resolution** with a three quarters majority.

##### Creditors' meeting

The company must call a **meeting of creditors** for a day not later than the 14th day after the day on which the special resolution was passed. The creditors must receive at least 7 days notice of the meeting.

The **notice** must state either:

- The name and address of an **insolvency practitioner** who will furnish creditors free of charge with such information as they reasonably require, or
- A place in the locality where on the two days before the meeting of creditors is held, a list of the names and addresses of the **company's creditors** will be available for inspection free of charge.

**Notice** of the creditors' meeting must be **advertised** in the *Gazette* and in at least two newspapers circulating in the locality in which the company's principal place of business was situated.

### Liquidator

During the period before the creditors' meeting but after the resolution for winding-up the **members' nominee** will act as **provisional liquidator**. They will have restricted powers to act during this period, subject to application to the court. This restriction is necessitated by the practice of 'centrebinding', whereby the assets are fraudulently disposed of before the creditors' meeting.

At the creditors' meeting the **creditors may appoint their own nominee** to act as liquidator. The **creditors' choice will prevail** over the members' choice if there is a conflict; usually there is not.

### Statement of affairs

The **directors** of the company must prepare and lay before the creditors' meeting a **statement of affairs** of the company but, importantly, they do not have to make a statutory declaration of solvency.

## 93 Compulsory winding up

**Text reference.** Chapter 21.

**Top tips.** Note that the question relates to compulsory winding up: do not get side tracked into other types of liquidation.

**Easy marks.** Explaining what compulsory liquidation is and its effects.

### Compulsory winding-up

The statutory provisions on **compulsory winding up** are in the Insolvency Act 1986, to which all section references in this question refer.

The two **general effects** of compulsory liquidation are:

- That the management of the company passes to a liquidator and the **directors' powers cease**, and
- **Dispositions** of the company's **property or shares**, and **actions** against the company, are **restrained**.

There is **no** automatic cancellation of company contracts, but many commercial contracts provide for cancellation at the option of the other party if the company goes into liquidation.

### Commencement

**Compulsory winding up** is deemed to commence from the date on which the petition was presented, unless the company was then already in voluntary liquidation. In effect the order for compulsory liquidation is retrospective.

### Effects

The more **specific effects** of compulsory liquidation are as follows.

- The **Official Receiver** becomes **liquidator** from the making of the order, and they continue until some other liquidator, who must be an insolvency practitioner, is appointed: s 136.
- The **powers of the directors are terminated** and they are **dismissed**.
- Any **disposition of the company's property** from the commencement of the liquidation is **void** unless approved by the court.



The court may give approval with **retrospective effect** but it is safer to apply for it in advance, when the petition has been represented. The court will only give its approval if it considers that it is in the interests of the company and its creditors that the company should continue to carry on its business pending a decision on the petition.

- Any **transfer of the company's shares is void** unless approved by the court: s 127.
- **No creditor may commence or continue legal action** against the company except with the leave of the court: s 126.
- The **employment of the company's staff ceases** unless the liquidator retains them to carry on the business.
- **Floating charges crystallise**.

## 94 Lazy Days

**Text reference.** Chapter 21.

**Top tips.** At all times remember the purpose of administration. It is not a winding up, but an attempt to save the business. Do not stray off the subject matter or you will lose marks and waste time.

**Easy marks.** If you set out the law in parts (a) and (b) then applying it is very straightforward and will earn you the easy marks here.

### (a) Administration

An **administration order** is an order of the court which puts an insolvency practitioner in control of the company with a defined programme for rescuing the company from insolvency as a going concern.

Its effect is to insulate the company from its creditors while it seeks:

- To **save itself**, or failing that
- To achieve a **better result** for creditors than an immediate winding up would secure, or failing that
- To **realise property** so as to make a distribution to creditors.

During the process, the company is **protected** as follows:

- Voluntary and compulsory **liquidation** cannot be applied for
- Company **property cannot be seized** as payment of debts
- Goods on **lease** or **hire purchase** cannot be seized
- **Legal proceedings** against the company cannot be instigated

**Administration orders** and **liquidation** are **mutually exclusive**. Once an administration order has been passed by the court, it is no longer possible to petition the court for a winding up order against the company. Similarly, however, once an order for winding up has been made, an administration order cannot usually be granted.

### (b) Procedure

A company or its directors may **appoint an administrator** if (subject to the articles of association):

- They have not done so in the last **12 months** or been subject to a moratorium as a result of a voluntary arrangement with its creditors in the last 12 months
- The company is, or is likely to be, **unable to pay its debts**
- **No petition** for winding up nor any administration petition in respect of the company has been presented to the court and is outstanding
- The **company is not in liquidation**
- **No administrator** is already in office

The company or its directors must give notice to any **floating chargeholders** entitled to appoint an administrative receiver or an administrator. This means that the floating chargeholders may appoint their own administrator within this time period, and so block the company's choice of administrator.



Once the notice period is over, the company or its directors must, as soon as reasonably practicable, file at court:

- The **notice** in the **prescribed form** identifying the proposed administrator
- A **statutory declaration** that:
  - (i) The company **is**, or is **likely to be, unable to pay its debts**
  - (ii) The company is **not in liquidation**
  - (iii) As far as ascertainable there is **no restriction** in making the appointment

(c) **Granting an order**

The court will grant the **administration order** if it is satisfied that:

- The company is, or is likely to be, **unable to pay its debts**, and
- The administration order is **reasonably likely** to achieve the purpose of administration

**Lazy Days**

In Lazy Days Ltd's case the issue is not whether the company is unlikely to be **able to pay its debts**, but whether or not the **purpose** of administration will be achieved. The company is currently running at a £7,000 loss per month and this must be **solvable** for the order to be granted. If the company can argue that it has a good chance of increasing trip sales from 50% to nearer 80% to 90% and that these extra sales will make up the shortfall in revenue then it would have a good chance of obtaining the order.

## 95 Earl

**Text reference.** Chapters 10, 16, 17 and 21

**Top tips.** You must be prepared to answer questions such as this which cross syllabus areas. It is not just about insolvency but also has elements of share capital, borrowing and company charges. Establishing from the start that there are three distinct issues will give structure to your answer and will show the examiner that you have a good understanding of the law.

**Easy marks.** The calculation of the amount outstanding on Earl's shares in Part (b).

**Examiner's comments.** The skill, in this question, was to identify the relevant areas of law and apply that law to the facts stated in the problem. Explanations of the meaning and procedures involved in voluntary and compulsory liquidations were not relevant to this question. The focus should be on Earl and the legal issues raised by his concurrent relationships with Flash Ltd.

### Marking scheme

	Marks
(a) A good to thorough explanation of the situation of employees as preferred creditors.	2–3
Little or no knowledge of the relevant law.	0–1
(b) A good general knowledge of the liability of holders of unpaid shares.	2–3
Little or no knowledge of the relevant law.	0–1
(c) A good explanation of fixed charges together with accurate application of the law.	2–4
Some knowledge, but lacking in detail or application.	0–1

## Issues

**Earl** has **three relationships** with **Flash Ltd**: as an **employee**, a **shareholder** and a **debentureholder**. The liquidation of the company has raised issues concerning his unpaid salary, the loss in value of his partly- paid shares and the repayment of his secured loan. Each issue is subject to different rules which we consider below.

### (a) Unpaid wages

Earl will become an **unsecured creditor** in respect of his **unpaid wages** and as such he will only have a claim to have the debt paid to him after the secured creditors have been repaid in full. He will be in a slightly better position than other unsecured creditors (such as suppliers) since in law he will be treated as a preferential unsecured creditor for payment of his unpaid salary and any redundancy payments to which he is entitled. This protection is up to a statutory limit.

### (b) Shareholding

The nominal value of a share (plus any premium on issue) represents the total amount of a shareholder's interest in the company. Any **amount of nominal value** that is **unpaid must be contributed to a company in the event of a winding up**. Once all the creditors have been repaid the balance is then distributed among the shareholders. In cases of insolvent liquidation there is often no money left for the shareholders who therefore lose the whole amount that they invested.

Earl's shares were only **75% paid up** and therefore he has a **liability** for the **25% balance**:

$$25\% \times £5,000 = £1,250$$

He must pay this money over to the liquidator.

### (c) Debentures

Earl's debentures are secured by a **fixed charge** on the land that the factory is built on and he is therefore a **secured creditor** of the company. Should the company fail to repay the loan or any interest due, the debentureholders may appoint a receiver for the asset who will sell it to realise cash to repay them. As the company is being liquidated the asset will be sold anyway.

Earl and the other **debentureholders** will be **repaid their debentures from the sale of the land**; any balance left over will be available to repay the company's other creditors. Should the asset realise less than the total debt secured by the fixed charge then each debentureholder will receive proportionately less. The good news is that as land is such a valuable asset it is likely that Earl's loan will be repaid in full.

## 96 Directors and corporate governance

**Text reference.** Chapters 19 and 22.

**Top tips.** This question needs you to explain the concept of corporate governance. In part (b) you need to look at the different roles that the different directors have. Do not just explain what they do, however. You need to link back their duties and tasks to the concept of corporate governance.

**Easy marks.** State what is meant by (a) corporate governance and (b) auditors (definition).

### Marks

8–10	A good explanation of the meaning of corporate governance generally and the roles of the two types of directors in particular. Reference might well be made to the OECD or the Combined Code.
5–7	A sound understanding of this area, although perhaps lacking in detail.
2–4	Some understanding of the area, but lacking in detail, perhaps failing to deal with the relationship of the two groups of directors.
0–1	Little or no knowledge of the area.

### (a) Corporate governance

Corporate governance is the **system by which companies** (bodies corporate) **are directed and controlled** (governed). It is important that companies are governed well because companies are often directed and controlled by different people from those who have an interest in the company. Such interested parties are known as **stakeholders**.

Examples of **stakeholders** in a company may include:

- Shareholders (members of the company)
- Employees
- Tax authorities
- Customers
- Society
- Creditors

Each of these parties has a **stake** in the company. For example, shareholders finance the company, employees depend on the company for their livelihood, tax authorities rely on the company's returns of their profitability to assess them for their tax liabilities, customers use their products and so on.

It is therefore **important** to each of these parties that the **company is well run** and is not run into financial difficulties. The leadership of the company (**directors**) is in a position by their policies to seek to prevent such problems. Bad corporate governance can open the company up to all sorts of problems.

### (b) Executive directors

An **executive director** is a director who performs a **specific role** in a company under a **service contract** which involves a regular, possibly daily, involvement in management. A director may also be an employee (usually a member of management) of their company.

**Directors** who have additional **management duties** as employees may be distinguished by special titles such as '**finance director**'. Such titles do not affect their personal legal position.

### Non-executive directors

A **non-executive director**, on the other hand, acts only as a member of the board of directors. Their usual involvement is to attend board meetings. They are not involved in the day to day management of the company. In a public limited company, the role of the non-executive director has become more important in recent years with the increasing emphasis on, and regulation of, **good corporate governance**.

The **tasks** of the non-executive director include the following:

- To contribute an **independent** view to the board's deliberations;
- To help the board provide the company with effective **leadership**;
- To ensure the continuing **effectiveness of the executive directors and management**;
- To ensure **high standards of financial probity** on the part of the company.

Non-executive and executive directors are subject to the same statutory and fiduciary duties.

# 97 Huge plc

**Text reference.** Chapter 23.

**Top tips.** Insider dealing questions tend to encompass more than one of the offences being committed, and this is no exception. While Slye's guilt is very clear, you have to look a little harder to decide on Mate and Tim.

**Easy marks.** State what is meant by insider dealing, dealing, inside information, insider and money laundering (definitions).

## Marking scheme

### Marks

8–10	A good analysis of the scenario with a clear explanation of the law relating to the insider dealing, with detailed reference to statutory provisions.
5–7	Some understanding of the situation but perhaps lacking in detail or reference to the statutes.
0–4	Weak answer lacking in knowledge or application, with little or no reference to the statute.

### Insider dealing

The law attempts to prevent people '**in the know**' from making a profit or avoiding a loss in buying or selling shares or other securities on the back of their **inside knowledge** and at the expense of open dealings in the market. Significant inside knowledge – of a takeover, an oil strike or a massive fall in profits – will affect the share price when it becomes known, so it is not right that insiders should benefit from dealing in advance of the knowledge becoming generally known.

### Criminal Justice Act 1993

In the context of the **Criminal Justice Act 1993**, **insider dealing is dealing in securities while in possession of inside information as an insider, the securities being price-affected by the information**. An offence is also committed if an individual, in possession of information as an insider, **encourages another person to deal** in the price-affected securities, knowing or having reasonable cause to believe that dealing would take place. Finally, it is also an offence for an insider to **disclose the information to another person** otherwise than in the proper performance of the functions of their employment, office or profession.

### Slye and others

At the time of the chain of events that is described, the information that Huge plc is to make a takeover bid for Large plc is not in the **public domain** and could therefore be considered to be **inside information**, since it is **price sensitive** in respect of both Huge plc and Large plc.

Slye is a director of Huge plc and the fact that the company has decided to make the bid (as stated at its board meeting) **qualifies as inside information** since it relates to particular issuers of securities that will be **price-affected** (Huge plc and Large plc), it has not been made public and it will, once made public, have a significant effect on price. It is **specific information** on the making of the takeover bid rather than precise information.

### Slye

**Slye has inside information as an insider** as a director and employee of Huge plc. Slye knows that the information is inside information. He then buys shares in Large plc, which constitutes **dealing** because he is 'acquiring securities'. He has therefore dealt in price-affected securities while in possession of inside information as an insider, and has **committed the offence of insider dealing**.

## Mate

As an insider, in telling Mate about the takeover bid without any justification of it being by way of employment etc, Slye has committed the **further offence of disclosing the inside information**. Mate has knowingly received inside information from a person whom he knows to be an insider (Slye), so he has **become an insider** and in dealing he too has **committed the primary offence of insider dealing**.

## Tim

In advising Tim to buy shares in Large plc, Slye has committed the third possible insider dealing offence: an insider **encouraging another person to deal in price-affected securities**, knowing or having reasonable cause to believe that Tim would take his advice and do so. However, **Tim did not receive inside information** as what Slye told him was neither precise nor specific, so he has **committed no offence**.

# 98 Sid and Vic

**Text reference.** Chapter 23.

**Top tips.** There are some areas of the syllabus that you just have to learn and be able to repeat in an exam. The rules on insider dealing are one of them. Make sure you understand the three offences.

**Easy marks.** There are no easy marks unless you can remember the rules.

**Examiner's comments.** There seemed to be a general lack of detailed knowledge about the meaning of insider dealing and contents of the Criminal Justice Act 1993 and those who did have such knowledge tended not to apply it properly. There was a general misunderstanding that insider dealing was simply having 'secret' information without explaining the specific, price-sensitive, nature of that information and the need to deal in shares on the basis of that information.

## Marking scheme

This question requires candidates to consider the criminal offence of insider dealing. However, it also requires some understanding of the practical nature of the activity together with an ability to apply that knowledge to the facts contained in the problem.

- |            |  |
|------------|--|
| 8–10 marks | A thorough understanding of the legislation together with an accurate application of it to the individuals in the question is to be expected for the very highest marks. |
| 5–7 marks  | Good but limited analysis, or perhaps unbalanced in not dealing equally well with the application of the law.  |
| 3–4 marks  | Some, but limited, knowledge of what the question is about, or a recognition of what it is about but lacking in any analysis.  |
| 0–2 marks  | Little if any understanding of what the question is about.   |

### (a) Insider dealing

The **Criminal Justice Act 1993** (CJA) contains rules on **insider dealing** which is a crime. To convict it must be proved that the possessor of inside information (under s 52 CJA):

#### **Dealt in price-affected securities on a regulated market**

Dealing is acquiring or disposing of or agreeing to acquire or dispose of relevant securities whether directly or indirectly: s 55 CJA.

#### **Encouraged another to deal in price-affected securities on a regulated market**

This occurs where an individual, having information as an insider, encourages another person to deal in price-affected securities in relation to that information. They must know or have reasonable cause to believe that dealing would take place.

It is **irrelevant** whether:

- The person encouraged **realises** that the securities are price-affected securities
- The **inside information** is **given** to that person.
- Any **dealing takes place**, the offence being committed at the time of encouragement

**Disclosed the information other than in the proper performance of their employment, office or profession**

This would occur for instance where a finance director provides inside information to a friend and not as part of their professional duties.

### **Inside information**

Inside information must be likely to have a **significant effect on price** and it must be **specific or precise**.

CJA defines **inside information** as:

- Relating to **particular securities**
- Being **specific** or **precise**
- **Not made public**
- Likely to have a **significant effect** on the **price of securities**

Under s 57 a person has information as a **primary insider** if it is (*and they know* it is) inside information, and if they have it (*and know* they have) from an inside source:

- Through being a **director, employee** or **shareholder** of an issuer of securities
- Through access because of **employment, office** or **profession**

### **Defences to dealing and encouraging others to deal**

Under s 53, an individual has a **defence** if they prove that:

- They **did not expect** there to be a **profit** or **avoidance of loss**
- They had **reasonable grounds** to believe that the **information** had been **disclosed widely enough** to ensure that those taking part in the dealing would be prejudiced by having the information
- They **would have done what they did even if they did not have the information**

### **Defences to disclosure of information by an individual**

An individual has a defence to this offence if:

- They **did not expect** any person to deal
- Although dealing was expected, **profit** or **avoidance of loss** was **not expected**

### **Application to Sid**

Under s57, Sid is an **insider** by virtue of his position as **director** in Trend plc and Umber plc. The information he holds is **price-sensitive** as it concerns large profits and large losses. Therefore, it would appear that he is **liable** under s52 for **dealing in price-affected securities**. None of the **defences** would apply to him as he clearly expected to make a profit in one transaction and to avoid a loss in the other.

He also becomes liable for the offence of **encouraging another to deal in price-affected securities** when he advises his brother to buy shares in Umber plc. This is even though we are not told whether the brother actually bought the shares and that no inside information was passed. Sid's offence is merely for encouraging.

No **specific information** was passed to the brother which means he has committed no offence.

#### **(b) Vic**

Vic's position is **wholly unrelated** to Sid. He sold his shares **willingly** and it is unfortunate for him that the share price subsequently may have risen. It may be possible for the company to take action against Sid for breach of his duties as a director although this would not be open to Vic as an individual shareholder.

# 99 Wrongful trading

**Text reference.** Chapter 23.

**Top tips** You need to have a detailed knowledge of S214 IA86 to score anything approaching a pass mark.

**Easy marks.** Notice that the question is asking you for both the **meaning** and the **effect** of wrongful trading. Try to define the term in as much depth as you can, and then explain the effect, for example on directors who cause a company to engage in wrongful trading.

**Examiner's comments.** Although this was quite a popular question, it was not one that was generally done very well. It required a detailed analysis of S214 IA86, but rather than focus on that, candidates tended to introduce irrelevant material. For example many candidates concentrated on breach of directors' duties and even insider dealing. Many others cited every instance of wrongdoing and acting as director whilst disqualified.

Some of the better candidates referred to the fact that the duty directors owe to their companies has increased as a consequence of S214.

## Marking scheme

- 6-10 marks A good to full answer explaining both the provision of section 214 of the Insolvency Act and the effect of that provision. The very best answers will provide reasons for the introduction of the section.
- 0-5 marks Some knowledge of the concept behind the section but perhaps lacking in detailed knowledge of its content or its effect

## Wrongful trading

Under s.214 Insolvency Act 1986, where a company has gone into insolvent liquidation and where the liquidator can show that a director **knew, or should have known**, that there was no reasonable prospect that the company could have avoided going into insolvent liquidation, the director may be liable for **wrongful trading**.

The element of real dishonesty needed for liability for **fraudulent trading** under s.213 need not be shown. The offence of wrongful trading was introduced to make it easier for creditors to make negligent directors liable for company debts owing to the difficulties in proving the necessary fraudulent intent. The assets available for distribution in a winding up may be significantly increased by **directors' contributions** ordered under this statutory provision.

s.1157 Companies Act 2006, which provides **relief** from court in proceedings for **negligence** or **breach of duty** or **trust** to directors who acted **honestly** and **reasonably**, is not available as a defence to proceedings under s.214 (*Halls v David and Another* 1989). A director may **avoid** or **lessen liability** however, by showing that they took **all steps to minimise the potential loss** to the company's creditors after the time at which they knew or ought to have known that insolvent liquidation was inevitable.

## Objective test

An **objective test** will be applied, namely whether a **reasonably diligent person** with the **general knowledge, skill** and **experience** that might **reasonably be expected** of a **person carrying out that particular director's duties** would have concluded that the company could not avoid insolvent liquidation. A director cannot claim lack of knowledge where it results from failing to comply with Companies Acts requirements, such as preparation of accounts (*Re Produce Marketing Consortium* 1989). In addition, a director's liability can even be **increased** by applying a subjective test based on the director's particular knowledge, skill and experience.

## Effect

In the event of **liability**, the court can require a director to **contribute to the assets of the company** in an amount determined by the court. The extent of liability will be assessed in the light of all relevant circumstances of the case, but will not be low or nominal merely because there is no fraud (*Re Produce Marketing*).



A director found guilty of fraudulent or wrongful trading is **liable to disqualification** under the Company Directors Disqualification Act 1986 (CDDA). The court has a discretion to make such an order where a person is convicted of an indictable offence in connection with the promotion, formation, management or liquidation of a company or with the receivership or management of a company's property. The maximum period of disqualification is 15 years.

## 100 Push Ltd

**Text reference.** Chapter 23.

**Top tips.** Application of the rules on fraudulent and wrongful trading should not pose you any problems providing you know them. Remember intention must be proved in fraudulent trading cases. In wrongful trading cases liability will be established if it is proved that the defendant knew or should have known about the impending insolvency – directors are deemed to know or should know about the financial position of their company.

**Easy marks.** Stating the fraudulent and wrongful trading rules.

### (a) **Fraudulent trading**

If a court finds that the business of a company in liquidation has been carried on with **intent to defraud creditors** or for any fraudulent purpose it may declare that **any persons** who were knowingly parties to carrying on the business in this fashion shall be liable for the debts of the company as the court may decide: s213 Insolvency Act 1986. This is a civil penalty.

Various rules have been established to determine **what is fraudulent trading**:

- Only persons who **take the decision** to carry on the company's business in this way or play some active part are liable.
- '**Carrying on business**' can include a single transaction and also the mere payment of debts as distinct from making trading contracts.

If a liquidator considers that there has been fraudulent trading they should apply to the court for an order that those responsible are liable to make good to the company all or some of the **company's debts**.

The liquidator should also report the facts to the Crown Prosecution Service and Director of Public Prosecutions so that **criminal proceedings** may be instituted under the Companies Act. The **burden of proof** for liability for fraudulent trading is **high**, as the liquidator must **prove intention** to defraud.

#### **Owen and Norm**

In the case of Owen it is likely that he will be found liable for fraudulent trading, as he has confessed to it. Norm is unlikely to be found liable, as there is no evidence to suggest any intention to defraud on his part.

### (b) **Wrongful trading**

The problem of proving intention to defraud in cases of alleged fraudulent trading resulted in a further civil liability of '**wrongful trading**' being introduced. Like s 213, s 214 Insolvency Act 1986 applies to companies in **liquidation** but **no dishonesty or intention to defraud need be proved**.

A director will be liable for **wrongful trading** if the liquidator proves that they:

- **Knew, or should have known**, that there was **no reasonable prospect** that the **company could have avoided going into insolvent liquidation**. This means that directors cannot claim they lacked knowledge if their lack of knowledge was a result of failing to comply with Companies Act requirements: *Re Produce Marketing Consortium 1989*.
- Did not take **sufficient steps** to minimise the potential loss to creditors.

The section goes on to provide that the **directors** will be **deemed to know** that the company could not avoid insolvent liquidation if that would have been the conclusion of a **reasonably diligent person** with the **general knowledge, skill and experience** that might reasonably be expected of a person carrying out that particular director's duties (ie a reasonable occupant of a similar post). If the director has greater than usual skill then they will be judged with reference to their own capacity.



## Owen and Norm

**Owen** will be **personally liable** under s 214 for the increase in the company's debts since it is already established that he is likely to be liable for fraudulent trading which carries a higher burden of proof. **Norm** will **also be liable** since as a director of a company he should have been aware of the situation.

# 101 Money laundering

**Text reference.** Chapter 23.

**Top tips.** Make sure that you allocate your time equally to the two halves of the question, ie allow nine minutes for each. Try to be as detailed as possible in your answer, as the question is on quite a narrow area.

**Easy marks.** To earn the easy marks on both parts of this question, try to ensure that you do not duplicate your effort on the two parts. You do not need to go into any detail about the Proceeds of Crime Act in part (a) as you are specifically asked about it in part (b). You won't get extra marks in part (b) for repeating what you have already said in part (a).

**Examiner's comments.** Although this question covered a subject area that is relatively new to the syllabus, it was generally well tackled by students. A good proportion of answers contained a high level of detail particularly in relation to the offences where knowledge of the statutory sources extended to the levels of punishment. Not all students were able to name the specific processes within money laundering, but they could earn marks by describing them.

Poorer answers showed little or no knowledge of the Proceeds of Crime Act 2002 but did make an attempt to define money laundering. The weakest answers merely linked money laundering to organised crime and terrorism in a generalised manner without reference to the actual processes involved.

## Marking scheme

- 8-10 marks    Good explanation of both the meaning of the concept and offences under the Act.
- 5-7 marks    Fair explanation of the general concept but lacking in detail in relation to the Act.
- 0-4 marks    Very unbalanced answer or lacking any detail.

### (a) Money laundering

**Money laundering** is the term given to **attempts to make the proceeds of crime appear respectable**. It can refer to any process by which criminals seek to hide the source and ownership of the proceeds of criminal activities, enabling them to keep control over such proceeds and, ultimately, to provide an apparently legitimate cover for their sources of income.

The **money laundering process** aims to disguise the source of the proceeds so that the criminal can remain free from suspicion as to its source. The process usually involves three phases:

#### Placement

This is the actual disposal of the proceeds of the initial illegal activity, usually into an apparently legitimate activity.

#### Layering

This involves the transfer of money from business to business, or one geographical location to another, in order to conceal the original source.

### Integration

Having been layered, the money takes on the appearance of coming from a legitimate source and, therefore, of being legitimate funds.

Money laundering was recognised as a criminal offence in the United Kingdom under the **Drug Trafficking Offences Act 1986**. It is now regulated by the **Proceeds of Crime Act 2002**. Other relevant legislation includes certain **anti-terrorist legislation**, in particular the Terrorism Act 2000 and the Anti-Terrorism, Crime and Security Act 2001.

- (b) The **Proceeds of Crime Act 2002** identifies three categories of criminal offence: laundering, failure to report, and tipping off.

### Laundering

This involves the **acquisition, possession or use of the proceeds of criminal conduct**, or assisting another to retain the proceeds of criminal conduct, and concealing the proceeds of criminal activity. Under the Act, it is an offence to conceal, disguise, convert, transfer or remove criminal property from the United Kingdom. 'Concealing or disguising criminal property includes concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to it.'

**Criminal property** is defined as property which the alleged offender knows (or suspects) to constitute or represent benefit from any criminal conduct. It includes, by way of example, proceeds of tax evasion, any benefit obtained through bribery and corruption and benefits obtained through the operation of a criminal cartel.

The offence of **knowingly assisting** in the laundering of criminal funds is punishable by imprisonment up to a maximum of fourteen years and/or a fine.

### Failure to report

This is failure to disclose knowledge or suspicion of money laundering. Under the Act it is an offence for a person who 'knows or suspects ... that another person is engaged in money laundering, where the information or other matter on which his knowledge or suspicion is based ... came to him in the course of a business in the regulated sector' not to report the fact to the appropriate authority.

The offence only relates to **individuals**, such as accountants who are acting in the course of business. Any individual who is covered by the section is required to make disclosure to the nominated money laundering reporting officer within their organisation. Alternatively, disclosure may be made directly to the **Serious Organised Crime Agency (SOCA)**.

The offence of failure to report is punishable by imprisonment up to a maximum of five years and/or a fine.

### Tipping off

This involves **disclosing information** to any person if disclosure may prejudice an investigation into drug trafficking, drug money laundering, terrorist-related activities or laundering the proceeds of criminal conduct. It therefore covers the situation where an accountant informs a client that a report has been submitted to the SOCA.

The offence of **tipping off** is punishable by imprisonment up to a maximum of five years and/or a fine.

## 102 Greg

**Text reference.** Chapter 23.

**Top tips.** This question is a little unusual because it is a scenario question which is broken down into two parts. However, don't let this put you off from applying the ISAC approach to each.

**Easy marks.** Stating the basic points of law concerning insider dealing and money laundering.

**ACCA examiner's answers.** The ACCA examiner's answer to this question can be found at the back of this kit.

**Examiner's comments.** This question required candidates to explain the meaning and regulation of the two criminal offences of insider dealing and money laundering and apply that law to a problem scenario.

This question tended to be sufficiently well done.

The money laundering aspect of the problem was particularly well done, with candidates explaining in very full terms what was involved in the process and the details of its legal regulation. However, there was some concern as to the insider dealing part of the problem, which raised some concerns and which suggest that a full question on that area would have met with much less success. The essential problem was that candidates seemed to think that insider dealing was just using or revealing information gained from inside a company. That, of course, is completely incorrect and it is not insider dealing unless the purchase or sale of securities is involved.

### Marking scheme

This question requires candidates to explain the meaning and regulation of the two criminal offences of insider dealing and money laundering and apply that law to a problem scenario. Candidates may mention market abuse as an alternative to insider dealing in which case they should be credited for their knowledge.

- 8–10 marks Clear analysis of the problem scenario – recognition of both the criminal law issues raised and a convincing application of the legal principles to the facts.
- 6–7 marks Sound analysis of the problem – recognition of the major principles involved and a fair attempt at applying them. Perhaps sound in knowledge but lacking in analysis and application.
- 3–5 marks Unbalanced answer perhaps showing some appropriate knowledge but weak in analysis or application.
- 0–2 marks Very weak answer showing little analysis, appropriate knowledge or application.

#### (a) Insider dealing

##### Issue

The issue here is whether or not Greg's activity in arranging for Jet Plc to buy Kop Plc shares ahead of its takeover constitutes **insider dealing**.

##### The law

The **Criminal Justice Act 1993 (CJA)** contains the rules on **insider dealing** and states that it involves **dealing in securities** while in possession of **inside information as an insider**, the securities being **price-affected** by the information.

##### Dealing

According to s 55 CJA, dealing is **acquiring or disposing** of or **agreeing to acquire or dispose** of relevant securities whether **directly** or **through an agent** or nominee or a person acting according to direction.

##### Insider

Under s 57 a person has information as a **primary insider** if it is (*and they know* it is) inside information, and if they have it (*and know* they have) from an inside source:

- Through being a **director, employee or shareholder** of an issuer of securities
- Through access because of **employment, office or profession**

##### Price-affected

Inside information must, if made public, be likely to have a **significant effect on price** and it must be **specific or precise**. Specific would, for example, mean information that a takeover bid would be made for a specific company; precise information would be details of how much would be offered for shares.

## Defence

Under s 53, the individual has a **defence** regarding dealing if they prove that:

- They did **not expect** there to be a **profit** or avoidance of loss
- They had **reasonable grounds to believe** that the information had been **disclosed widely** enough to ensure that those taking part in the dealing would be prejudiced by having the information
- They would have **done** what they did **even** if they did not have the **information**, for example, where securities are sold to pay a pressing debt

## Application and conclusion

On the facts, Greg's position as a director of Huge plc makes him an insider, the takeover information is clearly inside information and by instructing Jet plc to buy Kop plc shares he was involved in dealing. Therefore he has committed the offence of insider dealing and is liable for **imprisonment** and/or a **fine**. It is unlikely that any of the three defences available to him will be acceptable to the court.

### (b) Money laundering

#### Issue

The issue here is whether or not by arranging the transfer of the profit on the sale of the Kop plc shares to Imp plc, and then to himself via a dividend transfer, Greg committed the offence of **money laundering**.

#### The law

Under the **Proceeds of Crime Act 2002**, money laundering is defined as the acquisition, possession or use of the proceeds of criminal conduct, or assisting another to retain the proceeds of criminal conduct and concealing, disguising, converting, transferring or removing criminal property. This relates to its nature, source, location, disposition, movement or ownership of the property.

For the purposes of laundering, '**criminal property**' is defined by s 3 CJA as a property which the alleged offender knows (or suspects) constitutes or represents being related to any criminal conduct. This is any conduct that constitutes or would constitute an offence in the UK.

## Application and conclusion

It has already been established that the profit on the sale of the Kop plc shares was created as a result of insider dealing – a criminal offence. Greg has sought to disguise the profit by transferring it as a consultancy fee to Imp plc and as a dividend to himself. Therefore he has also committed the offence of money laundering under the Proceeds of Crime Act 2002 and is liable for imprisonment and/or a fine.



# Mock exams



# **ACCA Fundamentals Level**

## **Paper F4**

### **Corporate and Business Law**

#### **(Eng)**

## **Mock Examination 1**

<b>Question Paper</b>	
<b>Time allowed</b>	
Reading and Planning Writing	<b>15 minutes</b> <b>3 hours</b>
<b>ALL TEN questions are compulsory and MUST be attempted</b>	
<b>During reading and planning time only the question paper may be annotated</b>	

**DO NOT OPEN THIS PAPER UNTIL YOU ARE READY TO START UNDER EXAMINATION CONDITIONS**





# All TEN questions are compulsory and MUST be attempted

## Question 1

- (a) Explain the powers of the courts in interpreting legislation, paying particular regard to the rules they use in so doing. (7 marks)
  - (b) How has the Human Rights Act 1998 affected this process? (3 marks)
- (Total = 10 marks)

## Question 2

Explain the ways in which a contractual offer can come to an end. (10 marks)

## Question 3

In relation to the law contract explain:

- (a) The doctrine of privity (3 marks)
  - (b) How the doctrine can be avoided at common law (4 marks)
  - (c) How the doctrine is avoided under statute (3 marks)
- (Total = 10 marks)

## Question 4

Explain in relation to the formation of a company what is meant by the terms:

- (a) Promoter (5 marks)
  - (b) Pre-incorporation contract (5 marks)
- (Total = 10 marks)

## Question 5

Briefly describe what an individual must prove in order to be successful in a claim for damages in the tort of negligence. Arrange your answer in the following areas:

- (a) Duty of care (3 marks)
  - (b) Breach of duty of care (2 marks)
  - (c) The chain of causality (3 marks)
  - (d) Remoteness of damage (2 marks)
- (Total = 10 marks)

## Question 6

Explain the following within the context of company general meetings:

- (a) Who has the power to call meetings? (6 marks)
  - (b) How are votes taken? (4 marks)
- (Total = 10 marks)

## Question 7

- (a) Explain what is involved in the criminal offence of insider dealing. (4 marks)
- (b) In particular explain the meaning of the following terms:
- (i) Dealing (2 marks)
  - (ii) Inside information (2 marks)
  - (iii) Insider (2 marks)
- (Total = 10 marks)

## Question 8

Fine Ltd specialises in providing software to the financial services industry. It has two offices, one in Edinburgh and the other, its main office, in London. In January 20X3, Gus was employed as a software designer attached to the Edinburgh office. However, by May 20X4, Gus was informed that he was to be transferred to the head office in London, which is more than 350 miles from his usual workplace.

Gus refused to accept the transfer on the basis that he had been employed to work in Edinburgh not London. Consequently, on 1 June 20X4 he wrote to Fine Ltd terminating his contract with them.

*Required*

Analyse the scenario from the point of view of employment law and in particular advise Gus as to:

- (a) His rights on the termination of his contract of employment with Fine Ltd (6 marks)
- (b) Any remedies which might be available to him (4 marks)
- (Total = 10 marks)

## Question 9

Hilary is the managing director of Artworks Ltd, a company which distributes and sells the work of modern artists. Chris and Martin are the other directors. Hilary owns 60% of the issued shares in the company and Chris owns 25%. Hilary is also a shareholder in Oilprojects Ltd, a company which mass produces original oil paintings.

In her capacity as managing director of Artworks Ltd Hilary ordered 10,000 paintings from Oilprojects Ltd. Oilprojects Ltd paid Hilary personal commission for the order; the shares in Oilprojects Ltd also doubled in price because of the order. Hilary sold her shares in Oilprojects Ltd and made a considerable profit.

*Required*

Advise Chris and Martin as to whether Artworks Ltd has any claim against Hilary in relation to the commission paid by Oilprojects Ltd and the profit made by Hilary on her share in Oilprojects Ltd. (10 marks)

## Question 10

Five years ago Kim, Liz and Meg formed Orb Ltd in which Kim and Liz each hold 40% of the share and Meg owns the remaining 20%. They are the only directors. The objects of Orb Ltd contained in its articles are restricted to research, production and marketing environmentally-friendly cleaning products.

In the course of a research project for Orb Ltd, Kim discovered a new highly powerful industrial cleaner, but unfortunately it was extremely toxic and not at all environmentally-friendly. She has persuaded Liz that Orb Ltd should market the new product but Meg maintains that to do so would be contrary to the restrictions stated in Orb Ltd's articles. Nonetheless Kim and Liz insist that they will use their majority power to make and market the new cleaner.

*Required*

Advise as to the rules relating to the doctrine of *ultra vires* and whether Meg can take any action against Kim and Liz for ignoring the objects of Orb Ltd. (10 marks)

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(Total = 100 marks)

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# Answers

**DO NOT TURN THIS PAGE UNTIL YOU HAVE  
COMPLETED THE MOCK EXAM**



# A plan of attack

If this were the real Corporate and Business Law exam and you had been told to turn over and begin, what would be going through your mind?

Perhaps you're having a panic. Stop that now! What you should do is spend a good five minutes looking through the paper in detail, thinking about the topics and working out the order in which to attempt the questions. So turn back to the paper and let's sort out a plan of attack.

## Looking through the paper

You have no choices in this paper and must attempt all questions. During reading and planning time you should decide the order that you will attempt them.

### The questions in this paper are as follows.

- Question 1 requires you to talk about the interpretation of legislation, with three marks on the Human Rights Act.
- Question 2 asks for an explanation of how a contractual offer ends.
- Question 3 asks for an explanation of privity of contract.
- Question 4 is on promoters and pre-incorporation contracts.
- Question 5 is a complete test of what is needed to prove a claim of negligence.
- Question 6 examines the rules on convening company meetings and conducting voting.
- Question 7 is on one of the examiner's favourite subjects: insider dealing.
- Question 8 is a short scenario based question on termination of employment.
- Question 9 is a scenario-based question on the duties of directors.
- Question 10 is a scenario-based question on restrictions on company objects and *ultra vires*.

## Tackling the paper

You can answer the questions in any order, but we would advise you to **take the first seven questions first**. This is because the questions are more straightforward than the last three scenario questions and you can build up marks quickly, by ensuring that you get the simple marks in each of the questions you undertake. Also, if you do miscalculate your time apportionment and you have done the scenario questions first, you run the risk of missing a knowledge-based question out, and consequently losing the straightforward marks in that question, in favour of marks which are harder to get in other questions.

Here are some points to note:

- It is not wise to ignore a syllabus area when revising, as you reduce your potential score by 10% for each question you cannot answer in the exam.
- If you think that there are any questions that you cannot do, look through them all carefully. Do any of the questions have parts that you think you can attempt? At least attempt the parts that you can answer.

The last three scenario questions are longer than the seven knowledge-based questions and usually require you to apply legal principles to situations. We suggest that you tackle them second when you have 'warmed up' by answering the knowledge-based questions.

A key skill is to be able to break down the larger questions into the components within them, to see where you will build up your marks.

## **Allocating your time**

BPP's advice is always allocate your time according to the marks for the question in total and for the parts of the question. That means for paper F4 that you should spend 18 minutes on each question. However, use your common sense. If you are doing a question but know you can't answer part (c), allocate those minutes to another question, where you may be able to pick up more marks.

## **Forget about it!**

And don't worry if you found the paper difficult. More than likely other candidates will too. If this were the real thing you would need to forget the exam the minute you left the exam hall and think about the next one. Or, if it is the last one, celebrate!

# Question 1

**Text reference.** Chapters 2 and 3.

**Top tips.** You should have been able to gain good marks in part (a) of this question if you have revised this area properly. Notice what the examiner says (below) about the depth of answers given. To pass this exam, you are required to demonstrate an understanding of the law and legal process, not just list the facts or rules you have read in your Study Text. This is why making reference to case law can assist your answers as cases illustrate the law in practice. This is not to say you will fail if you don't refer to cases. Just make sure you explain how the law works in practice; using cases is one way of doing that.

Part (b) may have seemed more difficult if the Human Rights Act seems daunting. You should have been able to make reference to the requirements to interpret English law in a way that is compatible with the convention. Revise this area using the suggested answer if not.

**Easy marks.** The question asks specifically for the rules of statutory interpretation, so make sure that you mention them.

**Examiner's comments.**

- (a) Although most candidates could identify the three main rules of interpretation used by the courts, there were wide differences in the level of understanding of them and the ability to do any more than merely naming them. Where candidates mentioned the other rules of and aids to interpretation, they were given credit. Most candidates appreciated the fact that although in principle Parliament is the supreme source of law, judges continue to play an important part in the interpretation of legislation to solve problems of ambiguity and uncertainty.
- (b) Not many candidates were able to demonstrate other than a basic knowledge of the Human Rights Act 1998. Very few could explain the effect that the Act has on the role of the UK courts in their capacity as interpreters of legislation.

## Marking scheme

		Marks
(a)	Explanation of interpretation	1
	Literal rule (1 for explanation; ½ for example)	1½
	Purposive rule (1 for explanation; ½ for example)	1½
	Contextual rule (1 for explanation; ½ for example)	1½
	Presumptions	1½
		<u>7</u>
(b)	Background to HRA	1
	UK interpretation to be compatible	1
	Declaration of incompatibility	1
		<u>3</u>
		<u>10</u>

### (a) Need for statutory interpretation

Although the wording of a **piece of legislation is carefully scrutinised** at all stages of its development, from its initial drafting through to the various stages of its passage through the two Houses of Parliament, **difficulties may nonetheless be encountered in its application.**

When the statute comes to be applied in the courts, there may be uncertainty over the **precise meaning** of a word or whether a particular term applies to the circumstances of the case. The applicability of legislative provisions may be uncertain when **unforeseeable or unforeseen developments** have occurred since the legislation was enacted.



It is the **role of the judiciary to apply the law made by Parliament as legislation**. The courts are therefore required to determine the meaning of such legislation. In doing so, they will apply a number of well-established rules and principles to interpret the statute.

### Rules of statutory interpretation

The following rules of statutory interpretation have been developed by the courts:

(i) **The literal rule**

The most important guide to the purpose of the statute is the wording of that statute. Under the literal rule, words are to be given their literal, or plain and ordinary, meaning and to be interpreted in the same way throughout the statute. This means that if the words used are clear, the courts must apply them even if they find the consequences distasteful. Therefore in *Whitely v Chapell 1868*, a statute made it an offence to impersonate any person entitled to vote at an election. The accused was acquitted because they impersonated a dead person (who clearly was not entitled to vote).

(ii) **The purposive rule**

The words of a statute are interpreted not only in their ordinary, literal and grammatical sense, but also bearing in mind the purpose of the legislation: what is it trying to achieve? An example is seen in *Gardiner v Sevenoaks RDC 1950* when it was held that the term 'premises' should include a cave where film was stored, as the purpose of the Act concerned was the safety of people in premises.

(iii) **The contextual rule**

Under the contextual rule, a word in a statute should be construed in its context. The court can look at the statute as a whole to ascertain the meaning of a word in it.

Increasingly it is thought that the courts should apply the law for the purpose that Parliament intended.

### Presumptions of statutory interpretation

In addition to these main rules of statutory interpretation, the courts will also apply a number of other **principles and maxims**, for example the *eiusdem generis* rule, which provides that where a statute appends general terms to a list of specific words, the general words are to be limited in their meaning to other things of the same type as the preceding specific word (*Evans v Cross*).

(b) **The Human Rights Act 1998**

The Human Rights Act 1998 incorporates the European Convention for Human Rights and Fundamental Freedoms and came into operation on 2 October 2000. The extent of the impact of the legislation will become clearer as case law develops.

The effect that this Act has on statutory interpretation is that UK courts are now required to **interpret UK law in a way compatible with the Convention so far as it is possible to do so** (s3). They must also take into account previous decisions, judgments, declarations and adverse opinions of the European Court of Human Rights.

Where a court considers that any legislative provision is incompatible with the Convention, it cannot disregard it but may make a **declaration of that incompatibility**. The provision remains valid in domestic law until amended by legislation or statutory instrument.

## Question 2

**Text reference.** Chapter 4.

**Top tips.** This is a straightforward question. Any introductory material must be kept brief. Remember to write about all the different aspects of end of offer instead of putting too much detail about one area. Refer to the marking guide: only a limited number of marks are available for each reason for termination.

**Easy marks.** Lots of marks would be available for quoting cases in this sort of question.

	Marks
Lapse within a fixed or reasonable time	1/2
Case or example	1
Rejection	1/2
Request for further information	1
Counter-offer	1
Case or example	1/2
Revocation at any time up to acceptance	1
Unless an option granted	1
Express revocation	1/2
Or via a reliable third party	1
Revocation by post	1/2
Death	1
Failure of condition	1/2
	<u>10</u>

## Offers

An **offer may be accepted** so as to form a binding contract **only for so long as it remains open**. It is therefore important to be able to identify the point at which an offer is terminated. The most **common reasons** for the termination of an offer are **lapse of the offer**, **rejection** of the offer by the offeree or **revocation** of the offer by the offeror.

## Lapse

An offer may be **expressed to remain open** (or the parties may agree that it shall remain open) for a **specified length of time**, in which case it will **terminate upon expiry of that time**. It cannot be accepted thereafter.

If no express time limit is set, it will be deemed to **expire after a reasonable time**. What is reasonable depends upon the circumstances of each individual case (*Ramsgate Hotel v Montefiore*).

## Rejection

A **clear rejection** of an offer **will terminate the offer**. A request for further information is not a clear rejection of the offer, as in *Stevenson v McLean*, where one of the parties asked if the other would accept payment by instalments.

However, an offer is terminated where a **response introduces a new term**. This is known as **counter-offer** (for example, if one party is asking for £1,000, the other saying 'I'll give you £950'). **Counter offer always terminates the original offer** (*Hyde v Wrench*).

## Revocation

The general rule regarding revocation or cancellation is that the **offeror may revoke** the offer **at any time up to acceptance** (*Payne v Cave*). However, this is not true if they have granted a separate option agreement to keep the offer open for a period of time, for which consideration has been given (*Routledge v Grant*). **Once accepted, an offer cannot be revoked**.

Revocation may be an **express statement** to that effect. It may also be an **act of the offeror** indicating that the offer is no longer in force (for example sale of the goods to a third party). Whatever form it takes, it is **essential that the revocation is communicated** to the offeree in order to be effective. Revocation of an offer may be communicated **by the offeror or by any third party who is a sufficiently reliable informant** (*Dickinson v Dodds*).

While a postal acceptance of an offer is usually effective from the time of posting, a **postal revocation of an offer does not take effect until received by the offeree** (that is, it has actually been communicated to the offeree).

Therefore, where a letter of revocation of offer crosses in the post with a letter of acceptance, a legally binding contract will have been formed from the time the letter of acceptance was posted (*Byrne v van Tienhoven*).

Where an **offer is intended to be accepted by conduct** (a unilateral contract), it has been held that the **offer cannot be revoked once the offeree has begun to perform the necessary act** required to accept the contract.

### Death

**An offer will terminate in the event of death of the offeree.** Death of the offeror normally has the same effect, although if the offeree accepts the offer in ignorance of the offeror's death and the offer is not of a personal nature, a valid contract may still result (*Bradbury v Morgan*).

### Failure of condition

In the case of a **conditional offer, if the stated condition fails or is not satisfied**, then the offer cannot be accepted (*Financings Ltd v Stimson*).

## Question 3

**Text reference.** Chapter 5.

**Top tips.** Allocate the time available in proportion to the marks available for the different parts of the question. Try not to discuss points relevant to the next part of the question in the part that you are dealing with, for example when explaining the doctrine in part (a) do not embark on a discussion of how it can be avoided.

**Easy marks.** In each part of the question clearly address the precise requirement of the question and cite cases in support as much as possible.

**Examiner's comments.** A significant number of candidates ran their answers to parts (b) and (c) on common law and statutory exceptions to the doctrine together, rather than keeping them separate. This meant that they tended to focus on common law rather than statutory exceptions and therefore did not gain the marks available for the latter. Very few candidates mentioned collateral contracts or the Contracts (Rights of Third Parties) Act 1999.

### Marking scheme

This question is divided into three parts although the marks are indicative of how candidates should allocate their time and answers will most likely be done as one.

- |            |   |
|------------|---|
| 8-10 marks | A thorough understanding of privity demonstrated by references to cases or examples.  |
| 5-7 marks  | A clear understanding of the topic perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in others. |
| 2-4 marks  | Some, but limited, understanding of the topic or clear understanding of only one aspect.  |
| 0-1 marks  | Little or no knowledge of the topic.  |

#### (a) Privity of contract

The doctrine of **privity of contract** provides that only a **party to the contract** has **enforceable rights and obligations** under it and a person who is not party to the contract cannot enforce it, even if the promises are given for their benefit.

In the leading case in this area, *Dunlop v Selfridge 1915*, Dunlop supplied tyres to a distributor, for resale, and the distributor sold them to Selfridge. The contract between Selfridge and the distributor provided for payments to Dunlop if Selfridge sold the tyres at less than a fixed price. Although Selfridge failed to observe this clause and sold the tyres at a lower price, Dunlop was unable to enforce the promise. It was held that this was part of the contract between Selfridge and the distributor, to which Dunlop was not a party.

There are some **exceptions** to the general rule of privity of contract, both at **common law** and under **statute**, where a third party may be allowed to enforce a contract:

(b) **Common law**

**Where the beneficiary may sue in some other capacity**

In *Beswick v Beswick* 1968 a widow sued for specific performance in her capacity as her husband's administratrix (rather than simply as his widow) to enforce a contract between her husband and the successor to his business. The contract provided for payment of an annuity to the widow. In her capacity as administratrix, she was able to enforce the contract for her own benefit as third party to the contract. In her personal capacity as recipient, she had no right of action.

**Where there is a collateral contract**

In *Shanklin Pier v Detel Products Ltd*, the claimant entered into a contract to have their pier repainted. The painters used a particular paint produced by the defendant as required by the claimant. The paint was unsatisfactory. The defendant fought an action by the claimant on the basis that they had only entered into a contract of supply with the painters and since the claimant was not a party to that contract they could not enforce it. The court held that there was a collateral contract between the claimant and the defendant by which the defendant guaranteed the suitability of the paint in return for the claimant requiring the painters to use it.

**Where a party validly assigns the rights contained in a contract**

A party may not assign the burden of their contractual obligations without the other party's consent.

**Where breach of contract results in loss or damage to a third party which was clearly foreseeable**

In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* 1994, a contract for works was entered into with the likelihood that the property would subsequently be transferred to a third party. Although no formal assignment was made, the House of Lords held that the original promisee should be able to claim full damages on behalf of the third party for breach of contract. The commercial nature of the contract and the circumstances which made the subsequent transfer so likely were relevant factors.

**Where equity provides that an implied trust has been created**

In *Gregory and Parker v Williams* 1817, Parker owed money to Gregory and Williams and agreed to transfer his property to Williams if Williams paid Parker's debt to Gregory. When the property was transferred, Williams refused to pay Gregory who was clearly not a party to the contract between Parker and Williams. Nonetheless, the court held that Parker could be regarded as a trustee for Gregory under an implied trust and so Gregory could bring an action jointly with Parker.

**Where there is an agency relationship**

If an agent enters into a contract with a third party apparently on their own behalf but in fact on behalf of an undisclosed principal, the agent may sue the third party (since they are treated as the other party to the contract) until such time as the principal intervenes and enforces the contract on their own behalf. Where the principal is disclosed, the contract is treated as one between the principal (and therefore enforceable by the principal) and third party even though made by the agent.

**Restrictive covenants**

Where there is a **restrictive covenant** that attaches to the land so that successors in title are bound by covenants to which they were not originally covenanters (*Tulk v Moxhay* 1848).

(c) **Statutory exceptions**

Some **statutory exceptions** to the doctrine exist, for example a road accident victim can claim from the other party's insurers (**Road Traffic Act 1972**) and the **Married Woman's Property Act 1882** allows a husband or wife to enforce life insurance taken out by the other for his or her benefit.

The principal statutory exception is contained in the **Contracts (Rights of Third Parties) Act 1999** which sets out the circumstances in which a third party can enforce a contract in the event of breach, or have it varied or rescinded. These are either (a) where the contract expressly so provides or (b) where the term confers a benefit on the third party (unless it appears that the contracting parties did not intend them to have the right to enforce it). The **third party must be identified** in the contract by name, class or description but need not be in existence when the contract is made. The Act does not confer third party rights in relation to employment contracts.

## Question 4

**Text reference.** Chapter 14.

**Top tips.** Take a minute or two to plan how you are going to tackle a question like this. The risk otherwise is that you will confuse the two parts and waste time by repeating points in both.

**Easy marks.** Try to expand your definitions as much as possible, or try to produce more than one definition, for example, for the term promoter. Easy marks will be available for cases too, so bring in as many as you can.

**Examiner's comments.** Some candidates did not use the guidance of the structure of the question and included points in part (a) which should really have been in part (b). They did not lose marks because of this, but it probably meant that they wasted time.

### Marking scheme

		Marks
(a)	Definition, eg <i>Twycross v Grant</i>	2
	Not solicitors/accountants	1
	Duty of skill and care	1
	Duty not to benefit secretly	1
		<u>5</u>
(b)	Definition/explanation	2
	Co. not bound	1
	Promoter personally liable	1
	Novation possible	1
		<u>5</u>
		<u>10</u>

### (a) Promoters

A **promoter** is 'one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose' (*Twycross v Grant*). The term promoter also includes anyone who makes any **business preparations** for the company. They will normally require the company to agree to reimburse their expenses incurred in the promotion and formation once the company has been incorporated.

A solicitor, accountant or other **professional** who acts in their professional capacity in connection with the formation of a company is not a promoter on that basis. Whether someone is a promoter is a question of fact.

#### Duties

A promoter owes a **general duty of reasonable skill and care**. Where some or all of the shares are to be allotted to persons other than the promoter, they also owe the customary fiduciary duties of an **agent**.

It follows that promoters must not put themselves in a position where their own **interests conflict** with those of the company and they **must account for any benefits** they receive through acting as promoter. They must make a **full and proper disclosure** of any **personal advantage** to existing and prospective shareholders or to an independent board of directors.

The promoter will be in **breach** of their fiduciary duty if they profit personally from a contract as promoter but not where they acquire property and then sell it to the promoted company at a **profit** (which they have disclosed).

In the event of a **breach of fiduciary duty**, the company may **rescind** the contract and **recover its money**. If rescission is not possible, the promoter must account for their **wrongful profit** and may also be **sued for damages**.

The general rule is that a promoter is **personally liable** on any completed pre-incorporation contract (see (b)) entered into with a third party.

(b) **Pre-incorporation contracts**

A **pre-incorporation contract** is a contract purported to be made by a company or its agent at a time before the company has received its certificate of incorporation. Since the company does not exist at the time the contract is made, it cannot be held liable in respect of its terms, nor can it ratify it. It may however enter into a new contract (a '**novation**') on similar terms after incorporation. Mere recognition of the pre-incorporation contract by performing it or accepting benefits under it is not sufficient to constitute a new contract.

**Promoter liability**

The promoter is liable for damages for **breach of warranty of authority** in any pre-incorporation contract where the promoter can be said to have warranted to the other party that the company (the principal) existed when in fact it did not (*Kelner v Baxter*).

Section 51 CA 2006 provides that **the person purporting to act for the company shall be personally liable on the contract subject to any agreement to the contrary**. Any agreement to the contrary must be an **express agreement** and cannot be implied. It is irrelevant whether the other party knew that the company did not exist or whether the contract is made in the company's name or in the agent's name.

The **promoter** might seek to **avoid liability** by **postponing completion** of the contract until after incorporation of the company or by providing that their liability shall cease as and when the newly incorporated company enters a new contract on identical terms.

## Question 5

**Text reference.** Chapter 8.

**Top tips.** Like many similar questions, pay close attention to the marks on offer and do not spend too long on each part. It is better to have a short description on all parts than a long description on one or two.

**Easy marks.** Stating the three tests for a duty of care from the *Caparo* case.

### Marking scheme

This question tests the candidates understanding of the stages involved in proving a liability in negligence. Parts (a to d) – one mark for each valid point up to a maximum available for question part

(a) **Duty of care**

In the landmark case of *Donoghue v Stevenson 1932* the House of Lords ruled that a person might owe a duty of care to another with whom they had no **contractual relationship** at all.

In that case the House of Lords laid down the **general principle** that every person owes a duty of care to their 'neighbour', to 'persons so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected'. If a person breaks this duty they may be liable in negligence.

Over time the principle has developed and now a claimant must prove the following for a duty of care to exist. *Caparo Industries plc v Dickman (1990)*.

- Was the harm **reasonably foreseeable**?
- Was there a **relationship of proximity** between the parties?
- Considering the circumstances, is it **fair, just and reasonable** to impose a duty of care?

(b) **Breach of duty of care**

Breach of duty of care is the second issue to be considered in a negligence claim. The **standard of reasonable care** requires that the person concerned should do what a **reasonable man** would do. If a person did not act in the manner of a reasonable man, taking into account the probability of injury and the seriousness of the risk, then they may be found to have breached their duty of care.

(c) **The chain of causality**

To satisfy the requirement that harm must be caused by another's actions, the **'But for'** test is applied. The claimant must prove that 'but for' the defendant's actions they would not have **suffered damage**. Therefore claimants are unable to claim for any harm that would have happened to them anyway irrespective of the defendant's actions.

Certain events may break the chain of causality, and therefore prevent a defendant from becoming liable. Where there are **multiple possible causes** of an injury, the claimant must prove it is most likely to be caused by the negligence of the defendant. **Acts of the defendant, claimant and natural events** may also break the chain. It is up to the claimant to prove that they do not.

(d) **Remoteness of damage**

Even where causation is proved, a negligence claim can still fail if the damage caused is 'too remote'. The test of **reasonable foresight** developed out of *The Wagon Mound (1961)*. Liability is limited to damage that a **reasonable man** could have foreseen. This does not mean the exact event must be foreseeable in detail, just that the eventual outcome is foreseeable. If the claimant cannot prove that the damage is not too remote then the claim will fail.

## Question 6

**Text reference.** Chapter 20.

**Top tips.** This is another two-part 'explain' question. Part (b) of this question is probably more tricky than part (a), particularly because it might be tempting to talk about resolutions as this is an area you were very likely to be well prepared, while you were less so about the mechanics of voting. Use the answer to this question in your revision. Remember, no matter how learned you are on your chosen specialised subject, always, always, always answer the question set. Answers which sadly do not answer the question will win no marks at all.

**Easy marks.** Good marks can be gained for relatively simple and short explanations of polls and show of hands.

### Marking scheme

			Marks
(a)	AGM called by directors	1	6
	Timing requirements	1	
	Members can call if directors fail	1	
	General meetings (1 mark for each possibility)	<u>3</u>	
(b)	Show of hands	1	4
	One person one vote	1	
	Poll	1	
	Depends on shareholdings	<u>1</u>	
			<u>10</u>



(a) **Meetings**

**Annual general meeting**

An annual general meeting ('AGM') must be called by the **directors** of **public companies** **once in each calendar year** (within **six months** of the company's **year end**). Private companies are not required by law to hold AGMs unless their constitution requires it.

**General meetings at other times**

A general meeting that is not an AGM may be called in any of the following ways:

- By the **directors** whenever they see fit. This power is usually conferred to them in the articles.
- Under s303 CA by the directors on the requisition of **members holding at least 10% of the paid up share capital carrying voting rights** or (if there is no share capital) 10% of the voting rights, in which case the meeting must be called within 28 days of the requisition being deposited. If the directors fail to call the meeting within 21 days of the members' requisition being issued, the members may themselves convene the meeting for a date within 3 months of the requisition. Where the company is **private** and no meeting has been held for **12 months** the requisite percentage is **5%**.
- By the **court**, on the application of a director or member (s306 CA). This is usually in the case of deadlock (for example where one member of two refuses to attend and so provide a quorum).
- By an **auditor** who gives a statement detailing the circumstances for their resignation or other loss of office and requires their explanation to be considered by the company (s518 CA).
- **Compulsorily**, by the directors of a public company where the **net assets fall to half or less of the amount of its called up share capital** (s656 CA).

(b) **Votes**

Unless a poll is demanded, a resolution is decided upon by a **show of hands**, where every **person** and **proxy** present has **one vote**. On a poll, each share normally carries one vote, so a member or their proxy may use as many votes as their shareholding grants them. It need not be held at the time, but can be postponed so that arrangements to hold it can be made. In either case, the number of votes cast determines the result and votes which are available but not used are disregarded.

A **poll** may be demanded by not less than **5 members** (unless the articles provide for a lesser figure) or members representing at least **10%** of the total **voting rights** or members holding shares which represent at least **10%** of the **paid up capital**. When a poll is held, any previous vote on a show of hands is disregarded and the votes cast are checked against the register of members.

## Question 7

**Text reference.** Chapter 23.

**Top tips.** Notice the way in which part (a) of the question is quite general, while part (b) requires an explanation of some specific terms. Don't duplicate your effort by going into detail in part (a) on the terms that are requested in part (b).

**Easy marks.** In part (a) expand upon your basic definitions of these terms as much as possible in order to get the full 2 marks for each.

**Examiner's comments.** Although this topic has been examined on a number of occasions in the past, the structure of the presentation seemed to throw candidates. Some answers were very good, but many less so. Some candidates were confused about the very nature of insider dealing and thought that it was related to directors' conflict of interest.



This question requiring a general explanation of the offence of Insider Dealing and in particular the terms used in regard to the offence, is divided into four parts. Marks will be allocated as indicated in the paper: four marks for part (a), and two marks for each element in part (b).

- (a) 3-4 marks Good general understanding of the area.  
1-2 marks Some but limited knowledge.
- (b) Marks will be awarded in line with thoroughness of explanation of each part.

### (a) Insider dealing

**Insider dealing** is the name given to the offence where someone buys or sells securities as a result of having received **confidential information** which affects the value of those securities. Usually they are in possession of that confidential information because of some connection they have with the company, perhaps as an employee, director or professional adviser to the company.

Clearly with such **information**, someone can profit from buying shares at a time when they know of an anticipated increase in their **market value** and from selling shares when they have foreknowledge of a decrease in the shares' market value.

The **Criminal Justice Act 1993** makes it an offence:

- To **deal in securities** while in possession of inside information as an insider, the securities being price-affected by the information (s52);
- To **encourage another to deal** in them knowing, or having reasonable cause to believe, that dealing would take place. (It is irrelevant whether the person encouraged realises that the securities are price-affected and whether any dealing actually takes place); and
- To **disclose the information** to another person other than in the proper performance of their employment, office or profession.

'**Securities**' include shares and debentures (s54).

Breach of the Act is a **criminal offence** but it will not in itself invalidate contracts which have been entered into in contravention of its provisions. On indictment, the offence carries an unlimited fine and/or imprisonment for up to seven years.

### Defences

The Act lays down a number of **general** and **special defences**. It is a general defence if the offender can show that they **did not expect there to be a profit or avoidance of loss**, or that they had **reasonable grounds** to believe that the **information had been widely disclosed**, or that they **would have done what they did even if they had not had the information** (s53). In an offence of disclosing the information, it is a defence to show that the offender did not expect any person to deal or, if dealing was expected, that no profit or avoidance of loss was expected.

- (b) (i) '**Dealing**' is defined (s55) as acquiring or disposing of or agreeing to acquire or dispose of relevant securities whether directly or through an agent or nominee or a person acting according to direction.
- (ii) '**Inside information**' is defined (s56) as 'price-sensitive information' relating to a particular issue of securities that are price-affected and not to securities generally. They are 'price-affected' if the information, being made public, would be likely to have a significant effect on price.
- (iii) '**Insider**' means (s57) a person who has information which is (and they know it to be) inside information where they have that information, knowingly, from an inside source either (i) through being a director, employee, shareholder or issuer of securities or (ii) through access because of employment, office or profession or (iii) if the direct or indirect source falls within category (i) or (ii).

## Question 8

**Text reference.** Chapter 11.

**Top tips.** Read questions like this very carefully, at least twice. Although there is not much information, it is all relevant and you need to pick it all up. Notice the split of the mark allocation, and make sure that you give the appropriate amount of time to each part.

**Easy marks.** Make sure that you do what the question asks you to do and keep your answer focused.

**Examiner's comments.** The examiner expressed surprise that some candidates did not recognise the issue of unfair dismissal in the question. In part (a) some candidates provided general essays on unfair dismissal, which was not what was required, while others wrote about redundancy, which was not relevant and earned no marks. Part (b) was generally well-answered.

### Marking scheme

The question is divided into two distinct elements; part (a) for six marks requiring an explanation of unfair dismissal and an application of the general law to the particular situation of the scenario, and part (b) carrying four marks which required an explanation of the remedies that are available for a successful claimant for unfair dismissal. Marks will be allocated as indicated in the exam paper.

- |     |           |   |
|-----|-----------|---|
| (a) | 4-6 marks | Full understanding of the concept of unfair dismissal, locating constrictive dismissal within it, together with a thorough explanation of the law relating to it. |
|     | 1-3 marks | Lacking in detail in some or all aspects of the concept of unfair dismissal or lack of application.   |
| (b) | 3-4 marks | Full understanding of the remedies for unfair dismissal.  |
|     | 1-2 marks | Lacking in detail in some or all aspects of the remedies available for unfair dismissal.  |

#### (a) Constructive dismissal

**Constructive dismissal** takes place where the **employer repudiates some vital term of the employment contract** and, despite the employer's willingness to continue the employment, the **employee resigns** because of it. No notice of termination is served on either party. In such cases, the employer is liable for breach of contract. Provided the breach is sufficiently serious, the employee may still make a claim for unfair dismissal (s136 ERA).

The employee must show that the **employer has committed a serious breach of contract**, that they left because of it and that they have not waived the breach, thereby affirming the contract. If the employee waits for too long before resigning, for example, they may be taken to have accepted the breach and waived their rights in respect of them. However, delaying for a reasonable period while they find alternative employment may be acceptable.

#### Case law

The breach must be **serious** and amount to a **repudiatory breach** (*Western Excavating (ECC) Ltd v Sharp 1978*). In this case, the employee was suspended without pay for misconduct. This caused them financial difficulties and so they applied for an advance of holiday pay. This was refused, as was a subsequent request for a loan, so they left and claimed constructive dismissal. On appeal, it was held that the employer's actions did not amount to a breach of contract.

**Unilaterally imposing a complete change in the employee's duties** (*Ford v Milthorn Toleman Ltd 1980*) or **reducing the employee's pay** (*Industrial Rubber Products v Gillon 1977*) have been held to be sufficiently serious to entitle the employee to claim breach of contract and claim for constructive dismissal. Similarly, a **failure to provide a suitable working environment** (*Waltons and Morse v Dorington 1997*) and a **failure to follow the prescribed disciplinary procedure** (*Post Office v Strange 1981*) have also been held to be sufficient grounds for a constructive dismissal.

## Gus

Applying this to the scenario given, it is suggested that, unless Gus's contract includes an **express mobility clause**, the actions of the employer could amount to constructive dismissal. Gus will therefore have grounds for an unfair dismissal claim.

### (b) Unfair dismissal remedies

Where unfair dismissal is shown, three remedies are available:

- **Reinstatement to the same job** without any break in the continuity of employment;
- **Re-engagement in a different but comparable and suitable job** with the same employer or their successor or associate;
- **Compensation.**

In considering **reinstatement** and **re-engagement**, all factors, including the employee's wishes and the practicality and overall fairness of such an award will be taken into account. An order for re-engagement will not be made where there has been a breakdown in confidence between the parties (*Wood Group Heavy Industrial Turbines Ltd v Cross an 1998*).

**Compensation** is the most usual award. This consists of a basic award, calculated on age, length of service and weekly wage. Therefore, employees aged over 40 receive 1.5 weeks pay (to a maximum £350 gross pay per week) for each year of service (to a maximum of 20 years). For employees between 22 and 40, the base figure is 1 week's pay and, for those aged under 22, 0.5 weeks pay.

There may also be a **compensatory award** for additional losses of earnings, expenses and benefits, calculated on ordinary common law principles of damages for breach of contract and up to a maximum of £66,200.

## Question 9

**Text reference.** Chapter 19.

**Top tips.** In tackling a question like this:

- **Identify** the **issues** (directors' duties)
- **State** the law (what their duties are)
- **Apply** the law (to this situation)
- **Conclude** (advise the parties)

**Easy marks.** This is a straightforward question on directors' duties with many easy marks available for stating the law in this area.

### Marking scheme

	Marks
Directors must avoid conflicts of interest	2
Directors cannot obtain personal advantage	2
Case or illustration	1
Defrauding the company	2
Case or illustration	1
Hilary can only retain profit with shareholder consent	1
Hilary must account to company	1
	<u>10</u>

## Directors' duties

Two of the main duties owed by a director to a company are to **avoid conflicts of duty** and **personal interest** and to **account to the company for any profits** or **personal advantage** obtained from their position as director without the company's consent.

### Concern for company's interests

Under s175 of the Companies Act 2006 a director must show **undivided concern** for the **company's interests**, regardless of whether or not the company is prejudiced by a conflict of interests. Conflicts are inevitable where a director has an interest in a contract with their company. For example a contract between the company and one of its directors employing that director in the management of the business. A statutory framework exists enabling directors to be interested in contracts with the company but only subject to certain safeguards (declaration to the board under s 177).

### Directors' personal advantage

The principal common law condition is that a director **cannot obtain personal advantage** from their position as director unless permitted by the company.

In *Regal Hastings v Gulliver*, the directors of one company, which owned one cinema, subscribed for shares in a new company which purchased two further cinemas since the first company had insufficient funds for the acquisition. The directors made substantial profits from the later sale of their shareholdings in the new company.

The House of Lords held that the directors were accountable to the company for their profits since they had obtained it from an **opportunity** which **came** to them as directors. The fact that the company had lost nothing since it was unable to make the acquisition itself was irrelevant. Had the company agreed by resolution passed in general meeting, the directors could have retained their profits and, in the absence of fraud, their controlling shareholdings could have been used to pass such a resolution.

### Defrauding the company

This should be compared with *Cook v Deeks* where the directors could not have ratified their own actions as members in general meeting because they had **defrauded** the **company** by appropriating the company's property. In this case, the directors, who were also controlling shareholders, negotiated a contract in the name of the company. They then took the contract for themselves and passed a resolution in general meeting declaring that the company had no interest in the contract. It was held that the contract belonged in equity to the company and the directors' purported resolution was invalid.

### Hilary's position

In the present case, Hilary, a director and majority shareholder received a commission from Oilprojects Ltd and makes a profit from the sale of her shares in that company. Both sums have come to her as a result of her directorships and **conflicts of interest** in the two companies. Consequently any profit can only be retained with the **consent** of the **company** in general meeting. In any event there is no suggestion that any such approving resolution has been passed. Hilary will be required to account to the company for the commission and profits she has received.

## Question 10

**Text reference.** Chapter 15.

**Top tips.** You must be very well-prepared to be able to earn a good proportion of 10 marks on the *ultra vires* doctrine. Ensure you are familiar with the law in this area and plan your answer carefully.

**Easy marks.** Explain S39 CA 2006 in as much detail as you can.

This question requires candidates to consider, explain and apply the *ultra vires* doctrine.

8-10 marks	Thorough to complete answers, showing a detailed understanding of the doctrine of <i>ultra vires</i> as it applies in the problem scenario.
5-7 marks	A clear understanding of the topic but perhaps lacking in detail or application.
2-4 marks	Some knowledge although perhaps not clearly expressed, or very limited in its application.
0-1 marks	Little or no knowledge of the topic.

### Company capacity

The contractual capacity of a registered company is usually **unrestricted** and it may enter into any lawful contract. However the members may resolve to restrict the activities of the company (the objects), or the articles may have included restrictions at the time the company was registered.

### Ultra vires

Any contract entered into which is affected by restrictions is in theory *ultra vires* (and void). However, given that the validity of a company's acts cannot be questioned on the grounds of it having lacked legal capacity (s.39 CA 2006), the *ultra vires* rule is of very limited effect insofar as third parties are concerned.

**Internally**, the *ultra vires* rule is still relevant. Under s171 CA 2006 the directors owe a duty to exercise their powers and use the company's assets **in accordance with the company's purposes or objects**. A member can obtain an injunction to restrain the doing of an *ultra vires* act before it is done. However, in the event that the directors are in breach of this duty, the action can be ratified by **ordinary resolution** (and their liability relieved by a separate resolution).

**Externally**, s39 CA 2006 provides that 'the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution'. Neither the company nor the third party can plead *ultra vires* to escape their obligations and under s40 as long as the third party acts in good faith they can safely assume the directors have any power that they profess to have. Therefore, the *ultra vires* rule has effectively been abolished in relations to acts done between a company and a third party **unless the third party acts in bad faith and the directors exceed their authority**. Now almost all such acts will be capable of validation at the instance of either party.

Any *ultra vires* transaction between a **company** and a **director** will be **voidable** at the instance of the company **unless ratified** or third party rights intervene or where restitution can no longer be made (s.41).

### Meg

Applying this to the scenario, it appears that the **intention** to market the new cleaner is *ultra vires*. Meg may therefore seek to restrain her colleagues from proceeding with this venture. However, under s39, any transaction with outsiders will be **binding** on the company. Internally, Meg's colleagues may well seek to unrestrict the company's objects by **special resolution** which, since they control 80% of the shares, would be successful.

# **ACCA Fundamentals Level**

## **Paper F4**

### **Corporate and Business Law**

#### **(Eng)**

## **Mock Examination 2**

<b>Question Paper</b>	
<b>Time allowed</b>	
Reading and Planning Writing	<b>15 minutes</b> <b>3 hours</b>
<b>ALL TEN questions are compulsory and MUST be attempted</b>	
<b>During reading and planning time only the question paper may be annotated</b>	

**DO NOT OPEN THIS PAPER UNTIL YOU ARE READY TO START UNDER EXAMINATION CONDITIONS**



# All TEN questions are compulsory and MUST be attempted

## Question 1

Assess the importance of delegated legislation as a source of contemporary law paying particular attention to the powers of the Courts with respect to it. (10 marks)

## Question 2

In relation to the law of contract:

- (a) Distinguish between express and implied terms (4 marks)
- (b) Explain the circumstances under which terms may be implied in contracts (6 marks)

(Total = 10 marks)

## Question 3

Explain in relation to remedies for breach of contract:

- (a) The difference between liquidated damages and penalty clauses (5 marks)
- (b) The duty to mitigate losses (5 marks)

(Total = 10 marks)

## Question 4

In relation to the dismissal of employees, explain:

- (a) The grounds on which dismissal may be fair (5 marks)
- (b) The ground on which dismissal will be automatically unfair (5 marks)

(Total = 10 marks)

## Question 5

Explain the meaning of the following terms when found at the end of the names of business organisations:

- (a) & Co (3 marks)
- (b) Ltd (3 marks)
- (c) plc (4 marks)

(Total = 10 marks)

## Question 6

Describe the effect of the following judgements on the duty of care of accountants.

- (a) *Caparo Industries plc v Dickman 1990* (5 marks)
- (b) *Morgan Crucible Co plc v Hill Samuel Bank Ltd and others 1990* (2 marks)
- (c) *ADT Ltd v BDO Binder Hamlyn 1995* (3 marks)

(Total = 10 marks)



## Question 7

In relation to company law explain:

- (a) The meaning of winding up (3 marks)
- (b) The procedures involved in
  - (i) a members' voluntary winding up (3 marks)
  - (ii) a creditors' voluntary winding up (4 marks)

(Total = 10 marks)

## Question 8

Amy always took her car to be serviced at Brakes Ltd and did so again in January. On the three previous occasions, before handing her car over to the garage, Amy had always been required to sign a contractual document which contained the following statement.

'Brakes Ltd accepts no responsibility for any consequential loss or injury sustained as a result of any work carried out by the company, whether as a result of negligence or otherwise.'

On the most recent occasion, due to the fact that the garage was very busy when she arrived, Amy was not asked to sign the usual document. She was, however, given a receipt for the car, which she accepted without reading. On the back of the form was printed Brakes Ltd's usual business terms including the above statement.

After collecting the car after its service, Amy was driving home when she suddenly lost control of the car and crashed into a tree. As a consequence, Amy was severely injured and was unable to work for three months and the car was completely destroyed. It subsequently emerged that the accident had been caused by a mechanic at Brakes Ltd who had failed to properly reconnect the car's steering mechanism. Brakes Ltd have accepted that their employee was negligent but deny any liability, relying on the exclusion clause.

*Required*

Advise Amy:

- (a) Whether the exclusion clause was incorporated into her contract with Brakes Ltd (8 marks)
- (b) Assuming it has been, whether it exempts Brakes Ltd for liability for all or any of the damage suffered as a result of the crash (2 marks)

(Total = 10 marks)

## Question 9

Mat is considering setting up a new internet café as a private limited company. He has been told that in order to register the company he should submit appropriate articles of association and memorandum of association. He has also been informed that he can borrow money from a bank but only if the company provides the bank with a fixed charge against its assets.

He also thinks that as there is an existing business called Netscape Ltd it would be a good idea to call his new company Netscope Ltd in the chance that he could transfer some of its business to his new company.

Advise Mat as the following.

- (a) The difference between the articles of association and the memorandum of association (4 marks)  
**Do not** describe the contents of the articles and memorandum.
- (b) The meaning and effect of a fixed charge (3 marks)
- (c) The meaning and effect of an action for 'passing off' (3 marks)

(Total = 10 marks)

## Question 10

Two years ago Fin inherited some money and decided to invest the money in company shares.

At that time he heard that Heave Ltd was badly in need of additional capital and that the directors had decided that the only way to raise the needed money was to offer fully paid up £1 shares to new members at a discount price of 50 pence per share. Fin thought the offer was too good to miss and he subscribed and paid for 20,000 new shares on this basis. However, Heave Ltd has since gone into insolvent liquidation, owing a considerable sum of money to its unsecured creditors.

With the remaining money of his investment Fin subscribed for 10,000 shares in Irk plc. Although they were nominally £1 shares, he was required to pay a premium of £1 for each share he subscribed for. The shares are currently trading at £2 per share.

Apart from the above shares, Fin has absolutely no other wealth.

*Required*

Advise Fin as to the following matters.

- (a) His potential liability for the debts of Heave Ltd (5 marks)
- (b) The prospect of his recovering his premium payment from Irk plc (5 marks)

**(Total = 10 marks)**

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**(Total = 100 marks)**

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# Answers

**DO NOT TURN THIS PAGE UNTIL YOU HAVE  
COMPLETED THE MOCK EXAM**



# A plan of attack

If this were the real Corporate and Business Law exam and you had been told to turn over and begin, what would be going through your mind?

Perhaps you're having a panic. Stop that now! What you should do is spend a good five minutes looking through the paper in detail, thinking about the topics and working out the order in which to attempt the questions. So turn back to the paper and let's sort out a plan of attack.

## Looking through the paper

You have no choices in this paper and must attempt all questions. During reading and planning time you should decide the order that you will attempt them.

### The questions in the Paper are as follows

- Question 1 is on delegated legislation.
- Question 2 asks for an explanation of the terms of a contract.
- Question 3 asks for an explanation of some terms relating to remedies for breach of contract.
- Question 4 is on fair and unfair dismissal.
- Question 5 asks for an explanation of terms that form parts of business names.
- Question 6 is a difficult test of case law in the area of professional negligence.
- Question 7 asks about different types of winding-up of a company.
- Question 8 is a scenario-based question examining aspects of the law relating to exclusion clauses.
- Question 9 is a scenario-based question which examines the meaning of various key terms in company law.
- Question 10 is a fairly complicated scenario-based question on share capital, the ability to recover it and the liability of shareholders for debts of a company.

## Tackling the paper

You can answer the questions in any order, but we would advise you to **take the first seven questions first**. This is because the questions are more straightforward than the last three scenario questions and you can build up marks quickly, by ensuring that you get the simple marks in each of the questions you undertake. Also, if you do miscalculate your time apportionment and you have done the scenario questions first, you run the risk of missing a knowledge-based question out, and consequently losing the straightforward marks in that question, in favour of marks which are harder to get in other questions.

Here are some points to note:

- It is not wise to ignore a syllabus area when revising, as you reduce your potential score by 10% for each question you cannot answer in the exam.
- If you think that there are any questions that you cannot do, look through them all carefully. Do any of the questions have parts that you think you can attempt? At least attempt the parts you can answer.

The last three scenario questions are longer than the seven knowledge-based questions and usually require you to apply legal principles to situations. We suggest that you tackle them second when you have 'warmed up' by answering the knowledge-based questions.

A key skill is to be able to break down the larger questions into the components within them, to see where you will build up your marks.

## **Allocating your time**

BPP's advice is always allocate your time according to the marks for the question in total and for the parts of the question. That means for paper F4 that you should spend 18 minutes on each question. However, use your common sense. If you are doing a question but know you can't answer part (c), allocate those minutes to another question, where you may be able to pick up more marks.

## **Forget about it!**

And don't worry if you found the paper difficult. More than likely other candidates will too. If this were the real thing you would need to forget the exam the minute you left the exam hall and think about the next one. Or, if it is the last one, celebrate!

# Question 1

**Text reference.** Chapter 2.

**Top tips.** It is important that you notice that the question effectively has two requirements running into each other: to consider the importance of delegated legislation and to consider how it is controlled. Don't make the mistake of simply writing all that you know about delegated legislation: try and tailor your answer to the requirements of the question. Why do the advantages of delegated legislation make it important?

**Easy marks.** In this 10 mark question you should be able to earn at least five marks by considering the advantages of delegated legislation and relating them to its importance. So, for example, it saves parliamentary time, so that parliamentary attention can be spent on other matters. Give some time to addressing the other aspect of the question, ie control. Even a brief attempt at discussing this should earn you a mark or two.

**Examiner's comments.** Most candidates were able to fulfil the first requirement, to assess the importance of delegated legislation, but many made little or no attempt to discuss the issue of control, or became irrelevant when doing so.

## Marking scheme

This question asks candidates to explain both what delegated legislation is and its importance in the contemporary legal system. It specifically requires a consideration of the way in which the courts seek to control it, but mention should also be made of Parliamentary control

6-10 marks    A thorough answer which explains the meaning of delegated legislation and how it is introduced. The perceived advantage and disadvantages should be considered and all aspects of control should be mentioned. For full marks reference should be made to the Human Rights Act 1998.

0-5 marks    A less complete answer, perhaps lacking in detail or unbalanced in that it does not deal with some aspects of the question. beneath

## Delegated legislation

The complexity of much modern legislation means that, in many instances, there is a great deal of **detail** which cannot conveniently be included in an Act of Parliament. The **time** available to Parliament is limited and the volume of legislation that is required to regulate a complex modern society is extremely high. Therefore, much modern legislation contains sections allowing for the full scope of legal rules to be completed by Parliament's delegates who are normally **ministers, government commissions or local authorities**.

The legislation is often enabling in nature, which means that it sets out the broad objectives and purpose of the Act, leaving the detail to be delegated to individuals or bodies outside Parliament. This is the means by which delegated legislation is made.

There are various **forms of delegated legislation**.

- Most often, these laws take the form of **statutory instruments**, with power having been delegated by Act of Parliament to a government minister. Different component parts of much legislation, such as employment legislation, are brought into effect by statutory instrument;
- **Bye-laws** are made by local authorities and apply within a specific locality.
- **Rules of Court** may be made by the judiciary to **control court procedure**.
- Parliament also gives powers to various **professional bodies**, such as the ACCA, in connection with the regulation by the professional body of the conduct of its members.
- **Orders in Council** contain rules which are often laid down by the Privy Council.



Delegated legislation is **important** for a number of reasons.

### **Volume of work**

Without delegated legislation, Parliament would be **overwhelmed by the volume of work**. Even now, the government of the day is frequently unable to fulfil all its proposals for new legislation within the allotted period. This enables Parliament to concentrate on the broader principles of the legislative framework, rather than getting bogged down in details.

### **Speed**

The use of delegated legislation enables new laws to be passed much more **quickly**, especially advantageous in times of **emergency**.

### **Expertise**

The subject of new legislation is often highly **detailed, technical and complex**. It makes sense, therefore, for the exact content and wording to be arrived at by consultation with professional, commercial or industrial groups outside parliament.

### **Tidier primary legislation**

It also means that the **primary legislation is less voluminous** because the details are left to other delegated legislation documentation.

### **Flexibility**

Delegation leads to greater **flexibility**, because regulations can be altered later without the need to revert to Parliament.

### **Disadvantages of delegated legislation**

There is also some **disadvantage** inherent in passing legislative powers into the hands of persons outside Parliament itself. The volume of delegated legislation means that it can become difficult for Parliament to keep track of the effect of the legislation that it has enabled. Also, although Parliament is ultimately responsible for the legislation that is in force, it is likely that much of the detail has actually been drafted and finalised by individual ministers or by **civil servants**. Since civil servants are unelected, the degree to which lawmaking powers should be delegated to them is a matter for some debate.

### **Control over delegated legislation**

It is therefore important that delegated legislation is **properly controlled** and that control is exercised by the courts and by Parliament.

### ***Ultra vires***

The **power** to make delegated legislation is conferred by the **enabling Act of Parliament** and this also defines the extent of that power. A statutory instrument may be challenged in the courts on the grounds that it is *ultra vires* – in other words that it exceeds the prescribed limits or that it has been made without due compliance with the correct procedure. The courts are often required to interpret legislation which is rarely drafted sufficiently to cover every eventuality. In this way they may be said to exercise some degree of control or influence over it.

### **Human Rights Act 1998**

The **Human Rights Act 1998** introduced an additional check on delegated legislation. In any proceedings in which a court determines whether a provision of primary legislation is compatible with a Convention right, the court may declare the provision incompatible with the Convention right. It cannot declare it invalid. However, in any proceedings in which a court determines whether a provision of delegated legislation is compatible with a Convention right, it may declare the delegated legislation to be invalid.

### **Parliament**

Control over delegated legislation is also exercised by Parliament. This is achieved by means of providing for statutory instruments to be **laid before Parliament for 40 days** before they take effect and for members to propose (within 40 days) a resolution of veto if there are objections. Alternatively, some regulations must be affirmatively approved by Parliament before they take effect. In addition, there are standing committees ('Scrutiny Committees') of both Houses of Parliament whose duty it is to examine statutory instruments with a view to raising objections if necessary (usually on the grounds that the instrument is obscure, expensive or retrospective).

## Question 2

**Text reference.** Chapter 6.

**Top tips.** The key to the difference between express and implied terms is the court's approach to them. Don't dwell too much on implied terms in part (a) as you can discuss them at length in part (b).

**Easy marks.** Try to quote as many cases as possible to maximise your marks, otherwise it is a rather narrow question, and quite difficult to find enough to say.

**Examiner's comments.** Not many candidates were able to explain the importance of the court's approach, and many just rephrased the question, adding little else. A significant minority confused representations and implied terms. Few candidates referred to case law or gave examples in part (b).

### Marking scheme

		Marks
(a)	Terms can be settled by the court	1
	Cases/examples	1
	Express terms description	1
	Implied terms description	1
		<hr/>
		4
(b)	Desire to maintain the contract	2
	<i>The Moorcock</i> (or example)	1
	'Bystander test' (or example)	1
	Terms implied by SOGA 1979	1
	Terms implied by custom	1
		<hr/>
		6
		<hr/>
		10

### (a) Contractual terms

As a general principle, the parties to a contract may include in their contract **whatever terms they choose**. The agreement reached on the terms must be **complete** in order to be legally binding and those terms must be sufficiently **clear and precise** (*Scammell v Ouston*). However, it is always possible for the parties to leave an essential term to be settled by specified means outside the contract, for example by agreeing to sell at open market value on the day of delivery or to invite an arbitrator to determine a fair price (*Hillas & Co Ltd v Arcos Ltd*). If, however, the parties defer an essential term for later negotiating (rather than specifying a means for its ascertainment), there is no binding agreement.

#### Express terms

An **express term** may be defined as any term which has been included by the parties. It may be written or oral and the court will ascertain as a question of fact whether any oral statement constitutes a term of the contract or simply a representation. However, if a contract exists and contains all necessary terms to make it an effective contract, generally speaking oral evidence will not be admitted in order to add to, vary or contradict any of the written terms.

#### Implied terms

An **implied term** is one which is deemed to form part of a contract even though not expressly stated by the parties, whether orally or in writing. Some terms are implied by the courts as necessary to give effect to the parties' presumed intentions or by statute or in accordance with relevant trade practices. Implied terms can normally be excluded or varied by the parties save where this is prevented by relevant statutory provisions.

(b) **Implying terms into contracts**

The usual reason for a court to imply a term in a contract is in order to give **business efficacy** to that contract. In such cases the term which is implied will be one which, it appears to the court, the parties inadvertently omitted or which is so obvious that it goes without saying and it can be assumed that the parties simply took it for granted that such a term would apply. The courts will be **keen to prevent the failure of an otherwise sound contract** and to implement the manifested intention of the parties (*The Moorcock*).

**Bystander test**

The test, commonly referred to as '**the bystander test**' was formulated in *Shirlaw v Southern Foundries*: 'Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if while the parties were making their bargain an officious bystander were to suggest some express provision for it in their agreement they would testily suppress him with a common 'Oh, of course' '.

The court may imply terms which it considers to be required implicitly by the nature of the contract itself. In *Liverpool City Council v Irwin*, the defendants were tenants of a maisonette in a tower block owned by the claimants with no formal tenancy agreement. The defendants withheld rent, alleging that the claimants had breached implied terms because (*inter alia*) the lifts did not work and the stairs were unlit. The court concluded that since tenants could only occupy the building with access to stairs and/or lifts, therefore terms needed to be implied on these matters, including an implied obligation on the landlord's part to keep these parts reasonably safe.

The courts have also established a number of **implied terms into employment contracts** concerning employers' and employees' duties.

**Statute law**

**Terms will be implied by statute** where that is the expressed intention of the legislation, for example under The Sale of Goods Act 1979, terms are implied as to the vendor's **title** and the **description** and **quality** of the goods in a contract for the sale of goods. In some cases, the statute provides that the implied terms cannot be overridden (there are several instances of this in SGA 1979, but in others, express provisions to the contrary will prevail).

**Custom and practice**

The parties may be considered to have entered into a contract subject to a **custom or practice of their trade**. In *Hutton v Warren*, the defendant landlord gave the claimant, a tenant farmer, notice to quit the farm. They insisted that the tenant should continue to farm the land during the period of notice. The tenant asked for 'a fair allowance' for seeds and labour from which they received no benefit (as they left before harvest time). It was held that by custom they were bound to farm the land until the end of the tenancy, but they were also entitled to a fair allowance for seeds and labour. However, any express term overrides a term which might be implied by custom (*Les Affreteurs v Walford*).

## Question 3

**Text reference.** Chapter 7.

**Top tips.** Make sure that you give the appropriate amount of time to the two halves of this question, that is nine minutes each. You cannot earn more than half marks on this question if you devote all your energies to part (a) and produce a wonderful answer but don't make a proper attempt at part (b). Try to focus on the precise requirements of the question: it is not about remedies for breach of contract generally but about specific aspects.

**Easy marks.** Explain what liquidated damages, penalty clauses and mitigation are, and try to quote a case as an illustration of each. By doing that you should earn more than half marks on the question.

**Examiner's comments.** In part (a) some candidates wrote a general essay on remedies for breach of contract rather than focusing on the precise requirements of the question. Part (b) was generally answered badly. Some candidates confused mitigation with the measurement of damages.

This question requires an explanation of two aspects of the law relating to damages for breach of contract. It is split into two parts and the marks will be awarded equally.

- |     |           |  |
|-----|-----------|--|
| (a) | 3-5 marks | A good explanation of the difference between liquidated damages and penalty clauses with perhaps some examples or cases. |
|     | 0-2 marks | Some, if little, knowledge or both elements of the question or unbalanced in only dealing with one of the elements.      |
| (b) | 3-5 marks | A thorough explanation of the duty to mitigate losses with examples or cases.  |
|     | 0-2 marks | Some, if little, knowledge of the duty but not clear or lacking in detail  |

(a) **Liquidated damages**

The parties to a contract may seek to avoid complicated calculations of loss and disputes as to damages by providing a **formula for the calculation** of such damages in the contract itself, for example a daily rate of payment in the event of late completion or late delivery of goods. A **liquidated damages clause** will be upheld by the court in the event of breach provided it is a genuine attempt to anticipate the appropriate level of damages (*Ford Motor Co (England) Ltd v Armstrong 1915*).

**Penalty clauses**

Any term which amounts to a **penalty clause** will be **void**. In determining whether the clause in question is a penalty clause or a liquidated damages provision the courts will look to see if the clause represents a **genuine pre-estimate of loss** (*Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd 1915*). If so, the clause will be upheld, even if the actual loss is greater or smaller. In the Dunlop case, the garage sold tyres at below a minimum retail price, arguing that the £5 per tyre which the manufacturer was entitled to under the contract was in fact a penalty rather than a genuine pre-estimate of loss. Although the court stated that, generally, when a fixed amount is payable for breaches of different kinds, some more serious than others in their consequences, the clause would be void as a penalty clause, it held that here the formula was a genuine attempt to agree on liquidated damages.

In *Bridge v Campbell Discount Co 1962*, a clause in a hire purchase contract required the debtor to pay on termination both arrears of payments due before termination and an amount which, together with payments made and due, amounted to two-thirds of the total hire purchase price, and to return the goods. It was held that this was a penalty clause – and therefore void. In most circumstances, the creditor would receive on termination more than 100% of the value of the goods.

(b) **Mitigation**

In the event of a breach of contract, the injured party must take reasonable steps to **mitigate their loss** or they may not receive their full losses. This means that they must take reasonable steps to put themselves in **as good a position as if the contract had been performed**. For example, where goods are not delivered the buyer must take steps to buy the same goods from elsewhere as cheaply as possible. Equally, if the seller of goods does not receive payment, they are required to obtain as good a price as possible for them elsewhere.

In *Payzu v Saunders 1919*, the buyer in a contract for delivery of goods by instalments failed to pay for the first instalment within the agreed credit period. The seller refused to make any further deliveries unless the buyer paid cash in advance on the remaining instalments. The buyer refused to accept delivery on those terms, the price of the goods rose and the buyer sued for breach of contract. It was held, first, that the seller had no right to repudiate the original contract and, secondly, that the buyer should have mitigated its loss by accepting the seller's offer of delivery against cash payment. Damages were therefore limited to the amount that the buyer would have lost if they had paid in advance, which amounted to the interest that would have been foregone over the period of any pre-payment.

The **injured party** does not have to take discreditable or risky measures to mitigate their loss (*Pilkington v Wood 1953*). In this case, which involved negligence by a solicitor in checking title of a property, the buyer of the property sued the solicitor, claiming the difference between the valuations with good and defective title respectively. The solicitor argued that the buyer should have mitigated their loss by claiming against the previous owner of the property, but it was held that the claimant was under no duty to embark upon complicated litigation which might well not have succeeded.

## Question 4

**Text reference.** Chapter 11.

**Top tips.** Try to give the appropriate amount of time (nine minutes to each part) to each of the two parts of the question, to maximise the marks that you can earn. Before you start to write take a minute to think through the grounds for both fair and unfair dismissal. Be as specific as you can in the examples that you give: vague references to bad behaviour are not sufficiently detailed.

**Easy marks.** In each of the two parts of the question try to think of five specific examples, and you should pick up a good proportion of the marks available.

**Examiner's comments.** In part (a) the weaker candidates tended to give rather vague examples of unsuitable behaviour without referring specifically to the Employment Rights Act. Candidates who could just list the statutory reasons scored full marks. In part (b) those candidates who had done well in part (a) tended to do so again, but most were not able to explain the topics in any detail.

### Marking scheme

This question requires candidates to explain the provisions of the Employment Rights Act 1996 relating to the statutory grounds covering both fair and unfair dismissal. It is divided into two parts and the marks will be allocated equally.

- |     |           |  |
|-----|-----------|--|
| (a) | 3-5 marks | A good explanation of the grounds upon which dismissal may be fair.                      |
|     | 0-2 marks | Some awareness of the area but lacking in detailed knowledge.                            |
| (b) | 3-5 marks | A thorough explanation of the grounds upon which dismissal will be automatically unfair. |
|     | 0-2 marks | Some awareness of the area but lacking detailed knowledge.                               |

### Unfair dismissal

The relevant legislation governing **unfair dismissal** is the **Employment Rights Act 1996**. Some grounds for dismissal are **potentially fair**, while others are **automatically unfair**. Even if a reason is potentially fair, the tribunal may find that the dismissal is unfair if the employer did not act in a **reasonable** manner.

#### (a) Potentially fair grounds for dismissal

To defeat a claim for unfair dismissal the employer must show that their main or sole reason for the dismissal was related to one of the following:

##### A lack of capability or qualifications

The employee lacks the necessary capacity or qualifications to perform the work of the kind which they are employed to do. The employee's competence will be judged with reference to the requirement of the contract, the work standards achieved by employees generally and by the standard achieved by the employee in question. The **Employment Rights Act 1996** states that 'capability is to be assessed by reference to skills, aptitude, health or any other physical or mental quality'. The level of incompetence must be sufficient to justify dismissal (*Lewis Shops Group Ltd v Wiggins 1973*). Qualification means 'any academic, technical or professional qualifications relevant to the position that the employee holds'.

The **employer** must have **behaved reasonably**, for example by consulting with the employee, allowing time for improvement, providing training if necessary and considering alternatives to dismissal. If the employer relies on ill-health as the grounds for incapability, there must be proper medical evidence and they are entitled to consider their own business needs (*International Sports Ltd v Thomson 1980*).

### **Misconduct**

A distinction is sometimes made between 'gross misconduct', which may justify dismissal on the first occasion (such as theft) and 'ordinary misconduct', which is usually not sufficient grounds unless it is persistent (such as rudeness to customers or persistent absence from work). Assault on a fellow employee, conduct endangering others, unpleasant behaviour towards customers and persistent absence from work have been regarded as sufficient misconduct to justify dismissal.

### **Redundancy**

This is a fair reason for dismissal as long as the employer has implemented a **redundancy procedure** in accordance with good industrial relations practice. This requires consultation and objective criteria of selection. The criteria set out in *Williams v Compair Maxam Ltd 1982* are widely accepted as laying down the required standards of behaviour (including giving warnings, offering alternative employment and consulting with any trade union).

### **Illegality**

Dismissal may be fair where **continued employment would be illegal** (for example if an in-house solicitor is barred by the Law Society or an employee who is employed as a driver is banned from driving).

### **Some other substantial reason**

A reason other than these may suffice if it is substantial, for example refusal to accept changed working practices agreed by a majority of the workforce.

#### **(b) Automatically unfair reasons for dismissal**

Some grounds put forward for dismissal will be automatically unfair, as follows.

### **Pregnancy**

Regardless of the length of service, a dismissal on grounds of **pregnancy** or a pregnancy-related illness, or any matter related to childbirth.

### **Trade Union activities**

A dismissal on the grounds of an employee's actual or proposed membership of an independent **trade union**, their taking part at an appropriate time in the activities of such a trade union, or their refusal to be a member of a trade union. However, provided *all* employees involved in a strike, lockout or other industrial action are dismissed, such dismissals may be fair.

### **Spent convictions**

An employee dismissed on the basis of a conviction which is actually **spent** under the **Rehabilitation of Offenders Act 1974**.

### **Health and Safety**

Where an employee takes steps to carry out **health and safety** related activities as requested by their employer or brings health and safety risks or dangers to the employer's attention or where they leave work reasonably believing themselves to be in danger.

### **Enforcing statutory rights**

Where an employee takes action against an employer to enforce **statutory rights and duties** and the employer dismisses them as a result.

### **Whistleblowing**

Where an employee is dismissed dismissal for '**whistleblowing**' – ie for making a protected disclosure in the public interest, according to the procedure laid down in the Public Interest Disclosure Act 1998.

## Question 5

**Text reference.** Chapter 13.

**Top tips.** This is an extremely straightforward question. A well-prepared student should score extremely well on a question like this. However, as the examiner points out (below) there is also scope to make mistakes, for example, thinking plcs are all listed companies. Of course, this is not the case. You must ensure that you have a good understanding of the basics of these legal entities. Also note the comments made below about the style of answers.

**Easy marks.** Notice the mark allocation: if there are three marks for each of (a) and (b) make sure that you make three points. Likewise, make four points for part (c).

**Examiner's comments.** This was a very popular question, answered by the vast majority of candidates, and in general it was done competently with most candidates earning a clear pass mark. The main weakness was the failure of some candidates to cite case law and statute in support of their arguments. Candidates must try to quote the relevant legal authority to substantiate the points that they make. A discursive essay style is preferable to a list of bullet points, although appropriate credit was given for the latter.

One of the main errors was to state that a public company and a listed company are effectively the same thing. Candidates should expect this type of question to feature frequently in forthcoming exams, and they provide an excellent opportunity for earning high marks.

### Marking scheme

		Marks
(a)	Identification of '& Co.'	1
	Definition of a partnership	1
	Limited liability partnerships	1
		3
(b)	Identification of private limited company	1
	Explanation of limited liability	1
	Required wording for ltd company	1
		3
(c)	Public limited company	1
	Memo must state a plc	1
	Can offer shares to the public	1
	Examples of more stringent regulations	1
		4
		<u>10</u>

#### (a) Partnership

The words '& Co' show that the business organisation is a **partnership**. A partnership is the relation which subsists between persons carrying on a business in common with a view of profit (Partnership Act 1890 s 1).

A partnership is not a separate legal entity but merely the partners as a group working in a particular relationship with each other. In a partnership, **every partner is liable without limit for the debts of the partnership**. A partnership may exist without any written agreement – though it is normal practice to have a written agreement – in fact a partnership may even arise without the persons concerned intending it to do so.

There must be at least **2 partners** and no more than 20, save where an exception applies, as in the case of professional partnerships, such as accountants and solicitors.

The **Limited Liability Partnership Act 2000** provides for limited liability partnerships which are to have separate legal personality and therefore some of the attributes of registered companies.



(b) **Private company**

'Ltd' shows that the business organisation is a limited company, and, in particular, a **private limited company** as opposed to a public limited company. The essential characteristic of a company is the distinction between the corporation and its members (*Salomon v Salomon & Co Ltd*) which means that its assets and liabilities are its own and a company can enter into and enforce contracts in its own right without members into the bargain. Following on, therefore, a company is liable for breach of contract and may have to pay damages or suffer some other remedy against it.

The significance of the word 'limited' is that the **liability of the company's members is limited to such amount as is unpaid on their shares**. Once shares are fully paid up, the owners of those shares have no further liability in respect of the debts of the company. A company will not cease to exist on a change in its membership.

(c) **Public company**

'Plc' denotes a **public limited company** which is also a separate legal entity distinct from its members, whose liability is limited to the amount outstanding on their shares. A public company must state in its constitution that it is a public company and its name must end with the words 'public limited company' or 'PLC' or 'plc' or its Welsh equivalent.

Unlike a private company, a public company can raise capital from the public. Many are listed on the Stock Exchange. Generally speaking, a public limited company is subject to more stringent accounting and other regulations than a private limited company.

## Question 6

**Text reference.** Chapter 9.

**Top tips.** If this question came up in the real exam, would you have been able to answer it? If not, do not assume any area of law is off-limits and make sure you learn these major cases.

**Easy marks.** Stating the law in each of these cases – if you had learnt them!

### Marking scheme

		Marks
This question tests the candidates' ability to recall and explain three key cases regarding professional negligence.		
(a)	Duty owed to shareholders as a whole	1
	No liability to investors or existing shareholders increasing their stakes	2
	Explanation:	
	Information prepared for specific transaction	1
	Information prepared for general circulation	<u>1</u>
		5
(b)	Higher duty of care owed for takeovers	2
(c)	Takeover situation	1
	Partner's comments	1
	'Final Hurdle'	<u>1</u>
		<u>3</u>
		<u>10</u>



(a) **Caparo Industries plc v Dickman (1990)**

This case made considerable changes to the tort of negligence as a whole, and the **negligence of professionals** in particular, and set a precedent which now forms the basis for courts when considering the liability of professional advisers.

It was decided in this case that auditors only owe a duty of care to the **shareholders as a whole**. They do not owe a duty to potential investors or those increasing their stakes.

The case centred on a takeover bid by Caparo to buy Fidelity plc. The last audited accounts showed a profit of £1.3m, but after the takeover Caparo claimed that it should have shown a £400,000 loss. It claimed that the auditors owed a duty of care to **investors and potential investors** in respect of the audit. They also should have been aware that a press release stating that profits would fall significantly had made Fidelity vulnerable to a takeover bid and that bidders might well rely upon the accounts.

The House of Lords decided that there were **two different** circumstances that may face a person giving professional advice.

Firstly, that they are preparing information in the knowledge that a particular person was **contemplating a transaction** and would rely on the information in deciding whether or not to proceed with the transaction. Secondly that they prepare a statement for **general circulation**, which could foreseeably be relied upon by persons unknown to the professional for a variety of different purposes.

It was held therefore that a public company's auditors owed no duty of care to the **public at large** who relied on the audit report in deciding to invest – and, in purchasing additional shares, an existing shareholder was in no different position to the public at large.

(b) **Morgan Crucible Co plc v Hill Samuel Bank Ltd 1990**

In this case the court held that the duty of care of accountants is **higher** when advising on takeovers than when auditing. The directors and financial advisors of the target company in a contested takeover bid were held to owe a duty of care to a known takeover bidder in respect of financial statements prepared for the purpose of contesting the bid.

(c) **ADT Ltd v BDO Binder Hamlyn 1995**

In this case, auditors were held liable for a statement made by an audit partner. A meeting was arranged between the auditors and ADT Ltd who were considering a takeover of one of the auditor's clients. This meeting was described by the judge as the **'final hurdle'** before ADT finalised its bid and the partner confirmed that they stood by the results of the audit.

The audit was found to have been carried out negligently and as a result greatly overvalued the target. ADT lost a large amount of money in the deal and sued Binder Hamlyn for damages. The judge found in ADT's favour as Binder Hamlyn **assumed responsibility** for the statement made by the audit partner and so a 'special relationship' was established.

## Question 7

**Text reference.** Chapter 21.

**Top tips.** Make sure that you allocate your time appropriately to the parts of this question. You should not be spending much more than five minutes on a 3 mark section. Notice that part (b) is asking you about the distinction between members' and creditors' voluntary winding up, so you needn't go into too much detail about them in part (a).

**Easy marks.** Part (b) asks for the procedures involved in the two forms of winding up, so go into as much detail as you can, for example on resolutions and filing requirements. There will be marks available for all of these points.

**Examiner's comments.** Although some candidates did this question really quite well, others clearly had some knowledge of winding up but not enough to be able to talk in detail about the two types requested in the question. Part (a) tended therefore to be better done than part (b). Many candidates were obviously confused between creditors' and compulsory winding up.

This question requires candidates to explain what is meant by winding up generally before going on to consider the two specific forms of winding up.

- (a) 3 marks are available for explaining what is meant by winding up generally and will be awarded pro rata with regard to clarity of understanding.
- (b) 5-7 marks Clear explanation of both members' and creditors' voluntary liquidation. The two types must be mentioned to get all 4 marks.  
2-4 marks Lacking in knowledge or clarity or unbalanced.  
0-1 marks Little if any knowledge

### (a) Winding-up

'Winding-up' refers to the process of **liquidation** of a company, leading to **dissolution**, where the life of a company is brought to an end, its debts are paid and any surplus assets distributed among its members and/or creditors. The rules governing a winding up are set out in the Insolvency Act 1986.

A company liquidation may be **compulsory** or **voluntary**, **solvent** or **insolvent** and will be governed by the relevant provisions of the Insolvency Act.

A **voluntary winding-up** (s.84 IA) is where the members in general meeting resolve to wind up the company. Whether it is a members' or creditors' voluntary winding-up will depend on whether the directors believe that the company will or will not be able to pay its debts in full. Only an ordinary resolution is required where the articles provide for liquidation on the expiry of a given period or the happening of a specified event, but more commonly a special resolution is required.

A **compulsory winding up**, by contrast, is made by the court in certain circumstances.

### (b) (i) Members' voluntary winding-up

A **members' voluntary winding-up** occurs only where all the directors, or a majority of them, make and deliver to the Registrar a **declaration of solvency**, including a statement of the company's assets and liabilities. Such a declaration must state that, having made full enquiries into the company's affairs, they believe that it will be able to pay its debts together with interest, within a specified period (up to 12 months). It is a criminal offence punishable by fine or imprisonment, for a director to make a declaration of solvency without having reasonable grounds for it.

The **liquidator** is **appointed by the members** and their task is to wind up the company's affairs, realise the assets and distribute the proceeds. A voluntary liquidation is generally quicker, simpler and less expensive than a compulsory winding-up.

Once the liquidator has wound up the company affairs and performed their duties, they call a final meeting of members and deliver their final account, following which they send a copy of the accounts to the Registrar who **dissolves the company** 3 months later, by removing the company name from the Register.

### (ii) Creditors' voluntary winding-up

Where no declaration of solvency is filed, the liquidation proceeds as a **creditors' voluntary winding up**. In this case, the directors convene a general meeting for the passing of a **special resolution** and also convene a meeting of the creditors, giving at least 7 days' notice. Although the members will appoint a liquidator at their meeting, the creditors (who normally meet 14 days later) have the final say in selecting and appointing a liquidator. They may also appoint a **liquidation committee** with five representatives from each of the members and the creditors to work in conjunction with the liquidator.

Once the **liquidator** has **wound up the company affairs** and performed their duties, they call a final meeting of members (and creditors if appropriate) and deliver their final account, following which they send a copy of the accounts to the **Registrar** who dissolves the company 3 months later, by removing the company name from the Register.

## Question 8

**Text reference.** Chapter 6.

**Top tips.** Read the question carefully at least twice. Highlight the question paper for key points or annotate the margin. Make sure that you identify the issues involved and are fully familiar with the scenario before you start your answer.

**Easy marks.** Try to have some breadth in your thought processes here. Most candidates will think quite easily of the common law rules here with regard to exclusion clauses, but don't forget the statutory rules as well. There are easy marks available for referring for example to the Unfair Contract Terms Act.

### Marking scheme

This question requires candidates to decide whether or not an exclusion clause was incorporated into a contract and whether or not it is effective.

		Marks
(a)	2 marks for explaining exclusion clauses	
	Up to 2 marks for explaining the following (cases must be quoted to gain 2 marks)	
	Proper incorporation	2
	Parties must both be aware	2
	Nature of liability	2
	Previous dealings	2
		<u>8</u>
(b)	Clauses void	1
	Clauses included if reasonable	1
		<u>2</u>
		<u>10</u>

#### (a) Exclusion clauses

An **exclusion clause**, or **exemption clause**, can be defined as 'a clause in a contract which purports to exclude liability altogether or to restrict it by limiting damages or by imposing other onerous conditions.'

As a general principle of contract law, the **courts will not usually interfere** where two parties negotiate a contract from positions of **comparable bargaining strength**. However, the law will seek to protect a weaker party, for example in the case of **standard term contracts** put forward by the party in the stronger bargaining position. The validity of exclusion clauses is governed by the common law, the **Unfair Contract Terms Act 1977** and a number of other statutory regulations.

It is first necessary to determine whether the exclusion clause that Brakes Ltd is seeking to rely on has been **properly incorporated** into the contract with Amy.

#### Incorporating exclusion clauses

The common law provides that an exclusion clause must be **properly incorporated into a contract**, or in a document which is an integral part of the contract, before it can be effective (*Chapelton v Barry UDC 1940*). Provided this is the case, a term cannot usually be disputed if the document has been signed, even if the signatory could not read the terms (*L'Estrange v Graucob 1934*). This is unless the party putting forward the document gives a misleading explanation of the term's effects (*Curtis v Chemical Cleaning Co 1951*).

### Unsigned contracts

In the case of an **unsigned contract**, then it must be shown either that the party affected actually **knew of the clause** or that the person seeking to rely on the exemption clause has taken reasonable steps to bring the existence of the clause to the attention of the other party at the time of or before the contract was made. Therefore a sign on a hotel room wall was not incorporated into the contract between hotel and client since it was not seen until after the contract was made (*Olley v Marlborough Court 1949*).

### Liability

The court will have regard to the **nature of the liability** which is being excluded when deciding whether a clause has been effectively incorporated. If the terms are particularly unusual or wide, a more prominent notice may be necessary (*Thornton v Shoe Lane Parking Ltd 1971*).

### Prior notice

**Prior notice** of the terms is not necessary, however, where the parties have had **previous consistent dealings** and the documents used previously contained similar terms they will be incorporated (even if the claimant has never read them (*Spurling v Bradshaw 1956*)).

Where there have been **previous dealings**, but **not on a consistent basis**, then the party to be bound by the term must be sufficiently aware of it at the time of making the latest contract (*Hollier v Rambler Motors 1972*).

A particularly **unusual** or **onerous term** must be highlighted if it is to be incorporated into the contract (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd 1988*).

### Amy

In this case, it is apparent that Amy has **signed contractual documents** containing the relevant exemption clause on previous visits to Brakes Ltd. However, because she did not sign a contract on this visit, Brakes Ltd is unable to rely on *Estrange v Graucob*. The company will therefore seek to rely on the existence of a previous course of dealings (and *Spurling v Bradshaw*), but will need to show that Amy was **actually aware** of the exclusion clause on this occasion.

- (b) Once incorporated into the contract, the exclusion clause may still be invalid.

The **Unfair Contract Terms Act 1977**, which applies to clauses covering business liability, divides these clauses into two types; those which are **void** and those which are **valid only as far as they are reasonable**.

**Liability for personal injury or death due to negligence may never be excluded.** An exemption for loss due to negligence in other circumstances will be valid only insofar as it is **reasonable**. Reasonableness is to be considered with reference to the parties' obligations of skill and care.

Therefore in this case, **Brakes Ltd would not be able to rely on the exclusion clause** to avoid liability for the injuries to Amy which arose from its **negligence** due to the actions of the mechanic. The company would also be most unlikely to succeed in avoiding liability for damage to Amy's car since it is reasonable to expect the garage to exercise reasonable skill and care.

## Question 9

**Text reference.** Chapters 15 and 17.

**Top tips.** Make sure that you notice the different mark allocations for each of the parts, and spend the appropriate time on each.

**Easy marks.** Make sure that you tackle all of the issues identified in the question, and cite at least one case in support of each.

This question requires candidates to explain a number of company law areas. A company's constitutional documents, fixed charges and passing off.

	Marks
(a) Four differences, 1 mark each	4
(b) 1 mark per valid point on fixed charges	3
(c) 1 mark per valid point on passing off or case	3
	<u>10</u>

### (a) Articles of Association

A company's **articles of association** deal mainly with matters affecting the **internal conduct** of the company's affairs including the issue and transfer of shares and class rights, dividends and alterations of capital structure, the convening and conduct of general meetings, the appointment, powers and proceedings of directors and company accounts.

A company may have its own full-length special articles or it may adopt **model articles under the Companies Act**. Model articles will be deemed to apply to the extent that the company does not submit its own articles in substitution.

A company's articles of association, along with any resolutions or agreements that it may make, **binds its members to the company, the company to its members and its members to each other** (s.33 CA 2006).

#### Memorandum of Association

The **memorandum** is a **document** which is signed and dated by the **subscribers** of the company. It states that the subscribers wish to **form a company** and that they undertake to **subscribe for at least one share**.

### (b) Fixed charges

A **fixed or specific charge** attaches to the relevant asset as soon as the charge is created. For example a charge over named property given as security for a loan to the owner of the property. If the company needs to dispose of the charged asset, it will either repay the secured debt out of the sale proceeds so that the charge is discharged or dispose of the asset subject to the charge. A fixed charge may be legal or equitable and over land or other company assets, from buildings and chattels to book debts. Where the assets charged are to be dealt with without reference to the chargee, usually on a regular basis (for example stock in trade), the appropriate form of charge is a floating charge. Holders of fixed charges, properly created and registered, rank in priority to subsequent claimants against the company's charged assets.

### (c) Passing off

A company cannot be **registered** with a **name** which is the **same** as that of any **existing company** which appears in the statutory index at the Companies Registry. However, a company may carry on business under a name other than its registered name.

At common law, a company can be prevented from using a name if the use of that name causes the company's goods to be **confused** with those of another company.

The court may grant an injunction in a **passing off** action brought by that other company and may also force the defendant company to **change its name** (see *Ewing v Buttercup Margarine Co Ltd 1917* where a sole trader was prevented from using the business name 'The Buttercup Dairy Co' in the north of England because of confusion with the business in the London area of Buttercup Margarine Co Ltd).

#### Matt

Mat is likely to be **liable** for an action in passing off, particularly as he has declared that his aim is to benefit from the goodwill of an existing company. He is advised not to call his new company Netscope Ltd.

## Question 10

**Text reference.** Chapter 16.

**Top tips.** Read a question like this at least twice and make certain that you have fully absorbed all of the information in it before you put pen to paper.

**Easy marks.** Set out as clearly as possible the law relating to each part of the question, for example that shares cannot be issued at a discount on their nominal value.

### Marking scheme

This question requires candidates to consider various issues relating to the issuing of shares by companies, the requirement for those shares to be paid for by shareholders and shareholders' potential liabilities for the debts of their companies. It is divided into four parts with each part being awarded 5 marks.

8-10 marks Full and thorough treatment of both parts.

6-7 marks Good treatment of both parts but perhaps lacking balance and knowledge

4-5 marks Lacking in detail in some or all parts.

0-3 marks Little knowledge of either of the parts.

#### (a) Shareholder liability

It is possible for **part of the payment for shares to be deferred** to a future date – either fixed or on demand from the directors for example – or to be payable in instalments. In such cases the shares are referred to as '**partly paid**'. In the event of the shares being transferred, the unpaid capital passes with the shares as a debt payable by the holder at the time when payment becomes due.

The legal position is set out in the Companies Act 2006. If a company contracts to **issue shares** to an allottee at a **discount**, it is unable to enforce the contract against the proposed allottee. However if the allottee does enter into the contract, they are then bound to pay the full amount due. In respect of the shares issued at a discount, they are liable to pay the full nominal value together with interest at the appropriate rate. This **prevents** a company from issuing shares at a discount to the **disadvantage** of the **company's creditors**.

It should be noted that the issue of shares at a price which is less than the **market value** (but equal to or more than the nominal value) of existing shares does not contravene the provision.

#### Fin

Applying this to the scenario, it is apparent that Fin is liable to Heave Ltd for the **unpaid element** of 50p per share. He will therefore have to pay up to a maximum of £10,000 to Heave Ltd, depending on the actual liabilities of the company.

#### (b) Share premium

A company may issue shares for a price in excess of the nominal value of those shares. The excess is called the '**share premium**' and must be credited to a share premium account. It is not necessary for the articles of association to include a power to issue shares at a premium since it is implied.

The general rule is that reduction of the **share premium account** is subject to the same restrictions as reduction of share capital. No part of the account can be distributed as dividend.

The account can be used to pay up fully paid shares under a **bonus issue** since this operation simply converts one form of fixed capital into another. It can also be used to **pay issue expenses** and **commissions** in respect of a **new share issue**.

## **Fin**

Applying the above to the present scenario, it is apparent that Lrk plc **cannot** repay in cash any amount of the share premium account to Fin or any other shareholders.

# **ACCA Fundamentals Level**

## **Paper F4**

### **Corporate and Business Law**

#### **(Eng)**

## **Mock Examination 3**

### **(December 2009)**

<b>Question Paper</b>	
<b>Time allowed</b>	
Reading and Planning Writing	<b>15 minutes</b> <b>3 hours</b>
<b>ALL TEN questions are compulsory and MUST be attempted</b>	
<b>During reading and planning time only the question paper may be annotated</b>	

**DO NOT OPEN THIS PAPER UNTIL YOU ARE READY TO START UNDER  
EXAMINATION CONDITIONS**





# All TEN questions are compulsory and MUST be attempted

## Question 1

In relation to the courts' powers to interpret legislation, explain and differentiate between:

- (a) The literal approach, including the golden rule; and (5 marks)
- (b) The purposive approach, including the mischief rule. (5 marks)

(Total = 10 marks)

## Question 2

In relation to the law of contract, explain:

- (a) The postal rule; (5 marks)
- (b) The doctrine of privity. (5 marks)

(Total = 10 marks)

## Question 3

In relation to remedies for breach of contract, explain:

- (a) The difference between liquidated damages and penalty clauses; (7 marks)
- (b) The duty to mitigate losses. (3 marks)

(Total = 10 marks)

## Question 4

In relation to the law of negligence, explain the extent of a company auditor's duty of care and to whom any such duty is owed. (10 marks)

## Question 5

In relation to company law:

- (a) Explain the meaning of limited liability. (3 marks)
- (b) Explain and distinguish between:
  - (i) Unlimited companies; (2 marks)
  - (ii) Companies limited by guarantee; (2 marks)
  - (iii) Companies limited by shares. (3 marks)

(Total = 10 marks)

## Question 6

In the context of companies in financial difficulty, distinguish between and explain the operation of:

- (a) Compulsory winding up; (4 marks)
- (b) Administration. (6 marks)

(Total = 10 marks)

## Question 7

In the context of contracts of employment, explain the common law duties imposed on:

- (a) Employers;
- (b) Employees.

**(6 marks)**

**(4 marks)**

**(Total = 10 marks)**

## Question 8

Whilst at work Andy always parked his car in a car park operated by Bash Ltd. On the entry to the car park just in front of the payment machine there is a large sign in fluorescent red paint which states:

'These premises are not staffed by our employees and may be dangerous. Clients use these facilities strictly at their own risk and Bash Ltd accept no liability whatsoever for any damage or injury sustained by either those using this facility or their vehicles or property, no matter how caused.'

Andy was aware of the sign, but had never paid much attention to it. However, one day he returned to his car to find that it had been badly damaged by a towing vehicle driven by an employee of Bash Ltd. Whilst on his way to the car park office to complain he was hit by the same towing vehicle, which was clearly being driven dangerously by one of Bash Ltd's employees. As a result, not only was his car severely damaged, but he suffered a broken leg and was off work for eight weeks.

Bash Ltd has accepted that its employee was negligent on both counts but denies any liability, relying on the exclusion clause.

*Required*

On the understanding that the clause excluding Bash Ltd's liability was incorporated into its contract with Andy, advise Andy whether there is any action he can take against Bash Ltd.

**(10 marks)**

## Question 9

Caz is a director of Dull plc, but she also carries out her own business as a wholesale supplier of specialist metals under the name of Era Ltd.

Last year Dull plc entered into a contract to buy a large consignment of metal from Era Ltd. Caz attended the board meeting that approved the contract and voted in favour of it, without revealing any link with Era Ltd.

*Required*

Analyse the situation explaining any potential liability that Caz may have in relation to the sale of the metal to Dull plc by Era Ltd.

**(10 marks)**

## Question 10

Fran, Gram and Hen registered a private limited company Ire Ltd in January 20X5 with a share capital of £300, which was equally divided between them, with each of them becoming a director of the company.

Although the company did manage to make a small profit in its first year of trading, it was never a great success and in its second year of trading it made a loss of £10,000.

At that time Fran said he thought the company should cease trading and be wound up. Gram and Hen, however, were insistent that the company would be profitable in the long-term so they agreed to carry on the business, with Fran taking less of a part in the day-to-day management of the business, although retaining his position as a company director.

In the course of the next three years Gram and Hen falsified Ire Ltd's accounts to disguise the fact that the company had continued to suffer losses, until it became obvious that they could no longer hide the company's debts and that it would have to go into insolvent liquidation, with debts of £100,000.

### *Required*

Advise Fran, Gram and Hen as to any potential liability they might face as regards:

- (a) Fraudulent trading, under both criminal and civil law; (5 marks)
- (b) Wrongful trading under s.214 of the Insolvency Act 1986. (5 marks)

**(Total = 10 marks)**

**(Total = 100 marks)**



# Answers

**DO NOT TURN THIS PAGE UNTIL YOU HAVE  
COMPLETED THE MOCK EXAM**



# A plan of attack

If this were the real Corporate and Business Law exam and you had been told to turn over and begin, what would be going through your mind?

Perhaps you're having a panic. Stop that now! What you should do is spend a good five minutes looking through the paper in detail, thinking about the topics and working out the order in which to attempt the questions. So turn back to the paper and let's sort out a plan of attack.

## Looking through the paper

You have no choices in this paper and must attempt all questions. During reading and planning time you should decide the order that you will attempt them.

### The questions in this paper are as follows.

- Question 1 requires an explanation of some rules of statutory interpretation.
- Question 2 requires an explanation of two important rules of contract law.
- Question 3 is a straightforward question on damages.
- Question 4 is a highly relevant question to accountants and auditors that of their duty of care.
- Question 5 requires an explanation of limited liability and some types of companies.
- Question 6 simply asks for you to distinguish between compulsory winding up and administration. This should be very straightforward.
- Question 7 requires an explanation of the duties of employers and employees.
- Question 8 is a scenario-based question on exclusion clauses.
- Question 9 is a very short scenario-based question on directors' liability.
- Question 10 is a scenario-based question on fraudulent and wrongful trading.

## Tackling the paper

You can answer the questions in any order, but we would advise you to **take the first seven questions first**. This is because the questions are more straightforward than the last three scenario questions and you can build up marks quickly, by ensuring that you get the simple marks in each of the questions you undertake. Also, if you do miscalculate your time apportionment and you have done the scenario questions first, you run the risk of missing a knowledge-based question out, and consequently losing the straightforward marks in that question, in favour of marks which are harder to get in other questions.

Here are some points to note:

- It is not wise to ignore a syllabus area when revising, as you reduce your potential score by 10% for each question you cannot answer in the exam.
- If you think that there are any questions that you cannot do, look through them all carefully. Do any of the questions have parts that you think you can attempt? At least attempt the parts that you can answer.

The last three scenario questions are longer than the seven knowledge-based questions and usually require you to apply legal principles to situations. We suggest that you tackle them second when you have 'warmed up' by answering the knowledge-based questions.

A key skill is to be able to break down the larger questions into the components within them, to see where you will build up your marks.



## **Allocating your time**

BPP's advice is always allocate your time according to the marks for the question in total and for the parts of the question. That means for paper F4 that you should spend 18 minutes on each question. However, use your common sense. If you are doing a question but know you can't answer part (c), allocate those minutes to another question, where you may be able to pick up more marks.

## **Forget about it!**

And don't worry if you found the paper difficult. More than likely other candidates will too. If this were the real thing you would need to forget the exam the minute you left the exam hall and think about the next one. Or, if it is the last one, celebrate!

# Question 1

**Text reference.** Chapter 2.

**Top tips.** You should have been able to gain good marks in both parts of this question if you revised this area properly. To pass this exam, you are required to demonstrate an understanding of the law and legal process, not just list the facts or rules you have read in your Study Text. To do this, it is often worth including a general introductory paragraph or two to explain the background of your answer, before going into the detail later on.

**Easy marks.** This question tests specific rules of statutory interpretation, so make sure that you are certain in your understanding of them, then be clear and concise in your explanation of them and their differences.

## Marking scheme

This question requires candidates to consider the powers of judges to interpret legislation and the rules they apply in exercising such interpretative powers. Although the question requires answers to focus on the two main general approaches, it also requires an explanation of the various traditional rules of statutory interpretation employed by the courts.

- (a) Requires a consideration of the literal approach, including the golden rule.
- |           |   |
|-----------|---|
| 3–5 marks | Full detailed explanation with supporting cases or examples.              |
| 1–2 marks | Limited knowledge of the topic; perhaps lacking detail or cases/examples. |
| 0 mark    | No knowledge on the topic under consideration.                            |
- (b) Requires a consideration of the purposive approach, including the mischief rule.
- |           |   |
|-----------|---|
| 3–5 marks | Full detailed explanation with supporting cases or examples.              |
| 1–2 marks | Limited knowledge of the topic; perhaps lacking detail or cases/examples. |
| 0 mark    | No knowledge on the topic under consideration.                            |

Candidates may simply produce a global answer considering the traditional rules and will be marked according to the content provided.

## Statutory interpretation

Although the working of a **piece of legislation is carefully scrutinised** at all stages of its development, from its initial drafting through to the various stages of its passage through the two Houses of Parliament, **difficulties may nonetheless be encountered in its application**.

When the statute comes to be applied in the courts, there may be uncertainty over the **precise meaning** of a word or whether a particular term applied to the circumstances of the case. The applicability of legislative provisions may be uncertain when **unforeseeable or unforeseen developments** have occurred since the legislation was enacted.

It is the **role of the judiciary to apply the law made by Parliament as legislation**. The courts are therefore required to determine the meaning of such legislation. In doing so, they will apply a number of well-established rules and principles to interpret the statute.

## Rules of statutory interpretation

The following rules of statutory interpretation have been developed by the courts:

### (a) The literal and golden rule

The most important guide to the application of the statute is the wording of that statute. Under the **literal rule**, words are to be given their literal, or plain and ordinary meaning. This means that if the words used are clear, the courts must apply them even if they find the consequences distasteful. Therefore in *Whitely v Chapell 1868*, a statute made it an offence to impersonate any person entitled to vote at an election. The accused was acquitted because they impersonated a dead person (who clearly was not entitled to vote).

The literal rule is extended by the **golden rule** which states that words should be given meaning under the literal rule unless this would lead to manifest absurdity or inconsistency with the rest of the statute. Therefore the golden rule can be distinguished from the literal rule as it adds a degree of 'common sense' to the interpretation of the statute.

(b) **The purposive approach and the mischief rule**

Under the **purposive approach**, the words of a statute are interpreted not only in their ordinary, literal and grammatical sense, but also bearing in mind the purpose of the legislation, ie what is it trying to achieve? An example is seen in *Gardiner v Sevenoaks RDC 1950* when it was held that the term 'premises' should include a cave where film was stored, as the purpose of the Act concerned was the safety of people in premises.

The **mischief rule** takes a similar approach to interpretation. By applying this rule, a judge will consider what mischief the Act was trying to prevent and in that regard it is designed to remedy a weakness in the legislation by ensuring the correct interpretation is the one which achieves its aims.

## Question 2

**Text reference.** Chapters 4 and 5.

**Top tips.** Each part of this question is worth five marks, which means that you can only spend nine minutes on them. Don't give in to the temptation to over-run on part (a) and therefore not leave yourself enough time to do justice to part (b), which is equally straightforward. The examiner will not allow you to score over the mark allocation on one part of a question even if you devote all your time to it and produce a brilliant answer.

Your answer to part (b) could have also validly mentioned trustees, statutory exceptions, agency and covenants as exceptions to privity rules.

**Easy marks.** Get the easy marks by stating what the postal rule and privity of contract are, and if possible citing a case or quoting an illustration in support.

### Marking scheme

This question is divided into two parts relating to distinct aspects of the law of contract.

- |     |           |   |
|-----|-----------|---|
| (a) | 4–5 marks | A good to excellent understanding of the postal rule demonstrated by references to cases or examples. |
|     | 2–3 marks | Some, but limited, understanding of the topic, or clear understanding of only one aspect.             |
|     | 0–1 mark  | Little or no knowledge of the topic.  |
| (b) | 4–5 marks | A good to excellent understanding of privity demonstrated by references to cases or examples.         |
|     | 2–3 marks | Some, but limited, understanding of the topic, or clear understanding of only one aspect.             |
|     | 0–1 mark  | Little or no knowledge of the topic.  |

(a) **The postal rule**

The postal rule in contract law covers situations when the use of the post was in the contemplation of both parties and one or either of the parties uses the post to communicate with the other. It is necessary because it covers problems caused by delays in the postal system or if mail is lost altogether.

It applies where one party accepts an offer, or where the offeror decides to revoke their offer.

## Acceptance

Communication of acceptance by post is subject to the rule established in *Adams v Lindsell 1818*. This provides that where the use of the post is in the contemplation of both parties and the acceptance is correctly addressed and stamped and is actually put in the post, then acceptance will be valid and effective once posted and it is irrelevant whether the offeror actually receives the letter.

There is no need for the offer to specifically state that acceptance must be communicated by post – whether this was in the contemplation of the parties may be deduced from the circumstances. For example if the offer was itself made by post (*Household Fire and Carriage Accident Insurance Co v Grant 1879*).

Clearly if it was evident that the parties did not intend the postal rule to apply then the rule will be excluded (*Holwell Securities v Hughes 1974*).

## Revocation

While a postal acceptance of an offer is usually effective from the time of posting, a postal revocation of an offer does not take effect until received by the offeree (ie communicated to the offeree). Therefore, where a letter of revocation crosses in the post with a letter of acceptance, a legally binding contract will have been formed from the time the letter of acceptance was posted (*Bryne v van Tienhoven 1880*).

### (b) Privity of contract

The term '**privity of contract**' is a general rule which means that only a person who is a party to a contract has enforceable rights or obligations under it. **Third parties** generally have no right to sue on a contract: *Dunlop v Selfridge 1915*. If a party to a contract imposes a condition for the benefit of a third party or obtains a promise of a benefit for a third party, then that party (not the third party) can usually enforce it. However damages cannot be recovered on the third party's behalf, since a claimant can only recover damages for a loss they have suffered.

## Exceptions

There are some **exceptions** to the rule that third parties cannot enforce a contract.

### Where the contract has been validly assigned to the third party

Benefit from a contract can be re-assigned from the original beneficiary to a third party if the assignment is in writing, if it transfers the same to the new beneficiary and if it has the consent of the other party.

### Where they sue in another capacity

In *Beswick v Beswick 1968* a widow was able to sue in her capacity as administrator of her late husband's estate rather than purely as his wife.

### Where the contract is a collateral contract

In *Shanklin Pier v Detal Products Ltd 1951* the owners of a pier were able to sue the suppliers of paint used by contractors to paint the pier. The paint supplier confirmed to the contractor that the paint was suitable for the job but this did not turn out to be true. The pier owners were able to sue the paint suppliers, even though they were not party to the contract for the sale of the paint, as they were party to the collateral contract between them and the contractors responsible for painting the pier.

### Where there is foreseeable loss to a third party

In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd 1994* a third party was in the contemplation of both parties at the time the contract was made. As it was reasonably foreseeable that the third party may suffer a loss as a result of breach of contract the claimants successfully sued contractors for poor workmanship on behalf of the third party.

## Question 3

**Text reference.** Chapter 7.

**Top tips.** Note the unequal mark scheme and make sure that you give the appropriate amount of time to the two halves of this question. You cannot earn good marks if you devote all your energies to part (b) but don't make a proper attempt at part (a).

**Easy marks.** Explain what liquidated damages, penalty clauses and mitigation are, and try to quote a case as an illustration of each. By doing that you should earn more than half marks on the question.

### Marking scheme

This question requires an explanation of two aspects the law relating to damages for breach of contract. It is split into two parts with 7 marks being available for part (a) and 3 marks for part (b).

- |     |           |  |
|-----|-----------|--|
| (a) | 5–7 marks | A good explanation of the difference between liquidated damages and penalty clauses with perhaps some examples or cases. |
|     | 3–4 marks | Some, but limited, understanding of the topic, or clear understanding of only one aspect.                                |
|     | 0–2 marks | Little knowledge of either element of the question or unbalanced in only dealing with one of the elements.               |
| (b) | 2–3 marks | A thorough explanation of the duty to mitigate losses with examples or cases.  |
|     | 0–1 mark  | Some, if little, knowledge of the duty but not clear or lacking in detail.   |

#### (a) Liquidated damages

**Liquidated damages** are a fixed or ascertainable sum agreed by the parties which is payable in the event of a breach of contract.

The parties to a contract may seek to avoid complicated calculations of loss and disputes as to damages by providing a **formula for the calculation** of such damages in the contract itself, for example a daily rate of payment in the event of late completion or late delivery of goods. A **liquidated damages clause** will be upheld by the court in the event of breach provided it is a genuine attempt to anticipate the appropriate level of damages (*Ford Motor Co (England) Ltd v Armstrong 1915*).

#### Penalty clauses

A **Penalty clause** is a sum payable in the event of a breach of contract to deter the breach occurring.

Any term which amounts to a **penalty clause** will be **void**. In determining whether the clause in question is a penalty clause or a liquidated damages provision the courts will look to see if the clause represents a **genuine pre-estimate of loss** (*Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd 1915*). If so, the clause will be upheld, even if the actual loss is greater or smaller. In the Dunlop case, the garage sold tyres at below a minimum retail price, arguing that the £5 per tyre which the manufacturer was entitled to under the contract was in fact a penalty rather than a genuine pre-estimate of loss. Although the court stated that, generally, when a fixed amount is payable for breaches of different kinds, some more serious than others in their consequences, the clause would be void as a penalty clause, it held that here the formula was a genuine attempt to agree on liquidated damages.

In *Bridge v Campbell Discount Co 1962*, a clause in a hire purchase contract required the debtor to pay on termination both arrears of payments due before termination and an amount which, together with payments made and due, amounted to two-thirds of the total hire purchase price, and to return the goods. It was held that this was a penalty clause – and therefore void. In most circumstances, the creditor would receive on termination more than 100% of the value of the goods.

### The difference

Under the common law, an injured party should not benefit from claiming damages – the award should cover their **actual losses**. Liquidated damages attempt to achieve this by setting out in advance what a party's losses will be in given circumstances and are therefore acceptable under common law. Penalty clauses on the other hand are designed to **penalise** one party, and by definition the other party will benefit. This is why they are not enforceable.

#### (b) Mitigation

In the event of a breach of contract, the injured party must take reasonable steps to **mitigate their loss** or they may not receive their full losses. This means that they must take reasonable steps to put themselves in **as good a position as if the contract had been performed**. For example, where goods are not delivered the buyer must take steps to buy the same goods from elsewhere as cheaply as possible. Equally, if the seller of goods does not receive payment, they are required to obtain as good a price as possible for them elsewhere.

In *Payzu v Sanders 1919*, the buyer in a contract for delivery of goods by instalments failed to pay for the first instalment within the agreed credit period. The seller refused to make any further deliveries unless the buyer paid cash in advance on the remaining instalments. The buyer refused to accept delivery on those terms, the price of the goods rose and the buyer sued for breach of contract. It was held, first, that the seller had no right to repudiate the original contract and, secondly, that the buyer should have mitigated its loss by accepting the seller's offer of delivery against cash payment. Damages were therefore limited to the amount that the buyer would have lost if they had paid in advance, which amounted to the interest that would have been foregone over the period of any pre-payment.

The **injured party** does not have to take discreditable or risky measures to mitigate their loss (*Pilkington v Wood 1953*). In this case, which involved negligence by a solicitor in checking title of a property, the buyer of the property sued the solicitor, claiming the difference between the valuations with good and defective title respectively. The solicitor argued that the buyer should have mitigated their loss by claiming against the previous owner of the property, but it was held that the claimant was under no duty to embark upon complicated litigation which might well not have succeeded.

## Question 4

**Text reference.** Chapters 8 and 9 .

**Top tips.** It is advisable to begin your answer with a brief explanation of duty of care generally before leaping into an explanation of the cases that are relevant to auditors.

**Easy marks.** Stating the basic rules of duty of care and the *Caparo* case. Use other cases to illustrate the other rules relating to auditors.

### Marking scheme

This question requires candidates to explain the extent of a company auditor's duty of care and to whom such a duty is owed.

8–10 marks	A thorough understanding of how professional negligence applies to auditors demonstrated by references to cases or examples.
5–7 marks	A clear understanding of the topic, perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in the others.
2–4 marks	Some, but limited, understanding of the topic, or clear understanding of only one aspect.
0–1 mark	Little or no knowledge of the topic.

## Duty of care

The concept of duty of care is central to the tort of **negligence**. To succeed in a claim the claimant must prove that:

- The defendant had a **duty of care** to avoid causing injury, damage or loss
- There was a **breach** of that duty by the defendant
- In consequence the claimant **suffered** injury, damage or loss

In the landmark case of *Donoghue v Stevenson 1932*, the House of Lords ruled that a person might owe a duty of care to another with whom they had **no** contractual relationship at all. It stated that **every person** owes a duty of care to his 'neighbour', to 'persons so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected'.

## Duty of care and auditors

The first hurdle that a claimant must overcome when attempting to prove that an auditor is liable to them for negligence is that the auditor owed them a **duty of care**. The courts generally decide whether a duty is owed on a case by case basis, with each new case setting a precedent based on its own particular facts.

The starting point for an auditor's duty of care is the **common law position** for negligence in general. This states that the actions of persons who hold themselves out to possess a particular skill shall be judged against another reasonable person who possesses the same skill. Professions (such as auditors) can set their own standards that their members should meet.

Over the years there has been much case law concerning **auditors**. Most of it has concerned whether or not an auditor should owe a duty of care to a person that they do not know, especially if they had no idea of the purpose that person would use, say, their audit report for.

The following cases are important in determining the duty of care owed by an auditor.

### Caparo Industries plc v Dickman (1990)

This case made considerable changes to the tort of negligence as a whole, and the **negligence of professionals** in particular, and set a precedent which now forms the basis for courts when considering the liability of professional advisers.

It was decided in this case that auditors only owe a duty of care to the **shareholders as a body** to allow them to exercise proper control over the management of the company. They do not owe a duty to potential investors or those increasing their stakes.

The case centred on a takeover bid by Caparo to buy Fidelity plc. The last audited accounts showed a profit of £1.3m, but after the takeover Caparo claimed that it should have shown a £400,000 loss. It claimed that Fidelity plc's auditors owed a duty of care to **investors and potential investors** in respect of the audit. They also should have been aware that a press release stating that profits would fall significantly had made Fidelity vulnerable to a takeover bid and that bidders might well rely upon the accounts.

The House of Lords decided that there were **two different** circumstances that may face a person giving professional advice.

Firstly, that they are preparing information in the knowledge that a particular person was **contemplating a transaction** and would rely on the information in deciding whether or not to proceed with the transaction. Secondly, that they prepare a statement for **general circulation**, which could foreseeably be relied upon by persons unknown to the professional for a variety of different purposes.

It was held therefore that a public company's auditors owed no duty of care to the **public at large** who relied on the audit report in deciding to invest – and, in purchasing additional shares, an existing shareholder was in no different position to the public at large.

### Morgan Crucible Co plc v Hill Samuel Bank Ltd 1990

In this case the court held that the duty of care of accountants is **higher** when advising on takeovers than when auditing. The directors and financial advisors of the target company in a contested takeover bid were held to owe a duty of care to a known takeover bidder in respect of financial statements prepared for the purpose of contesting the bid.

## ADT Ltd v BDO Binder Hamlyn 1995

In this case, auditors were held liable for a statement made by an audit partner. A meeting was arranged between the auditors and ADT Ltd who were considering a takeover of one of the auditor's clients. This meeting was described by the judge as the '**final hurdle**' before ADT finalised its bid and the partner confirmed that they stood by the results of the audit.

The audit was found to have carried out negligently and as a result greatly overvalued the target. ADT lost a large amount of money in the deal and sued Binder Hamlyn for damages. The judge found in ADT's favour as Binder Hamlyn **assumed responsibility** for the statement made by the audit partner and so a 'special relationship' was established.

## Question 5

**Text reference.** Chapter 13.

**Top tips.** At first sight this looks like a gift of a question, but do make sure that you write sufficient worthwhile points about each type of company to maximise your mark.

**Easy marks.** Explaining how member liability is different in each type of company.

### Marking scheme

This question is likely to be answered in a global way and marks will be awarded inline with points made.

- (a) Up to 3 marks for a general explanation of limited liability.
- (b)
  - (i) Up to 2 marks for an explanation of unlimited liability and why it might be used.
  - (ii) Up to 2 marks for knowledge of companies limited by guarantee. What they are, where they are used and the nature of liability.
  - (iii) Up to 3 marks for a thorough explanation of liability limited by reference to the amount unpaid on shares and how it operates.

#### (a) **Limited liability**

The **Companies Act** provides that an incorporated company may have either (a) no limit to the members' liability ('an **unlimited company**'), (b) the liability of its members limited to the amount unpaid on the shares respectively held by them ('a **company limited by shares**'), or (c) the members' liability limited to such amount as the members undertake to contribute to the assets in the event of a winding up ('a **company limited by guarantee**').

#### (b) (i) **Unlimited companies**

An **unlimited company's** constitution makes no reference to members' liability as there is **no limit to their liability**. In the event of a liquidation, all members can be required to contribute as much as necessary in order to pay the company's debts in full. An unlimited company has the advantages of not being required to file copies of its annual accounts and reports (save in certain cases) and it may purchase its shares from its own members without following any formal processes.

#### (ii) **Companies limited by guarantee**

In a **company limited by guarantee**, each shareholder is liable to contribute to the company the amount specified in the **company's constitution** in the event of the company going into liquidation but not before. Creditors have no direct claim on members since the guarantee is between the member and the company only.



(iii) **Companies limited by shares**

In a **company limited by shares**, the fixed amount of each share will be specified in the company's constitution and that amount fixes the maximum liability of each shareholder which they agree to pay in money or money's worth either in one sum or by instalments. In the event of a winding up, the **members can be required to contribute any part of their stated liability which remains unpaid at that date** but not more. As above, creditors are owed debts by the company and have no claim against the members save in the event of liquidation.

## Question 6

**Text reference.** Chapter 21.

**Top tips.** Note that the question relates to compulsory winding up and administration only. Do not get side tracked into other types of liquidation. This question has quite a wide scope and the ACCA model answer indicated marks would also be awarded for describing the role of the Official Receiver or Liquidator.

**Easy marks.** Explaining what compulsory liquidation and administration are (definitions) and their effects.

### Marking scheme

This question, in two parts, carrying 4 marks for part (a) and 6 marks for part (b), requires candidates to explain the meaning of the terms 'compulsory winding up' and 'administration'.

- |     |           |  |
|-----|-----------|--|
| (a) | 3–4 marks | A good explanation of the meaning and effect of winding up generally and compulsory winding up in particular.                            |
|     | 0–2 marks | Some, if little knowledge of winding up, or perhaps too general or unbalanced in not dealing specifically with compulsory winding up.    |
| (b) | 4–6 marks | A good explanation of the meaning and effect of administration generally and contrasting its purpose with that of compulsory winding up. |
|     | 2–3 marks | Some, if little, explanation of administration, but perhaps too general or lacking in detail.  |
|     | 0–1 mark  | Little or no knowledge of the topic.   |

#### (a) **Compulsory winding-up**

Compulsory winding up involves the termination of a company's life under one of seven grounds, however only two are common. The statutory provisions on **compulsory winding up** are in the Insolvency Act 1986, to which all section references in this question refer.

The first main ground is under s122(1)(f) – the company is **unable to pay its debts**. This can be brought by a creditor who is owed £750 or more, where the company has failed to pay the debt within 21 days of receiving a formal written demand.

The second main ground is under s122(1)(g) – it is **just and equitable to wind the company up**. This can be brought by any company member but the court will need strong evidence that it is the right thing to do as closing an otherwise healthy company is a drastic step.

**Compulsory winding up** is deemed to commence from the date on which a petition was presented, unless the company was then already in voluntary liquidation. In effect the order for compulsory liquidation is retrospective.

## Effects

Some **specific effects** of compulsory liquidation are as follows.

- The **Official Receiver** becomes **liquidator** from the making of the order, and they continue until some other liquidator, who must be an insolvency practitioner, is appointed: s 136.
- The **powers of the directors are terminated** and they are **dismissed**.
- Any **disposition of the company's property** from the commencement of the liquidation is **void** unless approved by the court.
- Any **transfer of the company's shares is void** unless approved by the court: s 127.
- **No creditor may commence or continue legal action** against the company except with the leave of the court: s 126.
- The **employment of the company's staff ceases** unless the liquidator retains them to carry on the business.
- **Floating charges crystallise**.

## (b) Administration

**Administration** puts an insolvency practitioner in control of a company with a defined programme for rescuing it from insolvency as a going concern.

Its effect is to insulate the company from its creditors while it seeks:

- To **save itself**, or failing that
- To achieve a **better result** for creditors than an immediate winding up would secure, or failing that
- To **realise property** so as to make a distribution to creditors.

During the process, the company is **protected** as follows:

- Voluntary and compulsory **liquidation** cannot be applied for
- Company **property cannot be seized** as payment of debts
- Goods on **lease** or **hire purchase** cannot be seized
- **Legal proceedings** against the company cannot be instigated

**Administration orders** and **liquidation** are **mutually exclusive**. Once an administration is in place it is no longer possible to petition the court for a winding up order against the company. Similarly, however, once an order for winding up has been made, an administration order cannot usually be granted.

A company, its directors and floating chargeholders may **appoint an administrator** either with or without a court order. Fixed chargeholders can only put the company into administration through the courts.

The administrator of a company may do **anything necessarily expedient** for the management of the affairs, business and property of the company. This usually means that they **take on the powers previously enjoyed by the directors** and they therefore have the following specific powers to:

- Remove or appoint a **director**
- Call a **meeting of members or creditors**
- **Apply to court for directions** regarding the carrying out of his functions
- Make payments to **secured or preferential creditors**
- With the permission of the court, **make payments to unsecured creditors**

The administration period **ends** when:

- The administration has been successful
- Twelve months have elapsed from the date of the appointment of administrator
- The administrator applies to the court to end the appointment
- A creditor applies to the court to end the appointment
- An improper motive of the applicant for applying for the administration is discovered.

The administrator automatically vacates office after **12 months of his appointment**. This time period can be extended by court order or by consent from the appropriate creditors.

Alternatively, the administrator may **apply to the court** when he thinks:

- The purpose of administration cannot be achieved
- The company should not have entered into administration
- The administration has been successful (if appointed by the court)

## Question 7

**Text reference.** Chapter 10.

**Top tips.** Notice that this question is asking for the common law duties, not duties in general. Make sure that you don't waste your time by listing all of the duties you can think of from whatever sources: focus your answer on what the question requires.

**Easy marks.** Stating the duties of employee and employer

### Marking scheme

This question requires an explanation of the common law duties owed by both employers and employees.

- (a) 5–6 marks Good awareness of the implied duties imposed on employers. Examples used to highlight answers.
- 3–4 marks Sound understanding but perhaps no examples.
- 0–2 marks Limited knowledge only about the topic.
- (b) 3–4 marks Good awareness of the implied duties imposed on employees.
- 0–2 marks Limited knowledge about the topic.

#### (a) Employer's duties

Common law duties of the employer include:

##### **Mutual trust and confidence**

The overriding duty of the employer at common law is a duty of **mutual trust and confidence**. The employer should not act in a manner which could damage their relationship with the employee. For example, a director calling his secretary 'an intolerable bitch on a Monday morning' was held to breach their relationship: *Isle of Wight Tourist Board v Coombes 1976*.

##### **To indemnify the employee**

An employer should **indemnify the employee** against expenses and losses incurred in the course of employment.

##### **Reasonable care**

First, the employer has a duty to take **reasonable care for the safety** of the worker. Therefore, they must provide competent staff, safe premises and equipment and a 'safe system of work'. The employer could be liable in negligence if this is not done.

##### **Remuneration**

In the unlikely circumstances of there being no agreement as to remuneration, the rate of **remuneration** must be reasonable. However, statute largely governs the method and rate of payment (including the Equal Pay Act 1970 and the National Minimum Wage Act 1998).

### Provide work

In certain circumstances, the common law will imply a **duty to provide work**. Employees protected include those paid on a piecework or commission basis and those whose earning power and reputation is founded on active occupation, for example actors and journalists. If there is in fact no work available, the duty will not be breached as long as the employee continues to receive remuneration, unless the employee is skilled and needs relevant work in order to prevent the skills falling into disuse.

### (b) Employee duties

At common law, employees owe duties to their employer.

#### Reasonable competence, skill and care

Employees are expected to show **reasonable competence, skill and care** when performing their job: *Lister v Romford Ice and Cold Storage Co 1957*.

#### Obey lawful instructions

Employees are expected to **obey their employer's** instructions unless they require them to do an unlawful act or to expose themselves to personal danger or are instructions outside the employee's contract. For example, in *Pepper v Webb 1969* a gardener failed to follow his employer's instructions and swore at the employer.

#### Account for all money and property

Employees have a duty to account for all money and **property** received during the course of their employment. For example, in *Boston Deep Sea Fishing and Ice Co v Ansell 1888* a company was justified in dismissing an employee who accepted personal commissions from suppliers on orders which he place with them for goods supplied to the company.

#### Faithful and personal service

Faithful service means that the employee should not pass on **confidential information**, such as trade secrets, to third parties as in *Faccenda Chicken Ltd v Fowler 1986*, or work for a competitor in the spare time as in *Hivac Ltd v Park Royal Scientific Instruments Ltd 1946*.

**Personal service** means that the employee may not delegate their duties without the employer's express or implied consent.

## Question 8

**Text reference.** Chapter 6.

**Top tips.** Read the question carefully at least twice. Highlight the question paper for key points or annotate the margin. Make sure that you identify the issues involved and are fully familiar with the scenario before you start your answer.

**Easy marks.** Try to have some breadth in your thought processes here. Most candidates will think quite easily of the common law rules here with regard to exclusion clauses, but don't forget the statutory rules as well. There are easy marks available for referring for example to the Unfair Contract Terms Act.

This question requires candidates to apply the law relating to exclusion clauses to a specific problem scenario. Marks will be awarded for both knowledge and application, but application is essential.

8–10 marks	The best candidates should provide a clear understanding of the legal control of exclusion clauses and be able to apply the law. Some detailed reference should be made to the provisions of the Unfair Contract Terms Act (UCTA) 1997 and the very best answers will at least mention the Unfair Terms in Consumer Contracts Regulations 1999. Cases or examples should be used to demonstrate points made.
5–7 marks	Weaker candidates may show little detailed knowledge of the legislation but be able to consider the UCTA generally.
3–4 marks	Some but limited knowledge of the appropriate law or lacking in application.
0–2 marks	The poorest candidates will provide nothing but the briefest reference to the legislation.

### Exclusion clauses

An **exclusion clause**, or **exempt clause**, can be defined as ‘a clause in a contract which purports to exclude liability altogether or to restrict it by limiting damages or by imposing other onerous conditions.

As a general principle of contract law, the **courts will not usually interfere** where two parties negotiate a contract from positions of **comparable bargaining strength**. However, the law will seek to protect a weaker party, for example in the case of **standard term contracts** put forward by the party in the stronger bargaining position. The validity of exclusion clauses is governed by the common law, the **Unfair Contract Terms Act 1977** and a number of other statutory regulations.

Usually it is necessary to determine whether the exclusion clause that Bash Ltd is seeking to rely on has been **properly incorporated** into the contract with Andy. However, as we are told that the term has been properly incorporated we shall move on to consider whether or not the term is successful in protecting Bash Ltd from liability.

### Liability

The **Unfair Contract Act 1977**, which applies to clauses covering business liability, divides exclusion clauses into two types; those which are **void** and those which are **valid only as far as they are reasonable**.

Under s2, **liability for personal injury or death due to negligence may never be excluded**. An exemption for loss due to negligence in other circumstances will be valid only insofar as it is **reasonable**. Reasonableness is to be considered with reference to the parties’ obligations of skill and care.

### Andy’s injury

Taking into account s2 of UCTA 1977, **Bash Ltd would not be able to rely on the exclusion clause** to avoid liability for the injuries to Andy which arose from its **negligence** due to the actions of the towing vehicle’s driver.

### Damage to Andy’s car

The exclusion clause seeking to exempt Bash Ltd from liability for the damage to Andy’s car will only be valid if it is **reasonable**. Courts will take into account all the circumstances which were known, or ought to have been known by the parties when the contract was made and it will be up to Bash Ltd to prove that the clause was reasonable: *St Albans City and District Council v International Computers Ltd 1994*.

The company would be **unlikely** to succeed in avoiding liability for damage to Andy’s car since it is reasonable to expect its driver not to be negligent.

## Question 9

**Text reference.** Chapter 19.

**Top tips.** Read the question carefully at least twice so that you appreciate exactly what the scenario involves and make a note of the points you need to make before starting to write your answer.

**Easy marks.** For each of the two parts of the question, make sure that you:

- **Identify** the law
- **State** the law
- **Apply** the law
- **Conclude** on the situation in the question

### Marking scheme

This question requires candidates to analyse a problem scenario and explain and apply the law relating to directors' contracts with their companies.

8–10 marks	A good analysis of the scenario with a clear explanation of the law relating to contracts between directors and their companies, both at common law and under statute. Cases and/or references to the Companies Act will be provided.
5–7 marks	Some understanding of the situation but perhaps lacking in detail or reference to the statute.
3–4 marks	Weak answer lacking in knowledge or application, with little or no reference to the Companies Act.
0–2 marks	Little if any knowledge of the appropriate legal principles.

### Directors' duties

Since they make contracts as agents of the company and have control of its property, **directors** are said to be akin to trustees and therefore owe **fiduciary duties** to the company in the same way that trustees owe fiduciary duties to the trust. Therefore a director must act *bona fide* and honestly and not seek any personal advantage. Under the Companies Act 2006 they also owe a number of **statutory duties**.

Under s 175 a director must avoid any **conflict of duty and personal interest** and must not obtain any **personal advantage** from their position as director without the consent of the company. In *Regal Hastings v Gulliver 1942* the directors funded the creation of a subsidiary company in order to purchase two more cinemas. This resulted in profits on a later sale of the company. It was held that they had only made the profits because of their position as directors of the parent company and they were therefore required to account for the profits.

It is not necessary to prove an actual conflict, nor that the company has been **prejudiced** in any way by any such conflict.

A statutory and common law framework exists enabling directors to be interested in contracts with the company but only subject to certain safeguards, the **principal common law condition** being that a director **cannot obtain personal advantage** from their position qua director unless permitted by the company. Without such consent, the contract would be voidable at the instance of the company.

Under s177 of the Act, directors must always disclose the **nature** and **extent of any interest, direct or indirect**, that they have in a **contract** or **proposed contract** with the company.

The disclosure must be made **before** the company enters into the transaction and should be made to the directors by **general** or **written notice** or **verbally** at a board meeting. Disclosure just to the members is not sufficient and should the disclosure become void or out of date then a fresh one should be made.

Under s182 of the Act, directors must disclose an interest in an **existing contract**. This duty is identical to the s177 duty except it applies to transactions which have already occurred.

### Caz

Turning to the case in question, it appears that Caz has not disclosed either her **interest** in Era Ltd or her interest in this particular contract. Under s177 of the Companies Act 2006 the interest should have been stated at the board meeting that Caz attended which approved the contract. It was not. It should also have been declared under s182 once it had occurred – but it was not either. She will therefore have to account to Dull plc for any **profit** that she makes on the transaction and she may also be subject to a **fine**. Had she dealt honestly with Dull plc by declaring her interest and obtaining company approval, she would have been permitted to retain any profit which is made.

## Question 10

**Text reference.** Chapter 23.

**Top tips.** Application of the rules on fraudulent and wrongful trading should not pose you any problems providing you know them. Remember intention must be proved in fraudulent trading cases. In wrongful trading cases liability will be established if it is proved that the defendant knew or should have known about the impending insolvency – directors are deemed to know or should know about the financial position of their company.

**Easy marks.** Stating the fraudulent and wrongful trading rules.

### Marking scheme

This question requires candidates to consider fraudulent trading both under s.993 of the Companies Act 2006 and s.213 of the Insolvency Act 1986, and wrongful trading under s.214 of the Insolvency Act 1986.

- |     |           |  |
|-----|-----------|--|
| (a) | 4–5 marks | Clear explanation of operation of the law relating to fraudulent trading, under both criminal and civil law, but with the emphasis on the Insolvency Act provisions. |
|     | 2–3 marks | Some to good understanding but lacking detail.   |
|     | 0–1 mark  | Little or no knowledge.  |
| (b) | 4–5 marks | Clear explanation of the law relating to wrongful trading, probably, but not necessarily referring to case law.  |
|     | 2–3 marks | Some to fair understanding but lacking detail.   |
|     | 0–1 mark  | Little if any knowledge.   |

### (a) Fraudulent trading

If a court finds that the business of a company in liquidation has been carried on with **intent to defraud creditors** or for any fraudulent purpose it may declare that **any persons** who were knowingly parties to carrying on the business in this fashion shall be liable for the debts of the company as the court may decide: **s213 Insolvency Act 1986**. This is a civil penalty.

There is also a criminal offence of **fraudulent trading** under **s993 of the Companies Act 2006** which applies to anyone who has been party to carrying on a business with the intention to defraud creditors, other persons or for any other fraudulent purpose.



Various rules have been established to determine **what is fraudulent trading**:

- Only persons who **take the decision** to carry on the company's business in this way or play some active part are liable.
- '**Carrying on business**' can include a single transaction and also the mere payment of debts as distinct from making trading contracts.

If a liquidator considers that there has been fraudulent trading they should apply to the court for an order that those responsible are liable to make good to the company all or some specified part of the **company's debts**.

The liquidator should also report the facts to the Crown Prosecution Service and Director of Public Prosecutions so that **criminal proceedings** may be instituted under the Companies Act.

The **burden of proof** for liability for fraudulent trading is **high**, as the liquidator must **prove intention** to defraud.

### **Fran, Gram and Hen**

As Gram and Hen both actively **falsified the company's accounts**, they are likely to be guilty of intention to defraud under both civil and criminal law. As a consequence they may be imprisoned and made to contribute towards the company's debts.

There is not enough evidence to prove Fran is guilty – the prosecution is unlikely to be able to prove he **intended** to defraud the creditors or others.

#### **(b) Wrongful trading**

The problem of proving intention to defraud in cases of alleged fraudulent trading resulted in a further civil liability of '**wrongful trading**' being introduced. Like s 213, s 214 Insolvency Act 1986 applies to companies in **liquidation** but **no dishonesty or intention to defraud need be proved**.

A director will be liable for **wrongful trading** if the liquidator proves that they:

- **Knew, or should have known**, that there was **no reasonable prospect** that the **company could have avoided going into insolvent liquidation**. This means that directors cannot claim they lacked knowledge if their lack of knowledge was a result of failing to comply with Companies Act requirements: *Re Produce Marketing Consortium 1989*.
- Did not take **sufficient steps** to minimise the potential loss to creditors.

The section goes on to provide that the **directors** will be **deemed to know** that the company could not avoid insolvent liquidation if that would have been the conclusion of a **reasonably diligent person** with the **general knowledge, skill and experience** that might reasonably be expected of a person carrying out that particular director's duties (ie a reasonable occupant of a similar post). If the director has greater than usual skill then they will be judged with reference to their own capacity.

### **Fran, Gram and Hen**

**Gram and Hen** will be **personally liable** under s 214 for the increase in the company's debts since it is already established that they are likely to be liable for fraudulent trading which carries a higher burden of proof. **Fran will also be liable** for the company's debts since as a director of a company he should have been aware of the situation.





ACCA examiner's answers:  
June 2009 paper  
December 2009 paper



- 1 (a) The doctrine of binding precedent, or *stare decisis*, lies at the heart of the English legal system. The doctrine refers to the fact that, within the hierarchical structure of the English courts, a decision of a higher court will be binding on a court lower than it in that hierarchy. In general terms, this means that when judges try cases, they will check to see if a similar situation has come before a court previously. If the precedent was set by a court of equal or higher status to the court deciding the new case, then the judge in the present case should follow the rule of law established in the earlier case. Where the precedent is from a lower court in the hierarchy, the judge in the new case may not follow but will certainly consider it.

Not everything in a case report sets a precedent. The contents of a report can be divided into two categories:

(i) *Ratio decidendi*

It is important to establish that it is not the actual decision in a case that sets the precedent; that is set by the rule of law on which the decision is founded. This rule, which is an abstraction from the facts of the case, is known as the *ratio decidendi* of the case. The *ratio decidendi* of a case may be understood as the statement of the law applied in deciding the legal problem raised by the concrete facts of the case.

(ii) *Obiter dictum*

Any statement of law that is not an essential part of the *ratio decidendi* is, strictly speaking, superfluous; and any such statement is referred to as *obiter dictum* (*obiter dicta* in the plural), that is, said by the way. Although *obiter dicta* statements do not form part of the binding precedent, they are persuasive authority and can be taken into consideration in later cases, if the judge in the later case considers it appropriate to do so.

The division of cases into these two distinct parts is a theoretical procedure. Unfortunately, judges do not actually separate their judgments into the two clearly defined categories and it is up to the person reading the case to determine what the *ratio* is. In some cases, this is no easy matter, and it may be made even more difficult in appellate cases where each of the judges may deliver their own lengthy judgments with no clear single *ratio*.

(b) *Binding precedent*

If a precedent was set by a court of equal or higher status to the court deciding the new case then the judge in the present case should normally follow the rule of law established in the earlier case.

*The Hierarchy of the Courts*

The House of Lords stands at the summit of the English court structure and its decisions are binding on all courts below it in the hierarchy. As regards its own previous decisions, up until 1966 the House of Lords regarded itself as bound by its previous decisions. In a Practice Statement ([1966] 3 All ER 77) of that year, however, Lord Gardiner indicated that the House of Lords would in future regard itself as free to depart from its previous decisions where it appeared right to do so. There have been a number of cases in which the House of Lords has overruled or amended its own earlier decisions (e.g. *Conway v Rimmer* (1968); *Herrington v British Rail Board* (1972); *Miliangos v George Frank (Textiles) Ltd* (1976); *R v Shivpuri* (1986)) but this is not a discretion that the House of Lords exercises lightly. It has to be recognised that in the wider context the House of Lords is no longer the supreme court and its decisions are subject to decisions of the European Court of Justice in terms of European Community law, and, with the implementation of the Human Rights Act 1998, the decisions of the European Court of Justice in matters relating to human rights.

In civil cases the Court of Appeal is generally bound by previous decisions of the House of Lords and its own previous decisions. There are, however, a number of exceptions to this general rule. The exceptions arise where:

- (i) there is a conflict between two previous decisions of the Court of Appeal.
- (ii) a previous decision of the Court of Appeal has been overruled by the House of Lords. The Court of Appeal can ignore a previous decision of its own which is inconsistent with European Community law or with a later decision of the European Court.
- (iii) the previous decision was given *per incuriam*, i.e. in ignorance of some authority that would have led to a different conclusion (*Young v Bristol Aeroplane Co Ltd* (1944)).

Courts in the criminal division, however, are not bound to follow their own previous decisions which they subsequently consider to have been based on either a misunderstanding or a misapplication of the law.

The Divisional Courts of the High Court are bound by the doctrine of *stare decisis* in the normal way and must follow decisions of the House of Lords and the Court of Appeal. They are also normally bound by their own previous decisions, although in civil cases it may make use of the exceptions open to the Court of Appeal in *Young v Bristol Aeroplane Co Ltd*, and in criminal appeal cases the Queen's Bench Divisional Court may refuse to follow its own earlier decisions where it feels the earlier decision to have been wrongly made.

The High Court is bound by the decisions of superior courts. Decisions by individual High Court Judges are binding on courts inferior in the hierarchy, but such decisions are not binding on other High Court Judges although they are of strong persuasive authority and tend to be followed in practice.

Crown Courts cannot create precedent and their decisions can never amount to more than persuasive authority. County courts and Magistrates' courts do not create precedents.

### *Persuasive precedent*

From the foregoing it can be seen that courts higher in the hierarchy are not bound to follow the reasoning of courts at a lower level in that hierarchy. However, the higher courts will consider, and indeed may adopt, the reasoning of the lower court. As a consequence of the fact that the higher court is at liberty *not* to follow the reasoning in the lower court such decisions are said to be of persuasive rather than binding authority. It should also be borne in mind that English courts are in no way bound to follow the reasoning of courts in different jurisdictions, and it should be remembered that for this purpose Scotland qualifies as having its own legal system. However, where a court from another jurisdiction has considered a point of law that subsequently arises in an English case, the English courts will review the reasoning of the foreign courts and may follow their reasoning if they find it sufficiently persuasive.

- 2 This question invites candidates to examine some of the principles relating to the doctrine of consideration in relation to the law of contract.

- (a) English law does not enforce every promise that might be made under every circumstance. One way in which the courts limit the type of promise that they have to deal with is through the operation of the doctrine of consideration. English law does not enforce gratuitous promises, i.e. promises given for no return, unless of course such promises are given by way of formal deed. The requirement is that for a simple promise to be enforced in the courts as a binding contract, it is necessary that the person to whom the promise was made, i.e. the promisee, should have done something in return for the promise. That something done, or to be done, constitutes consideration. Consideration can be understood, therefore, as the price paid for a promise. The element of bargain implicit in the idea of consideration may be seen in Sir Frederick Pollock's definition of it, subsequently adopted by the House of Lords in *Dunlop v Selfridge* (1915), as:

'An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.'

An alternative and shorter definition of consideration is that it is 'some benefit to the promisor or detriment to the promisee'. It is important to note, however, that both elements stated in that definition are not required to be present to support a legally enforceable agreement. Although in practice there usually is a reciprocal exchange of benefit and detriment, it is nonetheless possible for a promisee to provide consideration for a promise without the action directly benefiting the promisor. For example, A can promise to pay B for doing something that benefits C. In such a situation A enjoys no direct benefit but can enforce the agreement, whilst C who enjoys the benefit cannot directly enforce the agreement between A and B.

- (b) (i) The statement that consideration must be sufficient but need not be adequate refers to the fact that it is for the parties themselves to determine the terms of their contract. In deciding the contractual validity of any agreement, the court will merely look to ensure that there is some element that constitutes valid consideration. As long as it finds formal consideration, the court will not intervene to require substantive equality in the value of the goods or promises exchanged, as long as the agreement has been freely entered into. Thus in *Thomas v Thomas* (1842) the executors of a man's will promised to let his widow live in his house in return for rent of £1 per year. It was held that £1 was sufficient consideration to validate the contract, although it did not represent an adequate rent in economic terms. Equally, in *Chappell & Co v Nestle Co* (1959), it was held that a used chocolate wrapper was sufficient consideration to form a contract, even although it had no economic value whatsoever to Nestle.

It has generally been accepted that performance of an existing duty does not provide valid consideration (*Glassbrook v Glamorgan CC* (1925) and *Stilk v Myrick* (1809)). However, the more recent authority of *Williams v Roffey Bros* (1990) has indicated a contrary possibility.

- (ii) Past consideration does not actually count as valid consideration sufficient to make any agreement based on it a binding contract. Normally consideration is provided either at the time of the creation of a contract or at a later date. In the case of past consideration, however, the action is performed before the promise that it is supposed to be the consideration for. Such action is not sufficient to support a promise, as consideration cannot consist of any action already wholly performed before the promise was made (*Re McArdle* (1951)).

There are exceptions to the rule that past consideration will not support a valid contract. For example, where the plaintiff performed the action at the request of the defendant *and payment was expected*, then any subsequent promise to pay will be enforceable (*Re Caseys Patents* (1892)).

Also, under s.27 of the Bills of Exchange Act 1882, past consideration can create liability on a bill of exchange.

- 3 This question requires candidates to consider the law relating to terms in contracts. It specifically requires the candidates to distinguish between terms and mere representations and then to establish the difference between express and implied terms in contracts.

- (a) As the parties to a contract will be bound to perform any promise they have contracted to undertake, it is important to distinguish between such statements that will be considered part of the contract, i.e. terms, and those other pre-contractual statements which are not considered to be part of the contract, i.e. mere representations. The reason for distinguishing between them is that there are different legal remedies available if either statement turns out to be incorrect.

A representation is a statement that induces a contract but does not become a term of the contract. In practice it is sometimes difficult to distinguish between the two, but in attempting to do so the courts will focus on when the statement was made in relation to the eventual contract, the importance of the statement in relation to the contract and whether or not the party making the statement had specialist knowledge on which the other party relied (*Oscar Chess v Williams* (1957) and *Dick Bentley v Arnold Smith Motors* (1965)).

- (b) Express terms are statements actually made by one of the parties with the intention that they become part of the contract and thus binding and enforceable through court action if necessary. It is this intention that distinguishes the contractual term from the mere representation, which, although it may induce the contractual agreement, does not become a term of the contract. Failure to comply with the former gives rise to an action for breach of contract, whilst failure to comply with the latter only gives rise to an action for misrepresentation.

Such express statements may be made by word of mouth or in writing as long as they are sufficiently clear for them to be enforceable. Thus in *Scammell v Ouston* (1941) *Ouston* had ordered a van from the claimant on the understanding that the balance of the purchase price was to be paid 'on hire purchase terms over two years'. When *Scammell* failed to deliver the van *Ouston* sued for breach of contract without success, the court holding that the supposed terms of the contract were too uncertain to be enforceable. There was no doubt that *Ouston* wanted the van on hire purchase but his difficulty was that *Scammell* operated a range of hire purchase terms and the precise conditions of his proposed hire purchase agreement were never sufficiently determined.

Implied terms, however, are not actually stated or expressly included in the contract, but are introduced into the contract by implication. In other words the exact meaning and thus the terms of the contract are inferred from its context. Implied terms can be divided into three types.

#### *Terms implied by statute*

In this instance a particular piece of legislation states that certain terms have to be taken as constituting part of an agreement, even where the contractual agreement between the parties is itself silent as to that particular provision. For example, under s.5 of the Partnership Act 1890, every member of an ordinary partnership has the implied power to bind the partnership in a contract within its usual sphere of business. That particular implied power can be removed or reduced by the partnership agreement and any such removal or reduction of authority would be effective as long as the other party was aware of it. Some implied terms, however, are completely prescriptive and cannot be removed.

#### *Terms implied by custom or usage*

An agreement may be subject to terms that are customarily found in such contracts within a particular market, trade or locality. Once again this is the case even where it is not actually specified by the parties. For example, in *Hutton v Warren* (1836), it was held that customary usage permitted a farm tenant to claim an allowance for seed and labour on quitting his tenancy. It should be noted, however, that custom cannot override the express terms of an agreement (*Les Affreteurs Reunis SA v Walford* (1919)).

#### *Terms implied by the courts*

Generally, it is a matter for the parties concerned to decide the terms of a contract, but on occasion the court will presume that the parties intended to include a term which is not expressly stated. They will do so where it is necessary to give business efficacy to the contract.

Whether a term may be implied can be decided on the basis of the officious bystander test. Imagine two parties, A and B, negotiating a contract, when a third party, C, interrupts to suggest a particular provision. A and B reply that that particular term is understood. In just such a way, the court will decide that a term should be implied into a contract.

In *The Moorcock* (1889), the appellants, owners of a wharf, contracted with the respondents to permit them to discharge their ship at the wharf. It was apparent to both parties that when the tide was out the ship would rest on the riverbed. When the tide was out, the ship sustained damage by settling on a ridge. It was held that there was an implied warranty in the contract that the place of anchorage should be safe for the ship. As a consequence, the ship owner was entitled to damages for breach of that term.

Alternatively the courts will imply certain terms into unspecific contracts where the parties have not reduced the general agreement into specific details. Thus in contracts of employment the courts have asserted the existence of implied terms to impose duties on both employers and employees, although such implied terms can be overridden by express contractual provision to the contrary.

- 4 (a) Except in relation to specifically exempted companies, such as those involved in charitable work, companies are required to indicate that they are operating on the basis of limited liability. Thus private companies are required to end their names, either with the word 'limited' or the abbreviation 'Ltd', and public companies must end their names with the words 'public limited company' or the abbreviation 'plc'. Welsh companies may use the Welsh language equivalents (Companies Act (CA) 2006 ss.58, 59 & 60).

Companies Registry maintains a register of business names, and will refuse to register any company with a name that is the **same** as one already on that index (CA 2006 s.66).

Certain categories of names are, subject to the decision of the Secretary of State, unacceptable *per se*, as follows:

- (i) names which in the opinion of the Secretary of State constitute a criminal offence or are offensive (CA 2006 s.53)
- (ii) names which are likely to give the impression that the company is connected with either government or local government authorities (s.54).
- (iii) names which include a word or expression specified under the Company and Business Names Regulations 1981 (s.26(2)(b)). This category requires the express approval of the Secretary of State for the use of any of the names or expressions contained on the list, and relates to areas which raise a matter of public concern in relation to their use.

Under s.67 of the Companies Act 2006 the Secretary of State has power to require a company to alter its name under the following circumstances:

- (i) where it is the same as a name already on the Registrar's index of company names.
- (ii) where it is 'too like' a name that is on that index.

The name of a company can always be changed by a special resolution of the company so long as it continues to comply with the above requirements (s.77).

- (b) The tort of passing off was developed to prevent one person from using any name which is likely to divert business their way by suggesting that the business is actually that of some other person or is connected in any way with that other business. It thus enables people to protect the goodwill they have built up in relation to their business activity. In *Ewing v Buttercup Margarine Co Ltd* (1917) the plaintiff successfully prevented the defendants from using a name that suggested a link with his existing dairy company. It cannot be used, however, if there is no likelihood of the public being confused, where for example the companies are conducting different businesses (*Dunlop Pneumatic Tyre Co Ltd v Dunlop Motor Co Ltd* (1907) and *Stringfellow v McCain Foods GB Ltd* (1984). Nor can it be used where the name consists of a word in general use (*Aerators Ltd v Tollitt* (1902)).

Part 41 of the Companies Act (CA) 2006, which repeals and replaces the Business Names Act 1985, still does not prevent one business from using the same, or a very similar, name as another business so the tort of passing off will still have an application in the wider business sector. However the Act introduced a new procedure to deal specifically with company names. As previously under the CA 1985, a company cannot register with a name that was the same as any already registered (s.665 Companies Act (CA) 2006) and under CA s.67 the Secretary of State may direct a company to change its name if it has been registered in a name that is the same as, or too like a name appearing on the registrar's index of company names. In addition, however, a completely new system of complaint has been introduced.

- (c) Under ss.69–74 of CA 2006 a new procedure has been introduced to cover situations where a company has been registered with a name
- (i) that it is the same as a name associated with the applicant in which he has goodwill, or
  - (ii) that it is sufficiently similar to such a name that its use in the United Kingdom would be likely to mislead by suggesting a connection between the company and the applicant (s.69).

Section 69 can be used not just by other companies but by any person to object to a company names adjudicator if a company's name is similar to a name in which the applicant has goodwill. There is list of circumstances raising a presumption that a name was adopted legitimately, however even then, if the objector can show that the name was registered either, to obtain money from them, or to prevent them from using the name, then they will be entitled to an order to require the company to change its name.

Under s.70 the Secretary of State is given the power to appoint company names adjudicators and their staff and to finance their activities, with one person being appointed Chief Adjudicator.

Section 71 provides the Secretary of State with power to make rules for the proceedings before a company names adjudicator. Section 72 provides that the decision of an adjudicator and the reasons for it, are to be published within 90 days of the decision.

Section 73 provides that if an objection is upheld, then the adjudicator is to direct the company with the offending name to change its name to one that does not similarly offend. A deadline must be set for the change. If the offending name is not changed, then *the adjudicator will decide* a new name for the company.

Under s.74 either party may appeal to a court against the decision of the company names adjudicator. The court can either uphold or reverse the adjudicator's decision, and may make any order that the adjudicator might have made.

- 5 (a) As shareholders in limited companies, by definition, have the significant protection of limited liability the courts have always seen it as the duty of the law to ensure that this privilege is not abused at the expense of the company's creditors. To that end they developed the doctrine of capital maintenance, the specific rules of which are now given expression in the Companies Act (CA) 2006. The rules, such as that stated in CA 2006 s.580 against shares being issued at a discount, ensure that companies receive at least the full nominal value of their share capital. The rules relating to the doctrine of capital maintenance operate in conjunction to those rules to ensure that the capital can only be used in limited ways. Whilst this may be seen essentially as a means of protecting the company's creditors, it also protects the shareholders themselves from the depredation of the company's capital.

There are two key aspects of the doctrine of capital maintenance: firstly that creditors have a right to see that the capital is not dissipated unlawfully; and secondly that the members must not have the capital returned to them surreptitiously. There are a number of specific controls over how companies can use their capital, but perhaps the two most important are the rules relating to capital reduction and company distributions.

- (b) The procedures through which a company can reduce its capital are laid down by ss.641–653 Companies Act 2006.

Section 641 states that, subject to any provision in the articles to the contrary, a company may reduce its capital in any way by passing a special resolution to that effect. In the case of a public company any such resolution must be confirmed by the court. In the case of a private company, however, it is also possible to reduce capital without court approval as long as the directors issue a statement as to the company's present and continued solvency for the following 12 months (ss.642 & 643). The special resolution, a copy of the solvency statement, a statement of compliance by the directors confirming that the solvency statement was made not more than 15 days before the date on which the resolution was passed, and a statement of capital must be delivered to the registrar within 15 days of the date of passing the special resolution.

Section 641 sets out three particular ways in which the capital can be reduced by:

- (a) removing or reducing liability for any capital remaining as yet unpaid. In effect the company is deciding that it will not need to call on that unpaid capital in the future.
- (b) cancelling any paid up capital which has been lost through trading or is unrepresented by in the current assets. This effectively brings the balance sheet into balance at a lower level by reducing the capital liabilities in recognition of a loss of assets.
- (c) repayment to members of some part of the paid-up value of their shares in excess of the company's requirements. This means that the company actually returns some of its capital to its members on the basis that it does not actually need that level of capitalisation to carry on its business.

It can be seen that procedure (a) reduces the potential creditor fund, for the company gives up the right to make future calls against its shares and procedure (c) reduces the actual creditor fund by returning some of its capital to the members. In recognition of this fact, creditors are given the right to object to any such reduction. However procedure (b) does not actually reduce the creditor fund, it merely recognises the fact that capital has been lost. Consequently creditors are not given the right to object to this type of alteration (ss.645 & 646).

Under s.648 the court may make an order confirming the reduction of capital on such terms as it thinks fit. In reaching its decision the court is required to consider the position of creditors of the company in cases (a) and (c) above and may do so in any other case. The court also takes into account the interests of the general public. In any case the court has a general discretion as to what should be done. If the company has more than one class of shares, the court will also consider whether the reduction is fair between classes. In this it will have regard to the rights of the different classes in a liquidation of the company since a reduction of capital is by its nature similar to a partial liquidation.

When a copy of the court order together with a statement of capital is delivered to the registrar of companies a certificate of registration is issued (s.649).

- 6 The Company Directors Disqualification Act (CDDA) 1986 was introduced to control individuals who persistently abused the various privileges that accompany incorporation, most particularly the privilege of limited liability. The Act applies to more than just directors and the court may make an order preventing any person (without leave of the court) from being:

- (i) a director of a company;
- (ii) a liquidator or administrator of a company;
- (iii) a receiver or manager of a company's property; or
- (iv) in any way, whether directly or indirectly, concerned with or taking part in the promotion, formation or management of a company.

The CDDA 1986 identifies three distinct categories of conduct, which may, and in some circumstances must, lead the court to disqualify certain persons from being involved in the management of companies.

- (a) *General misconduct in connection with companies*

This first category involves the following:

- (i) A conviction for an indictable offence in connection with the promotion, formation, management or liquidation of a company or with the receivership or management of a company's property (s.2 of the CDDA 1986). The maximum period for disqualification under s.2 is five years where the order is made by a court of summary jurisdiction, and 15 years in any other case.



- (ii) Persistent breaches of companies legislation in relation to provisions which require any return, account or other document to be filed with, or notice of any matter to be given to, the registrar (s.3 of the CDDA 1986). Section 3 provides that a person is conclusively proved to be persistently in default where it is shown that, in the five years ending with the date of the application, he has been adjudged guilty of three or more defaults (s.3(2) of the CDDA 1986). This is without prejudice to proof of persistent default in any other manner. The maximum period of disqualification under this section is five years.
- (iii) Fraud in connection with winding up (s.4 of the CDDA 1986). A court may make a disqualification order if, in the course of the winding up of a company, it appears that a person:
  - (1) has been guilty of an offence for which he is liable under s.993 of the CA 2006, that is, that he has knowingly been a party to the carrying on of the business of the company either with the intention of defrauding the company's creditors or any other person or for any other fraudulent purpose; or
  - (2) has otherwise been guilty, while an officer or liquidator of the company or receiver or manager of the property of the company, of any fraud in relation to the company or of any breach of his duty as such officer, liquidator, receiver or manager (s.4(1)(b) of the CDDA 1986).

The maximum period of disqualification under this category is 15 years.

(b) *Disqualification for unfitness*

The second category covers:

- (i) disqualification of directors of companies which have become insolvent, who are found by the court to be unfit to be directors (s.6 of the CDDA 1986). Under s. 6, the minimum period of disqualification is two years, up to a maximum of 15 years;
- (ii) disqualification after investigation of a company under Pt XIV of the CA 1985 (*it should be noted that this part of the previous Act still sets out the procedures for company investigations*) (s.8 of the CDDA 1986). Once again, the maximum period of disqualification is 15 years.

Schedule 1 to the CDDA 1986 sets out certain particulars to which the court is to have regard in deciding whether a person's conduct as a director makes them unfit to be concerned in the management of a company. In addition, the courts have given indications as to what sort of behaviour will render a person liable to be considered unfit to act as a company director. Thus, in *Re Lo-Line Electric Motors Ltd* (1988), it was stated that:

'Ordinary commercial misjudgment is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although ... in an extreme case of gross negligence or total incompetence, disqualification could be appropriate.'

(c) *Other cases for disqualification*

This third category relates to:

- (i) participation in fraudulent or wrongful trading under s.213 of the Insolvency Act (IA)1986 (s.10 of the CDDA 1986);
- (ii) undischarged bankrupts acting as directors (s.11 of the CDDA 1986); and
- (iii) failure to pay under a county court administration order (s.12 of the CDDA 1986).

For the purposes of most of the CDDA 1986, the court has discretion to make a disqualification order. Where, however, a person has been found to be an unfit director of an insolvent company, the court has a duty to make a disqualification order (s.6 of the CDDA 1986). Anyone who acts in contravention of a disqualification order is liable:

- (i) to imprisonment for up to two years and/or a fine, on conviction on indictment; or
- (ii) to imprisonment for up to six months and/or a fine not exceeding the statutory maximum, on conviction summarily (s.13 of the CDDA 1986).

**7** Redundancy is defined in s.139(1) of the Employment Rights Act (ERA) 1996 as being: 'dismissal attributable wholly or mainly to:

- (a) the fact that his employer has ceased, or intends to cease, to carry on the business for the purposes of which the employee was employed by him, or has ceased, or intends to cease to carry on that business in the place where the employee was so employed, or
- (b) the fact that the requirements of that business for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where they were so employed, have ceased or diminished or are expected to cease or diminish.'

In order to qualify for redundancy payments an employee must have been continuously employed by the same employer or associated company for a period of two years. At the outset of redundancy proceedings the onus is placed on the employee to show that they have been dismissed which they do by demonstrating that they are covered by s.136 of ERA 1996, which provides four types of dismissal. These are:

- (i) the contract of employment is terminated by the employer with or without notice;
- (ii) a fixed-term contract has expired and has not been renewed;

- (iii) the employee terminates the contract with or without notice in circumstances which are such that he or she is entitled to terminate it without notice by reason of the employer's conduct;
- (iv) the contract is terminated by the death of the employer, or the dissolution or liquidation of the firm.

Once dismissal has been established a presumption in favour of redundancy operates and the onus shifts to the employer to show that redundancy was not the reason for the dismissal.

Employees who have been dismissed by way of redundancy are entitled to claim a redundancy payment from their former employer. Under the ERA 1996 the actual figures are calculated on the basis of the person's age, length of continuous service and weekly rate of pay subject to statutory maxima. Thus employees between the ages of 18 and 21 are entitled to  $\frac{1}{2}$  weeks pay for each year of service, those between 22 and 40 are entitled to 1 weeks pay for every year of service, and those between 41 and 65 are entitled to  $1\frac{1}{2}$  weeks pay for every year of service.

The maximum number of years service that can be claimed is 20 and as the maximum level of pay that can be claimed is £330, the maximum total that can be claimed is £9,900, (i.e.  $1.5 \times 20 \times 330$ ).

Disputes in relation to redundancy claims are heard before an Employment Tribunal and on appeal go to the Employment Appeal Tribunal. The employer must act as would be expected of a 'reasonable employer' and in determining whether the employer has acted reasonably, the Employment Tribunal will consider whether, in the circumstances 'including the size and administrative resources of the employer's undertaking, the employer acted reasonably or unreasonably in treating the reason given as sufficient reason for dismissing the employee.' (s.98(4) ERA 1996). Reasonable employers should follow the ACAS 'Code of Practice on Disciplinary Practice and Procedures in Employment' in relation to the way they discipline and dismiss their employees. Thus redundancy, *per se*, does not provide a justification for dismissal, unless the employer had introduced and operated a proper redundancy scheme, which included preferably objective criteria for deciding who should be made redundant, and provided for the consideration of redeployment rather than redundancy.

- 8** The essential issues to be disentangled from the problem scenario relate to breach of contract and the remedies available for such breach.

There seems to be no doubt that there is a contractual agreement between Arti and Bee Ltd. Normally breach of a contract occurs where one of the parties to the agreement fails to comply, either completely or satisfactorily, with their obligations under it. However, such a definition does not appear to apply in this case as the time has not yet come when Arti has to produce the text. He has merely indicated that he has no intention of doing so. This is an example of the operation of the doctrine of anticipatory breach. This arises precisely where one party, prior to the actual due date of performance, demonstrates an intention not to perform their contractual obligations. The intention not to fulfil the contract can be either express or implied.

Express anticipatory breach occurs where a party actually states that they will not perform their contractual obligations (*Hochster v De La Tour* (1853)). Implied anticipatory breach occurs where a party carries out some act which makes performance impossible (*Omnium Enterprises v Sutherland* (1919)).

When anticipatory breach takes place the innocent party can sue for damages immediately on receipt of the notification of the other party's intention to repudiate the contract, without waiting for the actual contractual date of performance as in *Hochster v De La Tour*. Alternatively, they can wait until the actual time for performance before taking action. In the latter instance, they are entitled to make preparations for performance, and claim the agreed contract price (*White and Carter (Councils) v McGregor* (1961)).

It would appear that Arti's action is clearly an instance of express anticipatory breach and that Bee Ltd has the right either to accept the repudiation immediately or affirm the contract and take action against Arti at the time for performance (*Vitol SA v Norelf Ltd* (1996)). In any event Arti is bound to complete his contractual promise or suffer the consequences of his breach of contract.

#### Remedies for breach of contract

- (i) *Specific performance*

It will sometimes suit a party to break their contractual obligations, even if they have to pay damages. In such circumstances the court can make an order for specific performance to require the party in breach to complete their part of the contract. However, as specific performance is not available in respect of contracts of employment or personal service Arti cannot be legally required to write the book for Bee Ltd (*Ryan v Mutual Tontine Westminster Chambers Association* (1893)). This means that the only remedy against Arti lies in the award of damages.

- (ii) *Damages*

A breach of contract will result in the innocent party being able to sue for damages.

Bee Ltd, therefore, can sue Bob for damages, but the important issue relates to the extent of such damages.

The estimation of what damages are to be paid by a party in breach of contract can be divided into two parts: remoteness and measure.

#### *Remoteness of damage*

The rule in *Hadley v Baxendale* (1845) states that damages will only be awarded in respect of losses which arise naturally, or which both parties may reasonably be supposed to have contemplated when the contract was made, as a probable result of its breach.

The effect of the first part of the rule in *Hadley v Baxendale* is that the party in breach is deemed to expect the normal consequences of the breach, whether they actually expected them or not. Under the second part of the rule, however, the party in breach can only be held liable for abnormal consequences where they have actual knowledge that the abnormal consequences might follow (*Victoria Laundry Ltd v Newham Industries Ltd* (1949)).

#### Measure of damages

Damages in contract are intended to compensate an injured party for any financial loss sustained as a consequence of another party's breach. The object is not to punish the party in breach, so the amount of damages awarded can never be greater than the actual loss suffered. The aim is to put the injured party in the same position they would have been in had the contract been properly performed. In order to achieve this end the claimant is placed under a duty to mitigate losses. This means that the injured party has to take all reasonable steps to minimise their loss (*Payzu v Saunders* (1919)). Although such a duty did not appear to apply in relation to anticipatory breach as decided in *White and Carter (Councils) v McGregor* (1961) (above).

Applying these rules to the fact situation in the problem it is evident that as Arti has effected an anticipatory breach of his contract with Bee Ltd he will be liable to them for damages suffered as a consequence, if indeed they suffer damage as a result of his breach. As Bee Ltd will be under a duty to mitigate their losses, they will have to commit their best endeavours to find someone else to produce the required text on time. If they can do so at no further cost then they would suffer no loss, but any additional costs in producing the text will have to be borne by Arti.

However, if Bee Ltd is unable to produce the required text on time the situation becomes more complicated.

- (i) As regards the profits from the contract to supply the accountancy body with all its text, the issue would be as to whether this was normal profit or amounted to an unexpected gain, as it was not part of Bee Ltd's normal market when the contract was signed. If *Victoria Laundry Ltd v Newham Industries Ltd* were to be applied it is unlikely that Bee Ltd would be able to claim that loss of profit from Arti. However, it is equally plausible that the contract was an ordinary commercial one and that Arti would have to recompense Bee Ltd for any losses suffered from its failure to complete contractual performance.
- (ii) As for the extensive preliminary expenses Arti would certainly be liable for them, as long as they were in the ordinary course of Bee Ltd's business and were not excessive (*Anglia Television v Reed* (1972)).

- 9 This question requires an analysis of the doctrine of corporate opportunity and the rules relating to directors' duties. Section 178 of the Companies Act (CA) 2006 places directors' duties on a statutory basis, and although s.170 provides that the new statement of duties replaces the old common law rules and equitable principles, it nonetheless expressly provides that the duties now stated in the Act are to be interpreted and applied in the same way as those rules and principles were. Section 178 specifically preserves the existing civil consequences of breach of any of the general duties, so the remedies for breach of the newly stated general duties will be exactly the same as those that were available following a breach of the equitable principles and common law rules that the general duties replace. Section 178(2) specifically provides that the directors' duties are enforceable in the same way as any other fiduciary duty owed to a company by its directors and remedies available may include:

- (i) damages or compensation where the company has suffered loss;
- (ii) restoration of the company's property;
- (iii) an account of profits made by the director; and
- (iv) rescission of a contract where the director failed to disclose an interest.

It should be noted that the foregoing does not apply to the duty to exercise reasonable care, skill and diligence under s.174, which is not considered to be a fiduciary duty.

Section 175 of the Act specifically deals with the duty to avoid conflicts of interest and replaces the previous no-conflict rule. Under the previous rule, certain consequences followed if directors placed themselves in a position where their personal interests came into conflict with their duties to the company, unless the company knew about the conflict and specifically consented to it. Section 175 continues that procedure in an amended form, which allows the other independent directors to authorise the conflict. Any conflicted directors must not count in the quorum for the meeting or vote. The section makes clear that a conflict of interest may, in particular, arise when a director makes personal use of information, property or opportunities belonging to the company or specifically under ss.177 and 182 where the duties to declare interests in transactions are set out, when a director enters into a contract with his company. This is the case whether or not the company itself could have taken advantage of the property, information or opportunity, so once again the previous common law and equitable rules are maintained. As well as allowing the directors to approve a conflict under s.175, s.180 preserves the ability of the members of a company to authorise conflicts that would otherwise be a breach of this duty.

Applying the preceding rules to the facts of the problem scenario it can be seen that Des has breached his statutory duty under CA 2006 s.175 by allowing a conflict of interest to arise without declaring it to the board and getting the approval of the other directors or indeed the members.

The operation of the previous fiduciary duty not to make an undisclosed benefit from the position as directors and not to profit personally from what is a corporate opportunity even survived after the director in question has left the company (*IDC v Cooley* (1972)). As the CA 2006 continues the previous equitable principles and specifically states that the duty to avoid conflicts of interest applies to former directors, Des will still be liable for his action.

It is also now clear that the rules against allowing a conflict of interest to arise apply even if the company cannot itself take advantage of the opportunity wrongly misappropriated, which continues the previous very strict application of principle (*Regal (Hastings) v Gulliver* (1942)). However the duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest: s.175(4)(a).

Applying this to the facts of the problem it would appear that Des has acted in breach of his statutory duty and will be held liable to account to the company for any profits he made on the transaction.

He will not be allowed to hide his personal profit behind the separate personality of Flush Ltd as the courts will simply lift the veil of incorporation as in *Gilford Motor Co v Horne* (1933).

- 10** This question requires candidates to recognise and explain the law relating to two criminal offences: insider dealing and money laundering.

- (a)** Insider dealing is dealing in shares, on the basis of access to unpublished price sensitive information. Such activity is unlawful and is governed by part V of the Criminal Justice Act 1993 (CJA). Money laundering refers to the attempt to disguise the origin of money acquired through criminal activity in order to make it appear legitimate. The aim of the process is to disguise the source of the property, in order to allow the holder to enjoy it free from suspicion as to its source.

Such activity is regulated by the Proceeds of Crime Act 2002 (PCA) together with the specifically anti-terrorist legislation, the Terrorism Act 2000 and the Anti-terrorism Crime and Security Act 2001 and the Prevention of Terrorism Act 2005.

Under s.52 of the Criminal Justice Act (CJA) 1993 an individual is guilty of insider dealing if they have information as an insider and deal in price-affected securities on the basis of that information.

Section 54 specifically includes shares amongst those securities and dealing is defined in s.55, amongst other things, as acquiring or disposing of securities, whether as a principal or agent, or agreeing to acquire securities.

Section 56 defines 'inside information' as:

- (i) relating to particular securities;
- (ii) being specific or precise;
- (iii) not having been made public; and
- (iv) being likely to have a significant effect on the price of the securities.

Section 57 states that a person has information as an insider only if they know it is inside information and they have it from an inside source and covers those who get the inside information directly through either:

- (i) being a director, employee or shareholder of an issuer of securities; or
- (ii) having access to the information by virtue of their employment, office or profession.

On summary conviction, an individual found guilty of insider dealing is liable to a fine not exceeding the statutory maximum and/or maximum of six months imprisonment. On indictment the penalty is an unlimited fine and/or a maximum of seven years imprisonment. It is quite clear from the facts of the problem scenario that Greg has engaged in insider dealing under the CJA 1993.

- (b)** Although he has tried to disguise his criminal activity, that has merely involved him in further criminal activity; money laundering.

Under s.327 of the Proceeds of Crime Act 2002 it is an offence to conceal, disguise, convert, transfer or remove criminal property from England and Wales, Scotland or Northern Ireland. Concealing or disguising criminal property is widely defined to include concealing or disguising its nature, source, location, disposition, movement or ownership or any rights connected with it. These offences are punishable on conviction by a maximum of 14 years' imprisonment and/or a fine.

Applying the general law to the problem scenario, one can conclude that Greg is an 'insider' as he receives inside information as a result of his position as a director of Huge plc. The information fulfils the requirements for 'inside information' as it: relates to particular securities, the shares in Kop plc; is specific, in that it relates to the company's take-over plans; has not been made public; and is likely to have a significant effect on the price of the securities. On that basis Greg is clearly guilty of an offence under s.52 of the CJA when he arranges for Jet Ltd to buy the shares in Kop plc.

It is equally apparent that Greg has attempted to disguise the source of his profit from the illegal activity of insider dealing by pretending that it is the result of legitimate work that he has carried out for his company Imp Ltd. As a consequence he would also be liable for prosecution under s.327 of the Proceeds of Crime Act 2002.

- 1** This question requires candidates to consider the doctrine of precedent and in particular to explain particular terms operative within that doctrine.
- (a) 3–4 marks A thorough, to complete answer, explaining the meaning of the two terms.  
0–2 marks A less than complete answer, probably unbalanced, focusing only on one of the terms, or lacking in detail.
- (b) 4–6 marks Thorough treatment of the topic. Clearly explaining the meaning of the two types of precedent.  
2–3 marks Less thorough answer, but showing a reasonable understanding of the topic of precedent.  
0–1 mark Weak answer, perhaps showing some knowledge but little understanding of the topic generally.
- 2** This question requires candidates to examine some of the essential principles relating to the doctrine of consideration in relation to the law of contract.
- 8–10 marks A thorough, to complete answer detailing what is meant by consideration and the two rules. It is likely that case authority will be provided, and they will be rewarded accordingly.  
5–7 marks A limited understanding, or a lack of balance or clarity in regard to the various parts of the question.  
0–4 marks Very unbalanced, only dealing with parts of the question or lacking in detail.
- 3** (a) 2–3 marks A good explanation of the distinction between terms and representations. No reference to misrepresentation is needed.  
0–1 mark Very little knowledge of the meaning of the concepts.
- (b) 5–7 marks Thorough treatment of the topic. Clearly distinguishing between the two types of terms and explaining most, if not all of the ways in which terms may be implied into contracts.  
2–4 marks Less thorough answer, but showing a reasonable understanding of the topic.  
0–1 mark Weak answer, perhaps showing some knowledge but little understanding of the topic generally.
- 4** (a) 3–4 marks Good explanation of the rules relating to company names.  
0–2 marks Some but limited knowledge of the control over company names.
- (b) 3–4 marks Good explanation of the tort of 'passing off' with case authority to support the explanation.  
0–2 marks Some but limited knowledge of 'passing off' or control over company names.
- (c) 2 marks Good explanation of the role of the company names adjudicators and why they are necessary.  
0–1 mark Little if any knowledge of the concept.
- 5** (a) 3–4 marks Thorough explanation of the doctrine of capital maintenance perhaps with some examples of its application.  
0–2 marks Some knowledge but lacking in detail.
- (b) 4–6 marks Good to full consideration of the procedure for reducing capital. Reference must be made to the 2006 Act procedure and the difference between public and private companies should be mentioned specifically.  
2–3 marks Some general knowledge but lacking in detail as regards to the process or not mentioning the difference between the two company forms.  
0–1 mark Little or no understanding of the process.
- 6** This question requires candidates to explain the operation of the Company Directors Disqualification Act 1986.
- 8–10 marks Thorough to complete answers, showing a detailed understanding of the legislation.  
5–7 marks A clear understanding of the topic, but perhaps lacking in detail. Alternatively an unbalanced answer showing good understanding of one part but less in the other.  
2–4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the topic.  
0–1 mark Little or no knowledge of the topic.
- 7** This question requires candidates to explain the meaning of the term redundancy and the legal rules relating to it.
- 8–10 marks Thorough to complete answers, showing a detailed understanding of the concept of redundancy, the rules for calculating payment and probably making reference to the legislation.  
5–7 marks A clear understanding of the topic, but perhaps lacking in detail.  
Alternatively an unbalanced answer showing good understanding of one part but less in the other.  
2–4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its knowledge and understanding of the topic.  
0–1 mark Little or no knowledge of the topic.

- 8** This question requires candidates to analyse a problem scenario from the perspective of contract law and apply the appropriate legal rules.
- 8–10 marks Clear analysis of the problem scenario – recognition of the contract law issues raised and a convincing application of the legal principles to the facts. Appropriate case authorities are likely to be cited.
  - 6–7 marks Sound analysis of the problem – recognition of the major principles involved and a fair attempt at applying them. Perhaps sound in knowledge but lacking in analysis and application.
  - 3–5 marks Unbalanced answer perhaps showing some appropriate knowledge but weak in analysis or application.
  - 0–2 marks Very weak answer showing little analysis, appropriate knowledge or application.
- 9** This question requires a consideration of the statutory duties placed on company directors under the Companies Act 2006.
- 8–10 marks Thorough to complete answers, showing a detailed understanding of the rules relating to conflict of interest.
  - 5–7 marks A clear understanding of the topic but perhaps lacking in detail or application.
  - 2–4 marks Some knowledge, although perhaps not clearly expressed, or very limited in its application.
  - 0–1 mark Little or no knowledge of the topic.
- 10** This question requires candidates to explain the meaning and regulation of the two criminal offences of insider dealing and money laundering and apply that law to a problem scenario. Candidates may mention market abuse as an alternative to insider dealing in which case they should be credited for their knowledge.
- 8–10 marks Clear analysis of the problem scenario – recognition of both the criminal law issues raised and a convincing application of the legal principles to the facts.
  - 6–7 marks Sound analysis of the problem – recognition of the major principles involved and a fair attempt at applying them. Perhaps sound in knowledge but lacking in analysis and application.
  - 3–5 marks Unbalanced answer perhaps showing some appropriate knowledge but weak in analysis or application.
  - 0–2 marks Very weak answer showing little analysis, appropriate knowledge or application.





1 Tutorial note:

In order to apply any piece of legislation, judges have to determine its meaning. In other words they are required to interpret the statute before them in order to give it meaning. The difficulty, however, is that the words in statutes do not speak for themselves and interpretation is an active process, and at least potentially a subjective one depending on the situation of the person who is doing the interpreting.

Judges have considerable power in deciding the actual meaning of statutes, especially when they are able to deploy a number of competing, not to say contradictory, mechanisms for deciding the meaning of the statute before them. There are, essentially, two contrasting views as to how judges should go about determining the meaning of a statute – the restrictive, literal approach and the more permissive, purposive approach.

(a) The literal approach

The literal approach is dominant in the English legal system, although it is not without critics, and devices do exist for circumventing it when it is seen as too restrictive. This view of judicial interpretation holds that the judge should look primarily to the words of the legislation in order to construe its meaning and, except in the very limited circumstances considered below, should not look outside of, or behind, the legislation in an attempt to find its meaning.

Within the context of the literal approach there are two distinct rules:

(i) The literal rule

Under this rule, the judge is required to consider what the legislation actually says rather than considering what it might mean. In order to achieve this end, the judge should give words in legislation their literal meaning, that is, their plain, ordinary, everyday meaning, even if the effect of this is to produce what might be considered an otherwise unjust or undesirable outcome (*Fisher v Bell* (1961)) in which the court chose to follow the contract law literal interpretation of the meaning of offer in the Act in question and declined to consider the usual non-legal literal interpretation of the word (offer).

(ii) The golden rule

This rule is applied in circumstances where the application of the literal rule is likely to result in what appears to the court to be an obviously absurd result. It should be emphasised, however, that the court is not at liberty to ignore, or replace, legislative provisions simply on the basis that it considers them absurd; it must find genuine difficulties before it declines to use the literal rule in favour of the golden one. As examples, there may be two apparently contradictory meanings to a particular word used in the statute, or the provision may simply be ambiguous in its effect. In such situations, the golden rule operates to ensure that preference is given to the meaning that does not result in the provision being an absurdity. Thus in *Adler v George* (1964) the defendant was found guilty, under the Official Secrets Act 1920, with obstruction 'in the vicinity' of a prohibited area, although she had actually carried out the obstruction 'inside' the area.

(b) The purposive approach

The purposive approach rejects the limitation of the judges' search for meaning to a literal construction of the words of legislation itself. It suggests that the interpretative role of the judge should include, where necessary, the power to look beyond the words of statute in pursuit of the reason for its enactment, and that meaning should be construed in the light of that purpose and so as to give it effect. This purposive approach is typical of civil law systems. In these jurisdictions, legislation tends to set out general principles and leaves the fine details to be filled in later by the judges who are expected to make decisions in the furtherance of those general principles.

European Community (EC) legislation tends to be drafted in the continental manner. Its detailed effect, therefore, can only be determined on the basis of a purposive approach to its interpretation. This requirement, however, runs counter to the literal approach that is the dominant approach in the English system. The need to interpret such legislation, however, has forced a change in that approach in relation to Community legislation and even with respect to domestic legislation designed to implement Community legislation. Thus, in *Pickstone v Freemans plc* (1988), the House of Lords held that it was permissible, and indeed necessary, for the court to read words into inadequate domestic legislation in order to give effect to Community law in relation to provisions relating to equal pay for work of equal value. (For a similar approach, see also the House of Lords' decision in *Litster v Forth Dry Dock* (1989) and the decision in *Three Rivers DC v Bank of England (No 2)* (1996).) However, it has to recognise that the purposive rule is not particularly modern and has its precursor in a long established rule of statutory interpretation, namely the mischief rule.

The mischief rule

This rule permits the court to go behind the actual wording of a statute in order to consider the problem that the statute is supposed to remedy.

In its traditional expression it is limited by being restricted to using previous common law rules in order to decide the operation of contemporary legislation. Thus in *Heydon's case* (1584) it was stated that in making use of the mischief rule the court should consider what the mischief in the law was which the common law did not adequately deal with and which statute law had intervened to remedy. Use of the mischief rule may be seen in *Corkery v Carpenter* (1950), in which a man was found guilty of being drunk in charge of a carriage although he was in fact only in charge of a bicycle.



- 2 (a) The effect of the postal rule is such that where acceptance of a contractual offer is through the postal service, acceptance is complete as soon as the letter, properly addressed and stamped, is posted. The contract is concluded, even if the letter subsequently fails to reach the offeror. Thus in *Adams v Lindsell* (1818), the defendant made an offer to the plaintiff on 2 September. Due to misdirection, the letter was delayed. It arrived on 5 September and Adams immediately posted an acceptance. On 8 September, Lindsell sold the merchandise to a third party. On 9 September, the letter of acceptance from Adams arrived. It was held that a valid acceptance took place when Adams posted the letter. Lindsell was, therefore, liable for breach of contract.

The postal rule applies equally to telegrams (*Byrne v Van Tienhoven* (1880)), but it does not apply when means of instantaneous communication are used (*Entores v Far East Corp* (1955)). Also the postal rule will apply only where it is in the contemplation of the parties that post will be used as the means of acceptance. If the parties have negotiated either face-to-face, for example in a shop, or over the telephone, then it might not be reasonable for the offeree to use the post as a means of communicating their acceptance and they would not gain the benefit of the postal rule.

Where acceptance is by e-mail, it has been argued that this situation should be treated as a 'face-to-face' situation where receipt only occurs when the recipient reads the e-mail (*Brinkibon Ltd v Stahag Stahl und Stahlwarenhandels-gesellschaft mbH* (1983)). Where the agreement is conducted on the Internet, regulation 11 of the Electronic Commerce (EC Directive) Regulations 2002 indicates that the contract is concluded when the service provider's acknowledgment of receipt of acceptance is received by electronic means.

(b) Privity of contract

The doctrine of privity in contract law provides that a contract can only impose rights or obligations on persons who are parties to it. Its operation may be seen in *Dunlop v Selfridge* (1915). Dunlop sold tyres to a distributor, Dew and Co, on terms that the distributor would not sell them at less than the manufacturers list price, and that they would extract a similar undertaking from anyone they supplied with tyres. Dew and Co resold the tyres to Selfridge who agreed to abide by the restrictions and to pay Dunlop £5 for each tyre they sold in breach of them. When Selfridge sold tyres at below Dunlop's list price, Dunlop sought to recover the promised £5 per tyre sold. It was held that Dunlop could not recover damages on the basis of the contract between Dew and Selfridge to which they were not a party.

There are a number of ways in which consequences of the application of strict rule of privity may be avoided to allow a third party to enforce a contract. These occur at both common law and under statute.

(i) Common law:

- The beneficiary sues in some other capacity.

A person who was not originally a party to a particular contract may, nonetheless, acquire the power to enforce the contract where they are legally appointed to administer the affairs of one of the original parties. An example of this can be seen in *Beswick v Beswick* (1967) where a coal merchant sold his business to his nephew in return for a consultancy fee of £6-10 shillings (in pre-decimal currency) during his lifetime, and thereafter an annuity of £5 per week payable to his widow. After the uncle died, the nephew stopped paying the widow. When she became administratrix of her husband's estate, she sued the nephew for specific performance of the agreement in that capacity as well as in her personal capacity. It was held that, although she was not a party to the contract and therefore could not be granted specific performance in her personal capacity, such an order could be awarded to her as the administratrix of the deceased person's estate.

- The situation involves a collateral contract.

A collateral contract arises where one party promises something to another party if that other party enters into a contract with a third party, for example, A promises to give B something if B enters into a contract with C. In such a situation, the second party can enforce the original promise, that is, B can insist on A complying with the original promise. In *Shanklin Pier v Detel Products Ltd* (1951), the plaintiffs contracted to have their pier repainted. On the basis of promises as to its quality, the defendants persuaded the pier company to insist that a particular paint produced by Detel be used. The painters used the paint but it proved unsatisfactory. The plaintiffs sued for breach of the original promise as to the suitability of the paint. The defendants countered that the only contract they had entered into was between them and the painters to whom they had sold the paint, and that as the pier company were not a party to that contract they had no right of action against Detel. The pier company were successful. It was held that, in addition to the contract for the sale of paint, there was a second collateral contract between the plaintiffs and the defendants by which the latter guaranteed the suitability of the paint in return for the pier company specifying that the painters used it.

- There is a valid assignment of the benefit of the contract.

A party to a contract can transfer the benefit of that contract to a third party through the formal process of assignment. The assignment must be in writing, and the assignee receives no better rights under the contract than the assignor possessed. The burden of a contract cannot be assigned without the consent of the other party to the contract.

- Where it is foreseeable that damage caused by any breach of contract will cause a loss to a third party.

In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* (1994), the original parties had entered into a contract for work to be carried out on property with the likelihood that it would subsequently be transferred to a third party. The defendant's poor work, amounting to a breach of contract, only became apparent after the property had been

transferred. There had been no assignment of the original contract and, normally, under the doctrine of privity, the new owners would have no contractual rights against the defendants and the original owners of the property would have suffered only a nominal breach as they had sold it at no loss to themselves. Nonetheless, the House of Lords held that, under such circumstances, and within a commercial context, the original promisee should be able to claim full damages on behalf of the third party for the breach of contract.

- One of the parties has entered the contract as a trustee for a third party.

There exists the possibility that a party to a contract can create a contract specifically for the benefit of a third party. In such limited circumstances, the promisee is considered as a trustee of the contractual promise for the benefit of the third party. In order to enforce the contract, the third party must act through the promisee by making them a party to any action. For a consideration of this possibility, see *Les Affréteurs Réunis SA v Leopold Walford (London) Ltd* (1919).

The other main exception to the privity rule at common law is agency, where the agent brings about contractual relations between two other parties even where the existence of the agency has not been disclosed.

(ii) *Statute*

The first area in which statute has intervened in relation to the doctrine of privity is in relation to motor insurance where third parties claim directly against the insurers of the party against whom they have a claim.

The most significant alteration of the operation of the doctrine of privity however, has been made by the *Contracts (Rights of Third Parties) Act 1999* which sets out the circumstances in which third parties can enforce terms of contracts. In order for the third party to gain rights of enforcement, the contract in question must, either, expressly confer such a right on them or, alternatively, it must have been clearly made for their benefit (s.1). The contractual agreement must actually identify the third party, either by name, or as a member of a class of persons, or answering a particular description. The third person need not be in existence when the contract was made, so it is possible for parties to make contracts for the benefit of as yet unborn children. This provision should also reduce the difficulties relating to pre-incorporation contracts in relation to registered companies. The third party may exercise the right to any remedy which would have been available had they been a party to the contract. Such rights are, however, subject to the terms and conditions contained in the contract and they can get no better right than the original promisee.

Section 2 of the Act provides that, where a third party has rights by virtue of the Act, the original parties to the contract cannot agree to rescind it or vary its terms without the consent of the third party; unless the original contract contained an express term to that effect.

Section 3 allows the promisor to make use of any defences or rights of set-off they might have against the promisee in any action by the third party. Additionally, the promisor can also rely on any such rights against the third party.

Section 5 removes the possibility of the promisor suffering from double liability in relation to the promisor and the third party. It provides, therefore, that any damages awarded to a third party for a breach of the contract be reduced by the amount recovered by the original promisee in any previous action relating to the contract.

The Act does not alter the existing law relating to negotiable instruments, contracts of employment, or contracts for the carriage of goods or the statutory contracts constituted by to companies' constitutional documents.

- 3 This question requires an explanation of two aspects the law relating to damages for breach of contract. Every failure to perform a primary obligation is a breach of contract. The secondary obligation on the part of the contract-breaker, by implication of the common law, is to pay monetary compensation to the other party for the loss sustained by him in consequence of the breach (*Photo Productions Ltd v Securicor Transport Ltd* (1980)). Such monetary compensation for breach of contract is damages. There are, however, two distinct aspects to this general concept that have to be considered.

(a) *Liquidated damages and penalty clauses*

It is possible, and common in business contracts, for the parties to an agreement to make provisions for possible breach by stating in advance the amount of damages that will have to be paid in the event of any breach occurring. Damages under such a provision are known as liquidated damages. They will only be recognised by the court if they represent a genuine pre-estimate of loss, and are not intended to operate as a penalty against the party in breach. If the court considers the provision to be a penalty, it will not give it effect, but will award damages in the normal way.

In *Dunlop v New Garage and Motor Co* (1915), the plaintiffs supplied the defendants with tyres, under a contract designed to achieve resale price maintenance. The contract provided that the defendants had to pay Dunlop £5 for every tyre they sold in breach of the resale price agreement. When the garage sold tyres at less than the agreed minimum price, they resisted Dunlop's claim for £5 per tyre, on the grounds that it represented a penalty clause. On the facts of the situation, the court decided that the provision was a genuine attempt to fix damages, and was not a penalty. It was, therefore, enforceable.

In deciding the legality of such clauses, the courts will consider the effect, rather than the form, of the clause as is seen in *Cellulose Acetate Silk Co Ltd v Widnes Foundry (1925) Ltd* (1933). In that case, the contract expressly stated that damages for late payment would be paid by way of penalty at the rate of £20 per week. In fact, the sum of £20 was in no way excessive and represented a reasonable estimate of the likely loss. On that basis, the House of Lords enforced the clause in spite of its actual wording.

(b) *The duty to mitigate losses*

This rule relates to the rule that the injured party in the situation of a breach of contract is under a duty to take all reasonable steps to minimise their loss. The operation of the rule means that the buyer of goods that are not delivered, as required under the terms of a contract, has to buy the replacements as cheaply as possible. Correspondingly, the seller of goods that are not accepted in line with a contractual agreement has to try to get as good a price as they can when they sell them.

In *Payzu v Saunders* (1919), the parties entered into a contract for the sale of fabric, which was to be delivered and paid for in instalments. When the purchaser, Payzu, failed to pay for the first instalment on time, Saunders refused to make any further deliveries unless Payzu agreed to pay cash on delivery. The plaintiff refused to accept this and sued for breach of contract. The court decided that the delay in payment had not given the defendant the right to repudiate the contract. As a consequence, he had breached the contract by refusing further delivery. The buyer, however, should have mitigated his loss by accepting the offer of cash on delivery terms. His damages were restricted, therefore, to what he would have lost under those terms, namely, interest over the repayment period.

In *Western Web Offset Printers Ltd v Independent Media Ltd* (1995), the parties had entered into a contract under which the plaintiff was to publish 48 issues of a weekly newspaper for the defendant. In the action, which followed the defendant's repudiation of the contract, the only issue in question was the extent of damages to be awarded. The Court of Appeal decided that as the claimant had been unable to replace the work due to the recession in the economy and, therefore, had not been able to mitigate the loss, it was entitled to receive the full amount that would have been due in order to allow it to defray the expenses it would have had to pay during the period the contract should have lasted.

However, in relation to anticipatory breach of contract the injured party can wait until the actual time for performance before taking action against the party in breach. In such a situation, they are entitled to make preparations for performance, and claim the agreed contract price, even though this apparently conflicts with the duty to mitigate losses (*White and Carter (Councils) v McGregor* (1961)).

- 4 Whilst there is a contractual relationship between an auditor and his client the company as a legal entity, on which the client company can sue, the contentious legal area arises in respect of other people who may rely on reports made or advice given in a non-contractual capacity. Indeed, in many situations, the potential plaintiff may be unknown to the accountant. Although it is apparent that the law of negligence allows individuals in non-contractual relationships to sue for damages sustained as result of the negligent behaviour of another party, the success of any such action in relation to company auditors appears to depend upon the purpose for which reports are made or accounts prepared and on establishing a duty of care between the auditor and the person making the claim in negligence. The applicable law may derived from a number of important cases.

In *JEB Fasteners v Marks, Bloom and Co* (1983), the defendants, a firm of accountants, negligently overstated the value of stock in preparing audited accounts for their client. At the time of preparation, the accountants were aware that their client was in financial difficulties and actively seeking financial assistance. After seeing the accounts, the plaintiffs decided to take over the company. They then discovered the true financial position and sued the accountants for negligent misstatement. It was held that a duty of care was owed by the accountants as it was foreseeable that someone contemplating a takeover might rely on the accuracy of the accounts, but that they were not liable as their negligence had not caused the loss to the plaintiffs. The evidence revealed that, when they took over the company, they were not interested in the value of the stock but in acquiring the expertise of the directors, so, although they relied on the accounts, the accounts were not the cause of the loss as they would have taken over the company in any respect.

The case of *Caparo Industries plc v Dickman* (1990) served to limit the potential liability of auditors in auditing company accounts. Accounts were audited in accordance with the Companies Act 1985. The respondents, who already owned shares in the company, after seeing the accounts, decided to purchase more shares and take over the company. They then incurred a loss which they blamed on the inaccurate and negligently audited accounts. It was held that when the accounts were prepared, a duty of care was owed collectively to members of the company, that is, the shareholders, but only so far as to allow them to exercise proper control over the company; enabling the shareholders collectively to question the past management of the company, vote for or against the appointment of directors and take other decisions affecting the company. This duty did not extend to members as individuals, even when they used the accounts as the basis for purchasing more shares in the company, and it certainly did not extend to potential outside purchasers of shares. The onus was clearly on the appellants in these circumstances to make their own independent enquiries as it was unreasonable to rely on the auditors.

However, in *Morgan Crucible Co plc v Hill Samuel Bank Ltd* (1991), it was held that, where express representations are made about the accounts and the financial state of the company by directors or financial advisers of that company, with the intention that the person interested in the takeover will rely on them, then a duty of care is owed, and the auditor will be responsible for consequential losses. This was also the situation in *ADT v BDO Binder Hamilton* (1995) where a partner in the defendant accountancy firm told the plaintiff company that he stood by the audited accounts of BSG, the company that the ADT were in the process of taking over. This was taken as an assumption of responsibility and as the accounts had been prepared negligently, Binder Hamilton were held liable to repay the amount that ADT had overpaid for BSG a total of £65 million.

Following *Caparo Industries plc v Dickman* (1990) it can be stated that a company's auditors certainly do owe a duty of care to shareholders collectively as a body to allow them to exercise proper control over the management of the company.

As regards members individually, then again following *Caparo*, normally the auditors do not owe them a duty of care, even when they use the information supplied to purchase more shares in the company.

Following from the foregoing it can be seen that auditors owe no duty of care to non-members unless they actually assume responsibility for the accuracy of information they supply (*Morgan Crucible Co plc v Hill Samuel Bank Ltd* (1991) and *ADT v BDO Binder Hamilton* (1995)).

5 This question requires candidates to explain the concept of limited liability and to consider three alternative categories of companies; the first unlimited in nature, whilst the second and third are limited in different ways.

- (a) In this context, liability refers to the extent to which shareholders in companies are responsible for the debts of their companies and limited liability indicates that a limit has been placed on such liability. The point is that the limitation on liability is enjoyed by the member shareholders rather than the company. One of the major advantages of forming a company is that the members of the company may achieve limited liability. The great majority of registered companies are limited liability companies. This means that the maximum liability of shareholders is fixed and cannot be increased without their agreement. As will be seen below there are two ways of establishing limited liability.
- (b) Section 3 of the Companies Act (CA) 2006 sets out the various types of companies that can be registered in term of different liabilities.
- (i) Companies can be formed without limited liability. These, by virtue of s.3(4) CA 2006, are referred to as unlimited companies. Such companies are incorporated under the Companies Acts and receive all the benefits that flow from incorporation except limited liability. Consequently the shareholders in such unlimited companies remain liable to the full extent of their personal wealth for any unpaid debt of the company. It should be noted that, in line with the doctrine of separate personality, even in the case of unlimited companies any subsequent debt is owed to the company and not directly to the creditors of the company. The compensating benefit enjoyed by such companies is that they do not have to submit their accounts and make them available for public inspection.
  - (ii) The company limited by guarantee (s.3(3) CA 2006) is usually restricted to non-trading enterprises such as charities and professional and educational bodies. It limits the shareholders' liability to an agreed amount which is only called on if the company cannot pay its debts on being wound up. In reality, the sum guaranteed is usually a nominal sum, so no real risk is involved on the part of the guarantor.
  - (iii) The more common procedure is to limit liability by reference to shares (s.33(2)). The effect of this is to limit liability to the amount remaining unpaid on shares held (Insolvency Act 1986 s.74(2)(d)). If the shareholder has paid the full nominal value of the shares to the company, then that is the end of responsibility with regard to company debts. Consequently, if the company should subsequently go into insolvent liquidation the shareholders cannot be required to contribute to its assets in order to pay off its outstanding debts.

6 This question requires candidates to explain the meaning of the terms 'compulsory winding up' and 'administration'.

- (a) Winding up, or liquidation, is the process whereby the life of the company is terminated. It is the formal and strictly regulated procedure whereby the business is brought to an end and the company's assets are realised and distributed to its creditors and members. The procedure is governed by the Insolvency Act (IA) 1986 and may be divided into three distinct categories:

*Member's voluntary winding up,  
Creditors' voluntary winding up,  
Compulsory winding up.*

This question requires attention to be focused on the last of these three. A compulsory winding up is a winding up ordered by the court under s.122 of the IA 1986. Although there are seven distinct grounds for such a winding up, the most common reason for the winding up of a company is its inability to pay its debts. Section 123 provides that, if a company with a debt exceeding £750 fails to pay it within three weeks of receiving a written demand, then it is deemed unable to pay its debts.

On the presentation of a petition to wind a company up compulsorily, the court will normally appoint the Official Receiver to be the company's provisional liquidator. The Official Receiver will require the present or past officers, or indeed employees of the company to prepare a statement of the company's affairs. This statement must reveal:

- particulars of the company's assets and liabilities;
- names and addresses of its creditors;
- any securities held by the creditors (fixed or floating charges) and the dates on which they were granted;
- any other information which the Official Receiver may require.

After his appointment, the Official Receiver calls meetings of the company's members and creditors in order to select a liquidator to replace him and to select a liquidation committee if required. Once again, in the event of disagreement, the choice of the creditors prevails.

Section 142 of the IA 1986 states that the functions of the liquidator are 'to secure that the assets of the company are got in, realised and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it'. Once the liquidator has performed these functions, he must call a final meeting of the creditors, at which he gives an account of the liquidation and secures his release from the creditors. Notice of the final meeting has to be submitted to the registrar of companies and, three months after that date, the company is deemed to be dissolved.

- (b) Administration, on the other hand is a means of safeguarding the continued existence of business enterprises in financial difficulties, rather than merely ensuring the payment of creditors. Administration was first introduced in the Insolvency Act 1986. The aim of the administration order is to save the company, or at least the business, as a going concern by taking control of the company out of the hands of its directors and placing it in the hands of an administrator. Alternatively, the procedure is aimed at maximising the realised value of the business assets.



Once an administration order has been issued, it is no longer possible to commence winding up proceedings against the company or enforce charges, retention of title clauses or even hire-purchase agreements against the company. This major advantage was in no small way undermined by the fact that, under the previous regime, an administration order could not be made after a company has begun the liquidation process. Since companies are required to inform any person who is entitled to appoint a receiver of the fact that the company is applying for an administration order, it was open to any secured creditor to enforce their rights and to forestall the administration procedure. This would cause the secured creditor no harm, since their debt would more than likely be covered by the security, but it could well lead to the end of the company as a going concern.

The Enterprise Act 2002 introduced a new scheme, which limited the powers of floating charge holders to appoint administrative receivers, whose function had been essentially to secure the interest of the floating charge holder who had appointed them, rather than the interests of the general creditors. By virtue of the Enterprise Act 2002, which amends the previous provisions of the Insolvency Act 1986, floating charge holders no longer have the right to appoint administrative receivers, but must now make use of the administration procedure as provided in that Act. As compensation for this loss of power the holders of floating charges are given the right to appoint the administrator of their choice.

The function of the administrator is to:

- Rescue the company as a going concern, or
- Achieve a better result for the company's creditors as a whole than would be likely if the company were to be wound up, or
- Realise the value of the property in order to make a distribution to the secured or preferential creditors.

The administrator is only permitted to pursue the third option where:

- He thinks it is not reasonably practicable to rescue the company as a going concern, and
- Where he thinks that he cannot achieve a better result for the creditors as a whole than would be likely if the company were to be wound up, and
- If he does not unnecessarily harm the interests of the creditors of the company as a whole.

An application to the court for an administration order may be made by a company, the directors of a company, or any of its creditors, but in addition the Enterprise Act allows the appointment of an administrator without the need to apply to the court for approval. Such 'out of court' applications can be made by the company or its directors, but may also be made by any floating charge holder.

During the administration process the administrator has the powers to:

- do anything necessary for the management of the company
- remove or appoint directors
- pay out monies to secured or preferential creditors *without the need to seek the approval of the court*
- pay out monies to unsecured creditors *with the approval of the court*
- take custody of all property belonging to the company
- dispose of company property. This power includes property which is subject to both fixed and floating charges, which may be disposed of without the consent of the charge holder, although they retain first call against any money realised by such a sale.

The administration period is usually 12 months, although this may be extended by six months with the approval of the creditors, or longer with the approval of the court. When the administrator concludes that the purpose of their appointment has been achieved, a notice to this effect is sent to the creditors, the court and the companies registry. Such a notice terminates the administrator's appointment. If the administrator forms the opinion that none of the purposes of the administration can be achieved, the court should be informed and it will consider ending the appointment. Creditors can always challenge the actions of the administrator through the courts.

- 7 (a) Although a contract of employment need not be in writing, the employer must provide the employee with particulars of the main terms of the contract in writing as required by the Employment Rights Act 1996. Such express terms are agreed upon by the employer and employee on entering into the contract of employment. However, in the absence of stated terms the law will impose duties on both employer and employee. Such implied terms have to be read subject to any express terms to the contrary. Although where the implied term is necessary to give efficacy to the contract, the implied term will take precedence over the express term (*Johnstone v Bloomsbury Health Authority* (1991)).

Duties of the employer

- (i) *To provide work*

The employer normally will be expected to provide work for the employee and where the employee is skilled and needs practice to maintain those skills, there may be an obligation to provide a reasonable amount of work *Langston v Amalgamated Union of Engineering Workers* (1974). No breach of this implied duty will occur so long as the employee continues to be paid even though there may be no work available.

- (ii) *To pay wages*

Normally the rate of pay is expressly stated in the contract of employment. However, in the absence of an express provision, the law will impose the duty to pay a reasonable remuneration for the work done. Following from (i) above, an employer must pay employees their wages even if there is no work available, although an express term to the contrary

may be included in the contract of employment. Where workers, in the pursuit of an industrial dispute, offer only part performance by working to rule or adopting a 'go-slow' policy, the employer can refuse to accept such part performance and can refuse to make any payment for work done.

(iii) *To indemnify the employee*

Where the employee in the course of his or her employment incurs any legal liability or necessary expenses on behalf of the employer, the employee is entitled to be indemnified or reimbursed.

(iv) *Mutual respect*

The employment relationship is assumed to be based on mutuality of respect, trust and confidence and the employer must not act in a way calculated to damage such mutuality. As will be seen this is a reciprocal relationship, but it is clear that employers cannot treat their employees in an abusive manner (*Isle of Wight Tourist Board v Coombes* (1976)) and must be prepared to address any grievances they might have (*WA Gould (Pearmak) Ltd v McConnell & Another* (1995)).

(v) *To provide a safe system of work*

At common law the employer is required to take reasonable care for the health and safety of his employees. Failure to comply will render the employer liable for an action in negligence. The duty extends to the provision of competent fellow employees, safe plant and equipment, a safe place of work and a safe system of work. If the employer has taken all reasonable steps to comply with the duty of care then they will not be liable for any injury sustained (*Latimer v AEC Ltd* (1953)).

(b) There are a number of implied duties imposed on employees, which may all be understood as deriving from their relationship of trust and confidence with their employer and the consequential duty of loyalty and faithful service that derives from that relationship. The specific duties may be cited as:

(i) *to act faithfully*

This is the fundamental duty and it covers such aspects of confidentiality, i.e. not passing on information derived from one's employment to outsiders and not competing with the employer either directly or indirectly.

The courts are reluctant to accept that what workers do in their spare time should be of any concern to their employer (*Nova Plastics Ltd v Froggett* (1982)). However, sometimes an employer's interests may be harmed by an employee's spare-time work if this involved direct competition with the employer's business (*Hivac Ltd v Park Royal Scientific Instruments Ltd* (1946)).

An employee may not do anything while still employed, which is in breach of the duty to act faithfully. However, it is perfectly lawful for ex-employees to canvass customers of their former employer after leaving service. Moreover, they are entitled to make use of any knowledge and skills acquired while in the former employer's business, apart from such information which can be classified as a trade secret. In this sense the implied duty of confidentiality for ex-employees is narrower than in the case of an existing employee (*Faccenda Chicken Ltd v Fowler* (1986)).

(ii) *to obey reasonable orders*

Employees must obey any reasonable and lawful instruction given to them by their employer. Whether any instruction fulfils these criteria is a matter of fact in each instance. The classic case in this area is *Pepper v Webb* (1969) in which a gardener not only indicated that he was not willing to follow an instruction but actually swore at his employer. In a subsequent action it was held that as the order was both lawful and reasonable the gardener had breached his implied duty.

(iii) *to use skill and care*

Should an employee not exercise the level of skill and care that may reasonably be expected, then they will not only be liable to dismissal, but they may also lose the protection of the employer's duty to indemnify them for losses (see part (a) above), and be made personally liable for claims for compensation. The classic case in this instance is *Lister v Romford Ice and Cold Storage Ltd* (1957) in which an employee lorry driver, rather than his employer, was held liable to compensate a fellow worker, due to his gross negligence in driving his lorry, which was held to breach his implied duty of skill and care.

(iv) *not to take bribes or make a secret profit*

This duty almost goes without saying, as an example of the general duty of good faith, but it covers the situation where an employee has received money or gifts from customers or clients. In this instance the classic case is *Boston Deep Sea Fishing Ice Co v Ansell* (1888) in which a managing director of a company was held to have been properly dismissed for having taken money as commission from the company's suppliers for orders he placed with them.

- 8 Given that the question scenario clearly states that the exclusion clause was incorporated into the contract between Andy and Bash Ltd (and there can be no doubt that it is), it is only necessary to consider the effect of the clause. On the basis of the clear wording, it would appear that the wording of the exclusion clause is sufficiently clear and specific to cover Bash Ltd's negligence. As a consequence, it only remains to consider how the legislation governing exclusion clauses would be likely to deal with this particular clause in the context of the question.

The Unfair Contract Terms Act 1977 (UCTA) is the original statutory attempt to control exclusion clauses. The original Unfair Terms in Consumer Contracts Regulations (UTCCR) were enacted in 1994 to implement the European Unfair Contract Terms Directive and were subsequently replaced by the current regulations in 1999.

Section 2(1) of UCTA provides an absolute prohibition on exemption clauses in relation to liability in negligence resulting in death or injury. It is therefore apparent that Bash Ltd cannot avoid responsibility for the injury sustained by Andy and will be liable for the injuries and the consequential loss he suffered.

Section 2 also provides that any exemption clauses relating to liability for other damage caused by negligence will only be enforced to the extent that they satisfy the 'requirement of reasonableness'; and s.11 provides that the requirement of reasonableness means 'fair and reasonable ... having regard to the circumstances ...'.

In looking at the circumstances of the case the court will take into account matters relating to the relative strength of bargaining power: inducements to accept the restrictions: whether the customer knew or ought to have known of the exclusion: whether the goods involved were specially made or adapted. The final outcome, therefore, is dependent on judicial interpretation. The onus of showing reasonableness rests with the party relying on the clause (*St Alban's CDC v International Computers Ltd* (1994)). If one were to ask the question: 'Was it reasonable for Bash Ltd to deny responsibility for the consequence of their negligence in this case?' the answer is likely to be no. Consequently Bash Ltd is likely to be liable for all the damages consequent upon its vicarious negligence, and the exclusion clause to have no effect (see *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* (1983) and *Smith v Bush* (1989)).

Although the Unfair Terms in Consumer Contracts Regulations 1999 do not affect the outcome of the situation in any material way, it is worth mentioning them at this point. The regulations are potentially wider in scope than UCTA, in that they cover all terms and not just exclusion clauses. Regulation 3(1) states that it applies to 'any term in a contract concluded between a seller or supplier and a consumer where the term has not been individually negotiated'. Under regulation 4(i), a term is unfair 'if contrary to the requirements of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer'. Consequently reg.5(1) provides that if a term is found to be unfair it will not be binding on the consumer, although the remainder of the contract will continue to operate if it can do so after the excision of the unfair term.

- 9 This question requires candidates to analyse a problem scenario and explain and apply the law relating to directors' contracts with their companies.

As a consequence of the position they hold, company directors owe fiduciary duties to their companies. One such duty is *the duty not to permit a conflict of interest and duty to arise*. This equitable rule is strictly applied by the courts and the effect of its operations may be seen in *Regal (Hastings) v Gulliver* (1942). In that case, the directors of a company owning one cinema provided money for the creation of a subsidiary company to purchase two other cinemas. After the parent and subsidiary companies had been sold at a later date, the directors were required to repay the profit they had made on the sale of their shares in the subsidiary company on the grounds that they had only been in the situation to make that profit because of their positions as directors of the parent company. It is not necessary to prove an actual conflict of interest, merely the possibility of such a conflict, and the rigorous nature of this principle may be seen in *Boardman v Phillips* (1967).

One obvious area where directors place themselves in a position involving a conflict of interest is where they have an interest in a contract with the company. The common law position was that in the event of any such situation arising, any contract involved was voidable at the instance of the company (*Aberdeen Ry Co v Blaikie* (1854)). However, s.182 of the Companies Act 2006 places a duty on directors to declare any interest, direct or indirect, in any contracts with their companies, and provides for a fine if they fail in this regard. A director's disclosure can take the form of a general declaration of interest in a particular company, which is considered sufficient to put the other directors on notice for the future. Any declaration of interest must be made at the board meeting that first considers the contract, or if the director becomes interested in the contract after that, at the first meeting thereafter. Failure to disclose any interest renders the contract voidable at the instance of the company and the director may be liable to account to the company for any profit made in relation to it.

Applying the above to the problem scenario, it appears that Caz did not declare her interest in either Era Ltd generally, or the particular contract in question. Dull plc could have avoided the contract had they found out earlier and acted sooner, but in any case Caz can be held liable to account to Dull plc for any profit she made on the deal. Caz will also be liable to prosecution and a fine under s.183 of the Companies Act 2006, which criminalises any failure to comply with the requirements of s.182.

- 10 This question requires candidates to consider fraudulent trading both under s.993 of the Companies Act 2006 and s.213 of the Insolvency Act 1986, and wrongful trading under s.214 of the Insolvency Act 1986.

- (a) There has long been civil liability for any activity amounting to fraudulent trading. Thus, s.213 of the Insolvency Act (IA) 1986 governs situations where, in the course of a winding up, it appears that the business of a company has been carried on with intent to defraud creditors, or for any fraudulent purpose. In such cases, the court, on the application of the liquidator, may declare that any persons who were knowingly parties to such carrying on of the business are liable to make such contributions (if any) to the company's assets as the court thinks proper. There is a major problem in making use of s.213, however, and that lies in meeting the very high burden of proof involved in proving dishonesty on the part of the person against whom it is alleged. It should be noted that there is also a criminal offence of fraudulent trading under s.993 of the Companies Act 2006, which applies to anyone who has been party to the carrying on of the business of a company with intent to defraud creditors or any other person, or for any other fraudulent purpose.

Given that it is stated that Gram and Hen hid the fact that Ire Ltd was insolvent it is possible that they might be liable under the fraudulent trading provisions both civil and criminal. As a consequence they may well be liable for a maximum prison sentence of 10 years and may have to contribute to the assets of the company to cover any loss sustained by creditors as a result of their actions. There is no evidence to support either action against Fran.

- (b) Wrongful trading does not involve dishonesty but, nonetheless, it still makes particular individuals potentially liable for the debts of their companies. Section 214 applies where a company is being wound up and it appears that, at some time before the start of the winding up, a director knew, or ought to have known, that there was no reasonable chance of the company avoiding insolvent liquidation. In such circumstances, then, unless the directors took every reasonable step to minimise the potential loss to the company's creditors, they may be liable to contribute such money to the assets of the company as the court thinks proper. In deciding what directors ought to have known, the court will apply an objective test, as well as a subjective one. As in common law, if the director is particularly well qualified, they will be expected to perform in line with those standards. Additionally, however, s.214 of the IA 1986 establishes a minimum standard by applying an objective test which requires directors to have the general knowledge, skill and experience, which may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company.

The manner in which incompetent directors will become liable to contribute to the assets of their companies was shown in *Re Produce Marketing Consortium Ltd* (1989), in which two directors were held liable to pay compensation from the time that they ought to have known that their company could not avoid insolvent liquidation, rather than the later time when they actually realised that fact. Interestingly, the common law approach to directors' duty of care has been extended to accommodate the requirements of s.214 (*Re D'Jan of London Ltd* (1993)).

It is clearly apparent that both Gram and Hen will be personally liable under s.214 for the increase in Ire Ltd's debts from £10,000 to £100,000. However, as a director of the company Fran will also be liable to contribute to the assets of the company under s.214.



- 1 This question requires candidates to consider the powers of judges to interpret legislation and the rules they apply in exercising such interpretative powers. Although the question requires answers to focus on the two main general approaches, it also requires an explanation of the various traditional rules of statutory interpretation employed by the courts.
- (a) requires a consideration of the literal approach, including the golden rule.
- 3–5 marks Full detailed explanation with supporting cases or examples.
- 1–2 marks Limited knowledge of the topic; perhaps lacking detail or cases/examples.
- 0 mark No knowledge on the topic under consideration.
- (b) requires a consideration of the purposive approach, including the mischief rule.
- 3–5 marks Full detailed explanation with supporting cases or examples.
- 1–2 marks Limited knowledge of the topic; perhaps lacking detail or cases/examples.
- 0 mark No knowledge on the topic under consideration.
- Candidates may simply produce a global answer considering the traditional rules and will be marked according to the content provided.
- 2 This question is divided into two parts relating to distinct aspects of the law of contract.
- (a) 4–5 marks A good to excellent understanding of the postal rule demonstrated by references to cases or examples.
- 2–3 marks Some, but limited, understanding of the topic, or clear understanding of only one aspect.
- 0–1 mark Little or no knowledge of the topic.
- (b) 4–5 marks A good to excellent understanding of privity demonstrated by references to cases or examples.
- 2–3 marks Some, but limited, understanding of the topic, or clear understanding of only one aspect.
- 0–1 mark Little or no knowledge of the topic.
- 3 This question requires an explanation of two aspects the law relating to damages for breach of contract. It is split into two parts with 7 marks being available for part (a) and 3 marks for part (b).
- (a) 5–7 marks A good explanation of the difference between liquidated damages and penalty clauses with perhaps some examples or cases.
- 3–4 marks Some, but limited, understanding of the topic, or clear understanding of only one aspect.
- 0–2 marks Little knowledge of either element of the question or unbalanced in only dealing with one of the elements.
- (b) 2–3 marks A thorough explanation of the duty the duty to mitigate losses with examples or cases.
- 0–1 mark Some, if little, knowledge of the duty but not clear or lacking in detail.
- 4 This question requires candidates to explain the extent of a company auditor's duty of care and to whom such a duty is owed.
- 8–10 marks A thorough understanding of how professional negligence applies to auditors demonstrated by references to cases or examples.
- 5–7 marks A clear understanding of the topic, perhaps lacking in detail.  
Alternatively an unbalanced answer showing good understanding of one part but less in the others.
- 2–4 marks Some, but limited, understanding of the topic, or clear understanding of only one aspect.
- 0–1 mark Little or no knowledge of the topic.

- 5 This question is likely to be answered in a global way and marks will be awarded inline with points made.
- (a) Up to 3 marks for a general explanation of limited liability.
  - (b) (i) Up to 2 marks for an explanation of unlimited liability and why it might be used.
  - (ii) Up to 2 marks for knowledge of companies limited by guarantee. What they are, where they are used and the nature of liability.
  - (iii) Up to 3 marks for a thorough explanation of liability limited by reference to the amount unpaid on shares and how it operates.
- 6 This question, in two parts, carrying 4 marks for part (a) and 6 marks for part (b), requires candidates to explain the meaning of the terms 'compulsory winding up' and 'administration'.
- (a) 3–4 marks A good explanation of the meaning and effect of winding up generally and compulsory winding up in particular.
  - 0–2 marks Some, if little knowledge of winding up, or perhaps too general or unbalanced in not dealing specifically with compulsory winding up.
  - (b) 4–6 marks A good explanation of the meaning and effect of administration generally and contrasting its purpose with that of compulsory winding up.
  - 2–3 marks Some, if little, explanation of administration, but perhaps too general or lacking in detail.
  - 0–1 mark Little or no knowledge of the topic.
- 7 This question requires an explanation of the common law duties owed by both employers and employees.
- (a) 5–6 marks Good awareness of the implied duties imposed on employers. Examples used to highlight answers.
  - 3–4 marks Sound understanding but perhaps no examples.
  - 0–2 marks Limited knowledge only about the topic.
  - (b) 3–4 marks Good awareness of the implied duties imposed on employees.
  - 0–2 marks Limited knowledge about the topic.
- 8 This question requires candidates to apply the law relating to exclusion clauses to a specific problem scenario. Marks will be awarded for both knowledge and application, but application is essential.
- 8–10 marks The best candidates should provide a clear understanding of the legal control of exclusion clauses and be able to apply the law. Some detailed reference should be made to the provisions of the Unfair Contract Terms Act (UCTA) 1997 and the very best answers will at least mention the Unfair Terms in Consumer Contracts Regulations 1999. Cases or examples should be used to demonstrate points made.
  - 5–7 marks Weaker candidates may show little detailed knowledge of the legislation but be able to consider the UCTA generally.
  - 3–4 marks Some but limited knowledge of the appropriate law or lacking in application.
  - 0–2 marks The poorest candidates will provide nothing but the briefest reference to the legislation.
- 9 This question requires candidates to analyse a problem scenario and explain and apply the law relating to directors' contracts with their companies.
- 8–10 marks A good analysis of the scenario with a clear explanation of the law relating to contracts between directors and their companies, both at common law and under statute. Cases and/or references to the Companies Act will be provided.
  - 5–7 marks Some understanding of the situation but perhaps lacking in detail or reference to the statute.
  - 3–4 marks Weak answer lacking in knowledge or application, with little or no reference to the Companies Act.
  - 0–2 marks Little if any knowledge of the appropriate legal principles.

**10** This question requires candidates to consider fraudulent trading both under s.993 of the Companies act 2006 and s.213 of the Insolvency Act 1986, and wrongful trading under s.214 of the Insolvency Act 1986.

- (a)** 4–5 marks Clear explanation of operation of the law relating to fraudulent trading, under both criminal and civil law, but with the emphasis on the Insolvency Act provisions.  
2–3 marks Some to good understanding but lacking detail.  
0–1 mark Little or no knowledge.
- (b)** 4–5 marks Clear explanation of the law relating to wrongful trading, probably, but not necessarily referring to case law.  
2–3 marks Some to fair understanding but lacking detail.  
0–1 mark Little if any knowledge.

DRAFT









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