Answers

1 The question sought to test the candidates' knowledge of the sources of law in the Russian Federation, and the role of the judges in the courts of law.

(a) The overall framework for the Russian legal system was established by the Constitution, which was introduced in 1993. The Constitution not only established the institutions of government and provided the basis upon which legal acts are implemented (Chapters 5 and 6), but acts as a source of law in that it lays down the basic rights of citizens (Chapter 2).

In common with many other nations, the Russian legal system is codified. Legal codes lay down broad principles that apply universally within various spheres. For example, the Civil Code elaborates on the rights of citizens in their personal and business life and provides generic models through which legal entities may be established and operated.

Primary legislation is enacted by the Duma and the Federation Council, and is signed into law by the President. All federal laws enacted by organs of government and their agents are subordinate to the Constitution. Those whose rights are compromised by actions or decisions that are inconsistent with the Constitution may petition the Constitutional Court for remedy. The provisions of the Constitution may be changed by a referendum of the people. In turn, many federal laws confer rights of others to make subordinate legislation within stated terms of reference.

Consistent with the federal system of government, many bodies are empowered to make laws that apply within their stated jurisdictions, including regional governments, municipal territories, cities and towns (Article 5 of the Constitution). These legal acts may not conflict with the provisions of the Constitution or primary legislation.

The President of the Russian Federation has the power to enact laws by issuing decrees. Such decrees must be consistent with the provisions of the Constitution. The President's power was reinforced in this respect during the 1990s during a period of political instability. The President is also able to resolve *law lacunae*, which arise when there is no clear way of dealing with an issue through existing laws. This has become less important in recent years as the body of laws in Russia has become more comprehensive.

The Constitution acknowledges the general principles of international law and the provisions of international treaties entered into by the Russian Federation. It gives such provisions legal force, so they are binding on the government and other subjects of law. Article 15(4) of the Constitution gives any accepted provisions of international agreements superiority over other laws.

Customs and traditions of each region or area have a minor role to play in the decisions of judicial bodies.

The doctrine of judicial precedent, through which judges in the courts may actually create laws, has no role in the Russian Federation and there is no equivalent to judicial precedent in Russian law. However, the decisions of the courts are formally documented and serve as a source of reference for judges dealing with current cases.

(b) Judges operate within a general framework of rules established in Chapter 7 of the Constitution.

Judges are responsible for ensuring that due process is followed in cases put before them. As such, this role is to preside over the conduct of trials and hearings.

As in all codified systems of law, judges must interpret laws and apply their provisions to cases put before them. They must apply the law exercising independent judgement, free from external or personal influences.

In order to resolve many cases, judges must take decisions based on the facts before them. This is especially important in civil disputes, such as those relating to contractual obligations and instances in which harm or damage has been caused.

Judges may have to apply analogy when it is necessary to deal with a situation in which there is no direct law to govern an outcome. Failing this, they may have to decide on the intention of existing laws.

The courts are organised in a hierarchical manner and provide for appeals of decisions in the courts of first instance. Therefore, judges in appeal cases have to review the cases previously heard in lower courts.

2 The question tested the candidates' knowledge of the law relating to non-contractual obligations and the consequences of incurring non-contractual obligations.

(a) A non-contractual obligation arises when a civil wrong is committed. Such wrongs may take several forms including negligence, slander, libel and trespass. They are governed by detailed provisions set down in Chapter 59 of the Civil Code.

A pre-requisite for a non-contractual obligation to arise is that one person or entity carries out a wrongful action that has an adverse impact upon another. This may occur by actions, such as the careless storage of chemicals by a worker causing harm to a co-worker or customer, or may be due to failing to act when it is reasonable to do so, such as neglecting to move the chemicals to avert the danger.

In order for the obligation to arise there must be some fault, though not necessarily intention on the part of the person incurring the obligation. This may require some subjective judgement on the part of a court that has to consider the matter, and will often turn upon what a reasonable person would have done under the circumstances.

A claim for a non-contractual obligation also depends on the actual harm caused. This may be a financial loss (such as loss of earnings caused by an accident), damage to property (such as destruction to inventory caused by inappropriate storage) or moral harm (such as damage to reputation or perceived integrity).

Lastly, for culpability to be established it is necessary to prove a causal link between action or inaction and consequence. This may appear obvious, but as some losses arise through a chain of events a court will sometimes have to decide on the fault that underpins the loss or harm. For example, if person A's actions cause a fire resulting in damage to person B's property, ensuing damage may be caused by person C who, when fighting the fire, accidentally floods an adjoining property belonging to person D.

(b) Article 1064(1) of the Civil Code states that injury inflicted on a person or property, and damage done to the property of a legal entity must be compensated in full by the person or entity inflicting the harm. This Article envisages that the responsibility for compensation may fall to someone other than the party inflicting the harm. For example, when harm is inflicted using the property of an enterprise (such as a company vehicle), it is not necessarily just the driver who will be held liable. It is also possible that compensation may be payable even if the actions of the person causing the harm are lawful.

Where the damage is quantifiable, such as loss of money or damage to inventory or premises, the amount of compensation will be financial and reflect the actual harm caused. In such cases, the court will most often decide on compensation based on indemnity, reflecting the position that the harmed party would have been in had the harm not arisen. The principle may also extend to less direct consequences, such as loss of earnings or sales.

Article 1082 also enables compensation to be awarded in kind, such as the replacement or repair of damaged goods.

Less tangible damage such as moral harm has to be estimated by the courts. It is much more difficult to assess moral harm, as it involves a subjective judgement on the part of the court. Article 1100 identified situations in which such moral harm may arise and must be compensated, including that inflicted by a person in a situation where there is special danger (such as driving a vehicle), cases of false conviction, house arrest or imprisonment, and circumstances in which honour, dignity and business standing have been denigrated.

Supplemental to the provisions relating to compensation, Article 1065 empowers the court to impose necessary steps to remove the source of harm or damage.

There are various factors that can limit the award of compensation.

Persons under 14 years of age cannot be held financially accountable for no-contractual obligations. In such cases, Article 1074 states that the parents or guardians may be held liable. Those with partial active capacity (14–18 years of age) may be accountable, except where it can be established that they have no income or assets to support the claim for compensation, in which case the parents or guardians may be liable. Articles 1076 and 1077 make additional provisions in respect of those lacking civil capacity: generally they are not deemed to be financially accountable except when the damage has arisen due to controllable factors such as intoxication.

Article 1064(3) states that a party causing harm may be absolved of responsibility if the actions or inactions causing the harm occurred with the consent or acquiescence of the injured party.

When harm or damage is caused by an employee in the normal course of his or her duties, the employer is vicariously liable. The employer takes responsibility for the acts or omissions of the employee. In turn, the employer may seek compensation from the employee, but the financial exposure of the latter is limited by law. In this way, the employee is shielded to some extent from the financial impact of his or her actions or inactions (Chapter 38, Labour Code).

Article 1066 states that harm caused in the course of justifiable self-defence shall not be compensated.

3 The question asked candidates to explain the different ways in which a labour agreement can be terminated.

A labour agreement is a contract, and like any other contract sets down the rights and obligations of the parties to it, in this case the employer and the employee. All of the clauses set down in a labour agreement must be compliant with the provisions of the Labour Code.

A labour contract may be terminated by the employer or the employee.

If the labour agreement is of fixed duration, the employer may terminate the contract at the end of the fixed period specified in the agreement (Articles 58(2) and 79 of the Labour Code). The fixed term must not exceed five years. This is a common feature of labour contracts for individuals in senior positions, such as chief executives and finance directors. The fixed duration contract may also be used for certain other types of employment, such as seasonal work and employees taken on to substitute for a temporarily absent permanent employee. It enables the organisation to anticipate the need to change key personnel.

Article 71 of the Labour Code states that a labour agreement that is subject to a probationary period may be terminated if the employer is not satisfied with the results of the employee's work.

In the event of serious contravention of internal rules the employer may summarily (instantly) dismiss an employee without the contractual period of notice and without pay for the equivalent period of notice. This would occur in the event of gross misconduct such as physical violence against others, misuse of alcohol or drugs whilst in the workplace or disclosure of strategic information to competitors. Article 76 of the Labour Code specifies that the employer must dismiss the employee if it appears that the employee:

(1) has been at work in a state of alcoholic, narcotic or other intoxication;

(2) has not completed education and knowledge assessment in the area of labour protection;

(3) has not attended a compulsory initial or periodical medical examination;

(4) is not able to perform the job requirements as specified in the labour agreement due to a medical condition;

(5) cannot continue to be employed without breaching other laws.

Article 81 of the Labour Code provides a long list of instances in which the employer may dismiss the employee, including truancy, repeated non-compliance with the requirements of the job, disclosure of secrets, theft and similar offences and violation of labour protection regulations.

Redundancy arises when a job no longer exists, where the nature of the work changes significantly or where the employer relocates (Article 81(1) and (2)). It frequently occurs because the business is closing down altogether or where the job becomes obsolete, perhaps due to the introduction of new technology or processes or where the organisation decides to spin off or otherwise divest a particular part of its operation. Articles 72, 73 and 75 provides for dismissal if the employee on various bases relating to redundancy, including refusal to accept different working conditions, refusal of alternative work and organisational restructuring.

Article 78 of the Labour Code enables the labour agreement to be terminated by mutual agreement of the employer and the employee. Article 80 enables the employee to voluntarily withdraw from the agreement, subject to a minimum of two weeks notice. The most common ground for doing so is of course when the individual secures alternative employment and gives the required period of notice to the employer. It is then up to the employer as to whether the individual is asked to fulfil the period of notice. If the individual is moving to a competitor, the employer may choose to pay off the worker for the period of notice and ask him or her to leave immediately.

Articles 83 and 84 of the Labour Code envisage the right to terminate the labour agreement due to external factors, such as emergencies (such as war and catastrophe), the imposition of a penalty by a court that precludes the employee from continuing in the job and conscription to military service or equivalent civil work.

The employee may of course breach the contract by leaving the job without giving notice.

Lastly, the labour agreement is also terminated on death or loss of legal capacity.

4 The question asked candidates to describe the characteristics of a limited liability company, and to explain the matters that can only be dealt with by the shareholders acting collectively in a general meeting.

(a) The characteristics of a limited liability company are described in Article 87 of the Civil Code.

A limited liability company is a legal entity that may be established by one or more persons.

The participants make contributions to the authorised capital in denominations determined by the constitution of the company. In doing so, the liability of the participants is limited to the size of the contributions that they undertake to make. Therefore, in the event of liquidation, the participants stand to lose the capital invested plus any capital that they have agreed to contribute but have not yet paid.

Specific matters in relation to the constitution, management and administration of limited liability companies are laid down in the Federal Law on Limited Liability Companies.

The participants in limited liability companies have a right to withdraw their capital. However, under the Federal Law 312-FZ enacted in 2008 this is no longer an absolute right, as it is dependent on such a provision being contained in the Charter of the company. A sole participant may not withdraw from the company. The same law also empowers the participants to enter into an agreement through which certain aspects of management and administration will be decided (for example, exercising of voting rights, divestment of shares, etc).

(b) The matters that fall within the exclusive competence of the general meeting of shareholders of a limited liability company are set out in Article 91 of the Civil Code.

As the shareholders own the company, it is only the shareholders that can change the constitutional documents of the company. These decisions may relate to the Charter or other documents who define the constitutional boundaries of the company.

The shareholders may change the composition of the authorised capital of the company, subject to constraints imposed by the Federal Law on Limited Liability Companies. For example, the shareholders would not be able to approve a reduction in capital that would result in capital falling below the statutory minimum.

The shareholders are responsible for the appointment of the executive bodies of the company. They are also able to remove these bodies, though they would not be able to change the terms of existing contracts unilaterally.

The shareholders approve the financial report and accounts each year. They also take decisions on the distribution of profits and losses.

Decisions on reorganisation or liquidation may only be taken by the shareholders.

The shareholders decide on the election of the auditor.

The Charter may make additional provisions in respect of matters that fall within the exclusive competence of the shareholders.

5 The question asked candidates to explain the duties and powers of the internal audit commission, and to explain how the role of the external auditor differs from that of the internal audit commission.

(a) The internal audit commission is a management body consisting of employees of the company, though its members are elected by the general meeting of shareholders each year (Article 48, Federal Law on Companies Limited by Shares). Although the commission is not totally independent of the company, its duties must be discharged independently of other management bodies.

Article 85 of the Federal Law on Companies Limited by Shares defines the role and powers of the internal audit commission. The company may confer additional responsibilities on the commission.

The internal audit commission is responsible for monitoring the activities of directors and other executive bodies. Its role is essentially concerned with the oversight of internal control systems. In discharging its role, the commission will consider the accuracy of financial information, examine systems for the safeguarding of assets and prevention of fraud and other dishonest acts, and consider whether internal controls are sufficiently robust to provide reasonable assurance that the company is compliant with the law and can meet its objectives. In addition, the commission may be asked to carry out *ad hoc* examinations or investigations by the directors or the shareholders.

A recent study by the Institute of Internal Auditors and the Russian Institute of Directors suggested that some companies are extending the terms of reference of the internal audit commission to include matters relating to corporate governance and risk management.

The internal audit commission has the power to obtain documents necessary to discharge its functions. It also has the right to seek explanations from managers in order to validate information used in the course of its work. It may also obtain documents from companies that provide banking services to the company in order to confirm the true cash position in respect of deposits and loans.

If considered appropriate to do so, the internal audit commission has the power to call a general meeting of the shareholders (Article 55, Federal Law on Companies Limited by Shares).

(b) The external auditor is a professional accountancy firm, appointed by the shareholders' meeting annually (Articles 48 and 86, Federal Law on Companies Limited by Shares) and engaged by the company under a civil contract.

The role of the external auditor is to provide an independent opinion on the financial statements of the client company ('to effectuate the verification of the financial/economic activity of the company' – Article 86). The primary responsibility of the external auditor is to the shareholders. To this end, it delivers the auditor's report to the general meeting of shareholders.

Article 103 of the Civil Code states that the role of the external auditor is to verify and confirm the accuracy of the financial statements of the company. It also states that the external auditor must not be connected in any way with the company.

In discharging its duties, the external auditor must carry out checks in order to verify that the financial statements of the company are a true and accurate record of transactions made during the relevant period. In common with the powers of the internal audit commission, the external auditor may request any documents of the company and seek explanations from directors and managers as necessary.

In common with the powers of the internal audit commission, the external auditor may convene a general meeting of shareholders (Article 55, Federal Law on Companies Limited by Shares).

6 The question asked candidates to explain the rights of ordinary shareholders, preference shareholders and providers of long-term loans in a company limited by shares.

(a) The rights of ordinary shareholders are set out in Article 31 of the Federal Law on Companies Limited by Shares. All ordinary shareholders are afforded equal rights under this Article.

Ordinary shareholders have a right to participate in the general meeting of shareholders and have the right to vote on all matters that fall within the competence of the meeting. Such matters are set down in Article 48 of the same law.

Ordinary shareholders have the right to a dividend, however, this may not exceed the recommendation of the board of directors (Article 42(3)). In turn, the recommendation will be based on the financial performance of the company and the perceived need to retain profits.

Ordinary shareholders have a right to the return of their capital on liquidation, subject to prior payment of other obligations. This right is severely limited in practice, as shareholder rank after all other claims on the company. Therefore, if the company is insolvent, there is a prospect that not all capital will be repaid, and in some cases, there will be no return of capital at all.

(b) The rights of preference shareholders are set down in Article 32 of the Federal Law on Companies Limited by Shares. Holders of each class of preference shares have equal rights as specified in the Charter of the company or otherwise prescribed by law.

Article 32(1) states that preference shareholders do not have the right to vote except on matters specified in Article 32(3), (4) and (5) or in the Charter of the company.

The matters on which preference shareholders may vote are:

(1) Questions concerning reorganisation and liquidation;

(2) Proposed changes to the Charter that would modify the rights attached to their shares;

(3) Proposed changes that would modify the priority of claims against other shareholders;

(4) Any matters considered at a general meeting that immediately follows a decision not to pay dividends to preference shareholders;

(5) Any matters on which the Charter explicitly confers a right of preference shareholders to vote.

The dividend paid to preference shareholders is fixed with reference to a percentage of the nominal value of the share or a fixed monetary amount. This is specified in the Charter of the company. The dividend paid to preference shareholders is paid with priority over any dividend to ordinary shareholders.

On liquidation, the preference shareholders have a priority claim over ordinary shareholders, but rank after all other claims on the company.

(c) The rights of providers of long-term capital are governed by the contract between the lender and the company and are subject to the general laws on obligations as set down in Chapters 21–29 of the Civil Code.

The contract sets out the rights and obligations of the parties. The company enters into a commitment to pay interest and capital when payments fall due. Failure to comply with these commitments gives the creditor redress against the company, including realisation of security if applicable.

The rights of creditors rank ahead of all shareholders are laid down in the Law on Bankruptcy.

In addition to standard financial covenants, the agreement between the lender and the company may specify further commitments, such as a requirement to submit financial reports, declarations of compliance with covenants and notifications of adverse material changes in the company.

If the long-term borrowing takes the form of bonds, Article 33 of the Federal Law on Companies Limited by Shares sets down additional provisions.

Bonds may only be issued subject to the provisions of the Charter or decisions of the board of directors. The claim against the company is set with reference to a par value.

The repayment of bonds must be effected in money or property, consistent with the terms of issue.

If bonds are lost, the holders have a right to the issue of a replacement document, though the company may charge for this. If the lost security is a bearer bond, the owner is entitled to a replacement on the decision of a court.

If the bond is convertible into equities, the holder has the right to exercise the right of conversion.

7 The question asked candidates to define the term 'corporate governance' and explain why corporate governance is of special significance to open companies limited by shares.

(a) The Organisation for Economic Cooperation and Development (OECD) defines corporate governance as follows:

'Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.'

(OECD Principles of Corporate Governance, 2004)

A more concise definition, proposed by the Cadbury Committee in the UK, is:

'Corporate governance is the system through which an organisation is directed and controlled.'

(Report of the Cadbury Committee, 1992).

In common with most countries, the Russian Federation has no laws specifically relating to corporate governance, although the provisions of many existing federal laws clearly promote the aspirations set out in the above definitions.

It is generally recognised that corporate governance is primarily concerned with the fair treatment of shareholders and preservation of their rights, the promotion of corporate strategies that address the needs of stakeholders, effective direction and management of enterprises, and the formulation and implementation of appropriate policies in relation to disclosure and transparency.

(b) Policies that foster good practices in corporate governance are relevant to many types of commercial organisation, as well as public sector and not-for-profit organisations. However, it is generally acknowledged that corporate governance is especially relevant to companies whose securities may be traded on recognised capital markets.

Open companies limited by shares usually have many hundreds or even thousands of shareholders, resulting in an inevitable separation of those who own the company (the shareholders) and those who manage it on their behalf (the directors). This means that the latter take on a special responsibility of stewardship, acting effectively as agents for the owners. Well-documented and publicised problems in many countries, including Yukos in Russia, Enron in the USA and Parlamat in Italy confirm the need to establish good systems of governance in publicly quoted companies.

Effective systems of governance, monitored by internal and external oversight bodies, promote the protection of shareholders, as well as the dissemination of accurate and complete information. Without this information, shareholders lack the means of taking effective investment decisions.

Effective corporate governance underpins confidence in markets, which is particularly relevant to new investors. By contrast, failures of governance denigrate public confidence in large corporations, suppressing investment and potentially harming future entrepreneurial activity.

By establishing best practices in corporate governance, the potential for exploiting deficiencies in laws is reduced. In most countries it is possible to comply with the law yet still act in a manner that is unethical or morally reprehensible. In a limited liability company, or a closed company limited by shares it is arguable that the decision-takers can only harm themselves, but in an open company limited by shares the inappropriate actions of directors have a broader consequence, not only to shareholders, but a broad array of employees, creditors, suppliers and other stakeholders.

With the notable exception of the United States of America, which chose to legislate in response to the Enron collapse (the Sarbanes-Oxley Act), most countries now address corporate governance through the promotion of principles-based systems, based on the notion that companies should either comply with broad and universally accepted principles, or explain to the shareholders the rationale for not doing so. The principles thus agreed can be modified or reinforced on a regular basis in response to changing circumstances, relieving governments of the seemingly impossible task of legislating whenever change is necessary.

8 The question tested the candidates' ability to apply their knowledge of contract law to a situation in which an art dealer has advertised two statues for sale to prospective purchasers. In particular, the question required an understanding of the concepts of offer, acceptance and withdrawal.

A general advertisement placed in a magazine cannot be regarded as an offer, as it is not addressed to 'one or more concrete persons' (Article 435, Civil Code). It is regarded in law as an expression of willingness to sell goods. Any response by prospective customers to the advertisement is an offer, and not an acceptance of the terms of the advertisement.

Article 433 of the Civil Code states that a contract comes into effect when an offer has been accepted.

Ivan and Ekaterina:

Ekaterina's letter sent to Ivan represents an offer, which Ivan is able to accept, reject or alternatively make a counter-offer.

When Ivan returned to his office he received Ekaterina's letter and fax. If a person making an offer withdraws the offer and the withdrawal reaches the offeror before or at the same time as the withdrawal, it cannot be accepted (Articles 435(2), Civil Code). Ivan is wrong to inform Ekaterina that her fax cannot cancel the offer. However, as no contract has been formed, his subsequent letter to Ekaterina is an offer.

As Ivan sold the statues to Nikolai, he can withdraw his offer to Ekaterina, provided his withdrawal reaches her before she accepts it. He is fortunate, in that had Ekaterina not changed her mind, Ivan's reply to her would have been an acceptance of her offer to sell a statue that he had already sold to Nikolai.

Ivan and Leonid:

The lower price offered by Leonid is not a counter-offer, as the original advertisement cannot be regarded as an offer. However, Leonid's letter to Ivan is an offer, capable of acceptance, rejection or counter-offer. Ivan's fax to Leonid has accepted Leonid's offer, and as the fax is a virtually instantaneous form of communication a binding contract has been formed between them. Ivan is unable to withdraw from the contract with Leonid, unless there was a problem with the fax transmission. As he has sold both statues to Nikolai, Ivan may now be liable for breach of contract.

Ivan and Nikolai:

Nikolai made an offer in person which Ivan accepted, so a legally binding contract has been concluded between the parties.

9 The question sought to test the candidates' ability to apply their knowledge of various corporate forms to a case study scenario.

There are various forms that could be adopted in order to move Natasha's plans forward. The characteristics of the various forms that could be considered are set out in Chapter 4 of the Civil Code.

The simplest option is for Natasha to promote the new production as an individual entrepreneur, relying on Maria to advance the necessary funds. This would involve minimal administration but would expose Maria to a personal credit agreement with Natasha, and thereby totally on Natasha's ability (and willingness) to repay. The credit agreement between them could be supported by a contract conferring rights to revenues from the finished production.

The advantage of the individual entrepreneur form is its simplicity. The disadvantage is the exposure of both parties to risk. Natasha would be entirely reliant on finance provided by Maria, and if the investment is large and the project fails, may not be able to repay the debt. In turn, Maria would have little prospect of recovering her investment. For these reasons, the individual entrepreneur approach is entirely unsuitable.

Natasha and Maria could enter into an unlimited (general) partnership. They could draw up a partnership agreement with express provisions relating to their rights and obligations. They could also form the unlimited partnership for the sole purpose of carrying out one collaborative venture together, terminating the partnership on conclusion of the production.

The advantages of the unlimited partnership are its simplicity and the flexibility of being able to draw up the partnership agreement according the precise requirements of each partner. However, Maria would bear joint and several liability with Natasha, and neither would be able to shield their general assets from the risks of the production. These disadvantages suggest that the unlimited partnership would be unsuitable for them.

Natasha and Maria could form a limited partnership, with Natasha participating as the unlimited partner and Maria participating as a limited (or commandite) partner, contributing a pre-determined capital sum. This form would enable Maria to limit her exposure to her capital contribution. Again, the partnership could be terminated on conclusion of the production.

The limited partnership is a suitable option for the venture. Maria could participate as an investor, and as she has no desire to play an active role in Natasha's production, this is entirely consistent with the role of the investing partner as envisaged by the Civil Code. Another advantage is the ability to limit Maria's liability.

Although the limited partnership is not a popular business form in Russia, the equivalent model is used in several countries for funding productions in the creative arts. The main disadvantage of the limited partnership is that Maria could not intervene in the running of the business at all without the prospect of losing her limited liability status.

Natasha and Maria could establish a limited liability company. They would become participants in the new enterprise, each contributing a capital amount specified at the outset.

Of the various company models, the limited liability company is perhaps the simplest and most flexible. It involves the least bureaucracy and probably the least expense. The company could be dissolved on conclusion of the production. The disadvantages are the potentially disadvantageous position of each participant on withdrawal of either from the business and the need to go through the formalities of setting up the company, including agreeing a Charter and any inner Rules deemed to be necessary.

Natasha and Maria could form either a closed or open joint-stock company (company limited by shares). Either model enables them to take shares in the enterprise and to agree precise rights and obligations that could be formally included in the Charter and inner Rules. The formation of either type of company opens up the possibility of future collaboration and the ability to raise capital from additional shareholders if they choose to do so. To form a company they would have to draw up proper constitutional documents and take share capital in the new enterprise. It is possible for either version to be set up for a set period of time, or for the completion of a task or series of tasks.

Both types of company are unsuitable for this investment. Neither Natasha nor Maria would appear to benefit from establishing a company of this kind. It involves more administration and probably greater cost than the other options. Unless their aspirations changed radically, they would not need to raise capital from third parties, or relinquish any degree of control over their activities by inviting additional shareholders to participate. In particular, it would be extremely unusual for just two investors to set up an open company limited by shares for a project of this kind.

10 The question tested the candidates' ability to apply their knowledge of company law to a situation in which a general director appeared not to be acting in the best interests of the company.

(a) Alexander is employed under a fixed term labour contract, so if the directors feel that the evidence provided by the internal auditor is sufficient to justify dismissal, they will remove him from his post immediately on the grounds of misconduct. However, this is subject to having such power reserved in the Charter of the company. If not, it would be the responsibility of the shareholders to consider such action.

If Alexander has shared confidential information with executives of a major competitor, this must be regarded as a serious breach of trust. It is also possible that he will have inflicted harm on the company as a result. Under the provisions of the Federal Law on Joint-Stock Companies (Companies Limited by Shares), Alexander may bear responsibility for losses inflicted on the company. Such damage would be difficult to quantify in this instance, but any award of the court would be based on an estimate of both financial and moral harm. Such action could be instigated by the company itself or the shareholders.

Even if Alexander is dismissed from his post, he would remain a shareholder. The shares are his personal property and he cannot be dispossessed of these. However, Alexander's ability to influence the future of the company would be confined to exercising his constitutional rights at general meetings.

(b) To avoid being dismissed, Alexander would have to provide compelling evidence to refute the accusations of the internal auditor and justify the interactions with executives from -ZAO- PQR. If he proved his case, Alexander would be able to claim compensation from the company, including the damage to his reputation that would inevitably have arisen from the incident.

As he is a shareholder in the company, Alexander has several further important rights:

He would be able to address the shareholders at a general meeting to put his case to them. If a general meeting is due to be held in the near future, he could insist that his concerns be discussed by adding an item to the agenda of the meeting. This would of course be subject to appropriate notice.

As he holds in excess of the 10% of the shares necessary to convene a general meeting of shareholders, he could call such a meeting for the specific purpose of explaining his actions and securing the support of he shareholders. He would be able to decide the agenda for the meeting. In turn, the other directors would have the opportunity to put their case.

1	**(a)**	Explanation of any of the following, subject to maximum of 6 marks:	
		Constitution	1 mark
		Legal codes	1 mark
		Primary federal legislation	1 mark
		Subordinate legislation	1 mark
		Presidential edicts	1 mark
		International law	1 mark
		Custom	1 mark
			(6 marks)
	(b)	Explanation of the following:	
		Role in presiding over due process	1 mark
		Interpretation of law	1 mark
		Making judgements/decisions	1 mark
		Role in resolving *law lacunae*	1 mark
			(4 marks)
			(Total 10 marks)
2	**(a)**	Wrongful act or omission	1 mark
		Fault, not necessarily intent	1 mark
		Actual harm	1 mark
		Causal link	1 mark
			(4 marks)
	(b)	Compensation for measurable loss	1 mark
		Moral harm	1 mark
		Each factor limiting compensation awarded	1 mark, maximum 4 marks
			(6 marks)
			(Total 10 marks)
3	Agreement to terminate contract		1 mark
	Termination by notice of parties		1 mark
	Termination during probationary period		1 mark
	Termination of fixed term contract		1 mark
	Dismissal and grounds for dismissal		Up to 3 marks
	Redundancy		Up to 2 marks
	Dismissal under operation of the law		1 mark
			(Total 10 marks)
4	**(a)**	Each characteristic of a limited company	1 mark, maximum 5 marks
			(5 marks)
	(b)	Changes to Charter	1 mark
		Decisions on capital	1 mark
		Appointment and removal of executives	1 mark
		Approval of report and accounts	1 mark
		Election of auditor	1 mark
			(5 marks)
			(Total 10 marks)

5	**(a)**	Duties of internal audit commission	Up to 3 marks
		Powers of internal audit commission	Up to 3 marks
			(6 marks)
	(b)	Professional external accountancy firm	1 mark
		Nature of relationship with company	1 mark
		True and fair view	1 mark
		Report to shareholders	1 mark
			(4 marks)
			(Total 10 marks)
6	**(a)**	Variable dividend	1 mark
		Constitutional rights	Up to 2 marks
			(3 marks)
	(b)	Fixed dividend	1 mark
		Voting rights	Up to 2 marks
			(3 marks)
	(c)	Nature of contractual relationship	1 mark
		Right to interest/capital	1 mark
		Specific features relevant to bonds	Up to 2 marks
			(4 marks)
			(Total 10 marks)
7	**(a)**	Definition and scope of corporate governance	Up to 3 marks
			(3 marks)
	(b)	Separation of ownership and management	Up to 2 marks
		Protection of shareholders	1 mark
		Information/transparency	Up to 2 marks
		Confidence in markets	1 mark
		Compliance	1 mark
			(7 marks)
			(Total 10 marks)
8	Factors relating to general offer		Up to 2 marks
	Factors relating to offer, acceptance and withdrawal		Up to 3 marks
	Application to scenario		Up to 5 marks
			(10 marks)
			(Total 10 marks)
9	Advantages/disadvantages of:		
	Individual entrepreneur		1 mark
	Unlimited partnership		Up to 2 marks
	Limited partnership		Up to 3 marks
	Limited liability partnership		Up to 2 marks
	Closed/open company limited by shares		Up to 2 marks
			(10 marks)
			(Total 10 marks)
10	**(a)**	Discussion of dismissal	Up to 2 marks
		Action by company/shareholders for losses	Up to 2 marks
		Implications of shareholding	Up to 2 marks
			(6 marks)
	(b)	Rights to challenge dismissal	1 mark
		Rights to call/address meeting	Up to 3 marks
			(4 marks)
			(Total 10 marks)