Examiners' report

F4 Corporate and Business Law (CYP)
June 2008

General Paper Comments

The examination consisted of ten questions in total: seven questions testing candidates' knowledge of the law, and three problem-based questions which aimed to test candidates' ability to apply the law. All ten questions were compulsory.

Most candidates attempted all questions. Candidates are strongly advised to tackle all the questions.

The overall performance of candidates was satisfactory, bearing in mind that this was the second sitting of the F4 (CYP) examination, after the syllabus had been updated, and the new style of examination had been introduced.

As always, candidates are advised to pay more attention to the wording of the questions, and to focus their answers on tackling the particular issues involved, rather than attempting to reiterate everything they know on the general subject-matter of the question.

Candidates should note that each question should be started on a new page.

Specific Comments

Question 1
This was a question on the legal system of Cyprus. Even though part (a) of Question 1 was generally well answered, answers to parts (b) and (c) were in general not satisfactory.
In part (b) candidates appeared to be confused about the distinction between case law of the Supreme Court of Cyprus and English case law. Many candidates answered part (b) by discussing the provisions of section 29 of the Courts of Justice Law, L.14/60. However this is not relevant in relation to the application of the case law of the Supreme Court, which applies and constitutes a main source of law in Cyprus as a result of the application of the doctrine of precedent. Furthermore, a number of candidates answered part (b) by analysing the jurisdiction of the Supreme Court, something which was also irrelevant.
A common error in part (b) was to state that case law of the Supreme Court acts simply as guidance for inferior courts; however, decisions of the Supreme Court are in fact binding upon inferior courts and must be followed provided the material facts of the case are the same.
It was surprising to note in part (c) that a lot of candidates were not familiar with the concept of "equity" at all.

Question 2
This question focused on the law of torts and, in particular, on the general duty of care of accountants and auditors, as well as the rules on remoteness of damage.

In part (a) it was pleasing to see a lot of candidates being familiar with *Caparo Industries* v. *Dickman* and the three-stage test for establishing whether one person owes a duty of care to another. However almost all candidates failed to mention the existence of section 51 of the Civil Wrongs Act, Cap. 148 which, inter alia, incorporates the general principle of duty of care in relation to people exercising any profession, trade or occupation.

In part (a) many candidates discussed the general role and duties of auditors in a company. Others discussed the duty of accountants to report to MOKAS any suspicious transactions potentially involving money laundering. However this is a duty imposed on accountants not by the law of torts but rather by the money laundering regulations.

In part (b) most candidates were familiar with the rule in *Hadley* v. *Baxendale*, although they often failed to mention both of its parts. The *Hadley* v. *Baxendale* rule is twofold as it provides that in case of breach of contract, the innocent party is entitled to receive from the party in breach compensation (i) for losses that may fairly and reasonably be considered arising "naturally" i.e. according to the usual course of things from the breach, or (ii) for losses that may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it.

A common error in part (b) was to discuss general rules relating to awards of damages, or rules relating to causation.

Question 3
Question 3 tested candidates' knowledge on employment law.

Results were generally satisfactory.

However most candidates still failed to restrict their answers to the particular questions asked and included a lot of irrelevant information, such as the rules relating to the amount of compensation that an employee dismissed by redundancy may claim and the procedure for doing so. Such information was irrelevant.

Question 4
Question 4 was a question on the personal liabilities of sole traders, shareholders, and partners. Results were generally satisfactory.

Candidates should note that, in relation to general partners, even if the partnership agreement provides that partners shall be liable to each other to contribute different proportions to any amount paid with regard to the firm's liabilities, this does not affect liability of each partner in relation to third parties. In other words, general partners are fully liable for the partnership's debts, subject to their right to claim contribution from their partners in accordance with the partnership agreement.

In part (b) additional marks were awarded for mentioning that a shareholder in a private company limited by shares may have personal liability in case the veil of incorporation is lifted as, for example where the number of members of a public company falls below seven and this continues for six months. In this case the remaining members, if aware of the situation, are liable jointly and severally with the company for any debts contracted by the company after the six months.

However in general candidates should note that a shareholder's liability for any amount unpaid on the nominal value of the shares held is owed to the company itself and not to third parties.

In part (c) additional marks were awarded for distinguishing liabilities between new and retiring partners.

Question 5
Question 5 focused on the contents and purpose of a company's memorandum and articles of association and the procedure for amending the articles. This was one of the best-answered questions on the paper.

Nonetheless, a common error in part (a) was to mention that the memorandum and articles of association have to be signed by the company's directors and secretary. This is not correct. Instead, the memorandum and articles are signed by the subscribers, and the articles (but not the memorandum) are also signed by an advocate who certifies that he drafted the articles in accordance with the law.

In relation to part (b), a common error was to mention that court approval is required for amending the articles. However the articles may be amended by passing a special resolution and this is then notified to the Registrar of Companies.

Question 6
Question 6 required candidates to define and distinguish between (a) debentures and shares, and (b) fixed and floating charges. This is an area which has been examined many times before and answers were generally satisfactory.

A common error in part (b) was to state that if the registration requirement was not satisfied then the charge would be invalid. However this is not correct. According to section 90 of the Companies Law, failure to register a charge to which section 90 applies results in the charge being void as against any creditors and the liquidator of the company; although any obligations of the company towards the security holder pursuant to the charge will remain in force.

In part (a) candidates were rewarded for mentioning other distinctive points such as that shares may be accompanied by voting rights whereas debentures may not, and that dividends in relation to shares must be paid out of distributable profits only whereas interest in relation to debentures may be paid out of capital.

Question 7
Question 7 focused on the meaning and legal regulation of insider dealing. This topic was added to the syllabus recently and it was evident that a lot of the candidates were unprepared for it, as many failed even to attempt it. Nonetheless, there were some sound answers.

Candidates should note that the law does not prohibit disclosure of information in general but rather disclosure of unpublished information of a precise nature relating, directly or indirectly, to one or more of issues of financial instruments.

The law prohibits any person who possesses inside information from (i) using that information by acquiring or disposing or attempting to do so for himself or another, either directly or indirectly, financial instruments to which the information relates; (ii) disclosing inside information to another unless in the course of exercise of his duties; and (iii) recommending or inducing another, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates.

Anyone guilty for insider dealing is liable to an administrative fine by the Cyprus Securities and Exchange Commission of up to CYP500.000 (equivalent to EUR855.000) or CYP1.000.000 (equivalent to EUR1.710.000) in case of a repeated offence, and is also guilty of a criminal offence which carries maximum penalty of ten years' imprisonment or CYP100.000 (equivalent to EUR171.000) or both.

Some candidates discussed the rules relating to market manipulation although this was outside the scope of question 7.

Question 8
Question 8 tested candidates' ability to apply the principles of contract law to the given problem-scenario.

In part (a) the issue was whether Anna's advertisement constituted an invitation to treat or a unilateral contract i.e. a promise to provide consideration in return of the performance of an act as well as monetary consideration.

A common error in part (a) was to state that Ben could claim damages for mental distress. This is not correct. Damages for mental distress can be awarded only where the predominant object of the contract was to obtain some mental satisfaction (e.g. a holiday) or to relieve a source of distress. It is not enough if for example Ben

hoped to obtain peace of mind as a result of Anna's contractual performance; Anna must have promised, expressly or impliedly, that she would provide Ben peace of mind or freedom from distress. In other words, it is not the case that every time that a breach of contract causes disappointment or discomfort to the innocent party, the latter can claim for mental distress; this is possible only where the purpose of the contract was to provide mental satisfaction.

The loss that Ben suffered in this case was financial loss, which can be calculated by subtracting the purchase price (EUR200) from the poster's market price. Damages for breach of contract will be awarded to put Ben in the position he would have been had the contract been performed.

In part (b) some candidates mentioned that Celine could claim the difference in price between the apartment she contracted to buy from Daniel and the apartment she may choose to buy next. This is obviously incorrect. Celine can claim either for specific performance (provided the conditions prescribed by the law are met), or for the loss of her profit i.e. the value of the apartment less the purchase price.

Another common error in part (b) was to state that if there is no contract in writing then there is no contract at all. This is not true, although a written contract is a prerequisite for ordering specific performance.

Another common error in part (b) was to state that Daniel had breached a term of the contract. In fact Daniel has repudiated the contract i.e. he has expressed his intention of not performing his side of the bargain.

In relation to part (a), many candidates again mentioned that Celine could claim damages for mental distress. However the same remarks mentioned above apply here as well. Celine had a contract for the sale of land, not for obtaining mental satisfaction.

Moreover, the question of whether Celine can recover the fees she has paid to the nursery school depends on whether she can recover damages to protect her reliance interest so that she is put in the position which she would have been in had she not entered into a contract with Daniel. The general rule is that Celine will have a right to elect whether to claim for loss of bargain damages or for wasted expenditure. It should be noted however that it is not so clear whether the fees are in fact wasted expenditure. Given Celine's duty to mitigate her loss she will have to show for example that such fees were not recoverable.

Question 9

Question 9 dealt with directors' duties.

Candidates should note that the duty of directors to disclose their interest in a potential transaction with the company is owed to the board of directors. Therefore Felix, being the sole director, cannot be held in breach of this duty. However the issue is not whether Felix has disclosed his personal interest to the board of directors but rather whether he has obtained a personal benefit from the company's business to which the shareholders have not given their consent. In other words, even if the contract for the purchase of chairs was in fact for the benefit of the company, Felix will still have to account to the company for his profit unless the shareholders approve.

Some candidates thought that the contract for the purchase of chairs from Felix & Co will be void, unless the company gives its consent. This is not true. According to section 33A of the Companies Law, F & G Ltd will be bound by the contract unless Felix has acted beyond the powers conferred or permitted to be conferred to him by the law.

Some candidates answered the question by advising the partnership rather than the company. This is a consequence of failure to read the instructions carefully.

Question 10

This was a question about liquidation procedures and activities falling outside the company's objects-clauses.

It was generally well-answered, although almost every candidate missed the point that even though the shares held by Mia had not been registered in her name for at least six months, Mia could still apply to the court for compulsory liquidation since the shares devolved to her after the death of the previous shareholder.