CHIEF EXAMINER COMMENTS WITH SUGGESTED ANSWERS

SEPTEMBER 2020

LEVEL 6 - UNIT 1 - COMPANY & 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

As in previous sessions the stronger answers contained the following:

Clear and accurate answers to the questions posed;
Detailed analysis and references to statute and case law as relevant;
Careful and accurate application to the facts in the part B scenarios.

These candidates are to be commended as they paid careful attention to the information given and the actual questions asked. It is vital for candidates to read the questions carefully and think about what is being asked. It is not sufficient, as is often the case with the poorer answers, to merely regurgitate what has been learned about a particular topic without thought to how the question is worded and what it is actually looking for. There was also evidence of candidates having learned prior answers by heart and merely re-writing them – again this was without thought to the actual questions. Candidates need to work on avoiding purely descriptive answers and ensure they evaluate and analyse as needed.

The Chief Examiner continues to be dismayed by the lack of case law referred to in many scripts. It is tricky to remember many case names, but this paper

required analysis and application by reference to any relevant statutory provisions and case law. The better candidates were comprehensive in their treatment of both. This is something the Chief Examiner feels the learning centres or providers need to emphasise more.
Candidates are encouraged to think broadly when looking at questions and planning, but at the same time ensure they address all elements of the question and check for a particular focus or angle to be explored.

CANDIDATE PERFORMANCE FOR EACH QUESTION

Section A

Question 1 (a) Pre-incorporation contracts and (b) section 33:

The second most popular question. Part (a) was generally better answered than (b). There was only one exceptional answer that addressed the question carefully. Most answers were somewhat lacking in evaluation or analysis and case law for example – as already mentioned above.

Question 2

Section 994 and Part 11 claims: Answers tended to be a little light in terms of comparison and – again – lacking in case law of which there is plenty.

Question 3

Fixed and floating charges: the most popular question. The same issues as above apply here. The good answers, of which there were several, provided lots of detail and relevant case law as well as the comparison as the question required.

Question 4

Maintenance of capital: this was only answered twice. Answers were superficial and lacked detail.

Section B

Question 1

Corporate veil: this was a reasonably popular question that produced some good answers. But the same points already made above apply here. To do well candidates need to reference case law carefully and in detail.

Question 2

Partnership issues: this was popular and there were some good answers where candidates addressed the different elements of the questions thoroughly. Overall, it generated the best answers. There was careful attention in many to the different elements of section 1 of the Partnership Act for example and the nature of liability.

Question 3

Substantial property transactions and removal of a director: this was not a popular question (only 3 answers), and candidates unfortunately missed the key issues. It was apparent that candidates were unfamiliar with the issues and had not grasped the implications of the facts.

Question 4

CVAs: only 1 candidate answered this and it was a reasonable answer. They paid attention to the question itself and referred to and applied the facts.

SUGGESTED ANSWERS

LEVEL 6 - UNIT 1 – COMPANY & PARTNERSHIP LAW

Question 1(a)

A promoter was defined in Twycross v Grant [1877] as 'one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose'. It might include therefore both someone who takes the procedural steps to incorporate the company, and someone who sets up the company's business itself. It does not include, however, those who act merely in a professional capacity and on the instructions of the promoter, such as a solicitor or accountant.

A promoter may enter into a contract or contracts on behalf of the company before it is formed; ie pre-incorporation contracts. Normally, a person entering into a contract on behalf of a company acts as the company's agent, and it is the company which is liable on that contract. However, this cannot be the case for a pre-incorporation contract, as at the date of the contract there is no company in existence to act as principal. Rather, s51 Companies Act 2006 (CA 2006) makes it clear that the promoter is personally liable in respect of the contract, but this rule applies unless there is any 'agreement to the contrary'. In other words, it is possible, when the promoter enters into a contract on behalf of the company she is forming, to expressly agree with the other party to that contract, that the promoter will not be personally liable.

Such agreement cannot be implied into the contract. The court in Phonogram Ltd v Lane [1981] made it clear that any such 'agreement to the contrary' must be expressly and clearly included within the contract. In that case, the promoter signed the contract 'for and on behalf of Fragile Management Ltd' (the name of the company being incorporated). The court held that these words were insufficient to amount to an agreement excluding the personal liability of the promoter. It is not therefore sufficient to exclude a promoter's personal liability merely to add additional words to the promoter's signature to indicate she signs purportedly as an agent for the company being formed. It must be shown that there is actually an agreement with the other party to the contract excluding personal liability.

To protect herself against personal liability, the promoter could, as noted above, enter into an 'agreement to the contrary' with the other party to the contract. Alternatively she could enter into a contract with the company once it is incorporated, whereby the company promises to perform the obligations under the original contract with the third party, and to indemnify the promoter against her liability under that contract, as long as the company is able to perform these obligations. If the company goes insolvent, then the third party will still be able to sue the promoter personally and the promoter's right of indemnity against the company will be of little value.

A better solution is to form a new contract with both the company and the third party (a contract of novation), under which the company agrees to perform on the same terms as in the original contract, and under which the third party releases the promoter from the promoter's previous personal liability. The difficulty with this however is that, once the third party has the benefit of a contract with the promoter, there is no obvious reason why the third party would agree to enter into a novation contract releasing the promoter from her personal liability. A term in the original contract that the promoter's liability will cease at some point in the future if the company is incorporated and if the company agrees to take over the promoter's liability would avoid this issue.

This solution is close to the 'agreement to the contrary' in s51 although the solution does also create a (albeit temporary) personal liability of the promoter. Finally, since the problem of personal liability arises because of the time gap before the formation of the company, one way around the problem is simply to create the company as quickly as possible. To this end, a shelf company might be used or the same day incorporation service at Companies House.

1(b)

Section 33(1) CA 2006 states that 'the provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions'. The articles of association of the company form the basis of the contract and address the rights and obligations of the company and each member. This contract offers one form of protection for minority shareholders.

As a result of this contract, either party may enforce the provisions of the articles. This has been established in case law: for example, in Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915], the company enforced an arbitration clause in the articles against a member. Conversely, in the case of Pender v Lushington [1877], the court found in favour of a member whose rights under the articles had been breached.

The contract created by section 33 is unusual however in that it is for example not rectifiable in the same way as a 'normal' contract even if the articles do not express the true intention of the parties (Scott v Frank F Scott (London) Ltd [1940]). The articles can only be amended by special resolution of the company members under section 21 CA 2006, meaning that at least 75% of the shareholders must agree to the amendment. However, the courts have been seen to interpret articles using the 'reasonable person' test (Attorney General of Belize v Belize Telecom Ltd [2009]).

In addition, the nature of the contract means enforcement is limited to provisions concerning membership (Eley v Positive Government Security Life Assurance Co [1876]). A member cannot for example seek to enforce a provision that relates to directorship of a company (Beattie v E & F Beattie Ltd

[1938]). The courts also appear to have accepted an enforceable relationship between members (Rayfield v Hands [1958]), as well as between the company and each member, at least where there seems to be a form of partnership existing behind the corporate veil.

A limitation period of six years from breach applies to enforcement of rights under the articles as the covenants given under section 33 are not under seal.

Question 2

S994 CA 2006 (CA 2006) and Part 11 offer protection of shareholder rights, particularly where the company is unwilling to take action following directors' wrong-doing, because it is itself under the control of the wrong-doers.

To begin with s994, a member may complain to the court where 'the company's affairs have been conducted in a manner that is unfairly prejudicial' to the interests of the members generally or some part of them including his own. The courts have interpreted the 'interests of the members' broadly: such interests could be based on the formal rights of the shareholder – under provisions of the CA 2006, or the company's own constitution – but also on understandings which were never recorded in the articles. These have been referred to both as 'legitimate expectations' (Re Saul D Harrison & Sons plc [1995]) and as 'equitable considerations'. One of the earliest cases to establish this judicial approach is Ebrahimi v Westbourne Galleries [1973]. In O'Neill v Phillips [1999], Lord Hoffmann stressed that the task of the court is to give effect to the parties' own understanding, and not to override what the parties had themselves agreed. Indeed, the court will take into account what may be very informal agreements. Further, the courts have generally accepted that interests enjoyed in a capacity other than as a member could also be enforced under s994: see eg Gamlestaden Fastigheter AB v Baltic Partners Ltd [2007].

Another level of protection under s994 lies in the range and effectiveness of the remedies available to the court. Under s996, the court can make any order it sees fit to remedy the unfair prejudice including the purchase of the petitioner's shares. This is by far the most common remedy sought by minorities, and awarded by the courts, which have also generally insisted that a fair price be paid for the shares (i.e. not discounted for being a minority holding): (Re Bird Precision Bellows [1986]; O'Neill v Phillips [1991]).

By contrast, under Part 11, what are called derivative claims may be brought by members on behalf of the company for any breach of duty (s260), rather than, as was previously the case, only for 'fraud on the minority'. The ground for bringing a claim must involve an act or omission involving negligence, default, breach of duty or breach of trust by a director. This contrasts with a claim under s994 that may be brought in respect of any conduct of the company's affairs that is 'unfairly prejudicial' to the interests of members. Any member bringing a derivative claim must also obtain the court's permission to continue it. S263 identifies the factors to be considered in the granting of such permission. The court must refuse permission when the company has given authority before the act (before or has ratified after the act. This reasserts the rule giving the majority the power to deny the minority the right to continue their claim (although in the case of ratification, that majority must not include the wrongdoer or those connected with her: s239).

Additionally, permission must not be given where a 'hypothetical director' acting to promote the success of the company (under s172 CA 2006) would not continue the claim: relevant considerations here include the costs of the action, the prospects of its success, the ability of the director to satisfy any order made against her, and the harm that might be caused to the company's business by continuing the claim against the director – all of which are commercial considerations, upon which a court may be ill-equipped to judge (Iesini v Westrip Holdings Ltd [2009]. Consequently, the courts have in fact been reluctant to rely on this bar to permission to continue. They have said that only if 'no reasonable director' would continue the claim should the courts refuse permission on this ground (Iesini). This may seem helpful to the minority, but this 'hypothetical director' test reappears as one of the discretionary factors the court must take into account where no mandatory bar requires the court to refuse its permission for continuation. When applying this discretionary factor, the courts have accepted arguments (and even from the directors of the company who are the alleged wrongdoers) that continuing the action would not be in the company's best interests: see eg Kleanthous v Paphitis [2011].

Finally, the court must also ask if the member bringing the claim would instead have a personal cause of action in respect of the wrong complained of. In several cases, the courts have used this discretionary factor to rule that the member would be better off bringing a claim for unfair prejudice under s994: see eg Franbar Holdings v Patel [2008]; Mission Capital v Sinclair [2008]. It would therefore appear that the courts consider the unfair prejudice remedy as a better solution for the minority.

Occasionally, however, it may be that the member does not actually wish to leave the company as they believe the company has good prospects and they and their investment are better protected by remaining shareholders (Wishart v Castlecroft Securities Ltd [2010]).

To conclude, a s994 claim is a personal claim, while a derivative claim is one brought on behalf of the company. The grounds on which a derivative action can be brought are arguably narrower than under s994. The procedure for bringing a derivative claim is more complex, involving a two-stage process, and there are more potential bars to bringing a claim than under s994. Finally, the sanctions available to the Court under s994 are extremely wide including ordering a purchase of the complainant's shares at fair value.

Question 3

A number of elements distinguish fixed and floating charges and illustrate their relative advantages and disadvantages for creditor.

A fixed charge can be legal or equitable, and can be over a specific asset, such as land or plant and machinery, as well as over both present and future assets. Generally speaking, a legal charge can vest legal title to the asset in the creditor, but this requires the execution of a deed. An equitable charge will vest only equitable title to the asset, and a deed is not required. It may be sufficient to deposit the documents of title. Sole traders, companies, partnerships and LLPs can create fixed charges.

Only a company (or a limited liability partnership (LLP)) however can create a floating charge. This is a charge over a generic class of assets, such as stock or book debts, but the charged assets can be both present and future. (Re Panama, New Zealand and Australian Royal Mail Co [1870]).

Unlike a fixed charge that requires the creditor to have control over the assets, with a floating charge, the company will be free to deal with the assets, whose composition is likely to change from time to time. This will continue until the floating charge 'crystallises', thereby attaching to the particular assets in the class. (Re Yorkshire Woolcombers Association Ltd [1903]).

At common law a floating charge will automatically crystallise on the occurrence of certain events such as the making of a winding up order, the appointment of a receiver or administrator or the company ceasing to carry on business. In addition, the charge document usually specifies events that will trigger crystallisation such as the creation or attempted creation of a security interest over any of the charged assets in favour of a third party.

The main advantage of a fixed charge from the creditor's perspective is that she retains a high degree of control over the charged asset: the company is not free to sell or otherwise deal with the asset without the creditor's consent. If the company wishes to sell the asset, the charge must either be released or (if permitted by the terms of the charge) the asset sold subject to the charge. Valuation of the charged asset is also therefore easier. By their nature the value of the assets charged by a floating charge, such as stock or book debts, will fluctuate.

Creditors will normally prefer to take a fixed charge because on the company's insolvency a fixed charge ranks ahead of a floating charge; i.e. the holder of a fixed charge will be paid before the holder of a floating charge. Note that a charge that was a floating charge when created will be treated as such on insolvency.

However, even if a charge is expressed in the deed creating it to be a fixed charge, it may not in fact be one. It is the substance of the charge itself that matters. A number of cases have considered this where there has been an attempt to create a fixed charge over book debts and bank accounts. The leading case on this is National Westminster Bank plc v Spectrum Plus Limited and Others [2005] where the House of Lords held that, although in theory it would be possible to create a fixed charge over book debts, the charge in question was in fact only a floating charge, due to insufficient control by the creditor over the relevant assets.

Floating charge holders also rank for payment behind the expenses of winding up and payment of preferential creditors and a proportion of the proceeds remaining for distribution to floating charge holders has to be 'ring-fenced' for payment to unsecured creditors. Furthermore, a floating charge (but not a fixed charge) can be set aside, in certain circumstances, under s245 Insolvency Act 1986 (IA 1986).

The principal advantage of a floating charge is that it is a commercially flexible form of security that enables the borrower to deal with the charged assets without reference to the creditor so long as the charge remains uncrystallised. From the creditor's perspective this may be seen as a disadvantage, but it does give the creditor the opportunity to take some form of security over assets such as stock and book debts that might not otherwise be amenable to a fixed charge.

A holder of a qualifying floating charge (i.e. one created in accordance with Schedule B1, paragraph 14, IA 1986 is entitled to appoint an administrator in defined circumstances affecting the company's solvency. This may help to protect the interests of the creditor (and other creditors).

Where created by a company, both types of charge can be registered at Companies House by delivering a statement of particulars in the prescribed form, known as a 's859D Statement of Particulars' (s859D CA 2006), within 21 days of the creation of the charge (s859A(4) CA 2006). Registration is now voluntary, but it is in the interest of the creditor that the charge is registered. Otherwise, the charge is void as against a liquidator or administrator of the company. Any underlying debt however remains enforceable and will become immediately due and payable if the security is rendered void for failure to register or failure to do so within the 21 day period (s859H CA 2006). Registration of either type of charge is therefore an advantage for the lender. Registration may be effected by the company or 'any person interested in the charge', but it is in the creditor's interest to ensure registration takes place.

Question 4

The long-standing principle of company law that companies must maintain their capital for the benefit of creditors derives from the common law (Trevor v Whitworth [1887]). In other words, the money subscribed by shareholders for their shares cannot be returned to them except after payment of all the company's creditors in a winding up or in one of the ways permitted by the CA 2006.

The reason behind the rule is that shareholders have limited liability in relation to the company. As a result, they cannot be made liable for the debts of the company beyond the amount remaining unpaid on their shares. The amount of a company's called up share capital therefore has to be maintained as a fund of last resort to protect the interests of creditors.

Although the common law principle established in Trevor v Whitworth remains, it has now been overlaid with substantial statutory regulation. Some of this re-enforces the Trevor v Whitworth principle, while other statutory provisions set out conditions under which the principle may be departed from. In addition, the regulations affecting public companies are markedly stricter than those applicable to private companies, reflecting their generally larger size and creditors' exposure to financial risk.

The following are examples of ways in which statutory regulations implement the maintenance of capital principle.

There is a general statutory prohibition on companies purchasing their own shares (s658 CA 2008), breach of which is subject to criminal sanctions, although this rule is now subject to a number of statutory exceptions referred to below.

Companies (public and private) are restricted in the circumstances in which they can pay dividends. Essentially a company wishing to pay a dividend can only do so out of its accumulated realised profits, so far as not previously used for distribution or capitalisation, less its accumulated realised losses, that have not been previously written off in a reduction of capital or re-organisation duly made (s830 CA 2006). The distribution must be justified by reference to the company's last annual accounts. If a company makes an unlawful distribution then any member who knows or has reasonable grounds for believing the distribution is made in contravention of the statutory rules is liable to repay it and the directors may be liable for breach of duty (Bairstow v Queen's Moat Houses plc [2002] and It's a Wrapp (UK) Limited v Gula [2006]).

Furthermore, public companies are prohibited from providing financial assistance for the purchase of their own shares, both at the time of the purchase and subsequently (s678 CA 2006). The prohibition extends to subsidiaries of public companies giving financial assistance for the purchase of shares in their holding company and to public company subsidiaries giving financial assistance for the purchase of shares in their private holding companies (ss678 and 679 CA 2006). "Financial assistance" is broadly defined and includes financial assistance given by way of gift, guarantee, security or indemnity and by way of loan and any other financial assistance that has the effect of materially reducing the net assets of the company (s677 CA 2006). There are various exceptions, both conditional and unconditional, to the general rule and breach of the prohibition is a criminal offence.

Other means of enforcing the rule relate to the issue of share capital:

- Shares must have a fixed nominal value (s542 CA 2006) and a company may not issue its shares at a discount to their nominal value (s580 CA 2006). In theory at least, this ensures that companies receive the full nominal amount for their issued shares.

- Shares can however be issued partly paid, although public companies may not allot shares unless at least one quarter of the nominal value and the whole of any premium is paid up (s586 CA 2006); and most modern articles prohibit the issue of partly paid shares altogether (see for example Article 21 of the Model Articles for Private Companies).

- Companies may allot shares at a premium to their nominal value. However the amount of any premium must be credited to a share premium account (s610 CA 2006) which is treated for most purposes as part of the paid up share capital and can only be reduced in the same way and subject to the same safeguards that the share capital can be reduced.

- Public companies, formed as such, may not commence in business or borrow unless they have an "authorised minimum" share capital i.e. the nominal value of its allotted share capital must not be less than £50,000 (s761-763 CA 2006). Private companies re-registering as public companies are subject to a similar requirement.

- Shares can be issued for a non-cash consideration but in the case of public companies they may not allot shares as fully or partly paid for a consideration other than cash unless the consideration for the allotment has been independently valued (s593 CA 2006).

On the other hand, the two principal statutory exceptions to the maintenance of capital rule are as follow.

First a company may reduce its share capital in one of the ways permitted by Chapter 10, Part 17, CA 2006.

- That is, in the case of a private company, by special resolution supported by a solvency statement and for both public and private companies by special resolution confirmed by an order of the court (s641(1) CA 2006).

- The CA 2006 specifies a number of circumstances in which a company may reduce its share capital, such as reducing or extinguishing the liability on any of its share capital that is not paid up or cancelling any share capital that is lost or unrepresented by available assets, but also provides a more general power to reduce its share capital "in any way".

- Whatever the circumstances, a primary consideration will be the interests of creditors and the solvency of the company following the reduction.

- A solvency statement, required for private companies, is a statement by each of the directors that they are satisfied at the date of the statement that there is no ground on which the company could be found to be unable to pay its debts and they have formed the opinion the company will be able to pay its debts in full for the next 12 months.

- In the case of a court-confirmed reduction, creditors are entitled to object and the court may not make an order confirming the reduction unless it is satisfied that every creditor entitled to object has either consented to the reduction or his claim has been discharged or secured (s643 CA 2006).

Second, notwithstanding the general prohibition on companies purchasing their own shares (s658 CA 2006), they can issue redeemable shares and purchase their own shares, subject to the provisions of Chapters 3 and 4, Part 18 CA 2006.

- Generally speaking, redemption and buy-back of shares must be financed out of distributable profits or the proceeds of a fresh issue of shares made for the purpose. In that way the existing capital of the company is protected. Usually, such buybacks are subject to shareholder approval but there are de minimis thresholds.

    - Private companies however can redeem or purchase shares out of capital. If the payment exceeds either £15,000 or 5% of the company's share capital, then the use of capital is subject to the provisions of Chapter 5, Part 18 CA 2006. The provisions in Chapter 5 provide a number of safeguards for creditors. Under chapter 5, the redemption or purchase must be financed first out of any available profits and only the balance (the "permissible capital payment") can be paid out of capital; the directors must make a declaration of solvency supported by an auditor's report and the permissible capital payment must be sanctioned by special resolution of the shareholders.

SECTION B

Question 1

It should first be noted that a company has a legal personality separate from that of its members (Salomon v Salomon [1897]) and, accordingly, liabilities incurred by the company belong to the company itself, not its members. Here therefore following this principle EP's liability to its employees should be enforceable only against EP. Further, if EP were to go into insolvent liquidation, its shareholder, ie PL, would have no obligation to contribute towards its assets in the winding up of the company (save to the extent of any amount unpaid on its shares). This is because EP is a company limited by shares.

There are, however, a number of qualifications to these principles.

First, the courts will very occasionally 'pierce the corporate veil', disregarding the separate legal personality of a company. This could result in a shareholder, here PL, becoming liable to contribute to its company's (EP's) liability. However, UK courts have generally been very reluctant to lift the veil. This reluctance is evident from the leading cases, such as Adams v Cape Industries Plc [1990] and Prest v Petrodel Resources Ltd [2013].

In Prest, for example, the court held that the only 'true' ground for veil piercing was where a company, here EP, is a mere façade or sham, or being used to perpetrate a fraud; see eg Gilford Motor Co Ltd v Horne [1933] and Jones v Lipman [1962]. Although it is not entirely clear what constitutes a mere façade, Adams and Prest suggest that the façade arises where a company is being used to allow the controller of that company *to evade an existing obligation*. In our scenario, however, it seems that PL, the controller of EP, has not used EP to evade any obligation which PL was already under. Rather, PL has only ever used EP to ensure that future liabilities, that might arise from the pursuit of the new (packaging) business venture, would, as they arose, fall on EP rather than on itself.

There are other situations which, although they do not technically amount to veil piercing, could nevertheless result in a shareholder finding itself liable as a result of the actions of its subsidiary. Four such situations might be mentioned here.

The first is where the separate legal identities of companies in a group are disregarded, and those companies viewed as a 'single economic entity'. However, the court in Adams held that this would be appropriate only where the proper interpretation of a statutory provision, or of a contractual document, required the court to disregard the separate identity of members of a group. There appears to be no issue here around such interpretation and therefore this ground is not applicable.

The second situation is where there is an agency relationship between company and shareholder. Such an agency relationship has been found in cases such as Re F G (Films) Ltd [1953], but the court in Adams suggested there should be an express agency agreement for this relationship to exist. This certainly does not appear to be the case in our facts.

The third situation is where a shareholder is sued directly in tort. In Chandler v Cape Plc [2012], the Court of Appeal laid down a number of preconditions for imposing on a parent company a duty of care towards the employees of its subsidiary, breach of which duty might give rise to liability as a joint tortfeasor. The first of these is that the parent and the subsidiary companies must be 'in the same line of businesses'. This seems to be satisfied here - EP and PL are involved in the same industries. If PL were a 'pure holding company', leaving all trading activities to its subsidiaries, the first condition would not be satisfied (see Thompson v Renwick Group [2014] and Okpabi v Royal Dutch Shell Plc [2017]), but this does not seem to be the case here.

The second condition in Chandler was that the parent company had a superior knowledge of issues of health and safety than did the subsidiary. This condition also seems to be satisfied, given that an employee of the parent company (Karl) has responsibility for matters of health and safety in the subsidiary company, and through him the parent is clearly made aware of the safety issues in the subsidiary.

However, it is worth noting that in Vedanta Resources plc v Lungowe [2019] the court seemed to suggest that a parent would only be held liable for injuries caused by its subsidiary if the parent had either 'taken over the management' of the activity causing the injury, or had 'given relevant advice to the subsidiary' about how to manage the risky activity. In other words, Vedanta seems to suggest that parents will be liable only for their own *mis*feasance. In our case, neither of these examples of misfeasance seem to apply to PL's conduct. It seems to be guilty only of *non*feasance – of a failure to act and prevent EP's unsafe practices continuing.

Fourth, and finally, PL may face liability for wrongful trading, under s214 Insolvency Act 1986. It would need to be shown that the directors knew, or ought to have known, that insolvency of EP was inevitable. If that could be established, the directors would be liable unless they could show that, from the moment they knew or ought to have known that insolvency was inevitable, they took all steps to minimise the loss to the company's creditors as they ought to have taken. The determination to continue trading, in the face of the company's poor financial performance, might be evidence of a failure to take all such steps to protect creditors. Since only directors can be sued, this would not seem to provide any means of holding PL liable. However, by s214(7), 'directors' includes 'shadow directors'. A shadow is a person in accordance with whose instructions the (legal) directors of EP are accustomed to act. If, then, Megan were 'accustomed to act' in accordance with PL's instructions, then PL might qualify as a shadow director.

Therefore, our advice to PL would be that it may find itself liable as a joint tortfeasor for injuries sustained by the EP employees, following Chandler, although the later case of Vedanta must cast some doubt on this. As a separate matter, it may also possibly be liable to contribute to EP's assets on the basis of wrongful trading.

Question 2(a)

Partnership is defined as the relation that subsists between persons carrying on business in common with a view of profit (s1 PA 1890). A written agreement is not necessary provided the s1 definition is satisfied. There are a number of key elements to this definition.

First, there must be two or more persons carrying on a business in common – as we have in this scenario. 'Business' is defined fairly widely by s45 PA

1890 as including every trade, occupation or profession and would therefore include the repair and restoration activities that are being pursued. Section 2 PA 1890 provides a number of rules for deciding whether a partnership exists. Thus, co-ownership, whether in the form a joint tenancy, tenancy in common, joint property, common property or part ownership does not of itself create a partnership. For the most part however, these provisions are indicative only and not determinative of the existence of a partnership.

A business may consist of a single venture or, perhaps more frequently, a series of continuing activities. Khan and Another v Miah and Another [2001]. There must however be more than mere agreement to form a partnership (Ilott v Williams [2013]). Neither of these factors should be in question in our scenario.

The concept of a business being carried on "in common" also implies some shared responsibility for decision making, in contrast to the employer-employee relationship where ultimately the employee must act in accordance with his employer's instructions. As Fahd and Gloria have impliedly agreed to take on different management roles, this seems to suggest they have a common interest.

Second, there must be an intention to carry on business "with a view of profit" i.e. a profit motive. Section 2 (3) PA 1890 provides that the receipt by a person of a share of profits is prima facie evidence that he is a partner but does not of itself make him a partner. In effect it is only one of several factors that must be taken into account.

The sharing of profits is nonetheless a strong indicator of the existence of a partnership and is one of the factors that distinguish partnership from other forms of business relationship again such as employer and employee. Fahd and Gloria have been in business together and sharing profits for a year which strongly indicates they are in partnership.

It would therefore seem there are very strong grounds for concluding that Fahd and Gloria are working in partnership – in particular, the shared responsibility for decision making and the participation in profits.

The fact that there is no written agreement means that their relations will be governed by the PA 1890, save to the extent of any contrary oral agreement or a contrary agreement can be inferred from a course of dealing between them.

2(b)

In terms of Helen's potential liability, in an unlimited partnership the individual partners are liable without limit for the debts and other liabilities of the partnership (s9 PA 1890). Partners face unlimited liability for a partnership's debts as there is no legal separation between the partners and the firm. Section 9 PA 1890 and the Civil Liability (Contribution) Act 1978 provide that every partner is jointly and severally liable for all debts and obligations of the firm incurred while she is a partner. After her death, her estate is severally liable while such debts remain unsatisfied.

How partners bind the partnership and thus create the liabilities referred to in section 9 is governed by issues of express and implied authority. A partnership deed may contain limits on the authority of a partner to bind the partnership

– it may be that Helen could request that a partnership agreement is drawn up. If the partner breaches such a provision, she may find herself liable to indemnify the partnership for any loss should the partnership as a whole be found responsible for the debt incurred. Implied authority may arise through a course of dealings. In the absence of an agreement, as currently in this scenario, the partnership and liability issues are governed by the PA 1890.

The law of agency can also impact on a partner's liability, as set out in s5 PA 1890: partners act as agents of the firm when making contracts for the firm with third parties. The section begins with 'every partner is an agent of the firm and his other partners for the purpose of the business of the firm', and the acts of the partners will normally bind the firm. However, Helen may find herself liable for a contract with a third party if she has acted outside her authority.

In addition, if at the time a partnership is wound up or dissolved the partnership's assets are insufficient to meet its liabilities, Helen could be called upon to contribute to the shortfall from her personal assets.

(c)

Under s17 PA 1890 a partner does not become liable for debts incurred before they join a partnership. However, if Helen were to allow herself to be held out as a partner – in other words knowingly be represented as such – under s14 PA 1890, then she could become liable for debts before she formally joins. This could arise if she were to allow her name to appear on the stationery before the beginning of September.

To protect herself she could insist that the new stationery is not issued until she formally joins, or she could require that the current partners indemnify her against any liabilities arising before September. As mentioned above, she might also suggest that a partnership agreement is drawn up to formalise arrangements in which the indemnity could be inserted.

Question 3(a)

In relation to the purchase of the new building, the fact that this transaction was between the company and someone (Sonia) who seems to have a relationship with a director (Amelia) raises two legal issues.

The first concerns s177 CA 2006. This requires a director, who has an interest in a transaction into which their company is proposing to enter, to disclose that interest to the board. We know that Amelia and Sonia are civil partners and this would be a relationship close enough to require disclosure. Such a relationship is likely to be sufficient to mean that Amelia would be regarded as having an interest in this transaction, and therefore bound to disclose that interest to the board. We are not told if Amelia did so, but the facts suggest she did not. Disclosure is unnecessary if the board either was, or ought reasonably to have been, aware of the director's interest in the transaction. Again, given what Ryan now says about the board's ignorance of Amelia and Sonia's relationship, it seems unlikely either of these possibilities would apply here.

CA 2006 does not say what consequences follow from the director's failure to disclose his interest under s177; it merely says the consequences are the same as those that applied 'at common law' (s178). This probably means (although it is not entirely clear) that the contract to purchase the building becomes voidable at the instance of the company.

However, even if Amelia did disclose her interest in the contract to the board, the second legal provision that may be relevant is s190 CA 2006. S190 (1) (b) provides that a company may not enter into a transaction under which the company acquires or is to acquire a substantial non-cash asset from a person connected with a director of the company unless the arrangement has been approved by the members of the company.

- The building is a non-cash asset i.e. any property other than cash (s1163 CA 2006)
- An asset is substantial if its value exceeds £100,000 (s191 (2) (b) CA 2006) – here it is valued at £550,000

However, is the purchase from someone (Sonia) who is 'connected to a director'? s252 defines those who are 'connected' with directors. It includes 'members of the director's family', who are in turn defined in s253. They include 'any other person (whether of a different sex or the same sex) with whom the director lives as partner in an enduring family relationship'. Again, as Sonia and Amelia are said to be in a civil partnership, this seems to satisfy this test.

Assuming s190 applies here, then it seems likely from the facts that shareholder approval has not been obtained. What is the consequence of that? This is covered by s195. First, the contract is again made voidable at the instance of the company (s195(2)). In addition, by s195(3), both Sonia (because she is both a party to the transaction and connected to a director), and Amelia (because he is the director to whom Sonia is connected) face further personal liability to the company. They are liable to account to the company for any gain each of them has personally made from the transaction, and to indemnify the company against any loss it suffers. Of course, if the transaction is avoided, then it may be the company will end up with no loss, and Sonia and Amelia will have no gain. If the transaction is not avoided, the fall in the value of the building means some gain and some loss may well exist.

3(b)

Turning to Cameron, the company can, by ordinary resolution, remove him as a director under s168 CA 2006. Special notice of the proposed resolution to remove him must be given (28 days) and Cameron will have a right to defend his position before the relevant general meeting.

The company's right to remove Cameron, under s168, applies notwithstanding his three-year contract. However, the company's right to remove Cameron under s168 does not deprive Cameron of his right to compensation if his removal results in a breach of his service contract (s168(5)). Cameron's right to compensation would depend, then, on the period of notice to which he would be entitled under his service contract.
At first sight, this would seem to be the unexpired portion of the three-year term he was given. However, under s188 CA 2006, where a company is proposing to award a director a service contract that includes provision for a guaranteed term of more than two years, that term must first be approved by ordinary resolution of the shareholders. It is not clear such shareholder approval was obtained. If it were not, then the three-year term would be void,

and replaced by a provision entitling the company to terminate the contract at any time by giving merely reasonable notice. The amount of any compensation payable to Cameron would then be based not on the unexpired part of the three-year fixed term, but rather only on the 'reasonable notice' to which he would be entitled instead.

Question 4

A company voluntary arrangement ('CVA') is defined by s1 IA 1986 as a proposal to the company and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs. It may be initiated by the directors of the company – as here. A CVA may therefore involve a proposal to re-pay creditors over a longer period than originally provided for by any credit or loan agreement or to re-pay only a proportion of the debt. Creditors may well be prepared to agree to this if, as here, the only alternative is liquidation, where for unsecured creditors certainly, the prospect is of receiving nothing or far less than they are owed.

The directors must appoint a 'nominee' who must be a qualified insolvency practitioner and who will supervise the CVA. The directors must submit to the nominee details of the proposed CVA and a statement of the company's affairs.

The nominee reports to the Court within 28 days of being given notice of the proposal on whether in his opinion the proposed CVA has a reasonable prospect of being approved and implemented and whether meetings of the company's shareholders and creditors should be summoned to approve the proposal.

If the meetings are recommended, the nominee will propose a date and time for them in his report, unless the court directs otherwise. The meetings will then decide to approve the proposals with or without modifications or to reject them. The proposal is approved at the shareholders' meeting if agreed to by more than 50% of those present and voting; approval at the creditors meeting must be by a majority representing more than 75% in value of creditors present and voting.

The CVA takes effect if it is approved at the meetings by the requisite majorities. If it is approved by the creditors' meeting only, it would still take effect, but would do so subject to the right of any shareholder to apply to the Court for an order that the decision of the shareholders' meeting take effect instead (s4 IA 1986). On the facts of the question, assuming all creditors attend and vote at their meeting, the Bank could not block the CVA as it holds less than 25% of the total value of company debt. Of course, if a smaller number of creditors attended the meeting, and the Bank then held more than 25% of the value of the debts represented by creditors present at the meeting, then the Bank would be able to block the proposals.

Once approved the CVA binds every creditor and member of the company as if they were parties to it (s5 IA 1986).

The meetings cannot approve a proposal however which would affect the rights of secured creditors to enforce their security without the consent of the creditor concerned (s4 (3) IA 1986). Here therefore the Bank would still have the right to enforce the charges under the term loan.

A difficulty in respect of the board's proposals concerns the release of the directors' personal guarantees in favour of the Bank. The Bank might be able to challenge any attempt to use the CVA to secure this release, and in two ways. First, the CVA cannot operate so as to affect the liability of third parties (here the directors) to creditors (see s4 (3) IA 1986 and <u>Prudential Assurance Co Ltd v PRG Powerhouse Ltd</u> [2007] and <u>Mourant & Co Trustees Ltd v Sixty UK Ltd (in administration)</u> [2010]). However, Prudential also confirmed that whilst the CVA could not directly affect the position as between the third party and the creditor, it could nevertheless create an obligation on the creditor, owed to the company, not to enforce its rights against the third party. If that were applied here, it would mean the Bank would have an obligation to Savignan not to pursue Savignan's directors.

The second challenge the Bank might make would be to argue that the proposed release of the personal guarantees is 'unfairly prejudicial' to the interests of the Bank. The court accepted this argument in <u>Prudential</u> because a number of landlords of a company entering into a CVA were losing the benefit of personal guarantees. The concern was that different landlords were treated differentially in that those landlords with personal guarantees were losing more than those without. It appears from our facts that there is only one bank set to lose the benefit of the guarantees.

Further, the Bank may still seek to enforce its security or petition for the company to be wound up before the company can obtain approval for the CVA. The Bank is already pressing for repayment of its overdraft and will have powers to appoint a receiver and/or administrator under the terms of its security.

The Bank could be prevented from taking this action if the directors apply to the court for a moratorium under the IA 1986 pending approval of the CVA. The effect is to 'freeze' actions that can be taken by creditors for the duration of the moratorium: for example, no petition can be presented for winding up the company and no step may be taken to enforce any security over the company's property without leave of the Court.

A moratorium is only available to 'eligible' companies; that is, companies meeting at least two of the requirements of a small company under s382 of the Companies Act 2006 during the year ending with the date on which the application is made to the Court or the company's previous financial year. Savignan appears to meet these requirements in that its turnover does not exceed £6.5 million and it employs only 38 persons.

To obtain a moratorium the directors must file various documents with the Court including a document setting out the terms of the proposed CVA, statements of the company's affairs, that the company is eligible for a moratorium and a statement from the nominee that she is willing to act. The nominee's statement also includes for example her opinion that the CVA has a reasonable prospect of success, and that meetings of the company and its creditors should be called.

The moratorium begins from when the documents are filed with the court and ends on the day the meetings to approve the CVA are held, although the meetings may approve an extension to the moratorium for up to two months after the last of the meetings.

The Bank will therefore be prevented from taking any action to enforce its security.