Answers

1 (a) Terms implied by custom or trade usage

Terms may be implied into a contract by adducing evidence of local custom or trade usage with respect to matters upon which the contract is silent. A local custom has been defined to mean a particular rule which has existed in a locality from time immemorial and obtained the force of law in that locality, even though it was not consistent with the common law of the land. 'Time immemorial' means for as long as anyone can remember. If anyone can prove that there was a time when it did not operate, then it cannot be implied. To be valid, a local custom must not be contrary to any statute. A good example is *Van Breda* v *Jacobs* (1921). Jacobs set his net first. But Van Breda and his crew of fishermen set their net between Jacobs' net and an approaching shoal of fish and, as a result, caught the whole shoal. Jacobs relied on a custom among fishermen between Cape Point and Fish Hoek which prohibited the interception of a shoal of fish in this way. It was held that a local custom which is contrary to the general law will be applied if it is proved beyond reasonable doubt and is long-established, reasonable, uniformly observed and certain. Jacobs succeeded in proving all these requirements and was awarded the value of the fish he would have caught.

A trade usage may be implied by law into contracts between persons engaged in a particular trade which has its own trade usages. Unlike a custom, a trade usage applies to a particular trade throughout the country. It is not confined to a particular part of the country. Unlike a local custom, it does not have the force of law but could become a term of the contract in two ways: first, if both parties to a contract are familiar with the trade usage, then it may be presumed that they have tacitly agreed to make that usage a term of their contract. Second, if one party is ignorant of the trade usage, they would be bound by that trade usage only if it can be shown that the trade usage has been universally and uniformly observed within the particular trade, that it has been long-established, is notorious, reasonable and certain, and does not conflict with any rule of positive law which the parties could not alter by their agreement. A trade usage, unlike custom, need not exist from time immemorial and must not be inconsistent with the common law of the land. Parties, of course, are free to exclude a trade usage by *expressly* agreeing to the contrary. Suppose, for example, a farmer delivered a quantity of mohair for sale at the mohair auction to a Bloemfontein agent. When the agent could not sell the mohair in the just concluded auction, the farmer demanded his mohair back. The agent may refuse to release it unless the farmer paid him the commission he would have obtained had he sold the mohair if he could prove a trade usage to that effect.

The spheres of operation of custom and trade usage differ. A rule of common law can be replaced by a valid custom but a trade usage can only vary contractual rules. Thus, while a local custom has to be proved beyond a reasonable doubt, a trade usage need not be proved as strictly. The classical *turba tertium* (Latin, for a crowd of witnesses) is not required; the evidence of one witness alone which is clear, convincing and consistent is enough. Instances of the usage having been acted upon should also be provided to establish the existence of the usage.

(b) Exclusion clauses

A party to a contract may attempt to include a term which excludes or limits his liability for the consequences of a breach of contract or negligence. Such clauses are known as an exclusion or exemption clause, and may be included as an express term in a contract or may be incorporated into the contract by reference to another document, or a notice or a ticket. Everyday examples exist in car parks, or cloakrooms, or dry cleaning establishments, where businesses seek to exclude liability by notices indicating that goods are left at the owner's risk, or words to similar effect.

Courts have tried to limit the effect of such clauses. The defendant may rely on an exemption clause only if it has been incorporated into the contract, and, in addition, if the exclusion clause, as a matter of construction, extends to the loss in question.

Establishing that the clause was incorporated into the contract is not difficult if the plaintiff signs a contractual document containing the exemption clause. In that case, the plaintiff is bound by it, even if the plaintiff has not read the document and regardless of whether the plaintiff understood it or not.

If the exclusion clause is contained in an unsigned document, then the situation is a little different. If it is contained in a notice or on a ticket, it will be up to the defendant being sued for a breach to establish that the document or ticket was of a type that could be presumed to be part of the contract, and that reasonable steps were taken to bring the term to the notice of the person receiving the ticket. The term must also be brought to the notice of the other party before, and not after, the contract has been formed.

Even if an exclusion clause is incorporated in the contract either by signature or by reasonable notice, the courts, while interpreting it, 'lean against them'. It means that courts will not allow a party to exempt themselves from liability unless the exemption clause clearly covered the breach that has occurred. The basic rule is that liability can only be excluded by clear words. Courts interpret the exemption clause narrowly and any ambiguity or uncertainty in the wording of the exclusion clause is interpreted against the *proferens*, i.e. the party who drew that clause.

2 Summary dismissal is dismissal without notice. 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 them during the notice period. Under s.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 Code. Therefore, common law can be used to define misconduct.

At common law whether employee's conduct amounts to a serious misconduct will depend on individual circumstances of each case. Dishonesty – theft, fraud, bribery, embezzlement and the like – drunkenness on duty, gross negligence or incompetence, wilful disobedience of lawful orders, revealing trade secrets of the employer, persistent idleness, competing with the employer in the same line of business and serious absenteeism have been held as instances of misconduct. In *Lehlohonolo Khoboko* v *Lesotho Building Finance Corpn* (1994), it was held that calling the managing director 'a madman/lunatic with a gun which he exercised in a dangerous manner' was an instance of serious misconduct. The Labour Court has held, more than once, that going on an illegal strike amounts to a misconduct. [*Lesotho Haps Development Co* v *Employees of the Lesotho Haps Development Co* (1995)]

In certain circumstances, misconduct outside the contract of employment may justify summary dismissal if there is a sufficient and clear nexus between such misconduct and the employer's business or if the misconduct is such that it seriously impairs the ability of the employee to carry out their duties in a satisfactory manner. For example, if an employer runs a private girls' school and one of the teacher employees regularly has sex with some of the female students outside the working hours with the result that the reputation of the school and the earnings of the employer suffer precipitously, it may justify summary dismissal.

It is common to suspend an employee for serious misconduct on full pay pending the outcome of disciplinary action. It is possible, however, to suspend an employee without pay as a penalty or corrective measure. In *National Union of Metalworkers* v *Delta Motor Corporation* (2003), one of the workers disregarded an instruction given by his supervisor. He was suspended without pay for one day as a disciplinary measure. It was challenged by the Union as an unfair labour practice and also on the ground that no disciplinary hearing was held prior to the suspension. It was held in South Africa by the Commission for Conciliation, Mediation and Arbitration that insubordination in many circumstances can even justify dismissal and the employer, in fact, had been lenient. It further held that an employer cannot be expected to hold a formal disciplinary hearing every time an employee breached a rule. Suspension without pay is an alternative to dismissal in cases of serious misconduct. The Lesotho courts are likely to follow this ruling.

In certain circumstances gross incompetence or serious neglect by an employee may justify a summary dismissal as well. In a Tanzanian case, an employee was specifically directed to put lubricating oil in a machine every 30 minutes to prevent overheating. He felt bored after some time and went away to get a drink. When he returned, the motor had been burnt due to lack of oil. His summary dismissal was held justified under the circumstances.

In *Tesekuoa Tsekoa and Others* v *General Manager, Lesotho Flour Mills and Others* (1988), all the workers of Lesotho Flour Mills went on strike in support of their claim for salary increments in line with the review of salaries in the Civil Service. The entire labour force was summarily dismissed on the ground, *inter alia*, that they had wilfully disobeyed lawful instructions of the employer to return to work. The High Court decided against the workers and the decision was confirmed by the Court of Appeal. Disobedience of an employer's lawful order can justify summary dismissal only when such disobedience is sufficiently serious and amounts to a repudiatory breach. In *Lesotho Flour Mills'* case, there was evidence that striking workers posed a serious threat to the safety of the plant and machinery and some of its regular customers.

In *National Union of Retail & Allied Workers* v *Sotho Development Corporation* (1996), the company dismissed two of its workers following a disciplinary hearing where they were found guilty as charged. This led to all the workers going on an illegal strike demanding the reinstatement of their two dismissed colleagues. Management tried to inform the workers several times that the dismissed workers could challenge their dismissal before the Labour Court if they so wished, rather than resorting to an illegal strike. Eventually, the management gave them an ultimatum that if they chose not to return to work, they should consider themselves suspended. The Labour Court upheld their dismissal that, under the circumstances, failure to return to work was a repudiation of their contract of employment.

3 This question requires the candidates to explain and distinguish between liquidated damages and penalty clauses.

Liquidated damages are an amount representing a genuine pre-estimate by the parties of the loss which the injured party is likely to suffer through a breach of contract. It is a real attempt to estimate in advance what the loss will be. A penalty, on the other hand, is an extravagant sum in the nature of a threat held over the other party for the purpose of securing their performance. It is designed to intimidate them to comply with the contract.

If the sum payable is liquidated damages, then, provided the plaintiff can prove a breach of contract, they are entitled to the sum. Contrary to the general rule, they do not have to prove that they have suffered any damages. The sum cannot be increased or reduced by the court since the parties have agreed to it.

The courts take an entirely different view of penalties. Since they are imposed only to secure performance, the plaintiff must prove not only the breach of contract but also the actual damage they have suffered. The plaintiff can recover damages, but not more than the amount of the penalty. Where the amount mentioned in the contract does not compensate for the actual loss suffered by the innocent party, they may ignore the penalty and recover damages in full in an action for breach of contract. It is only where they sue on the penalty that they cannot recover in excess of it. This does not apply to liquidated damages and the plaintiff can never recover in excess of the sum agreed under whatever head they bring their action.

In deciding the legality of such clauses, the courts consider the effect, rather than the form, of the clause. Even if the contract expressly stated that damages for late payment would be paid by way of a penalty of a certain sum, if the court found that the stipulated sum was in no way excessive and represented a reasonable estimate of the likely loss, the court would enforce the clause in spite of its actual wording: see *Cellulose Acetate Silk Co Ltd* v *Widnes Foundry* (1933).

How to tell whether a sum is a penalty or liquidated damages

This is a question of interpreting the contract in order to discover what the parties intended. The words which they themselves used will not necessarily be decisive for a penalty may be found disguised as liquidated damages. The courts have formulated the following rules for deciding the issue:

(a) If the sum is extravagant in relation to the greatest loss which could follow from a breach, it is a penalty. Thus, if a builder agrees to pay R1,000 per day if he fails to finish a job by a specific date and the job merely relates to the repair of a small house for which he is to be paid R100, this sum is clearly excessive and a penalty.

(b) If the obligation is to pay a certain sum of money and the parties agree that if the promisor fails to do so they shall pay a much larger sum, this is a penalty. It is because failure to pay money on a fixed date only causes the innocent party to lose the interest on that sum.

(c) If a single lump sum is payable upon the occurrence of one or more of several events, some of which may result in serious damages and others in merely trivial loss, there is a presumption that this is a penalty. This is because such provision suggests that there has been no serious and genuine attempt by the parties to make an assessment of the loss which might result. In *Pearl Assurance Co Ltd* v *Union Government* (1934), the appellants guaranteed to the respondents that they would pay them £10,000 if a firm of diamond cutters did not perform certain obligations. These obligations consisted of the erection of a factory, the provision of machinery, the importation of skilled workmen, the training of 100 apprentices and the payment of the wages of the apprentices at an agreed rate. Clearly a failure to pay an apprentice the agreed wage would not be as big a breach as the failure to put up a factory. Yet the £10,000 was payable whatever the breach. The Privy Council held that this was a penalty and that therefore the respondents had to prove the actual damage which they claimed they had suffered.

(d) It follows from the presumption above that if one sum is payable upon only one breach, this may be regarded as indicative of liquidated damages. However, this too is only a presumption and it can be rebutted.

It may be added that the law in Lesotho is same as the law in the United Kingdom in view of the Privy Council decision in *Pearl Assurance Co* v *Union Government* (1934). In South Africa, the case has been overruled by the Conventional Penalties Act 15 of 1962.

4 Defective consumer products create a serious risk for an unwary consumer. This is typified by the celebrated English case of *Donoghue* v *Stevenson* (1932) in which a woman enjoying ginger ale in a café suffered shock and gastroenteritis when she poured the remains of the bottle into her glass and, to her horror, out came the remains of a decomposed snail. In the Anglo-American jurisprudence, it is covered by what is called products liability law. In Lesotho's law, an *Aquilian* action would lie.

Wrongfulness of the manufacturer's conduct lies in the violation of a legal duty. In accordance with the legal convictions of the community (*boni mores*), the manufacturer has a duty to take reasonable steps to prevent defective products from being placed on the market and infringing the interests of consumers. In *Ciba-Geigy (Pty) Ltd* v *Lushof Farms* (2002), it was stated that a manufacturer acts wrongfully if they make a defective product commercially available which causes damage to a consumer of the product. A product may be considered defective if it fails to meet the expectations of a reasonable consumer with regard to its safety. The presence of a defect in a product is a necessary pre-requisite for wrongful conduct of a manufacturer. In *Ciba-Geigy case*, Ciba-Geigy were manufacturers of a herbicide for eradicating weeds, which they claimed was safe for use in pear orchards. The plaintiff bought it and used it on his pear orchards in accordance with the printed instructions. The pear crop suffered damage because of the herbicide. It was held that Ciba-Geigy were wrongful in placing a defective product on the market.

Apart from wrongfulness, the plaintiff has to establish that there was negligence (fault) on the part of the manufacturer. However, a plaintiff has no knowledge of, or access to, the manufacturing process either to determine its workings generally or, more particularly, to establish negligence in relation to the making of the item or substance which has apparently caused the injury complained of. To get around this problem, British courts use the doctrine *res ipsa loquitur* (facts speak for themselves). This doctrine raises two presumptions: first, the presumption that the manufacturer used an unsuitable manufacturing process, and the second, the presumption that the manufacturer's employees were negligent in executing the manufacturing process. In practice, it is very difficult for a manufacturer to rebut these and, as a result, a no-fault liability arises.

Lesotho courts too make use of the *res ipsa loquitur* doctrine but they do not use it in a similar fashion to impose a no-fault or strict liability on manufacturers of defective products. In *Wagener and Cuttings* v *Pharmacare Ltd* (2003), it was strenuously argued that the fundamental human rights in the Constitution require the court to protect the life and health of the consumers by developing strict liability for the manufacturers of defective products. It was further argued that while in a sale, the seller impliedly warrants that the product is free from latent defects, there is no similar warranty in delict in regard to manufacturers. The court, however, declined to do so, saying that it was a task for the legislature. The plaintiff's remedy is limited to the *Aquilian* action to protect their physical integrity. In due course, perhaps courts may gradually refine and develop the *res ipsa loquitur* doctrine to assist the plaintiff. In *Wagener and Cuttings case*, Anna and Rita were, at different times and in different hospitals, injected with Regibloc, a local anaesthetic, which because of negligent manufacturing was defective. It caused paralysis in both the women. The respondent manufacturer contended that the appellants had failed to prove fault (negligence) in the manufacture of Regibloc. The court accepted that the respondent manufacturer was under a legal duty in delict to avoid reasonably foreseeable harm resulting

from defectively manufactured Regibloc being administered to the appellants and, secondly, that duty was breached. Thus, wrongful conduct on the part of the respondent was clearly established. But the respondent manufacturer contended that this was not enough and they were not liable because the appellants had failed to prove fault (negligence) in the manufacture of Regibloc. The appeal did not succeed because the focus of appellants' arguments was on establishing strict liability for manufacturers. They did not plead *res ipsa loquitur* to establish fault.

In *Ciba-Geigy case*, the court stated they were *prima facie* negligent in not including a warning in the instructions for use of the herbicide that it may be harmful to pear trees. The onus then shifted to Ciba-Geigy to establish that they acted like a reasonable manufacturer and carried out necessary tests to determine the effect of the herbicide on the pear trees. They failed to prove it and, therefore, were held liable in delict to compensate the plaintiff. This appears to be nothing but an application of *res ipsa loquitur* doctrine.

5 This question requires a discussion of the various ways in which the relationship of the principal and agent can be created.

Generally speaking, the relationship of principal and agent can be created in writing or by oral agreement between the parties or by the conduct of the parties. Agency may be created by an express or implied agreement, or by ratification or by estoppel.

(a) **Appointment by express agreement**

A person may be appointed an agent by express agreement with the principal. This agreement is usually a contract and the usual rules for the formation of contracts apply. Generally speaking, no formalities are needed to appoint an agent; the agreement can be oral or in writing, or partly oral and partly in writing. But there are few exceptions. The Deeds Registry Act, 1967, for example, requires that an agent executing a deed has to be authorised by the owner in writing by a power of attorney.

(b) **Appointment by implied agreement**

If the parties have not expressly agreed to become principal and agent, it may be possible to find an implied agreement based on their conduct or relationship. The assent of the principal may be implied where the circumstances clearly indicate that they have given authority to another to act on their behalf and the assent of the agent may be implied from the fact that they have acted intentionally on another's behalf. See: *Coetzer* v *Mosenthals Ltd* (1963).

(c) **Agency by ratification**

In certain circumstances, the relationship of principal and agent can be created or extended retrospectively under the doctrine of ratification. What this means can be explained by an example. If Thabo purports to act as an agent of Peter in a certain transaction – although Peter never authorised Thabo to do so –, Peter may subsequently ratify or adopt what Thabo has done. In such a case, Thabo is deemed to have been acting as an authorised agent when he effected the transaction. However, ratification validates only past acts of the 'agent' and gives no authority for the future. Ratification does not require any special form and can be express, implied or even inferred from the conduct.

There are a number of conditions which need to be satisfied before a principal can ratify the acts of an agent:

(i) The principal must have been in existence at the time the agent made the contract.

(ii) If an agent does not disclose that they are entering into a contract on behalf of a principal, then the undisclosed principal cannot ratify the acts of such an agent.

(iii) If the principal does not have the capacity (for example due to minority) to enter into the contract, then they cannot ratify a contract entered into by an agent in their name.

(iv) A principal cannot ratify a contract entered into by the agent, where the contract is void.

(v) Ratification must take place within a reasonable time.

The effect of ratification is to make the transaction binding on the principal from the moment it was made by the agent. Since the doctrine of ratification allows a principal to choose whether to ratify a transaction or reject it, it may be potentially unfair to a third party.

(d) **Agency by estoppel**

Agency by estoppel is created when one person (the principal), by words or conduct, allows another to appear to the outside world as their agent, with the result that third parties deal with them as an agent, and would suffer prejudice, were the principal to repudiate this apparent agency. In such circumstances, the principal is treated as if they had in fact authorised the agent to act in the way they did. In such cases, the 'principal' is said to 'hold out' as their agent someone as having authority to act on their behalf.

6 The legislature has always been ready to remove the shield of limited liability and impose legal liability for the obligations of the company on the shareholders or directors personally in a small number of cases.

(a) **Minimum numbers:** Under what was s.29 Companies Act 1967, if the company carried on business for more than six months with fewer than two members in a private company or below seven in a public company, any person who was a member after those six months became liable for the payment of debts of the company contracted during that period. This rule stands abolished in the Companies Act 2011 as any company, public or private, can be formed by a single member alone.

(b) **Misdescription of the company:** Under what was s.86(4) Companies Act 1967, directors incurred personal liability where they signed or authorised the signature on behalf of their company on any bill of exchange, promissory note, cheque or order for money or goods, and the name of the company was not mentioned thereon in legible characters unless the amount was duly paid by the company. Common examples were when the word 'limited' was omitted or when the company was described by a wrong name. Under s.17 Companies Act 2011, it is mandatory for every company to state its full name, including its number issued by the Registrar, and address clearly on all documents issued or signed by or on behalf of the company. If the company fails to do so, the directors or its officers who knowingly or negligently cause the failure are jointly and severally liable to compensate any person who suffered loss as a result. As before, it makes no difference that the third party has not been misled by the misdescription.

(c) **Fraudulent trading:** Section 275 Companies Act 1967 provided that if, in the course of winding up or judicial management of a company, it appeared that any business had been carried on with intent to defraud creditors or for any fraudulent purpose, the courts, on the application of the Master of the High Court, the liquidator, the judicial manager, a creditor or a member, might declare that any persons, including present and past directors, who were knowingly parties to the fraud shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company. There is no corresponding section in the Companies Act 2011.

One wonders if the framers thought that s.63, which deals with fundamental duties of a director, could be used to cover both wrongful and fraudulent trading. Section 63 requires that a director must always act in good faith in the interests of the company when exercising his/her powers or performing his/her duties. The directors, including former directors, are severally and individually liable to the company, its shareholders and any other person for any loss suffered by the company, its shareholders or any person as a result of the directors' failure to perform their duties.

Both fraudulent and wrongful trading are incompatible with the directors' duty to act in good faith in the interests of the company. If so, they can be made liable, individually and severally, not only to the company and its shareholders but to any other person as well for any loss they may have suffered as a result of fraudulent and wrongful trading.

(d) **Group companies:** Even relatively modest businesses often operate through a group of companies and large businesses invariably do. The principle of limited liability applies to group companies and the courts do not pierce the veil within a group of companies simply on the ground that the group constitutes a single economic entity. However, when it comes to financial reporting, the position is different. When the holding or parent company controls others (subsidiary and sub-subsidiaries companies), a 'true and fair' view of the overall position of the company may require the parent company to present group financial statements, as well as its own individual statements to avoid the misleading impression which the latter alone might give. Section 94 Companies Act 2011 obliges the board of directors to produce group accounts at the end of the financial year. The group accounts may consist of more than one set of consolidated statements dealing respectively: (i) with the company and subsidiaries and their sub-subsidiaries, or (ii) with the company and each of the subsidiaries, or (iii) with the company alone but expanding the information about the subsidiaries in the company's own statements, or (iv) any combination of these.

Group accounts need not deal with a subsidiary of a company if the board of directors are of the opinion that: (i) it is impractical, or (ii) would be of no real value to shareholders of the company in view of the insignificant amounts involved, or (iii) would involve expenses or delay out of proportion to any value that shareholders of the company may derive, or (iv) if the result would be misleading.

Under s.2(2) Companies Act 2011, a company is a subsidiary of another company (its holding company) if the latter: (a) controls the composition of the board of the subsidiary company and is in a position to control majority votes that can be exercised at a meeting of the subsidiary company, or (b) holds more than half of the issued voting shares of the subsidiary company, or (c) is a subsidiary of a company which is itself a subsidiary of the holding company.

7 This question tests the understanding of the candidates regarding the limitations placed on the powers of a company to issue shares at a discount under the Companies Act 2011.

It is a basic principle of company law that every share of a limited company must have a nominal value. Regulation 8 Companies Act 2011 provides that once a company has been duly registered, it shall be issued with a 'document setting out the particulars of the company'. Schedule 6 details such particulars. One of them specifies the share capital of the registered company and the nominal value of the share it has been divided into. Unlike the Companies Act 1967, a registered company does not have a memorandum of association. It only needs to file an application for incorporation, para 4 of which requires the proposed company to state the authorised share capital with which the company proposes to be registered.

Members of a limited company have limited liability and are not required to contribute more once they have paid in full the amount payable on the shares. Shares cannot be issued by a company at a discount to their nominal value. This was established in *Ooregum Gold Mining case* (1892) where members, who acquired the shares of the company at a discount, were forced to pay the amount that was necessary to make up the total amount equal to the nominal value of their shares. It is argued that for the creditors, it was natural to look to the share capital of a company as their security and that they might be prejudiced if a company is allowed to issue shares at a discount. There is nothing in the Companies Act 2011 or in the model articles that allows a company to issue shares at a discount.

However, the utility and rationale of the rule have been questioned. First, once a company starts trading, a company's net asset value may not correspond with its share capital. Accordingly, a creditor is normally interested not so much in the nominal or

paid-up share capital of the company, but the assets and liabilities at a particular time. In other words, it is not entirely accurate to say that creditors look to the nominal share capital as their security. Second, when a company nears insolvency, its shares may trade at less than the nominal value. If the company wishes to raise more capital, it cannot expect investors to pay more than the prevailing market price for the shares. Yet the *Ooregum Gold Mining case* (1892) prevents a company from accepting the economic reality in the pricing of the new issue of shares, even though it may help the company to come out of insolvency. The creditors are very likely to benefit if the value of share capital goes up, no matter how little, through the new issue.

Perhaps, the rule in *Ooregum Gold Mining case* (1892) protects shareholders, rather than creditors, in as much as it prevents a company from devaluing the interest of existing shareholders in the company by issuing new shares at a discount.

From a practical point of view, *Ooregum Gold Mining case* (1892) rule has lost its utility completely because nowadays virtually every company intentionally keeps the price of their nominal shares low and raises most of the capital from the share premium. A subsequent issue with a lesser premium does not attract the wrath of *Ooregum* rule. Section 19(2) Companies Act 2011 authorises the board of directors to 'decide the consideration for which the shares shall be issued' and further, 'resolve that in their opinion the consideration for and terms of issue are fair and reasonable to the company and to all existing shareholders.' The directors supporting the resolution must certify this in writing and lodge the certificate with the Registrar within 15 days of the resolution.

The primary objective of s.19(2) is to regulate the issue of shares by a company for non-cash consideration, which is quite common. In *Re Wragg* (1897), it was observed that provided a company does so honestly and not colourably, an agreement to pay for property or services in paid-up shares is valid and binding on it. Since the vendor may sell his property or his services at a profit, it may be possible to 'water' the shares by accepting in payment something actually worth less than their normal value. But if the 'consideration given by way of payment is a mere blind or clearly colourable or illusory, it would be ineffectual. All that the Companies Act 1967 required in s.56(1)(b) was that the consideration must be disclosed and the contract of sale, as well as the contract allocating the shares signed by both the parties filed with the Registrar. The scenario has been considerably improved by virtue of ss.19(2) and 63(3) Companies Act 2011. The effect of these provisions is to require the board to certify in writing that the non-cash consideration for the issue of shares is fair to the company and all its shareholders and makes the directors, including former ones, liable, severally and individually, to the company, shareholders and any other person for any loss suffered by the company.

Lastly, s.19(8) Companies Act 2011 makes it lawful for a company to pay a commission or grant discount to any person in consideration of his or her subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares in the company, provided such commission or discount does not exceed 5% of the issue price, is authorised by the directors and disclosed in the prospectus or statement in lieu of prospectus.

8 The problem scenario deals with a pre-incorporation contract. A pre-incorporation contract has been defined under the Companies Act 2011 as a contract made by a person on behalf of a company before and in contemplation of its incorporation.

Until Royal Hotel Company Ltd has been incorporated, it cannot enter into a contract. Nor, once incorporated, can it become liable on, or entitled under, the contract purported to be made on its behalf prior to incorporation. Royal Hotel Company Ltd cannot ratify the contract either because ratification is not possible when the company did not exist at the time the original contract was made. Two contracting parties are necessary to a contract, whereas the company, before incorporation, is a non-entity.

However, Royal Hotel Company Ltd may be liable on a pre-incorporation contract made on its behalf under s.10 Companies Act 2011.

Section 10 requires that before entering into a pre-incorporation contract on behalf of the company, the promoters first must reserve the proposed name of the company with the Registrar and then incorporate the company with the same name within 14 days. It is assumed that Samuel made his offer after making sure that all this had been done by the promoters. If not, then the pre-incorporation contract becomes null and void and Samuel would not be able to benefit from the provisions of s.10 Companies Act 2011.

Section 10 allows the company to ratify a pre-incorporation contract after its incorporation. Since no period is specified in the contract, Royal Hotel Company Ltd may ratify it within a reasonable time after the incorporation. Under the Model Articles of Incorporation, the business of the company is managed by the directors and they have the power to ratify the pre-incorporation contract made on behalf of their company by the promoters.

Section 10 also takes care of a situation where a promoter enters into a pre-incorporation contract on behalf of the company, but the company chooses not to ratify. Unless a contrary intention is expressed in the contract, a promoter who enters into a pre-incorporation contract impliedly warrants, that (a) the company will be incorporated within the period specified in the contract, or if no period is specified, within a reasonable time after the making of the contract; and (b) the company will ratify the contract within such period. The promoters in the problem scenario did not express a contrary intention.

For breach of this implied warranty, Royal Hotel Company Ltd would be liable to pay damages to Samuel. The court would proceed on the basis as if the pre-incorporation contract were ratified by Royal Hotel Company Ltd and then cancelled by it unilaterally. The court would award damages to Samuel on the ground that the company failed to perform its obligations under the pre-incorporation contract made by the promoters on its behalf.

Section 10 also entitles Samuel, if Royal Hotel Company Ltd does not ratify a pre-incorporation contract after its incorporation, to approach the court for an order:

(a) that the furniture acquired by Royal Hotel Company Ltd under the contract be returned to Samuel (the seller); and

(b) for any other relief in relation to that furniture, for example, compensation for use or damage to the furniture; or

(c) specific performance of the contract.

Section 10 Companies Act also covers a situation when a company after ratifying a pre-incorporation contract breaches it. In that case, Samuel can approach the court, which may make such order for the payment of damages or other relief as the court considers just and equitable.

9 This problem tests the understanding of the candidates as regards the principle that a company has legal personality separate from the shareholders.

The first thing Thabo should be advised about is the validity of a one-man company under the Companies Act 2011.

In *Salomon* v *Salomon & Co* (1897), since Salomon was a predominant shareholder having all the shares except six that his wife and their five children held, he controlled the company and it was effectively a 'one-man company'. However, the legitimacy of this arrangement was accepted by the court. *Salomon's case*, thus, foresaw the formation of single shareholder companies. Section 5 Companies Act 2011 allows the registration of a one-man company. In the problem scenario, Thabo Boots & Shoes (Pty) Ltd was registered after the enactment of the Companies Act 2011. Therefore, the company is legally established.

Second, Thabo should be advised about the validity of his contract with the company.

In *Lee* v *Lee's Air Farming Ltd* (1961), it was held that a person could be the controlling shareholder and the managing director and could also be an employee of the company under a contract of employment. However, in the following three circumstances, an alleged contract of employment could be ignored:

(i) where the company itself was a sham;
(ii) where it was entered into for an ulterior purpose; and
(iii) where the parties did not conduct their relationship in accordance with the contract of employment.

Though the mere fact that an individual had a controlling shareholding would not of itself prevent a contract of employment arising, yet it might raise doubt as to whether Thabo was an employee. In the problem scenario, there is no indication that Thabo Boots & Shoes (Pty) Ltd is a sham, or Thabo entered into the employment contract for an ulterior purpose or that Thabo and Thabo Boots & Shoes (Pty) did not conduct their relationship as employee and employer. Therefore, Thabo is a validly employed employee of the company: see *Clark* v *Clark Construction Initiatives Ltd* (2008).

Third, Thabo should be advised about his claim under the insurance policy for the fire damage.

Any business assets are owned by the company itself and not the shareholders. This is normally a major advantage in that the company's assets are not subject to claims based on the ownership rights of its members. It can, however, cause unforeseen problems as may be seen in *Macaura* v *Northern Assurance* (1925). Macaura had owned a timber estate and later formed a one-man company and transferred the estate to it. He continued to insure the estate in his own name. When the timber was lost in a fire, it was held that Macaura could not claim on the insurance as he had no personal interest in the timber, which belonged to the company. In the problem scenario, though Thabo is the sole shareholder of the company, he does not have any ownership rights over the company's property. Thabo took out the insurance policy in his own name in 2010 prior to the incorporation of Thabo Boots & Shoes (Pty) Ltd. He should have assigned the policy to the company and made the company pay the policy premia from then on. That way the company would have an insurable interest and would be able to recover for the fire damage. Since this was not done, neither the company nor Thabo would be able to claim from the insurance company.

Last, Thabo should be advised about his claim as a secured creditor of the company.

Thabo is a secured creditor and the company is solvent. Since the company has assets that exceed its liabilities, Thabo as a secured creditor of the company is entitled to and shall be paid back the loan (R30,000) he advanced together with the interest, if not already paid, in full. Like *Salomon's case*, shares in the company were allotted to Thabo in respect of the business that was transferred to it for non-cash consideration. In law, the company is entitled to place whatever value it likes on the assets transferred to it in the absence of fraud: see *Re Wragg Ltd* (1897). Thabo, as a shareholder, has a right to a return of capital once all the debts are paid off.

10 Money laundering is the process by which the proceeds of a criminal activity are disguised to conceal their origin. The intention is to convert such proceeds into assets, which appear to have a legitimate rather than an illegal origin so that the holder can enjoy them free from suspicion as to their source.

Money laundering usually involves three basic steps:

(a) Placement: The launderer disposes of the proceeds of criminal activity into apparently legitimate business activity or property.
(b) Layering: It involves the transfer of money from business to business, or place to place, in order to conceal its initial source.
(c) Integration: This is the final phase when the money takes on the appearance of coming from a legitimate source.

In the problem scenario, Sam, with the help of his accountant Harry, disposes of the proceeds of illicit diamond sales by using them in building the apartment complex. Ostensibly, the building of the apartment complex has been funded by the bank loans and savings from Sam's legitimate contracting business. The real cost of building the apartment complex has been concealed with the help of Harry, the accountant. Once the apartment complex is ready, Sam rents out some of the individual apartments at a good rent and disposes of some others at huge profit. The rents and the sale proceeds from the apartments take on the appearance of coming from a legitimate source.

The whole scheme is nothing but a money laundering activity and is prohibited by s.25 Money Laundering and Proceeds of Crime Act (MLPCA) 2008.

MLPCA 2008 seeks to control money laundering by making it an offence. It is an offence to launder property, knowing or having reason to believe that such property has been derived directly or indirectly from acts or omissions, which constitute a criminal offence punishable by imprisonment for not less than 24 months in Lesotho. Acquiring, possessing, using, converting or transferring such property with the aim of concealing or disguising its illicit origin, or concealing or disguising its true nature, origin, location, disposition, movement or ownership are criminal offences. These offences are punishable on conviction by not less than 10 years of imprisonment and/or a fine of not less than R50,000, and in the case of body corporate not less than R500,000.

It is apparent from the problem scenario that Sam and Harry are liable to prosecution under the MLPCA 2008 as they are involved in money laundering. The building of the apartment complex ostensibly with bank loans and savings from the legitimate contracting business, but in reality with moneys earned from an illicit transaction and then laundering it through renting out some of the apartments and selling off some others amount to a money laundering activity.

Sam would, therefore, be guilty of the primary offence of money laundering under s.25 MLPCA 2008. Harry is also guilty of an offence under the same section as he is actively involved in concealing and disguising Sam's illicit gains.

In terms of s.18 MLPCA 2008, if an accountant has reasonable grounds to suspect that any transaction is related to the commission of a money laundering offence, he is required to report it to the Anti-Money Laundering Authority in writing. Harry, being an accountant, thus, is also liable under s.18 of the Act because he failed to report the money laundering activity to the Anti-Money Laundering Authority. The offence carries imprisonment for a period not exceeding 10 years, or a fine of not less than R50,000 or both.

Fundamentals Level – Skills Module, Paper F4 (LSO)
Corporate and Business Law (Lesotho) **December 2013 Marking Scheme**

This marking scheme is given only as a guide to markers in the context of suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned answers are provided. This is particularly the case for essay type questions where there may often be more than one way to write an answer.

1 This question requires an explanation of the term implied by customs or usage.

(a) 3–5 marks A clear explanation of the meaning of the term. Reference to cases/examples is expected.

0–2 marks A less than complete answer, perhaps lacking focus or only dealing with one aspect of implied terms.

(b) 3–5 marks Full explanation of effect of exclusion clauses. Examples or cases will be provided and credited.

0–2 marks Some understanding of the meaning of exclusion clauses but otherwise a very weak answer.

2 This question requires a discussion as to when an employee can be summarily dismissed.

8–10 marks A clear understanding of the meaning of summary dismissal and the circumstances when an employee may be summarily dismissed. Examples or cases will be provided and credited.

5–7 marks Shows awareness of the topic of summary dismissal but perhaps lacking in legal knowledge or perhaps only a limited understanding of the law.

0–4 marks A very basic answer showing little knowledge or explanation of the topic.

3 This question requires the candidates to explain and distinguish between liquidated damages and penalty clauses in a contract.

8–10 marks A good explanation of the difference between liquidated damages and penalty clauses with perhaps some examples or cases.

5–7 marks Shows some knowledge of the difference but perhaps lacking in details, no example or case provided.

0–4 marks A limited understanding of the difference showing little knowledge or explanation of the topic.

4 This question asks candidates to explain the liability of a manufacturer for the defective products manufactured by it and placed on the commercial market.

8–10 marks Full explanation of the principles that govern the liability of a manufacturer for defective consumer products with reference to relevant cases.

5–7 marks Reasonable treatment or a less complete treatment of the topic with some reference to cases.

0–4 marks Very weak answer, focusing only on some aspects of the topic and without any reference to cases.

5 This question requires a discussion of the various ways in which the relationship of the principal and agent can be created.

8–10 marks Clear and thorough understanding of the rules relating to the creation of a contract of agency.

5–7 marks Reasonable treatment or a less complete treatment of the topic with some reference to cases.

0–4 marks Very weak answer, focusing only on some aspects of the topic and without any reference to cases.

6 This question invites candidates to explain the circumstances when the corporate veil can be lifted under the Companies Act 2011.

8–10 marks Full understanding and explanation of the topic.

5–7 marks Some knowledge of the topic but lacking in detail.

0–4 marks Very little, if any, understanding of the topic.

7 This question tests the understanding of the candidates regarding the limitations placed on the powers of a company to issue shares at a discount under the Companies Act 2011.

8–10 marks	Complete explanation of the limitations under the Companies Act 2011 on the power of a company to issue shares at a discount.
5–7 marks	Reasonable, but less than full, explanation of the limitations.
0–4 marks	Unbalanced answer merely dealing with a partial explanation or demonstrating no real understanding of the nature of the question.

8 This question tests candidates' understanding regarding pre-incorporation contracts.

8–10 marks	Answers will demonstrate a clear knowledge and understanding of the pre-incorporation contract and the relevant provisions under the Companies Act 2011. Accurate application of legal principles to the problem scenario.
5–7 marks	Answers will be generally sound in relation to the law but may be lacking in analysis or application.
2–4 marks	Answers will demonstrate some knowledge of the law relating to the question but not to the degree expected of a reasonably satisfactory answer. They may be weak in analysis and/or application.
0–1 mark	Little or no understanding of the law relating to the question. Extremely weak in terms of analysis and application.

9 This problem tests the understanding of the candidates as regards the principle that a company has legal personality separate from the shareholders.

8–10 marks	Answers will demonstrate a thorough knowledge of the principle of corporate personality, together with a clear analysis of the problem situations and a deployment of the appropriate legal principles.
5–7 marks	Good analysis and application of the law, although perhaps limited in appreciation of all the aspects of the scenario.
2–4 marks	Recognition of the areas covered by the question, but lacking in detailed analysis.
0–1 mark	Little or no understanding of the law relating to the question. Extremely weak in terms of analysis and application.

10 This question requires candidates to explain the meaning of money laundering generally, together with a consideration of the way in which the legislation seeks to control it.

8–10 marks	Good explanation of both the meaning of the concept and offences under the legislation, together with a good analysis of the scenario with a clear explanation of the law relating to the parties.
5–7 marks	Fair explanation of the general concept but lacking in detail in relation to the legislation. Lower band answers would show only some understanding of the situation.
3–4 marks	Unbalanced answer, perhaps lacking detail, or application.
0–2 marks	Weak answer lacking in knowledge, with little or no reference to the legal regime.