**CHIEF EXAMINER COMMENTS WITH SUGGESTED ANSWERS**

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

**JUNE 2019**

**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 June 2019 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; 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 so 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 knows. However, that approach will not work at this level. It has been stated before that 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:

It 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 being 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 in 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, when tackling questions, that they 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 book 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 see to embellish answers and candidate performance.

## CANDIDATE PERFORMANCE FOR EACH QUESTION

**Question 1**

This question looked at the liability for an order placed by a partner, who operated outside her remit but was part of a partnership agreement had been put in place. This required not only elements of the partnership agreement to be applied but also, and importantly, an in-depth analysis of the provisions of the Partnership Act 1890. Those that did look to establish via this route did well.

The second part of the question looked how a partner would be removed from a partnership. Regrettably not all candidates managed to fully apply and relay the provisions of the agreement that would have taken precedent over the Partnership Act 1890. For the full requirements, candidates are referred to the suggested answers.

**Question 2**

This question looked at the appointment of a director and the procedural requirements to make that appointment. It is worth noting that this question did not ask for or require a discussion of the award of a service contract, nor, as the individual was as of yet appointed, did it require a discussion of s177 Companies Act 2006 or Article 14 of the Model Articles. Whilst many identified

the means by which to appoint, too few candidates covered the meeting requirements.

The second part looked at how a director could be protected, in so far as it is possible, from a move to seek their removal. Whilst many covered the s168 requirements, not enough then discussed s312 or 169, likewise, when the amendments to a set of articles were covered how those amendments would be made were often missed. Additionally, not many candidates identified either a long-term service contract or shareholder agreements as possible means by which to frustrate such a move against a director. Note, s994 was not required in this instance.

Candidates are referred to the Suggested Answers for further guidance.

**Question 3**

The first part of this question asked candidates to advise on the transfer of assets exchanged for shares, i.e. 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.

The second 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 particularly.

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 4**

The first part of this looked at the granting of loans by the company to two directors. Whilst s197 was identified, the exemptions were however poorly identified and applied. One of the loans would not be exempted and would require approval, the other not. Additionally, very few candidates identified the need to make a declaration of interest and to be precluded from voting. This required consideration.

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.

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**

**JUNE 2019**

**Question 1(a)**

The question is looking at the potential liability of partners. As a basic premise, every partner in a firm is jointly liable for all of the debts of the firm incurred whilst she is a partner (s9 Partnership Act 1890). Despite the wording of s9 Partnership Act 1890, by virtue of the Civil Liability (Contribution) Act 1978, partners are now effectively jointly and severally liable for the debts of the firm.

The firm, and therefore the partners, will be liable for a debt if incurred by someone (in this case Amanda Lington) acting on behalf of the firm with authority. The limitation placed on Amanda, and all the other partners by virtue of the partnership deed, clause 15 (£2,500), will not be binding on the other party to the contract unless that party has knowledge of the restriction in accordance with s8 Partnership Act 1890. There is nothing on the facts to suggest this, and therefore the firm could be liable.

Finally, will the Partnership be bound under s5 Partnership Act 1890? This requires the application of the following test:

1) Is the act related to business of the kind carried on by the firm? Objective test: yes - the purchase is from a supplier of wine.
2) Would Amanda usually be expected to have authority? Objective test: a partner is usually expected to have authority to buy goods related to the Partnership.
3) Does company know or believe Amanda to be a partner? Subjective test: on the facts, there is no reason for the supplier to question this; Amanda placed the order to be delivered to a bonded warehouse operated by the partnership.
4) Does the other party to the contract know or believe Amanda to have no authority? Subjective test: again, there is no reason, on the facts, for the other party to know of the lack of authority.

By applying the above tests, it is clear that Amanda did not have actual authority, as her ability to incur liabilities on behalf of the firm is capped at £2,500 and She has spent considerably over this sum. In this instance the firm is only liable if the seller can rely on s5 Partnership Act 1890. Given the nature of the business of the Partnership it is likely that the purchase of the wine, would be regarded as an act for carrying on in the usual way the business of the Partnership.

Therefore, the firm is liable. In terms of liability for the order, Amanda is bound under privity of contract. All the current partners will be bound jointly under s9 Partnership Act 1890.

**1(b)**

Neither Sebastian Crispin, Thomas Goswell or Sabrina Tinker, as partners, will be able to expel Amanda Lington, as a partner, from the Partnership unless the right to do so has been expressly agreed between the partners (s25 Partnership Act 1890).

Accordingly, the partners will have to look to the terms of the Partnership Agreement and see if it gives a power of expulsion in the light of Amanda's past behaviour. Clause 18 of the partnership deed is relevant here. Amanda has incurred a debt for any single transaction over the limit set by the partnership deed of £2,500 (clause 15). This arguably amounts to 'a breach of the terms of the agreement or any duty which has as its object or effect the material disadvantage of the partnership', giving a power of expulsion (clause 18.1.1).

Amanda can only be expelled if two thirds of the other partners vote to expel her (Clause 16.1). This would require Sebastian, Thomas and Sabrina to be in agreement. The expulsion will not terminate the partnership as regards the other partners (clause 2) who can buy out Amanda's interest (schedule 2).

The procedure by which the partners can effect the expulsion of Amanda in accordance with the partnership deed is as follows:

- Amanda must be served with 14 clear days' notice of his proposed expulsion (clause 18.1) together with a statement of the grounds for the expulsion (clause 16.1)
- the meeting itself must be quorate (clause 16.1)
- Amanda must be given opportunity to be heard at the meeting (clause 16.1)
- two thirds of the other partners must vote for expulsion (clause 16.1)
- notice of expulsion must then be given within 3 months of becoming aware of the breach or ground for expulsion (ie three months from date when accountants raised problem) (clause 18.1).

**Question 2(a)**

Sebastian Crispin (and for that matter, Thomas Goswell and Sabrina Tinker) may, in accordance with Article 17(1) Model Articles, be appointed either by the directors in a Board Meeting or by members in a General Meeting by Ordinary Resolution.

For the members to appoint the new directors, the current directors will need to call a general meeting on 14 days' notice or on short notice (s307 CA 2006 and Art 48). Alternatively, CGT Imports Limited could use the written resolution procedure under ss288–300 CA 2006.

However, at this early stage until the subscriber shares have been issued it is unlikely, and in fact unnecessary, for a shareholder meeting to be called. Rather it will be more straightforward for the new directors to be appointed by the shelf company's current directors.

As the company that will become CGT Imports Limited is formed from a shelf company, and assuming that the existing shelf company directors will resign then they will not do so until new directors have been appointed, otherwise the company will be left without any director and incapable of appointing new

directors or operating. Therefore, the existing directors will resolve at a Board Meeting to appoint the continuing partners as new directors, then resign themselves.

Administration: Board Meeting minutes (and general meeting minutes should the appointments be made by general meeting) need to be prepared. The new directors will then be entered in the register of directors, and forms AP01 (appointment) (and possibly TN01 (resignation)) to be completed and filed with the Registrar.

**2(b)**

Sebastian Crispin may be removed from office by an ordinary resolution of the shareholders.

Special Notice (s312 CA2006) of any such proposed resolution must be given to the company at least 28 days before the general meeting.

Sebastian is entitled to protest his removal by speaking at the meeting called to consider the resolution to remove her and to make written representations to the meeting (s169 CA 2006).

Sebastian can be protected in the following ways:

- include a Bushell v Faith clause in the Articles to give her enhanced voting rights in the event of a resolution to remove her or to amend or remove the Bushell v Faith clause from the Articles (the Bushell v Faith clause might also be prevented from amendment or removal by a 'provision for entrenchment', under s22 CA 2006)
- amend Article 18 Model Articles to reduce the circumstances in which a director would be disqualified from holding office
- by a clause in a separate shareholders' agreement which requires parties to that agreement to vote against any resolution to remove her as a director. This would not prevent his removal under s168 but might provide a remedy in damages for breach of contract if the provision were to be breached
- the award of a long-term service contract. Whilst this will not necessarily prevent removal it will however act as a financial disincentive not to do so as Sebastian will be entitled to compensation.

The articles of association may be amended by special resolution (s21 CA 2006), with a copy filed at Companies House (s30 CA 2006), together with a reprinted copy of the amended articles of association (s26 CA 2006).

**Question 3(a)**

This will be a substantial property transaction. Sebastian Crispin, Thomas Goswell and Sabrina Tinker will be directors of the Company prior to the transfer of the business of the partnership by her (and her fellow partners) 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, CGT is to acquire from its directors various non-cash assets. A 'non-cash' asset is any property or interest in property other than cash (s1163 CA 2006). In this instance, under s191 CA 2006 the non-cash asset are "substantial" as the value exceeds £100,000. CGT has been formed from a shelf company that has yet to trade. At most CGT will only have issued the two subscriber shares. The net assets of CGT are effectively nil. The transfer of the partnership assets will therefore be substantial in value.

Accordingly, the acquisition requires the approval of members of CGT 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 each director 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).

Each director 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).

However, the partners will not be permitted to vote at the directors' meeting at which this matter is considered nor will count in the quorum (Article 14 Model Articles). As all three directors will be interested in the transaction quorum will not be achieved (Article 11 Model Articles). Therefore, an ordinary resolution under Article 14(3) Model Articles to disapply the articles (either generally or for the single transaction) will be required to allow the directors to vote on the transaction at directors' meeting despite the fact that they are interested.

**3(b)**

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 is 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).

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).

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 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.

**Question 4(a)**

The request for guarantees by Bedford Bank plc in relation to the proposed loans to Sebastian Crispin and Thomas Goswell amount to loans to directors by the company, CGT Imports Limited (CGT). The relevant law is s197 CA 2006, which prohibits a company from entering into any loan guarantee in connection with a loan made by any person to one of its directors, unless approved by a shareholders' ordinary resolution.

S197 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 or written resolution.

Both loans (guarantees) to the directors will require such shareholder approval unless they fall within one of the exceptions under the Act that may apply to each loan:

Loan A: The exemption that might seem to apply is found in s207 CA 2006, which covers small loans. However, these are defined as being less than £10,000. As the loan here is for £25,000, the exception will not apply, and an ordinary resolution of the shareholders will be required.

Loan B: This is likely covered by the exemption under s204 and 207 CA 2006 as it is for the purpose of the company's business; Thomas is going to use the money to attend a conference to develop the company's business contacts.

In any event the decision to grant the loans is a directors' decision. Both directors will need to disclose their interests (s177 CA 2006) and cannot vote on matter so cannot count in quorum under Article 14 MA. However, each can vote on the other's loan whilst abstaining from voting on their own.

**4(b)**

The steps that Bedford Bank plc could take prior to granting the loans to the directors include:

- CGT'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 (CA 2006), any company has unlimited capacity, save insofar as the company's articles of association expressly limit its capacity. CGT has the Model Articles of Association for a private company limited by shares. The Model Articles do not contain any such express limitation of the company's capacity. At common law a trading company has an

implied power to borrow money. Therefore, it will have the power to borrow money and to give security. Moreover, the Model Articles also give the directors a general authority to exercise all the powers of the company which would include the power to borrow without limit and to give security (Model Articles, Article 3).

- However, it may be prudent to incorporate into the constitution an express power authorising the directors to exercise the company's power to borrow/issue guarantees. It is highly likely that the Bank's advisers will request such an amendment. The articles of association may be amended by special resolution (s21 CA 2006), with a copy filed at Companies House (s30 CA 2006) together with a reprinted copy of the amended articles of association (s34 CA 2006).

- Undertake searches for any existing charges over the company's freehold property in the company's register of charges, at the Registrar of Companies and at the Land Registry/ Land Charges Registry to determine how indebted the company is.

The reason why it would be advisable for Bedford Bank to undertake such steps relates to the protection afforded under s40 CA 2006. A person who deals with a company in good faith, where such dealing is conducted either through its board of directors acting collectively, or through someone to whom the board has delegated responsibility to conduct the dealing, is entitled to assume that there is no constitutional limit on the authority of the directors to bind the company or to delegate responsibility to conduct the dealing (s40 CA 2006).

Accordingly, a certified copy minute is evidence of the board exercising its power to bind the company. Provided the bank deals with the company in good faith, if the directors do not actually have the power to decide on the grant of the guarantees, the lack of power on their part does not invalidate the directors' act – the directors' powers are deemed to be without limit. The minutes are evidence to enable the bank to rely on the protection of s40 CA 2006.