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THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2011 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC12: COMPANY LAW

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SUGGESTED SOLUTIONS

1. (a) Section 6(1) of the Companies Act states that the memorandum of a company limited by shares should contain:

(i) the name of the company;

(ii) the restrictions, if any, imposed on the business which the company can carry on;

(iii) the amount of share capital and the number of shares into which the capital is divided;

(iv) where the shares are divided into two or more classes, the rights, privileges and conditions which attach to each class;

(v) whether the company is private or public;

(vi) that the liability of its members is limited, and

(vii) the full name address and occupation of each subscriber to the memorandum.

(b) Section 17 of the Companies Act provided that when registered, the Articles of Association have the effect of a contract under seal between the company and its members and between the members themselves: ***Hickman v Kent*** The contract is that they agree to observe and perform the provisions of the two documents as they to the company or to the members as such.

(c) In terms of Section 21 of the Companies Act, a registered company is deemed to have the capacity of a natural person of full capacity and any act done on behalf of the company will be regarded as the company's act there are however circumstances under which the law departs from the rule and will go behind the corporate façade to expose the real actor, and hold the members or officers responsible liable for what would have been the company's act. The reason for this is because to hold otherwise would create problems or lead to absurdities: ***Daimler Co. vs Continental Tyre & Rubber Co., Gifold Motor Co v Horne.***

(d) (i) In terms of Section 42 of the Companies Act, if the number of members falls below the minimum of two and the company carries on business for more than six months, every member or director who is aware of the default will severally be liable to pay all the debts incurred by the company.

(ii) In terms of Section 337 of the Companies Act, if in the course of winding up, it appears that the business was carried on for any fraudulent purpose, any person who knowingly was part of the fraud is personally liable without limitation.

(iii) In terms of Section 130(3) of the Companies Act, if the company's name is not endorsed on a negotiable instrument or order for goods or services, the officer in default will be personally liable.

2. (a) In terms of Section 5(1)(c) of the Companies Act, an unlimited company is a company that has no limit on the liability of its members. What this means is that if the company is being wound up with debts, its members will be personally responsible to discharge those debts without any limit on the liability.

In the case of a limited company, on the other hand, the amount of capital to be contributed tom the company by a member on the winding up of the company is fixed to the respective amounts remaining outstanding on the shares which they hold in the company, or if the company is limited by guarantee, the amount which each one of them undertakes to contribute towards the payment of those debts.

(b) Section 5(1)(a) of the Companies Act provides that a company limited by shares is one whose liability of its members is limited to the amount, if any, unpaid on the shares held by them. Thus, if they have fully paid for the shares, they cannot, when the company is being wound up, be asked to contribute to the repayment of any debts incurred in its business operations.

In terms of Section 5(6) of the Companies Act, a company limited by guarantee is a company where liability of its members when the company is winding up is limited to the amount that they have respectively undertaken to contribute towards the settlement of its debts on winding up. This type of company will be ideal for not-for-profit making organizations.

(c) (i) Section 25(1) and 26(1) of the Companies Act provides that a company limited by shares can be converted into an unlimited company on two conditions: First of all, members of the company must give a written consent to the conversion. Secondly, the company must adopt a Memorandum and Articles appropriate to its new status.

Thereafter, the following documents must be delivered to the registrar: the company's certificate of incorporation. a copy of the new memorandum and articles; a copy of the special resolution sanctioning the company's adoption of the two documents above; and a statutory declaration by the company's directors and secretary confirming that the company has fulfilled the two conditions mentioned above.

(ii) Section 24(1) provides for the conversion of a company limited by shares into a company limited by guarantee as follows: First, the company's shares must be fully paid up; each member of the company must agree in writing to the conversion and to voluntarily surrender to the company for cancellation all shares held by him immediately before the conversion; secondly, a new memorandum and articles appropriate to a company limited by guarantee must be adopted by the company, each member must agree in writing to contribute to the assets of the company in the event of its being wound up with debts, such sums as may be required.

If these conditions are satisfied the company must deliver to the registrar the following: the company's certificate of incorporation, a copy of the new memorandum and articles together with the special resolution at which the company adopted these documents and a statutory declaration by the company's directors and secretary confirming that the four conditions listed above have been complied with.

3. (a) (i) An Annual General Meeting is the forum in which members contribute to their company's decision making. According to Section 104(1) of the Companies Act, every registered company must hold at least one general meeting for the year so that 15 months should not pass between one meeting and the next. A company however, by written agreement of the members entitled to attend the meeting may waive the holding of such a meeting for a particular year. Failure to hold the meeting without written agreement of the members entitled to attend it, is an offence under Section 104(5).

(ii) Article 2 of Table A of the Companies Act defines an extraordinary general meeting as any meeting of the company other than an annual general meeting. In terms of Section 105 of the Companies Act Directors will convene this type of meeting whenever they think it fit to do so.

In terms of Section 106(1) of the Companies Act, on the requisition of any member or members of the company holding at least 5% of the total voting rights of all the members having a right to vote at general meetings of a company can convene an extra ordinary general meeting. The requisition according to Section 106(2) must state the business to be transacted and must be signed by the requisitionists, and be deposited at the company's registered office.

If the directors do not, within 21 days of the deposit of the requisition, convene the meeting, the requisitions may convene it themselves. They must do so within three months of depositing the requisition at the company's registered office (Section 106(1) of the Companies Act).

(iii) Section 47 of the Companies Act allows a registered company of to create different classes of shares by attaching certain rights or restrictions to some of its shares. To vary these rights the company may have to convene a meeting of holders of the class of shares concerned. According to Section 48(2) of the Companies Act, if the memorandum allows variation of the rights of any class of shareholders, but does not provide the procedure by which the variation should be made, the rights may be varied by a special resolution passed at a separate general meeting of the holders of the shares of that class.

Class meetings are therefore meetings to be attended by members of a particular class of shares only convened to discuss rights relating to that class of shares only.

Section 124(1) of the Companies Act provides that provisions of the Act relating to general meetings will apply to such a meeting. The major difference, however, between these two types of meetings is that where a class of shareholders comprises one member, that member will be deemed to constitute a meeting. On the other hand, the quorum for company general meetings is usually two members.

(b) A class meeting must only be attended by holders of the class of shares concerned. If holders of other types of shares are also present, that may affect the validity of the meeting. However, if these members come in after deliberations are over and voting is about to start and the legitimate participants do not object to their presence, the meeting will still be valid (See *Carruth v Imperial Chemical Industries Ltd*)

In the present case, the preference shareholders could not have objected to the presence of other shareholders because they were not aware that members of another class of shares were also in attendance. What they should therefore do is to make an application for the quashing of the resolution passed as the validity of the same is affected by the other members who should not have attended the meeting.

4. (a) The rule in the case of *Royal British Bank v Turquand* is that a company will still be liable for the acts of its director even if the appointment of the said director or his authority is questionable or did not exist. The rule states that the absence of appointment or authority will not affect an outsider who deals with the director unless the person actually knew that the person was not a director or that he did not have the authority to bind the company. The person dealing with the company is not bound to enquire into the rules governing the company's internal management before he enters into any transaction with a person purporting to act on its behalf.

(b) The doctrine of *ultra vires* relates to a company's lack of capacity to do something or enter into a particular transaction e.g. where the transaction is outside the company's objects or is within restrictions imposed on the business it can carry on. *Ultra vires* may also arise if even where the act is within the company's powers but it is done for a purpose outside its powers. Thirdly lack of capacity may arise where directors enter into a transaction which is within its powers but in contravention of a limitation on their powers or in contravention of certain procedures laid down by either the memorandum or articles. At common law, an *ultra vires* transaction could not be ratified although members could restrain it by injunction.

(c) Section 22(1) of the Company Act provides that a company shall not carry on any business or pursue any object or exercise any power that is restricted by its memorandum or articles although an act or transfer of property to or by the company is not invalid merely because it contravenes those prohibitions.

Section 22(2) allows a member of the company or holder of a debenture secured by a floating charge over its property to apply for an injunction prohibiting the act, conveyance or transfer.

A member may also seek relief under Section 203 of the Companies Act which provides remedy to any aggrieved member against a company's oppressive manner of conducting its business. By allowing alteration of a company's objects in its memorandum under Section 10, the Act also relaxes the application of the doctrine of *ultra vires*.

5. (a) Circumstances under which the court may order the winding up of a company are outlined under Section 213(1) and (2) as follows:

(i) If the company has resolved by a special resolution that it be wound up by the court;
(ii) If the business (if any) of the company is not commenced by the company within a year from its incorporation or if the company suspends its business for a year;
(iii) If the number of members is reduced to below two;
(iv) If the company is unable to pay its debts;
(v) If the period fixed for the duration of the company by the memorandum or articles expires or the event occurs in which the memorandum or articles provided that the company should be wound up;
(vi) If the court is of the opinion that it is just and equitable that the company be wound up.

(vii) If, on the petition of the Attorney General, the Court is of the opinion that the business or objects of the company are unlawful or that that company is being operated for any illegal purpose or the company has persistently failed to comply with any of the provisions of the Act.

(b) A company is deemed to be unable to pay its debts if, according to Section 213(3):

(i) A creditor to whom the company is indebted in a sum exceeding K1,000 then due has served on the company a written demand requiring payment and the company has 21 days thereafter neglected or failed to pay the sum or to secure or to compound it to the reasonable satisfaction of the creditor.
(ii) Execution or other process issued on a judgement, decree or order of any court in favour of a creditor of the company is wholly or partly unsatisfied.

(iii) If it is proved to the satisfaction of the court that the company is unable to pay its debts.

(c) The court's power under Section 213(1)(f) to wind up a company on the ground that it is just and equitable so to do is discretionary. Some examples are as follows:

(i) Where the substratum of the main object of the company has failed. ***(Re: German Date Coffee Co***.

(ii) Where there is deadlock in management: ***(Re: Yenidje Tobacco Co***.

(iii) Where the company was formed for a fraudulent purpose.

(iv) Where the company never in fact has any business or property.

(v) Where a director has voting control and refuses to hold meetings, produce accounts or pay dividends: ***Lock v Blackwood***.

6. (a) The expression 'director' is defined in Section 140 of the Companies Act as meaning a person by whatever name he is called, who is appointed to direct and administer the business and affairs of a company. The section goes further to subject some category of persons to the same duties and liabilities if they were duly appointed directors. These are:

(i) those who hold themselves out or knowingly allow themselves to be held out as director of the company; or

(ii) those on whose directions or instructions the duty appointment directors are accustomed to act.

(b) The categories of persons disqualified from being directors are outlined in Section 142(1) of the Companies Act and these are:

(i) a body corporate;

(ii) An infant or any other person under legal disability;

(iii) Any person prohibited or disqualified from acting as a director by any order of the court;

(iv) An undischarged bankrupt except with the leave of the court.

(c) A director of a company will cease to hold the office of director if:

(i) he is adjudged bankrupt;

(ii) he is removed by a court from an office of trust on account of misconduct;

(iii) he resigns;
(iv) by special resolution of company members.

(d) (i) Directors must always act bonafide for the benefit of the company. Here, two points must be borne in mind:

- Their duty is to the company and not to individual members. Thus in *Percival vs Wright*.

- Their duty to the company as directors does not prevent them from voting as member at general meeting in any way that they wish: *Hogg v Grampton*.

(ii) They must act with such care as is reasonable in a person of their knowledge and experience; or they will be liable for negligence. But they may have no knowledge of the company's business, and little experience, so that a reasonable standard of care may be as a very low one. *Marzett's case (1880)*: In law therefore, a director may safely be ignorant, inexperienced and lacking in judgement so long as he is honest and careful: *Marzett's case*.

(iii) They must be reasonable and diligent in attending to the company's affairs though they need attend every board meeting.

(iv) As regards duties which may properly be left to some other official, a director is justified in trusting that official to perform those duties honestly, unless there are suspicious circumstances.

7. (a) (i) According to Section 44 of the Companies Act, each issued share must be distinguished by a definite number. The object of this requirement is to provide a means of tracking these shares. Certain transactions in shares depend, for their validity, on whether or not the shares are fully paid up. Therefore unless there is a definite way of establishing which issued shares are fully paid up and which ones are not, these proviso will be difficult to comply with. And to underline this, the proviso to Section 44 states that if all the issued shares of a company or a particular class are fully paid up, none of the shares need thereafter have a distinguishing number.

(ii) Once shares have been allotted to an allottee the company will issue to him a certificate that he is the holder of those shares. This document will show the number and class of shares of which he is the holder, give their distinguishing number and the extent to which they are paid – Section 52(10) of the Companies Act.

There is however a limit to this rule. According to Section 53 of the Companies Act the certificate is only *prima facie* evidence of the holder's title to the shares shown on it. His entitlement to the shares and his rights in respect of them depend not on the certificate but entry of his name in the company's shareholder register.

(iii) A company limited by shares may also issue a share warrant in respect of any of its shares. The warrant will state that the bearer and not the person named in it is entitled to the shares named in it. A bonafide purchaser of a share warrant acquires title which is free from equities.

(iv) Section 36(2) of the Companies Act provides that a company is not obliged to ensure that a trust is created for its shares. Indeed even if a trust is created, neither the company nor the registrar need receive notice of it and if the company receives the notice, it need not enter it on the register of members – Section 36(2) of the Companies Act. This means that a company can register a nominee as a holder of its shares even though it knows who their beneficial owner is.

(b) Tinkhani cannot successfully sue Nkontho Breweries Ltd in the circumstances of this case. If he is contemplating any legal proceedings, then he can only proceed against Vitumbiko himself. This is because the position under the company law is that the receipt by a person in whose name a share stands in the register of members, is valid and binding discharge of the company's responsibility or dividend or other payments in respect of that share – Section 36(3) of the Companies Act.

8. (a) (i) A fixed charge is a charge on specified and identifiable property of the company such as land, ship, buildings, motor vehicles etc. A floating present or future property of the company. It is described as floating because before crystallization, it simply hovers over property on which it is created which is usually in the form of continually changing assets such as raw materials, stocks, cash, debts.

(ii) A floating charge becomes fixed when an event has occurred which in the terms of the debenture, makes the security enforceable *Indefund v Manguluti and Manguluti*. More especially a floating charge will crystallize when any of these happen: the principal or interest payable on it is in arrears; the security is in jeopardy; the company commences winding up proceedings; or the company ceases to operate – *Re Woodroffes Musical Instruments Ltd*.

(b) A floating charge is quite advantageous on the part of the company because it allows the company to put up puts stock in trade as security for a loan without losing the freedom to turn over the stocks in the course of its business to generate the money needed to settle its indebtedness to the lender. In other words, the floating charge allows it to borrow money even where it has no fixed assets but a collection of current assets.

In spite of this major advantage to the borrower company, a floating charge has major disadvantages to the lender as follows:

(i) A floating charge ranks after a fixed charge even if the latter is created or registered after it.

(ii) Before crystallization, the lender does not know for sure which assets constitute his security.

(iii) According to Section 95(1) of the Companies Act, if the security is realized, preferential debts of the company must be paid out of the proceeds before the holder of a floating charge is paid.

(iv) According to Section 287(4) of the Companies Act, where the company's assets available for the payment of general creditors on winding up are not enough to meet the preferential debts, these debts will have to be paid out of the company's assets over which floating charges have been created prior to the payment of the claims of the debenture holders in respect of whom the charges are created.

(v) General Section 289 of the Companies Act renders any floating charge created 12 months before the commencement of a company's winding up invalid unless the company was solvent immediately after the creation of the charge.

(vi) A floating charge created on a company's stock-in-trade may lose priority to the unpaid seller of the stock who has reserved his title to the goods – *Aluminium Industrie Vaasen v Romapa Aluminium*.

(c) (i) The function of a receiver is to manage or realize the assets which are given as security for the money borrowed by the company. The object, in so doing is to pay out of those assets what is due to the debenture holders whom he represents. Upon discharging the debts, he will vacate his office and the directors will resume full control of the company.

(ii) Usually, the debenture will contain a provision empowering the debenture holder or his trustee to appoint a receiver on the occurrence of an event or events which make the security enforceable. Once such events take place and a receiver is appointed, the directors will surrender control of the security given or the debenture (which may well be the entire business of the company) to the receiver: *Indefund v Manguluti and Manguluti*.

If however, the debenture does not contain any power to appoint a receiver the debenture holder can apply to have the appointment made by the court – Section 94(i) of the Companies Act empowers the court to appoint a receiver whenever a charge has become enforceable which will be by reasons of the occurrence of any of the events enumerated by Justice Mtegha in the above case. Moreover, where a debenture is secured by a floating charge, the court may appoint a receiver even though the charge has not become enforceable, if it is satisfied that the security is in jeopardy.

(d) The circumstances of the case shows that the security of Unity Bank Ltd is in jeopardy. The property of Oasis Purified Water Ltd is about to be seized by the sheriff. This is an event which renders it reasonable in the interest of the debenture holders (Unity Bank Ltd) for Oasis Purified Water Ltd to make an application to court for an order to have a receiver appointed. In *Re : London*

Pressed Hinge Co. Ltd in which the facts were similar to those in the present case, it was held that the debenture holder in whose favour the floating charge was created was entitled to the appointment of receiver because the imminent seizure of the company's assets had put his security in jeopardy.

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