

ENGLISH CORPORATE LAW

JUNE 2010 EXAMINATION

PART ONE: CONTENTS

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- Unit Two: Classification of Companies
- Unit Three: The Formation of a Company
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QUESTIONS FOR SUBMISSION

CD:

GRIER: 1998 – 2002 Examinations, examiner's reports & examiner's guidance

SHEPHERD: 2002 – November 2009 Examinations and examiner's reports

Additional sources:

TEXTBOOKS:

Ann Ridley: Key Facts: Company Law at your fingertips.

Chris Shepherd: Key Cases: Company Law at your fingertips

SUPPLEMENT:

FORM IN01

MODEL ARTICLES for a PRIVATE COMPANY limited by shares

MODEL ARTICLES for a PUBLIC COMPANY

INTRODUCTION

Welcome to the first part of your distance learning course. I do hope you enjoy your study of one of the law's great creations- the limited liability company.

You have chosen an interesting time to learn company law. Last year the Companies Act 1985 was finally completely replaced by the largest single piece of legislation in English legal history – the Companies Act 2006. It had been introduced in instalments.

We will refer to the past law when it is important to an understanding of current company law.

Addition to ICSA syllabus: the ICSA examiner has decided to add subjects to the syllabus for this exam in the latest ICSA newswire:

“Candidates are now required to have outline knowledge of the **law of meetings**, concentrating on the different types of meetings and the various resolutions that can be passed at them.

Candidates are also required to have an understanding of the **content of a company prospectus when a company makes an offer of shares to the public**. In addition, candidates should be able to identify the remedies available to an investor as a result of a misleading prospectus.”

From the **June 2008** exam the examiner was unhappy with the ICSA text and added a five page “**Auditors**” supplement.

For the **November 2008 exam and onwards**, he was not happy with Chapter 17 on **Insolvency** of the ICSA text and requires students to read the **Insolvency chapter in another textbook** by Mayson, French and Ryan.

Please do not worry about any of these changes – they are all covered in this course.

The ICSA textbook: The ICSA text you received from ICSA is **Corporate Law 7th edition by Dine and Koutsias (which is actually from the Palgrave Macmillan masters series)**. We will include references to this book. **(Good luck with the size of the font.....)**

Our accompanying texts: We include two books from the “Facts at Your Fingertips” series. The “Key Cases” is by your chief examiner, Chris Shepherd who lectures at Southbank University. Again we will include references to these books.

THE EXAMINERS

The examiner from 1998 to 2002 was **Nicholas Grier**. His latest textbook, “*Company Law*” *Third edition* is still worth reading although its primary audience is students studying Scottish Company Law. I include references to it in this course. Grier’s examination questions were demanding and of a high standard. They are on the CD that accompanies our course. We will not refer to them in the booklets but they can always be accessed for further practice.

THE EXAMINATION FORMAT

Your examination is three hours long. It is a closed book exam. It is divided into a compulsory Section A consisting of ten short answer questions worth 4 marks each making a total of 40 marks. Section B requires three questions from a choice of five worth 20 marks each making a maximum of 60 marks. Pass mark is 50.

All the past examination papers for the last two examiners, plus their comments are on the accompanying CD. Do look at them and read them, especially the contemporary examiner as they are a good guide to what the examiner requires.

HOW WE ARE GOING TO APPROACH THE SUBJECT

Our objective is to get you prepared for the next exam. We want you to be able to sit the examination and pass it. We will use a mixture of reading and learning from these little study texts, the writing and marking of a regular supply of past examination questions and conversations over the phone or internet.

Please read through this booklet completely to get an idea of what the subject is and then go through each unit trying to memorise the ideas and sources of law. When you are ready attempt the first question at the back of the booklet and send to me for marking. I will mark and return with a marking code or guide as to what I think is required. Often I will set past examination questions and you should look these up in the CD and then write your answer. It does not appear to affect your result in the exam if you base your answer on the model answer (although a straight cut and paste will do little to help). Just remember to keep its length to something you could produce under exam conditions.

Good Luck and remember I am on the end of the phone if you get stuck - Alan

A.G.G.CAMPBELL: DISTANCE LEARNING

UNIT ONE: GENERAL CHARACTERISTICS OF COMPANIES

TYPES OF BUSINESS ORGANISATION

In law there are three basic types of business organisation:

- a) Sole trader
- b) Partnership
- c) Limited Company

It is possible to recognise the different types from the names used:

- a) 'Joe Brown'; 'JB Co'; sole trader.
- b) 'Joe Brown & Partners'; 'Joe Brown & Co'; partnership
- c) 'Joe Brown Ltd.'; 'Joe Brown & Co. Ltd'; 'AB plc': limited companies.

The principal difference between the three organisations is that a **LIMITED COMPANY IS AN INDEPENDENT LEGAL PERSONALITY.**

a. THE SOLE TRADER

This is the simplest form of business organisation and normally consists of one person working alone making articles for sale or selling a personal service.

The sole trader must be distinguished from the employee. The sole trader is an independent contractor working under a contract for services instead of the contract of service used by employees. The sole trader is his own boss accountable only to his creditors.

The sole trader is not an independent legal personality. This means that his business is not distinct from his private affairs. If he is unable to pay his business debts his creditors can take his personal property to settle the amounts outstanding.

If the sole trader has insufficient assets to pay his business and personal debts he can be declared insolvent by the court and becomes a bankrupt. The result is that the sole trader loses all his property except the tools of his trade, if any, and sufficient bedding, clothing and furniture as to satisfy the basic needs of his family.

b. THE PARTNERSHIP

It is rare for a sole trader to be able to expand his business to any size without help. It is often advantageous to form a partnership.

One person brings their skill and judgement to the business whilst the other has the capital funds necessary for expansion.

Partnerships are governed by the Partnership Act 1890, which defines a partnership as: 'The relation which subsists between persons carrying on a business in common with a view of profit'.

Partnerships can be formed by express agreement when a document called the Articles of Partnership is drawn up and signed.

A partnership can also be formed by implication if the court finds that groups of people in business satisfy the definition in the Partnership Act.

The partnership is called the firm and all partners are agents of the firm. All partners are liable for the firm's debts and, unless they agree differently, all partners are entitled to an equal share of the profits.

There are advantages in forming a partnership:

- i. Pooling of skill and experience,
- ii. Sharing of risks,
- iii. The conduct of the partnership is secret unlike a public company,
- iv. No formalities are required to create a partnership.

However a partnership is not an independent legal personality and each partner's personal property can be taken to satisfy the debts of the firm.

c. THE LIMITED COMPANY

What happens if the number of partners in a firm becomes too large for effective management? They would form joint-stock companies. Members would not have the power of partners but still had unlimited liability. These were risky affairs.

This was the case in the eighteenth and early nineteenth centuries. (For a mixture of business, bankruptcy and sex in the seventeenth century read Daniel Defoe's 'Roxana' or 'Moll Flanders').

From the middle of the last century it has been possible for investors to limit their liability for the company's debts to the value of their investment.

In short, their personal property cannot be taken to pay off the company's creditors. The investor will only lose that money which he has put into the company. In order to create this limited liability, Acts of Parliament had to be passed. This concept was not popular with creditors and was tested in the courts in the leading case of *Salomon v Salomon & Co Ltd* [1897].

SALOMON v SALOMON & CO.LTD. [1897]

Salomon ran a small business as a leather merchant. It was a sole trader operation. Salomon then formed a limited company in which he himself took up 20,001 shares and his wife and children one share each making 20,007 in all. Salomon then sold his business to the company for £39,000. Payment was not in cash but by shares and a special form of loan called a debenture. Salomon became managing director. The company continued in business and raised further loans. Then the company failed and went into liquidation. It owed £7,000. There was insufficient to pay all the creditors. One of those creditors was Salomon because of his debenture. The special feature of a debenture is that it must be paid back before unsecured, usually trade, creditors. At the same time as the company went into liquidation Salomon's personal affairs were not much better - he had gone bankrupt. So there were two sets of creditors: those of the firm and those of Salomon personally.

The business was sold and there was a dispute as to who would take the proceeds: was it to be the company's creditors but not Salomon or was it to be Salomon's personal creditors and not the company's unsecured creditors?

The House of Lords held that the limited company is a distinct separate legal personality distinct from those who own, work and manage it. This applied even though the company was still in reality one man. The debenture was to be paid first.

Salomon v Salomon ironically established something else, the second important feature of the limited company: the reason limited liability can operate is that the company is an independent legal personality.

However there is a price to be paid for limited liability and independent legal personality. It is:

- a. Government Regulation
- b. Publicity

Unlike partnerships and sole traders companies must be registered.

There are a vast number of statutory regulations starting with the actual name used, ranging through the requirement to hold meetings and ending with the methods by which a company can be closed down. e.g. Private companies are required to end their name with the word "Limited" (Ltd) and public companies with the words "Public Limited Company" (plc).

However there is little doubt that the creation of the independent legal personality in the company, especially the company's ability to own shares in other companies is one of the determining features of twentieth century life: it has given rise to the phenomenon of the multinational corporation!

EIGHT DIFFERENCES BETWEEN A LIMITED COMPANY AND A PARTNERSHIP:

1. Members of a company have limited liability; Partners are liable for all partnership debts.
2. Company exists separately in law; Partnership is not recognised as separate from the partners.
3. Companies are formed by registration; Partnerships are formed by agreement.
4. Certain company documents are open to public inspection; Partnerships are private.
5. No member of a company has power to contract on company's behalf unless appointed; All partners have implied authority as agents.
6. The Company's powers are determined in its constitution (i.e. memorandum of association); Partnership can do anything the members wish.
7. The company is managed by an elected board of directors; All partners are entitled to take part in management.
8. The company is dissolved when the registrar of Companies cancels its registration; A partnership is dissolved by agreement or the court.

THE GENERAL CHARACTERISTICS OF A COMPANY

There are essentially two:

- **Independent legal personality**
- **Limited liability**

From these two other characteristics arise:

- a. The owners of the company are only liable for the amounts unpaid on their shares;
- b. Ownership can be transferred by the transfer of shares;
- c. Death of an owner does not directly affect the company – it has **perpetual succession**;
- d. Ownership of the company's assets lies with the company itself and not the shareholders;
- e. Management of the company is by directors who are responsible to the company and not to the shareholders;
- f. The relationship between directors and company and between shareholders and company is to be in writing with established procedures for alteration.

- b. **Lord Denning & Group enterprise: DHN Food Distributors v London Borough of Tower Hamlets (1976).** Three companies with the same directors and shareholders were to be treated as one so that compensation for disturbance of business in one company was paid when the land owned by another company was compulsorily purchased.
- c. **Current position:** **Ord v Belhaven Pubs (1998);** Involved dispute over lease of a pub. Belhaven Pubs Ltd had no funds so action for its holding company to be substituted. Failed. Separate legal entity
- The two CAPE cases:**
Adams v Cape Industries (1990);
Lubbe v Cape Industries (2001).
In both the Cape cases the injury was to employees of a subsidiary. Cape was the holding company for subsidiaries dealing in asbestos. In Adams the subsidiary was in the US and the plaintiffs sought to pursue the case in London – the veil was not lifted. In Lubbe the subsidiary was in South Africa and the veil was lifted for the plaintiffs to sue in London because South Africa was a developing country. Cape settled out of court for £21 million.
- d. **The use of commercial tort:** **Williams v Natural Life Health Foods.** (Managing director was also majority shareholder. Sold franchises. Details in brochure wrong and franchisee lost money. Sued NLHF which went bust. Continued against managing director. House of Lords held director only liable if personal reliance.
4. “Perhaps the most disturbing use of limited liability occurs within group structures. In group structures limited liability’s facilitation of asset partitioning allows a very effective double limitation for parent companies and their members. Investors in a parent company can achieve limitation of liability not only for themselves but also for the parent company by structuring its business through a number of subsidiaries...

The word LTD or PLC after a parent company name now effectively means the company itself has achieved limited liability. ...**this represents an enormous extension of the Salomon principle.” Dignam & Lowry**

READING:

DINE & KOUTSIAS: Chapter 1, 2 & 3

RIDLEY: Chapter 1, 2 & 3

SHEPHERD: Chapter 1 & 2

GRIER: Chapter 1 & 2

PAST QUESTION ANALYSIS:

Lifting the veil was the discussion topic in June 2004 (3) and again in June 2005(2).

Two Section B questions in November 2006!! The first, question 2, required us to illustrate the statutory and common law requirements of “companies and their directors” to disclose information. This must be all the public documents available for inspection at Companies House together with shareholder and creditor rights to inspect. The second, question 5, after a sub-question on the

definition of a subsidiary turns on lifting the veil of subsidiary in favour of the parent company and is based on *Adams v Cape* [1998].

In June 2007(1)(a) we wondered what he wanted for an explanation of "limited liability".

In November 2007(1)(c) we needed to write about phoenix companies – s.216 Insolvency Act 1986

June 2008(6)(a) was a problem question on employees of a subsidiary suffering injuries and whether they could sue the holding company for damages. 6(b) was whether they could sue the directors of the holding company. This was lifting the veil - have a look at page 28 in Shepherd's book.

Nothing more clear in June 2009(1)(a) – what is meant by the term "veil of incorporation" ... only four marks.