LEGAL PROFESSION ADMISSION BOARD

MARCH 2013

LAW OF ASSOCIATIONS

Time: Three Hours

This paper consists of **six** questions.

Candidates are required to attempt any **four** questions.

No question is compulsory.

All questions are of equal value.

If a candidate answers more than the specified number of questions, only the first **four** questions attempted will be marked.

All questions may be answered in one examination booklet.

Each page of each answer must be numbered with the appropriate question number.

Candidates must indicate which questions they have answered on the front cover of the first examination booklet.

Candidates must write their answers clearly. Lack of legibility may lead to a delay in the candidate's results being given and could, in some circumstances, result in the candidate receiving a fail grade.

This examination is worth 80% of the total marks in this subject.

Permitted Materials: **This is an open book examination. Candidates may refer to any books and any printed or handwritten material they have brought into the examination room.**

As some instances of cheating, plagiarism and of bringing unauthorised material into the examination room have come to the attention of the Admission Board, candidates are warned that such conduct may result in instant expulsion from the examination and may result in exclusion from all further examinations.

This examination should not be relied on as a guide to the form or content of future examinations in this subject.

Question 1

In October 2010 Australian Food Products Limited ("**AFPL**") was a public listed comp and its shares were listed on the ASX.

A wholly owned subsidiary of AFPL, Fruit Juices Pty Limited ("**Fruit Juices**") manufactured and sold fruit juices in Australia. Fruit Juices was subject to claims for damages for personal injuries suffered by those who consumed the fruit juices manufactured by Fruit Juices by reason of the carcinogenic nature of the fruit juices manufactured by Fruit Juices.

In October 2010 the Directors of AFPL passed a resolution, the effect of which was to separate Fruit Juices from AFPL. This was done by AFPL establishing a foundation named the Australian Food Products Compensation Fund (the "**Foundation**") to manage and pay out claims made against Fruit Juices. Fruit Juices would enter into a Deed of Indemnity with AFPL under which Fruit Juices would make no claim against and indemnify AFPL in respect of all claims made against Fruit Juices. In return for entering into the Deed of Indemnity, AFPL would pay Fruit Juices an amount of money. New shares would be issued by Fruit Juices to be held by or for the ultimate benefit of the Foundation. Shares held by AFPL in Fruit Juices would be cancelled. A new company, Food Products NV ("**FPNV**") would be incorporated in the Netherlands and that company would become the immediate holding company of AFPL.

It was further resolved by the Directors of AFPL in October 2010 that an announcement be made to the ASX concerning future damages claims against Fruit Juices (the "**ASX Announcement**"). The ASX Announcement stated:

> *"The Foundation has sufficient funds to meet all legitimate compensation claims anticipated from people injured by the products manufactured by Fruit Juices.*
>
> *In establishing the Foundation, AFPL sought expert advice from a number of firms, including CPA Accountants and the actuarial firm Calculus. AFPL is satisfied that the Foundation has sufficient funds to meet anticipated future claims."*

The ASX Announcement was drafted by the management of AFPL and the Directors of AFPL accepted the content of the ASX Announcement. The Directors relied on the management of AFPL to draft the ASX Announcement because the Directors believed that the management of AFPL were in a better position than the Directors to analyse the advice from CPA Accountants and from the actuarial firm Calculus and that it was the management of AFPL who were concerned with communications strategy.

The ASX Announcement was false in that there was not sufficient funds in the Foundation to meet future claims from people injured by the products of Fruit Juices.

There is evidence that at its May 2010 meeting the Directors of AFPL received draft accounts for the year ended 31 March 2010 which were included in the Board Papers. The draft accounts for the year ended 31 March 2010 included a contingent liability note with respect to the uncertainty surrounding the valuation of future claims made against Fruit Juices. The note stated:

(Question 1 continues)

(Question 1 continued)

> *"AFPL cannot measure reliably its exposure with respect to future claims against Fruit Juices. The Directors rely upon various internal and public reports and seek expert actuarial advice in assessing the ongoing exposure to claims. A contingent liability exists in respect of the ultimate cost of settlement of claims yet to be made which cannot be measured reliably at the present point in time."*

ASIC has now commenced proceedings against the Directors of AFPL. ASIC contends that the Directors of AFPL, by resolving to make the ASX Announcement, failed to exercise the degree of care and diligence required of them pursuant to section 180 of the *Corporations Act*.

Advise the Directors having regard to section 180 of the *Corporations Act* and the relevant case law.

(20 marks)

(Question 2 follows)

Question 2

Joanne and Max were Directors of Flower in the Desert Pty Limited (the "**Compa** which operated a hotel in the Northern Territory. The Company owned the hotel buildin and the surrounding land valued at $3 million (the "**Company Premises**"). In June 2010 Joanne, purporting to act on behalf of the Company, met with Simon, an officer of Lots of Money Bank Pty Limited (the "**Bank**"), with a view to obtaining a loan in the amount of $2 million for the Company using the Company's Premises as security. In order to facilitate the loan application Simon gave Joanne an application form to complete. Joanne completed the application form and signed it as a Director of the Company. Joanne also forged the signature of Max as Director on the application form. The application form was then posted back to Simon. Max was unaware of the loan application and was unaware that his name had been forged on the application form.

After receiving the application form from Joanne, Simon decided to undertake searches of the Company at ASIC. Those searches revealed that both Joanne and Max were the only Directors of the Company. With that information Simon decided not to inquire any further as to the authority of Joanne to act on behalf of the Company or as to whether Max knew of the loan application.

On 1 July 2010 Simon telephoned Joanne and informed her that the loan application had been approved by the Bank and that all that remained to be done was for the Company to execute security documentation over the Company's Premises. Upon receipt of the security documentation Joanne immediately affixed her signature as a Director of the Company and again forged the signature of Max, describing him as the "Secretary" for the Company. Once again, Max was unaware that his name had been forged to the security documentation. Max was not the Secretary of the Company but only a Director and that fact was revealed by the ASIC search that Simon had previously undertaken.

When time for payment of the loan funds occurred Joanne told Simon that notwithstanding the loan was in the Company's name, the loan funds should be made out to her personally and not to the Company. Upon receiving that request Simon became suspicious and when he looked at the executed security documents Simon noticed that the purported signature of Max on that document differed slightly from the purported signature of Max that was contained on the application form. Despite his suspicions Simon made no further inquiries.

On 28 July 2010 Joanne received a personal cheque in the amount of $2 million. After receiving the cheque Joanne ran off with one of the hotel guests and has not been seen since. The loan moneys of $2 million was never repaid. On 1 September 2010 the Bank commenced proceedings to take possession of the Company's Premises.

Advise Max whether he could succeed in having the loan and the security documentation over the Company's Premises declared invalid and set aside. Give reasons for your answer. You should have regard to the *Corporations Act* and the relevant case law.

(20 marks)

(Question 3 follows)

Question 3

Tony and Peter are shareholders in Groove Furniture Pty Limited ("**Groove**"), a furniture manufacturing company located in Sydney. The other shareholders in Groove are Rosanna, Fiona and Sue. Each shareholder holds one ordinary share in Groove. The Directors of Groove are Rosanna, Fiona and Sue. Tony and Peter are not Directors of Groove.

In October 2011 Rosanna, Fiona and Sue incorporated another company called Made to Order Furniture Pty Limited ("**Made to Order Furniture**"). Made to Order Furniture also manufactured furniture.

During the period November 2011 to November 2012 Rosanna received numerous furniture orders from customers of Groove. In many cases Rosanna, Fiona and Sue caused those orders to be filled by Made to Order Furniture resulting in profit to that company. Further, in those cases, Groove received no financial benefit from the respective transactions.

Tony and Peter were previously unaware that orders from customers of Groove had been passed on to Made to Order Furniture and in December 2012 Tony and Peter confronted Rosanna, Fiona and Sue demanding that the profits that were made by Made to Order Furniture be returned to Groove. Rosanna, Fiona and Sue refused. Tony and Peter then called a meeting of Groove and proposed a resolution that Groove commence proceedings against Rosanna, Fiona and Sue. Rosanna, Fiona and Sue, who together held a majority shareholding, voted against the resolution and the resolution failed.

Tony and Peter allege that the diversion of business from Groove to Made to Order Furniture was in the circumstances a breach of Directors duties by Rosanna, Fiona and Sue.

Tony and Peter seek your advice as to whether they can apply to the Court to bring proceedings on behalf of Groove against Rosanna, Fiona and Sue. In your answer you should identify the relevant principles that are needed to be satisfied pursuant to section 237 of the *Corporations Act*.

(20 marks)

(Question 4 follows)

Question 4

From 1995 to 2010 Don operated a business as a sole trader (the "**Business**"). The Business manufactured machines which were capable of making bone screws. In October 2010 Don invited Mark to assist him in financing the Business. Mark agreed. The parties then signed a written agreement which contained terms to the following effect:

(a) Don would manufacture machines for sale;

(b) The machines would be sold by the Business;

(c) Mark would advance $100,000 to the Business;

(d) Don would provide engineering expertise to the Business;

(e) The assets of the Business were owned by Don and Mark jointly;

(f) Profits from the Business would be used first in repaying to Mark the $100,000 that he had advanced and then the profits were to be shared equally;

(g) Don was to meet all expenses associated with the manufacture and sale of the machines;

(h) Business decisions were to be resolved jointly, however Mark was required to approve all sales prior to them being entered into;

(i) It was expressly stated that Don and Mark were not partners in the Business.

In December 2010 Don sold a machine to Hospital Products Pty Limited ("**Hospital Products**"). Mark was unaware of the sale and in any event did not approve it. Further, at the time of the sale of the machine to Hospital Products, Hospital Products was unaware of the existence of Mark or his involvement in the Business. Hospital Products thought that Don was a sole trader. The machine proved to be faulty and led to Hospital Products incurring significant losses of profit because it could not fulfil orders which it had from its customers.

In March 2011 Don was made bankrupt. Hospital Products now discovers that Mark had an involvement with the Business and seeks to claim from Mark as a partner in the Business.

Hospital Products seeks your advice as to whether it has any rights against Mark. Give reasons for your answer.

(20 marks)

(Question 5 follows)

Question 5

Australian Hardware Pty Limited (the "**Company**") is a company which manufactures hardware products (the "**Business**"). The Company was incorporated in 2005 and at all times since its incorporation the Directors were Chris, Robert and Justin. Further, Chris, Robert and Justin each owned beneficially one ordinary share in the Company and each was involved in the management of the Company and each was paid a salary.

In the period 2005 to April 2012 the Company regularly paid dividends to Chris, Robert and Justin.

From June 2012 the Company ceased to hold any shareholders meetings and directors meetings despite Justin requesting such meetings to be held pursuant to the Company's constitution. Despite these requests Chris and Robert have refused to attend or convene meetings of any type and have also refused to discuss with Justin matters of management of the Company. Further, dividends no longer are paid despite the Company making a profit and all decisions of the Company have been made since that time by Chris and Robert without informing or consulting Justin. Finally, Chris and Robert have given themselves an increase in salary. Justin, who also received a salary, was not given an increase. Chris and Robert increased their salary to take up the profits made by the Company in any year.

Justin has now commenced oppression proceedings in the Supreme Court against both Chris and Robert pursuant to section 232 of the *Corporations Act* in which Justin is seeking that Chris and Robert compulsorily purchase his share pursuant to section 233 of the *Corporations Act*. Expert evidence has been received by Justin valuing his share in the Company at $800,000.

Since commencing the oppression proceedings but prior to the Hearing, a liquidator was appointed provisionally to the Company and the liquidator has sold the whole of the Business conducted by the Company. Both these steps were done with the concurrence of Chris, Robert and Justin. The liquidator sold the Business assets back to Chris and Robert for 10 cents in the dollar. The amount recovered on the sale of the Business by the liquidator was applied entirely to the costs and expenses of the provisional liquidation.

Advise Justin of his prospects at the Hearing of:

(a) The Court finding that Chris and Robert engaged in conduct which was oppressive pursuant to section 232 of the *Corporations Act*; and

(b) If Chris and Robert's conduct was oppressive, the Court ordering Chris and Robert that they compulsorily purchase Justin's share in the Company for $800,000 pursuant to section 233 of the *Corporations Act*.

(20 marks)

(Question 6 follows)

Question 6

The Timber Works Pty Limited (in liq) (the "**Company**") was wound up in December 20[illegible]. The Company conducted a family business with Jacob and his wife Marie as the sole Directors of the Company. Jacob and Marie were the sole Directors of the Company since its incorporation and were its Directors at the time the Company was wound up. Tania was employed by the Company as its Financial Officer, but was not a director of the Company.

The liquidator now seeks to recover from Jacob and Marie the sum of $600,000, being the amount which corresponds with the total of some debts incurred by the Company between 2010 and 2011. The liquidator alleges that when each of the debts were incurred the Company was insolvent.

Both Jacob and Marie allege that they had reasonable grounds to expect that the Company was solvent at the relevant time and that it would have remained solvent even if the Company had incurred those debts and any other debts at that time. In support of this contention Jacob and Marie state that throughout the relevant period the debts incurred and which would continue to be incurred by the Company could have been paid by recourse to the sale of the assets of the Company and that Jacob and Marie believed it was possible that those assets could have been sold over a 90 day period.

Further, Jacob and Marie state that they were advised by Tania during the relevant period that the Company was solvent and was able to meet its obligations because most of the creditors did not press for payment within the normal trading terms and because there was an understanding that the creditors would not take recovery action against the Company provided that the Company paid within a reasonable time after a 30 day notice was given. Tania says that she was never asked to monitor solvency and that her job was more akin to being a bookkeeper and that she did what she was told by Jacob and Marie.

Advise Jacob and Marie of their prospects of resisting the liquidator's action. Your answer should include an analysis of the essential elements that are necessary to be shown by the liquidator to be successful and an analysis of any such defences that Jacob and Marie may have to any such application.

(20 marks)

END OF PAPER