CHIEF EXAMINER COMMENTS WITH SUGGESTED ANSWERS

LEVEL 6 - UNIT 16 – PRACTICE OF COMPANY & PARTNERSHIP LAW

JANUARY 2020

Note to Candidates and Learning Centre Tutors:

The purpose of the suggested answers 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 2020 examinations. The suggested answers set out a response that a good (merit/distinction) candidate would have provided. The suggested answers do not for all questions set out all the points which candidates may have included in their responses to the questions. Candidates will have received credit, where applicable, for other points not addressed by the suggested answers.

Candidates and learning centre tutors should review the suggested answers 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

This paper is a Level 6 paper and was appropriately demanding. Congratulations to those candidates that have passed this Unit.

Overall those candidates that performed well reflected their abilities to apply their understanding to the facts and thereby produce good solid answers deserving of a higher mark. Fortunately (and unusually) the majority of candidates had taken little time to consider the documents provided in the case study materials and thereby sought to use the facts imparted and apply the documents as they progressed through the paper.

General performance:

Much of what is set out below in this section has been stated before, but it still needs to be stated – particularly in response to requests for feedback.

Unsuccessful candidates need to be able to relate to their own performance to what was being required of them and to be able adapt their approach to this topic, revision and the assessment so that they are able to be successful

in the future. Candidates are strongly encouraged not to just focus on the answer, but their overall approach.

It is worth a general observation that the performance by candidates was generally reflected by those who had fully and carefully prepared and reviewed the case study materials. They were prepared to answer any change in the facts presented – as in previous papers, this paper relied on a good understanding of a set of facts set out in the Case Study materials. As per previous papers, the application of the mechanics of the document together with statute was key. There is always a marked differentiation in that such well performing candidates applied themselves according to their ability to tackling the questions such that they used their knowledge to provide sound advice taking into the facts supplied, as required by the questions. Those candidates that sought only to demonstrate knowledge of reading and imparting all that was known on a subject, did not score as well.

General Advice:

In terms of approach and technique for examinations at this level, candidates must bear in mind that the intention is for the candidate to be able to apply his/her understanding of the practice partnership and company law, such they are able to advise clients in a practical manner. In order to achieve this, candidates must resist the urge to write all that they know about a subject, which in this paper was all too often a problem; understandably it is a natural desire to demonstrate all that the candidate has read and knows. However, that approach will not work at this level. As has been stated before, application to the facts when answering questions is extremely important and often carries marks that candidates who only impart knowledge do not give themselves the opportunity to be awarded.

Additionally, as before, candidates whilst revising should not then be doing so in such a manner that they are rehearsing pre-prepared questions and answers. Less so in this paper than before, there remained instances where pre-prepared answers appeared to be relied upon with little consideration to the need to remain flexible and to be able to answer the questions as posed, rather than as desired.

Common weaknesses:

As has been said before, many candidates failed to appreciate that it is important when tackling problem questions to answer the question in the context to the issue raised by the question. Often the answers set out the law on a topic in issue without any great reference to the facts of the scenario, and often with no attempt being made to apply the principles that were actually relevant. This would then be followed by only a cursory discussion of the facts of the problem, often with only scant reference to the previous explanation of the law. A proper conclusion can only be demonstrated after careful application of the relevant principles of law to the facts of the scenario, and that demonstration is all the better made if the marker is then taken through the issues on a step-by-step basis with each step applied to the facts – candidates are strongly recommended to review the Suggested Answers for further guidance on how they may achieve the intended aims.

Review of Case Study Materials:

Candidates are recommended to consider the manner in which they prepare following the release of the Case Study materials. Candidates should try not to anticipate the questions following a review of the case study materials; rather analyse the facts to fully understand what is going on and then consider all the issues surrounding those facts, identify issues only and identify where problems may arise, of where there is uncertainty.

It is also worth repeating advice given in the past. Namely that candidates must not, when reviewing the Case Study materials, make assumptions about the facts or attempt to question spot – what the candidate may consider as a certain in terms of the type and wording of the question will invariably not be the question actually posed. Review the Case Study materials with an eye to be adaptable and fluid come the examination; remember the facts can be developed further come the examination, this can then alter the assumptions that may have been considered. Those candidates that do question spot invariably come to the examination with a pre-rehearsed answer which will not fit the question posed or be capable of incorporating additional or changed facts. Candidates should treat the examination as they would meeting a client for the first time, what you know from a brief telephone call or attendance note could change immediately when the client walks in the room.

15 Minutes Reading:

Candidates should also make appropriate use of the 15-minute reading time at the start of the examination. It is during this period that the candidate can read through the additional information provided in the examination paper, and how this relates to and moves on the pre-released Case Study materials. Candidates should pay particular attention to the wording or facts of the questions and discuss the relevant law, connecting their arguments to the actual issues raised by the questions. The candidate should always bear in mind that when tackling questions, the candidate must be able to demonstrate why the law he/she is writing about is relevant to the question, i.e. make sure that as you identify the relevant fact that demonstrates why it is so. It is the latter aspect that some candidates fail to do. Accordingly, it may be useful during this period to make notes on the key points of the law to be used and applied and the key facts to employ in giving a fully reasoned and considered piece of advice.

Examination technique:

When tackling the questions posed in the examination, it is important to keep in mind the IRAC approach to answering question - Issue, Rule, Application, and Conclusion. This approach will help you structure your answers, and as you do, you will be demonstrating to the examiners how you have reached your conclusions by leading them through your thought process and step-by-step analysis:

(1) *Issue*: read the questions carefully and identify that which is relevant from the facts, state exactly what the question of law is;

(2) *Rule*: identify and cite the applicable cases, statutory provisions or procedures that will help you make a correct legal analysis of the issue at hand - briefly, explain their requirements, identifying any key tests that must be applied;

(3) *Application* (or *Analysis*): this is the most important section of an IRAC because it develops the answer to the issue at hand. It requires you to apply the applicable statutory law or procedures identified to the facts – this is the provision of the advice. It is important in this section to apply the rules to the facts of the case and explain or argue why a particular rule applies or does not apply in the case presented; and finally

(4) *Conclusion*: by summarising what you have set out above and for problem questions, whether the client can or cannot achieve their intended aims, or in the case of an essay question, whether you agree or not with the statement you have been set to discuss. It is important that your conclusion does not introduce any new rules or analysis; restates the issue and provides the final answer.

Statute book:

Although previously stated, candidates are reminded that they are able to take with them into the examination room, the prescribed statute book, a valuable resource if used correctly – if used correctly when studying, during revision and then in the examination itself, a source to rely upon for all answers. Candidates should seek to use the statute book as a means by which to support their answers, in that the statute books will provide the necessary statute references, the correct terminology, clarification of the necessary procedure that is being applied and the resource to flick through to identify additional points for inclusion. Candidates must learn how to use this resource effectively in the exam room, and this starts with revision – when revising a topic, locate and identify the correspondence statutory provisions, read and understand the manner in which they operate. The effective use of statute in the exam will only see to embellish answers and candidate performance.

CANDIDATE PERFORMANCE FOR EACH QUESTION

Question 1

The first part of this question looked at identifying whether a business relationship was a partnership and the potential liability of being involved in a partnership and liability generally. Candidates that sought to identify and consider their understanding to the various tests and addition requirement under the Partnership Act 1890 did well. Likewise, so did those candidates that looked to relate this application back to the facts performed well on this aspect of the question. However, too many candidates did seek to state the position of the law only, without application – it is important to continually seek to apply the law to the facts and draw conclusions that provide the necessary advice that is sought.

The second part of the question looked at any potential claim that could be made against a partner for the use of partnership assets for her own purpose and for not focussing sufficient time on the partnership. Generally, the issues were identified, however more was required to identify what is partnership property and to ensure that first if a partner uses partnership property without permission from the other partners, then that partner must account for any profits as a result. Likewise, that if there is no provision dealing with work input and competing with the partnership, the implied position under the PA 1890 and common-law apply. It may not necessarily be possible to stop the

individual involvement in their own enterprise as there is no obligation on a partner to spend time on the partnership business.

Question 2

This question required candidates to advise the company on the steps it would be required to undertake in order to allot ordinary shares. In relation to the issue of shares, most candidates covered the basic requirements for the allotment of shares well, although generally application and the use of statute was lacking – however, in this instance it was s550 that applied (the Company was a one class share company; ms551 did not apply nor the need to seek members resolutions). Whilst most candidates identified that requirements under the right of pre-emption (and the means by which this could be either disapplied or waived – the latter being most appropriate given that the facts suggested that the current shareholders were most likely to agree the investment) this was only covered in a cursory manner; the detail and application was lacking by most candidates and the answers were then in general terms relating to the allotment of shares – too many candidates only sought to outline the procedure with little reference to the particular circumstances in hand.

When addressing the procedural requirements, only a few candidates covered this well addition, and only a few identified the need to credit the share account in respect of that sum representing the nominal value of the shares.

A failing of candidates was the failure to consider those involved. In this instance, all the directors who were in post at this point in time would be required to declare their interests in the share allotment. This consequently required the issue of s177 and Article 14 to be addressed – and given the provisions of s177(6) and Art 14(4) which have permitted exclusions, nothing further was required, i.e. there was no issue associated with quorum. Only occasionally was this identified. Candidates are referred to the Suggested Answers for further guidance; the means by which the answer is demonstrably applied to the facts should also be noted.

The second part of this question was not, as many thought, the taking of a charge by a Bank over assets, that was not suggested by the facts or asked for, but rather whether the company had capacity to enter into the loan. Only a few candidates answered this question well.

Question 3

The first of this question asked candidates to both appoint and then award a long-term-service contract to a director. Whilst the requirements to cover the need to seek members' approval was generally well (although more was required in terms of the disclosure requirements of the term of the contract to members covered), only a few candidates fully covered the need for the director to make a declaration of interest under s177 and Art 14.

The need to make a declaration of interest and to be precluded from voting arises in a number of questions, but is still not covered by candidates well. In this instance, it did not preclude the business of the Company from proceeding as quorum could be achieved.

When addressing the procedural requirements, only a few candidates covered this well addition, and only a few identified the need to credit the share

account in respect of that sum representing the nominal value of the shares. The requirement for the term of the contract to be on display at the registered office does mean that the short notice could not be used, rather a written resolution or general meeting on full notice is required.

The second part of this question asked candidates to advise on the transfer of assets exchange for shares, ie a s190 substantial property transaction. Whilst the s190 was identified, the answers lacked full analysis and application of facts and statue. It is also worth noting that the question specifically asked for share allotment not to be addressed, yet far too many scripts did exactly that.

Additionally, the procedural requirements were only covered in a cursory manner and very few candidates identified the need to make a declaration of interest and to be precluded from voting. Note: s177 is a declaration of interest only, not a precluding of voting as many candidates stated. It is Article 14 that potentially precludes a director from participating in quorum.

Question 4

The first part of this question looked at the consequences for the directors in the event that the company is able to pay its debts. This required consideration of the onset of insolvency under s122-123 Insolvency Act 1986, and then wrongful trading. Whilst most candidates were able to identify these issues, the discussion as it applied in these circumstances was not necessarily well done. More particularly, this discussion required the need to identify and apply the various tests and liability arising for the debts of the company to two directors that had been relatively absent from the running of the company. More application was possibly required in relation to identifying liability for each director and the requirements to contribute funds in the event of insolvency.

The second part of the question looked at the consequences of being declared bankrupt for one of the directors. This required the application of article 18 of the model articles and issues dealing with the disqualification of a director under the Companies Directors Disqualification Act 1986. On the whole this question was answered with mixed results, but generally with little detail applied nor a full discussion of the CDDA.

Candidates are referred to the Suggested Answers for further guidance; the means by which the answer is demonstrably applied to the facts should also be noted.

Question 1(a)

The business that Grace Tait has entered into with Ian Bell is a partnership, i.e. a relationship which subsists between persons carrying on a business in common with a view of profit (s.1(1) Partnership Act 1890). S.2 Partnership Act 1890 states that the sharing of profits of the business is *prima facie* evidence of being a partner. Moreover, whilst s.2 Partnership Act 1890 lists a number of situations where a receipt of a share of profits does not, by itself, make a person a partner, there is no suggestion that any of those situations apply to the facts of this question. As such, on the basis of the information provided, a business has been set up, the purpose behind which is clearly to make a profit. Therefore, the business carried on by Grace and Ian satisfies s.1(1) Partnership Act 1890 and can be viewed as a partnership.

In respect of any liability that Grace may incur in relation to this partnership, and others' authority to bind the partnership (and thereby Grace), liability arises under the Civil Liability (Contribution) Act 1978 and s.9 Partnership Act 1890. The Partnership Act 1890 liability is only joint, whereas the Civil Liability (Contribution) Act 1978 provides that a claimant can bring action successively against partners who are jointly liable, even if the judgement was obtained against the other partners.

Authority to bind the firm arises by virtue of:

- S.6 Partnership Act 1890 a partner will bind the firm if he/she is authorised, such authority being vested in a partner by express agreement or implied by the conduct of the members of the firm
- S.5 Partnership Act 1890 covers apparent authority for the partner to bind the firm and need to use the four stage test:

    1. Is it the type of business carried on by the firm?
    2. Would a partner usually have authority to bind the firm?
    3. Does the third party know or reasonably suspect that the partner did not have authority?
    4. Does the third party know or believe that the individual is not a partner?

- S.7 Partnership Act 1890 where an individual pledges the credit of the firm for a purpose not connected with the firm's business, the firm is not bound unless the pledge was specifically authorised by the other partners
- S.8 Partnership Act 1890 provides that a restriction on a partner's authority will not bind a third party unless they have notice of it.

Grace will be liable for debts whilst a partner under s17 Partnership Act 1890.

(b)

We are not told precisely what equipment Ian Bell is using for his consultancy business. However, if the equipment were bought using partnership money, then it would be partnership property (s21 Partnership Act 1890).

Under s.20 Partnership Act 1890, partnership property must be used exclusively for the partnership. Therefore, the Partnership can in theory ask for any items to be returned, or as appropriate ask Ian to compensate the Partnership.

Section.29 Partnership Act 1890 states that if a partner uses partnership property without permission from the other partners, then that partner must account for any profits as a result. On the facts, it appears that the partners have not given consent for Ian to use these items. Therefore, Ian must account for any profits earned by his own consultancy business as a result of using such items.

As there is no partnership deed, there is presumably no express agreement dealing with work input by the partners, or competition against the partnership. Accordingly, these matters are dealt with by the implied terms found in the Partnership Act 1890 and the common law. No claim could be brought against Ian for his failure to spend time on the business of the partnership, since there is no implied obligation on a partner to spend time on the partnership business.

Section 30 Partnership Act 1890 may apply in this instance if the business that Ian is undertaking is of the same nature as that of, or in competition with, the firm. As such Ian will not be required to account for profits from his separate business activities under s30 Partnership Act 1890.

However, under s.29 Partnership Act 1890, which we have already noted above in connection with Ian's use of partnership property, a partner is also obliged to account for profits made as a result of the use of the partnership name or its 'business connexion'. This may also apply to our question, if Ian has been marketing/supplying clients of Tait's Ice Cream.

Question 2(a)

In relation to the proposed allotment of shares, the 'new shelf' company that is to be used is already incorporated and has no restriction on the available share capital for the company to allot. Currently it has only two shares already allotted to two partners of the firm as subscriber shares (these shares will need to be transferred to the new members).

To allot the new shares to the new members, Tait's Ice Cream Limited ('TIC') will first need to appoint, as directors, Grace Tait and Jane Hook, and they must then be authorised to make the necessary allotments (s549-551 Companies Act 2006).

The directors of a private company with only one class of shares may exercise any power of the company to allot shares (or grant rights to subscribe for or to convert any security into shares) without any further authority, unless they are prohibited from doing so by the company's articles of association (s550 Companies Act 2006). Shares are of one class for this purpose if the rights attaching to the shares are in all respects uniform (s629 Companies Act 2006).

Alternatively, the directors may be authorised to allot shares pursuant to an authority contained in the company's articles or by ordinary resolution of the shareholders (s551 CA 2006). Any such authorisation may be for a particular exercise of the power or for its exercise generally; it must state the maximum

number of securities that can be allotted and specify the date it will expire which may not be longer than 5 years (s551 CA 2006).

As there are no restrictions in TIC's articles on the power of allotment and there is only one class of share in issue before and after the proposed allotment, it would seem that TIC can rely on the more relaxed regime for private companies contained in s550 CA 2006. The directors will therefore need to pass a board resolution resolving to allot the new ordinary shares which should be recorded in board minutes.

Under s561 Companies Act 2006 where a company is proposing to allot the ordinary shares ("equity securities") for cash, statutory pre-emption rights will apply that the existing members should be offered the new ordinary shares first in proportion to their existing holdings. This allows those shareholders to preserve their percentage holding after the issue, provided that they have sufficient funds available to subscribe for the new allotment. In the case of a private company with only one class of shares, statutory pre-emption rights may be dis-applied by a provision in the company's articles or by special resolution (s569 CA 2006).

In this case as TIC is proposing to allot the new ordinary shares in unequal proportions to the shareholders, and the ordinary shares will be classes as equity securities for the purposes of pre-emption rights, the members will need to dis-apply pre-emption rights by special resolution of the members. However, on the presumption that the allotment is with the agreement of both Grace and Jane, only a waiver of their pre-emption rights will be required.

As directors of TIC, Grace Tait and Jane Hook, *prima facie*, will have to declare their interest under s177 Companies Act 2006 in relation to the allotment of shares at the board meeting. However, since both directors can reasonably be assumed to be aware of the other's interest, they will be exempt from this requirement under s177(6)(b) CA 2006. Article 14, Model Articles provides that a director may not vote or be counted in the quorum in respect of an arrangement or transaction with the company in which he is interested. This however does not apply where the director's conflict of interest arises, as here, from a proposed subscription for shares.

Administration: a number of documents will need to be prepared, namely, Board Meeting minutes and resolutions (to first decide on the allotment, then to hold any required General Meeting and subsequent Board Meeting to finalise the allotment), Notice of General Meeting and minutes, the necessary Ordinary Resolution, a statement of capital, Form SH01 (allotment of shares for cash consideration), and letters noting the declaration of interest on the part of the directors and updating of the registers of allotments.

2(b)

Steps to accept the loan by Bedford Bank plc to Tait's Ice Cream Limited ('TIC'):

In order to accept the loan, TIC's articles of association should be reviewed to confirm that there are no restrictions on the company's power to borrow money and to give security, and that its directors have the power to approve the loan and to issue a debenture. By virtue of s31 Companies Act 2006, any company has unlimited capacity, save insofar as the company's articles of association expressly limit its capacity. TIC has adopted the Model Articles of

Association for a private company limited by shares (see company search). Those Model Articles do not contain any such express limitation of the company's capacity. Therefore, TIC will have the power to borrow money and to give security. Moreover, the Model Articles also give the directors a general power of management which would include the power to borrow without limit and to give security (Model Articles, Article 3).

It may be prudent to incorporate into the constitution an express power authorising the directors to exercise the company's power to borrow. It is highly likely that Bedford Bank plc, as part of its due diligence, will request such an amendment. The articles of association may be amended by Special Resolution (s21 Companies Act 2006), with a copy filed at Companies House (s30 Companies Act 2006) together with a reprinted copy of the amended articles of association (s34 Companies Act 2006).

As the loan is to be secured by a first fixed and floating charge over the assets of the company, searches should be undertaken of the company's register of charges, at Companies House and at the Land Registry/Land Charges Registry to make sure there are no prior charges registered.

Once the charges have been created, they should be registered by delivering a s859D statement of particulars to Companies House (s859A(2) Companies Act 2006), and a certified copy of the instrument creating the charge (s859A(3) Companies Act 2006). It is very likely that the lender will want to register the charges using Form MR01. The Form MR01 and the charging document must be submitted to Companies House within 21 days beginning with the day after the day on which the charge was created (s859A(2) and (4) Companies Act 2006), together with the fee.

Registration of the charge is voluntary but failure to register it within the time limit renders the charge void against a liquidator or an administrator of the company, and also against the company's other creditors (s859H(3) Companies Act 2006). For that reason the lender will want to make sure the charges are registered.

The Registrar issues a certificate of registration (s859A(2) Companies Act 2006) and provides a certificate of registration (s859I(3) Companies Act 2006), which (under s859I(6) Companies Act 2006) is conclusive evidence that the charge is properly registered. The charge over the freehold property should be registered with the Land Registry if it is registered land.

In the event that the charge was not registered, an application to the court for registration out of time under s873 Companies Act 2006 may be made; this procedure allows the court, if satisfied the omission to register was accidental, to extend the time for registration. Alternatively, the Bank may request TIC to grant a new charge and attempt to ensure that this is registered before any third party registers a prior charge that would take precedence. A further risk in granting a new charge is that if the company goes into insolvent liquidation or administration shortly after its creation, the new charge may be open to challenge either as a preference under 239 IA 1986 or the floating charge may be invalid under s245 IA 1986 unless it was granted for new consideration.

Procedure: accept the loan, grant Bedford Bank plc a debenture, specifying rate of interest and term, seal the debenture, and receive the loan and register.

Question 3(a)

Grace Tait may be appointed either by the directors in accordance with Article 17(1) Model Articles in a Board Meeting or by members in a General Meeting by ordinary resolution.

To appoint by GM, directors will need to call a GM on 14 clear days' notice or short notice (s307 CA 2006 and Article 48 Model Articles). Alternatively, MED could use the written resolution procedure under s288-300 CA 2006.

However, Grace Tait is also to be awarded a director's service contract of three years. As this is for a fixed term exceeding two years, it must be approved by an ordinary resolution of the company (s188 CA 2006). A copy of the proposed agreement or a memorandum of its terms, including the term which requires members' approval, must be available for inspection by the members of the company at the company's registered office for not less than 15 days (s188(5) CA 2006). If such a term is granted before the members' approval is obtained, it is void and the agreement terminable at any time by the company on giving reasonable notice (s188(5) CA 2006).

Accordingly, as an ordinary resolution is required, the appointment and approval of the contract should be deferred to a General Meeting of the company. Grace need not declare her interest in the grant of her service contract under s177(6)(c) CA 2006 but should be advised to do so as a matter of good practice. She may not however vote or be counted in the quorum at the board meeting called to approve her service contract (Article 14 Model Articles).

A number of documents will need to be prepared, namely, Board Meeting minutes and resolutions (to first decide on the appointment, then to hold the required General Meeting to approve the term and finally the subsequent Board Meeting to authorised and grant the service contract), Notice of General Meeting and minutes, the necessary Ordinary Resolution, the proposed agreement or a memorandum of its terms will need to be prepared, and letters noting the declaration of interest on the part of the director, updating of the registers of directors and Form AP01 to be completed and filed with the Registrar.

(b)

This will be a substantial property transaction. Grace has been appointed a director of MED prior to the transfer of the vehicles and equipment owned by her to the company.

Under s190 CA 2006 a company may not acquire from a director and a director may not acquire from the company, a substantial non-cash asset unless the arrangement is either first approved or made conditional upon being approved by a members' ordinary resolution.

In this instance, MED is to acquire from one of its directors, Grace Tait, various non-cash assets (equipment and vehicles). A 'non-cash' asset is any property or interest in property other than cash (s1163 CA 2006). Under s191 CA 2006

a non-cash asset is "substantial" in relation to the company if its value exceeds 10% of the company's net asset value and is more than £5000 or its value exceeds £100,000. MED's most recent set of audited accounts show it has net assets of £85,000. The equipment and vehicles to be transferred will therefore be substantial in value.

Accordingly, the acquisition requires the approval of members by ordinary resolution. If members' approval is not obtained the transaction will be voidable at the instance of the company. Directors who authorise the transaction without members' approval will be liable to indemnify the company for any loss or damage which results from the transaction.

In addition, as Grace Tait will be interested in the transaction this will require a disclosure of interest under s177 Companies Act 2006 unless all the other directors are already aware of her interest (s177 (6) (b) CA 2006). Grace Tait will not be permitted to vote at the directors' meeting at which this matter is considered nor will she count in the quorum (Article 14 Model Articles).

However, MED currently has four other directors and therefore quorum will be achieved. Quorum for a directors' meeting is two under Article 11 of the Model Articles. Without a quorum business cannot be validly conducted at board meetings. Note, although s177 Companies Act 2006 and Article 14 Model Articles applies in relation to a directors' meeting each shareholder is free to vote at the general meeting according to their own personal interest.

Question 4(a)

A director is not ordinarily liable for contracts entered into by the company. However by virtue of s214 Insolvency Act 1986 the court may hold that any person is liable to make such contribution to the company's assets as the court thinks proper if the company goes into insolvent liquidation; at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and that person was a director of the company at that time.

The criteria against which a director's knowledge and actions is measured are the knowledge possessed and the action that would have been taken by a reasonably diligent person, having both the general knowledge, skill and experience to be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and the general knowledge, skill and experience that that director actually has (s214(4) Insolvency Act 1986).

As noted, for liability under s214 to arise, the company must go into insolvent liquidation. Creditors will be able to petition the Court for the compulsory winding up of MED on the ground that it is unable to pay its debts (s122(1)(f) Insolvency Act 1986). A company is deemed to be unable to pay its debts, inter alia, if a creditor for more than £750 has served a statutory demand and remains unpaid for three weeks or if it is proved to the satisfaction of the court that it is unable pay its debts as they fall due (s123 Insolvency Act 1986).

If the directors continue to trade and in the process increase the liabilities of the company they may be guilty of wrongful trading under s214 Insolvency Act 1986. There is a defence to wrongful trading but only if the director concerned can prove to the satisfaction of the court that after he concluded

there was no reasonable prospect of the company avoiding going into insolvent liquidation, he took all reasonable steps to minimise the loss to the company's creditors.

If found guilty of wrongful trading the court may, on application of the liquidator, order the delinquent directors to make such contribution to the assets of the company as it thinks proper. In the circumstances, it may well be that Simon Rhind's liability will be greater than that of other directors, given his knowledge that invoices have been left unpaid.

4(b)

Should Simon be served with a bankruptcy petition by his creditors and be unable to settle his debts, he is liable to be declared bankrupt. If that were to happen, he would no longer be able to continue in office as a director of MED.

As MED has adopted the Model Articles, Simon will automatically lose his office of director on the making of the bankruptcy order (Article 18 Model Articles).

In addition, the Company Directors Disqualification Act 1986 provides for the disqualification of directors on a number of different grounds.

Under s10 Company Directors Disqualification Act 1986 where the court orders that a person make a contribution to a company's assets on its winding up under s214 Insolvency Act (as may be the case here) it may also make a disqualification order for a maximum period of 15 years.

Under s11 Company Directors Disqualification Act 1986 it is an offence for an undischarged bankrupt to act as a director or take part in the management of the company without leave of the court.

If Simon continues to act as director (or manager) in contravention of a disqualification order, he would be personally responsible for the debts and liabilities of the company incurred during the period when he so acts s15 Company Directors Disqualification Act 1986.