CIMA REVISION CARDS

Business Law

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- Professional negligence

The civil and criminal law

- The criminal law regulates behaviour by punishing offenders.
- The state prosecutes the accused.
- If found guilty, the accused may be punished; for example, by fine or imprisonment.
- The civil law regulates behaviour by providing a facility through which a claimant may obtain a remedy.
- The claimant sues the defendant.
- If found liable, the court may order the defendant to compensate the claimant.
- A single event can give rise to criminal and civil liability.

Note

All criminal cases start in the Magistrates Court.

To be guilty, it must be proved **beyond reasonable doubt** that the accused committed the offence.

In a civil case, the liability of the defendant must be proved on the **balance of probability**.

The sources of English law

1. Custom/common law

- Important historical source.
- A new custom can arise today.
- After the conquest in 1066 the Normans ruled by applying local customs.
- Some local customs were recognised by the courts and applied throughout the whole country.
- Those customs were common to all the people and thus became the common law.

Note

The sources of English law are:

1. Custom/common law.
2. Equity.
3. Legislation.
4. European law.
5. Other sources.

The sources of English law

2. Equity

- Equity developed by the Court of Chancery to supplement the common law.
- The rules of equity were developed by clerics, not lawyers.
- Equity filled in gaps in the common law; for example, by developing alternative remedies such as injunctions and specific performance.
- All courts can apply common law and equitable remedies.
- In the event of a conflict between equity and the common law, equity prevails.

Remember!

Equity has developed rules or 'maxims' such as:

'He who comes to equity must come with clean hands.' This means, if you are asking for an equitable remedy you must show that you have acted equitably yourself.

'Delay defeats equity.'

'Equity will not assist a volunteer.'

This is very important

The sources of English law

3. Legislation

- An Act of Parliament is the supreme source of law, except where it conflicts with European law.
- An Act starts as a Bill and becomes an Act once approved by the House of Commons and the House of Lords and signed by the Monarch.
- The government cannot make law without the authority of the parliament.
- The parliament often delegates law-making authority to government departments and others. Examples of delegated legislation are statutory instruments and by-laws.

Note

When interpreting statutes the courts use canons (or rules) of construction, such as:

The literal rule

The golden rule

The mischief rule

The purposive rule

The sources of English law

4. European law

- Treaties are the primary source of European law and are automatically binding on member states.
- The main legislature of the EU is the Council of Ministers.
- Regulations are binding without the need for further legislation by member states.
- Directives require member states to make changes to domestic law.
- Decisions may be addressed to individuals, companies or member states and are binding on those to whom they are addressed.
- Recommendations have no formal legal effect but considerable persuasive force.

European law became binding on UK citizens following the enactment of the European Communities Act 1972.

Member states may refer matters concerning European law to the European Court of Justice for a preliminary ruling as to how the law should be applied.

This ensures that European law is applied the same throughout all the member states.

The sources of English law

5. Other sources

- If there are no English or European laws applicable to the matter before the court, other sources may be referred to as accurately reflecting the English law.
- Other sources include the laws of other common law jurisdictions, such as Commonwealth countries; and
- The work of renowned textbook writers.

Note

'Other sources' are not binding on English courts, but are said to be 'persuasive'.

Judicial precedent

1. The hierarchy of civil courts

- Most cases start in the County Court.
- If large sums of money are involved, the case may start in the High Court.
- Appeal lies from the County to the High Court, then to the Court of Appeal and finally to the House of Lords – if the matter involves a point of law of general public importance.
- If the case involves European law, courts below the House of Lords ***may*** and the House of Lords ***must***, refer the matter to the European Court of Justice for a preliminary ruling.

Definition

Judicial precedent is a system whereby the decisions of the higher courts are binding on lower courts dealing with cases involving similar material facts.

2. The hierarchy of criminal courts

- All criminal cases start in the Magistrates Court.
- Major crimes, such as rape and murder, are heard in the Crown Court before a judge and jury.
- Appeals by way of 'case stated' go from the Magistrates Court to the Divisional Court of the Queens Bench Division.
- Appeal lies from the Crown Court to the Court of Appeal; and the House of Lords hears appeals from the Court of Appeal and the Divisional Court of the QBD.

See the summary on the next page

Judicial precedent

3. Summary of the main rules

- The decisions of the House of Lords are binding on all lower courts, but the House is not bound by its own previous decisions.
- The Court of Appeal is bound by its own previous decisions and by those of the House of Lords.
- The High Court is bound by the decisions of the House of Lords and the Court of Appeal, but not by its own previous decisions.
- The County Court is bound by the decisions of all other courts, but not its own previous decisions.

Remember!

Only the ***ratio decidendi*** of the case forms a binding precedent and not ***obiter dicta.***

Definition – *Ratio decidendi*

The ***ratio decidendi*** is the rule of law decided by the court.

Definition – *Obiter dicta*

Obiter dicta are statements of law made 'by the way', i.e., not based on the material facts. Such statements are 'persuasive', not binding.

The tort of negligence

The three elements of the tort

1. The claimant must prove that the defendant owed him/her a ***duty of care***.
2. The defendant must have acted in ***breach of the duty of care***.
3. ***Loss or injury*** must have been caused by the breach.

Remember these three elements!

The tort of negligence

1. The duty of care

1. A duty of care is established if it can be shown that it was ***reasonably foreseeable*** that the defendant's actions would be likely to affect the claimant.
2. This is the so-called 'neighbour principle', established in the case of Donoghue v Stevenson (1932).
3. This applies in the case of physical harm and damage to property. For professional negligence, see later.

Note

The tort of negligence is only actionable if loss or injury has resulted from the breach of the duty of care.

The tort of negligence

2. Breach of duty

- To prove that the defendant acted in breach of the duty of care it must be shown that he/she ***failed to take reasonable care.***
- This is an ***objective*** test, as the defendant is judged by the standards of a reasonable person.
- If the thing that caused the injury was under the control of the defendant, the claimant may plead ***res ipsa loquitur*** (the facts speak for themselves). This places the burden of proof on the defendant, who must prove that he was not negligent to escape liability.

Remember!

The greater the risk of harm the greater the standard of care expected of the defendant.

3. Damage caused by the breach

- The claimant cannot succeed in the tort of negligence unless he/she has suffered damage or loss.
- The claimant must show that the damage or loss was ***caused*** by the defendant's breach.
- The defendant will not be liable in negligence if he/she can show that the loss was ***too remote.***
- Remoteness of damage is proved by showing that it was not reasonably foreseeable that such loss would occur.

Contributory negligence

If it can be shown that the claimant was partly responsible for his/her own injuries, the damages payable by the defendant will be reduced proportionately.

Professional negligence

The tort of negligence and professional advisers

- The same three elements apply as above, i.e., duty of care, breach of duty and resulting loss.
- To establish a duty of care, however, it must be shown that there is a 'special relationship' between the claimant and the defendant.
- A special relationship may be shown by proving that the adviser knew that the claimant was going to rely on his advice for a particular purpose and that he did rely on that advice and lost money because the advice was careless.

Remember!

If a professional adviser causes loss to his/her ***client,*** any action is likely to be brought in contract and not in tort.

Establishing Contractual Obligations

Examining how a contract is formed

Topics

- The essential elements of a valid simple contract
- Form
- Agreement (offer and acceptance)
- Consideration
- Intention to create legal relations
- Misrepresentation

Key Study System questions

1.6 simple contracts
1.7 form
1.8 agreement

The essential elements of a valid simple contract

- **Agreement** (Offer and acceptance).
- **Consideration**. Each party must provide something of value.
- **Legal intent**. Each party must intend contractual relations.
- **Reality of the consent**. If it is shown that the agreement was brought about by misrepresentation or duress, etc., the contract may be voidable.
- **Capacity (or ability) to contract**. To have full contractual capacity a person must be over 18 years of age and be of sound mind.
- **Legality of purpose**. If the object of the contract is illegal it may not be valid.

Note

A simple contract is one that does not have to be in any particular form.

Form

- The vast majority of contracts are 'simple', in that they do not have to be in any particular form. Most contracts are made by word of mouth.
- Some contracts have to be in a particular form:
  - **In writing:** bills of exchange, cheques, contracts of marine insurance, contracts for the transfer of shares and the legal assignment of debts.
  - **By deed:** Promises not supported by consideration. A lease of more than three years.

Note

Although simple contracts may be made entirely orally, for proof purposes it is far better if the contract is made in writing.

Form

- A contract for the sale of land is only enforceable if it is in writing.
- The usual sequence of events would be:
  - (i) the parties agree the sale/purchase 'subject to contract.'
  - (ii) The parties exchange copies of an agreed written contract.
  - (iii) Legal title to the land is conveyed from the vendor to the purchaser.

Note

In a transaction involving a sale of land, either party may withdraw when the sale is 'subject to contract.'

The parties are only bound following the exchange of formal written contracts.

Agreement (offer and acceptance)

The offer

- Offers distinguished from invitations to treat: Goods advertised for sale in shop windows, in supermarkets, at auctions, in newspapers and in catalogues constitute an **invitation to treat.**
- In these situations it is the buyer who makes the offer and the seller has the choice whether or not to accept.
- At an auction the bid is the offer and the fall of the hammer the acceptance.
- Exceptionally, an advertisement may amount to an offer if a reasonable person would consider it so (Carlill v Carbolic Smokeball Co (1893)).

Invitation to treat

An invitation to treat is an invitation to potential buyers to make an offer.

An offer

An offer is a definite statement of willingness to be bound in contract without further negotiations.

Termination of an offer

An offer lapses after a reasonable time or when revoked, accepted or rejected.

Agreement (offer and acceptance)

The acceptance

- Acceptance must be absolute and unqualified.
- An acceptance with conditions amounts to a **counter offer.** This destroys the original offer and puts the counter offer in its place.
- Acceptance may be by words spoken or written, or it may be implied from conduct.
- The general rule is that the acceptance must be communicated to the offeror.
- Exceptions to the rule are: (a) where the offeror waives the need to communicate (as in Carlill's case) and (b) the post rule, under which the acceptance is valid as soon as it is posted.

Acceptance

An acceptance is the unconditional assent to all the terms of the offer.

Remember!

An offeror cannot impose silence as the means of acceptance.

Consideration

- An agreement is only binding if each party has provided consideration. A promise to do something is unenforceable – unless purchased by the other party.
- Consideration must be sufficient but need not be adequate. It must have some value but need not be of equal market value.
- Generally, performing existing contractual or legal obligations cannot amount to consideration.
- Past consideration is no consideration – it usually amounts to a gift.
- If an act is requested a reasonable sum must be paid for the act.

Consideration

An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought and the promise thus given for value is enforceable.

Executory consideration

Consideration to be handed over at a later date.

Executed consideration

Consideration handed over at the time of the contract.

Consideration

Consideration and debts

- Payment of less than the amount due cannot satisfy the full debt (The Rule in Pinnel's Case (1602)).
- Exceptions: Something of value added to the part payment, e.g., early payment.
- Part payment by a third party.
- Compositions e.g., all debtor's creditors agree to accept part payment, or to accept an individual voluntary arrangement under the Insolvency Act 1986.
- Part payment in settlement of a disputed debt.
- Promissory estoppel.

Promissory (or equitable) estoppel

If a creditor agrees to accept part payment of a debt in full settlement, he will be prevented from going back on his word if it would be inequitable to allow him to do so.

Remember!

Estoppel can only be used as a defence. It is a 'shield and not a sword.'

Intention to create legal relations

- In **social and domestic agreements** it is presumed that the parties **do not** intend to create legal relations, e.g., family arrangements.
- In **commercial agreements** it is presumed that the parties **do** intend legal relations, e.g., an agreement to sell goods.
- The parties may agree that the agreement should not have contractual effect by stating that it is 'binding in honour only.'
- A promise by a holding company to ensure that its subsidiary meets its financial obligations to a bank, contained in a 'letter of comfort', is not legally enforceable.
- Generally an 'ex gratia' payment is one made without legal obligation.

Remember!

Where legal intent is '**presumed**,' the presumption may be overturned (or rebutted) by evidence showing that the parties have no legal intent, e.g., a **commercial** agreement which the parties have agreed is binding in honour only.

Where it is presumed that the parties have no legal intent (e.g., a family arrangement) there too the presumption may be rebutted by evidence that the parties intended to contract, e.g., a contract of employment given by a father to a son.

Misrepresentation

- Misrepresentation is an untrue statement of fact (not mere opinion) which induces a contract. All these elements must be proved.
- Generally, silence cannot amount to misrepresentation – **caveat emptor** – let the buyer beware.
- Exceptions:

  (a) Where the person making the statement owes a fiducuiary duty (duty of good faith) to the misrepresentee.

  (b) Contracts *uberrimae fidei* (of the utmost good faith), e.g., contracts of life insurance which require full disclosure.

  (c) Where there has been a change in circumstances before the contract is made.

Remember!

A person cannot claim a remedy in misrepresentation unless he/she was **induced** to contract by the false statement.

Misrepresentation

- There are three types of misrepresentation: (a) fraudulent; (b) negligent and (c) innocent.
- A fraudulent misrepresentation is one made dishonestly. A claimant must sue in the tort of deceit.
- A negligent misrepresentation is one made without reasonable care. A claimant may sue either in the tort of negligence or under the Misrepresentation Act 1967.
- An innocent misrepresentation is neither fraudulent nor negligent.
- A claimant may obtain a remedy for innocent misrepresentation under the Misrepresentation Act 1967.

Note

If suing in the tort of deceit the criminal standard of proof applies, so that fraud must be proved beyond reasonable doubt.

Misrepresentation

- The innocent party may repudiate (or cancel) the contract and claim rescission, which is an equitable remedy, placing the parties in their pre-contract position.
- Rescission may be lost if it is not possible to return the parties to their pre-contract position, a third party has acquired rights, or the misrepresentee waits too long to claim ('delay defeats equity').
- Damages and rescission are recoverable for fraudulent and negligent misrepresentation.
- Damages in lieu of rescission may be recovered for innocent misrepresentation.

Remember!

All misrepresentations render a contract voidable. This means the contract is valid until steps are taken to avoid it.

Performing the Contract

Examining the contents and performance of a contract

Topics

- The contents of a contract
- Contractual terms
- The control of unfair terms
- Discharge of a contract by performance
- Reasons for non-performance

Key Study System questions

1.12 exclusion clauses
1.13 conditions and warranties
1.15 reasons for non-performance

The contents of the contract

- To be **incorporated** into a contract as a term, a clause must be known to each party, or reasonable notice of it must have been given before the contract is entered into.
- If a person **signs** a contract he/she is deemed to know of its contents.
- The more **onerous** the clause the more needs to be done to bring it to the other person's attention.
- If the parties have been dealing with each other regularly, terms may be incorporated by a **course of dealings**.
- Terms may be **implied by statute** and **by the courts** (e.g., trade customs and to achieve business efficacy).

The Sale of Goods Act 1979 (SOGA)

The SOGA imply terms into every contract for the sale of goods.

Section 12 (title).

Section 13 (sale by description).

Section 14 (satisfactory quality and fitness for purpose).

Section 15 (bulk to comply with sample).

The status of contractual terms

- A **condition** is a fundamental term going to the root of the contract. Breach of a condition entitles the innocent party to repudiate the contract and claim damages OR to affirm the contract and claim damages.
- A **warranty** is a minor term in a contract. Breach of a warranty entitles the innocent party to claim damages only.
- If the term is **innominate,** i.e., it is not clear whether it is a condition or a warranty, its status is determined by checking whether a breach entitles the innocent party to cancel the contract.
- If this is not clear, it must be asked whether the breach has substantially deprived the innocent party of the main benefit of the contract.

Remember!

The terms implied by the Sale of Goods Act 1979 as to description, quality and sample are ***conditions***.

The control of unfair terms

- If the clause is not incorporated into the contract it has no effect.
- Ambiguous terms will be read against those seeking to rely on them (*Contra proferentem* rule).
- Under the Unfair Contract Terms Act 1977 (UCTA), any term excluding liability for death or personal injury caused by negligence is void.
- Terms excluding liability for damage to property caused by negligence are void unless reasonable under UCTA.
- Terms excluding liability for breach of contract are void unless reasonable under UCTA.
- Terms implied by the Sale of Goods Acts cannot be excluded in consumer sales, but can in non-consumer sales where reasonable.

The 'reasonable' test under UCTA

The court will take account of relevant factors in determining whether the clause is reasonable. Examples are:

- Equality of bargaining power;
- Any inducements offered;
- The availability of insurance.

The Unfair Terms in Consumer Contract Regulations 1999

If a term causes a 'substantial imbalance' between the rights of the parties it is not binding.

The control of unfair terms

- A consumer sale is one in which:
  - (a) One party acts in the course of business;
  - (b) the other does not; and
  - (c) the goods are of a type ordinarily supplied for private use.
- A non-consumer sale is one in which any one of the above three requirements is not present.

Examples

1. An example of a consumer sale is where an ordinary member of the public purchases goods from a shop.
2. An example of a non-consumer sale is where a wholesaler sells goods to a retailer.

Discharge of a contract by performance

- General rule: each party must perform precisely all the terms of the contract.
- Minor discrepancies will be ignored under the *de minimis* rule.
- Exceptions:
  - (a) Divisible contracts.
  - (b) Substantial performance: the contract price less an allowance for the defects is payable.
  - (c) Voluntary acceptance of partial performance: reasonable sum payable.
  - (d) Performance prevented by the other party: compensation on a *quantum meruit* may be claimed.
  - (e) Contract frustrated – see next page.

Substantial performance

The contract is substantially performed if it has been completed but there are minor defects. If the contract is, e.g., 80% performed, that falls within the general rule and is not substantial performance.

Quantum meruit

Quantum meruit means, 'as much as he deserves' and allows a reasonable sum to be claimed, e.g., for work done when performance is being prevented.

Reasons for non-performance

- The parties may agree to discharge the existing contract. To be binding there must be 'accord and satisfaction', i.e., agreement and consideration.
- One party may use the other's breach as an excuse for refusing to perform. To be valid the breach must be of a condition.
- If a contract is frustrated it is unenforceable. Examples of frustrating events:
  - (a) Physical impossibility (Taylor v Caldwell (1886)).
  - (b) Non-availability of one of the parties (Condor v Barron Nights (1966)).
  - (c) Contract becomes illegal following a change in the law.
  - (d) Failure of the main purpose of the contract (Krell v Henry (1903)).

Definition of frustration

A contract is frustrated when it becomes impossible to perform through no fault of either party.

Remember!

1. A contract is not frustrated merely because it has become more expensive to perform.
2. Self-induced frustration is no frustration.

Reasons for non-performance

The effect of frustration

- If the contract provides for the frustrating event, e.g., by the inclusion of a *force majeure* clause, the contract must be followed.
- If not, the contract is unenforceable – subject to the following financial repercussions:
  - Under the Law Reform (Frustrated Contracts) Act 1943, money paid or payable is recoverable or not payable, but an allowance may be claimed for expenses incurred (Section 1(2)).
  - A party who has received a benefit before the contract was frustrated, must pay for the benefit (Section 1(3)).
  - Best advice – cover the risk with insurance.

Definition of *force majeure*

Force majeure clauses are commonly found in contracts. They specify the position of the parties in specified circumstances, e.g., the rights of the parties to a contract for a skiing holiday in the event of no snow.

Contractual Breakdown

The rights of the parties following breaches of contract

Key Study System questions

1.16 remedies
1.17 rescission
1.18 specific performance

Topics

- The type of breach which causes contractual breakdown
- Remedies

The type of beach which causes contractual breakdown

- No breach automatically causes contractual breakdown.
- Breach of a condition (a major term in a contract) gives the innocent party a choice:
  - (a) He can affirm (ignore) the breach and continue.
  - (b) affirm and claim damages.
  - (c) repudiate (cancel) the contract and claim rescission and damages.
  - (d) do nothing and use the other's breach as a defence if himself sued for breach.

Remember!

Breach of a warranty, a minor term in a contract, only entitles the innocent party to damages. If he repudiates the contract, he is also in breach.

Remedies

Damages – causation and remoteness

- All breaches of contract entitle the innocent party to damages. If no loss has been caused – nominal damages only.
- If loss suffered – to claim damages the breach must have caused the loss.
    - The loss must not be too remote. Every contract breaker is liable for the natural consequences of the breach; but
    - If the loss exceeds the natural consequences, the contract breaker is only liable if he contracted knowing of the special circumstances.

Remedies

Damages – quantification

- If the seller of goods is in breach – the buyer can claim the difference between the contract price and the market value of the goods.
- If buyer is in breach – the seller can claim the difference between the contract price and the market value of the goods.
- If the buyer or seller is a trader and the breach causes the loss of a sale – the loss of profit may be claimed.
- If goods or services are defective – damages are those necessary to remedy the defect.
- Damages may be refused if reasonable steps have not been taken to mitigate the loss.

Remember!

1. Damages are generally not recoverable for distress or disappointment – but may be where the contract is for enjoyment, e.g., a holiday.
2. If the goods have been delivered and all that remains is for the buyer to pay the price – the seller can claim the price. This is not an action for damages and remoteness and mitigation are irrelevant.

Remedies

Liquidated damages clauses

- If the contract contains a liquidated damages clause it will be enforced, even if it does not fully compensate the innocent party for his loss.
- A liquidated damages clause is a term which genuinely attempts to estimate the loss which would be caused by a breach.
- If the clause is in reality a penalty clause, i.e., it is designed to frighten the other party to perform, it is void (e.g., a term specifying a large financial penalty for non-performance).

Remember!

The court will not be bound by the title given to the clause by the parties. Thus, a clause will not be treated as a penalty clause just because it is called a penalty clause. The court will look at the substance of the clause – not its title.

Equitable remedies

- Specific performance. If damages would not provide an adequate remedy, e.g., because the goods are unique and cannot be purchased elsewhere, the innocent party may claim specific performance.
- Specific performance cannot be obtained in respect of a contract of service or services.
- An injunction may be obtained to enforce an express negative stipulation in a contract.
- A mandatory injunction will require a person to undo something done in breach, e.g., demolishing a wall built in breach of contract.
- An order of rescission will restore the parties to their pre-contract position.

Remember!

All equitable remedies are discretionary and may be lost by waiting too long to make a claim.

The Law of Employment

Examining the essentials of employment law

Key Study System questions

1.19 employer's duties
1.20 employee rights
1.21 employment contracts

Topics

- Employees and independent contractors
- The contents of an employment contract
- Unfair and wrongful dismissal
- Health and safety

Employees and independent contractors

- Employees – contract of service.
  Independent contractors – contract for services.
- Under the control test, a worker is an employee if subject to the control of an employer as to what to do and how to do it.
- Under the organisation or integration test, a worker is an employee if he is an integral part of the organisation, whereas a contractor remains outside it.
- The modern economic reality or multiple test takes account of all factors, e.g., whether tax deducted at source; whether working hours fixed; (suggests employee) worker provides his own tools; can send a substitute (suggests contractor).

Employers/independent contractors – importance of the distinction

- Employer vicariously liable for damage caused by an employee in the course of his/her employment.
- All the legislation providing employment rights apply to employees but not contractors.

The contents of an employment contract

- Contents established by express negotiation, e.g., wages payable, working hours, notice periods, sick pay and pension rights.
- Employee entitled to a written statement of particulars of employment within 2 months of starting work.
- Terms implied into contracts by custom, statute and European law.
- Rights implied by Race Relation Act; Sex Discrimination Acts 1975–1986; Employment Rights Act 1996; National Minimum Wage Act 1998; Welfare Reform and Pensions Act 1999; The Working Time Regulations 1998, etc.

Remember!

A contract of employment is a contract of service.

The contents of an employment contract

- **Duties of an employer:** To pay remuneration; provide holidays; holiday pay; maternity leave; time off for union duties; to indemnify employees for any expenses incurred carrying out duties; to provide a safe system of work; generally to behave reasonably and responsibly towards employees.
- There is no general duty to provide work. Exception: salesman paid by commission only; actors.
- **Duties of an employee:** to use reasonable care and skill; carry out reasonable instructions; to give loyal and faithful service, e.g., not to compete, or disclose confidential information.

Remember!

An employer is not under a duty to provide a reference, but if a reference is provided it must be accurate.

Unfair and wrongful dismissal

- Unfair dismissal: Governed by the Employment Rights Act 1996. Must be an employee and below normal retirement age and have one year's continuous employment – unless the dismissal is automatically unfair.
- Automatically unfair dismissals: joining or refusing to join a trade union; pregnancy; suing the employer to enforce a statutory right, etc.
- There must be actual (express) or constructive dismissal (employee forced to leave), with or without notice.
- Action must be brought before an employment tribunal within three months. Remedies – conciliation; reinstatement/re-engagement, or compensation.

Remember!

To escape liability an employer must show:

1. The main reason for dismissal falls within one of the following:
   (a) lack of capability/qualifications;
   (b) misconduct;
   (c) genuine redundancy;
   (d) contravention of statute;
   (e) some other substantial reason.
2. The tribunal must decide whether the employer acted reasonably in dismissing the employee.

Unfair and wrongful dismissal

- Wrongful dismissal: Common law remedy occurs when there has been dismissal in breach of the employment contract, e.g., termination without notice.
- No one year qualifying period.
- Actions barred after 6 years – not 3 months.
- Action brought before a tribunal or a court.
- Unfair dismissal is wider and more common.
- Summary dismissal, i.e., without notice, may be justified, e.g., for false declarations by the employee. The odd piece of poor workmanship will not justify summary dismissal.
- Damages are unlimited and compensatory. No award for hurt feelings. The employee must take reasonable steps to mitigate his/her loss. Damages must take account of taxation.

Note

Wrongful dismissal is a common law remedy.

Unfair dismissal is a statutory remedy.

Health and safety

- The law is contained in the Health and Safety at Work Act 1974 ('HASAWA') regulations and codes of practice.
- The law imposes a duty on employers and the self-employed to take measures with respect to materials, people and methods of working as are reasonably practicable to ensure safety.
- Under the Management of Health and Safety at Work Regulations 1992, employers must make an assessment of likely risks and take measures to eliminate them.
- The HASAWA is enforced by the Health and Safety Commission, acting through the Health and Safety Executive and its inspectorate.

Note!

1. Failure to comply with Health and Safety at Work legislation is a criminal offence.
2. Employees may claim compensation for breach of contract, under the tort of negligence or for Breach of Statutory Duty (but not in respect of HASAWA).

Company Formation

Examining the essentials of incorporation

Topics

- Business organisations
- Corporate personality
- Public and private companies
- Company registration
- The Memorandum and Articles of Association
- Company contracts
- Advantages of a company limited by shares

Key Study System questions

1.22 private companies
1.23 company formation
1.24 the Memorandum of Association

Business organisations

- The sole trader: one person responsible for the capital and expertise of the business. Unlimited liability for business debts.
- The general partnership: 'the relation which subsists between persons carrying on business in common with a view to profit'. (Section 1 Partnership Act 1890).
- Each partner is both a principal and agent of the firm. Each is jointly and severally liable for the debts and torts of the firm.
- Partners owe fiduciary duties to each other.

Remember!

- Each partner binds the firm if he carries on business of the kind carried on by the firm in the usual way – unless he has no authority and the person he is dealing with knows that, or does not know he is a partner.
- A person who is 'held out' as a partner may be liable as if he were a partner!

Limited Liability Partnerships

- Created by the Limited Liability Partnerships Act 2000, an LLP is a corporate body with a separate identity to the partners.
- Partners' liability is limited to the amount invested.
- Formed by sending two forms to Companies House.
- Companies House sends a certificate of registration.
- Must have two 'designated partners' who are responsible for sending documents to Companies House.
- An LLP is taxed as a normal partnership.

Note

The main users of LLPs are professional firms who wish to obtain the benefits of limited liability while still being taxed as a normal partnership.

Companies limited by shares

- The company limited by shares. The company is a separate person, distinct from shareholders and directors. The company is fully liable for its own debts. The company can own property, contract, sue and be sued.
- Generally, if the company should become insolvent directors have no liability for its debts.
- Shareholders' liability is limited to the amount (if any) due on their shares.
- Single shareholder (member) companies may be registered, but at least two people are needed, as a sole director cannot also be company secretary.

Remember!

The directors are the managers of the company;

The shareholders are the owners of the company;

The company itself owns the assets.

Corporate personality

- The main practical benefit of corporate personality is that the company can own property, contract in its own name, and is responsible for its own debts. This results in shareholders enjoying limited liability.
- The corporate veil may be lifted (Salomon's case ignored), by (a) statute and (b) the courts.
  - (a) Statute: examples include wrongful trading (see later) and where the full name of the company has not been stated on, e.g., a contract; person signing becomes personally liable.
  - (b) The courts: in general the courts will apply Salomon's case, but if the company is being used for fraud, or other improper purposes, the shareholders and company will be treated as one and the same.

Remember!
The 'corporate veil'

A company is a separate person at law distinct from its directors and shareholders (Salomon v Salomon & Co Ltd (1893)). This is known as the corporate veil.

Public and private companies

- The name: private companies must end with 'limited' or 'Ltd', public companies with 'public limited company' or 'plc'.
- Private companies cannot invite the public to subscribe for shares or lend to the company, public companies can.
- A plc must have at least two directors, a limited company one.
- A private company may trade as soon as it obtains its certificate of incorporation. A public company cannot trade until it has issued at least £50,000 of share capital, of which at least one-quarter and the total premium paid up.
- Private companies may take advantage of the elective regime, plcs cannot.

Note

Although a private company may not invite the public to subscribe for shares, the shareholders of the company may offer their shares to the public – subject to the Articles.

Company registration

- A company may be registered by sending to the Registrar of Companies: (a) Memorandum of Association; (b) Articles of Association; (c) form 10 (statement of first directors and company secretary); (d) form 12 (a statutory declaration of compliance with the Companies Acts). In addition, the registration fee of £20 must be sent.
- The documents of these 'tailor-made' companies can be drafted to suit the requirements of the promoters.
- Alternatively, a company may be purchased 'off the shelf.' These are registered companies that are not trading.
- The advantages of such companies are that cost and business can be commenced immediately.

Remember!

Articles of Association do not have to be sent to register a company. If they are not sent, Table A (a statutory form of articles) will automatically apply. Table A's provisions apply unless excluded by the company's own Articles.

The Memorandum of Association

- **The Memorandum of Association.** This document contains:
  - (a) The company's name. This must end in 'limited', or 'plc', etc., as appropriate.
  - (b) Whether the registered office is to be situated in England, Wales or Scotland.
  - (c) The objects clause, i.e., the business which the company has been registered to carry on.
  - (d) A statement that the members' liability is limited.
  - (e) The authorised capital. The document concludes with the 'association clause'.

The Memorandum of Association

This document sets down the ***external*** powers of the company.

Alteration of the Memorandum of Association

- The name may be altered by special resolution.
- The address of the registered office may be moved within the domicile by ordinary resolution.
- The objects clause may be altered by special resolution. The holders of 15% of the company's shares or debentures may object to the court.
- The authorised capital of the company may be increased by ordinary resolution. This is one of the few ordinary resolutions which must be filed at Companies House.

Remember!

In general, a private company may use a written resolution in place of any other type of resolution.

The Articles of Association

- **The Articles of Association.** This document contains (for example):
- Powers of directors and the procedure for calling and voting at board meetings.
- Rules for the appointment and retirement of directors.
- The procedure for calling general meetings (annual and extraordinary) and the rights of shareholders to attend and vote in person or by proxy.
- Rules for the transfer and transmission of shares.
- Dividend rights.

The Articles of Association

This document contains the rules for the ***internal management*** of the company.

Each provision of Table A applies unless excluded.

Alteration of the Articles of Association

- The Articles may be altered by special resolution (Section 9 CA 1985). The resolution must be filed within 15 days of its passing, together with a copy of the revised Articles.
- The alteration must not:
  - (a) Contradict the Memorandum.
  - (b) Require members to provide more capital without their written consent.
  - (c) Be in good faith in the best interests of all the members and not just in the interests of the majority.
  - (d) Be unfairly prejudicial to the interests of the members.

Note

If the shares of a company are separated into different classes, class rights contained within the Articles may only be altered with the approval of the class affected.

Memorandum and Articles of Association – legal status

- If there is any conflict between the Memorandum and the Articles – the Memorandum prevails.
- The Memorandum and Articles form a contract between the members (shareholders) and the company; and between the members *inter se* (Section 14 Companies Act 1985).
- These documents are only contractual in respect of 'ordinary membership rights', i.e., rights which affect the shareholders in that capacity, such as the right to vote and receive dividends.
- 'Outsider rights' in the Articles, for example, the right to be the company's solicitor, are not contractual under Section 14.

Note

Although a person cannot enforce an outsider right contained in the Articles using Section 14, a court may be prepared to accept that the right is a term of a separate contract (See re New British Iron Co Limited ex parte Bechwith (1898)).

Memorandum and Articles of Association – shareholder agreements

- Many private companies use shareholder agreements to avoid possible problems with the Memorandum and Articles. Shareholder agreements are advantageous in that:
  - They are private documents, unlike the Memorandum and Articles, which are open to the public.
  - They can only be changed by unanimous agreement, unlike the Memorandum and Articles, which can be changed by a majority vote.
  - All legal provisions are enforceable, including rights which would be regarded as 'outsider rights' if contained in the Articles.

Note

Shareholder agreements commonly include provisions restricting the company's business activities; governing the company's dividend policy; restricting the increase of the company's authorised capital; and the ability of the directors to borrow money.

Company contracts

[a] Pre-incorporation contracts

- A contract made on behalf of a company before it is registered is void against the company.
- The company cannot adopt or ratify the contract after formation.
- To be bound by the terms of the old contract, the company must enter into a new contract.
- The promoters who purport to contract on behalf of the company will be personally liable 'subject to any agreement to the contrary' under Section 36C CA 1985.
- To avoid personal liability, the promoters must make it clear that they are not intending to be personally liable on the contract.

Remember!

A promoter is a person who intends to form a company.

Company contracts

[b] Post-incorporation contracts

- A company which contracts for a purpose outside its objects clause is acting *ultra vires*.
- However, the validity of the act cannot be called into question on the ground of lack of capacity (Section 35 CA 1985).
- If the act is *ultra vires*, the directors must have acted in breach of fiduciary duty, as they have ignored the company's constitution.
- However, outsiders may rely on Section 35A CA 1985 and enforce the contract if they have acted in good faith, which is presumed.
- Any shareholder may apply for an injunction to stop the directors causing the company to act *ultra vires*.

Note

An *ultra vires* act may be ratified by special resolution. A separate special resolution is needed if directors are to be absolved of any breach of duty.

A contract between a company and a director (or his family) is voidable at the instance of the company. The relationship of the contractor must be fully disclosed to the company to be binding.

Advantages of a company limited by shares

- Limited liability. The shareholders' liability is limited to the amount, if any, due on their shares. If they are fully paid up, no further liability arises.
- Note that the company is fully liable for the debts – limited liability refers to the shareholders only.
- Taxation advantages.
- Perpetual succession.
- The company, as a legal person, can hold property, enter into contracts and sue and be sued.
- Shares are freely transferable in public and can be in private companies, subject to the latter's Articles of Association.

Remember!

The advantage of limited liability may be grossly exaggerated in the case of a private company, in the early stages of the company's life. This is so because the incorporators may need to borrow on behalf of the company and be required to give personal guarantees.

Corporate Administration

Examining company meetings, voting rights and resolutions

Key Study System questions

1.26 general meetings
1.27 resolutions

Topics

- Board and shareholder meetings
- Directors' and shareholders' voting rights
- Shareholder resolutions

Board and shareholder meetings

Board meetings

- The rules for the procedure at board meetings are contained in the Articles of Association.
- Under Table A any director can call a board meeting on reasonable notice. A quorum may be fixed by the directors, or two must be present.
- Board meetings are held to determine policy matters, such as whether to borrow, issue more shares, take on more staff, purchase additional premises, etc.
- Board resolutions are reached by majority decision. Minutes of meetings must be kept.
- To effect a transaction, the board may have to call a meeting of shareholders, if the Companies Acts so require.

Note

Written resolutions of directors: a resolution in writing, signed by all the directors entitled to notice for a board meeting, is as valid as if it were passed at a board meeting.

Board and shareholder meetings

Shareholder meetings

- Every company must hold an annual general meeting (AGM) each calendar year, not more than 15 months after the last AGM. Clear notice of 21 days is required. Less notice may be given if all shareholders agree.
- An AGM is held to allow shareholders the opportunity to question the board regarding the running of the company.
- Every shareholder meeting, other than the AGM, is an extraordinary general meeting (EGM). Usually an EGM requires 14 days notice.

Note

The board can call an EGM at any time.

An EGM can also be called by a minimum of two members who together hold at least 10% of the company's issued share capital.

Directors' and shareholders' voting rights

Directors' voting powers

- At a board meeting directors have one vote each on a show of hands.
- Under Table A, the chairman has a second or casting vote.
- Board resolutions are passed by simple majority vote.
- An equality of votes means that the motion is lost, unless the chairman uses his casting vote.
- Minutes of board resolutions must be kept. Directors but not shareholders are entitled to inspect the minutes.

Remember!

Even single member companies must hold board meetings and keep minutes.

Shareholder resolutions

(a) Ordinary resolutions: are passed by a simple majority (50% plus one) of those present and voting. Required notice 14 days. Ordinary resolutions with special notice require 28 days notice to the company.
(b) Special resolutions: are passed by 75% of those present and voting. 21 days notice.
(c) Extraordinary resolutions: are passed by 75% of those present and voting. 14 days notice.
(d) Written resolutions (private companies only): passed by all entitled to attend and vote. Used (with certain exceptions) in place of any other resolution. No notice required.
(e) Elective resolutions (private companies only).

Remember!

An elective resolution can be used by a private company to:

(a) Dispense with an AGM;
(b) Dispense with the laying of accounts and reports;
(c) Reduce the percentage required for short notice to 90% (from 95%);
(d) Increase the directors' authority to allot shares beyond 5 years;
(e) Dispense with the need to appoint auditors annually.

Shareholder resolutions

Examples:

- Ordinary resolution: to increase the company's authorised capital; to appoint directors; to authorise directors to allot shares for up to 5 years.
- Ordinary resolution with special notice: to dismiss a director or auditor.
- Special resolution: To change the Memorandum or Articles of Association. To sanction financial assistance and a reduction of capital.
- Extraordinary resolution: To put the company into voluntary liquidation.

Remember!

In general, a written resolution may be used by a private company in place of any other type of resolution.

Corporate Finance

Examining share and loan capital

Key Study System questions

1.28 purchase of own shares
1.29 shareholders and debenture holders
1.30 shares

Topics

- The nature and types of shares
- The issue of shares
- Issuing shares for an improper purpose
- The maintenance of capital
- Secured and unsecured loans

The nature of a share

- A share is a 'bundle of rights and obligations', including the right to attend and vote at general meetings and to receive dividends.
- The rights and obligations of shareholders are contained in the terms of issue of the shares and in the company's constitution, i.e., in the Memorandum and Articles of Association.
- In private companies the shareholders may also be parties to a 'shareholder agreement', which contains contractual rights and obligations and is binding on all the signatories in the same way as any other contract. These agreements can only be altered by unanimous agreement.
- A share certificate is ***prima facie*** evidence of share ownership, true ownership is determined by the register of shareholders.

Remember!

Under Section 14 of the Companies Act 1985 the Memorandum and Articles of Association form a contract, shareholder to shareholder and shareholder to the company.

Types of share

- ***Ordinary shares***: usually carry the right to vote but have no fixed dividend. If the company goes into solvent liquidation, the surplus available after payment of the creditors is shared amongst them.
- ***Preference shares***: give the holders the rights specified in the terms of issue or the Articles of Association. These invariably include the right to receive a fixed percentage dividend in preference to the ordinary shareholders.
- If the terms of issue of the preference shares are silent, the dividend is presumed to be cumulative (if it is not paid in one year it must be carried forward and paid in the next). In solvent liquidations the holders only get back their capital and cannot share in any surplus.

Note

The exact rights of all types of shareholders are determined by looking at the terms of issue and the Articles of Association.

Types of shares

- ***Deferred shares***: Such shares are very rare today and entitle the holders to receive a dividend only after payment of the preference and ordinary shareholders. Sometimes called 'management' or 'founders' shares.
- ***Redeemable shares***: All types of share may be issued on the basis that they can be redeemed (i.e., bought back) by the company.
- ***Stock***: Shares may be converted into stock. In theory this makes shares more easily transferable; e.g., Exe holds £1,000 of stock rather than 1,000 £1 shares. This means that he can sell, say, one ten thousandth of his stock if he wishes rather than being restricted to £1 units (subject to the Articles).
- ***Class rights***: are the rights given to each of these different types (or classes) of shares.

Note

Redeemable preference shares may be useful to a company in times of high interest rates, as capital can be acquired and dividends only paid if there are profits available.

The issue of shares

- Shares are issued by the directors, who must be authorised by the shareholders (ordinary resolution) or by the Articles (S80 CA 1985). Once given, the authority lasts for 5 years.
- The authorised capital must be checked to see if there are sufficient unissued shares. If all have been issued, authorised capital may be increased by ordinary resolution (S121 CA 1985).
- Where ordinary shares are being issued for cash, they must be offered to the existing shareholders rateably (S89 CA 1985). This is known as a ***rights issue***. Thus, if Mr Wye holds 5% of the existing shares, he must be offered 5% of the new shares. These statutory pre-emption rights may be disapplied by special resolution or by the Articles.

Remember!

In private companies a written resolution may generally be used in place of any type of resolution.

Note

Do not confuse statutory pre-emption rights, which apply on the ***issue*** of new shares, with pre-emption clauses, which appear in the Articles of private companies and apply to the ***transfer*** of shares by members.

The issue of shares

- A company cannot give away its shares. It must be paid either in cash or in kind.
- A company cannot issue shares at a discount, i.e., below their nominal or par value.
- A bonus issue of shares usually occurs when a company decides to capitalise some profits. Thus, instead of using the profits to pay dividends, the profit is capitalised and bonus shares issued to represent the new capital.
- A company may be paid by way of a non-cash consideration; e.g., X Ltd issues 100,000 ordinary £1 shares to Y to purchase his business.

Note

If a plc issues shares for a non-cash consideration, the consideration must be valued by the company's auditor, and must be transferred to the company within 5 years of the allotment.

The issue of shares for an improper purpose

- Even if directors have been given the legal authority to issue shares, their actions are subject to equitable considerations.
- Thus, shares must be issued to raise capital and not, for example, to increase the voting power of their supporters to enable the directors to maintain control of the board, or to prevent a take-over bid.
- The statutory pre-emption rights of shareholders go some way to negate the ability of directors to manipulate votes, but only apply to ordinary shares issued for cash.

Note

If directors issue preference shares, or ordinary shares for a non-cash consideration, these issues are outside the pre-emption rules. If issued to manipulate voting rights, equity will interfere to cancel the issue, or shareholders may be able to sue the board, on the ground that the companies affairs are being run in a manner 'unfairly prejudicial' to the interests of the members generally, under Section 459 CA 1985.

The maintenance of capital

- All companies must maintain their capital. This means that a company cannot simply give back share capital to its shareholders.
- This rule is supported by the following ***general*** rules:
  (a) Shares cannot be issued at a discount.
  (b) Dividends must be paid out of distributable profits.
  (c) In general, a company cannot purchase its own shares.
  (d) In general, a company cannot provide financial assistance for the purchase of its own shares.
  (e) A company cannot hold its own shares.

Note

As with most areas of law, there are a number of exceptions to these general rules, which are discussed later.

Maintenance of capital

Exceptions to the above general rules:

- 1. **Redeemable shares.** The Articles must allow them. Redemption must be out of distributable profits or the proceeds of a new share issue.
- A **private** company may redeem out of capital (the 'permissible capital payment'). But available profits or the proceeds of a new share issue must be used first.
- The directors must make a statutory declaration that the company will be able to pay all its debts immediately after the redemption and for the next 12 months.
- This must be supported by an auditor's report.
- The shareholders must agree by passing a special resolution.

Remember!

If a company issues redeemable shares, there must be at least one non-redeemable share in existence.

Maintenance of capital

- **2. Purchase by a company of its own shares.** The law now allows public and private companies to purchase their own shares.
- The Articles must allow this.
- 'Off market' purchases are authorised by special resolution (usually private companies).
- 'Market' purchases require an ordinary resolution (public companies only). The resolution must be filed at Companies House.
- The purchase must be out of distributable profits or the proceeds of a new share issue.
- Private companies may use capital. This is subject to the same rules as for redeemable shares (see above).
- The intention to purchase out of capital must be advertised in the London Gazette and the creditors have 5 weeks after the special resolution to object.

Note

Redeemable shares are those issued on the basis that they would be bought back by the company.

Purchase of shares applies where a company is buying back shares which were not originally issued as redeemable.

Maintenance of capital

- **3. Reduction of capital**. A company may reduce capital for any reason, but three possible reasons are given in S135 CA 1985: to cancel uncalled capital; to cancel paid up share capital which is lost; to pay off paid up share capital in excess of the company's wants. The procedure is:
  - The board will resolve to reduce capital;
  - Shareholders must pass a special resolution;
  - The court's authorization must be obtained.
- **4. Financial assistance for the purchase of a company's own shares.** All companies may provide assistance if it is 'an incidental part of a larger purpose' and the assistance is in good faith in the best interests of the company. Also companies may finance employee share schemes.

Note

Companies which have reduced capital may be required to say so on their business paper.

Maintenance of capital

A private company may provide financial assistance for any reason, as long as it follows the correct procedure, i.e.:

- Articles must allow this;
- Board will resolve to provide assistance;
- Directors make statutory declaration;
- Supporting auditors report;
- Shareholders pass special resolution;
- The board must then wait for 4 weeks to allow for objections (unless the resolution was passed unanimously);
- The assistance is given not more than 8 weeks after the statutory declaration.

Note

The ability of companies to purchase or provide financial assistance is useful to return unwanted capital to shareholders, purchase the shares of dissenting shareholders, facilitate management buy-outs and to provide a market for shares in a private company.

Secured and unsecured loans

- Most companies have an express power to borrow money in the Memorandum of Association.
- A board resolution is needed to borrow money.
- In practice, private companies usually borrow from a bank, which will require security. For small loans the bank may be satisfied with a directors' personal guarantee and no charge over the company's assets.
- For larger loans, security will be required in the form of a debenture giving a fixed and/or floating charge.
- A debenture is a document which evidences a loan made to a company.
- Companies are entitled to tax relief on loan interest.

Remember!

A trading company (one which buys and sells goods) has an implied power to borrow money.

Secured and unsecured loans

Fixed charges

- A fixed charge has two elements:
  (i) It is a charge over specific identifiable property (e.g., company land, plant and machinery); and
  (ii) The company is prevented from using the property freely in the ordinary course of business (e.g., the company will not be able to sub-let its land without the bank's permission).
- The holder of a fixed charge takes priority over all other creditors in the event of company insolvency.
- The holder is usually authorised by the debenture to send in a receiver, who may take control of and sell the assets charged in the event of default by the company.

Remember!

1. All charges must be registered at Companies House within 21 days of the creation of the charge. Otherwise the charge is void against other secured creditors.
2. Charges must also be registered in the company's own register of charges, but failure to do so does not affect the validity of the charge.
3. If the charge is over land it must also be registered at the Land Registry.

Secured and unsecured loans

Floating charges

- A floating charge has three elements:
  - (i) It is a charge over a class of assets present and future (e.g., stock);
  - (ii) The assets change from time to time (e.g., as stock is bought and sold); and
  - (iii) The charge enables the company to deal freely with the assets in the ordinary course of business.
- In the event of default by the company the charge 'crystallises', i.e., attaches to the assets currently in the possession of the company.
- A charge will crystallise on commencement of winding up; on the appointment of a receiver; and when specified in the debenture.

Note

If a public company borrows money from the public it is likely to give trustees powers equivalent to fixed and floating charges in the trust deed.

Secured and unsecured loans

Floating charges

- The holders of floating charges created before 15 September 2003 may appoint an administrative receiver, who has power to carry on the company's business, unlike a receiver appointed by the holder of a fixed charge, who has no such power.
- The holders of floating charges created after 15 September 2003 may appoint an administrator.
- A floating charge is subject to a number of disadvantages:

  (a) The floating charge holder receives the proceeds of sale of the assets charged after payment of the preferential creditors and after deduction of the 'prescribed part' for unsecured creditors (see later).

Note

The essential difference between an administrator and an administrative receiver is, that the former is required to act in the interests of all the creditors, whereas the latter is appointed to act for the charge holder only.

Following the Enterprise Act 2002 Crown debts (e.g., taxation) are no longer preferential debts.

Preferential debts are now restricted to:
(i) contributions due to occupational pension schemes, (ii) employee remuneration; and
(iii) coal and steel levies.

Secured and unsecured loans

Floating charges

(b) A fixed charge has priority over a floating charge, even if created after the floating charge – unless there is a negative pledge clause and the new lender has actual knowledge of it.

(c) Company stock subject to reservation of title clauses, or hire purchase, is not part of the charged assets, as ownership remains with the supplier of the goods.

(d) Landlords and judgment creditors may retain goods seized before crystallization.

(e) The charge may be invalidated by S245 Insolvency Act 1986.

Note

The Insolvency Act 1986 (Prescribed Part) Order 2003 provides that the following must be deducted from the amounts available for the floating charge holders and made available to the unsecured creditors:

1. 50% of the first £10,000;
2. 20% of £10,001 to £600,000.

Under Section 245 Insolvency Act 1986, if a company goes into liquidation or administration within 1 year (non-connected persons) or 2 years (connected persons) of the issue of the floating charge, the charge is void in respect of pre-charge borrowing.

Secured and unsecured loans

Shares and debentures

- A shareholder is a member of the company and can vote – a debenture holder is a creditor.
- Loan interest must be paid to debenture holders, even if the company is not making profits.
- Dividends can only be paid to shareholders if the company has available profits.
- Tax relief is available on the payment of loan interest, as it is an expense in earning profits. No tax relief is available for dividends, as they are profits.
- A company may pay off debenture holders at any time, but purchase of the company's shares is generally illegal (see maintenance of capital above).

Note

The risks are greater for shareholders than secured creditors. Shareholders are likely to do better than creditors if the company makes large profits, but worse if the company becomes insolvent.

Corporate Management

Examining the powers and duties of directors, shareholders and the company secretary

Topics

- The appointment, retirement, disqualification and removal of directors
- The powers and duties of directors
- The personal liability of directors of insolvent companies
- Directors' and shareholders' rights
- The company secretary

Key Study System questions

1.31 directors
1.34 personal liability of directors
1.35 the company secretary

Directors – definitions

- **Executive directors** are employees acting under a contract of service. **Non-executive directors** are not employees and act under a contract for services.
- A plc must have at least two directors and a private company at least one.
- The **first directors** are appointed by those who register the company on Form 10.
- **Subsequent directors** are appointed according to the rule in the Articles. In practice, most appointments are by the board and are then ratified by the shareholders at the next AGM by ordinary resolution.
- **A managing director** is appointed by the board. **A shadow director** is a person in accordance with whose instructions the board is accustomed to act.

Remember!

A director is anyone who acts as a director by whatever name called.

The company must keep a register of directors at its registered office.

Directors – appointment and disqualification

- Directors retire in accordance with the rules in the Articles of Association. Table A provides for the retirement of one-third each year.
- Generally, a director of a plc must retire at 70 years of age.
- Under the Directors Disqualification Act 1986, directors may be disqualified for up to 15 years if, for example, they are convicted of fraud.
- Other examples of behaviour causing disqualification are: persistent breach of the Companies Act regarding company administration; personal liability for wrongful trading; being an undischarged bankrupt.
- Persons who act as directors when disqualified commit a criminal offence and may be personally liable for the company's debts.

Note

If directors are to be given a service contract for more than 5 years, on terms that the director cannot be removed by reasonable notice, the shareholders must approve the contract by ordinary resolution.

Directors – removal

- Directors may be removed by ordinary resolution, irrespective of anything in the Articles (Section 303 CA 1985).
- The person proposing a resolution to dismiss a director must give special notice of 28 days to the company.
- The company will then send a copy of the proposed resolution to the director, who may make written representations to the company and insist on them being circulated to members. The director also has the right to speak at the meeting and can vote as a shareholder.
- Executive directors may be entitled to damages for unfair or wrongful dismissal.

Remember!

Directors may be irremovable if they have been given weighted voting rights in the Articles sufficient to outvote an ordinary resolution. Such 'Bushell v Faith' clauses are valid for **private** but not public companies.

Directors – powers and duties

- Directors' powers are contained in the Articles. Table A provides that directors have full power to manage the company, subject to directions by special resolution.
- Directors' powers are also contained in service contracts and the Companies Acts.
- Directors powers are exercised by board resolutions, which are usually reached by simple majority vote.
- Directors owe the following duties:
  (a) **Common law duties of care and skill**, i.e., to act reasonably according to their knowledge and experience.
  (b) **Fiduciary duties**. To act in good faith in the best interests of the shareholders as a body.

Remember!

Directors owe fiduciary duties to the shareholders as a body and not to individual shareholders.

An action for breach of fiduciary duty should be brought by the company.

Directors – duties

- Examples of fiduciary duties include: not allowing personal interests and duties to conflict; not to make secret profits.
- The main point is that directors must fully disclose their dealings to the board.
- Disclosure to the shareholders is also required in certain cases, for example, if the Articles so provide.
- A director involved in a 'substantial property transaction', i.e., a contract to transfer a non-cash asset (e.g., land, from or to a director, where the asset exceeds £100,000 or 10% of the company's net assets) must be sanctioned by ordinary resolution (S 320 CA 1985).

(c) Directors owe many **statutory duties,** for example, to comply with the administrative requirements of the Companies Acts.

Note

Directors must take account of the interests of employees. However, any action against the directors for breach of this duty must be brought by the company, and not the employees (S 309 CA 1985).

Directors of insolvent companies

- Generally, under common law, directors owe no duties to creditors, whose rights are against the company alone.
- However, if the company becomes insolvent, directors owe fiduciary duties to act in good faith in the best interests of the creditors.
- A director who acts whilst disqualified may be held personally liable for the company's debts.
- Directors of private companies are often required to provide personal guarantees when obtaining loans from banks.
- Directors may be held personally liable for the company's debts for fraudulent trading if, in the course of winding up, it appears that business has been carried on with intent to defraud creditors (**Fraudulent trading** S 213 Insolvency Act 1986).

Note

Fraudulent trading is difficult to prove, as intention to defraud creditors must be proved beyond reasonable doubt, i.e., the criminal standard of proof applies.

Directors of insolvent companies

- In practice, liquidators are more likely to pursue directors for **wrongful trading**, as it is easier to prove because the civil standard of proof applies.
- The section applies to directors, including former and shadow directors.
- It must be proved:
  - (a) that the directors ought to have known that insolvency was inevitable;
  - (b) from which date they ought to have known;
  - (c) whether, since that date, they took every step to minimise the loss to the creditors; and, if not,
  - (d) how much they should contribute to the company's assets.

Note

Directors may also be caught by the 'preference' provisions, e.g., if they prefer themselves of their families by repaying their debts in full before placing the company in liquidation. The court may make any order it thinks fit to restore the situation.

Directors who give away company assets, or sell them below market value, may also be caught by the 'transactions at an undervalue' provisions.

Directors' and shareholders' rights

- The board is empowered to manage the company and act as its agent.
- Shareholders, as such, have no rights to interfere in management.
- In some instances the board has competence to carry out transactions without shareholder approval, e.g., borrowing money.
- In other instances shareholder approval must be sought, e.g., authority to allot shares.
- The shareholders are given the opportunity at each AGM to question the directors' management of the company.
- In the unusual event of deadlock on the board, power reverts to the shareholders.

Remember!

The board is the agent of the company and not of the shareholders.

The rights of minority shareholders

- In general company law is based upon majority rule. Thus the rule in Foss v Harbottle (1843):
  - (a) If a wrong is alleged to have been done to the company, it is the company that should sue.
  - (b) If the act complained of may be ratified by the majority of shareholders in general meeting, minority shareholders will not be permitted to cause the company to sue.
  - (c) Exceptionally, however, minority shareholders will be allowed to sue in the company's name where the alleged wrongdoers have voting control of the company. This is called a 'derivative' action.
  - (d) Minority shareholders may obtain an injunction to stop a company going into an *ultra vires* activity.

Note

Shareholders may be allowed to sue on behalf of the company when the board is refusing to do so. The most common example of this is where the directors are the alleged wrongdoers.

The rights of minority shareholders

- The holders of 15% of the company's shares may apply to court to have an alteration of the objects clause cancelled (S5 CA 1985).
- Minority shareholders may apply to the court to have a company wound up on the 'just and equitable' ground under S122(g) Insolvency Act 1986.
- This is likely to be regarded as a last resort and will only be granted if the company is solvent and the shareholder(s) can show that they will be able to recover a substantial sum.
- A shareholder may petition the court on the ground that a company's affairs are being run in a manner 'unfairly prejudicial to the interests of the members' under section 459 CA 1985. This is by far the most important and widely used remedy for minority shareholders.

Remember!

A company may now purchase its own shares. This may be useful to the directors in the event of dissenting minority shareholders.

The company secretary

- Every company must have a company secretary.
- A sole director cannot also be company secretary.
- A single member (shareholder) company requires two persons, one to act as a director and the other to act as company secretary.
- The first company secretary is appointed on registration of the company on Form 10.
- Company secretaries of public companies only must be qualified.
- The company secretary is an officer of the company in charge of administration.

Note

As an officer of the company, a company secretary has actual and ostensible authority to bind the company in contract.