Examiner's report

F4 Corporate and Business law (LSO)

June 2014

General Comments

The performance of candidates overall continued to be unsatisfactory with a large number appearing to be unprepared for the examination. For the first time in many years, the number of candidates who did not attempt all ten questions was large. There was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or inadequate exam technique, as opposed to time pressure.

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.

The format of the exam, as in the past, does not help candidates who choose to rely on topic spotting or question spotting rather than trying to master all topics in the syllabus. 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 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. Pay special attention to problem scenario questions. Candidates would do considerably better if they do mock examinations based on past question papers. 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.

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 again.
- $ Inadequate layout of answers.

Specific Comments

Question One

This was a straightforward question asking candidates to explain the significance of the Southern African Customs Union (SACU) for the businesses in Lesotho. The objectives of the SACU Agreement include, (a) free and largely unrestricted movement of goods throughout the (Common Customs Area) CCA. Lesotho has a small market of about 1 million people but because of this objective, Lesotho businesses can take advantage of the entire market of CCA of more than 47 million people. Neither customs duties nor quantitative restrictions are imposed by any of the members of SACU on goods grown, produced or manufactured in the CCA. There are no rules of origin requirements either. Once goods have been imported into any one member country, they can move freely throughout the customs union area without the imposition of any tariff or restrictions. (b) The large CCA significantly increases investment opportunities in Lesotho because of the availability of relatively large skilled and educated manpower at relatively lower wage levels than South Africa. Indeed, several South African businesses have been relocated to Lesotho. (c) Increasing globalization requires the gradual integration of businesses in Lesotho into the global economy. SACU promotes this through enhanced trade and investment.

Indeed, Lesotho is Africa' s largest exporter of ready-made garments into the market of the United States. This has created both investment and employment opportunities. (d) Equitable sharing of revenue that is generated by the operation of customs and excise laws. The share of SACU revenue that Lesotho gets every year constitutes a significant part of the budget of Lesotho and is responsible for the business-friendly tax regime in Lesotho.

It is a common sight to see traders purchasing merchandise in South Africa for sale in Lesotho. The merchandise may be of South African origin or imported from another country. South African Rand is freely used throughout the CCA including Lesotho. Payment for the goods purchased in South Africa, therefore, is not a problem. Traders in Lesotho are permitted by the SACU Agreement to import into Lesotho any quantity of merchandise from South Africa without paying any customs duty. This was confirmed by the Court of Appeal decision in the case of *Don Min Hua* (2004).

A large number of candidates answered this question fairly well. However, many wasted their time writing about the history of SACU. Some candidates chose, instead, to discuss the hierarchy of the system of courts in Lesotho, which gained no marks.

Question Two

This question tested candidates' knowledge and understanding of the law relating to offer and an invitation to treat.

A large majority of the candidates correctly pointed that an offer, if accepted, brings into being a contract which imposes obligations on the parties to it which can be legally enforced. This is not the case in respect of an invitation to treat. Few also discussed that an offer made without *animus contrahendi* cannot give rise to a contract.

Many candidates wasted their time by writing very long answers. However, many candidates chose to discuss quasi-mutual assent and related cases, general offers and their acceptance, counter-offers and *Crawley* and Mrs Carlill's cases. This did not get them extra marks.

On the whole, most candidates scored high marks in this question.

Question Three

This question tested the understanding of the candidates regarding the duty to mitigate loss in relation to the remedies for breach of contract.

A plaintiff is not awarded the full amount of their loss if they did not mitigate their damage by taking reasonable steps to limit their loss. In *Forrester's* case (1978), between the time of his dismissal and the hearing of his case, Forrester had earned R300 from doing odd jobs. This amount was deducted when measuring his damages for breach of contract. In the *Victoria Falls case* (1915), the Mining Company reduced their loss of profit by keeping their old machinery working until the power arrived for the new machinery.

A fairly large number of candidates discussed *Hadley's* case and general and special damages and that if a loss was too remote, special damages could not be awarded, that no one should benefit from own wrong or that

losses incurred in contract means mitigation. Many candidates discussed Hadley's case to explain mitigation. All this was irrelevant to the question.

It is sometimes necessary to decide whether the plaintiff has incurred a particular item of expenditure to remedy the defendant's breach or to mitigate his damages. Where, for example, the defendant has failed to complete the work he has contracted to perform, the plaintiff may call in an outside contractor to complete the work. He will have to prove that the outside contractor's charges are reasonable if he relies on those charges as proof of the damages he has suffered. But if he has called in the outside contractor to mitigate the damages he would suffer if the work remained incomplete, it is for the defendant to prove that the plaintiff's action in paying those charges was unreasonable. This is not always an easy distinction to draw. Only a few candidates discussed this correctly.

Question Four

This question tested the understanding of candidates as regards the notion of fault in the law of delict. Most candidates did point out that a wrongful act is not enough to impose liability on the wrongdoer; he must also be at fault. A wrongdoer is at fault if he acted intentionally or negligently. Liability can be based either on intention (*dolus*) or on negligence (*culpa*).

Dolus is present if the defendant intended to cause harm and was aware of his wrongful conduct. It has two elements: intention to cause harm and knowledge of wrongfulness. Intention in the law of delict is not identical to the desire to cause harm. The wrongdoer will be found to have the necessary intention even if he did not wish the harm to be caused, provided he foresaw the possibility of harm, but nevertheless proceeded with his actions. *Wilkinson v. Downton* (1897) is an example. While many candidates did discuss *Wilkinson's case*, they did not relate the *ratio* of this case to the legal principle the notion of *dolus* embodies.

Intention also has a second element. The wrongdoer must have the knowledge that, under the circumstances it is, or might be, unlawful to cause the harm. This knowledge of unlawfulness is approached the same way as the intention to cause the harm. Only a few candidates discussed this.

In the absence of intention, the defendant's conduct may still be wrongful if he did not observe the standard of care which the law required of him. In such a case there is *culpa*. The foreseeability test is employed to determine this. *Cambridge Water Company v Eastern Leather Plc*, an unreported case, is an example. Several candidates did point out to this case but did not relate the *ratio* of the case to the underlying principle.

Several candidates discussed contributory fault in some detail. The question did not ask for it. Some others discussed vicarious liability and some even the concept of omission and how it might give rise to liability in delict.

Question Five

This was a straightforward question asking candidates to explain the circumstances under which a partnership can be dissolved by the operation of law. The circumstances are (a) insolvency, (b) supervening impossibility or illegality, (c) death of a partner, (d) partner becoming an alien enemy and (e) mental illness. A large number of candidates discussed some or all of these quite well. Alien enemy was often left out of their discussion. Some candidates prefaced their answers with detailed explanation of what a partnership is, the number of partners it

should be limited to and the requirement of sharing of profits. Many also discussed the process of dissolution of a partnership and distribution of assets on liquidation. A few candidates discussed *Salomon's case* as well.

Question Six

This was the best answered question in the exam and almost all candidates answered this question well and scored reasonable marks. The significance of name was not brought out clearly in a few cases because candidates mixed up their answers with what cannot be put in a company name. No candidates pointed out the significance of name as an identity of a company is a little less so now that the Registrar has to allot each company a company number as well.

A large number of candidates correctly discussed that the words (Pty) Ltd refer to a private company and Ltd to a public company and they were very well rewarded with good marks. A minority of candidates however thought the opposite was true.

Question Seven

This question required candidates to explain judicial management as an alternative to winding up under the Companies Act of 2011.

The focus of judicial management is to safeguard the continued existence of business enterprises in financial difficulties, rather than merely ensuring the payment of creditors. The aim of the judicial management order is to save the company, or at least the business, as a going concern, by taking control of the company out of the hands of its directors and placing it in the hands of a judicial manager. No candidate referred to this.

A company may be placed under judicial management by the court when a company is in difficulty, (a) because of mismanagement or any other issue, or (b) because the directors or other officers of the company have acted in a way that is contrary to the provisions of this Act, or (c) the assets of the company are being misapplied or misused and the viability of the company is threatened. No candidate discussed all three, instead most candidates discussed that a company is placed in judicial management when it is not able to pay its debts. Many candidates discussed in some length compulsory and voluntary winding up. A few candidates even brought into their discussion holding and subsidiary companies and their relationship.

An associated objective of judicial management is possibly to achieve a better result for the company's creditors as a whole than would be likely if the company were to be wound up. It is for this reason that a judicial manager is required to have experience in administering, or advising on the administration, of insolvent estates of companies. [s. 126 CA 2011]. It is the unsecured creditors that stand to benefit by the judicial management. Secured creditors hardly need protection because they enjoy a preferential right over the property of the company. [s.128(2) CA 2011] No candidate referred to this.

Question Eight

This question required candidates to analyse the problem scenario from the perspective of company law. For part (a) since the entire authorised capital of Sanderson Foods Ltd has been used up to issue fully-paid ordinary shares, the first step was to increase the authorised share capital so that new shares could be issued to Peter. Model article 27 authorises the shareholders to increase the share capital by passing a special resolution. Accordingly a special resolution would have to be passed by calling an extraordinary meeting to increase the

authorised capital, say by R5 million divided into 5 million shares of R1 each. Once the authorised capital was increased, directors will be able to issue new 1.5 million ordinary shares of R1 each at a premium of R1 to Peter. The Registrar has to be notified within 15 days of such issue in the Form 7 format.

Most of the candidates discussed the procedure for calling a meeting and voting. Only a few candidates pointed out that authorised share capital needed to be increased. But then they brought in extraneous matters like directors should consider issuing preference shares and the proposal to purchase a chain of fast food outlets from Peter, a shareholder, for R3 million, needed to be discussed with the shareholders first. This could be a result of not reading the question properly.

Section 19 Companies Act 2011 requires that if the consideration for the new shares consists of property then the board has to determine the consideration for which the shares are to be issued and, further, resolve that in their opinion, the consideration for the issue is fair and reasonable to the company, as well as, to the all existing shareholders. Making such a certificate knowing it to be false or misleading in a material way is an offence punishable, on conviction, with a fine of R500,000 or imprisonment for 20 years, or both. [s. 175 CA 2011].

The board of directors of Sanderson Ltd, thus, would have to make sure that R3 million is fair and reasonable for the food outlets not only to the company but also to all the existing shareholders. Section 63 of the Companies Act provides that it is a 'fundamental duty' of the directors to exercise their powers and perform their duties in good faith using such care, diligence and skill that a reasonable director would exercise in similar circumstances. Failure to do so makes the directors liable to the company and the shareholders individually and severally. The duties of directors were discussed generally without relating them to the problem scenario. No candidate discussed the importance of s. 63.

Candidates did not score well in this part of the question.

As regards (b) no candidate pointed out that neither the Companies Act nor the model articles have any specific provision on the rights issue. Companies are free to make provision for rights issue in their articles. It is assumed that the articles of Sanderson Ltd provide for it; if not articles would have to be amended. Section 20 of the Companies Act entitles a company to issue shares at any time and in any number it thinks fit so long as the total number of issued shares does not exceed the number of authorised shares. It is assumed that the authorised capital had been increased appropriately to take care of new shares for Peter and the rights issue. After the rights issue has been subscribed, the Registrar needs to be notified within 15 working days about the details of the rights issue and the contact details of the persons who have subscribed to the rights issue. The share premium has to be transferred to a share premium account.

No candidate answered this part of the question satisfactorily. As a result, candidates did not score well in this part of the question either.

Question Nine

This question tests candidates, understanding about redundancy and termination of a fixed term contract before the expiry of its fixed term.

The phrase 'redundancy' has not been used in the Labour Code Order, 1992, and for that matter in any other legislation in Lesotho. Section 66 Labour Code provides, in effect, that if an employee has been dismissed for a reason 'based on the operational requirements of the undertaking, establishment or service', then such dismissal shall not be regarded as unfair dismissal. The words 'operational requirements' of an undertaking or establishment have been interpreted to cover both redundancy and retrenchment. Dismissal has been defined to mean termination of employment at the initiative of employer. Redundancy occurs when an employer has ceased, or intends to cease, the business for which the employee was hired. It may also occur when the job for which a person was employed disappears for one reason or the other.

Many candidates did discuss this part of the question relatively well though only a few candidates discussed about the operational requirement provision of the Labour Code. The problem scenario specifically dealt with the application of this principle.

The work of the particular kind for which Joanthan was employed, namely, the preparation of teaching materials on taxation for South African students enrolled at Bloemfontein Technikon, had ceased and was no longer required. Accordingly, there is a *prima facie* case that that the operational requirements of the Institute no longer required Joanthan's services. So long as an employer fairly selects the employee for redundancy, the dismissal is not regarded unfair. The employee is also not entitled to hearing if the dismissal is on the ground of redundancy. From the facts, there was no indication that Joanthan was selected unfairly for dismissal on the ground of redundancy. This part of the question was dealt with by most candidates inadequately.

As regards (b) part of the question, Joanthan may not be able to claim compensation for termination of his contract before the completion of its term, if it was on the ground of 'operational requirements' of the undertaking. However, Joanthan was entitled to a severance payment under Section 79 Labour Code because he had completed more than 'one year of continuous service' with the same employer, even if the dismissal was fair. Severance payment is equal to two weeks wages for each completed year of continuous service. Joanthan has been in continuous service for 17 months and so the formula would entitle him to receive 23 days of wages. Few candidates indicated that Joanthan was entitled to 23 days of wages as severance pay. Most candidates indicated that he could sue for compensation for the remainder part of his contract.

Question Ten

This question asked candidates to explain and apply to the problem scenario the principles underlying formation of a contract and the doctrine of fictional fulfilment.

As regards (a)(i), Thabo and Susan are relatives. They can enter into a binding contract only if they have the requisite intention (*animus contrahendi*) to create legal relations. If the agreement between relatives is of a business nature, *animus contrahendi* is implied. The agreement between Susan and Thabo is of a business character; it involves benefits and detriments to both parties. Therefore, Thabo's offer and Susan's acceptance of that offer are valid and resulted in a binding contract.

While many candidates discussed it correctly, a large number of candidates discussed this part in terms of suspensive condition or that it could not result in a binding contract because parties to the contract were relatives. Discussion of suspensive condition was relevant to (b) not so much in (i).

For part (a) (ii), since the agreement was legally enforceable, Thabo was legally obliged to pay Susan R2,000 per month for so long as she remained at the Centre for Accounting Studies for the Registered Accountant programme. Of course, the payment cannot be for an indefinite period but only for a reasonable period. What was a reasonable period would depend on the facts and circumstances prevailing at the Centre. Apart from a few candidates, no one discussed this part of the question adequately. Many candidates stated that the agreement suffered from uncertainty because the period was not clearly stated and this made it void or voidable. Some others denied payment to Susan because the agreement between relatives could not result in legal obligations.

As regards (b), in Roman-Dutch Law, a contract with a suspensive condition is valid and binding from the moment it is made and neither party can resile from it. Thabo, therefore, cannot withdraw his promise to pay Susan R5,000 unilaterally. Moreover, if the conditional debtor – Thabo, in the question — prevents the fulfilment of the condition, then the doctrine of fictional fulfilment applies and the condition is deemed fulfilled as against the conditional debtor who prevented its fulfilment in order to avoid his contractual obligation: see Scott v. Poupard (1971). Thabo, therefore, is bound to pay Susan a bonus of R5,000, because she has passed the examination by December 2013.

No candidate discussed this part of the question well and except for a few, no one even mentioned fictional fulfilment. Consequently, candidates did not score well in this part of the question.

Conclusion

The format of examination requires a thorough preparation for the examination as all questions are compulsory. If a candidates stumbles in answering inadequately in 2-3 questions, the chances of their passing the examination gets slimmer. This time a fairly large number of candidates chose not to answer all 10 questions, affecting their chances of passing.