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Answers

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1 Precedent

The doctrine of binding precedent, or *stare decisis*, lies at the heart of the English legal system. The doctrine refers to the fact that within the hierarchical structure of the English courts, a decision of a higher court will be binding on a court lower than it in that hierarchy. When judges try cases they will check to see if a similar situation has come before a court previously. If the precedent was set by a court of equal or higher status to the court deciding the new case then the judge in the present case should normally follow the rule of law established in the earlier case.

The Hierarchy of the Courts

The House of Lords stands at the summit of the English court structure and its decisions are binding on all courts below it in the hierarchy. As regards its own previous decisions, up until 1966 the House of Lords regarded itself as bound by its previous decisions. In a Practice Statement ([1966] 3 All ER 77) of that year, however, Lord Gardiner indicated that the House of Lords would in future regard itself as free to depart from its previous decisions where it appeared right to do so. There have been a number of cases in which the House of Lords has overruled or amended its own earlier decisions (e.g. *Conway* v *Rimmer* (1968); *Herrington* v *British Rail Board* (1972); *Miliangos* v *George Frank (Textiles) Ltd* (1976); *R* v *Shivpuri* (1986)) but this is not a discretion that the House of Lords exercises lightly. It has to be recognised that in the wider context the House of Lords is no longer the supreme court and its decisions are subject to decisions of the European Court of Justice in terms of European Community law, and, with the implementation of the Human Rights Act 1998, the decisions of the European Court of Justice in matters relating to human rights.

The Court of Appeal. In civil cases the Court of Appeal is generally bound by previous decisions of the House of Lords and its own previous decisions. There are, however, a number of exceptions to this general rule. The exceptions arise where:

(i) there is a conflict between two previous decisions of the Court of Appeal.

(ii) a previous decision of the Court of Appeal has been overruled by the House of Lords. The Court of Appeal can ignore a previous decision of its own which is inconsistent with European Community law or with a later decision of the European Court.

(iii) the previous decision was given *per incuriam*, i.e. in ignorance of some authority that would have led to a different conclusion (*Young* v *Bristol Aeroplane Co Ltd* (1944)).

Courts in the criminal division, however, are not bound to follow their own previous decisions which they subsequently consider to have been based on either a misunderstanding or a misapplication of the law.

The Divisional Courts of the High Court are bound by the doctrine of *stare decisis* in the normal way and must follow decisions of the House of Lords and the Court of Appeal. They are also normally bound by their own previous decisions, although in civil cases it may make use of the exceptions open to the Court of Appeal in *Young* v *Bristol Aeroplane Co Ltd*, and in criminal appeal cases the Queen's Bench Divisional Court may refuse to follow its own earlier decisions where it feels the earlier decision to have been wrongly made.

The High Court is bound by the decisions of superior courts. Decisions by individual High Court judges are binding on courts inferior in the hierarchy, but such decisions are not binding on other High Court judges although they are of strong persuasive authority and tend to be followed in practice.

Crown Courts cannot create precedent and their decisions can never amount to more than persuasive authority. County courts and *Magistrates' courts* do not create precedents.

It is important to establish that it is not the actual decision in a case that sets the precedent; that is set by the rule of law on which the decision is founded. This rule, which is an abstraction from the facts of the case, is known as the *ratio decidendi* of the case.

Any statement of law that is not an essential part of the *ratio decidendi* is, strictly speaking, superfluous; and any such statement is referred to as *obiter dictum*, i.e. said by the way. Although *obiter dicta* statements do not form part of the binding precedent they are persuasive authority and can be taken into consideration in later cases.

Advantages of Case Law

There are numerous perceived advantages of the doctrine of *stare decisis*, such as:

(i) **Time saving** This refers to the fact that it saves the time of the judiciary, lawyers and their clients for the reason that cases do not have to be re-argued. In respect of potential litigants it saves them money in court expenses because they can apply to their solicitor/barrister for guidance as to how their particular case is likely to be decided in the light of previous cases on the same or similar points.

(ii) **Certainty** Once the legal rule has been established in one case, individuals can act with regard to that rule relatively secure in the knowledge that it will not be changed by some later court.

(iii) **Flexibility** This refers to the fact that the various mechanisms by means of which the judges can manipulate the common law provides them with an opportunity to develop law in particular areas without waiting for Parliament to enact legislation.

The main mechanisms through which judges alter or avoid precedents are:
Overruling, which is the procedure whereby a court higher up in the hierarchy sets aside a legal ruling established in a previous case.

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Distinguishing, on the other hand, occurs when a later court regards the facts of the case before it as significantly different from the facts of a cited precedent. Consequently it will not be bound to follow that precedent. Judges use the device of distinguishing where, for some reason, they are unwilling to follow a particular precedent.

Disadvantages of Case Law

(i) **Uncertainty** This refers to the fact that the degree of certainty provided by the doctrine of *stare decisis* is undermined by the absolute number of cases that have been reported and can be cited as authorities. This uncertainty is increased by the ability of the judiciary to select which authority to follow through use of the mechanism of distinguishing cases on their facts.

(ii) **Fixity** This refers to the possibility that the law in relation to any particular area may become set on the basis of an unjust precedent with the consequence that previous injustices are perpetuated. An example of this is the long delay in the recognition of the possibility of rape within marriage, which has only been recognised relatively recently.

(iii) **Unconstitutionality** This is a fundamental question that refers to the fact that the judiciary are in fact overstepping their theoretical constitutional role by actually making law rather than restricting themselves to the role of simply applying it.

2 Offer

An offer sets out the terms upon which an individual is willing to enter into a binding contractual relationship with another person. It is a promise to be bound on particular terms, which is capable of acceptance. The essential factor to emphasise about an offer is that it may, through acceptance by the offeree, result in a legally enforceable contract. The person who makes the offer is the offeror; the person who receives the offer is the offeree.

Offers, once accepted, may be legally enforced but not all statements will amount to an offer. It is important, therefore, to be able to distinguish what the law will treat as an offer from other statements which will not form the basis of an enforceable contract. An offer must be capable of acceptance. It must therefore not be too vague (*Scammel* v *Ouston* (1941)). In *Carlill* v *Carbolic Smoke Ball Co* (1893) it was held that an offer could be made to the whole world and could be accepted and made binding through the conduct of the offeree.

In addition an offer should be distinguished, from the following:

(i) **A mere statement of intention** Such a statement cannot form the basis of a contract even although the party to whom it was made acts on it (*Re Fickus* (1900)).

(ii) **A mere supply of information** As in *Harvey* v *Facey* (1893) where it was held that the defendant's telegram, in which he stated a minimum price he would accept for property, was simply a statement of information, and was not an offer capable of being accepted by the plaintiff.

Invitation to treat

However most difficulties arise in relation to invitations to treat, and it is most important, therefore, to distinguish offers from invitations to treat. These latter are distinct from offers in that rather than being offers to others, they are in fact invitations to others to make offers. The person to whom the invitation to treat is made becomes the actual offeror, and the maker of the invitation becomes the offeree. An essential consequence of this distinction is that, in line with the ordinary rules of offer and acceptance, the person extending the invitation to treat is not bound to accept any offers subsequently made to them.

The following are examples of common situations involving invitations to treat:

(i) **the display of goods in a shop window** The classic case in this area is *Fisher* v *Bell* (1961) in which a shopkeeper was prosecuted for offering offensive weapons for sale, by having flick-knives on display in his window. It was held that the shopkeeper was not guilty as the display in the shop window was not an offer for sale but only an invitation to treat.

(ii) **the display of goods on the shelf of a self-service shop** In this instance the exemplary case is *Pharmaceutical Society of Great Britain* v *Boots Cash Chemists* (1953). The defendants were charged with breaking a law which provided that certain drugs could only be sold under the supervision of a qualified pharmacist. They had placed the drugs on open display in their self-service store and, although a qualified person was stationed at the cash desk, it was alleged that the contract of sale had been formed when the customer removed the goods from the shelf. It was held that Boots were not guilty. The display of goods on the shelf was only an invitation to treat. In law, the customer offered to buy the goods at the cash desk where the pharmacist was stationed.

(iii) **a public advertisement** Once again this does not amount to an offer. This can be seen from *Partridge* v *Crittenden* (1968) in which a person was charged with 'offering' a wild bird for sale contrary to the Protection of Birds Act 1954, after he had placed an advert relating to the sale of such birds in a magazine. It was held that he could not be guilty of offering the bird for sale as the advert amounted to no more than an invitation to treat.

However, this should be contrasted with decisions such as that in *Carlill* v *Carbolic Smoke Ball Co* (1893), where the relevant newspaper advertisement in that case was held to be an offer. The differences between the groups of cases of which the above examples are representative illustrations rest in the intention of the advertiser (this was a particularly strong point in *Carlill*) and in the fact that the contract envisaged in such cases as *Carlill* is a unilateral contract and not a bilateral contract. In other situations where a unilateral contract is envisaged (the 'reward' cases) newspaper and other advertisements are treated as offers. With regard to the contractual status of invitations to traders to submit tenders, the position is that a tender will be regarded as the offer which the person or body seeking the goods or services is free to accept or not.

(iv) **a share prospectus**. Contrary to common understanding such a document is not an offer. It is merely an invitation to treat, inviting people to make offers to subscribe for shares in a company.

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3 This questions asks candidates to consider the rules relating to the award of damages for breach of contract.

Damages is the common law remedy for breach of contract and, unlike discretionary equitable awards, is available as a right where a pecuniary loss has been sustained by the innocent party. In deciding what damages are to be paid, the courts deploy a number of rules and principles to guide their action. These various rules may be considered under two headings: the rules relating to remoteness of damage and rules relating to the measure of damages.

(a) Remoteness of damage

It would be unfair if the party in breach of contract were held to be liable for every consequence of their action no matter how far down the chain of causation it appeared. In order to limit potential liabilities, the courts have established clear rules about consequential liability in such a way as to deny the award of damages for consequences that are deemed to be too remote from the original breach. The rule relating to remoteness of damages was clearly stated for the first time in *Hadley* v *Baxendale* (1854) to the effect that damages will only be awarded in respect of losses which:

(i) arise naturally, i.e. in the usual course of events; or which

(ii) both parties may reasonably be supposed to have contemplated as a probable result of its breach when the contract was made.

As a consequence of the first part of the rule in *Hadley* v *Baxendale*, the party in breach is deemed to expect the normal consequences of the breach, whether they actually expected them or not. It does not matter that they did not actually think of the consequences if those consequences were the natural outcome of their breach.

Under the second part of the rule, however, the party in breach can only be held liable for abnormal consequences where they have actual knowledge that the abnormal consequences might follow. In *Victoria Laundry Ltd* v *Newman Industries Ltd* (1949) it was decided that the plaintiff could claim damages in relation to the loss of normal profits due to the defendant's delay, as that loss was a natural consequence of the delay. A second claim for damages in relation to an especially lucrative contract failed, however, on the grounds that the loss was not a normal one, but was a consequence of an abnormal contract, about which the defendant knew nothing. The decision in the *Victoria Laundry* case was confirmed by the House of Lords in *The Heron II* (1969), although the actual test for remoteness was reformulated in terms of whether the consequence should have been 'within the reasonable contemplation of the parties' at the time of the contract.

(b) The measure of damages

The courts use a number of rules and principles to determine the actual extent of monetary damages owed. The general rule is that damages in contract are intended to be compensatory rather than punitive. The aim is to put the injured party in the same position they would have been in had the contract been properly performed. As the object is not to punish the party in breach but to compensate the injured party for any financial loss sustained as a consequence of the other party's breach, so the amount of damages awarded can never be greater than the actual loss suffered. It should be noted that the exact amount of the loss may differ depending on whether the innocent party's reliance interest or expectation interest is used as the criterion against which damages are measured. In practice it is usually the expectation loss that is compensated except where this permits the innocent party to escape responsibility for any loss they would have made in the contract in the absence of breach (see *CCC Films (London) Ltd* v *Imperial Quadrant Films Ltd* (1985)).

Where the breach relates to a contract for the sale of goods, damages are usually assessed in line with the market rule. This means that if goods are not delivered under a contract, the buyer is entitled to go into the market and buy similar goods, and pay the market price prevailing at the time. They can then claim the difference in price between what they paid and the original contract price as damages. Conversely, if a buyer refuses to accept goods under a contract, the seller can sell the goods in the market, and accept the prevailing market price. Any difference between the price they receive and the contract price can be claimed in damages.

The injured party is under a duty to take all reasonable steps to mitigate their loss. So in the above examples, the buyer of goods which are not delivered has to buy the replacements as cheaply as possible; and the seller of goods which are not accepted has to try to get as good a price as they can when they sell them. In such a way they are expected to minimise the actual loss they sustain, as may be seen in *Payzu* v *Saunders* (1919).

The foregoing has dealt with losses that are relatively easily quantified in monetary terms but matters are more complicated when it comes to assessing damages for non-pecuniary loss.

At one time, damages could not be recovered where the loss sustained through breach of contract was of a non-financial nature. The modern position is that such non-pecuniary damages can be recovered. Thus in *Jarvis* v *Swan Tours Ltd* (1973) it was held that the plaintiff was entitled to recover, not just the substantial financial loss he suffered, but also for loss of entertainment and enjoyment which amounted to an even greater sum.

The job of estimating damages may be made much simpler where the parties to an agreement make provisions for possible breach by stating in advance the amount of damages that will have to paid in the event of any breach occurring. Damages under such a provision are known as liquidated damages. They will be recognised by the court as long as they represent a genuine pre-estimate of loss, and are not intended to operate as a penalty against the party in breach. If the court considers the provision to be a penalty, it will not give it effect, but will award damages in the normal way (*Dunlop* v *New Garage & Motor Co* (1915)).

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4 This question requires candidates to explain the main features of the law relating to dismissal from employment on the basis of redundancy, paying particular regard to the way in which redundancy payments are calculated.

There are two major purposes behind the law relating to redundancy. The first purpose is to encourage employers to consider alternatives to dismissing their employees, and the second is to ensure that where employees have been dismissed on the grounds of redundancy that they should have at least a minimum level of payment to tide them over until hopefully they can regain employment. The law relating to redundancy is currently to be found in the Employment Rights Act 1996 (ERA). The determination of redundancy depends on the qualifying rules stated in that Act, and in order to be awarded redundancy payment individuals must follow the procedures stated therein.

Redundancy is defined in s.139(1) of the ERA as being: 'dismissal attributable wholly or mainly to:

(a) the fact that his employer has ceased, or intends to cease, to carry on the business for the purposes of which the employee was employed by him, or has ceased, or intends to cease to carry on that business in the place where the employee was so employed, or

(b) the fact that the requirements of that business for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where they were so employed, have ceased or diminished or are expected to cease or diminish.'

It should be noted that even where a dismissal clearly falls within the above categories, an individual will not be able to claim redundancy payments unless they meet the qualification requirements, the most important of which relates to length of service. In order to qualify for redundancy payments an employee must have been continuously employed by the same employer or associated company for a period of two years. (The decision to reduce the length of service in relation to a claim for unfair dismissal to one year has not been extended to redundancy claims (*R* v *Sec State for Employment ex p Seymour-Smith* (2000)).

Redundancy as a consequence of cessation of business is relatively straightforward and unproblematic although it should be noted that it applies to temporary as well as permanent cessation as seen in *Gemmell* v *Darngavil Brickworks Ltd* (1967).

Problems do tend to arise in relation to the closure and relocation of the place of business. If the employer offers the employee a similar job at the new location, *which involves the employee in no added inconvenience*, then the employee cannot claim redundancy (see *Managers (Holborn) Ltd* v *Hohne* (1977). Where the employee does suffer additional inconvenience then they cannot be required to move unless they have an express mobility clause in their contract of employment which require them to move with their job. An example of the former may be seen in *O'Brien* v *Associated Fire Alarms* (1969) in which the plaintiff successfully claimed redundancy when he was dismissed for refusing to move from Liverpool to Barrow-in-Furness. However in *Rank Xerox Ltd* v *Churchill* (1988) an employee with a mobility clause was not allowed to claim redundancy when required to move location of employment.

At the outset of redundancy proceedings the onus is placed on the employee to show that they have been dismissed which they do by demonstrating that they are covered by s.136 of ERA which provides four types of dismissal. These are:

(i) the contract of employment is terminated by the employer with or without notice;

(ii) a fixed-term contract has expired and has not been renewed;

(iii) the employee terminates the contract with or without notice in circumstances which are such that he or she is entitled to terminate it without notice by reason of the employer's conduct;

(iv) the contract is terminated by the death of the employer, or the dissolution or liquidation of the firm.

Normally employees who resign are not entitled to claim redundancy but type (iii) above provides for what is known as constructive dismissal in recognition of the situation where the unreasonable action of the employer has been tantamount to forcing the employee to resign. It is of course possible for the employee to behave in an unreasonable manner, and where they have refused to take up 'suitable' alternative employment offered to them by their employer they cannot claim redundancy. The difficulty arises in deciding what constitutes suitable alternative employment and can really only be decided on the facts of each case.

Once dismissal has been established a presumption in favour of redundancy operates and the onus shifts to the employer to show that redundancy was not the reason for the dismissal.

Employees who have been dismissed by way of redundancy are entitled to claim a redundancy payment from their former employer. Under the ERA the actual figures are calculated on the basis of the person's age, length of continuous service and weekly rate of pay subject to statutory maxima. Thus employees between the ages of 18 and 21 are entitled to $^1/_2$ week's pay for each year of service, those between 22 and 40 are entitled to 1 week's pay for every year of service, and those between 41 and 65 are entitled to $1^1/_2$ week's pay for every year of service.

The maximum number of years service that can be claimed is 20 and as the maximum level of pay that can be claimed is £270, the maximum total that can be claimed is £8,100 (i.e. 1·5 x 20 x 270).

Disputes in relation to redundancy claims are heard before an employment tribunal and on appeal go to the Employment Appeal Tribunal.

There is also a statutory requirement for an employer to consult a recognised trade union or elected employees' representatives in good time to consider ways in which any redundancies can be avoided.

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5 This question requires candidates to explain the meaning and procedures involved in the course of 'winding up' in company law.

(a) One of the many consequences of incorporation is that a registered company becomes a legal entity in its own right having existence apart from its member shareholders. One of the attributes of this legal personality is that the company has not only separate, but perpetual existence, in that it continues irrespective of changes in its membership. Indeed the company can continue to exist where it has no members at all. Winding up, or liquidation, is the process whereby the life of the company is brought to an end and its assets realised and distributed to its members and/or creditors. The rules governing winding up are detailed in the provisions of the Insolvency Act 1986 (IA) and the exact nature of procedure depends on the type of winding up involved and depends upon the solvency of the company at the time when liquidation commences. Winding up can be conducted on a voluntary basis, in which case the members of the company themselves determine that the time has come for it to come to an end. Alternatively the court may make an order that the company's life should come to an end. This question refers to the first of these alternatives, voluntary winding up.

(b) Section 84 IA states that a company may be wound up voluntarily:

(i) when any period fixed for the duration of the company by the articles expires or any event occurs which shall, according to the articles, lead to its dissolution. Under such circumstances the winding up has to be approved by an *ordinary resolution*.

(ii) for any other reason whatsoever. Under these circumstances a *special resolution* is required to approve the winding up.

(iii) where its liabilities make it advisable for it to be wound up. In this last case an *extraordinary resolution* is required to approve the winding up.

In any case the winding up is deemed to have started on the date that the appropriate resolution was passed.

There are two distinct forms of voluntary liquidation:

(i) *members' voluntary winding up*
This takes place when the directors of the company are of the opinion that the company is solvent and is capable of paying off its creditors. The directors are required to make a formal declaration to the effect that they have investigated the affairs of the company and that in their opinion it will be able to pay its debts within 12 months of the start of liquidation. It is a criminal offence for directors to make a false declaration without reasonable grounds. On appointment, by an ordinary resolution of the company, the job of the liquidator is to wind up the affairs of the company, to realise the assets and distribute the proceeds to its creditors. On completion of this task the liquidator must present a report of the process to a final meeting of the shareholders. The liquidator then informs the Registrar of the holding of the final meeting and submits a copy of his report to it. The Registrar formally registers these reports and the company is deemed to be dissolved three months after that registration.

(ii) *creditors' voluntary winding up*
This takes place when the company is insolvent when it is decided to wind it up. The essential difference between this and the former type of winding up is that, as the name implies, the creditors have an active role to play in overseeing the liquidation of the company. Firstly a meeting of the creditors must be called within 14 days of the resolution to liquidate the company at which the directors must submit a statement of the company's affairs. The creditors have the final say in who should be appointed as liquidator and may, if they elect, appoint a liquidation committee to work with the liquidator. On completion of the winding up the liquidator calls and submits his report to meetings of the members and creditors. The liquidator then informs the Companies' Registry of the holding of these final meetings and submits a copy of his report to it. The Registrar formally registers these reports and the company is deemed to be dissolved three months after that registration.

6 This question asks candidates to provide some of the likely content of articles of association, to explain the effect of the articles and to detail the procedure for altering them. The constitution of a company is established by two documents: the memorandum of association, and the articles of association. Whereas the memorandum mainly governs the company's external affairs, the articles deal with the internal regulation of the company. If there is any conflict between the two documents, the contents of the memorandum prevail over anything to the contrary contained in the articles, although provisions in the articles may be used to clarify particular uncertainties in the memorandum.

(a) Model memorandums and articles of association are set out in the Companies (Tables A to F) Regulations 1985, although companies may alter the models to suit their particular circumstances and requirements. It is usual for companies to draw up their own particular articles but if they elect not to draw up their own, then Table A model articles apply automatically. Table A also applies to the extent that the company's articles have not expressly excluded its provisions. The model articles cover such matters as the issue and transfer of shares, the rights attaching to particular shares, the rules relating to the holding of meetings, the powers of directors, and the payment of dividends.

(b) Section 14 of the Companies Act provides that 'the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.' This section has three effects.

(i) the documents establish a contract which binds each member to the company. Thus in *Hickman* v *Kent or Romney Marsh Sheep-Breeders' Association* (1915), the company was able to enforce an article against a member that provided that disputes involving the member and the company should go to arbitration.

(ii) the company is contractually bound to each of its members. On this basis in *Pender* v *Lushington* (1877) a member was able to sue in respect of the wrongful denial of his right to vote at a company meeting.

(iii) the articles constitute a contract between the members. In *Rayfield* v *Hands* (1960), the articles of the company provided that, where shareholders wished to transfer their shares, they should inform the directors of the company, who were obliged to take the shares equally between them at fair value. When the directors refused to purchase the plaintiff's shares, the court held that the directors were bound as members by the articles and therefore had to comply with the procedure set out there.

Articles only operate as a contract in respect of membership rights and obligations. Consequently it has been held that, although members can enforce them, non-members, or members suing in some other capacity than that of a member, will not be able to enforce promises established in the company's articles. In *Eley* v *Positive Government Security Life Assurance Co* (1876) the articles of a company stated that the plaintiff was to be appointed as the company's solicitor. It was held that Eley could not use the articles to establish a contract between himself and the company as those articles only created a contract between the company and its members. Although Eley was in fact a member, he was not suing in that capacity but in the capacity of solicitor, which was not a membership right.

(c) Section 9 of the Companies Act 1985 allows companies to alter their articles by passing a special resolution. Any attempt in the articles to provide that a particular provision is unalterable is ineffective. The articles cannot be altered however, in such a way as to conflict with the memorandum or any provision of the Companies Act. In particular no member can be bound by any alteration to subscribe for more shares or increase their liability in any way (s.16).

Any alteration must be made 'bona fide in the interest of the company as a whole', although the exact meaning of this phrase is not altogether clear. It is evident that it involves a subjective element in that those deciding the alteration must actually believe they are acting in the interest of the company. There is additionally, however, an objective element. In *Greenhalgh* v *Arderne Cinemas Ltd* (1951) it was stated that any alteration had to be in the interest of the '*individual hypothetical member*'.

In *Brown* v *British Abrasive Wheel Co* (1919) an alteration to the articles of the company was proposed to give the majority shareholders the right to buy shares of the minority. It was held that the alteration was invalid as it would benefit the majority shareholders rather than the company as a whole. However, in *Sidebottom* v *Kershaw Leese & Co* (1920), an alteration to the articles gave the directors the power to require any shareholder, who entered into competition with the company, to transfer their shares to nominees of the directors at a fair price. It was held that under those circumstances the alteration was valid as it would benefit the company as a whole.

7 This question invites candidates to consider the way in which companies acquire loan capital and specifically the mechanisms available for providing security against such loans.

Companies ordinarily raise the money they need to finance their operations through the issue of share capital, but it is equally common for companies to raise additional capital through borrowing. The essential difference between share capital and loan capital is that whereas the share represents a proportionate interest in the business and constitutes the shareholder a member of the company, the lender, even where they hold loan-stock, remains a creditor of the company rather than a member. Such borrowing on the part of the company does not give the lender any interest in the company but represents a claim against the company. The relationship between company and the provider of loan capital is the ordinary relationship of debtor/creditor, although specific mechanisms exist to facilitate the borrowing of companies and secure the interests of their creditors.

(a) Debentures

A debenture is a document which acknowledges the fact that a company has borrowed money. The use of the term debenture, however, has been extended to cover the loan itself. A debenture may be issued to a single creditor or to a large number of people, in which case each of the creditors has a proportionate claim against the total 'debenture stock'.

As creditors of the company, debenture holders receive interest on their loans and are entitled to receive payment whether the company is profitable or not. As regards repayment, debts rank in order of creation, so earlier debentures have to be paid before those created later. Where debentures are issued as part of a series, it is usual for a *pari passu* clause to be included in the document creating the debt, with the effect that all of the loans made within the series rank equally with regard to repayment.

Debentures which have no security are referred to as 'unsecured loan stock'. It is usual, however, for debentures to provide security for the amount loaned. Security means that if the company is wound up, the secured creditor will have priority in terms of repayment over any unsecured creditor. There are two types of security for company loans:

(b) Fixed charge

In this situation a specific asset of the company is made subject to a charge in order to secure a debt. Once the asset is subject to the fixed charge the company cannot dispose of it without the consent of the debenture holders. The asset most commonly subject to fixed charges is land, although any other long-term capital asset may also be charged, as may such intangible assets as book debts. It would not be appropriate, however, to give a fixed charge against stock in trade as the company would be prevented from freely dealing with it without the prior approval of the debenture holders. Such a situation would obviously prevent the company from carrying on its day to day business. If the company fails to honour the commitments set out in the document creating the debenture, such as meeting its interest payments, the debenture holders can appoint a receiver who will if necessary sell the asset charged to recover the money owed. If the value of the asset that is subject to the charge is greater than the debt against which it is charged then the excess goes to pay off the rest of the company's debts. If it is less than the value of the debt secured then the debenture holders will become unsecured creditors for the amount remaining outstanding.

(c) Floating charge

This category of charge is peculiar to companies and represents one of the advantages of the company over other business forms. The floating charge is most commonly made in relation to the 'undertaking and assets' of a company and does not attach to any specific property whilst the company is meeting its requirements as stated in the debenture document. The security is provided by all the property owned by the company, some of which may be continuously changing, such as stock in trade. Thus, in contrast to the fixed charge, the use of the floating charge permits the company to deal with its property without the need to seek the approval of the debenture holders. However, if the company commits some act of default, such as not meeting its interest payments, or going into liquidation, the floating charge is said to crystallise. This means that the floating charge becomes a fixed equitable charge over the assets detailed, and their value may be realised in order to pay the debt owed to the floating charge holder.

All charges, including both fixed and floating, have to be registered with the Companies' Registry within 21 days of their creation. Failure to register the charge as required has the effect of making the charge void, i.e. ineffective, against any other creditor, or the liquidator of the company. The charge, however, remains valid against the company, which means in effect that the holder of the charge loses their priority as against other company creditors. In addition to registration at the Companies' Registry, companies are required to maintain a register of all charges on their property. Although a failure to comply with this requirement constitutes an offence, it does not invalidate the charge.

It is possible to obtain court permission for later registration of a charge e.g. where failure to register was by mistake or due to inadvertence. However, the court cannot allow the rights of subsequent charge holders to be prejudiced. Thus, any charge that is now registered late is registered subject to those charges already registered. In relation to properly registered charges of the same type, they take priority according to their date of creation. However, as regards charges of different types, a fixed charge takes priority over a floating charge even though it was created after it. Generally there is nothing to prevent the creation of a fixed charge after the issuing of a floating charge, and, as a legal charge against specific property, that fixed charge will still take priority over the earlier floating charge. It is possible, however, for the debenture creating the original floating charge to include a provision preventing the creation of a later fixed charge taking priority over that floating charge. Such a negative pledge clause is effective if the subsequent fixed charge holder has actual notice of it.

8 This question requires candidates to consider the circumstances under which *private* companies are permitted to purchase their own shares and in particular it requires an explanation of the rules under which such companies can make use of their capital to finance such purchases.

(a) Purchase of own shares

It was once an extremely strict rule of company law that companies were not allowed to buy their own shares. Any such purchase was treated as a major contravention of the capital maintenance rules (*Trevor* v *Whitworth* (1887). Subsequently, companies were granted the power to issue specifically redeemable shares and such a power still exists in s.159 of the Companies Act (CA) 1985, although there are strict controls over how any such redemption has to be financed (s.160). However the right of companies to buy back their own shares has been extended to cover all, rather than just redeemable, shares as provided in ss.162 – 181 of the Companies Act 1985.

The rules for financing the purchase by a company of its own shares are the same as those that apply to the redemption of redeemable shares as stated in s.160 CA. The most essential rule is that no purchase or redemption is to be financed from the company's capital, and can only be paid from profits properly available for distribution to the company's members (s.162 applying s.160 CA).

(b) Capital redemption reserve

This concept reflects the controls that apply where companies buy their own shares. Thus even where the company uses distributable profits to pay for the purchase of its own shares, it is required under s.170 CA to establish a capital redemption reserve, equivalent to the value of the profits so used, which must be maintained in the same way as other capital. Any amount allocated to the capital redemption reserve may be reduced by transfer to a share capital account through the issue of bonus shares but otherwise cannot be reduced without the company going through the formal capital reduction process, requiring the approval of the court.

(c) Permissible capital payment

However, as in most areas of company law, there are relaxations of the strict rules in relation to private limited companies. Thus in ss.171 – 175, private companies are permitted to use the companies' capital to finance the purchase of their own shares, although even here the controls established are extremely rigorous.

Section 171 expressly allows the capital of a private company to be used to pay for the purchase of its own shares where its distributable profits are insufficient. However, s.173 sets out strict conditions for such payments, requiring:

(i) the approval of the payment by a special resolution;

(ii) a statutory declaration by the directors to the effect that the company will be able to pay its debts within the coming year;

(iii) a statement from the company's auditors supporting the directors' declaration.

Section 175 requires the company to advertise the fact that it intends to use its capital to buy back its shares in the *Gazette* and an appropriate national newspaper, and s.176 allows either members or creditors of the company to apply to the court to have any such resolution to be overturned.

9 This question invites the candidate generally to consider the incorporation of terms, and especially adverse terms, into contracts and to examine the effect of the law relating to unfair contract terms: i.e. The Unfair Contract Terms Act (1977) and The Unfair Terms in Consumer Contracts Regulations (1999). In particular it requires candidates to decide whether Amy and anyone else who suffered as a consequence of her accident can claim against Brakes Ltd for injury and losses sustained and the extent of such claims.

An exemption clause is a term in a contract which tries to exempt, or limit, the liability of a party in breach of the agreement. Exclusion clauses give rise to most concern when they are included in 'standard form' contracts, in which one party, in a position of commercial dominance, imposes their terms on the other party, who has no alternative.

(a) Incorporation

An exclusion clause can have no effect if it is not part of the contract so the first question that has to be decided is whether the exclusion clause has been incorporated into the contract or not. There are three ways in which such a term may be inserted into a contractual agreement: by signature, notice or custom.

(i) It is a well established principle that an exclusion clause will not be incorporated into a contract unless the party affected actually knew of it, or was given sufficient notice of it. As regards the notice in the receipt, Brakes Ltd will no doubt claim that it provided sufficient notice of their terms of trade to make it part of any subsequent contract. In order for notice to be adequate, however, the document bearing the exclusion clause must be an integral part of the contract, and given at the time the contract is made. Thus in *Chapleton* v *Barry* UDC (1940) notice on the back of a receipt was insufficient communication to incorporate an exclusion clause (see also *Olley* v *Marlborough Court Ltd* (1949)). Given judicial hostility to exclusion clauses it is unlikely that the notice in the brochure would be accepted as providing the actual terms of the contract entered into at a later date. And in any case Amy did not even see the notice in the receipt which raised doubts as to its clarity. As was held in *Thornton* v *Shoe Lane Parking Ltd* (1971) the greater the exemption, the greater the degree of notice required and in the circumstances the extent of the exclusion sought by Brakes Ltd would require extremely clear notification.

(ii) A second equally well established principle states that if a person signs a contractual document, then they are bound by its terms, even if they did not read it (*L'Estrange* v *Graucob* (1934)), the only exception to this being where they were misled by the other party into signing the contract (*Curtis* v *Chemical Cleaning* & *Dyeing Co* (1951)). In the problem scenario, although Amy had signed previous contracts including the exemption clause she did not actually sign anything on this occasion. Consequently Brakes Ltd cannot rely on this means of limiting their liability into the contract.

(iii) Where parties have had previous dealings on the basis of an exclusion clause, that clause may be incorporated into later contracts (*Spurling* v *Bradshaw* (1956)). However, it must be shown that the party subject to the exclusion clause was actually aware of its existence, and in this instance the previous signing of a document containing the exclusion is not sufficient to incorporate it into later contracts (*Hollier* v *Rambler Motors* (1972)). In the circumstances of the present problem, it is clear that Amy did sign contracts containing exclusion clauses previously. It is not certain, however, whether she was actually aware of the content of the contracts she signed. If she did know the content then the clause would be incorporated, if she did not, it would not be.

(b) Effect

Assuming that the clause is part of the contract the question that next arises is as to the extent of its effectiveness.

As a consequence of the disfavour with which the judiciary have looked on exclusion clauses, they have tended to interpret uncertainties or ambiguities in the exclusion clause against the meaning claimed for it by the person seeking to rely on it. Thus in *Hollier* v *Rambler Motors* (1972) it was held that an exclusion clause which could be interpreted as applying only to non-negligent accidental damage, or alternatively to include negligent damage, should be restricted to the narrower interpretation.

In the particular situation of the question, however, it would appear that the wording of the exclusion clause is sufficiently clear and specific to cover Brakes Ltd's negligence. As a consequence, it only remains to consider how the legislation governing exclusion clauses would be likely to deal with this particular clause in the context of the question.

The Unfair Contract Terms Act 1977 (UCTA) is the original statutory attempt to control exclusion clauses. The original Unfair Terms in Consumer Contracts Regulations (UTCCR) were enacted in 1994 to implement the European Unfair Contract Terms Directive and were subsequently replaced by the current regulations in 1999.

Section 2(1) of UCTA provides an absolute prohibition on exemption clauses in relation to liability in negligence resulting in death or injury. It is therefore apparent that Brakes Ltd cannot avoid responsibility for the injury sustained by Amy and will be liable for the injuries she suffered.

Section 2 also provides that any exemption clauses relating to liability for other damage caused by negligence will only be enforced to the extent that they satisfy the 'requirement of reasonableness'; and s.11 provides that the requirement of reasonableness means 'fair and reasonable . . . having regard to the circumstances . . .'.

In looking at the circumstances of the case the court will take into account matters relating to relative strength of bargaining power: inducements to accept the restrictions; whether the customer knew or ought to have known of the exclusion; whether the goods involved were specially made or adapted. The final outcome, therefore, is dependent on judicial interpretation. The onus of showing reasonableness rests with the party relying on the clause (*St Alban's CDC* v *International Computers Ltd* (1994)). If one were to ask the question: 'Was it reasonable for Brakes Ltd to deny responsibility for the consequence of their negligence in this case?', the answer is likely to be no. Consequently Brakes Ltd is likely to be liable for all the damages consequent upon its negligence, and the exclusion clause to have no effect (see *George Mitchell (Chesterhall) Ltd* v *Finney Lock Seeds Ltd* (1983) and *Smith* v *Bush* (1989)).

Although the Unfair Terms in Consumer Contracts Regulations 1999 do not affect the outcome of the situation in any material way, it is worth mentioning them at this point. The regulations are potentially wider in scope than UCTA, in that they cover all terms and not just exclusion clauses. Regulation 3(1) states that it applies to 'any term in a contract concluded between a seller or supplier and a consumer where the term has not been individually negotiated.' Under regulation 4(i), a term is unfair 'if contrary to the requirements of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer'. Consequently regulation 5(1) provides that if a term is found to be unfair it will not be binding on the consumer, although the remainder of the contract will continue to operate if it can do so after the excision of the unfair term.

10 (a) Property may be owned collectively by all of the partners and may thus amount to partnership property. Alternatively, it is possible for property to be used by the partnership as a whole and yet remain the personal property of only one of the partners.

Section 20 of the Partnership Act (PA) 1890 states that partnership property consists of all property brought into the partnership stock or acquired on account for the purposes of the firm. Section 21 further states that any property bought with money belonging to the firm is deemed to have been bought on account of the firm.

Whether or not any particular item of property belongs to the firm is always a matter of fact, to be determined in relation to the particular circumstances of any case. If there is no express agreement that property is to be brought into the firm as partnership property, the court will only imply such a term to the extent required to make the partnership agreement effective. In *Miles* v *Clarke* (1953), Clarke had carried on a photography business for some time before taking Miles into the partnership. The partnership agreement merely provided that the profits should be divided equally. When the partners fell out, a dispute arose as to who owned the assets used by the partnership. It was held that only the consumable stock-in-trade could be considered as partnership property. The leases of the business premises and other plant and equipment remained the personal property of the partner who introduced them into the business.

It is important to distinguish between partnership property and personal property for the following reasons:

- Partnership property must be used exclusively for partnership purposes (s.20 of the PA 1890)
- Any increase in the value of partnership property belongs to the partnership
- Any increase in the value of personal property belongs to the person who owns the property
- On the dissolution of the firm, partnership property is used to pay debts before personal property (s.39)
- Partnership and personal property are treated differently in the satisfaction of claims made by partnership creditors, as opposed to personal creditors. Under s.23, a writ of execution can only be issued against partnership property in respect of a judgment against the partnership. A personal creditor of a partner may not, therefore, take action against partnership property. They can, however, apply for a charging order against that partner's share in the partnership, which would entitle them to receive the partner's share of profits, or assets on dissolution, to the extent of the debt and interest.
- On the death of a partner, any interest in partnership land will pass as personalty, whereas land owned personally will pass as realty. In effect, this means that the interest may pass to different people, depending on whether or not the party has made an appropriate will.

(b) Upon dissolution, the value of the partnership property is realised and the proceeds are applied in the following order:

(i) in paying debts to outsiders;

(ii) in paying to the partners any advance made to the firm beyond their capital contribution;

(iii) in paying the capital contribution of the individual partners.

Any residue is divided between the partners in the same proportion as they shared in profits (s.44 of the PA 1890).

If the assets are insufficient to meet debts, partners' advances and capital repayments, then the deficiency has to be made good out of any profits held back from previous years, or out of partners' capital, or by the partners individually in the proportion to which they were entitled to share in profits.

Applying these rules to the partnership in question it is apparent firstly that the business premises remained Chick's private property and their value cannot be treated as partnership property to pay off the partnership debts.

Secondly the value of the assets must be realised in order to pay off the debts owed to the various creditors. As stated, the partnership assets are worth £15,000 and it has debts to outside creditors of £7,000. In addition the partnership owes Chick £1,000. As the value of the assets is sufficient to cover all of these debts, the creditors, including Chick, will be paid their debts in full before any allocating between the partners.

The next stage in the problem is to consider Delia's advance of £2,000 to the partnership and as stated above she is entitled to receive repayment of that sum before any further distribution to the partners.

The effect of these payments is that the amount left for distribution between the partners is only £5,000 (£15,000 less £7,000 to the outside creditors, less the £1,000 owed to Chick, less the advance owed to Delia). This means that the partnership has actually suffered a loss of £15,000 on the original capital contributed by the members. The manner in which that loss is distributed is to be allocated, is according to the partnership agreement, in proportion to the capital contribution. As the total capital contribution was £20,000, Chick who provided £10,000 must suffer half of the loss, Delia who provided £6,000 must suffer $^3/_{10}$th of the loss and Enid, who provided £4,000 will suffer $^1/_5$th of the loss. These losses will in fact be £7,500 for Chick, £4,500 for Delia and £3,000 for Enid.

In practice these losses will merely reduce the amount of capital returned to the partners. Thus Chick will receive £2,500, Delia will receive £1,500 and Enid will receive £1,000.

11 This question requires candidates to consider various issues relating to the issuing of shares by companies, the requirement for those shares to be paid for by shareholders and shareholders' potential liabilities for the debts of their companies.

(a) It is a requirement of United Kingdom law that the capital of any company having share capital must be divided into shares of a designated and fixed amount (s.2(5)). The authorised capital is the designated amount, set out in the company's memorandum of association at the initial registration of the company, which establishes the maximum amount of shares the company can issue and the nominal value of the shares in the company. Once issued the market value of the shares may diverge from that nominal value, but that nominal value remains fixed.

There is, however, no requirement that companies issue shares to the full extent of their authorised capital, nor indeed is there any requirement that the company require its shareholders to immediately pay the full value of the shares.

The proportion of the nominal value of the issued capital actually paid by the shareholder is called the paid up capital. It may be the full nominal value, in which case it fulfils the shareholder's responsibility to outsiders; or it can be a mere part payment, in which case the company has an outstanding claim against the shareholder. It is possible for a company to pass a resolution that it will not make a call on any unpaid capital. However even in this situation the unpaid element can be called upon if the company cannot pay its debts from existing assets in the event of its liquidation.

Applying this to Fin's case it can be seen that he has a maximum potential liability in relation to his shares in Gulp Ltd of 50 pence per share. The exact amount of his liability will depend on the extent of the company's debts but it may amount to £10,000.

(b) In relation to Heave Ltd Fin bought shares of a nominal value of £1. Although the company agreed to treat the shares as fully paid up Fin was only required to pay 50 pence for each share. This issue raises the rules preventing companies from issuing shares at a discount. And it is a long established rule that companies are not permitted to issue shares for a consideration that is less than the nominal value of the shares together with any premium due. The strictness of this rule may be seen in *Ooregum Gold Mining Co of India* v *Roper* (1892). In that case the shares in the company, although nominally £1, were trading at 12·5p. In an honest attempt to refinance the company, new £1 preference shares were issued and credited with 75p already paid (note the purchasers of the shares were actually paying twice the market value of the ordinary shares). When, however, the company subsequently went into insolvent liquidation the holders of the new shares were required to pay a further 75p.

The common law rule is now given statutory effect in s.100 Companies Act (CA) 1985 and is supported by s.99 which states that shares are only treated as paid up to the extent that the company has received money or money's worth. If a company does enter into a contract to issue shares at a discount it will not be able to enforce this against the proposed allottee. However, anyone who takes shares without paying the full value, plus any premium due, is liable to pay the amount of the discount as unpaid share capital, together with interest at five per cent (s.100(2)/CA 1985). Also any subsequent holder of such a share who was aware of the original underpayment will be liable to make good the shortfall (s.112 CA 1985). The reason for such rigour in relation to preventing the issue of shares at a discount is the protection of the company's creditors. Shareholders were seen to enjoy the benefit of limited liability but that privilege was only extended to them on the basis that they fully subscribed to the company's capital. That capital being seen as a creditor fund against which they could claim in the event of dispute.

Applying the foregoing to Fin's situation in relation to Heave Ltd it follows that he cannot avoid having to make a further payment on the shares to pay off the company's creditors. The extent of his payment will depend on the actual debts owed but cannot exceed the nominal value of the shares. Ignoring potential interest payments, his maximum liability in relation to the shares will be 50 pence per share, a total of £10,000.

(c) It is possible, and not at all uncommon, for a company to require prospective subscribers to pay more than that nominal value of the shares they subscribe for. This is especially the case when the market value of the existing shares are trading at above the nominal value. In such circumstances the shares are said to be issued at a premium, the premium being the value received over and above the nominal value of the shares. Section 130 of the Companies Act 1985 provides that any such premium received must be placed into a share premium account. The premium obtained is regarded as equivalent to capital and, as such, there are limitations on how the fund can be used. Section 130 provides that the share premium account can be used for the following purposes:

(i) to pay up bonus shares to be allotted as fully paid to members;

(ii) to write off preliminary expenses of the company;

(iii) to write off the expenses, commission or discount incurred in any issue of shares or debentures of the company;

(iv) to pay for the premium payable on redemption of debentures.

Applying the rules relating to capital maintenance it follows that what the share premium account cannot be used for is to pay dividends to the shareholders.

Once again applying the rules to Fin's situation it can be seen that he cannot get any of the premium paid for the shares in Irk plc back from the company in the form of cash.

(d) From the facts of the scenario it looks as if Fin has potential debts of £10,000 owed in relation to the share in both Gulp Ltd and Heave Ltd, making a total debt of £20,000. However as his shares in Ink plc are worth £20,000 he can sell them to realise the money to pay off his debts. Unfortunately he will be left with nothing from his legacy.

12 This question requires candidates to consider a number of aspects of the law relating to company directors:

(a) Directors' authority

Table A model articles of association provides that the directors of a company may exercise all the powers of the company. It is important to note that this power is given to the board as a whole and not to individual directors and consequently individual directors cannot bind the company without their being authorised in some way to do so. There are three ways in which the power of the board of directors may be extended to individual directors.

(i) The individual director may be given *express authority* to enter into a particular transaction on the company's behalf. To this end, Article 72 allows for the delegation of the board's powers to one or more directors. Where such express delegation has been made then the company is bound by any contract entered into by the person to whom the power was delegated.

(ii) A second type of authority that may empower an individual director to bind his company is *implied actual authority*. In this situation, the person's authority flows from their position. Article 84 provides for the board of directors to appoint a managing director and Article 72 also allows the board of directors to delegate to any managing director such powers as they consider desirable to be exercised by that person. Thus the board of directors may expressly confer any of their powers on the managing director as they see fit. The mere fact of appointment, however, will mean that the person so appointed will have the implied authority to bind the company in the same way as the board, whose delegate he or she is. Outsiders, therefore, can safely assume that a person appointed as managing director has all the powers usually exercised by a person acting as a managing director.

Implied actual authority to bind a company may also arise as a consequence of the appointment of an individual to a position other than that of managing director (*Hely-Hutchinson* v *Brayhead Ltd* (1968)).

(iii) The third way in which an individual director may possess the power to bind his company is through the operation of ostensible authority, which is alternatively described as apparent authority or agency by estoppel. This arises where an individual director has neither express nor implied authority. Nonetheless, the director is held out by the other members of the board of directors as having the authority to bind the company. If a third party acts on such a representation, then the company will be estopped from denying its truth (*Freeman and Lockyer* v *Buckhurst Park Properties (Mangal) Ltd* (1964)).

As regards Kells Ltd, it would appear that Len has ostensible authority to enter into contracts on the company's behalf due to the acquiescence of the other directors in his actions. Consequently the company would be bound by any usual business contracts entered into on its behalf by Len.

(b) Directors' duty of care and skill

Common law did not place any great burden on directors in this regard. Damages could be recovered against directors for losses caused by their negligence but the level of such negligence was high (*Lagunas Nitrate Co* v *Lagunas Syndicate* (1989)).

In *Re City Equitable Fire Assurance Co* (1925), it was held that:

(i) In determining the degree of skill to be expected, the common law applied a subjective test and established no minimum standard. A director was expected to show the degree of skill which might reasonably be expected of a person of their knowledge and experience.

(ii) The duties of directors were held to be of an intermittent nature and, consequently, directors were not required to give continuous attention to the affairs of their company.

(iii) In the absence of any grounds for suspicion, directors were entitled to leave the day to day operation of the company's business in the hands of managers and to trust them to perform their tasks honestly.

The laxity of the situation at common law has been much tightened by statute, particularly by the development of the offence of wrongful trading, which was introduced by s.214 of the Insolvency Act (IA) 1986. Section 214 applies where a company is being wound up and it appears that, at some time before the start of the winding up, a director knew, or ought to have known, that there was no reasonable chance of the company avoiding insolvent liquidation. In such circumstances, then, unless the directors took every reasonable step to minimise the potential loss to the company's creditors, they may be liable to contribute such money to the assets of the company as the court thinks proper. In deciding what directors ought to have known, the court will apply an objective test, as well as a subjective one. As in common law, if the director is particularly well qualified, they will be expected to perform in line with those standards. Additionally, however, s.214 of the IA 1986 establishes a minimum standard by applying an objective test which requires directors to have the general knowledge, skill and experience which may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company (*Re Produce Marketing Consortium Ltd* (1989)).

Applying the above to the situation of the directors in Kells Ltd it would appear that they would be in breach of their common law duty of care to the company as they apparently do not even attend board meetings. The company could consequently take action against them for any losses as a consequence of their breach of duty. In addition they also face the prospect of personal liability for company debts under s.214 of the Insolvency Act 1986.

(c) Directors' fiduciary duties

As well as having the potential to act as its agent, directors are also described as being in a fiduciary relationship with their company. This means that they are in a similar position to trustees. The importance of this lies in the nature of the duties that it imposes on directors. These duties are as follows:

(i) *to act bona fide in the interests of the company*

This places directors under the duty to act in such a way as they genuinely believe to be in the best interests of their company. However, the test is not purely subjective and, if an act or decision is one which no reasonable director could properly have come to, the court will intervene.

(ii) *the duty not to act for a collateral purpose*

A particular aspect of the general requirement is that directors must use their powers for the purpose for which those powers were given to them and not for any ulterior or improper purpose (*Howard Smith* v *Ampol Petroleum* (1974)).

(iii) *not to permit a conflict of interest to arise*

This rule is strictly enforced by the courts in the United Kingdom and it can be clearly stated that directors are forbidden from entering into any arrangement which will involve, even the possibility of, a conflict between their personal interests and the interests of their company. The simplest statement of the rule is that directors must not personally profit from their position without full disclosure and the prior approval of the company (*Regal (Hastings)* v *Gulliver* (1942)). It is possible, however, for the company to approve the fact of the directors making a profit as long as the transaction in question has been declared and specifically approved (*Adams* v *R* (1995)).

Once again applying the law to the problem scenario. If it can be proved that Len is accepting bribes then he is in clear breach of his fiduciary duties to act in the best interest of the company and not to permit a conflict of interest to arise. Consequently he would be held liable to account to Kells Ltd for any bribe he accepted together with any loss the company might have suffered on any contracts he entered into as a result.

(d) Len can be removed from the Board of Directors under s.303 of the Companies Act 1985, by the passage of an ordinary resolution at a general meeting of the company. The company must be given 28 days notice of the proposal and Len would be entitled to attend the meeting and defend himself.

1 This question requires candidates to explain the importance of the hierarchical structure of the English court system for the operation of the doctrine of precedent. It is essential that both aspects of the question be dealt with.

6 – 10 A good to full explanation of the doctrine of precedent together with a description of the position and relationship of the various courts within the hierarchy will result in full marks. The more full the explanation and the more detailed the description, the higher will be the marks awarded.

0 – 5 Unbalanced answer, perhaps lacking in detail in relation to the court structure or the operation of precedent. A mere diagram of the court structure will gain no more than 2 marks at most.

2 This question is a very straightforward question with little room for ambiguity.

6 – 10 A thorough, to complete answer detailing what is meant by the two terms and distinguishing them clearly. It is most likely that case examples will be provided.

0 – 5 A limited understanding, or a lack of clarity as to the distinction between the two concepts.

3 This question is divided into two parts, each worth 5 marks each. Each part should be marked independently on its own merits although candidates may well run the two parts together.

6 – 10 The best answers will provide a clear explanation of the test for deciding remoteness of damage and the various rules relating to fixing the amount of damages to be paid and reference will be made to cases.

0 – 5 Weaker answers may show little understanding of the rules. Alternatively they may be unbalanced or deal only with one aspect of the question.

4 This question requires candidates to explain the main features of the law relating to dismissal from employment on the basis of redundancy, paying particular regard to the way in which redundancy payments are calculated.

6 – 10 Candidates must not only show an understanding of what is meant by redundancy and the legal procedures controlling its operation, but must also be able to describe the way in which any payments are calculated. General principles relating to calculation is more important than the up-to-date numbers.

0 –5 This level of answer will be unbalanced, or may not deal with all of the required aspects of the topic. Alternatively the answer will demonstrate very little understanding of what is actually meant by redundancy.

5 This question requires candidates to explain what is meant by winding up generally before going on to consider the two specific forms of winding up.

(a) 3 marks are available for explaining what is meant by winding up generally and will be awarded pro rata with regard to clarity of understanding.

(b) 5 – 7 Clear explanation of both members' and creditors' voluntary liquidation. The two types must be mentioned to get all 4 marks.

2 – 4 Lacking in knowledge or clarity or unbalanced.

0 – 1 Little if any knowledge.

6 6 – 10 Thorough treatment of both the content and effect of articles of association. Answers towards the top end will provide cases to exemplify the operation of the articles and will be rewarded accordingly.

0 – 5 Weak understanding of the articles generally. Perhaps unbalanced in that there is knowledge of some apexes but little in other important areas.

7 This question is divided into three distinct parts carrying 3, 3 and 4 marks respectively.

6 – 10 The best candidates will show a full understanding of the nature of loan capital in company law and will be able to explain in clear terms the meaning of each of the three terms.

0 – 5 Weak candidates will either only be able to explain one of the categories or will not be able to explain any of them in a satisfactory manner. There might even be confusion between the various types.

8 This question requires candidates to consider the circumstances under which private companies are permitted to purchase their own shares and in particular it requires an explanation of the rules under which such companies can make use of their capital to finance such purchases. 6 marks are allocated for an explanation of the general rules and 2 each are allocated for specific explanations of the capital redemption reserve and the permissible capital payment.

6 – 10 The better candidates will be able to consider the general rules and explain the meaning and effect of both of the other specific terms.

0 – 5 Weaker candidates may not be aware of all of the rules or the specific terms, or alternatively may be aware of the terms but unable to explain the general rules.

9 This question is divided into two quite distinct parts each, the first of which carries 8 marks and the second 12 marks.
In relation to part **(a)**:

6 – 8 The best candidates will consider the rules governing the incorporation of exclusion clauses into contracts and analyse the problem scenario in order to decide whether the particular exclusion clause has formed a part of Amy's contract.

3 – 5 Weaker candidates may know the rules relating to incorporation, or at least some of them, but may not analyse the fact situation presented.

0 – 2 The poorest candidates will recognise what the problem entails but will not demonstrate any real knowledge of the rules relating to the question.

As for part **(b)**:

8 – 12 The best candidates should provide a clear understanding of the legal control of exclusion clauses. Some detailed reference should be made to the provisions of the Unfair Contract Terms Act 1977 and the very best answers will at least mention the Unfair Terms in Consumer Contracts Regulations 1999. Cases or examples should be used to demonstrate points made.

4 – 7 Weaker candidates may show little detailed knowledge of the legislation but be able to consider the UCTA generally.

0 – 3 The poorest candidates will provide nothing but the scantiest reference to the legislation.

10 This question is divided into two quite distinct parts each, the first of which carries 8 marks and the second 12 marks.

In relation to part **(a)**:

6 – 8 The best candidates will clearly explain the meaning of and distinction between the two types of property.

3 – 5 Weaker candidates may have an idea of the distinction but not explain the distinction clearly.

0 – 2 The poorest candidates will have little understanding of the meaning of, let alone the distinction between, the two types.

As for part **(b)**:

8 – 12 The best candidates should provide a clear understanding of the legal rules and apply them accurately to the facts of the situation.

4 – 7 Weaker candidates may show some detailed knowledge of the legislation but be unable to apply it accurately.

0 – 3 The poorest candidates will provide nothing but the scantiest reference to the legislation and fail to apply it to the problem scenario.

11 This question requires candidates to consider various issues relating to the issuing of shares by companies, the requirement for those shares to be paid for by shareholders and shareholders' potential liabilities for the debts of their companies. It is divided into four parts with each part being awarded 5 marks.

16 – 20 Full and thorough treatment of all four parts.

11 – 15 Full treatment of some but not all parts or some knowledge and application to all parts. Perhaps lacking balance.

6 – 10 Lacking in detail in some or all parts.

0 – 5 Little knowledge of any of the parts or perhaps some knowledge of only one or two parts.

12 This question requires candidates to consider various issues relating to the position of company directors. It is divided into four parts with part **(a)** **(b)** and **(c)** being allocated 6 marks with part **(d)** carrying 2 marks.

16 – 20 Full and thorough treatment of all four parts with the appropriate application of the law being provided.

11 – 15 Full treatment of some but not all parts or some knowledge and application to all parts. Perhaps lacking balance.

6 – 10 Lacking in detail in some or all parts.

0 – 5 Little knowledge of any of the parts or perhaps some knowledge of only one or two parts.