

CHIEF EXAMINER COMMENTS WITH SUGGESTED POINTS FOR RESPONSES

JANUARY 2023

LEVEL 6 UNIT 1 – COMPANY & PARTNERSHIP LAW

Note to Candidates and Learning Centre Tutors:

The purpose of the suggested points for responses is to provide candidates and learning centre tutors with guidance as to the key points candidates should have included in their answers to the January 2023 examinations. The suggested points for responses sets out a response that a good (merit/distinction) candidate would have provided. Candidates will have received credit, where applicable, for other points not addressed by the marking scheme.

Candidates and learning centre tutors should review the suggested points for responses in conjunction with the question papers and the Chief Examiners' **comments contained within this report**, which provide feedback on candidate performance in the examination.

CHIEF EXAMINER COMMENTS

Candidates need to focus on reading the question carefully, considering each element and the precise wording and responding to the command words. The wider implications of questions should be addressed. For example, in relation to the question on partnership authority, which was the most popular, many answers were limited to a description of section 5 PA 1890 authority without mention of actual (express and implied) and other types of authority under the PA 1890.

Overall stronger answers engaged in clear analysis or evaluation as required, cited cases and statute accurately and provided conclusions. These conclusions are particularly relevant where the question requires analysis, evaluation or assessment.

Many answers however failed to critically analyse or, in Part B, accurately apply the law to the facts. They merely stated the law, without evaluation or conclusion, and in Part B did not apply the advice to the facts in sufficient detail. In addition, references to case law and specific statutory provisions were absent in many answers. Statements made need to be supported as far as possible with relevant case law and statute.

In Part B, it is vital to refer to the facts and apply the law clearly and precisely. Aim when answering the questions to consider thoroughly all implications that arise from the facts.

CANDIDATE PERFORMANCE FOR EACH QUESTION

Section A

Question 1

Strong candidates engaged in critical analysis as required by the question and referred accurately to relevant case law. The poorer answers lacked specifics and adequate detail.

Question 2

This question was on an area that candidates do avoid or find trickier.

Question 3

Again, this was an area that candidates do seem to avoid. The stronger answers addressed all elements of the question, but even so lacked case references. The weaker answers failed to address all elements of the question.

Question 4

Answers were generally adequate, but none were outstanding. It was not a surprise that this question was so popular as it was on partnership law. However, answers to 4(b) were rather mediocre and limited in scope.

Section B

Question 1

On (a), candidates generally scored better with the good answers addressing case law and statute accurately. Some weaker answers failed to mention any case law and even missed the relevant statutory provision. On (b), there were some adequate answers, but most would have benefitted from greater detail on the case law for example.

Question 2

There were some fairly strong answers. Candidates could have scored more highly with more detailed application and case references.

Question 3: No candidates answered this question. One of the topics – share allotment – is one that is regularly avoided by most.

Question 4:

As this was most likely answered last, there were probably timing issues. Candidates failed to consider the wider implications of the questions and did not address each element in sufficient detail.

SUGGESTED POINTS FOR RESPONSE**JANUARY 2023****LEVEL 6 UNIT 1 – COMPANY & PARTNERSHIP LAW**

Question Number	Suggested Points for Responses	Marks (Max)
1(a)	<p>The answer consists of critical analysis of the nature and enforceability of the contract between a company and its members, with reference to statute and case law</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Analysis of the nature of the contract • Extent to which it can be enforced • Response is appropriately structured • Brief reasoned conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Contract is based on the articles of association • Section 33 states that the provisions of the constitution bind the company and members as if they were covenants • <u>Hickman v Kent or Romney Marsh Sheepbreeders</u>; <u>Pender v Lushington</u> • Unusual contract; eg it is not rectifiable as with a ‘normal’ contract (<u>Scott v Frank F Scott</u>), even if the articles do not express the parties’ true intention • Courts interpret the articles using the reasonable person test (<u>AG of Belize v Belize Telecom Ltd</u>) • Either party may enforce the contract • Enforcement is limited to provisions concerning membership (<u>Eley v Positive Government Security</u>) • And not for example relating to directorship (<u>Beattie v E&F Beattie</u>) • But some case law has, arguably, allowed the enforcement of ‘outsider rights’ (eg <u>Salmon v Quin and Axtens</u>) • Enforcement is subject to a 6 year limitation period <p>Responses could include:</p> <ul style="list-style-type: none"> • It is a form of protection of the minority • Apparent creation of relationship between members (<u>Rayfield v Hands</u>) 	12



	<ul style="list-style-type: none"> • Mention of courts' treatment of some breaches as 'mere internal irregularities' unenforceable by member under s.33 (<u>MacDougall v Gardiner</u>) 	
1(b)	<p>The answer consists of a critical evaluation of the effect of statute and common law on limitations company's articles can place on directors' powers and authority, with reference to statute and case law</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Discussion of possible limitations in the model articles and in tailored articles • Evaluation of the impact of statute and common law on such limitations • Reasoned conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Powers in the Model articles (eg MA 3, 5, 7 and 9) • Restrictions or limitations on powers, from MA 14 for example • Specific restrictions may be included, for example on borrowing or limits on entering into contracts • Requirement of shareholder approval over certain limits • Discussion of section 40 Companies Act 2006 (CA 2006) and its effect to override limitations • Power of directors to bind the company deemed free of any limitation in the company's constitution • Explanation of effect of section 41 CA 2006 • BUT subject to requirement of good faith on the part of the contracting third party • Discussion of what is good faith (<u>Wrexham Association FC Ltd (in Administration) v Crucialmove</u>) <p>Responses could include:</p> <ul style="list-style-type: none"> • A company may have an objects clause that limits capacity of company, and therefore authority of directors, but this will be rarer for companies formed after 2009. • Mention of <i>ultra vires</i> rule and <u>Royal British Bank v Turquand</u> (but largely superseded by CA 2006) • Mention of limits on powers under directors' duties provisions (sections 170 to 177) • Mention of shareholders' ability to enforce constitutional limitations on authority of directors (in accordance with sections 33 and 40(4)) • Mention of directors' duty to act in accordance with the constitution (including constitutional limitations on authority – section 171(a)). 	13
Question 1 Total:25 marks		
2	<p>The answer consists of critical assessment of how restrictions on companies support the principle of capital maintenance, with reference to statute and case law.</p> <p>Marks should be distributed in the following areas:</p>	25

	<ul style="list-style-type: none"> • the principle of capital maintenance • the restrictions imposed to uphold the principle • the exceptions to such restrictions • appropriate structure • a reasoned conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Outline of the principle and its purpose, derived from <u>Trevor v Whitworth</u> • Range of examples of restrictions to support the principle, such as: <ul style="list-style-type: none"> ○ General prohibition on purchase of own shares (s658 CA 2006) ○ Restrictions on payments of dividends (s830 CA) ○ Shares cannot be issued at discount to nominal value (s580 CA 2006) ○ Strict rules where there such restrictions are lifted (eg regarding buy back out of capital – see below) • Exceptions to the restrictions, such as: <ul style="list-style-type: none"> ○ Company may reduce its share capital (Chapter 10 CA 2006) ○ Subject to shareholder approval via special resolution and support of a solvency statement ○ Court approval of reduction is required ○ Company may also issue redeemable shares (but must also have in issue ordinary shares) (Part 18 CA 2006) ○ Companies may buy back their own shares out of distributable profits, a fresh issue of shares, or (only private companies) out of capital (only after distributable profits have been used) • Details of the procedural requirements on buy back, including necessary shareholder approval (ordinary or special resolution?); clear distinction between out of profits and out of capital procedures; solvency statement for buy back out of capital; mention of permitted capital payment • Conclusion that such exceptions themselves subject to strict procedural requirements <p>Responses could include:</p> <ul style="list-style-type: none"> • Possible breach of directors’ duties for unlawful distribution (eg <u>Bairstow v Queen’s Moat House</u>) • Prohibition on public companies providing financial assistance (s678 CA 2006) <p>Where shares are issued at a premium, premium is treated as part of the share capital and cannot be reduced (s610 CA 2006)</p>	
	Question 2 total: 25 marks	
3	<p>The answer consists of critical assessment of the powers of a liquidator, including the powers to avoid company transactions, with reference to statute and case law.</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Where the powers derive from • The main powers in outline 	25

	<ul style="list-style-type: none"> • Discussion of the transaction avoidance provisions, with reference to relevant statutory provisions and case law <p>Appropriate structure and reasoned conclusion</p> <p>Responses should include:</p> <ul style="list-style-type: none"> • Derivation of powers from section 167 the Insolvency Act 1986 (IA 1986) and associated rules • Paying off classes of creditors in full (if possible) (s175 IA 1986) • The order of payment of creditors, eg preferential creditors and prescribed proportions of floating charges • Bringing proceedings in the company's name • Summoning general meetings when necessary • Carrying on the company's business as necessary • Selling company property • Power to call into question the action of directors • Detailed discussion of sections 238, 239, 244, 245 and 423 in particular, including <ul style="list-style-type: none"> ○ requirement of inability to pay debts/insolvency and reference to section 123 IA 1986 ○ the nature of the transactions ○ time limits ○ nature and relevance of connected person ○ where the burden of proof lies ○ what the liquidator must prove to enable avoidance ○ the consequences of such avoidance ○ any defences available to the company or persons involved ○ references to case law (eg MC Bacon, Re M Kushler) <p>Responses could include:</p> <ul style="list-style-type: none"> • Brief mention of different types of winding up • Implications of registered charges • Disclaimer of onerous property • Bringing of misfeasance proceedings 	
Question 3 Total: 25 marks		
4(a)	<p>The answer consists of explanation, through comparison, of the formation of an unlimited partnership and of a limited liability partnership, with reference to statute and case law.</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • LLP formation – statute regulates clear-cut formalities and procedure • Partnership formation - no required formalities or registration; formation is based on s1 Partnership Act 1890 (PA 1890) and common law • A short conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • LLPs are formed by a statutory process of registration of documents with Companies House 	10

	<ul style="list-style-type: none"> • LLP Act 2000 section 2: at least 2 people carrying on a business with a view to a profit. • Registration form must state the name, the registered office, the subscribing members. • Registration document submitted to Registrar of Companies. • No such formalities required for the formation of a partnership • A partnership exists if it satisfies the statutory test of two or more persons carrying on business with a view of profit (s1 PA 1890). • With a view of profit: uncertainty in law on this. Receipt of profits is prima facie evidence of being partner. <u>Cox v Hickman</u>. There must be a profit motive • Varieties of co-ownership – eg joint tenancies – also are not a partnership • One off venture/commencement of business – eg <u>Mann v D’Arcy</u>; <u>Khan v Miah</u> • Lack of costs of formality of formation of partnerships can be a benefit. • Cost of compliance with formation (and ongoing) regulations can be relatively high for LLPs. <p>Responses could include:</p> <ul style="list-style-type: none"> • Mere ownership of land insufficient for example to constitute a partnership • • Hodson v Hodson – failure to draw profits was irrelevant. • Partnerships are advised to have a written partnership agreement to provide certainty • Reference to regulation of names of respective types of entity 	
<p>4(b)</p>	<p>The answer consists of critical analysis of the scope of a partner’s authority to bind an unlimited partnership in contract, with reference to statute and case law</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Correct identification of the nature of the partner as agent and the different types of authority • Discussion of how the types of authority arise and their implications <p>Appropriate structure and reasoned conclusion. Answers should include:</p> <ul style="list-style-type: none"> • Partner is an agent of the partnership when acting on behalf of it (s5 PA 1890) • Authority can be actual (express or implied) or apparent/ostensible • Implications of a partner acting within their authority: the partnership is liable in contract • Actual authority can arise from express agreement, eg set out in a partnership deed; or from course of dealings. Reference to ss 6 and 7PA 1890 • Examples of how express or implied authority can arise: express provision in a partnership agreement; activity accepted impliedly by other partners. 	<p>15</p>

	<ul style="list-style-type: none"> • If a partner acts outside their actual authority, sections 5 and 8 must be applied as apparent authority is to be considered. • Each of the elements of section 5 PA should be discussed carefully, and case law referenced (eg Polkinghorne and Mercantile Credit). • Consequently, liability can still fall on a partnership, because the partner's authority is 'apparent' to a third party. • Partnership agreement may require a partner to indemnify the partnership for breach of actual authority <p>Answers could include:</p> <ul style="list-style-type: none"> • Where the partnership is bound, if partnership assets are insufficient to meet partnership liabilities, the partners may have to use their own assets to meet such liabilities • If a partner binds a firm through apparent authority, the partnership may be able to recover from the partner for breach of actual authority – eg as a breach of the partnership agreement. • Even if a partner exceeds their actual and apparent authority, the other partners may ratify a transaction which that partner purports to make on behalf of the firm. 	
Question 4 Total:25 marks		

SECTION B

Question Number	Suggested Points for Responses	Marks (Max)
1(a)	<p>The answer consists of advice on the consequences of entering into a pre-incorporation contract as a promoter and how incorporation can protect the client from future business liabilities, including relevant statute and case law throughout</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Promoter and pre-incorporation contracts • Appropriate structure and brief conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Meaning of promoter and pre-incorporation contracts (<u>Twycross</u>) • Normal agency of person entering into contract on behalf of the company, but with pre-incorporation contracts, no company exists to be principal • S51 CA 2006: promoter is personally liable, subject to any 'agreement to the contrary' • <u>Phonogram Ltd v Lane</u> [1981]: clear any such 'agreement to the contrary' must be expressly and clearly included within the contract. • Court will not <i>imply</i> such agreement to the contrary. • Words signing for and on behalf of company are not sufficient to exclude liability • There must be actual agreement with other party to exclude personal liability. 	14

	<ul style="list-style-type: none"> Other ways Martha could protect herself re the pre-incorporation contract; eg novation <p>Responses could include:</p> <ul style="list-style-type: none"> possible mention of enforceability of contract by Martha (<u>Braymist</u>) Fiduciary duty of the promoter (<u>Erlanger</u>) 	
1(b)	<p>The answer consists of advice on how incorporation can protect the client from future business liabilities, including relevant statute and case law throughout</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> Nature of separate legal personality, limited liability lifting the corporate veil Brief conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> On future liabilities, company will be registered as a separate legal entity Outline of nature of separate legal personality (<u>Salomon v Salomon</u>) Company will be responsible for its own liabilities as well as being able to own assets, such as the business Shareholder liability is limited to the amount paid for shares Here Martha is transferring the business as consideration for her shares in the company. Corporate veil only lifted in rare circumstances (<u>Adams v Cape</u>, <u>Prest v Petrodel</u>, <u>Nutritek</u>): including sham or façade. Reference to likelihood that the bank will insist on Martha giving a personal guarantee in respect of bank borrowings <p>Responses could include:</p> <ul style="list-style-type: none"> brief mention of directors' duties and section 214 IA Possibility of tortious liability if she commits a tort during running of business 	11
Question 1 Total:25 marks		
2	<p>The answer consists of advice on the likely success of a claim under section 994 CA 2006 and a derivative claim, including relevant case law.</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> The action under section 994 CA 2006 The derivative claim under Chapter 11 CA 2006 Appropriate structure Conclusion on likelihood of success and possible remedies <p>Responses should include:</p> <ul style="list-style-type: none"> Section 994 CA 2006: member can petition court in relation to unfair prejudice suffered from act or omission of company or conduct of co affairs. 	25

	<ul style="list-style-type: none"> • Must show conduct of affairs of the company or omission unfairly prejudicial to interests as a member. • Distinguish between matters concerning running of company and merely 'private'. Most conduct here (absences and misuse of funds) concerns company • Sam must show her interest as a member is being prejudiced. (Gamlestaden) • Could amount to mismanagement of the company • Courts are clear that this includes member's formal rights, such as those found in the company's constitution, or in the Companies Act. • But member's interests are broader than strict formal rights: in quasi-partnerships, member's interests can arise from informal understandings between members. Here they have been running business together for nearly 14 years. • <u>Ebrahimi v Westbourne Galleries Ltd</u> [1973]. Defined quasi-partnership. Close personal relationship between members, some or all the members expected to participate in management, and restrictions on transfer of shares to outsiders. • Sam and Rachel have a close relationship as they are sisters and have run business together. • Likely remedies: order Sam to buy out Rachel (assuming Rachel is reluctant to sell), although often order is for majority shareholder to buy out minority. • Likely success under s994 as several instances of prejudice of member's interests <ul style="list-style-type: none"> • Derivative claim under Chapter 11 CA 2006 (eg s260) • Grounds narrower than s994 • Act or omission involving negligence, default, breach of duty, or breach of trust by director • Court must give permission to continue action; s263 gives factors for granting permission • There are 3 mandatory bars to permission – breach of duty authorised or ratified by members and where majority of members have right to deny minority from pursuing claim • Too late for Rachel to authorise her breach; ratification by her no longer possible, because of s239(4). • Where court concludes that a hypothetical director, acting in accordance with duty to promote success of company, would not continue the claim. • Courts have said no claim only if 'no reasonable director' would pursue it. <u>Iesini</u>; <u>Cullen Investments v Brown</u> (2015). • Less likely success as narrower grounds applied by the courts • Possible order to buy out shares, but often for the majority holder to buy out the minority Discussion of valuation of shares to be sold under s994 order <p>Responses could include:</p> <ul style="list-style-type: none"> • Relationship with Karina is a possible conflict situation in relation to director's duties 	
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	<ul style="list-style-type: none"> • Argument with employee not related to company • Possible discount applied to sale of shares but court may not grant this (Re Home and Office Fire Extinguishers) • Any order for Sam to buy out Rachel can be influenced by behaviour of respondent (Oak Development) • Derivative action: Take into account cost of action prospects of success, etc. • Claimant could ask for company indemnity against legal costs • Discussion of merits of respective claims 	
Question 2 Total:25 marks		
3	<p>The answer consists of advice on the legal issues and procedure in relation to the issue of shares, appointment of a director and the grant of a service contract, with reference to statute</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Issues around authority to allot shares • Disapplication of pre-emption rights • Appointment of a director • Grant of service contract • Suitable discussion of combining procedure into a single set of meetings • Appropriate structure • Brief conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Requirement for authority of directors to allot (s549 CA 2006) • How authority may be given – company with only one class of share (s550 CA 2006) – automatic authority. • Application to the facts – needs OR to grant authority under s551 • Description of the statutory right of pre-emption (s561 CA 2006) • “Equity securities” – definition (s560 CA 2006). • How pre-emption rights may be disappplied – s569 • Exclusion of pre-emption rights in case of non-cash consideration • Application to facts – not applicable to the acquisition but need to be disappplied by SR in relation to Penny’s subscription for ordinary shares for cash. <ul style="list-style-type: none"> • Appointment of director – MA 17 – by the board or by shareholders (OR) • Service contract – term of 3 years will require shareholder approval – OR again. (s188 CA 2006) • A memorandum of the contract must be available for inspection at least 15 days before the general meeting <ul style="list-style-type: none"> • Board will need to approve all proposals before shareholders do so. • General Meeting may be called by directors (s302 CA 2006) or requisitioned by shareholders (but not necessary in this case) 	25

	<ul style="list-style-type: none"> • Notice to be given of the meeting (s307 CA 2006) with minimum period 14 clear days. Could have shorter notice if requisite majority agree (majority in number holding 90% of shares). • When notice deemed to be given – s1147 CA 2006 • Requirement for a quorum and how quorum constituted (s318 CA 2006) • Voting on a show of hands or on a poll. • Majorities required for OR (simple) and SR (75%) • Need for registration of allotment (SH01) and SR. <ul style="list-style-type: none"> • <u>Possible Written Resolution</u> • Private company so WR regime applies • Directors may circulate a WR to all ‘eligible members’ • Definition of ‘eligible members’ • Requirements for content of WR – statement informing members how to assent and lapse period • WR passed when the requisite majority have signified agreement • Majorities required are of members representing a simple majority of votes of all eligible members (OR) or 75% (SR) <p>Responses could include:</p> <ul style="list-style-type: none"> • Could be OR under s551 CA, but not necessary because of s550 – conditions attaching to the authority. Max number of shares and time limit on authority • The need for a share purchase agreement • Meaning of ‘clear days’ – exclusive of the day notice is given and the day of the meeting (s360 CA 2006) • Short notice not possible for approval of service contract term because of pre-meeting inspection requirement. • If she is appointed before the contract is approved, declaration of interest by new director – section 177(6) will apply – no need for declaration • Also she can count in the quorum and vote as MA 14 has been excluded 	
	Question 3 Total:25 marks	
4(a)	<p>The answer consists of advice on proposals for a company to borrow money</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • Board approval of the loan and any loan agreement • Board and shareholder approval of the insertion of a borrowing restriction into the articles of association • Appropriate structure <p>Responses should include:</p> <ul style="list-style-type: none"> • Directors have the power to borrow under MA 3 	10

	<ul style="list-style-type: none"> • Loan and any draft agreement, should be approved in a board meeting, with appropriate notice and quorum. Shareholder approval is not required of the loan • Board must also approve in principle the change to the articles, prior to shareholder approval • Board must call GM on appropriate notice (full or short) or circulate a WR; draft articles must be provided to shareholders • Shareholders must approve change to the articles by SR (s21 CA 2006) in GM (on full or short notice) or by written resolution <p>Responses could include:</p> <ul style="list-style-type: none"> • New articles must be registered with Companies House, along with the SR approving them. • Appropriate minutes to be written for Board meeting and any GM 	
<p>4(b)</p>	<p>The answer consists of advice on the nature of a floating charge, its implications and the reasons for registration</p> <p>Marks should be distributed in the following areas:</p> <ul style="list-style-type: none"> • the nature of a floating charge and its implications • the registration of the charge • Appropriate structure and conclusion <p>Responses should include:</p> <ul style="list-style-type: none"> • Floating charges can only be granted by companies • They hover over the relevant assets (here the company’s undertaking and book debts) • When the charge crystallises (eg on default of the loan) the charge fixes to the asset • Panama and Woolcombers cases • Charges over book debts usually floating charges (not fixed) – where company has control over charged assets; Re Spectrum case • Bank as a qualifying FC holder will have the power to appoint an administrator • Registration is not compulsory but is advisable for the charge holder (s859A) • Register within 21 days of the creation of the charge. • Registration ensures the charge is not void against a liquidator and will take priority over any future floating charges. • It will however rank below the existing fixed charge. <p>Responses could include:</p> <ul style="list-style-type: none"> • If administrator appointed, they would take charge of the company’s assets and sell them. • Funds would be remitted to the bank • Bank may insist on a negative pledge clause to give potential protection from future charges. 	<p>15</p>
<p>Question 4 Total:25 marks</p>		

