LEVEL 6 - UNIT 1 – COMPANY AND PARTNERSHIP LAW
SUGGESTED ANSWERS – JUNE 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 June 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

One of the main features of an unlimited partnership is that the individual partners are liable without limit for the debts and other liabilities of the partnership (s9 Partnership Act 1890 (PA 1890)). The liability of the shareholders in a private company limited by shares on the other hand is limited to the amount, if any, outstanding on their shares. In a limited liability partnership (LLP) the liability of the partners is limited to the amount they have agreed to contribute to the assets of the partnership in the event of it being wound up (s74 Insolvency Act 1986 (IA 1986) as applied by Schedule 3 Limited Liability Partnership Regulations 2001 (LLPR 2001)).

This is one of the main advantages of using the private limited company or LLP. Members know, in theory, that whilst they may lose the amount they have invested in the company or LLP, in the event of its insolvency, their other (personal) property is not at risk. For partners in an unlimited partnership on the other hand, there is the risk of unlimited liability on their part for the debts of the business. If the business fails, the partners risk losing personal property.

In practice, however, there are steps partners can take to alleviate these risks. They can transfer property into the name of another - for example, their spouse. That property might then be put beyond the reach of the creditors of their business.

Private limited companies and LLPs, unlike unlimited partnerships, have separate legal personality (Salomon v Salomon & Co Ltd (1897)) distinct from their members. They are legal entities with most of the legal characteristics of a natural person – they can enter into contracts, sue and be sued but are liable without limit for their own debts and liabilities. The company or the LLP owns the business. This makes them commercially flexible vehicles through which to conduct business without the disadvantages of personal liability that attaches to partners.

It should be noted however that the limited company does not always provide such security for its members. In small private companies, it is very common for example for banks (and some other large creditors) to insist upon personal guarantees from members or directors. If the members are involved in running the company as directors, then there is also the potential for personal liability through breach of duties as directors or under various provisions of the IA1986, such as wrongful trading (s214 IA 1986). The courts will also sometimes (but only rarely) 'lift the corporate veil' and withdraw the benefits of limited liability.

An LLP, as separate legal entity, is normally liable for its own contractual obligations and the tortious acts of its members and employees. However partners of an LLP may incur personal liability in tort for negligence.

Companies and LLPs are, compared with partnerships, highly regulated by statute. The Companies Act 2006 (CA 2006), the IA 1986, the Limited Liability Partnerships Act 2000 and associated regulations all contain a formidable body of regulation which such entities must comply with.

In terms of relations between members, unlimited partnerships and LLPs are largely self-regulating in that the partners are free to decide such matters among themselves – PA 1890 and LLPR 2001 provide only a default set of rules in the absence of agreement to the contrary among the partners (s24 PA 1890 and Regulation 7 LLPR 2001).

On the other hand, relations among shareholders, and between shareholders and their company, are governed by a combination of CA 2006 and the company's articles of association. Further LLPs are largely corporate in form and many provisions of CA 2006 apply equally to LLPs (see LLPR 2001 (as amended by the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009). There is however more flexibility in the regulation of LLPs compared to private companies limited by shares, in that they do not have a share capital and are therefore not subject to the maintenance of capital rules; also the partners in an LLP are not subject to the statutory duties in the CA 2006 that apply to directors (ss170-177 CA 2006).

Only companies and LLPs can grant a floating charge to a lender. This can make it easier for companies to borrow compared with unlimited partnerships. Sometimes the decision to form a company or LLP, rather than remaining as a partnership, may be prompted by banks who have been asked to lend.

Companies and LLPs are formed by a statutory process of registration of documents with Companies House. In addition there are ongoing requirements under the CA 2006 to file annual accounts and to register other documents at Companies House recording changes in the company's constitution, directors, share capital, charges etc.

There are no formalities required for the formation of a partnership; a partnership exists if it satisfies the statutory test of two or more persons carrying on business with a view of profit (s1 PA 1890). However, most well run partnerships will have a bespoke partnership agreement, the drafting and negotiation of which may involve high legal costs.

The cost of compliance with the regulations described above can be relatively high for companies and LLPs compared with operating through the medium of a partnership, although recent company law reforms have sought to minimise the impact of regulation, particularly for small private companies.

Finally, it is worth noting that documents filed at Companies House are open to inspection by the public; a partnership on the other hand is an entirely private affair. This means that if secrecy is an issue for the members, partnership may be a more attractive option than a company or LLP.

Question 2

It is necessary to begin by explaining what is meant by the 'veil of incorporation'. It refers to the separate legal personality assumed by a company on its formation. This principle, confirmed in the case of Salomon v Salomon & Co Ltd (1897), means that a company has a legal persona distinct from that of its members or shareholders.

It means that a company assumes most of the same legal rights and responsibilities as a natural person. It can enter into contracts and sue and be sued in its own name, but is also responsible without limit for its own debts and liabilities. The general principle of Salomon v Salomon has traditionally also been applied to each member of a corporate group. Thus, even though a parent company may own the entire share capital of its subsidiary, the subsidiary alone is responsible for its own contractual or tortious liabilities, and its parent company cannot be held responsible for such liabilities.

Nevertheless, the courts have, exceptionally, 'lifted' or 'pierced' the corporate veil, and thereby disregarded a company's separate legal personality. The leading case in which the grounds for piercing the corporate veil were set out remains Adams v Cape Industries Plc (1990), a case which involved the relationship between a parent company and some of its subsidiaries. In that case, three grounds were suggested:

The first is where either some statutory provision, or some contractual document, requires the veil to be lifted. The second is where there is an agency relationship between the parent and its subsidiary. The Court of Appeal decision in Adams however has generally been understood as requiring courts to find such an agency relationship only where parent company has authorised the subsidiary to act as its agent. Courts, it seems, should not 'imply' such a relationship, merely because, for example, the parent wholly controlled its subsidiary. This is more restrictive than in previous cases, where courts seemed willing to imply an agency relationship based upon a shareholder's control over the company (see e.g. Re F G (Films) Ltd (1953)).

The third ground for veil lifting identified in Adams is where a company is a mere façade or sham, or being used to perpetrate a fraud. This reflects earlier cases such as Gilford Motor Co v Horne [1933], but it is not entirely clear what renders a company a mere façade or its use fraudulent. Adams indicated that the dividing line was whether the company is being used to evade an existing obligation (suggesting fraud) as opposed to merely shielding the parent company from a potential future obligation, which would not constitute fraud, and would not lead to the veil being lifted. This distinction between evading existing, and future, liabilities, was accepted in Prest v Petrodel Resources Ltd (2013).

In Adams, the court also followed Woolfson v Strathclyde Regional Council (1978) in finding that the mere fact that a group of companies constitutes a 'single economic entity' does not permit the veil to be lifted and, consequently the parent to be held responsible for the liabilities of its subsidiary. Previously the court had been more willing to lift the veil on the 'single economic unit' ground (see e.g. DHN Food Distributors Ltd v Tower Hamlets London Borough Council (1976)).

The court in Adams also rejected a further ground for veil lifting where it was 'in the interests of justice' to do so. The court declared that whilst the three specific grounds for veil lifting that it had identified might all be said to be based on what 'justice' demanded, nevertheless there was a difference between the specific grounds for veil lifting (interpretation of a statute, agency, façade) and the underlying purpose for that ground. Acceptance of 'justice' as itself an independent ground for veil lifting would give too much discretion to judges to lift the veil whenever, subjectively, they thought it desirable to do so. This would inevitably create much greater uncertainty in the law.

Adams, then, through the three grounds requires courts to adopt a restrictive approach to veil lifting, and denies that the veil can be pierced whenever justice so requires.

However, it is worth noting that courts have sometimes subsequently sought to escape from the restrictions of the Adams judgment. Perhaps the most relevant examples of this are those cases where injured employees of subsidiaries have sought to sue the parent company as a joint-tortfeasor. In Chandler v Cape Plc (2012), the court found that Cape, the parent, owed the employees of its subsidiaries a duty of care. Cape had assumed a responsibility for the health and safety of its subsidiary's employees, since it employed the manager who dealt with health and safety policy at its subsidiary. The judgment accepted that the parent and subsidiary were two separate legal entities, and thus each responsible only for its own torts. Therefore technically this may not amount to a lifting of the corporate veil. Nevertheless, it does represent a means of avoiding the narrowness of the decision in Adams. Note also that liability is imposed based on the existence of a duty of care arising from the parent company's 'assumption of responsibility'. Liability is not imposed on the ground merely that it would be 'in the interests of justice' to do so.

One precondition, which Chandler accepted, for imposing a duty of care on the parent company was that it was involved in the same line of business as its subsidiary. In Thompson v Renwick Group Ltd (2014), the court refused to impose a duty of care on a parent company because it was a 'pure' holding company. It did not itself carry on any businesses of its own; its only 'activity' was to hold shares in its subsidiaries.

Question 3(a)

There are several reasons why it is important to determine if property is 'partnership property', rather than the personal property of an individual partner. First, it affects the partners themselves. If the partnership is dissolved, then each partner is entitled to have the partnership property used to pay off the firm's debts in priority to using their personal property to pay the claims of creditors. Only if the partnership property is insufficient to pay the claims in full will the personal assets of the partners be at risk.

If there were on the other hand a surplus of partnership property remaining after the claims of creditors have been met in full that surplus will be distributed to the partners according to their respective shares.

Second, it affects priority of claims as between creditors of the partnership on the one hand, and creditors of the partner personally on the other. Creditors of the partnership are entitled to be paid out of property of the partnership first, and in priority to a partner's personal creditors. Third, it might matter in the event of a partner's death. Suppose that there is a question whether a piece of land belongs to P personally, or is the property of a partnership of which P is a partner. P dies, and leaves her real property to X, and her personal property to Y. A partner's interest in partnership property is usually treated as 'personality' (at least if that is the intention of the partners) even where that property includes land (real property). Thus, if the piece of land in our example belongs to P personally, then it will be acquired by X. If it is treated as property of the partnership, then Y will benefit instead.

Should there be any doubt as to whether property is partnership property or not, guidance can be sought from section 20 PA 1890. This specifies what property shall be regarded as partnership property. First, it includes 'property originally brought into partnership stock'. Second, it includes property 'acquired on account of the firm' and here it is presumed that property is being bought on account of the firm where it is purchased with money that belongs to the firm (see s21 PA 1890 and for example Wray v Wray (1905)). Third it includes property acquired 'for the purposes and in the course of the partnership business', and this is so even if the property is bought by a partner with his own money.

Difficulties can arise when there is no written partnership agreement as in Miles v Clarke (1953), but whether property is partnership property is a question of fact and intention must be shown to treat the property as part of the capital of the business (Davis v Davis (1894).

It is also worth noting that partners can be found liable to account for profits where they are found to misuse partnership property (see s29 PA 1890 where there is a duty to account for any benefit derived from the use of partnership property without the consent of the other partners) – another example of where it is important to identify partnership assets as such.

(b)

Generally speaking a retiring partner is not liable for the debts and obligations of the firm incurred after she has ceased to be a partner.

A retiring partner however remains liable for the debts and obligations of the firm incurred while she was a partner (s17 (2) PA 1890). She may nevertheless be discharged from such liabilities 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 she may be indemnified against such liabilities by the continuing partners.

A retiring partner may however find herself liable for debts incurred after she has ceased to be a partner under the doctrine of holding out; i.e. where there has been some representation or 'holding out' that a person is a partner, she will be estopped from denying it. Under s14 PA 1890 a person who represents herself or knowingly allows herself to be represented as a partner in a firm is liable to anyone who has on the faith of such representation given credit to the firm.

The 'apparent partner' must herself know that she is being represented by others that she is a partner in the firm (or she must be making the representation herself). However, she does not need to know that the representation has been made to (nor does she need to have allowed it to be made to) the specific person who has given credit to the firm based upon the representation. Liability under s14 only extends to contractual liability and not to liability in tort.

Further, where a person deals with the firm after a change in its membership, 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).

The requirement for notice can be satisfied in one of two ways. For creditors who have previously dealt with the firm and knew the person to have been a partner actual notice is required (s36 (1) and (3) PA 1890). For creditors who had no previous dealings with the firm a notice in the London Gazette will suffice (s36 (2) PA 1890).

The additional protections a retiring partner should seek therefore are:

- Covenants from her co-partners not to be held out as a partner following her retirement including contractual obligations to remove her name from the firms letterheads and stationery;

- An indemnity from the continuing partners in respect of any successful claim being brought for debts incurred after she has ceased to be a partner.

Question 4(a)

In order to validly transfer shares in a company from one shareholder to another, the transferor must complete a prescribed form, under section 770 CA 2006. This is because a company cannot register a transfer of shares unless 'a proper instrument of transfer has been delivered to it'. This instrument is a stock transfer form (under the Stock Transfer Act 1963) which is delivered with the share certificate (if there is one) to the transferee who then pays any consideration to the transferor.

The transferee is then responsible for getting the stock transfer form stamped at the Stamp Office and for paying stamp duty (50p per £100 of consideration). Once stamped the stock transfer form is delivered to the company along with any share certificate. The company then issues a new share certificate, and adds the new member to its register of members.

(b)

A company can impose restrictions in its articles on transfers of shares in a number of ways. It may give the directors the discretion whether or not to register a transferee of shares as a member, giving the directors a means of controlling who becomes a member of the company. Directors must however act in good faith in making such a decision to refuse (Re Smith v Fawcett Ltd (1942)).

Section 771 CA 2006 and Reg 26 of the Model Articles for Private Companies Limited by Shares govern the registration of share transfers. Reg 26 allows the directors to refuse to register a transfer. Section 771 provides that the transferee must be informed of such refusal, and given reasons for the refusal, within two months of the date of lodging of the transfer.

Smaller companies may also include in their articles a requirement that shareholders must first offer their shares to existing shareholders before transferring to a person outside the company. There may also be a special article that a director must sell any shares she owns in the company to existing shareholders if she ceases to be a director.

(c)

This question raises the issue of insider dealing, which is a criminal offence under the Criminal Justice Act 1993 (CJA). The primary offence is committed if an individual who has information as an insider deals in price affected securities on a regulated market (s52 (1) CJA). There are also the secondary offences of encouraging another person to deal in securities that are price affected securities knowing or having reasonable cause to believe that the dealing would take place (s52 (2) (a) CJA); and, disclosure of inside information by an individual otherwise than in the proper performance of his office, employment or profession to another person (s52 (2 (b) CJA)

There are a number of elements to these offences. First, the primary offence can only be committed by an individual. Second, the dealing must take place on a 'regulated market'. Regulated markets include the Main Market of the London Stock Exchange and the Alternative Investment Market. For the purposes of the CJA, a person 'deals' in securities if he acquires or disposes of securities as principal or agent or procures another person to do so including through his agent or broker (s55 CJA).

Information is "inside information" if it:

- Relates to particular securities or a particular issuer of securities
- Is specific or precise
- Has not been made public and
- If it were made public would be likely to have a significant effect on price.

Securities are 'price affected' if the information relating to them is 'inside information' and the inside information is 'price sensitive information' if the information would, if made public, be likely to have a significant effect on the price of the securities (s56 CJA). The CJA provides a non-exhaustive list of what is meant by information being 'made public' including where it is published in accordance with the rules of a regulated market for the purpose of informing investors and their advisers (s58 CJA).

The individual must have the information as an 'insider'. This will be so if the information is 'inside information' and the individual knows that it is inside information and he has it from an inside source (s57 CJA). He will have the information from an inside source if he has it through being a director, employee or shareholder himself or he has access to the information through his employment, office or profession or the direct or indirect source of the information is through one of those channels. It therefore covers both direct and indirect sources of information.

There are a number of statutory defences contained in s53 and special defences in Schedule 1 CJA. These defences include not expecting the dealing at the time to result in a profit; believing on reasonable grounds that the information had been disclosed widely enough to ensure that those dealing would not be prejudiced by not having the information; and dealing in good faith in the course of business as a market maker.

Penalties are a fine or imprisonment for a maximum of 7 years. A director may also be made the subject of a disqualification order under the Company Directors Disqualification Act 1986, disqualifying him from holding office as a director or being involved in the management of a company.

SECTION B

Question 1(a)

The lease agreement Amit will enter into is a 'pre-incorporation contract' – i.e. one entered into before the company is registered. Ordinarily, a person entering into a contract on behalf of a company acts as the company's agent, and it is accordingly the company which is liable on that contract, not the agent. With a pre-incorporation contract, however, this cannot be the case, for at the date of the contract there is no company in existence to act as principal. Rather, as s51 Companies Act 2006 makes clear, the position is that the promoter, here Amit, is personally liable in respect of the contract.

This rule is, by s51, made subject to any 'agreement to the contrary'. In other words, it is possible for Amit, when he enters into the lease on behalf of the company he is forming, to expressly agree, with the other party to that contract, that Amit as promoter will not be personally liable under the lease. However, in Phonogram Ltd v Lane (1981), the court made clear that any such 'agreement to the contrary' must be expressly and clearly included within the contract. The court would not imply any such agreement to the contrary. 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.

Thus, if Amit were merely to add some additional words to his signature to indicate he signs purportedly as an agent for the company being formed, that will not be sufficient to exclude his personal liability. It must be shown that there is actually an agreement with the other party to the contract excluding personal liability.

Whilst s51 makes clear that the promoter will incur a personal liability under the contract, it does not make clear whether the promoter will be entitled personally to enforce the contract: does she take the benefits, as well as the burdens, of the contract? The point was, however, settled in the case of Braymist Ltd v Wise Finance Co Ltd (2002). The Court of Appeal held that s51 provides both remedies for, but also imposes obligations on, a party who enters into a contract with a company that has not yet been formed, and those obligations can be enforced by the person purporting to act as agent of the unformed company.

What might Amit do therefore to protect herself against personal liability? One thing is, as noted above, to enter into an 'agreement to the contrary' with the other party to the contract. Another option would be for Amit to enter into a contract with the company once it is incorporated, whereby the company promises to perform the obligations under the (initial) lease (with the third party), and to indemnify Amit against his liability under the (initial) contract. This is however an incomplete solution, for it depends upon the ability of the company to perform these obligations. If the company is unable to do so, say because it becomes insolvent, then the third party will still be able to sue Amit personally and his right of indemnity against the company will be of little value. A better solution is a contract of novation – i.e. a new contract not only with the company but with the third party too, 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 the preceding suggestion is that, once the third party has the benefit of a contract with Amit, there is perhaps no obvious reason why the third party would agree to enter into a contract of novation which releases the Amit from his personal liability. A way around this would be to include a term in the original lease 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 Amit's liability. Clearly, this solution is close to the idea of an 'agreement to the contrary' that is provided for in s51 itself (see above) although this solution has the disadvantage of creating (albeit temporary) personal liability for Amit.

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, Amit could use a shelf company to have available a company immediately (although the acceleration of the incorporation process at Companies House achieves now a similar effect).

(b)

Before seeking to register the company, it is necessary to check if the name is already registered as it is not permitted to have two companies with the same name on the register (s66 CA 2006). In addition, the inclusion of 'Milton Keynes' could suggest association with a local authority and therefore consent from the secretary of state will be needed to use the name (s54 CA 2006). If there were also any similarity with another business name, the other business owner could take action in tort for passing off against Amit.

(c)

There is a statutory procedure in the CA 2006 that must be followed to register a company effectively. Amit must submit to Companies House the appropriate application form for registration which must include or be accompanied by:

- A memorandum of association signed by first subscribers;
- The proposed articles of association that could be the Model Articles for a private limited company;
- The names and details of the first director(s) and secretary (if any);
- Specific company name which must include Limited or Ltd;
- The address of its registered office;
- A compliance statement under s13 confirming compliance with the registration requirements; and
- A statement of capital and initial shareholdings.

These documents are sent to, with the registration fee, to the Registrar of Companies. If satisfied that the requirements have been fulfilled, the Registrar issues company's certificate of incorporation.

The company once registered may reimburse Amit's legitimate expenses as an ex gratia payment. The company cannot do so in a simple contract because of the concept of past consideration. Amit should ensure proper disclosure of the expenses and that the company's directors have the power to make such payments.

Question 2

Beginning with the Company's position regarding Patsy, the company can, by ordinary resolution, remove her as a director: s168 CA 2006. This is so, notwithstanding her three year contract.

However, the Company's right to remove Patsy under s168 does not deprive Patsy of her right to compensation if her removal results in a breach of her service contract (s168 (5)). Patsy's right to compensation would depend, then, on the period of notice to which she would be entitled under her service contract.

At first sight, this would seem to be the unexpired portion of the three year term she 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 reasonable notice. The amount of any compensation payable to Patsy would then be based not on the unexpired part of the three year fixed term, but rather only on the 'reasonable notice' to which she would be entitled instead.

Turning now to the purchase of the warehouse, the fact that this transaction was with someone (Michael) who seems to have a relationship with a director (Stephen) 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 are not told the precise nature of the relationship between Stephen, the director, and Michael, the vendor of the warehouse to the company. However, that relationship may be sufficient to mean that Stephen 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 Stephen did so, but the facts suggest he 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 Helen now says about the board's ignorance of Stephen and Michael'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's not entirely clear) that the contract to purchase the warehouse becomes voidable at the instance of the company.

However, even if Stephen did disclose his 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 warehouse 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 (Michael) 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'. We do not have enough information in the facts to know if this test is satisfied in respect of Michael and Stephen.

However, if s190 does apply 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 Michael (because he is both a party to the transaction and connected to a director), and Stephen (because he is the director to whom Michael 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 Michael and Stephen will have no gain. If the transaction is not avoided, the fall in the value of the warehouse means some gain and some loss may well exist.

Question 3

Under s549 Companies Act 2006 (CA 2006), directors of a company may not exercise any power of the company to allot shares (including both ordinary and preference shares) except in accordance with s550 CA 2006 or pursuant to an authority granted pursuant to 551 CA 2006.

Section 550 applies to issues of shares by a private company where there will be only one class of shares in issue before and after the proposed issue. This condition would be satisfied in respect of the allotment of the additional ordinary shares to Max, if this allotment were made first. Therefore, the directors would have authority, under s550 to make that allotment. However, in respect of the subsequent allotment of preference shares to Innovation Plc, this will result in FFL thereafter having two classes of shares, and so the directors will need to be given authority under section 551 CA 2006 to make this allotment.

Directors may be granted authority (s551) to allot shares either by the company's articles or by ordinary resolution of the members. Nothing on the facts suggests that the articles contain such authority, so an ordinary resolution granting authority is appropriate here. The authorisation must state the maximum number of shares that may be allotted, and the expiry of authority which is up to a maximum of 5 years from its grant.

Allotment of the ordinary shares to Max will also require the statutory pre-emption rights of existing shareholders under s561 CA 2006 to be addressed. Following this section, the company must first offer equity shares to existing shareholders pro rata to their existing holdings of ordinary shares.

'Equity securities' are defined to include ordinary shares which are all shares other than shares which carry a fixed entitlement to dividends and capital (s560 CA 2006).

Where directors are generally authorised for the purpose of s551, statutory pre-emption rights can be disapplied in the case of a private company by provision in articles or by special resolution (s570 CA 2006). Alternatively in the case of a private company (whether or not the directors are generally authorised for the purpose s551) pre-emption rights can be excluded by a provision contained in the company's articles (s567 CA 2006). The Model Articles however contain no such provision, and the Company will therefore need to pass a special resolution either to amend its articles (s21 CA 2006) or to grant the directors power to disapply pursuant to s570.

The preference shares to be issued to Innovation PLC do not fall within the definition of equity securities and therefore can be allotted following granting of the authority under section 551. However, the rights attaching to the new preference shares will need to be included in the FFL's articles: a special resolution (s21 CA 2006) will be needed to amend the existing articles or to adopt new articles.

Initial board approval of all the proposals will be needed as well as of the calling of a general meeting or the circulation of written resolutions.

In relation to the purchase of shares from Fatima, there is a general prohibition on a company acquiring its own shares (s658 CA 2006), reinforcing the general maintenance of capital rule. However, a company may purchase its own shares in accordance with s690. To do so, the shares must be fully paid – we are told the company's issues shares are all fully paid – and the company can use available distributable profits for the purpose. We are told they plan to do so and on the facts they have ample profits available. The right to repurchase the shares is also subject to any restriction or prohibition in the company's articles. Again, we are told that FFL's articles are the Model Articles which contain no such restriction or prohibition.

As FFL is a private company, we can assume that its shares are not traded on any of the recognised investment exchanges, and therefore the purchase of Fatima's shares will be an 'off-market purchase'. This will then be governed by ss694-700. A contract will have to be drawn up, identifying the parties to the transaction, and this must be approved in advance by the shareholders by ordinary resolution (s694(2)). The contract must be available for inspection at the company's registered office for 15 days before the shareholders' meeting to approve it: s696(2).

Fatima cannot vote in the resolution to approve the purchase contract, s695. We do not know the other respective shareholdings but this should not in any event be a problem as we are told all the other director/shareholders approve the buy back proposal.

The contract, if approved, can authorise the company to complete the deal with Fatima, but this authority cannot last for more than 5 years. Once the transaction is completed, the shares must be cancelled by the company.

Question 4(a)

Administration is a procedure introduced by the Enterprise Act 2002 whereby the affairs of a company are placed under the control of an insolvency practitioner who holds the office of 'administrator'.

Giorgy cannot alone appoint an administrator. The administrator can be appointed by the court or by the company's directors collectively. Where the appointment is by the directors, they must take the decision to appoint in accordance with the company's constitutional rules (as to the quorum for meetings and the like): Minmar (929) Ltd v Khalatschi (2011).

The court will only appoint an administrator if it is satisfied the company is or is likely to become unable to pay its debts (which seems the case here) and that the administration order is reasonably likely to achieve the purpose of administration (para 11 Sch B1 and para 3 Sch B1). There are three alternative purposes: to rescue a company in financial difficulty so that it may survive as a going concern; to achieve a solution for creditors of the company better than they could expect on a winding up; or to realise property of the company to repay, so far as it is possible, the company's secured and preferential creditors (para 3 Sch B1). It seems likely that one of these objectives might be realised from an administration order in our question.

Third, as noted above the person appointed an administrator must be an insolvency practitioner. We are not told if Yana has the requisite qualification.

As for the consequences of an administration order, under paras 40–43 Sch B1 IA 1986, no legal process, including proceedings, execution or distress, may be instituted or continued against the company or its property without the consent of the administrator or the permission of the court. Similarly, no winding up may be ordered. The company obtains a 'breathing space' against its creditors. So in a way Yana is correct, but administration is a finite process, which normally lasts at most for 12 month after which action could be taken if no arrangement can be reached by the administrator with the company's creditors during the administration process.

(b)

Paying off the loan would appear to be a preference under s239 IA 1986 – Dara has been preferred to other creditors. The administrator could apply to the court under the administration order to have the preference set aside.

However, to be set aside the preference must have been made within 6 months before the administration of the company commenced, or within 2 years if the preference is in favour of a connected person: s240. A connected person includes a spouse of a director, as here. The payment must be influenced by the desire to improve the creditor's position (Re M C Bacon Ltd [1990]) – there appears here no other reason for making the payment. Where the repayment is made to connected person, such influence is presumed and it will be for the other party to rebut the presumption.

On the sale of the property, under s238 IA 1986, the administrator could apply to have this transaction set aside on the ground that it is a 'transaction at an undervalue'. By s240, the transaction must have taken place within 2 years of the making of the administration application; here the sale took place in August 2016 and is therefore within the two years.

The transaction can only be set aside if the company was 'unable to pay its debts' at the time of the transaction (or became so as result of the transaction) (s240(2)). We would need more precise information on the company's financial situation.

We do need to ask however if this actually is a transaction at an undervalue. Under s238(4), a transaction is at an undervalue if company receives 'significantly less' than the value of what it gives in return. An administrator would want to know the value of the property at the time of sale. Even if it were found that the transaction was at an undervalue, the transaction cannot be set aside if the company had made it in good faith, and there were reasonable grounds for thinking it of benefit to the company. Good faith is doubtful here however given the information we have.