



Examiners' report

F4 Corporate and Business Law (GLO)

December 2007

General Comments

This is the first report on an examination conducted under the new syllabus and format. The change in format seems to have been less problematic than the change in syllabus with most candidates answering all of the questions, although it has to be said with various degrees of success. Some candidates are treating the three problem/application questions at the end of the paper in the same way as they dealt with the previous 20 mark problem questions, with the effect that the candidates are spending too much time dealing with these questions to the detriment of their general performance. This appears to be a particular concern with candidates who start their papers with the problem questions. Candidates should be made aware that these questions are worth no more than the other questions and they should be encouraged to manage their time better in making sure they have sufficient time to deal with all the questions equally well. It is always surprising the extent to which students will pursue marginal marks at the end of an answer rather than turn their attention to the easier marks to be had by answering a new question. Unfortunately it still remains a fact that in spite of the syllabus change some candidates are still trying to answer the Global syllabus questions using English law as their paradigm and it does not work; the legal regulations are different.

The report will begin with a few general points, and ones that have been made previously, before going on to look at the question in the paper in detail. First of all although indications of good practice will be given, it is in the nature of reports such as these to concentrate more attention on the negative aspects of performance in order to try remedy them for the future. So at the outset, it must be said that there were some very good performances indeed. However, there were also many poor performances, which indicated a lack, and in some cases a total lack, of legal knowledge.

A second introductory point to mention is the shortcomings found in scripts. Various failings in this regard are:

- not indicating the questions done **in** the paper
- not indicating the questions done in the box on the front of the paper
- where both of these occur it is sometimes difficult for the marker to actually recognise which question is being done
- not starting each question on a new page
- not using both sides of the paper, thus leading to bulkier scripts
- using additional booklets to no great effect, by simply repeating information
- producing general essay answers to problem questions which contain little information relating to the specific issues raised in the question.

Specific Comments

Question 1

This question was divided into three parts, requiring an explanation of the differences between criminal law, civil law and arbitration.

In part (a) which dealt with criminal law there was often an attempt to consider certain relevant factors such as criminal proceedings are brought by the state and civil proceedings by the individual and the aim of criminal proceedings is to punish by fines or imprisonment while civil proceedings aim to compensate by way of damages. Also there was some mention of the standard of proof.

Part (b) was also reasonably well done and candidates provided an explanation of the difference between criminal and civil law, with many also addressing the different standard of proof involved.

Answers to part (c) tended to be less well done with answers tending to be too cursory to deal with the topic in a satisfactory manner. This was surprising; given that this part carried four marks as against the three available for the other two parts. Nonetheless some sound and complete answers were provided.

Question 2

This question required candidates to explain the rules governing the seller's obligations in respect of the quality of the goods under the UN Convention. The question was dealt with fairly well by most candidates, the only comment being that those candidates who had studied the UN Convention of the International Sale of Goods (CISG) did far better than those who simply guessed at its provisions or tried to apply English law.

Question 3

This question requires candidates to explain the rules relating to the award of damages under the UN Convention. As in the previous question knowledge of CISG was essential and marks were in direct correlation to such knowledge. Some candidates produced answers that dealt with more than was required by the question in that they provided information about breach and matters unrelated to the essence of the question. However, once again the major source of concern was to those candidates who applied English law to the question and consequently missed the point almost completely.

Question 4

This question requires candidates to explain three of the clauses in a company's memorandum of association: the registered office clause, the capital clause and the name clause. Along with question 7 this was the best answered of all the questions. As there were many points that could be made in relation to each part, many candidates achieved the full 10 marks for this question. However, it has to be said that some candidates were less certain about the status of the registered office than the other two parts. Many incorrectly claimed that it was where the company carried out its business.

Question 5

This question required candidates to explain the rules relating to the lawful distribution of company dividends and further required the candidates to focus on the different rules that apply to public and private companies. The answers to the question were, on the whole, just about satisfactory. In part (a) the majority of candidates were able to explain the realised profits test for dividends but few were able to provide relevant authority. In relation to part (b) only a small percentage of candidates were able to cover the additional test applicable to distributions by public limited companies contained in s. 264 of the Companies Act 1985. Nevertheless, in part (c) the majority of candidates were able to correctly identify the potential liability of directors and shareholders for breach of the distribution rules.

Finally two general observations remain to be made. Firstly too many candidates focused their answers on the different type of shares that companies can issue and the order in which the holders of these different types of share receive their dividend. Secondly, and in a similar vein, too many candidates focused on the procedure for declaring dividends rather than on the rules relating to what can actually be paid.

Question 6

This question was divided into two parts and required candidates to explain some essential terms in relation to the United Nations Convention on International Bills Of Exchange and International Promissory Notes. Part (a) required a definition of what is meant by an international bill of exchange and part (b) required an explanation of the roles of specific parties; namely the drawer, the drawee and the payee.

On the whole this question was done fairly well, considering its recent introduction into the syllabus.

In part (a) candidates were usually quite adept in providing a comprehensive definition of a bill of exchange, but surprisingly they did less well at addressing the international aspect of the question.

Although part (b) should have been relatively easy to deal with, as usual, and as expected, candidates did tend to confuse the three roles, revealing their inherent uncertainty about the procedure.

Question 7

This question required candidates to consider the role of the auditor in relation to companies and the precise way in which this relationship is regulated by company law. The question mentioned three specific areas for candidates to focus on but the lack of an allocation of specific marks to these, indicated that the question was to be answered generally and marked globally.

As has already been stated this and question 5 provided the best answers by a long way. Even where candidates were not totally aware of the all the implications of considering external auditors in the context of corporate governance, the majority made at least some reference to it. However, it has to be said that it was in the substance of the question that candidates scored their high marks.

However, it is worth mentioning that there was a significant tendency for candidates to overstate the powers of auditors, even to the extent of suggesting that they could take over the running of the company or dismissing the board of directors. Perhaps of more importance in this regard, and certainly from the accountancy point of view, was the almost general tendency to assert that the auditors had *to ensure* that the accounts provided a true and fair view, rather than the correct approach that the auditors reported on whether the accounts presented actually portrayed a true and fair view. The difference is subtle but important.

Question 8

This question require candidates to analyse a problem scenario from the perspective of the UN Convention of the International Sale of Goods (CISG) and to apply that law appropriately. The question required candidates to analyse a problem scenario from the perspective of the law of international contracts for the sale of goods and to apply that law appropriately. In particular it focused on the creation of contractual relations and required an explanation of offers, acceptances and counter offers.

The question tended to be done reasonably well with most candidates achieving a pass mark on the basis of their recognition of the law involved in the scenario and their application of that law.

However, some of the problems inherent in the old exam structure were carried on in some answers. For example some candidates simply reproduced general contract essays, referring to issues that were not part of the problem scenario. Such irrelevant material gained no credit, indeed it tended to deflect from the candidate's performance by indicating that they actually did not recognise what the key issues in the problem were. Once again it has to be said that those who studied the appropriate law, CISG, did well, but those who had to guess at the answer did not. On this occasion, those trying to answer the question using English law and English authorities were hopelessly adrift as not only are CISG principles different, but the usual English case authorities cited are of absolutely no relevance.

Question 9

Many candidates answered parts of this question well. However, few candidates were able to deal with all the issues presented in the question. Generally, part (a) produced the weakest answers. Only a few candidates were able to describe the relevant statutory provisions.

The skill, in this question, was to identify the relevant areas of law and apply that law to the facts stated in the problem. Explanations of the meaning and procedures involved in voluntary and compulsory liquidations were not relevant to this question.

The focus should be on Earl and the legal issues raised by his concurrent relationships with Flash Ltd.

Earl's rights and liabilities:-

In part (a) Earl, as a creditor of the company through his employment, for his unpaid wages.

S 175 and Schedule 6 of the Insolvency Act sets out what are to be treated as preferred payments and specifically relates to employees' wages together with all accrued holiday pay. The Enterprise Act 2002 removed the Crown from those who can claim preference. Therefore, the state can no longer take priority (in relation to monies due to such as unpaid value added tax, National Insurance or income tax) over non-secured creditors.

The majority of candidates merely said Earl had a right to his wages. Only a few candidates went on to identify his right to preferred payments and even fewer identified his claim as an ordinary unsecured creditor, for the balance of the money due to him as an employee.

In part (b) Earl, as a member of the company through his shareholding, for his liability for partly paid up shares and any right to repayment for the value of his shares.

Flash Ltd is a private limited company. The company has unlimited liability for its debts. However, shareholders of such companies are given limited liability. Normally, the nominal value of a share fixes the amount, which the shareholder has to contribute to the assets of the company. Where the shares are fully paid up, the shareholder has no further liability. Members' liability is limited to the amount (if any) remaining unpaid on their shares, s 1(2) Companies Act 1985.

Shareholders must pay at least the nominal value of any shares issued to them. Shares must not be issued at a discount (s 100). Where shares are issued at a premium (that is, more than the nominal value) the shareholder will be liable to pay the amount owed, over and above the nominal value. The excess forms part of the company's capital. It is included in a share premium account (s 130).

Earl has paid 75 pence per £1 nominal share. Therefore, he is liable to pay the unpaid amount – 25 pence per share – a total of £1,250 – to the assets of the company, but only if such payment is necessary to satisfy the outstanding debts of Flash Ltd on winding up.

As far as reimbursement to Earl for the value of his shares, it must be noted that shareholders, the members, are the last to be paid out - after the creditors.

In the circumstances, immediate insolvent liquidation, it would seem unlikely that Earl would receive all, or any, of the value of his shares.

Many candidates raised the possibility of what may be due to Earl on winding up - reimbursement of his stake in the company - yet did not pick up the clue in the question of partly paid shares – such candidates then failed to consider Earl's liability.

In part (c) Earl, as a creditor through his debentures.

Earl is a secured creditor with a fixed charge over a specific asset of the company. Fixed charge holders take priority over any other creditors in the event of company liquidation.

The land on which the business stands is subject to a charge in order to secure the debt. Where the company fails to honour the commitment to the secured debenture holder, the debenture holder can appoint a receiver who will if necessary sell the asset to recover the money owed. In the case of company liquidation, the asset charged is realised and the sum of money raised goes to pay off the outstanding debts owed to the debenture holders.

Here, if the value of the land subject to the charge is greater than the debt, £5,000, then the excess goes to pay off the rest of the company's debts. On the other hand, if the land is less than the value of the debt secured then Earl will become an unsecured creditor for the amount outstanding.

Here, with a fixed charge against the land, the company's most valuable asset, Earl is likely to receive the full amount of the loan of £5,000.

Most candidates identified Earl's priority position in the list of creditors. Fewer candidates considered where any excess money, raised from the sale of the land, should go, that is to pay off the rest of the company's debts. Also, such candidates did not consider Earl's situation, should the sale not cover his debt, as an unsecured creditor for the amount outstanding.

Question 10

While the majority of candidates grasped the essence of this question, a fairly substantial minority failed to see what was required and based their answers on topics which were not central to the question. These topics were (i) a general account of the law of agency with no or virtually no reference to the position of company directors and/or (ii) a general description of the various types of directors, including shadow directors, and a detailed account of their functions and powers. These candidates generally then stopped there and did not attempt to analyse the scenario in the question or to apply what they had written to the situation.

While the information given in these answers was often reasonably accurate showing that the candidates had properly learnt and revised the topics they chose to cover in their answers, the question was not asking candidates indiscriminately to write "everything they know" about agency and directors; on the contrary it was asking them to select and apply relevant principles and law to the situation involving Len, Katch Ltd and Mo. Another type of answer began with the other extreme by stating that the contract was binding on Katch Ltd because Len was the managing director and then trying to justify this conclusion with unstructured references to boards of companies, agents and directors.

Many candidates however approached the question in a more structured and relevant way, explaining that by Article 70 of Table A of the Articles of Association it is the board as a whole which exercises the powers of the company and that for an individual director to enter into binding contracts on behalf of the company he needs to have acquired the authority to do so. He would of course be an agent of the company and answers went on to describe the various ways this could happen – by express authority, implied authority or ostensible authority. Some answers gave examples of each, as well as an explanation. Some answers failed to distinguish correctly between implied and ostensible authority and described Len's authority as implied, but the answers which included a full description of ostensible as "apparent" or "agency by estoppel" avoided this. Many answers dealt well with the attitude of the board which by accepting Len's reports without challenging his actions or making it public that they did not regard him as their managing director fully confirmed his position to the outside world, and therefore to Mo so that the board was estopped from denying Len's power and was bound by the contract and should either pay Mo or face an action for breach of contract.