

# UNIVERSITY COLLEGE LONDON

*University of London*

## EXAMINATION FOR INTERNAL STUDENTS

*For the following qualifications :-*

*LL.B.*

### **LL.B. Part II: Company Law**

COURSE CODE : LAWSII06

DATE : 22-MAY-02

TIME : 10.00

TIME ALLOWED : 3 hours 15 minutes

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**TURN OVER**

## COMPANY LAW

Answer **FOUR** questions, including at least one question from **PART A** and at least two questions from **PART B**.

### PART A

1. "The odd thing about articles of association is that they cannot be enforced and so do not even govern the way the members are to associate. Paradoxically, shareholder agreements operating entirely outside the legislative structure provide a better basis for arranging the rights of the shareholders."

Discuss.

2. "The corporate governance committees have made little impact on boardroom practice or culture. Corporate governance will never be a voluntary matter; legal sanctions are needed and there are insufficient at present."

Discuss.

3. "Limited liability is an unfair doctrine, and particularly so when one considers it in the context of corporate groups. It is puzzling that the courts and the legislature have so consistently declined to intervene in this field."

Discuss.

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## PART B

4. Bytes Ltd is a company engaged in the development of computer software. It was formed in 1996 with articles of association which were in the form of Table A except that:
- (i) Clause 4A provided that at least 50% of the annual profits of the company must be set aside for research into new products, and could not be made available to pay a dividend to the shareholders.
  - (ii) Clause 4B excluded the application of sections 89-90 of the Companies Act 1985, pursuant to the power contained in section 91.

Until 13 February 2002, the company had an issued share capital of 200,000 £1 ordinary shares. Calum, Dodi and Eric were then the only directors of the company and prior to 13 February they held 40,000 shares each. The remainder of the shares were spread out among forty other persons.

On 13 February 2002, Calum, Dodi and Eric issued more ordinary shares to themselves, claiming that the company was in need of more capital. This gave them the voting power necessary to pass a special resolution. They then passed a special resolution deleting clause 4A from the articles of association and replaced it with a clause giving the directors an unfettered discretion as to what proportion of the profits they used for dividend. They then announced that they intended use all the profits this year in paying dividends.

At the recent annual general meeting of Bytes Ltd, Freddy, who is Eric's nephew, was elected a director. Freddy is also a director of Pixels Ltd, which is in fierce commercial competition with Bytes Ltd. Evidence has emerged that Freddy has recently turned down a lucrative contract being offered by one of Bytes Ltd's usual customers and that Pixels Ltd has since secured the deal.

Leonie owns 3,000 shares in Bytes Ltd. She is angry about the above matters and wishes to take some action. She is also concerned about rumours that the directors have supplied false information to the company's auditors so as to inflate the annual profit figures.

Advise Leonie.

**CONTINUED**

5. Answer **BOTH** (a) **AND** (b).

- (a) “It is part of the culture of securities regulators that they uncritically accept the need to regulate insider dealing, in spite of the fact that there are no rational policy reasons for having such regulation.”

Discuss.

**AND**

- (b) Aggro plc, which is engaged in manufacturing electronic components, has an issued share capital of eighty million £1 shares and is listed on the main market of the London Stock Exchange. On 25 April 2002 the directors were about to announce that the company was going to make a takeover bid for a rival company, Targ plc and were excitedly discussing it at lunch in the directors’ dining room.

At 12.15pm Winnie, one of the waitresses in the directors’ dining room, overheard the directors’ conversations. At 2.00pm while having her lunch at a nearby cafe she described the directors’ conversations to her friend Sonia who worked as a secretary at a solicitors’ firm based nearby. At 2.30pm Sonia bought 2000 shares in Targ plc, on the London Stock Exchange, at £3 each.

At 3.00pm Harry, one of the directors, sold half his holding of 8,000 shares in Aggro plc, on the London Stock Exchange, at £4 each, intending to use the money to pay for a luxury holiday which he had just booked to celebrate the coming takeover battle.

At 4.00pm the news of the takeover bid was announced to the market and the price of Targ plc’s shares rose to £6, and because many users of the market felt that Aggro plc was overreaching itself, the price of Aggro plc’s shares fell to £2.

Discuss whether any offences have been committed under Part V of the Criminal Justice Act 1993.

**TURN OVER**

6. Rodo plc manufactures road sweeper trucks. It has a subsidiary, Pumps Ltd, in which Rodo plc holds 85% of the shares. Sally and Tim are the directors of Rodo plc, and Ulrich is the director of Pumps Ltd. Pumps Ltd manufactures heavy-duty water pumps most of which it supplies to Rodo plc under contracts which provide for prevailing market prices. Pumps Ltd is a reasonably successful company operating at a profit.

For some time now, the business of Rodo plc has not been going well, owing to a downturn in the market for road sweepers. At a meeting last month, with a view to raising cash for Rodo plc's operations, the directors of Rodo plc decided to sell Rodo plc's 85% shareholding in Pumps Ltd to Hamidul for £100,000. They decided upon the price of £100,000 after receiving a valuation report from a professional valuer that the shares are worth that amount. They have provisionally agreed with all the necessary parties that Rodo plc would lend Hamidul £30,000 to help finance the purchase, on the condition that Pumps Ltd would supply 100 pumps to Rodo plc at half-price, and Pumps Ltd would also secure the loan to Hamidul by issuing a debenture giving a floating charge over all of its assets.

Ulrich, the director of Pumps Ltd, feels that the only commercial benefit which could accrue to Pumps Ltd from the transaction is that by helping Rodo plc it would generally help to maintain the close commercial relationship with Rodo plc which he can see is essential to the long term prosperity of Pumps Ltd.

None of these arrangements is yet the subject of a binding contract and they are merely proposals. The boards of directors of both companies have just been told that the proposals may be in breach of section 151 of the Companies Act 1985 and may also infringe other aspects of company law.

Advise the directors.

7. The issued share capital of Factory Ltd, which was incorporated in 1996, consists of 100,000 £1 ordinary shares and 10,000 £1 preference shares.

The memorandum of association provides, *inter alia*, that: "The preference shares shall carry no rights to vote, except in class meetings, but shall carry rights to an annual 8% preference dividend, and a right to prior repayment of capital on a winding up and rights to participate in surplus assets on a winding up equally with the ordinary shares."

The articles of association are in the form of the 1985 Table A except that they provide that: "Marketo Ltd shall have rights of pre-emption in respect of any shares of the company which any member is desirous of transferring."

Ann holds 8,000 of the preference shares and Bob holds 2,000 of them. Marketo Ltd holds 20,000 ordinary shares which were issued to it in 1999 in return for its entering into a distribution and marketing arrangement in respect of products manufactured by Factory Ltd. Also as part of the consideration for that agreement, Factory Ltd agreed to alter its articles so as to give Marketo Ltd pre-emption rights in respect of shares transferred by shareholders of Factory Ltd. Holdings of the rest of the ordinary shares are spread out unevenly between 15 different people, including the 4 directors.

**CONTINUED**

The directors of Factory Ltd are proposing to make the following changes:

- (i) To increase the annual dividend on the preference shares to 14% and to remove the preference shareholders rights to participate in surplus assets on a winding up.
- (ii) To remove from the articles of association Marketo Ltd's rights of pre-emption.

Advise the directors, who wish to know whether their proposals can be carried out, and if so, how they should proceed and what legal challenges they may face. They have been told by Ann, who is having an affair with one of the directors, that she will agree to their proposals because her shareholding is "unimportant" to her.

8. Ragtime Fashions Ltd ("Ragtime") went into insolvent liquidation on 1 May this year. Scott (an insolvency practitioner) has been appointed liquidator. His investigation of the company's financial situation reveals a substantial net deficiency as regards unsecured creditors. After provision for the costs of liquidation, the company's assets are estimated to realise £150k, of which £50k consists of uncollected book debts. The claims of preferential creditors amount in total to £90k. There are numerous non-preferential creditors, of whom the most substantial is the Russell Bank plc, which had granted Ragtime an overdraft facility on its current account. That account was in deficit at its maximum permitted level (£300k) on 1 May.

Originally, the Bank had limited the overdraft facility to £150k, which was supported only by the directors' personal guarantees of £50k each. On 1 February this year, with the facility fully extended and with many key suppliers insisting on cash "up-front", Ragtime's two directors, Alan and Bert, had requested the Bank to double the company's borrowing limit. The Bank insisted on taking security over the company's assets and undertaking, which Alan and Bert reluctantly agreed on condition that the Bank would simultaneously release their personal guarantees. On that basis, they agreed that the company would grant the Bank a fixed charge over all uncollected debts, and a floating charge over all other assets, including the proceeds of collection of the book debts. As a further condition, the company was required until further notice to pay all cash or cheques into its account with Russell Bank within 24 hours of receipt.

On 1 February, Alan and Bert issued instructions to the company's usual solicitor, Joe Soap, to execute the instruments of charge in favour of the Bank. Joe happened to be away on holiday at the time, and it was not until his return three weeks later that the instruments were executed. Once this was done, the Bank ensured that the charges were properly registered, and it released the personal guarantees. In the meantime however, the overdraft had been allowed to grow by £100k. Soon afterwards, the overdraft reached its authorised limit, which was the position on 1 May.

Scott seeks your advice on the issues of law arising from the above facts. Explain the principles which determine how the company's assets will be distributed, and indicate whether there are any grounds on which Scott could try to augment the amount of funds available for distribution to the unsecured creditors. (**Note:** you are not required to attempt to calculate the rates of dividend that might eventually be paid. It will suffice to indicate the general effect of the operation of the legal rules you describe.)

**END OF PAPER**