Examiner's report

F4 Corporate & Business Law (LSO)
June 2013

General Comments

The examination consisted of ten compulsory questions. Three of them were problem scenario questions. 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.

This was the first examination based on the Companies Act 2011. Several candidates chose to apply the provisions of the Companies Act 1967.

The vast majority of candidates attempted all ten questions, and there was little evidence of time pressure. However, many candidates left one or more questions unanswered. This appeared to be due to a lack of knowledge or poor examination technique, as opposed to time pressure.

The performance of the 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.

The new 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 CA 2011 and 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 common sense were used to answer the questions. There is no substitute for hard work and thorough preparation.

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Inadequate time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish remaining questions.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes.

Specific Comments

Question One

This question asked candidates to explain the *importance* of the doctrine of precedent and delegated legislation as a *source of law.*

Lesotho courts are bound by the doctrine of precedent. Whether a decision is a binding precedent for a court on a particular issue depends on the position of the court in the hierarchy of courts in the country. However, in the wider context, the decisions of all courts, including the Court of Appeal must be consistent with the fundamental freedoms and human rights set out in the Constitution.

The actual part of the previous decision that is binding is the *ratio decidendi* of the case; that is the legal rule, which led to the decision in the earlier case. The *ratio* is an abstraction from the facts of the case. Everything else is termed *obiter dictum* and, although of persuasive authority, does not have to be followed by the later court. As the *ratio decidendi* of any case is an abstraction from, and is based upon, the material facts of the case, this opens up the possibility that a later court may regard the facts of the case before it as significantly different from the facts of a cited precedent and thus, consequentially, it will not find itself bound to follow that precedent. Judges use this device of distinguishing cases on their facts where, for some reason, they are unwilling to follow a particular precedent. There are numerous perceived advantages of the doctrine of precedent, amongst which are: consistency, certainty, efficiency and flexibility.

Most candidates did this part of the question well, though only a very few discussed the distinguishing of the cases as a technique to avoid applying a previous ruling.

Modern Acts of Parliament tend to be of the enabling type, simply stating the general purpose and aims of the Act. Such Acts merely lay down a broad framework, whilst delegating to government ministers the power to make detailed provisions designed to achieve those general aims. A validly enacted piece of delegated legislation has the same legal force and effect as the Act of Parliament under which it is enacted.

Delegated legislation may come in the form of regulations made by the Government ministers, bye-laws made by the local authorities and other public bodies, rules made by the High Court and the Court of Appeal to regulate procedures and regulations made by the professional bodies to regulate the profession. All forms of delegated legislation are invalid if they are *ultra vires* of the enabling legislation. The invalidity of a delegated legislation may be challenged in the courts through an action for judicial review.

Most candidates did this part of the question well. Some, however, thought that the courts, not the parliament, are a source of delegation and hardly any discussed that an invalid delegated legislation can be challenged through an action for judicial review. Some wrote that the source of delegated legislation is the power given to the ministers to make rules.

Question Two

This question tested candidates' knowledge and understanding about the ways in which an exemption clause may be incorporated into a contract by reference to OUTSIDE terms and conditions.

First, exemption clauses may be incorporated into a contract by reference to terms and conditions in *another* document. The document containing the reference must be a contractual document and not just a receipt or an invoice: see *Chapelton v Barry Urban District Council,* (1940). Furthermore, the existence of the exemption clause must be brought to the reasonable notice of the other party before, or at the time, the contract is entered into: see *Olley v Marlborough Court* (1949). Second, the exemption clause may also be incorporated by reference to previous course of dealing between the same parties if it could be shown that the contracting party had expressly or tacitly agreed to vary the existing contract: see *Dyer v Melrose Steam Laundry* (1912).

Not many answered this question well. By and large, candidates did not read the question carefully. The question asked them to discuss the incorporation of an exemption clause by reference to OUTSIDE terms and conditions. Most of the candidates chose to discuss signed documents and the narrow interpretation rule, which the question did not require. Reasonable notice was discussed but in the *context* of an unsigned document, not as an independent requirement to incorporate an exemption clause. Very few discussed both the ways in which an exemption clause gets incorporated into a contract. Very few referred to cases. Most candidates discussed the topic of exemption clauses generally. Candidates must focus only on those aspects required by the question. Some candidates discussed suspensive and resolutive conditions in answering the question on exemption clauses, which was not relevant.

Question Three

This question asked the candidates to explain the concept of wrongfulness in delict. The defendant's conduct is wrongful, if it infringes a legally-protected right or interest of another. Once it has been determined that there is an infringement of a legally-protected right or interest of another, then the courts inquire if it was unreasonable in the light of the facts and circumstances of the case. Courts often apply the test of *boni mores*, which is an objective test based on the criterion of reasonableness. To determine whether a defendant's conduct is reasonable, the courts consider and balance the conflicting interests of the parties, their relationship to each other, the particular circumstances of the case, whether the harm was foreseeable, whether any superior legal right exists, constitutional values and any other appropriate considerations of social policy.

Some candidates confused the breach of duty with the notion of wrongfulness; the latter is inextricably connected with *boni mores* or the legal convictions of the community. Most of the candidates explained the concept as causing harm to another intentionally or negligently. A large number of candidates wasted their time discussing passing off, manufacturer's liability, unlawful competition, elements of delict, *culpa* and the like. Candidates should realise that marks are awarded for answering what has been asked; displaying your knowledge about areas not asked do not help you to get marks. The two core elements were infringing the legally-protected interests of another and its unreasonability in the light of the legal convictions of the community. Barring one or two candidates, no -one focussed their answers on these core elements.

Overall performance on this question was unsatisfactory.

Question Four

This question required the candidates to explain and distinguish between actual and ostensible authority of an agent.

An agent, who has been expressly appointed may have both express and implied authority. Both express and implied authority are part of the actual authority of an agent. Implied authority is the actual authority, which the principal has consented, by implication, that the agent should have. It extends the scope of express authority. Third parties are entitled to assume that agents holding a particular position have all the powers that goes with their position: see *Goldblatt's Wholesale (Pty) Ltd v. Damali*s (1953). Ostensible (or apparent) authority arises

where a person makes a representation to third parties that a particular person has the authority to act as their agent without actually appointing them as their agent. There is a strong resemblance

between implied and ostensible authority and this may sometimes cause confusion. However, the two processes are, nevertheless, separate and distinct. In the one instance an actual authority is inferred from the conduct of the parties; in the other though there was no actual authority, the principal is prevented from relying on its absence to the prejudice of a person whom by his actions or his attitude he has misled.

On the whole, this question was answered well.

Question Five

This question asked candidates to explain the procedure for the formation of a limited company under the Companies Act (CA) 2011. Women married in community of property can also incorporate a company without obtaining the consent of their husband. No candidate mentioned that. The application for incorporation is required to state a number of things such as the company's proposed name, its trading name, if different, whether the company is to be public or private, its authorised share capital, the number of shares and the nominal value of each of the shares (though there is nothing in the CA 2011 which prevents a company from issuing no par shares), the main purposes/intended businesses of the company identified in terms of the Lesotho Business Classification Codes set out in Schedule I, a statement that the liability of the members is limited, rights, privileges, limitations and conditions attached to each share, if different from those set out in section 25 CA 2011, the maximum number of directors (at least two for a public company and one for a private one) and the names including prescribed details of each of the first directors and their consent, the address and contact details of the registered office of the company, and the address for the service of documents, whether the company would use the model or its own articles, and the shares taken by the promoters and the month and year the company expects to start its business. The application also declares that: "We agree to subscribe for the number of shares indicated opposite our names and hereby make application for company to be registered under the provisions of the Companies Act 2011.'

Very few candidates stated the requirements comprehensively. Some even mentioned the filing of memorandum of association, which is no longer a requirement. Some others confused between requirements under CA 1967 and CA 2011. Many candidates wasted their time writing the consequences of incorporating a limited liability company and about pre-incorporation contracts. As a result, candidates did not score well in this question.

Question Six

This question required the candidates to explain the meaning attributed to the term 'director' in the Companies Act 2011.

Companies Act 2011 provides a *functional* definition of a director by providing that a person is a director if they occupy the position of a director. It is the person's function rather than their title that defines them as a director and makes them subject to all the rules of company law that apply to directors. The director's function is to take part in making decisions by attending meetings of the board of directors. Anyone who does that is a director whatever they may be called. Furthermore, anyone who exercises, or is entitled to exercise, or controls the exercise of powers which would be exercised by the board is deemed a director under section 56(1). If articles require a director or board to exercise or refrain from exercising a power in accordance with a decision or direction of shareholders, a shareholder taking part in making such decision or direction is deemed to be a director in relation to that decision or direction. Any person who has been directly delegated by the board a power or duty that the board exercises, or who exercises the power or duty with the consent or acquiescence of the board is also deemed a director. If the articles of a company confer a power on shareholders which would otherwise be exercised by the board then a shareholder who exercises that power or who takes part in deciding whether to exercise that power is deemed to be a director in relation to the exercise of that power. In business parlance, these are called "deemed"or "shadow"directors.

However a person is not to be deemed a director simply for the reason that the directors act on advice given by them in a professional capacity. Thus neither accountants nor lawyers are made liable on the simple basis that they provide advice which the board of directors may act on.

Not a single candidate answered this question well. Candidates chose to discuss corporate governance, the procedure for appointing directors, the position of directors as employees, *alter ego* and trustees, duties and qualifications of the directors and the like. The question simply asked the candidates to explain the *meaning* attributed to the term 'director' in the Companies Act 2011, which nobody discussed. Consequently, all the candidates scored inadequately in this question. This could have been avoided had they focussed on what was asked in the question.

Question Seven

This question was in two parts. The first part required the candidates to explain the meaning of constructive dismissal. A very large number of candidates used expressions such as employer creating hardship or disliking the employee, or demonstrated unreasonable conduct, or misconducted themselves or created circumstances that were unbearable for the employee. Very few candidates explained that constructive dismissal occurs where the employer repudiates the contract by committing a breach which goes to the root of the contract: misconduct, hardship, unbearable circumstances, etc are simply not enough. The employee has to establish that a repudiatory breach occurred, that they left because of it and did not waive the breach for example, by remaining in the employment for too long. Constructive dismissal requires proof that there indeed has been a repudiatory breach going to the root of the contract.

As regards summary dismissal, section 63(2)(d) Labour Code 1992 allows an employer to dismiss an employee where there is a serious misconduct of such a nature that it would be unreasonable for the employer to continue to employ him during the notice period. Under section 79(2) Labour Code 1992 an employee dismissed fairly for serious misconduct is not entitled to severance payment either. The expression 'misconduct' has not been defined in the Labour Code. Therefore, common law is used to define misconduct. Again only a minority of candidates explained summary dismissal fully.

Candidates should remember that law is a technical subject.

Question Eight

This question tested candidates' understanding of the way in which contractual agreements are entered into, and the consequences of entering into such agreements. In particular it asks candidates to distinguish between offers and invitations to treat, offers and counter- offers and also consider options.

The advertisement in Daily News offering rare stamps for sale was an invitation to treat, and not an offer. Most candidates understood it well and stated it succinctly. They correctly identified that it was Mohapi who made an offer to buy the selected stamps. They also correctly stated that Sam made a counter-offer of R7,000 for the stamps and this amounted to rejection of Sam's offer. This part of the question was correctly answered by almost all the candidates. They also correctly referred to relevant cases. However a significant number of candidates stopped there and ended their answers. It affected their marks.

There was more to the problem. Sam granted Mohapi an option to keep his offer open, meaning that Sam made a binding promise to Mohapi not to sell the three stamps and wait for Mohapi's return. However when Mohapi returned to buy the stamps, he found that Sam had already sold them to someone else. Mohapi is entitled to take proceedings for damages against Sam for breach of the option contract, although this does not affect the validity of the contract made with the subsequent customer. This part of the problem was not answered by a very large number of candidates. Many candidates discussed suspensive and resolutive conditions unnecessarily. Some resolved the problem by applying the doctrine of fictional fulfilment. Others stated nothing could be done

because the stamps were already sold to someone else. Candidates should read a problem scenario question very carefully, apply their mind and answer all of its components.

Question Nine

This question required the candidates to analyse the problem scenario from the perspective of Chaba and Napo's potential liability under the Companies Act 2011. Best Greengrocers Ltd are insolvent and under section 125(2) Companies Act 2011 can be put into liquidation by the court on application by the Registrar of Companies, company itself, any of the shareholders, any of the director or creditor of the company. The realisable value of the company's assets is only R10,000 while the debts are R100,000. The sole question was whether Chaba and Napo are liable to contribute R90,000 to meet the liabilities of the company. No candidate understood this sole question.

A large number thought that the company should be put under judicial management. Many others applied Salomon's case and stated that Chaba and Napo have limited liability and if their shares are fully paid up, they are not liable to contribute at all.

Section 63(2) Companies Act 2011 requires that directors must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances taking into account the nature of the business of the company, the nature of the decision taken, the position of the director and the nature of the responsibilities undertaken by the director. Section 63(1) requires that a director, when exercising powers or performing duties, must act in good faith and on reasonable grounds in the interests of the company. Not a single candidate alluded to these provisions directly or indirectly.

No candidate mentioned that for breach of these duties, the directors are severally and individually liable to the company, its shareholders and any other person for any loss suffered by them. The reference to 'any other person' would include creditors of the company. No candidate mentioned that liability of the directors do not depend on their being dishonest. If it appears that, at some time before the start of the winding up, a director knew, or ought to have known, that there was no reasonable chance of the company avoiding insolvent liquidation, then unless the directors took every reasonable step to minimise the potential loss to the company's creditors, they may be liable to creditors for any loss suffered by them as a result of their actions. In deciding what directors ought to have known, the court is likely to apply an objective test, as well as a subjective one. Section 63(2) establishes a minimum standard by applying an objective test which requires directors to have the care, diligence and skill which may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company.

Since there was no real prospect of the company avoiding insolvent liquidation as early as January 2009, Chaba and Napo will be personally liable for any debts accrued by the company after that date, which in the problem scenario comes to R90,000. The realisable assets of the company are worth R10,000. As Chaba and Napo will be required to contribute R90,000 to the assets of the company as a consequence of their continued unwise trading, it follows that there is a total of R100,000 to meet the debts of the creditors. Consequently all of the creditors will receive 100% in payment of their debts.

No candidate scored well in this question. Probably, the candidates did not prepare the topic of directors well.

Question Ten

This question related to the authority of a partner to bind the firm, the position of third parties in such transactions and the right of a partner to renounce a partnership.

Most candidates correctly stated that the relationship between partnership and third parties is governed by the law of agency and that partners are agents of each other and liable jointly and severally. Mutual agency was mentioned by a large number of candidates. Most correctly wrote that a partner can bind the partnership if he

acts in the name of the partnership and within the scope of the partnership business. In the problem scenario, there is little doubt that what Ming ordered relates to the business of the firm.

In *Goodrickes v. Hall & another* (1978), it was held that the firm was bound to pay the creditors even if the ordering partner was expressly prohibited to do so as long as what was done was in furtherance of the partnership business and fell within the scope of the partner's implied or ostensible authority. No partnership can shelter behind private arrangements that are unknown to the third parties. The partners may be estopped from denying to a bona fide third party that the contracting partner did not have the requisite authority to enter into a binding contract on behalf of the partnership. Only a very few candidates stated that.

In the problem scenario, Tom did not know that Ming was prohibited to order materials from him. It was an internal limitation and would not affect Tom unless he knew it. Tom is, therefore, entitled to claim and receive R15,000 from the partnership and failing that from Chou and Ming. The partners are liable for the debts of the partnership jointly and severally to an unlimited extent. This part of the question too was inadequately answered by many candidates.

It did not matter if the partnership was registered or not because under section 28 Partnership Proclamation 1957 a creditor is free to enforce his claim against both registered and unregistered partnerships. This too was missed by the candidates.

In the problem, Chou, who contributed capital, did not take an active part in the running of the partnership business. However, this would not make him a limited partner. A limited partnership requires that the liability of the limited partner is clearly agreed to. This is not the case here. Consequently, the partnership, and the two partners, if need be, would be liable to pay Tom the full amount of R15,000. Many candidates incorrectly wrote that Chou was a sleeping partner and would not be liable beyond his contribution.

By ordering building materials from Tom Ming was in breach of his duty to observe the partnership agreement honestly. Ming's actions destroyed the mutual trust and confidence which is the foundation of any partnership. Chou, therefore, would be justified to renounce the partnership and unilaterally terminate the relationship on the ground that Ming's conduct in breaching the agreement wilfully has resulted in loss of confidence and that it would not be possible for them to work together. In short, the partnership can be dissolved. Only a handful of candidates wrote that.

On the whole, performance of the candidates in this question was unsatisfactory.