

UNIVERSITY COLLEGE LONDON

University of London

EXAMINATION FOR INTERNAL STUDENTS

For The Following Qualification:–

LL.B.

LL.B. Part II: Company Law

COURSE CODE : LAWSII06

DATE : 10-MAY-05

TIME : 10.00

TIME ALLOWED : 3 Hours 15 Minutes

COMPANY LAW

Answer **FOUR** questions including at least one question from **PART A**, and at least two questions from **PART B**.

PART A

1. "At times, the *Salomon* principle produces what appear to be unjust and purely technical results and in such circumstances, judges come under a moral and/or intellectual pressure to sidestep the *Salomon* principle and produce a result which seems more 'just' in the circumstances."

Discuss.

2. "Pending legislative reform, an analysis of English law relating to financial assistance has to be prefaced with a warning to the effect that certain key points are bounded by uncertainty."

Discuss.

3. "The time has now been reached when the Government should at last take the lead and legislate in order to construct a corporate governance regime based upon transparency and accountability."

Discuss.

TURN OVER

PART B

4. For some ten years Nadia and Choate have been operating a successful wholesaling partnership, specialising in high quality Italian clothing. Wishing to expand the business they invite Leila, a woman of substantial means but no business experience, to invest £50,000 in their venture. A new company, Chic Ltd, is formed, with the issued shares taken in three parts by Nadia, Choate and Leila. The understanding between the parties is that Chic Ltd will take over and expand the wholesaling business; that Nadia and Choate will work full-time in the business; that all three will be members of the board of directors and that the company's profits will be distributed in three equal shares as directors' remuneration. They also decided that Nadia will handle the financial affairs of Chic Ltd, although this side of the business is new to her, Choate having performed these tasks when the business operated as a partnership.

Chic Ltd is run in accordance with this understanding for three years. The company is profitable, but not on the scale anticipated by Nadia and Choate. They decide, without consulting Leila, that Chic Ltd should acquire a number of shops to sell their clothes. The scheme involves a large capital expenditure financed by a bank loan negotiated by Nadia at a rate of interest far in excess of that normally charged by banks to small businesses like Chic Ltd. Leila is informed that for the next two years, Chic Ltd, because of the debt-servicing burden the expansion scheme involves, will only be able to pay a fixed salary to Nadia and Choate in return for their full-time services and that Leila must forego profit in favour of the capital growth of her investment. Leila asks to be bought out. Nadia and Choate refuse, informing her that all company resources are needed for the expansion. Leila consults the company auditors who, on the basis of the latest statutory audit, assure Leila that the company is in good financial health and the predicted capital growth of her investment is almost certain to occur. Three years later, Leila is still not receiving any profit on her investment and the predicted capital growth has failed to materialise.

Advise Leila.

CONTINUED

5. The objects clause of Veridoze Ltd provides that:

- “(i) The objects of the company are to manufacture bedroom furniture.
- (ii) The company shall have power to carry out any act which is ancillary or conducive to the above objects.”

The articles of association provide, *inter alia*, that:

“At no time shall the board of directors allow the borrowings of the company to amount to more than £25,000.”

The company was founded in 2002 with an issued share capital of 1,000 £1 shares. It has carried on a profitable business of manufacturing premium quality bedroom furniture for the Do-It-Yourself market. In November 2004, Arthur, the managing director of the company, decided that it needed to diversify into the manufacture of kitchen appliances and fittings. In order to obtain the necessary capital to fund this diversification, he arranged an appointment with Robin, the manager of the X Bank plc. Arthur gave Robin copies of the company's memorandum and articles. He also tells Robin that he is acting under a power of attorney in the form of a deed, which he shows to Robin, executed under the seal of Veridoze Ltd and bearing the signatures of two directors. The impression of the seal is genuine but the signatures are forgeries. At the meeting, Robin promised that the bank would lend the company £100,000. The loan was evidenced by a debenture that was signed on Veridoze Ltd's behalf by Arthur. At no time did Robin enquire as to why the loan was needed. The bank lent the money and the company spent it on buying new plant and machinery needed for the kitchen venture, which was unsuccessful.

Veridoze Ltd has now been put into insolvent liquidation.

Advise the liquidator.

TURN OVER

6. Egon is the managing director of Acumen plc, a computer software company, which has two wholly owned subsidiaries, Gamma Ltd and Delta Ltd. In recent years the company has enjoyed record levels of profitability. The board of directors, recognising that the company's success is due to Egon's entrepreneurial skills, have been content to leave him to take day-to-day management decisions. The articles of association of Acumen plc provide:

"90. Remuneration of directors. The board shall fix the annual remuneration of the directors provided that without the consent of the company in general meeting such remuneration shall not exceed the sum of £150,000 per annum.

91. The board may, in addition to the remuneration authorised in article 90, grant special remuneration to any director who serves on any committee of the company..."

In the past twelve months, the following events have occurred:

- i) Egon is paid £1 million consultation fee for successfully guiding Acumen plc through its takeover of Startrite Ltd, a competing business. This payment was agreed by a special committee of the Acumen plc board constituted to advise the main board on mergers and acquisitions.
- ii) Egon forms a private company, Wiz Ltd., which manufactures components for use in computers. Egon places large orders with Wiz Ltd. without informing Acumen plc of his interest in Wiz Ltd. He also purchases property through Wiz Ltd which is adjacent to Acumen plc's manufacturing site. Six months prior to this taking place, the board of Acumen plc had resolved to expand its operations as soon as neighbouring land became available.
- iii) Egon arranges for company funds to be transferred to Gamma Ltd to enable it to pay a creditor who had been pressing for payment.

Acumen plc has recently been taken over by Xtel plc. The details of the events outlined above have now come to the notice of the board of Xtel. They wish to pursue any claims they may have against Egon.

Advise the board of Xtel plc.

CONTINUED

7. The share capital of XYZ Ltd. ('the company') consists of £500,000 divided into 400,000 £1 ordinary shares and 100,000 £1 preference shares. The preference shares carry rights to an annual 6% cumulative dividend. They also have the right to priority in the repayment of capital and limited participation rights out of any surplus on a winding up. The directors of the company felt that the preference shares represented a substantial obstacle to the future prosperity of the company and tried to negotiate terms for the repayment of capital to the preference shareholders and their elimination from the company, but it was clear that an overwhelming number of preference shareholders would reject this. The directors now seek advice on whether either of the following proposals might work:

Proposal A:

They would issue a further 300,000 shares with identical rights to the existing preference shares, and allot these to members sympathetic to their aims. They would call a class meeting of preference shareholders which would then vote in favour of the directors' proposal for repayment.

Proposal B:

They would cause the company to pass a special resolution reducing the company's capital in accordance with a proposal in terms of which the preference shareholders are to be repaid the full nominal value of their shares and are to be eliminated as shareholders.

Advise the directors.

TURN OVER

8. Euston Airways Ltd ("Euston") recently went into liquidation with a substantial deficiency of assets against total liabilities. The company operated "budget" airline services by means of a small fleet of somewhat elderly aircraft, and had been unprofitable for the previous three years. When the Bloomsbury Bank refused to grant a further extension of the company's overdraft facility, the directors had no option but to cease trading immediately. Linda (an insolvency practitioner) has been appointed liquidator of Euston. She has made the following discoveries:

- (a) Euston's tangible assets are expected to realize £350,000, of which £300,000 represents the amount likely to be realized through sale of the company's two airworthy planes. Intangible assets, in the form of uncollected book debts, are valued at a further £200,000. The aggregate liabilities of the company total £1.7 million, and include £50,000 owed to the company's employees in respect of unpaid salary; £200,000 owed to the Inland Revenue in respect of PAYE deductions; £300,000 owed to Customs and Excise in respect of VAT and Air Passenger Duty; £750,000 owed to the Bloomsbury Bank; and a further £400,000 owed to all other creditors. The expenses of the liquidation are expected to total £100,000.
- (b) The overdraft facility on the company's current account with Bloomsbury Bank had been progressively extended over the years since the company's formation in 1998. Although this was originally unsecured, the Bank insisted on taking security as a condition of meeting the directors' request in Autumn 2001 for a doubling of the facility to £750,000, as the company sought a "lifeline" to sustain it through the general collapse in airline business following "9/11". The security granted to the Bank consisted of a fixed charge over the aircraft, and a further fixed charge over Euston's current and future book debts, combined with a floating charge over all other assets of the company. Euston was further required to pay all proceeds of collection of its book debts into the current account with Bloomsbury Bank immediately on receipt of payment, and to submit quarterly, audited accounts to the Bank. The Bank's charges were duly registered.

Linda seeks your advice concerning the impact of recent developments in the law of corporate insolvency. Explain how the assets are required to be distributed according to the current state of the law. (Note: you are not required to attempt to calculate the rates of dividend that might eventually be paid to creditors. It will suffice to indicate the general effect of the operation of the legal rules which you describe in your advice.)

How, if at all, would your advice to Linda differ if, with all other facts as stated above, the company had gone into liquidation in May 2003?

Advise Linda.

END OF PAPER