Examiner's report

F4 Corporate and Business Law (LSO)
December 2011

General Comments

The performance of candidates overall continued to be unsatisfactory with a large number appearing to be unprepared for the examination. However, there is clear evidence of a growing number of candidates performing satisfactorily.

As usual, the examination was sufficiently testing to reveal those candidates who did not prepare well for the examination. However it did provide considerable opportunity to candidates to score high marks.

It has to be repeated again that candidates did not prepare for the format. The format does not help candidates who do topic spotting or question spotting. It demands that all candidates have to look at the syllabus, keeping in mind that all topics in syllabus have to be mastered. The old practice of selecting few topics and ignoring others simply cannot work. It also requires them to practise time management. The questions were clear in their demands and in line with the familiar pattern of the past examination papers. Many answers showed very superficial familiarity with the content of the course and the prescribed textbook.

The law examination is a technical examination and requires a good knowledge and understanding of the technical rules at the very least; problem scenario questions also require skills to analyse facts and then to apply the rules to the facts. Candidates and teachers should note that the problem scenario questions require much more in the way of analysis and application.

The overall result would have been considerably higher had candidates paid sufficient attention to the suggested answers to the past examination questions to get a feel of what is expected of them. The answers are available on the ACCA website; your course lecturer too could acquire them for you. Pay special attention to problem scenario questions. Candidates would do considerably better if they are asked to do mock examinations based on past question papers. Two or three such mock examinations would reveal where they have to improve upon and go a long way to improve their marks in the examination. Another suggestion is to ask the candidates to summarise the suggested answers to past examination papers in not more than 2 to 2 ½ pages. This should help them learn the quality of time management and to focus on what is asked in the question.

The key to marks lies in the breadth of knowledge of the leading cases. They are not many in any case. Candidates must also practise writing out the answers to questions; their prescribed textbook has many to choose from. This would give them the confidence and the ability to organise their thoughts. It was clear to the marker that the candidates on the whole did not prepare for the examination well, did not revise the syllabus and chose to ignore leading cases, as well as, key statutory provisions of the Companies Act. Too much guesswork and commonsense were used to answer the questions. There is no substitute for hard work and thorough preparation.

Specific Comments

Question One

This was a question asked candidates to explain and distinguish between the literal rule, the golden rule and the mischief rule. Except for a very few, almost all candidates answered this question well and scored high marks. On the negative side, candidates spent far more time answering it. Most answers were too detailed and too long.

Question Two

Part (a) tested candidates' knowledge and understanding of the law regarding a gratuitous promise. It is competent to enter into gratuitous obligations in Lesotho because the English doctrine of consideration does not apply in Lesotho. In *Conradie v. Rossouw (1919),* it was held by *Wessels AJA* that a good cause of action can be founded on a promise made seriously and deliberately and with the intention that a lawful obligation should be established, and that there is no need for consideration to be present in an enforceable promise. Since then so long as there is *justa causa* for the promise it will be binding.

Only a few candidates answered this question correctly. Many chose not to answer it at all. Many confused it with gratuity that some employees get at the end of their contract. Quite a few thought that the question related to social promises. Some answered it as promises binding on third parties. This was definitely the worst performed question by the candidates generally.

Part (b) - An offer is terminated by rejection. Any attempt to accept an offer on terms not contained in the original offer amounts to a counter-offer and a rejection of the offer. An offeree who makes such an attempt cannot later accept the original offer: See *Hyde v. Wench* (1840). Therefore, any one making a counter-offer takes a risk that if it is not accepted by the offeror, he will not be able to revive the original offer. If he does not wish to take that risk, he must not make a counter-offer.

However, an offer is not rejected merely by inquiring from the offeror whether he would be prepared to vary his terms: *Stevenson, Jacques & Co. v. McLean* (1880).

Almost all candidates answered this part of the question well. Many cited *Hyde v. Wench* (1840).

However, when it came to distinguishing a counter-offer from inquiries, quite a few performed unsatisfactorily. No one cited *Stevenson, Jacques & Co. v. McLean* (1880). Several referred to irrelevant cases.

Question Three

The relationship between employer and employees is known as a contract *of* service (employment contract), while that between an employer and independent contractor is known as a contract *for* services. Employees are those who work under a contract *of* service. Those who work under a contract *for* services are independent contractors. They are not employees, but are self-employed. It is essential, though, to distinguish between the two categories because important legal consequences flow from the placing of a person in one or other of the categories. Since the distinction has legal consequences, courts have developed three tests for distinguishing the two. The three tests are control test, organisation test and the multiple, or economic reality test.

Almost all candidates answered this question reasonably well. However, many candidates chose not to discuss the three tests and simply discussed some of the legal consequences that flow from placing a person in one or the other category. Discussing the tests was an integral part of the correct answer. Those who did not do so scored less as a result.

Question Four

This question was in two parts. The first part required candidates to explain the limitations on the use of company names and the second part the remedy of 'passing off'.

Part - (a) The Registrar may refuse to register a company by a name (i) which is identical with the name of another company, or (ii) which so nearly resembles the name of another company 'as to be calculated to deceive' (that is, likely to deceive) unless that company is in liquidation and signifies its consent to the registration of the new company with that name, or (iii) which is likely to mislead the public or to cause offence to any person, or (iv) which is suggestive of blasphemy or indecency [s 21(3) Companies Act, 1967]. In the last two cases (iii) and (iv) the Minister may direct the Registrar to register a company with such a name.

In addition, there are restrictions on the use of certain words in the name of a company. The words imperial, crown, royal, King, Queen, Regent, Government, Empire, state, commonwealth, dominion, United Nations or any other similar words cannot be used in the name of a company without proper authorisation.. Under the Industrial Property Order, 1989, trade names and trade marks which are registered or otherwise well-known in Lesotho cannot be expropriated and a company may not use them in its name because it may be harmful to legitimate business interests of other parties and also detrimental to public. [s. 21 Companies Act 1967].

Most of the candidates answered this question unsatisfactorily. No -one provided a complete answer. Many discussed completely irrelevant matter that had nothing to do with the question.

Part (b)-The remedy of passing off has been developed by the courts to prevent one person from using any name which is likely to divert business their way by suggesting that their business is actually that of some other person or is connected in any way with that other business. The remedy of passing off, thus, enables people to protect the goodwill they have built up in relation to their business activity. For a successful passing off action the complainant must show (i) that it is established in business under that name or has some other right to its use, (ii) that the company being sued is conducting business in such a way as to infringe the complainant's right to the use of the name, and (iii) that this is likely to cause damage to the complainant's business.

Unless the complainant is a very well-known person or company, the action is usually only available where the two companies are in a broadly similar line of business operating in the same or overlapping geographical areas. If the complainant's action is successful, the court will grant an interdict to stop the new company using the name. Damages are also available if infringement persists and there is, of course, the risk of legal costs.

Several candidates chose not to answer this part of the question at all. Others answered it partly.

Question Five

Part (a) This question asked candidates to explain and distinguish between companies limited by shares and companies limited by guarantee.

Section 2 Companies Act 1967 provides that 'company' means either a company limited by shares or a company limited by guarantee. In a company limited by shares, the liability of the members is limited to the amount, if any, unpaid on the shares held by them. The share capital of the company is divided into shares of a fixed amount, which determines the maximum liability of a shareholder in the event of the liquidation of the company. Were the shares fully paid up, the shareholder incurs no further liability should the company be wound up. Lastly, companies limited by shares must have a minimum of R1,000 as issued and paid up share capital.

On the other hand, a company limited by guarantee requires a licence granted by the Minister responsible for trade and industry. In such a company, the liability of the members is limited to such an amount as the members may undertake to contribute to the assets of the company in the event of its being wound up. [s 10, Companies Act 1967]. The liability of a member to make payment under the guarantee arises only when the winding up of the company has commenced. In the case of a company limited by shares a shareholder may be required to pay any amount outstanding on his shares, at any time during the lifetime of the company. Guarantee companies are not required to have a minimum capital and do not need a trading licence as they are essentially non-commercial.

On the whole, candidates could not explain the difference between the two satisfactorily. Several candidates only discussed companies limited by shares and omitted the discussion on the companies limited by guarantee.

Part (b) - Generally speaking, any limited liability company which is not a private company is a public company. There are a large number of differences between public and private companies. Most important of these differences are: (i) a private company have to raise its share capital through a private offer of shares and debentures. Any attempt to offer shares to the public may result it being declared a public company by default. (ii) A private company need not file a statement in lieu of prospectus to obtain a certificate to commence business. (iii) Directors of public companies, other than the first directors, must be voted into office individually at a general meeting, while two or more directors of a private company may be voted into office by a single resolution. (iv) Private companies require only one director; public companies require a minimum of two. (v) Proxies in a public company need not be a member, while they must be in a private company. (f) Private companies alone can use the written resolution procedure to pass resolutions. (vi) Private companies alone can make loans to their directors without the approval of the shareholders in a general meeting.

Most candidates discussed only some of the more important differences..

Question Six

Part (a) - A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with s. 4 Companies Act 1967.

Only a minority of the candidates explained the nature of a share properly. Most discussed the various kinds of shares that a company has and the rights of the shareholders therein.

Part (b) - A company may issue preference shares, if authorised by its articles [s 60(1) Companies Act 1967]. The articles may make provision for the issue of the following specific types of preference shares: (i) Cumulative preference shares; (ii) Participating preference shares and (iii) Convertible preference shares.

Quite a few candidates chose not to answer this part of the question at all. Others discussed it unsatisfactorily. Some discussed debentures and deferred shares.

Question Seven

This question required candidates to consider the important role of the company secretary in relation to the operation of companies. The essence of corporate governance is to ensure that companies are properly run and that their officers are accountable and subject to control. This is accomplished by setting up a corporate governance structure which distributes the rights and responsibilities among the different participants in the corporation, and spells out the rules and procedures for making decisions on corporate affairs. Company secretaries have an important function to perform in relation to proper conduct of company affairs.

Almost all candidates discussed the appointment, duties and powers of the company secretaries. Almost no- one attempted to discuss them in the context of corporate governance. No duty is cast on the board to ensure that the company secretary has the requisite knowledge and experience to discharge their functions. In the context of corporate governance, this seems to be a serious deficiency. A company secretary is often asked from time to time to provide advice and guidance to the board and its chair on all matters relating to corporate governance. *Lord Denning* in *Panorama Developments (Guildford) Ltd v. Fidelis Fabrics Ltd* (1971) observed that a company secretary is not a mere clerk but an organ of the company. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. While a secretary has no role in determining corporate policy or in managerial decision-making but he has to ensure that the policy and managerial decisions are implemented. All these have serious corporate governance implications.

Question Eight

This question required candidates to analyse the problem scenario from the perspective of the law of contract.

An agreement is the foundation of any contract. Agreement ordinarily refers to a meeting of minds of two or more parties. What the parties have said and done will often be used to conclude if there has been an agreement. So long as the parties *appear* to have agreed on the terms of the contract, there is, in law, a contract even though the parties to that contract may not actually be in agreement. This principle is called the principle of quasi-mutual assent and, it must be emphasised, operates only in favour of a party whose understanding and actions have been those of a reasonable man. The problem scenario required candidates to apply these principles.

Only a small minority of candidates answered this question properly. Many simply referred to *Pieters and Co. v. Salomon (1911)* by name or otherwise and chose not to discuss relevant legal principles. Candidates would score higher marks if they pay more attention to answering problem scenario questions. They pose a different kind of challenge as compared to an essay type question.

Question Nine
The first element of this question required a consideration of Nana's situation with respect to his potential liability. Partnerships cannot provide their members limited liability, unless the partnership has been registered as a limited partnership under the Partnership Act 1957. Partners did not go through the appropriate procedure for the establishment of a limited partnership. As a result, Nana is fully liable for any debts of the partnership and could be required to pay more than his agreed maximum payment of R100,000 to the third parties. Although he could be liable to outsiders beyond the R100,000, he would be able to claim reimbursement of any payments made above that limit from the other two partners, assuming that they were in a position to make such a payment. Only a few candidates discussed this.

The second element of this question concerned the liability of Viru. The partnership in the problem scenario is a trading partnership. So all the partners have the implied authority to borrow money on the credit of the firm and the bank is under no duty to investigate the purpose to which the loan was to be put. The partnership cannot repudiate the debt to the bank and each of the partners is liable for its payment. However, Viru will be personally liable to the other partners for the R10,000 and as a further consequence of the breach of his fiduciary duty not to act in any way prejudicial to the partnership business, the partnership could be wound up. No candidates discussed this.

The last element of the question concerned Timothy. Timothy's purchase of hair relaxers is clearly outside of the express provision of the partnership deed. Nonetheless the partnership is liable as the transaction is likely to be held to be within the implied authority of a partner in the sports goods business. Timothy, of course, is being liable to the other partners for any loss sustained in the transaction. No candidates discussed this either.

If the partnership cannot pay the outstanding debts then the individual partners become personally liable for it. One or more or all of the partners can be sued for the debt once it has been demanded from the firm, and those who have to pay have a right of reimbursement against the firm and their fellow partners. Once the debts owed to outsiders have been dealt with, only then the internal financial relationships of the partners amongst themselves will be dealt with according to the partnership deed. No candidates discussed this.

In short, this was an inadequately answered question. Almost all candidates discussed the liability of the partners generally without applying the principles to the facts in the problem scenario. Partnership cases, that have nothing to do with the problem scenario, were needlessly discussed. Candidates must learn the art of applying relevant principles to the facts in the problem scenario and reach apt solutions.

Question Ten
This question raises issues relating to the duties owed by the directors to their companies and the consequences of any breach of such duties. Directors have three duties: the duty to act *bona fide* in the best interests of the company as a whole, the duty to exercise their powers for a proper purpose and the duty not to allow his personal interests to conflict with his duties to the company. The problem scenario required candidates to look at these duties in the context of the given facts.

There can be no clearer instance of a conflict of interest than the situation of a director taking a bribe. The facilitation fee is a benefit from Graphics Ltd to induce Samuel to use his influence as a director to ensure the award of the contract to them. It is a bribe. As a result, Samuel has breached his fiduciary duty to Karibo Ltd and not only will he be liable to be dismissed from the board by a simple majority vote (Companies Act 1957, s.146), but he shall also be required to pay any money received from Graphics Ltd to Karibo Ltd.

Very few candidates saw the facilitation fee this way. Many did discuss that Samuel could be dismissed for accepting the benefit. Some wrote that Samuel could ask the shareholders or the board to allow him to keep the benefit.

Directors' powers should be used only for the purposes for which they were conferred and not for some extraneous or collateral purpose: *Howard Smith v Ampol Petroleum* (1974) and *Hogg v Cramphorn Ltd* (1966). The board of directors breached the duty because they used their power to allot shares, not for the primary purpose of raising capital for their company, but for the ulterior purpose of blocking a possible takeover. This could be taken care of by a subsequent general meeting ratifying the directors' actions. But without that ratification, Thomas could apply to the court to have the share allocation declared invalid. In that case, if any subsequent general meeting is called to ratify the improper use of the directors' powers, the directors would not be permitted to vote.

No candidate discussed this aspect of directors' duties and the relevant legal principles.

On the whole, this question was answered unsatisfactorily by all the candidates. The duties of directors are a very important topic of the syllabus.