STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2011 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC12: COMPANY LAW

(DECEMBER 2011)

TIME ALLOWED: 3 HOURS

SUGGESTED SOLUTIONS

1. (a) A promoter is a person who takes or participates in the taking of steps necessary for the formation of a company. Among other things, he is the one who conceives the company and its business, finds directors, make invitations for its shares, pays its preliminary expenses and does other things to ensure that the company is ready for incorporation: *Twycross v Grant; Enlanger v New Sombrero Phosphates company.*

(b) A promoter owes a fiduciary duty to the company he is forming and, as such, he is not allowed to make any secret profit from any transaction involving the company or at the expense of the company. If the promoter makes such a profit, he must disclose this to an independent board of directors or to the company's existing or future shareholders. If he fails to do so, the company can compel him to account the profit to it: *Gluckstein v Barnes*.

If the profit is made from a sale by the promoters to the company, the latter will also be entitled to rescind the contract of sale. This will involve refund of the purchase price and return of the property sold.

(c) (i) Pre-incorporation contracts are those contracts entered into on behalf of a company not yet formed to procure some of the things such as premises, office equipment and vehicles, which the company will need to operate after incorporation. Since the company will be non-existent at the time of such a contract, it will obviously not be a party to the contract. It can, therefore, not sue or be sued under the contract. Consequently it is that purported agent who will be liable to discharge the liability created by the contract Section 20(1) of the Companies Act provides that any person who purports to enter into a contract in the name of or on behalf of a company before its incorporation will be personally bound by the contract and be entitled to its benefits : *Nali Farms Ltd and Kholomana v National Seed Company of Malawi*.

(ii) Section 20(2) of the Companies Act provides that a company is allowed to adopt a written contract concluded on its behalf before it came into existence. The contract must be adopted with a reasonable time after the company's incorporation. The adoption may be express or implied from conduct which signifies intention on the part of the company to be bound by the contract.

There are two known exceptions to the rule to the legal position in Section 20(1) applicable on to written contracts. Section 20(4) of the Companies Act provides that if there is an express provision in the contract which excludes the liability of the person who concludes the contract on behalf of a company before its incorporation, then he will neither be bound by the contract nor be entitled to the benefit thereof. The effect of this will be to put the company in his shoes so that it is liable as if the contract had been concluded by it.

(d) (i) The significance of the Memorandum of Association is that it is the company's charter of incorporation that defines the limitations of the powers of the company for the benefit of those who wish to deal with it. It is one important document that sets the formation of the company into motion. Once it is drafted, the persons forming the company subscribe to it (endorse their names and signatures to it) and after attestation of their signatures, the document, among others, is deposited with the Registrar of Companies.

(ii) The significance of the Articles of Association is that they are rules for the conduct of the company's internal affairs. They deal with the procedures for the exercise of the company's powers, allotment of shares, conduct of the company's meetings, appointment of directors and as such it is very significant in the formation of a company. They are also required to be delivered for registration together with the Memorandum of Association.

2. (a) (i) Share Certificate

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

Since this information will be disclosed with the intention that it should be relied upon, the company will not be allowed to deny its authenticity : (*Dixon v Kennaway Co. Ltd)*. 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 on the entry of his name in the company's shareholder register. The certificate will merely represent that he is at the date of the certificate, the holder of the shares with or without any outstanding liability on them.

(ii) Share Distinguishing Number

According to Section 44 of the Companies Act, each issued share must be distinguished by a definite number. The object is to provide a means of tracking these shares. Certain transactions in shares depend on identification of shares, for instance, a company can have or claim a lien on shares only if there is unpaid liability on them; Similarly and redeemable shares can not be redeemed unless they are fully paid. Therefore, unless there is a definite way of establishing which issued shares are fully paid up and which ones are not, these provisions will be difficult to comply with. To underline this the proviso to Section 44 of the Companies Act states that if all the

issued shares of a company or of a particular class are fully paid up, none of the shares need thereafter have a distinguishing number.

(b) (i) Transfer of shares is the voluntary conveyance of rights and duties of a member as represented in a share from a shareholder to a person who desires to be a member. Section 43(1) of the Companies Act provides that shares of any member of a company limited by shares are part of his personal estate and movable property. As such he can transfer them to any person. Therefore, any provision in the articles which restricts the right to transfer shares in a company will be ineffective unless the shares are not fully paid up: Section 50(3) of the Companies Act.

(ii) Shares are transferable by a written instrument in the prescribed form or in any other form approved by the company's directors Section 43(1) of the Companies Act. The instrument must be executed by or on behalf of the transferor. Thereafter the instrument must be registered by the company because until the registration and the entry of the transferee's name in the company's membership register in respect of the shares are done, the transferor remains their holder.

According to Section 49(3) of the Companies Act the instrument may be lodged for registration by the transferor or the transferee. The transfer cannot be registered without the delivery of the instrument of transfer to the company according to Section 49(1) of the Companies Act.

(c) (i) Mr Chijere needs to be advised that his action in demanding money from the company and threatening to dismiss the branch manager of the bank was wrong and in contravention of the principle of corporate personality.

Firstly, Mr Chijere should realize that Equity Bank Ltd as an incorporated company is a body corporate, the effect of a certificate of incorporation under Section 5(2) is that the bank is a legal entity separate from the personalities of the shareholders, including Mr Chijere himself: *Salomon v Salomon & Co. Ltd, Lee v Lee's Air Franking Ltd, Macaura v Northern Co. Ltd*. An incorporated company assumes its own separate legal entity, none of the shareholders can exercise ownership rights over money, business or any other property of the company. Similarly none of the shareholders can directly involve himself with the management of the entity such as disciplining members of staff except as may be allowed by the Articles of Association of the company.

Secondly, Mr Chijere should be advised that while a shareholder is entitled to a dividend payment or claim the same, he had to follow prescribed procedures. As such, a shareholder is not entitled to base any claims against the company on undeclared prospective dividends.

(ii) The position outlined above would remain the same even if Mr Chijere was a majority shareholder. In the above cases of *Salomon v Salomon & Co. Ltd and Lee's Air Farming Ltd* the principle of corporate personality held even in situations where the companies had basically a single major shareholder.

3. (a) (i) A fixed charge is a charge on specified and identifiable property of the company such as land, ship, building, motor vehicles etc. A floating charge is a charge on present or future property of the company. It is said to be floating because before crystallization, it simply hovers over property on which it was created which is usually in the form of continually changing assets such as raw materials, stocks, cash debts. Lord Justice Romer in *Re: Yorkshire Woolcombers Association Ltd* said that a floating charge must comply with the following characteristics: charge on a class of assets present or future; if the class is one which in the ordinary course of business of the company would be charging from time to time and; if by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way while the charge subsits.

With a fixed charge a company usually remains in possession of the property charged but may not dispose of it without the consent of the debenture holders. If the fixed charge is a legal mortgage, title in the property passes to the mortgagee (the lender) subject to the company's right to redeem the property on payment of the principal sum and interest.

A fixed charge invariably ranks before a floating charge even though the floating charge was created before the fixed charge unless at the time of the creation of the fixed charge notice of the existing floating charge was given to the holder of the fixed charge.

(ii) On crystallization a floating charge becomes a fixed charge. This generally happens when an event has occurred which, in the terms of the debenture makes the security enforceable : *Indefund v Manguluti and Manguluti*: More specifically a floating charge will crystallize if:

(a) the principal sum or interest payable on it is in arrears;
(b) the security is in jeopardy;
(c) the company commences winding up proceedings;
(d) the company ceases to operate : *Re wordroffes Musical Instruments Ltd*.

(b) (i) The duty of a receiver is to manage or realize the assets which are given as security for the money borrowed by the company. The object is to pay out of those assets what is due to the debentureholders whom he represents. Upon discharging the debt, 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 debentureholder 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 for 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 debentureholder can apply to have the appointment made by the court. Section 94(1) of the Companies Act empowers the court to appoint a receiver whenever a charge has become enforceable which will be by reason of the occurrence of certain stipulated events in the debenture or when the principal or interest has fallen into arrears.

Again, 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.

4. (a) (i) The company's Act 1984 does not define the word prospectus. However, ordinarily it is understood to mean any notice, circular, Advertisement or any other invitation, offering to the public or inviting offers from the public for shares or debentures of a company for subscription or purchase.

(ii) When the issue of shares is on a small scale e.g. to a few relatives or friends the Act does not protect these persons from the results of their enthusiasm. However, where capital is raised from persons who have no direct knowledge of the undertaking e.g. the public, generally there are statutory provision aimed at their protection. Section 167(1) of the Companies Act provides that an invitation to the public to acquire shares or debentures of a public company should comply with the following:

(a) Within 6 weeks prior to the making of the invitation, the company should deliver a prospectus to the Registrar for registration.

(b) Every person to whom the invitation is made should be supplied with a true copy of such a prospectus at the time the invitation is made to him.

(c) Every copy of the prospectus should state that it has been registered and the date of registration is indicated.

(d) The company may also publish in a newspaper advertisement a summary of the prospectus so long as:

- It does not contain or accompany any form of advertisement for any shares or debentures.

- It states with reasonable prominence where copies of the full prospectus may be obtained and the fact that it has been registered and the date of registration.

- It is in terms previously approved by the registrar : *Section 162(2) of the Companies Act.*

(e) The prospectus issued should contain matters and reports specified in the fifth schedule to the Act: Section 168(1) *of the Companies Act*.

(f) If the prospectus is made by an expert the expert should before registration of the prospectus give his written consent to the publication thereof. A statement that he has given and not withdrawn his consent must appear in the prospectus. *Section 169(a)(b) of the Companies Act.*

(g) In terms of Section 169(2) of the Companies Act if before registration, but after delivery for registration, such consent has been withdrawn, this development must be communicated to the registrar by the person who presented it for registration.

(h) Where the invitation is being made by or on behalf of a company, *Section 170(1) of the Companies Act* imposes a duty that a copy of the prospectus delivered for registration be signed by every person named therein as director or proposed director.

(i) Section 170(5) of the Companies Act states that every copy of any prospectus delivered for registration should state at its head that a copy of it has been delivered to the registrar for registration and that he (the registrar) does not accept any responsibility for the accuracy of any statements made or for the financial soundness of the company or the value of the securities concerned.

(b) (i) Multichoice Merchants Ltd, as a public company, will be deemed to have made an invitation to the public if an offer to purchase the shares or an invitation to make such an offer is made in the following circumstances according to Section 165(1) of the Companies Act:

(a) published, advertised or disseminated in Malawi by newspapers, broadcasting, cinematography, prospectus, advertisement circular or any other means whatsoever.

(b) made or circulated among any section of the public comprising more than 15 persons whether selected as members or debentureholders of the company concerned or

as clients of the persons making or circulating the invitation or in any other manner.

(c) made to anyone or more persons upon the terms that the persons to whom it is made may renounce or assign the benefit or if any shares or debentures to be obtained thereunder in favour of any other person.

(ii) The invitation shall not be treated as having been made to the public if it can properly be regarded in all the circumstances of the case as being a domestic concern of the persons making and receiving it or add to existing shareholders and debentureholders and existing employees – provision to Section 165(1) of the Companies Act.

5. (a) Four ways in which an individual can become a member of a company limited by shares are:

(i) By subscribing to the Memorandum of Association upon registration of the company.

(ii) By application and allotment with the company to take a share and be placed on the register of members.

(iii) By transfer of shares from another member and be placed on the register of members.

(iv) By transmission on death or bankruptcy of a deceased or bankrupt member respectively and be placed on the register of members.

(b) An individual can cease to be a member of a company limited by shares in the following four ways:

(i) By transferring his shares to another person.

(ii) By his shares being fortfeited.

(iii) By his shares being sold to the company under some provision in its articles (e.g. for enforcing a lien).

(iv) By death but in such a case the deceased members' estate remains liable until the registration of some person entitled under the transfer from his executors or administrators.

(c) Four acts which a company can do only by special resolution are:

(i) Alter its objects;
(ii) Alter its articles;
(iii) Change its name;
(v) Reduce its capital.

(d) The company secretary of RHL should be advised to issue a resolution in lieu of a meeting; such a resolution must be in writing and signed by all directors entitled to vote on that resolution at a meeting of directors or

committee of directors. However, such a resolution in lieu of meeting is only possible in situations where the Companies Act or the articles do not expressly require a meeting to be held.

(e) Two types of companies limited by shares are:

(i) a public limited company in which membership is unrestricted and open to the public.

(ii) a private limited company which restricts its membership to a maximum of 50 members.

6. (a) Where a debenture is not secured by a mortgage or a charge the remedies of the holder are:

(i) He may bring an action to enforce the debenture and obtain judgement and then levy execution on the property of the company.

(ii) He may, either before or after judgment, present a petition for the winding up of the company, or, if there is a winding up in progress, he can prove in the winding up the amount due to him.

(b) The holder of a secured debenture has the following remedies:

(i) He may appoint a receiver who may proceed to sell the property of the company.

(ii) He may bring a debenture holders' action on behalf of himself and the other members of the class demanding payment and the enforcement of his security.

(iii) In rare cases, he may apply to court for foreclosure.

(iv) He is entitled to petition for the winding up of the company.

(c) The following persons are not eligible for appointment or competent to act as directors of a company:

(i) A body corporate
(ii) An infant or any other person under legal disability.
(iii) Any person prohibited or disqualified from so acting by any order of a court for the time being in force.
(iv) An undischarged bankrupt unless with leave of the court.

(d) Section 146(1) of the Companies Act allows a company to remove a director from office by an ordinary resolution passed in the general meeting of the company.**(1)**

Section 146 (2) provides that any person seeking to move a resolution to remove a director from office should give the company 35 days notice. The notice should be copied to the director who should also be allowed to speak on the resolution at the general meeting.

7. (a) Section 194 of the Companies Act stipulates the statutory duties and powers of auditors as follows:

(i) To act in such a manner as faithful, diligent, careful and ordinary skilful auditors would act in the circumstances Section 194(1). Section 194(2) provides that no provision whether contained in the memorandum or articles shall exempt the auditors from this duty.

(ii) Auditors have a right to the places of business and the books of accounts and vouchers of the company and are entitled to enquire from the officers of the company such information as is necessary for the performance of their duties.

(iii) Auditors are entitled to attend any general meeting of the company, to receive all notices and other communications relating to any general meeting and to be heard at any general meeting on any part of the business of the meeting which concerns them as auditors. Section 194(4) of the Companies Act.

(iv) Auditors may apply to court for directions in relation to any matter arising in connection with the performance of their functions under the Act.

(v) To make a report to the members on the accounts examined by them on any of every balance sheet, profit and loss account and savings accounts laid before the company in a general meeting.

(b) (i) Regarding the liability of the auditors I will advise the liquidator that the auditors are liable. Section 194(1) of the Companies Act imposes a duty on the auditor to act as a faithful, diligent careful and ordinarily skilful auditor would act. This section imposes a duty on the auditor not to act negligently in the performance of his duties. For an auditor to ignore or fail to investigate fraud in clearly suspicious circumstances that is an indication of negligence and a clear violation of the provisions of Section 194(1) of the Companies Act. No careful, skilful, faithful and diligent auditor would fail to conduct an investigation and therefore the auditors would be liable.

(ii) The auditors liability extends and covers every loss occasioned by the breach of the duty imposed on Section 194(1) of the Companies Act. The liquidator will have to assess such loss and lodge a claim against the auditors on behalf of the company. In *Re: Thomas Gerald's & Sons* a director of a company falsified the company's accounts by fraudulent entries. The auditors were suspicious and asked the director for an explanation, but made no further

investigations. As a result their estimate of the company's profits was wrong and the company declared dividends which it could not otherwise have done, paying tax which would otherwise not have been payable. The company went into liquidation and the liquidator took proceedings against the auditors. It was held that damages were recoverable against the auditors and that these damages included the dividends, costs of recovering the tax and any tax not recoverable.

(c) (i) A person qualified to be an auditor is the one entitled to act as such under the Public Accountants and Auditors Act – Section 192(1) of the Companies Act.

(ii) An auditor would cease to act as such when the company passes an ordinary resolution to remove him from office. Under Section 193(1) of the Companies Act. A resolution to remove an auditor is only effective if it is passed at a general meeting of the company. The said general meeting must be preceded by the requisite written notice to the company 35 days before the meeting. The notice must state the intention to move such a resolution. The company then must send a copy of the notice to the auditor concerned. The company must in turn give notice of the resolution to its members not less than 21 days before the meeting.

The auditor concerned is, under Section 193(2), entitled to be heard on the resolution and to send to the company a written statement copies of which shall together with the notice of general meeting be sent by the company to persons entitled to receive notice of the meeting.

8. (a) (i) Casual Director – a director who is appointed to a casual vacancy that has arisen between general meetings; e.g. because of the death or resignation of a director. The board is empowered to fill a casual vacancy or appoint additional directors up to the maximum specified (Table a).

(ii) Alternate Director – a person appointed by a director to act for him at board meetings which he is unable to attend. He can only be appointed if there is authority in the articles.

(iii) Shadow Director – a person in accordance with whose instructions the directors are accustomed to act unless the directs act on that person's advice only when it is given in a professional capacity.

(b) Every private company must have at least one director and for public company the minimum is two. There is no statutory maximum but the articles usually impose a limit. In terms of Section 141 and Section 143 of the Companies Act, external companies must have at least three local directors.

(c) The essential function of every director is to take part in collective decisions by attendance at board meetings. In general, an individual director has no management functions as a director except that when authorised to do so, he may sign documents on behalf of the company.

The articles usually provide that the board may appoint one or more of their body to the office of Managing Director (MD) for such period and with such powers as the board may determine.

As between the company and the MD, he has such actual authority as the board may give him. To anyone dealing with the company through an MD, the MD has apparent authority to do for the company whatever an MD normally does (unless the other party is aware that the MD's actual authority is restricted).

The normal and apparent authority of an MD is to enter into any ordinary business transaction for the company as its agent. He may enter into commercial contracts and borrow money and give security on its behalf. The apparent authority is confined to business matters and does not extend to giving approval for share transfers on behalf of the board, not to a sale of the company's business.

(d) Sometimes a director who has not been appointed MD is permitted by the board to act as if he were a duly appointed MD. If he acts or transacts and the board recognizes the acts or transactions as those of the company or if the board remains passive and takes no steps to make it known that he is not an MD, the company is said to represent that he is an MD and to hold him out as having the normal powers of an MD. This principle does not apply if the articles make it plain that he could not have been duly (authorized or appointed MD) or if it is clear from the memorandum that the transaction is *ultra vires*. This is because the person dealing with the company in these circumstances has constructive notice of any restrictions imposed by its memorandum or articles.

Where there is no operative restriction and the authority which the director purports to have could in fact have been given to him by appointing him MD, the company is estopped, i.e. prevented from denying its own representation that he is an MD and is bound by the contracts which he makes even though he acts without actual authority: *Freeman & Lockyer v Burchurst Park Properties (Mangal) Ltd*.

The principle of holding out is the only basis on which a company can be bound by the unauthorized acts of a director who is not an MD. Moreover the rule in *Royal British Bank v Turquand (1855)* operates to bind the company by a presumption that a single director (acting without the actual authority off the hand) is an agent of the statutes and powers of an MD. If there is only one director to monopolise their powers of management that may validate even an *ultra vires* contract.

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