Law Society of Scotland

Business Organisations

Thursday 25 July 2024

13.00 – 16.00

(three hours)

Candidates are required to answer **THREE** questions.

Candidates are expected to provide legal authority for all their assertions.

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Question 1

Arthur, Bill, Connor and Dave collectively agree that they will pool their business, military, security and journalistic expertise to set up a consultancy and publicity firm to advance the cause of men's rights in Scotland. They each put £10,000 into the partnership, whose name is agreed to be ABCD. They cannot be bothered to draw up a partnership agreement, but start contacting potential clients and publicity outlets from 1 July 2024.

The four men do not always find it easy to agree on matters, but they do agree that Dave, with his journalistic background, should be their spokesman. Whenever a controversial new policy that might affect men adversely is announced, TV reporters and others ask Dave for ABCD's opinion. He is good at doing this, but when he is asked if he would appear on a commercial television station to explain ABCD's position, he keeps the appearance fee for himself.

The four partners have agreed between themselves that they should have no dealings with with a particular independent television company, ScotTV. This is because they were once treated badly by ScotTV. A reporter on ScotTV took statements out of context and misrepresented ABCD. Arthur is nevertheless approached by a director of ScotTV who asked if ABCD would provide ScotTV with advice on how to reach a wider young male audience. Without consulting the others, Arthur agrees that ABCD will do this, and persuades his assistant to draft an advisory report for ScotTV. Arthur approves the report and sends it to ScotTV. ScotTV acts upon the advice, which turns out to be disastrous. ScotTV wants to sue ABCD for its incompetent advice. Bill, Connor and Dave say that ABCD is not liable at all as Arthur was not authorised to deal with ScotTV.

Bill organised a week-long responsibility to the victims festival for men (no women), hosted by ABCD, in a secluded glen in the Highlands, slightly like the Burning Man festival in Nevada. The high point of the festival was the burning of a giant wicker man. Bill has been involved in its construction, though many of the delegates to the festival helped build it. Bill was given the honour of igniting it. Having done so, a freak blast of wind toppled the burning wicker man over a number of spectators. They were badly injured. They wish to sue ABCD for their injuries. ABCD claims that it cannot be liable for unforseeable accidents and that their insurance cover is too small to meet all the victims' claims. At this point Connor reveals that, though he had not told anyone about it, he is actually an undischarged bankrupt. Connor, as it happens, having sold his security firm, is extremely rich but, seeing as he happened to be elsewhere at the time of the festival, states that he has no responsibility to the victims.

Explain the various points of law arising from the above scenario.

Question 2

Robin works in property maintenance. He set up an agency of his own, whereby he would keep an eye on properties, owned by his clients, which were not let out (instead lying empty) but which needed regular checks to ensure that there were no leaks or other concerns. He arranges for tradesmen to come in to repair any damage or fix any problems. He charges his clients a large fee for his services, but, as he points out, he needs high insurance cover, and it is a very responsible position, demanding trustworthiness and competence.

Kim, one of his clients, owns a flat which in the cold weather suffered a burst pipe. Robin hired an all-trades firm to fix the plumbing, replastering and painting. On completion, Robin passed the cost of the firm's fee plus 5% as a handling fee on to Kim, who duly paid the money to Robin. With the firm's previous permission, Robin deducted 5% from the sums due to the firm as commission for bringing the firm the business. Kim later discovered what Robin has done and challenged him on the fact that he both charged her a handling fee and also obtained commission from the firm. Robin pointed out that what passed between the plumbers and him was entirely a private arrangement and was no business of Kim's.

Iqbal has a house that Robin looks after. Iqbal is a very busy international financier, with little time for petty matters. Iqbal is away in a wealthy Middle Eastern merchant city. The agreement Robin and Iqbal have is that Robin can spend up to £50,000 on repairs without having to report to Iqbal. One day, part of the roof caves in as a result of undetected dry rot. It costs £75,000 to repair the roof. Robin tries to get hold of Iqbal, but Iqbal cannot be contacted. This is because Iqbal has been locked up in prison, having had an argument with a corrupt government official who arranged to have Iqbal arrested. When Iqbal is released, he is unhappy about the high cost of the roof repair. Robin states that if the roof had not been repaired, rain and snow would have got in, and the damage would have been even worse. Iqbal says that Robin was not authorised to incur such expenditure and sees no reason to reimburse Robin.

Robin is asked by another client to negotiate the purchase of a vintage car. The client is James, a wealthy collector. James knows that if he, James, approaches the seller directly, the seller will double the price of the vehicle. Robin may be able to negotiate a better price. Robin is indeed able to negotiate a better price, and manages not to reveal for whom he is acting. Robin and the seller agree a price, with payment to made on a certain date. It is agreed that it is a material term of the contract that payment is made on that date. Robin is asked if he is buying the car for himself. Robin evades the question. When the day for the sale itself arrives, Robin is unable to pay the seller as he has not been put in funds by James. The seller wants to make Robin pay the price of car. Robin says he is not liable.

Robin hires a firm of damp-proofers to inject the walls of one of the houses he looks after. This is to prevent damp rising into the building from the ground. The house is owned by Adam. The damp-proofers, who know that Robin is acting for Adam, complete the work and submit the invoice to Robin. Robin sends the invoice to Adam. In the meantime, Adam has disappeared. It turns out that the house is due to be sold by its standard-security holder, and that Adam, whether or not bankrupt, is nowhere to be found. Under the circumstances, the damp-proofers want Robin to pay their invoice. Robin says he cannot be responsible for his client's inability to pay the invoice.

Discuss the points of law in the above scenario.

Question 3

Muir and Co LLP is a firm of accountants specialising in audit.

One of its staff, Roger, carries out the audit of a limited company. The managing director of the limited company, Nahum, is aware that his company needs more capital. Nahum meets Evan at the golf club and they get talking. Nahum asks Evan if Evan would care to consider investing in Nahum's company, indicating that the company would both welcome the capital contribution and be a good return on investment. Evan says that he would like to look at the audited accounts. Nahum provides Evan with a copy of the audited accounts. On the basis of what he sees in the audited accounts, Evan agrees to invest a substantial sum of money and is issued some shares. Six weeks later the company collapses into insolvency. It turns out that the company's assets were misrepresented, and that the auditors never checked the true value of those assets. Nahum and the other directors have disappeared. Evan wishes to sue Muir and Co LLP for the inaccurate audit on which he had relied.

Another member of staff in Muir and Co LLP is Jane. Jane has been the auditor of Phlip Plc, a small chain of fast-food cafes run through franchises. Phlip Plc does not offer its shares to to the public. While carrying out her audit, she discovered a number of discrepancies between what the directors were claiming and what appeared to be the true position in the accounts. She drew this to the attention of the directors. The directors did not appreciate this, so they informed Muir and Co LLP that Phlip Plc would no longer use Muir and Co LLP. Jane's services are no longer required. Under these circumstances, and now that she is no longer the company's auditor, she is unsure what she is now required to do to comply with the relevant legislation.

Alex is another auditor in Muir and Co LLP. When carrying out an audit of a private company, he notices the directors being evasive in response to questions that he puts to them. While not wishing to go so far as resigning, he wants to know what his rights as an auditor are in such a situation, and where he may raise any concerns he may have about this.

Lianne is doing the audit of a subsidiary company that has made a substantial profit over the course of its financial year. The company has a long term liability for environmental costs relating to a project in North America. The company has the benefit of an insurance policy intended to cover those future costs. The company chooses to use its profits to pay a substantial dividend to its holding company. Lianne is asked to indicate that there is no reason not to pay this dividend, and on the basis of the accounts as presented she indicates this. The dividend is duly paid. The company then enters a members' voluntary winding-up. Four years later, and much earlier than anticipated, the environmental liability arises. The proceeds of the insurance policy, though welcome, turn out to be insufficient for the needs of the North American environmental agency ("NAea"). Given the shortfall, NAea initially was going to sue the directors of the subsidiary company for their breach of duty in permitting the dividend to be paid. The directors turn out not to be worth suing. NAea proposes to sue Muir and Co LLP instead.

You are the in-house legal counsel for Muir and Co LLP. Provide the appropriate legal advice for each of the above problems.

Question 4

The directors of Bamboo Ltd wish to make some changes to their company's articles. Bamboo Ltd is a holiday timeshare company. All those who buy timeshares from the company have to become members of the company. At present the company's articles are the standard Model Articles for private companies. The directors own 80% of the shares within the company, so there is little doubt that they will be able, in their capacity as shareholders, to make these changes to the articles. You are the lawyer for a small shareholder who has doubts about the wisdom or the legality of the proposed changes. The following are the proposed changes. Advise your client.

a. The directors wish to have a new provision that permits directors (and only directors) to receive their dividends in the form of further shares;

b. Notwithstanding the term in existing contracts for the sale of time-shares that says that a member may keep his time-share in perpetuity or transfer it to heirs or anyone else, and receive any other contractual benefits associated with those time-shares, with effect from the date of the passing of the resolution to alter the articles the transferability of the time-shares and the availability of benefits will be a matter henceforth reserved solely to the directors' discretion;

c. The articles will have a new provision that says that existing and new members consent to their renunciation of any rights under Companies Act 2006 ss.260-269 (derivative claims and derivative proceedings) to litigate on behalf of the company against the company's directors;

d. All existing members who wish to retain their shares must on the adoption of the changed articles pay an additional premium of £1,000 for each share that they own, such sums to be credited to the company's share premium account.

Question 5

You have a client, Bill, who has made some unfortunate business decisions relating to companies with which he became involved. He seeks your advice on the following matters:

a. He invested in a private limited company speculating in cobalt futures. He had been induced to do so by Andrew, its managing director and majority shareholder, who had misled Bill as to the extent of Bill's likely return on investment. At the time Bill invested, he was unaware that the company was involved in litigation involving a large fraud that Andrew had perpetrated through the company. The company had been found liable to the victims of the fraud, but before the decree against the company could be enforced, Andrew arranged for the assets of the company to be secretly extracted from the company and remitted elsewhere. The company now has no realisable assets. Bill thinks he may a claim against Andrew. Andrew's lawyers say any claims Bill may have should be directed to any liquidator appointed to Andrew's company.

b. Bill invested some money in a waste-removal company. The company clears old building sites and takes the waste to designated rubbish tips. The managing director of the company is Edwin. Edwin has 80% of the voting shares and Bill has 20%. Both men are directors. Bill and Edwin fall out because Bill believes that Edwin has been paying building contractors under-the-counter payments to obtain the contracts for waste disposal. Bill thinks this is dishonest and writes to the police. The police do not have the resources to deal with this, but Edwin hears of Bill's complaint all the same. Edwin then convenes a general meeting of the company, uses his majority shareholding to dismiss Bill as a director, arranges for Edwin's salary and pension contributions at the company's expense to be increased, and approves a rights issue which he knows Bill cannot afford to take up.

c. Bill happens to know Tom, the managing director of a leading listed company. They were chatting over a cup of coffee after church and Tom let slip the fact that he had recently had a heart scare. This fact was quite well known to Tom's social circle. Next day Bill sold his share's in Tom's company, not because of what Tom had told him but because the share price had risen over the last few weeks and Bill wanted to crystallise his gain. Some days later, Bill was talking about Tom to Ron, a sports writer in a local newspaper. Tom had been a supporter of a local football club. The next thing he knew, there was an announcement about insider dealing taking place in Tom's company's shares. There had been a wave of selling of shares. A few days later, a newspaper announced the reason for the sale of the shares – someone had divulged inside information about Tom's health. If Tom were ill, his company would be badly affected. Bill is very worried about being arrested.

d. Many years ago Bill set up a company that acquired flats to rent out to students. Meanwhile, Bill's ex-wife thinks that Bill is not paying her enough by way of maintenance. They had only been married for two years before they divorced. His ex-wife had played no part in the management of the company or its flats. Nevertheless, she wants to get an order from the court ordering him to make his company sell the flats in order to realise capital which could be paid to her. Leaving aside the question of whether she is owed any more money from Bill, or any tenants' rights, Bill is worried that as a matter of company law she might be able to force the sale of the flats.

Question 6

When a liquidator is appointed over a company, the liquidator has to maximise the assets of the company to be divided up between the creditors, and, if there is a surplus, returned to the members.

Bilge Ltd, when it goes into liquidation, is found to be owning one item of heritage, secured by a standard security but only to the extent of 60% of the value of that heritage, and with a floating charge over most, but not all, of Bilge Ltd's assets. The liquidator also establishes that the managing director had transferred the ownership of a van owned by Bilge Ltd to his wife six months ago. Bilge Ltd had suffered a loss of another valuable asset purely because the managing director could not be bothered to insure it properly before it was stolen. The managing director also had arranged that a loan that his mother had given the company was repaid a week before the company went into liquidation. The correspondence between the director and his mother suggested that he was trying to ensure that she would get her money back even if everything went wrong. The company has a number of employees, not all of whom had been paid their most recent salaries. There is also an outstanding VAT bill. In the light of this information, explain

a. the rights of the standard security holder,

b. what steps the liquidator may take to maximise the remaining assets of the company, and

c. how, and in what order, the liquidator divides up the realised assets amongst all those entitled to them, including the floating charge holder.

END OF PAPER