CILEx CHARTERED INSTITUTE OF LEGAL EXECUTIVES

LEVEL 6 - UNIT 1 – COMPANY AND PARTNERSHIP LAW
SUGGESTED ANSWERS – JANUARY 2017

Note to Candidates and Tutors:

The purpose of the suggested answers is to provide students and tutors with guidance as to the key points students should have included in their answers to the January 2017 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 students may have included in their responses to the questions. Students will have received credit, where applicable, for other points not addressed by the suggested answers.

Students and tutors should review the suggested answers in conjunction with the question papers and the Chief Examiners' reports which provide feedback on student performance in the examination.

SECTION A

Question 1(a)

The contract between a company and its members arises from section 33(1) of the Companies Act 2006 (CA 2006), which 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 contract is based on articles of association of the company, covering the rights and obligations of the company and each member, and offers one form of protection for minority shareholders.

Consequently, either party may enforce the provisions of the articles. 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 contractual relationship created by section 33 is unusual in that for example it is 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. However, the courts have been seen to interpret articles using the 'reasonable person' test (Attorney General of Belize v Belize Telecom Ltd [2009]).

The nature of the contract limits enforcement 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]).

It also appears to be accepted that, at least where there seems to be a form of partnership existing behind the corporate veil, an enforceable relationship is created between members (Rayfield v Hands [1958]), as well as between the company and each member.

Enforcement of rights under the articles is subject to a limitation period of six years from breach as the covenants given under section 33 are not under seal.

1(b)

The starting point is that directors are given a broad power by the articles to manage a company– see Model Article 3 - and it could be argued that there is minimal express limitation in the Model Articles on the exercise of those powers. For example, MA 7 provides that directors' decisions should be taken by majority vote in a meeting and MA 9 requires that usually there should be a quorum of two in a board meeting. On the other hand, directors may for example delegate their powers as they see fit (MA 5). However, a more stringent restriction is imposed by MA 14 in that a director is not permitted to count in the quorum or vote in relation to a matter in which s/he is interested, unless the articles provide otherwise. This restriction can be suspended by ordinary resolution of the shareholders, or the articles amended by special resolution.

A company need not adopt the Model Articles in full and therefore may impose stricter procedural restrictions on its directors, through amending the Model Articles. It may for example increase the required quorum for a directors' meeting. In addition, other company documents or decisions (shareholder agreements, board resolutions and the like) may create express restrictions on directors' actions.

In relation to the authority directors have to bind the company, the Model Articles themselves do not contain any specific restrictions on such authority, other than how powers may be exercised (as indicated above). A company may however impose express restrictions such as requiring shareholder approval of borrowing over a certain limit.

In addition, a company may have an objects clause which limits its capacity. Directors who act outside this capacity will be acting outside their authority. A contract entered in to by the directors for which they lack authority would ordinarily be void.

However, provisions in the Companies Act 2006 act to override limits in a company's articles in relation to directors' authority. Section 40 CA 2006 states that 'in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution'.

Good faith is presumed (s40(2)(b) CA 2006), and that presumption is not displaced even where the third party is aware of the terms of the constitution (and thus knows of the actual limitation on the directors' authority). What may prevent the third party having good faith is rather unclear. It may be that it requires the third party to know that the directors are not themselves acting for

the benefit of the company, or at least to be 'put on enquiry' that this is possible (see Wrexham Association FC Ltd (in Administration) v Crucialmove Ltd [2007]).

A further point is that the common law long held that a third party dealing with a company in good faith is not affected by 'internal irregularities' (directors failing to follow procedural requirements set out in the articles). This is the rule in Royal British Bank v Turquand [1856].

Finally, directors must exercise whatever powers they are granted in accordance with the duties imposed on them. They must act for the purpose for which the powers were given to them (see s171 CA 2006) and they must also always act 'in good faith to promote the success of the company for the benefit of the members' (s172 CA 2006).

In conclusion therefore, while articles can expressly limit the power and authority of directors, this is in turn curtailed by statute and the common law.

Question 2

The general prohibition on buy back of shares is set out in section 658 CA 2006. This arises from the principle that companies must maintain their capital for the benefit of creditors. This long-standing principle derives from common law (Trevor v Whitworth [1887]). In other words, a company cannot return to its shareholders the money it received on the issue of shares unless and until the company is wound up. Even then, money will only be returned to shareholders after the creditors of the company have been paid.

Sometimes it may be appropriate for a company to buy back its own shares, and statute provides circumstances for it to do so, thus creating exceptions to the maintenance of capital rule. The exceptions are however constrained by various conditions and procedural requirements.

Firstly, a company can issue shares on terms that they can be repurchased later by the company, ie redeemable shares. A private company can issue such shares as long as there is no prohibition in its articles s684(2). In order to issue such shares, the company's share capital cannot consist entirely of redeemable shares (s684(4)), and the shares can only be redeemed if fully paid (s686). The terms and manner of redemption must be approved by shareholders in general meeting (s685), unless the articles authorise the directors to settle the terms of redemption (for example see paragraph 22(2) of the Model Articles for Private Companies). However, in this case the directors must settle those terms before the shares are actually issued.

Protection is to an extent retained for creditors in terms of the restrictions on how redemption can be funded. Public companies must redeem out of distributable profits or the proceeds of a fresh issue, while for private companies, redemption can instead be paid for out of capital (s687). As these rules apply to share buy-backs as well, they will be considered further below.

The second exception to the general restriction on companies repurchasing their shares is provided by the general power of buy-back (even in respect of shares that were not issued as redeemable). As with redeemable shares, the right to purchase is subject to any prohibition in the articles (s690). Shares can only be bought back if fully paid, and once bought back there must still be other issued

shares in the company that are not redeemable (again s690). A private company can pay for the shares out of capital, but as with redeemable shares, a public company is limited to buy back out of distributable profits or a fresh issue of shares.

A private company will make an 'off-market' purchase, the contract for which must be approved in advance by an ordinary resolution (s694(2)), and the contract's terms must be available for inspection by the members at the company's registered office for at least 15 days prior to the meeting at which the resolution is to be passed (s696(2)). The seller of the shares should not vote on the resolution (s695). If they do so, and the resolution would not have been carried but for the exercise of their votes, the resolution is invalid. The authority given to the company to effect the buy-back must not last for more than five years. Once the buy back has been effected, certain particulars of the transaction must be filed with the registrar of companies within 28 days of the transaction (s707), and the contract for the buy back must be kept at the company's registered office for 10 years (s702).

The fact that s709 permits a private company to buy back out of capital is a risk to creditors, for it may reduce the company's ability to meet its obligations to creditors in the future. Accordingly, a number of additional rules are in place to protect creditors. These rules apply also where a private company is redeeming shares out of capital. First, the company must first use up its distributable profits to fund the buy-back, before it uses its capital: s710. Second, if the company is proposing to fund the buy-back from a new issue of shares, it must use the proceeds of that issue before it can use capital (although it is not required to make a new issue).

Third, the use of capital must be accompanied by a solvency statement by the directors, that the company will be able to continue as a going concern for a year after making the capital payment: s714. This must be supported by an auditor's report. Fourth, the payment must be approved by a special resolution (in addition to the ordinary resolution to approve the buy back contract), passed without the votes of the seller of the shares; ss716-7.

It is possible for any creditor of the company, or any member (provided they did not vote in favour of the payment) to apply to court to cancel the proposed payment: s721. They have five weeks from the passing of the resolution to make this application, and during this time, the payment cannot be made by the company: s723. Payment must be made no earlier than 5 weeks and not later than 7 weeks after the resolution is passed (s723).

Note finally that where a private company pays for its shares in cash, and the payment does not exceed the lower of either £15,000 or the value of 5% of the company's share capital, then such payment is permitted without having to be paid out of distributable profits, and regardless of whether it complies with the rules on payment out of capital described above (s692(1)).

Question 3

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 chargee, 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 lender to have control over the assets, with a floating charge, the company or LLP 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', and thereby fixes 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 will normally specify 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 lender's perspective is that she retains a high degree of control over the charged asset: the chargor is not free to sell or otherwise deal with the asset without the chargee's consent. If the chargor 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.

Lenders will normally prefer to take a fixed charge because on the chargor's insolvency a fixed charge ranks ahead of a floating charge. 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 lender 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.

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 lender so long as the charge remains uncrystallised. From the lender's perspective this may be seen as a disadvantage but it does give the lender 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, Insolvency Act 1986 (IA 1986) is entitled to appoint an administrator in defined circumstances affecting the chargor's solvency. This may help to protect the interests of the lender (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 chargee 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 may be effected by the company or 'any person interested in the charge' but it is in the chargee's interest to ensure registration takes place. On delivery of a statement of particulars within the 21 day period the Registrar must give a certificate of registration to the person who delivered the charge particulars; such a certificate is conclusive evidence that the charge has been properly registered within the period allowed for delivery (s859I(6) CA 2006).

Question 4(a)

Generally speaking, a person will not be liable for the debts of a partnership before she joins (s17(1) Partnership Act 1890 (PA 1890)). However, in certain circumstances it is possible to incur liability in contract before joining a partnership, and this arises particularly from the principle of 'holding out' as set out in s14 PA 1890:

- A person must have represented herself as a partner; or
- She must have allowed herself to have been represented as a partner; and
- A creditor giving credit to the firm must show reliance on the representations.

A person who is yet to join a partnership should therefore for example not allow her name to be added to the partnership stationery until she has actually joined the partnership.

4(b)

Section 9 PA 1890 provides that every partner is jointly liable for all debts and obligations of the firm incurred while he is a partner and after his death, his estate is severally liable while they remain unsatisfied.

How partners bind the partnership and thus create the liabilities referred to in s9 is governed by the law of agency as applied by 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'.

Section 5 PA 1890 operates as follows:

To bind the firm, the partner in question must either have express authority, or else must satisfy the various conditions which s5 applies for a partner to have implied authority. The first of these conditions is that the partner must be carrying on 'business of the kind carried on by the firm'. This can include business incidental to the main business of the firm, including investment advice given by solicitors (Polkingbourne v Holland [1934]) or undertakings that the firm holds funds for a client (United Bank of Kuwait Ltd v Hammoud [1988]).

There are however limits to what will be considered the normal scope of the business. The case of JJ Coughlan Ltd v Ruparelia and Others [2003] considered this. A fraudulent investment scheme in which a solicitor was involved was considered abnormal and incredible and therefore could not objectively be within the ordinary business of a solicitor.

The second condition in s5 is that the business must be carried on 'in the usual way', and this involves considering the kinds of transaction a partner acting as agent could carry out. This will depend on the nature of the business and whether the partner can be said to be acting within his usual authority in relation to the act in question. Courts have taken into account whether the partnership's business is buying and selling goods (ie trading) or providing services, such as solicitors or auctioneers (ie non-trading firms).

Thus partners in trading partnerships will have implied authority to bind the firm by buying and selling the firm's goods and borrowing money in the firm's name. Even if there is express agreement between the partners prohibiting such acts they will bind the firm unless the third party has actual notice of the prohibition (s8 PA 1890) (Mercantile Credit Co Ltd v Garrod [1962]). By contrast, partners in non-trading partnerships, such as professional firms, do not have implied authority to borrow or pledge the firm's property (Higgins v Beauchamp [1914]).

If however a partner has in fact exceeded his authority or had no authority in the first place and the person with whom he is dealing does not know or believe him to be a partner, then the firm will not be liable. This is set out in the second part of s5.

It is possible for the other partners to ratify a transaction even if a partner has exceeded his authority.

4(c)

A retiring partner will remain liable for the debts and obligations of the firm incurred while he was a partner (s17(2) PA 1890). However, he may be protected from such liabilities, either by a novation agreement to that effect between the retiring partner (1), the continuing partners (2) and the creditor(s) (3) (s17(3) PA 1890), or by obtaining an indemnity against such liabilities from the continuing partners.

A retiring partner is not usually liable for the debts and obligations of the firm incurred after he has ceased to be a partner. However, a retiring partner may be liable for such debts incurred under the doctrine of holding out (i.e. where there has been some representation or 'holding out' that a person is a partner, he will be estopped from denying it). The situation here is the same as with an incoming partner, discussed in (a) above, with s14 PA 1890 setting out the preconditions for a person's liability by holding out. To protect himself, a retiring partner should therefore seek covenants from his co-partners not to be held out as a partner following his retirement, including contractual obligations to remove his name from the firm's letterheads and stationery.

Section 36 also applies to a retiring partner. Where a person deals with the firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change (s36(1) PA 1890). If appropriate notice is given however, the outgoing partner should be protected from future liabilities:

- Actual notice must be given to creditors who have previously dealt with the firm and knew the person to have been a partner (s36(1) PA 1890).
- For creditors who had not dealt with the firm, notice in the London Gazette will suffice (s36(2) PA 1890).

Finally a partner who dies or becomes bankrupt or retires from the firm not having been known by the creditor to be a partner in the firm, will not be liable for debts contracted after his/her death, bankruptcy or retirement (s36(3) PA 1890).

SECTION B

Question 1(a)

To set up a private limited company, Anil and Dmytro will need to follow the procedure set out in the CA 2006 and in particular submit an application to Companies House for registration (form IN01), which will, amongst other things, specify the proposed name of the company and the country in which the registered office will be situated as well as its precise address.

They must also submit a memorandum of association, to which they will subscribe as shareholders, and articles of association (unless the company is to have the Model Articles) (s9 CA 2016). The memorandum is in a prescribed form and contains a statement that the subscribers wish to form a company and agree to become members of it. Articles of association contain the regulations for the management of the company – it will identify some of the powers they have as directors. The application also specifies that the liability of the members will be limited by shares and the name they wish to use.

The application must also specify the first directors (ie Anil and Dmytro) and any secretary contain a statement under s13 that the requirements of CA 2006 have been met in respect of the registration, and also a statement of capital and initial shareholdings. The application must be accompanied by the appropriate fee. A private limited company is not however required to have a secretary (s270 CA 2006) so Anil and Dmytro would need to decide if they wish to appoint one.

When the company is registered the name will, as mentioned above, be included in the registration form IN01. The name must end in 'Limited' or 'Ltd'. Here it includes the latter. It would be prudent to search at Companies House, prior to submitting the application for registration, to ensure no other company is already registered with the same name as it is not permissible to have two companies with the same or similar names.

Companies must also make certain trading disclosures under the Company, Limited Liability Partnerships and Business (Names and Trading Disclosures) Regulations 2015. The company must disclose its name at its registered office and other places of business – which would be at the two shops - as well as on business stationery such as letters, and invoices. Failure to comply with such obligations could result in civil or criminal liability (ss83 to 84 CA 2006).

Separate company business names are regulated by Part 41 CA 2006. Offensive names cannot be used for example, nor a business name that suggests a connection with a public authority. It is unlikely that this would be a problem here, especially as the name Rapture Sounds has been in use already.

The Registrar will issue the company's certificate of incorporation, if it is happy the company complies with the requirements. The company then exists and can then begin trading. As this is a private limited company and not a public limited one, no certificate of trading is required.

By contrast, there are no statutory formalities for creating a partnership. Section 1 PA 1890 states that a partnership exists where two or more persons carry on business in common with a view of profit. It arises, therefore, to reflect a relationship that exists in fact between two or more persons. Those entering into such a relationship may of course choose to make an express, written, partnership agreement to govern their future relationship, but they are under no obligation to do so. If they fail to do so, then PA 1890 will provide many 'default terms' governing their relationship in the absence of contrary agreement.

1(b)

In principle Anil and Dmytro's liability as members of the company would be limited to the amount, if any, outstanding on their shares. Such liability would arise if the company were to become insolvent. This reflects the principle of limited liability and separate legal personality in company law. As shareholders, they would not be personally liable for the debts of the company, nor could they be made to contribute towards any shortfall in the company's assets if the company became insolvent.

However, protection against personal liability for company debts is not completely guaranteed. So, the courts have 'lifted the corporate veil' and found persons other than the company liable for its debts. There does however appear to be a reluctance to pierce the veil (Adams v Cape Industries plc [1990]). The courts in this case suggested limiting lifting the veil to three situations: façade, statutory or contractual provisions relating to regarding a group of companies as a single entity and agency. This approach has been approved in for example VTB Capital v Nutritek [2013].

More importantly, as Anil and Dmytro will also be directors of the company, there is the potential for liability through the duties which directors owe to the

company, under the CA 2006. There is also the possibility of liability for either fraudulent or wrongful trading in sections 213 and 214 Insolvency Act 1986, respectively. If either commits actionable torts in their running of the company, they may be held personally liable for those. Finally in newly formed companies, as here, it is extremely common for banks (and some other large creditors) to insist upon personal guarantees from the shareholders or directors.

1(c)

To protect his position as a director, Dmytro could request that he is given weighted voting rights in the articles of association – also known as a Bushell v Faith clause. Such a clause would give Dmytro extra votes as shareholder on a resolution proposed to remove him as a director, as s168 CA 2006 provides that shareholders may remove a director from office by passing an ordinary resolution in general meeting. He should also require weighted voting on a resolution to remove the article granting him weighted voting. The extra votes could enable him to block these resolutions and therefore prevent his removal.

Question 2

Section 994 CA 2006 allows a member of a company to petition the court in relation to unfair prejudice suffered from an act or omission of the company or from the way the company's affairs are being conducted. To succeed in a claim, a shareholder must show that the way in which the affairs of the company have been conducted, or some act or omission of the company, was unfairly prejudicial to her interests as a member.

A first point to consider, then, is whether the matters that Eleanor is complaining about would amount to either 'the conduct of the company's affairs', or 'acts or omissions of the company'. The essential point here is that we must distinguish between, on the one hand, matters concerning the running of the company and, on the other hand, conduct which is merely 'private'. Nigel's hitting of the marketing manager might be argued to be a private matter – further information on the background to the dispute should be sought. Nigel's other behaviour does however appear to involve the conduct of the company's affairs: his absences and failing to be involved in the management, as well as the use (or rather misuse) of company funds for the yacht, likewise involves the conduct of the company's affairs.

Next, we need to ask whether these different issues affect Eleanor's interests as a member. First, she must show that the interest she has is being prejudiced, which is more than merely showing that she would like to be treated in a different way. In terms of how the interests might arise, the courts have made it clear that 'interests' here include the member's formal rights, such as those found in the company's constitution, or in the Companies Act. The difficulty here, however, is that it does not seem that any of Eleanor's formal rights have been infringed. However, the courts have interpreted s994 more widely and held that a member's interests are broader than her strict formal rights. In particular, the courts have accepted, at least in so-called quasi-partnerships, that a member's interests may derive from informal understandings between the members. This developed out of the case law on a just and equitable winding up of the company, especially Ebrahimi v Westbourne Galleries Ltd [1973], which also defined a quasi-partnership. This was a company in which there was a close personal relationship between the members, some or all the members expected

to participate in management, and there were restrictions on the transfer of shares to outsiders – as is the case here in the company's articles.

It would appear that, following Ebrahimi, there is a quasi-partnership as Eleanor and Nigel have a close relationship as mother and son, have run the business together for a number of years, initially as a partnership, and more recently as a small company; there is also a restriction on transfer of shares.

Next, Eleanor would have to show that her interests specifically as a member were being prejudiced. It is true that the courts have not applied this 'qua member' requirement in a strict or rigid way: see eg Gamlestaden v Baltic [2007]. They have accepted, for example, that removal from one's position as a director, although perhaps in one sense affecting the member in his capacity as a director, can be unfairly prejudicial to his interests as a member. The departure of the marketing manager is likely to be more problematic as it may not be regarded to be in relation to the company's affairs. Additionally, even if the departure were to be regarded as part of the conduct of the company, it might be suggested that any harm suffered is in Eleanor's capacity as an employee of the company, and not as a member of the company.

If Eleanor were successful in her claim, the court can, in theory, make any order it thinks fit to address the unfair prejudice. However, in practice the order made, in the overwhelming majority of cases, is that the majority shareholders buy out the shares of the petitioner, which would mean that Nigel buys out Eleanor. This is not what Eleanor wants.

However, the court certainly could order that Nigel sell to Eleanor. The court made such an order in Oak Investment Partners XII v Boughtwood [2009]. The court was influenced by the misbehaviour of the respondent, which amounted to mismanagement of the company. The misuse of funds and Nigel's long and unexplained absences could amount to mismanagement and thus constitute unfair prejudice. The court might also feel he ought not to continue as a member of the company for these reasons. This view might be reinforced by the fact that Eleanor has been largely running the company over the last 18 months or so.

Normally, when the petitioner is selling her shares, they will be valued by an independent valuer (which would exclude the company's own auditors), on a pro-rata basis (O'Neill and Another v Phillips and Others [1999]). Grace v Biagioli [2005] confirmed this was normally the appropriate order for the court to make. These buy-out terms have now been fairly well settled by case law. The application of a pro rata basis has more recently been confirmed in for example Re Addbins Ltd [2015].

Thus, the petitioner does not have any discount applied to her shares to reflect the fact she does not have control of the company. It might be argued that, where the respondent is selling his shares, and he has been guilty of misconduct, then a discount might be more appropriate, to reflect the fact of his misbehaviour. However, in Re Home and Office Fire Extinguishers Ltd [2012], the court declined to impose any discount, even though the selling shareholder was responsible for the breakdown of the shareholders' relationship. In valuing the shares, the value of the funds Nigel took from the company would be factored into the calculation, to ensure that he did not benefit from that.

Question 3(a)

This question deals with when a company could make a claim against a director for breach of duty. It is necessary to establish first if there has been such a breach. Directors' duties are codified in CA 2006. However, the Act makes clear that the duties set out in the statute are to be 'interpreted and applied in the same way as common law rules and equitable principles': s170(4) CA 2006.

Firstly, Tessa's behaviour looks like a potential breach of the duty to avoid conflicts of interest. Beginning with the purchase of the printer, she has taken an opportunity for her personal benefit that was first offered to Printfine, a company of which she is a director. She has thus created a conflict between her personal interests and those of Printfine.

The duty to avoid conflicts of interest is found in s175 CA 2006. Section 175(2) provides that this duty 'applies in particular to the exploitation of any property, information or opportunity' which covers Tessa's exploitation, for her personal benefit, of the opportunity initially offered to the company.

However, is it relevant that the company, as Tessa claimed, could not itself afford to purchase the printer? The Act suggests that such a situation is irrelevant, as s175(2) states that 'it is immaterial whether the company could take advantage of the property, information or opportunity'. This reflects earlier case law. In Regal (Hastings) v Gulliver [1967], for example, the court held directors liable for profiting from their position as directors, by taking an opportunity to invest in a subsidiary of their company, notwithstanding that their company was apparently unable, itself, to afford to make that investment. In IDC v Cooley [1972], a director was liable even though a third party was, apparently, only ever willing to award a contract to Cooley personally.

Would it make any difference if Tessa, in good faith, honestly believed that it would be too risky and unprofitable for the company? Again, Regal Hastings suggests the director's good faith is irrelevant.

The other aspect of Tessa's behaviour concerns her competing with Printfine. This will again be a breach of s175. It does not seem to matter that some of this activity relates to a line of business – 3D printing – that is arguably beyond Printfine's own scope of business: O'Donnell v Shanahan [2009]. The courts have also been fairly strict in controlling directors who set up and pursue competing businesses: see eg British Midland Tool [2003], which suggests that Tessa cannot take any significant steps to pursue her business without either resigning as a director, or else telling the board of her plans. She has clearly done neither. And whilst she would, after she resigned, be free to use her 'general fund of knowledge' acquired as a director for her competing business (Thermascan Ltd v Norman [2011]), she would not be able to use confidential information, or 'maturing business opportunities': IEF v Umunna [1986].

Another relevant duty is the duty of care, skill and diligence set out in s174. In other words, did Tessa (or any of the directors in fact here) act incompetently in not purchasing the printer and developing 3D printing services? The section has both an objective and a subjective strand. Objectively, directors must exhibit the care, skill and diligence of a reasonably diligent person with the knowledge, skill and experience reasonably expected of a person carrying out the functions of a company director. This standard is the minimum that must be shown by each

director. A director cannot escape liability by showing that, in fact, she lacked the appropriate level of knowledge, experience, or character.

The subjective element arises because the court must sometimes have regard to 'the general knowledge, skill and experience the director has', but this is only where that knowledge, etc is higher than the 'objective' standard described above. We do not know anything about the three directors, so further information should be obtained to establish if a higher standard should be applied to them.

Section 172 CA 2006 is another duty which may be relevant. It requires directors to act 'in good faith to promote the success of the company'. It might be argued Tessa (and Graham) failed to do so in not purchasing the printer. The difficulty with this is that the phrase 'in good faith' means the duty is a subjective one: did the directors subjectively believe they were acting for the success of the company? Did they really feel the company could not afford to purchase the printer, or that it would be too risky to embark on a new line of business?

If Tessa were found to be in breach, she would have to account for any profits made as a result of the breach: Boardman v Phipps [1967].

3(b)

Tessa may be removed from office by following the procedure laid down in the CA 2006. Section 168 CA 2006 states that members of a company may remove a director from office by ordinary resolution. However special notice must be given of the intention to move such a resolution. Under s312 CA 2006, the members intending to move the resolution to remove must give at least 28 days' notice of the said intention before the date of the meeting at which the resolution will be proposed.

Under s169 CA 2006, Tessa is entitled to be notified of the proposal to remove her and she may make representations at the meeting at which the resolution is to be proposed.

If she were removed from office under s168, Tessa would still have a right to claim compensation for loss of office (s168(5) CA 2006). For example, if her service agreement were also terminated (which is likely), she might be entitled any contractual damages arising from that termination.

It would be prudent to check the company's articles in case they contain weighted voting rights (under a Bushell v Faith clause) in favour of Tessa, which could prevent her removal.

Question 4

Samantha as liquidator has the right to challenge each of the three actions outlined.

In relation to the sale of the refrigeration unit, she could call for this to be set aside on the grounds that it was the sale of an asset at an undervalue under section 238 IA 1986.

A transaction at an undervalue occurs if at a 'relevant time' the company enters into a transaction with a person for no consideration or for a consideration the value of which in money or money's worth is considerably less than the consideration provided by the company (s238/(4) IA 1986). The unit was sold for less than half its value, so should satisfy the undervalue element.

For transactions at an undervalue, the 'relevant time' is the period of two years ending with the onset of insolvency (s240/(1) (a) IA 1986). This period applies irrespective of whether the transaction is with a 'connected person'. This transaction took place just under two years prior to liquidation. However, at that time the company must also be unable to pay its debts or become so as a result of the transaction (s240 (2) IA 1986). This is presumed where the company enters into the transaction with a connected person, as here, unless the contrary is proved. 'Connected person' is defined in s249 IA 1986 as a director or an associate which includes a director's spouse.

Whether a company is unable to pay its debts is to be ascertained by the tests contained in s123 IA 1986. These include where it is proved to the satisfaction of the court that the value of its assets is less than the value of its liabilities including contingent and prospective liabilities (s123 (2) IA1986). We do not have precise information on this but the facts suggest that the company was in financial difficulties, and it did go into liquidation only eight months later.

It is a defence and the court may not make an order under s238 if it is satisfied the company entered into the transaction in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for believing the transaction would benefit the company (s238/ (5) IA 1986). On the facts it seems unlikely this test would be satisfied as there seems to be no proper motive for the company selling the unit or for believing it would benefit the company.

Samantha could apply to have this transaction set aside.

Next, a floating charge created at a 'relevant time' before the onset of insolvency is invalid except to the extent that it is given for new consideration (s245 IA 1986). In other words, it is void to the extent that it is given for a pre-existing debt.

In the case of a charge created otherwise than in favour of a person connected with the company, the relevant time is 12 months ending with the onset of insolvency which in the case of company going into liquidation is the date of the commencement of the winding up.

It appears the charge was created to secure an existing debt, the overdraft facility with Southern Bank, and that it was created within the relevant time (about 5 months prior to insolvency) as there is no reference to new consideration being given. There is no suggestion that Southern Bank is a connected person in relation to Daisy Cosmetics Ltd. So, where the charge is not given to a connected person, it is invalid only if the company was unable to pay its debts at the time of the charge's creation, or became unable to do so as a result of the creation of the charge. This certainly seems to be the case here.

Finally, it would appear from the facts that Samantha could apply to the court for a declaration that any of the directors is or are liable to make such contribution

to the assets of the company as the Court thinks proper (s214/ (1) IA 1986). If the application is successful, then the amount to be awarded will be calculated on a 'compensatory' basis, i.e. to reflect the depletion in the company's assets caused by the wrongful trading; see Re Produce Marketing Consortium Ltd (No2) [1989].

The section applies in circumstances where a company has gone into insolvent liquidation and at some point before the commencement of the winding up the directors knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

It is necessary to establish the facts a director ought to know or ascertain and the conclusions he should reach and the steps he ought to take, i.e. those which a reasonably diligent person would have known, ascertained, reached or taken:

i) having the general knowledge, skill and experience that could reasonably be expected of a person carrying out similar functions; and

ii) the general knowledge, skill and experience the director has (s214/ (4) IA 1986).

If the director can satisfy the court that he took every step with a view to minimising the potential loss to creditors, the Court may not however make such a declaration (s214/ (3) IA 1986).

The question here is at what stage, if at all, the directors ought to have concluded on this basis that there was no reasonable prospect of the company avoiding insolvency.

Clearly the company was in serious financial difficulties by 2016 although we do not have precise figures. The directors continued to trade for almost a year afterwards despite a continuing deterioration in its financial position, and agreed to paying increased prices to its suppliers. In addition, the directors appear to have taken a rather relaxed approach to managing the company in the latter part of 2016, when they all went on holiday. In addition, they have not held a board meeting since then, suggesting that they have not taken every step to minimise the loss to creditors. (Re Brian D Pierson (Contractors) Ltd [1999]).