STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2012 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC12: COMPANY LAW

THURSDAY 6 DECEMBER 2012 **TIME ALLOWED: 3 HOURS**
2.00 PM - 5.00 PM

SUGGESTED SOLUTIONS

1. (a) The principle expounded in the classic case of *Salomon v Salomon (1892) A.C.22* relates to the legal effect of incorporation of a company. The principle is that once a company is incorporated, it becomes a body corporate with a personality of its own distinct from that of its members as well as that of its management.

Under **Section 15(2) of the Companies Act**, upon incorporation, a company can enjoy rights, own property, dispose of property, incur liability, sue or be sued in its own right and not as an agent or trustee of its members: See *Tesco Supermarkets Ltd v Nattras (1971), Macaura v Northern Assurance Co Ltd., Lennard Carrying Co Ltd v Asiatic Petroleum Co Ltd*, *Naidoo v Mazi Import & Export Ltd and Tchongwe*. **4 Marks**

(b) Under Section 20 of the Companies Act, upon incorporation, a company acquires a personality of its own so that whatever it does becomes the act of the company and not that of its members. Lifting the veil of incorporation happens when the law, for special reason, departs from the general rule to hold members or officers of a company personally responsible for actions which otherwise would have been the responsibility of the company.

The lifting of the veil as an exception to the rule occurs primarily where to hold otherwise would create problems or lead to absurdities. **4 Marks**

(c) (i) The lifting of the veil of incorporation under Statutory Law:

(1) Under Section 42(1) of the Companies Act, if the number of members of the company falls below the statutory minimum of two and the company carries on business for more than six months, every member or director who was aware that the company was carrying on business through that period will be severally and jointly liable for the company's debts and liabilities incurred during that period. **2 Marks**

(2) Under **Section 119 of the Taxation Act** where a company is liable to a penalty under the Act, every person who, at the time of commission of the offence, was an officer of the company, will be personally liable to the same penalty. **2 Marks**

(3) Under **Section 337(2) of the Companies Act** if, during the winding up of a company or any proceeding against it, it is shown that a debt was contracted by the company at a time when there was no reasonable or probable ground for its repayment, any member or officer who was knowingly party to the contracting of the debt will be held personally liable for it. **2 Marks**

(4) Under Section 130(3) of the Companies Act, if it appears that a company's business was being carried on with intent to defraud creditors or for any fraudulent purpose, any person

who was party to the carrying on of the business will be held personally liable for the debt or any other liabilities of the company **(Section 130(3) of the Companies Act)**. **2 Marks**

Any three = 6 Marks

(ii) Lifting of the veil of incorporation under Common Law:

(1) Where a company is using the veil of incorporation to evade legally binding obligations: *Gilford Motors Co Ltd v Horne*. **2 Marks**

(2) Where a company is using the veil of incorporation to evade tax: *Unit Construction Co. Ltd v Bullrek*. **2 Marks**

(3) Where a wholly owned subsidiary is in fact an agent or employee of its holding company, the holding and subsidiary company may be taken as one single economic unit: *Smith, Stone and Knight vs Birmingham Corporation*. **2 Marks**

(4) Where for security reasons e.g. during war the veil of incorporation is pierced to identify the true nationality of a company : *Daimer Co. Ltd vs Continental Tyre and Rubber Co. (Great Britain) Ltd*. **2 Marks**

6 Marks

(TOTAL: 20 MARKS)

2. (a) Four legal provisions regarding the alteration of Articles of Association of a company are:

(i) Every company has power under Section 13(1) of the Companies Act to alter, by special resolution, its Articles of Association. This provision expressly empowers the company to alter or add any provision to its articles. **2 Marks**

(ii) Unless cancelled by a court order under Section 203 on the ground that the alteration is unfairly discriminatory or unfairly prejudicial to any member of the company, the alteration or addition would be as valid as if it had been initially included in the Articles. **2 Marks**

(iii) Alteration of Articles of Association is subject to the Companies Act and the Memorandum of Association in terms of Section 13(1) of the Companies Act. In addition the alteration will be ineffective if it brings the Articles into conflict with the Act. **2 Marks**

(iv) No provision in the Articles can exclude the power of the company to alter its articles. Thus any contract entered into by a company that it would not alter its articles will not be binding on members of the company that would, by special resolution, decide to alter the

Company's articles: *Cumbirian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co.Ltd*.
2 Marks

(v) The power to alter Articles should be exercised bonafide for the benefit of the company. The alteration must be for the benefit of the shareholders as a body, as opposed to just some of them only. In applying the test, the view of the majority prevail. However, if the attraction is being done in bad faith, to disadvantage the minority, the court will hold it invalid: *Brown v British Abrasive Wheel Co. Ltd*.
2 Marks
Any four = 8 Marks

(b) Where a company has entered into a contract with a third person, a subsequent alteration of the articles may put the company in breach of the contract. This is exactly the sort of situation prevailing in the present case. It was held by Justice Byrne in *Punt vs Symons and Company (1903) 2 ch 506* that the statutory right of a company to alter its articles would normally be sufficient to prevent the granting of an injunction to restrain an alteration.

In *Southern Foundres (1926) Ltd vs Shirlaw (1940) AC 701* it was held that a company cannot be precluded from altering its articles but may nevertheless be a breach of contract if the alteration is in contrary to a stipulation in a contract validly made before the alteration.

This then means that while Paul cannot obtain an injunction restraining MIL from affecting an alteration of its articles of association he can, nevertheless, successfully sue MIL for damages for breach of contract.
5 Marks

(c) (i) Section 8(3) of the Companies Act provides that no member of the company shall be bound by the alteration in the memorandum made after the date on which he became a member in so far as the alteration requires him to take more shares than the number held by him before the alteration was made or in any way increases his liability to the company, unless he agrees in writing, whether before or after the alteration is made, to be bound thereby.

This therefore means that by virtue of Section 8(3) of the Companies Act the alteration of the Memorandum in question is ineffective as far as James is concerned. He is not bound to take up the additional shares allotted to him.
5 Marks

(ii) Section 8(3) referred to above is meant to protect members from having their financial obligations to the company forcibly increased, but it has a proviso which allows any member to agree in writing either before or after the alteration is made, to be bound by the

alteration. So, if James made the agreement in writing, he will be bound by the alteration made. **2 Marks**

(TOTAL : 20 MARKS)

3. (a) A registered company may be either limited or unlimited. According to Section 5(1)(c) of the Companies Act, an unlimited company has no limit on the liability of its members. What this means is that if the company is wound up with debts, its members will be personally responsible to discharge those debts without any limit on their liability. In the case of a limited company, on the other hand, the amount of capital to be contributed to the company by a member is fixed by agreement between him and the company. As a result, on the winding up of the company, he cannot generally be required to pay anything towards the company's debts except the agreed amount. **4 Marks**

(b) The limit on the liability of company members may take two forms, depending on whether or not the company members have contributed to the capital. If it has contributed to the capital then the member's liability will be limited by shares. 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. Each share is assigned a nominal value which a member may pay in full or in part. Where a company is limited by share, the liability of its members will be limited to the amount not paid on their shares. 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. **2 Marks**

On the other hand, instead of a share capital, a company may simply get a promise from each member to contribute a fixed amount to pay the companies debts in winding up. Such a company is a company limited by guarantee and therefore cannot, by virtue of Section 5(6) of the Companies Act, create or issue shares. The liability of members of such a company will be limited to the amount which they have respectively undertaken to contribute towards the settlement of its debts on winding up. Accordingly, it will be ideal for not-for-profit making organizations. **2 Marks**

(c) (i) Under Sections 25(1) and 26(1) of the Companies Act a company limited by shares can be converted into an unlimited company as follows:

First of all, members of the company must give a written consent for the alteration to the company. **1 Mark**

Secondly the company must adopt a Memorandum and Articles of Association appropriate to its new status as an unlimited company. **1 Mark**

Thirdly, 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; and a statutory declaration by the company's directors and secretary confirming that the company has fulfilled the two conditions mentioned above. **4 Marks**

(ii) Under Section 24(1) of the Companies Act, a company limited by shares can be converted into a company limited by guarantee as follows:

First, of all the company's shares must be fully paid up. **1 Mark**

Secondly, all members 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 and adopt a new Memorandum and Articles of Association appropriate to its status as a company limited by guarantee. **2 Marks**

Thirdly, the members 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. **1 Mark**

Finally, if these conditions are satisfied the company must deliver the following to the Registrar: the company's certificate of incorporation; a copy of the new memorandum and articles; a copy of 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. **2 Marks**

(TOTAL: 20 MARKS)

4. (a) The brief facts in the case of *Royal British Bank v Turquand* (The Turquand's case) were that a company's board of directors was authorized by the company's Memorandum and Articles to borrow such sums as may be authorized by a resolution. Acting on such powers the board borrowed £2000 from a bank without a specific resolution for the borrowing. Subsequently, when the company went into liquidation and the bank sued to recover the money the liquidator refused to pay the money arguing that the bank had borrowed without a resolution. The court however held that the liquidator was liable.

Thus, the rule in the Turquand's case 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 in good faith 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.

The rule is designed to protect the third party dealing with the company who may the rule both to enforce the transaction as well as a defence if sued by the company. **10 Marks**

(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 within restrictions imposed on the business it can carry on. *Ultra vires* may also arise 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 is in contravention of a limitation on their powers or in contravention of certain procedures laid down by either the Memorandum of Articles.

At common law, an *ultra vires* transaction could not be ratified although members could restrain it by injunction. However the transaction is not invalid and could still be enforceable. An *ultra vires* transaction is not voidable, under common law. **4 Marks**

(c) Section 22(1) of 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 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*. **6 Marks**

(TOTAL: 20 MARKS)

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; **2 Marks**

(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; **2 Marks**

(iii) if the number of members is reduced to below two; **2 Marks**

(iv) if the company is unable to pay its debts; **2 Marks**

(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 proved that the company should be would up; **2 Marks**

(vi) if the court is of the opinion that it is just and equitable that the company be wound up; **2 Marks**

(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 the company is being operated for any illegal purpose or the company has persistently failed to comply with any of the provisions of the Act. **2 Marks**

Any five = 10 Marks

(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. **3 Marks**

(ii) Execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is wholly or partly unsatisfied. **1 Mark**

(iii) If it is proved to the satisfaction of the court that the company is unable to pay its debts. **1 Mark**

5 Marks

(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 or the main object of the company has failed: *Re : German Date Coffee Co.* **1 Mark**

(ii) Where there is deadlock in management: *Re : Yenidje Tobacco Co*. **1 Mark**

(iii) Where the company was formed for a fraudulent purpose. **1 Mark**

(iv) Where the company never infact has any business or property. **1 Mark**

(v) Where a director has voting control and refuses to hold meeting, produce accounts or pay dividend : *Lock v Blackwood*. **1 Mark**

5 Marks

(TOTAL : 20 MARKS)

6. (a) To raise funds using the shares Henry has in Chitatata Milling Company, (CMC) Henry can either:

(i) Sell the shares; **1 Mark**

(ii) Mortgage the shares. **1 Mark**

2 Marks

(b) A debenture is a document issued by a company that creates or acknowledges indebtness on the part of the company. The term relates to the document and not the indebtness signified by the document. **4 Marks**

Section 76(1) of the Companies Act allow companies to raise loans by issuing debentures, a series of debentures or debenture stock. **4 Marks**

(c) Debentures of a company may be secured by:

(i) a specific charge on a mortgage on particular property of the company; **2 Marks**

(ii) a floating charge; **2 Marks**

(iii) both a specific and floating charge. When specifically secured debentures are issued, one may add, by way of a further security, a floating charge. **2 Marks**

6 Marks

(d) I would advise Rodrick that since General Construction Company (GCC) had defaulted on its obligations under the debenture, he has the following remedies, depending upon the terms of debenture.

(i) he can commence a debenture holder's action in court; **2 Marks**

(ii) he can appoint a receiver; **2 Marks**

(iii) he can move for foreclosure; **2 Marks**

(iv) he can commence winding up proceedings. **2 Marks**

8 Marks

(TOTAL: 20 MARKS)

7. (a) In the case of *Foss v Harbottle* two shareholders brought an action on behalf of themselves and all other shareholders except two directors who had committed a wrongful act to the company by selling their own land to the company for an undisclosed profit. The court held that as the loss, if any, had been suffered by the company and there was nothing to prevent it from suing the directors, it was only the company that was allowed to bring the action, and therefore the plaintiff's action could not succeed.

Thus, the rule in *Foss v Harbottle* is that the separate personality which a company acquires on its incorporation means that whenever a wrong is

committed to the company, only the company is harmed by the wrongful act and therefore only the company can sue to remedy it.
The principle has been illustrated in many cases such as: *Prudential Assurance Company Limited v Newmen Industries Limited and Commercial Bank of Malawi v Kaseko and others*. **8 Marks**

(b) (i) The most appropriate thing for John to do in the circumstance of this case is to avail himself of the remedy under section 203(1) of the Companies Act which provides that: Any member of a company may apply to the court for an order under this section on the ground that the affairs of the company are being conducted or the powers of the directors are being exercised in a manner oppressive to one or more of the members or in disregard of his or their proper interests as members of the company; or that some of the act of the company has been done or is threatened or that some resolution of the members or any class of them has been passed or is proposed, which unfairly discriminates against, or is otherwise unfairly prejudicial to, one or more of the members. **4 Marks**

(ii) It is undoubtedly clear in this particular case that the acts by management of NTL are or will be oppressive to or in disregard of John proper interests as he still wants to be shareholder in the company and further there is no act that John has done which justifies such an act on the part of management.

(iii) Further, since the facts show that the management has only decided to acquire the shares and have not actually acquired the same, it can properly be said to be threatening act which unfairly discriminates against, or it is otherwise unfairly prejudicial to John.

In *Re : Bovey Hotel Ventures Limited Ch D 31* the court, in referring to an English equivalent of Section 203, said that a member of a company will be able to bring himself within the section if he can show that the value of his shareholding in the company has been seriously diminished or a least seriously jeopardized by reason of a course of conduct on the part of those persons who have had *de facto* control of the company, which has been unfair to the member concerned. He went on to say that the test of unfairness is whether a reasonable bystander observing the consequences of their conduct, would regard it as having unfairly prejudiced the petitioner's interests.

(v) If the court is satisfied that the petition (in this case of John) is well founded, it is empowered by **Section 203(2)** to make such an order as it thinks fit. The court may amongst others:

(1) direct or prohibit any act or cancel or vary any transaction or resolution;

(2) regulate the conduct of the company affairs in future **(Section 203(2) of the Companies Act**. **12 Marks**

(TOTAL: 20 MARKS)

8. (a) An extraordinary general meeting of a company may be requisitioned by any member or members of the company holding, at the date of the requisition, not less than one twentieth of the total voting rights of the members having the right to vote at general meeting of the company. **2 Marks**

(b) The following persons are entitled to receive notices of general meetings of a company.

(i) every member having the right to vote at such meeting; **1 Mark**

(ii) every person upon whom ownership of a share devolves by reason of his being a legal personal representatives receiver, or trustee in bankruptcy of such a member; **2 Marks**

(iii) every director of the company; **½ Mark**

(iv) every auditor for the time being of the company. **½ Mark**

(c) (i) 21 days notice is required for any other meeting other than an annual general meeting or a meeting of the passing of a special resolution. **2 Marks**

(ii) 14 days notice is required for any other meeting other than an annual general meeting or a meeting or a meeting of the passing of a special resolution. **2 Marks**

(d) The following persons are entitled to attend and to speak at any general meeting of a company:

(i) every member of the company having the right to vote at such meeting; **1 Mark**

(ii) every person whom the ownership of a share devolves by reason of his being a legal representative, receiver or trustee in bankruptcy of such a member; **2 Marks**

(iii) every secretary of the company; **½ Mark**

(iv) every auditor for the time being of the company. **½ Mark**

(e) For a resolution to operate as a valid special resolution, it must have been passed by a majority of not less than three fourths of the votes case by such members of the company, as, being entitled so to do, vote in person or by proxy at a general meeting of which not less than 21 days notice, specifying the intention to propose the resolution as a special resolution, has been given. **3 Marks**

(f) A member's proxy at a general meeting has a right to attend and vote instead of the member and he shall have the same right as the member to speak at the meeting. **3 Marks**

(TOTAL: 20 MARKS)

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