CHARTERED INSTITUTE OF LEGAL EXECUTIVES

CHIEF EXAMINER COMMENTS WITH SUGGESTED ANSWERS

SEPTEMBER 2020

LEVEL 6 - UNIT 16 – THE PRACTICE OF COMPANY AND PARTNERSHIP LAW

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 September 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 as to what was being required of them and to be able to 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 prepared and reviewed the case study materials and 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. 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; likewise those that only gave cursory coverage to the question did not perform 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 of partnership and company law such that 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 there is a natural desire to demonstrate all that the candidate has read and know. 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 carried 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.

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.This is a valuable resource if used correctly; if used correctly when studying, during revision and then in the examination itself, it is 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 corresponding statutory provisions, read and understand the manner in which they operate. The effective use of statute in the exam will only seek to embellish answers and candidate performance. Care should be taken to identify and use the correct Model Articles – in too many assessments the wrong version has been used by candidates.

CANDIDATE PERFORMANCE FOR EACH QUESTION

Question 1

This question looked at issues relating to directors:

- Appointment – generally when done well, candidates scored well. However careful reading of the question still needed to be considered as, whilst it was not asked, candidates did discuss the award of service contracts.
- Removal of a director – generally, candidates lost marks by not fully covering the procedure under ss168-169 and 312. Likewise, all too often potential steps to prevent removal were discussed on the basis of those steps one would consider when being appointed, rather than at the time of removal. Accordingly, s994 CA 2006 and s122(1)(g) IA 1986 were frequently missed.
- Compensation – this was covered with mixed results, with the lack of detail being an issue for most candidates.
- Disqualification – this was generally done well.

For the full requirements, candidates are referred to the suggested answers.

Question 2

This question focussed on the buy-back of shares by the company. Those candidates that had studied and understood the Case Study materials well, were correct in their identification that this was a buy-back that was required to use capital. Most candidates did well to set out the requirements of the buy-back process and to work through the facts. More citation of authorities and a better understanding on the publicity and time limit requirements was required. What must be noted is that this question was not looking at the issue of new shares, as thought by some, nor was it dealing with redeemable shares which were not relevant/applicable on the facts.

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 3

The first part of the question looked at the potential acquisition of a property, by one party from another, that was obviously close to the onset of insolvency. Most candidates were able to recognise that this was a transaction at an undervalue and presented good arguments as to why the onset of insolvency was upon the selling company under s122-123 Insolvency Act 1986. The transaction was not, as some thought, a preference, nor was it one that saw a connected party issue arise. Most candidates did fail to identify that consequences for the acquiring party, namely that it could be a transaction set aside by a liquidator and the ensuing risks in entering into the transactions for those directors under s174.

The final part of this question was the issue of making a loan to a director. Generally, this was well tackled by candidates, although the application of the possible exemption that could arise was applied with mixed success, as was the decision that the making of a loan did not require members approval; this was ignored in some instances. Likewise, candidates typically ignored the issues with s177 and Article 14.

Candidates are referred to the Suggested Answers for further guidance.

Question 4

The first part of this question looked at identifying terms that could be included in a possible partnership agreement, on the formalisation of the partnership. This required consideration of the facts as they applied in the circumstances, and how they could be implemented to be best effect. The question did not require, as some candidates sought to do, a list of all possible terms that an agreement could include. Rather more consideration was required. Those that related both the facts and the applicable provisions of the Partnership Act 1890 did well. 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 the dissolution of the partnership and the settling of the debts. This required the careful consideration of how, in this instance, the partnership could be brought to a close, rather than a

consideration of all possible means of dissolving a partnership. It then required the application of section 44 of the partnership Act 1890.

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.

SUGGESTED ANSWERS

LEVEL 6 - UNIT 16 – THE PRACTICE OF COMPANY AND PARTNERSHIP LAW

Question 1(a)

Alice Woods 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 OR.

To appoint by General Meeting, directors will need to call a General Meeting on 14 days' notice or short notice (s307 Companies Act 2006 and Article 48 Model Articles). Alternatively, Colling Limited could use the written resolution procedure under s288-300 Companies Act 2006.

In order to achieve the appointment, the directors' meeting will need to be quorate. Quorum for a directors' meeting is two under Article 11 of the Model Articles. However, the model articles have been amended so the quorum is set at three and will therefore require Edward still to be a director at this point in time.

Administration: Board Meeting and General Meeting minutes to be prepared. Alice to be entered in the Register of directors, and form AP01 to be completed and filed with the Registrar.

Question 1(b)

As a director Edward may be removed from office by ordinary resolution (s168 Companies Act 2006), requiring 50%+ of the votes cast, provided the special notice procedure has been followed:

- Requires special notice to be given to the company of intention to remove Edward (s168(2) and 312 Companies Act 2006), i.e. notice of intention to move a resolution to remove Edward as director must be given to the company at least 28 days before the meeting at which it is moved.

- The directors must convene a general meeting of the shareholders on not less than 14 clear days' notice. It is not possible to use a written resolution (s288(2) Companies Act 2006). Note that if a meeting is convened for a date 28 days or less after the special notice is given it is nonetheless deemed to have been properly given though not within the time required (s312(4) Companies Act 2006).

- The directors must give notice of the resolution to remove Edward to its members at the same time and in the same manner as it gives notice

of the general meeting (s312(2) Companies Act 2006) (this is usually done by setting out the resolution in full in the notice of general meeting with a rider to the effect that special notice has been given in relation to it).

- A copy of the notice of the intended resolution must be sent forthwith to Edward.

The steps Edward might take to prevent his removal include the following:

- He would be entitled to require circulation of written representations (s169(3) Companies Act 2006), but note the conditions attached to the right and to have them read out at the meeting if not circulated (s169(4) Companies Act 2006). He would also be entitled to make representations at the meeting (s169(1) Companies Act 2006). The chair of the meeting should make sure that Edward's rights are observed.

- If Edward were entitled to 'weighted votes' on any resolution to remove him as a director, then such an arrangement would be enforceable according to Bushell v Faith. However, the company search shows that such a clause has not been incorporated into the articles. Therefore, as Edward only holds 10,000 shares, which represents only one-third of the shareholding, this is not sufficient to defeat the resolution seeking his removal. Edward could seek to change the articles to get such a clause incorporated.

Edward could petition the court for relief against 'unfair prejudice' resulting from some specific act or omission done or threatened by the company or the general conduct of the affairs of the company (s994 Companies Act 2006). If there were an understanding that Edward would be entitled to remain a director of the company, his removal might constitute unfairly prejudicial conduct. However, even if the court found this to be so, the court would be unlikely to order his reinstatement as a director.

Alternatively, Edward may be able to petition the court for the compulsory winding up of the company on the grounds that it would be 'just and equitable' (s122(1)(g) Insolvency Act 1986) This would only succeed if there was no other reasonable remedy available; it may be that the remaining director(s)/shareholders would be required to purchase Edward's shares in the company.

Question 1(c)

Edward will be entitled to compensation for loss of office, and damages for wrongful dismissal:

- Removal under s168 Companies Act 2006 does not deprive Edward of the right to compensation or damages if he can establish a cause of action (e.g. breach of service contract) (s168(5) Companies Act 2006).
- Edward's role as a director and any role that he has as an employee are distinguishable – they are separate roles and whilst Edward's removal from the board may amount to sufficient reason for him to claim constructive dismissal from Edward's employment a company that removes a director from the board needs also to end the contract

of employment (a separate act) if the intention is to sever all connections with that person.

Question 1(d)

Should Edward Normanington be served with a statutory demand he could then 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 will no longer be able to continue in office as a director of Colling in any event. As Colling has adopted the Model Articles, Edward will automatically lose his office of director on the making of the bankruptcy order (Art 18 Model Articles).

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

Under s10 CDDA 1986 where the court orders that a person make a contribution to a company's assets on its winding up under s214 Insolvency Act 1986 (as may be the case here if the rescue plan does not succeed and depending on the outcome of the investigation by BIS) it may also make a disqualification order for a maximum period of 15 years.]

Under s11 CDDA 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 Edward 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 CDDA 1986).

Question 2(a)

Colling may purchase Edward Normanington's shares by undertaking a buyback of shares, even though the basic principle is that a company limited by shares cannot acquire its own shares, s658 CA 2006. The reason for the general prohibition is that it is part of the body of legislation designed to preserve the share capital of companies.

However, there are exceptions to the basic principle; namely that a company limited by shares may purchase its own shares (subject to any prohibition or restriction in the articles) (s690 CA 2006) provided:

- the shares are purchased using distributable profits or the proceeds of a fresh issue of shares issued for that purpose or, if the company is private, out of capital (s692(1) and (2) CA 2006);
- that where the buyback is to be 'off market', which would be the case as the company is a private company, the terms of the contract by which the company is to purchase its shares are approved by ordinary resolution of the company before the contract is made (s696 CA 2006).

Given the reluctance of the other shareholders to purchase Edward's shares, it is unlikely that they will wish to subscribe for new shares or see the sale of new shares to an outsider. Consequently, all the consideration for all the shares, £250,000 will have to be funded by the company. However, as the company has only £210,000 of distributable reserves (profits), this is

insufficient for the purchase and the balance of the purchase price (i.e. £40,000) will have to be funded by the use of capital. Provided Colling follows the necessary procedure it is therefore possible for Colling to buy-back Edward's shares.

Question 2(b)

The procedures that need to be followed in order for Colling to purchase Edward's shares are:

As Colling has adopted the Model Articles, Article 36 Model Articles permits the purchase by a company of its own shares and the use of capital for that purpose.

An OR is required to approve the contract for the purchase of the shares. Additionally, a private company limited by shares (i.e. Colling) may buy its own shares using capital (s709 CA 2006) provided:

- capital is only used to the extent distributable profits are insufficient to satisfy the consideration to be paid by the company (s710 CA 2006);
- the directors and auditors make a statement that the company can carry on as a going concern (s714 CA 2006);
- the payment out of capital is first approved by special resolution of the company (s716 CA 2006);
- members who did not vote for the resolution, or creditors, have five weeks from the passing of the resolution to object to the court (s721 CA 2006) and the payment must not be made during that period (s723 CA 2006); and
- as Colling will be required to use capital to facilitate this purchase, a notice must be placed in the London Gazette and either the creditors must be informed or the notice must also be placed in a national newspaper (s719 CA 2006);
- the right to use capital is subject to any prohibition or restriction in the company's articles.

To use capital:

- Directors' statement in prescribed form with auditor's report annexed (s714 CA 2006).
- Special resolution to be passed within a week following the making by the directors of their declaration.
- The directors' declaration and the auditor's report must be available for inspection at the general meeting at which the special resolution is passed.
- The special resolution to use capital is void if it would not have been passed if the vendor had not voted.
- Note the publicity requirements and the time limit within which the purchase must be made.
- Create a capital redemption reserve.

Other procedural requirements: To buy back shares:

- Inspection of the contract or a memorandum of its terms (s696 CA 2006) (note timescales) and board approval of terms;

- The ordinary resolution to buy back is void if it would not have been passed if the vendor had not voted (s695 CA 2006).
- Return to registrar of companies within 28 days of purchase (s707 CA 2006) and amend the register of members.
- Preservation of contract and inspection facilities for 10 years at registered office s702 CA 2006.

Question 3(a)

The potential consequence of acquiring from Tracker & Co Limited (Tracker) the freehold office for £250,000 is that it could be held to be a transaction at undervalue.

Where, at the 'relevant time', a company has entered into a transaction in which the company (i.e. Tracker) receives, as in this instance, significantly less consideration than that provided by the company itself (i.e. the value of the property), the transaction may be held to be one at an undervalue and the court must make an order to restore the position to what it would have been if the company had not made the transaction (s238 Insolvency Act 1986).

The time at which a company enters into a transaction at an undervalue is a 'relevant time' if the transaction is entered into within two years of the onset of insolvency, provided that the company is unable to pay its debts at that time (s240 Insolvency Act 1986). It appears here that Tracker is indeed unable to pay its debts.

Applying the facts, the sale may well be deemed would be a transaction at an undervalue and it is difficult to see how it would benefit the company, as the company, Tracker, is seeking to sell a property valued at £345,000 for £250,000. However, there is a defence of good faith with reasonable grounds for believing that the transaction would benefit the company, although there is nothing to suggest this at the moment.

Consequently, the transaction would be set aside if Tracker were to go into liquidation within the relevant time, and the company were at the date of the transaction unable to pay its debts within the meaning of s123 Insolvency Act 1986. Tracker may be close to the 'onset of insolvency', which is the date of the presentation of the petition for the administration order or the date of the commencement of the winding up (s240 Insolvency Act 1986).

As such, should Tracker go into liquidation either an administrator or a liquidator can apply to the court to set aside the transaction (s238(1) Insolvency Act 1986). This could see the property being re-vested in Tracker, meaning that Colling would lose the building acquired and it is unlikely that they will be able claim they entered into the transaction in good faith as the value proposed is less than market value.

Accordingly, he directors of Colling should be aware of their general duties to promote the success of the company (s172) and exercise reasonable care, skill and diligence (s174 CA 2006); which they may breach if they proceed where they know or ought to know that the transaction is subject to challenge as a transaction at an undervalue.

Question 3(b)

The proposed loan to Sean Normington would be a loan to a director. The relevant law is s197 CA 2006, which prohibits a company from entering into any loan, or guarantee in connection with a loan made by any person, to one of its directors, unless approved by a shareholders' ordinary resolution. Section 197 CA 2006 requires that, in addition to obtaining member consent, a written memorandum setting out the nature of the transaction or arrangement, the amount and purpose of the loan and the extent of the company's liability connected with it must be made available to members before they give their approval by way of ordinary resolution.

Shareholder approval may not be required if an exception applies. The one most likely to be applicable here is the s204 CA 2006 exception for expenditure on company business where the proposed loan is less than £50,000. Given the reasons for making the loan, and the fact that it is £13,500, the exception will therefore apply, and an ordinary resolution of the shareholders will not be required.

In any event the decision to grant the loan is a directors' decision. Sean must also disclose his interest (s177 CA 2006) and cannot count in the quorum, and not vote on the matter (Article 14 Model Articles).

Question 4(a)

The provisions that should be included into the agreement to ensure Lucy devotes herself to the business will be positive obligations and should be such that she is required to use best skills and endeavours to promote/ carry on business and conduct herself in a proper and responsible manner. Lucy should also be required to devote the whole of her time and attention to the business. This is a useful requirement to include given that no obligation under the Partnership Act 1890 requires a partner to devote time to the business (the only obligation is under s30 Partnership Act 1890, namely to account for profits made through competing with the firm). All partners should be required to show good faith to the other partner(s) and give true account of, and full information about, all things affecting the Partnership. They should also be required to inform the Partnership, without delay, of any legal proceedings; punctually to pay and discharge debts and to account to the partnership for any profit derived from any business, office or appointment, or any personal benefit derived from the business, the use of the name, Partnership property or business connections of the Partnership. They may also wish to have restrictions on entering into contracts over an agreed value without the consent of other partners.

In addition, Lucy should be required not, without the prior (written) consent of the other partner(s), to engage or be concerned directly or indirectly in any business other than the Partnership business or accept any office or appointment. The agreement should state that partners should not derive any benefit from the use of the name, Partnership property or the business connections of the Partnership or engage in any contract or commitment on behalf of the Partnership, except under the name of the partnership.

The partnership in this instance should seek to include restrictive covenants preventing Lucy establishing a competing business. The clause in the agreement needs to be a careful balance to ensure that it is not a restraint of trade. It must therefore not be an unreasonable restraint but reasonable

between parties (e.g. as to the geographical area covered, and the duration of the restriction). Balance is essential.

Question 4(b)

In the absence of any agreement to the contrary, this partnership can be dissolved by serving notice of dissolution on the other partners (ss 26 or 32(c) Partnership Act 1890). This brings the business to an immediate end pursuant to the provisions of Partnership Act 1890.

As there is no formal partnership deed, or any other evidence of any contrary agreement between the partners, the provisions of the Partnership Act 1890 apply. Should Alice serve such notice, it brings the business to an immediate end.

s44 Partnership Act 1890 sets out the specific rules for the distribution of assets from the partnership. A final account has to be drawn up. Once an account has been drawn up, the order of dissolution would be:

- all losses must be paid first (first out of profits, then out of capital);
- any balance of losses outstanding must be met by the partners individually in the proportion in which they are entitled to share profits;
- capital is repaid pro-rata to the partners;
- payment to a partner for advances as distinguished from capital;
- any money left over is then divided between the partners in the proportion in which the profits are divisible.

After dissolution, the authority of the partners is limited to doing such things as are necessary for the winding up of the affairs of the partnership and completing unfinished transactions. Accordingly, Alice, Jane and Lucy as partners must give notice of dissolution of the partnership by giving actual notice to those who have dealt with the firm and by placing a notice in the London Gazette (s36 Partnership Act 1890). Additionally, a notice would usually be placed in the local press to make sure that third parties (i.e. outsiders, particularly suppliers) are aware of the limit on the authority of partners from the moment of dissolution.