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THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2013 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC12: COMPANY LAW

TUESDAY 3 DECEMBER 2013

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2.00 PM - 5.00 PM

SUGGESTED SOLUTIONS

1. (a) Five Distinguishing features between a Partnership and a limited company are as follows:

(i) In a partnership property of the firm belongs to individual members whereas in a limited company the property belongs to the company.

(ii) A member of a partnership can, on behalf of the partnership, dispose of property and incur liabilities within the scope of the business where as a member of a limited company has no such power.

(iii) A member of a partnership cannot contract with the firm whereas a member of a limited company can contract with the company.

(iv) Creditors of a partnership are creditors of the firm and where they obtain a judgment, can enforce the same and levy execution on individual members of the firm whereas in the case of a limited company, judgment against the company gives no right to levy execution on members of the company.

(v) In a partnership, restrictions on a members' authority contained in the Partnership Contract does not have any effect on outsiders dealing with the partnership where as in the case of a limited company such restrictions are effective and binding on those dealing with the company.

(b) (i) Under Section 5 (5) of the Companies Act, a public company is defined as any company other than a private company. Under Section 5(3) a private Company is one whose memorandum or articles restrict the right to transfer its shares, if any, limits the total number of its members to 50 and is prohibited from inviting the public to acquire its debentures and shares.

A private company, unlike a Public Company, enjoys privileges and exemptions under sections 182(1) (b) and 197(1) from the requirement to periodically send director's report and financial statements together with its annual returns to its members and debenture holders.

(ii) Under Section 2 of the Companies Act, a company is a holding company of another company or body corporate where the latter is its subsidiary. Where for instance one company is a member of another company which has the power to appoint or prevent the appointment, remove or prevent the removal of at least half of its directors, the latter company is a subsidiary. Another instance is where a Company more than half of the nominal value of another company's equity share capital.

2. (a) A promoter of a company is any person who takes major steps necessary for the formation and subsequent operation of a company: Twycross v Grant. The major steps include going through the formalities of registration of the company, funding its directors and members, raising its start up capital and

procuring assets to make the company operational immediately after incorporation.

(b) The common law imposes on the promoter some fiduciary duties towards the prospective company. Firstly, a promoter owes the company a duty to disclose his interest in any transaction involving the company. He is not allowed to make secret profit at the expense of the company: Gluckstein v Barnes. Secondly, where a promoter makes an undisclosed profit, he has a duty to account for it. Thirdly, where a promoter is selling or in any way dealing with the company, he has a duty to disclose beforehand all the relevant information to enable the company make an informed decision: Erlanger v New Sombrero phosphate Co.

The disclosure must be effective. It must be made to the members of the company or an independent board of directors as well as future members.

(c) 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 it comes into existence shall be personally bound by the contract and entitled to the benefits thereof.

A promoter will therefore be personally liable for any contracts he enters into before incorporation of the company: Kelner v Baxter; MarblestoneIndustries Ltd v Farchild. This is based on the contractual principle that a stranger to a contract cannot sue or be sued on it.

Where the promoter and the other party entered into a contract mistakenly believing the company was in existence the position is slightly different; both the promoter and the company will not be bound as there was no contract in the absence of an agreement between the two parties: New born v Sensolid (Great Britain) Ltd.

(d) Section 20(2) of the Companies Act provides that a company may, within a reasonable time after it comes into existence, expressly or by action or conduct signify its intention to be bound thereby, adopt a written contract made before it came into existence. At that point it becomes party to the contract entitled to sue or be liable to be sued on it.

This provision makes it possible for contracts to be made purportedly on behalf of a company or by a company even though both parties know that the company has not yet been formed. After adoption of the contract, the person who made the contract is generally released.

In addition Section 20(4) of the Companies Act provides that where a written pre-incorporation contract expressly provides that the prospective company is to be bound by the contract, then the company will be bound.

3. (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 being placed on the register of members .

(iv) By transmission on death or bankruptcy of a deceased or bankrupt member respectively and being 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 forfeited.

(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;

(iv) Reduce its capital.

(d) Under Section 148(1) of the Companies Act Unity Cement Company Limited can pass a valid resolution in lieu of a meeting. The company secretary should be advised to draft the required resolution which must be signed by all the 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.

4. (a) (i) A company may be wound up voluntarily in the following circumstances:-

(1) Under Section245(1)(a) of the Companies Act, when the period, if any, fixed for the duration of the company by the Memorandum or Articles expires, or the event, if any, occurs, on occurrence of which the memorandum or articles provide that the company is to be dissolved, and the company in a general meeting wound up voluntarily.

(2) Under Section 245(1)(b) of the Companies Act, if the company so resolves by special resolution.

(ii) The Procedure to be followed upon passing a resolution to winding up voluntarily under Section 245(2) of the Companies Act is as follows:-

(1) Within seven days of the passing of a resolution to wind up, a copy of the resolution should be delivered to the Registrar for registration.

(2) Within fourteen days of the passing of a resolution to wind up, notice of the writing up should be published in the Gazette.

(iii) Under Section 246 of the Companies Act. a voluntary winding of a company up shall commence at the time of the passing of the resolution for voluntary winding up.

(b) The effects of voluntary winding up of a company under Section 247 of the Companies Act are as follows:

(i) The Company shall, from the commencement of the winding up, cease to carry on its business, except so far as in the opinion of the liquidator, this is required for the beneficial winding up thereof, but the corporate state and corporate powers of the company shall continue until it is dissolved.

(ii) Any transfer of shares, not being a transfer made to or with the sanction of the liquidator, and alteration in the status of the members made after the commencement of the winding up, shall be void.

(c) (i) The Statement of affairs, under Section 248(2) of the Companies Act should show the following:

(1) The assets of the company, and the total amount expected to be realized therefrom;

(2) The liabilities of the company; and

(3) The estimated expenses of the winding up.

(ii) The conditions that must be satisfied in order to give effect to the declaration under Section 248(3) of the Companies Act are as follows:

(1) The declaration should be made at the meeting of directors.

(2) The declaration should be made within 5 weeks immediately preceding the date of the passing of the resolution for voluntary winding up.

(3) The declaration should be delivered to the Registrar for registration on or before the date on which the notices of the meeting at which the resolution for the winding up of the company is to be proposed are sent out.

5. (a) Discussion of the following types of shares:

(i) Ordinary Shares

Ordinary shares, as the name suggests, are the types of shares which a company limited by shares can issue. Thus, if a company has one class of shares, these will necessarily be ordinary shares. In fact, even where the company has more than one type of shares, it must have at least on ordinary share. Consequently, unless a company issues deferred shares, ordinary shares will form the residuary class in which is vested everything after the special rights of other classes have been satisfied. These shares usually carry one vote per share and have no right to a fixed divident.

(ii) Deferred Shares

A company will occasionally issue deferred shares to the founders of its business. No dividends are paid to deferred shareholders unless ordinary shareholders are paid a certain amount of dividend in that financial year. In other words, the deferred shareholder is entitled to participate in the distribution of the company's profits only after a declared dividend has been paid on ordinary shares. However, deferred shares are hardly in use any longer.

(iii) Preference Shares

The essential characteristic of a preference share is that its holder has priority in the return of capital on the company's winding up. However, this will have to be expressly stated in the articles as it does to automatically follow that a preference shareholder is entitled to priority in the distribution of assets on winding up (see Re: Syston and Thurmaston Gas Light and Coke. Ltd.

In the case of dividends, a preference shareholder is entitled to priority if the company decides to pay a dividend to its members. If it does not make that decision he cannot compel it to do so. (See Bond v Barrow Hematite steel and Co. Ltd.

These shares have restricted voting rights; they usually carry a divident at a fixed rate; and they are more like debentures than ordinary shares.

(b) Under Section 43(1) of the Companies Act 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. Shares of any member of a company limited by shares are part of his personal estate and movable property.

(c) Under Section 49(3) of the Companies Actshares can be transferred 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). Thereafter, the transfer shares 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 (Article 10 Table A). The instrument may be lodged for registration by the transferor or the transferee.

Under Section 49(1) of the Companies Act The transfer cannot be registered without the delivery of the instrument of the company. The company is empowered under section 50(2) of the Companies Act to refuse registration of any transfer which is not accompanied by the appropriate share certificate.

(d) Apart from transfer, shares may change hands through the operation of law. Section 54(2) of the Companies Act provides that on the death of a shareholder where he was a joint shareholder, his legal representative can be registered as shareholders in his place. Similarly where a receiving order is made against an individual under the Bankruptcy Act, ownership of his shares will devolve on his trustee in bankruptcy. In the case of a company which is in receivership, ownership of the shares which it held in another company will be transmitted to its receiver.

Under Section 54(3) of the Companies Act prior to registration in the company's membership register as holders of the shares, these persons will be entitled to the same dividends, rights and remedies as if they were already registered. However, they will not be allowed to vote at any meeting of the company before they are registered as members.

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 **k**

(ii) Those on whose directions or instructions the duly appointed 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 court from an office of trust on account of misconduct;

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

(d) The **three** main fiduciary duties of directors are: to act bonafide in what they believe to be in the interest of the Company; to exercise their powers for the purpose for which the powers were conferred on them and, to avoid conflict between their interests and those of the company. These duties are discussed in more detail as follows:

(i) <u>The Duty to Act Bonfide</u>

To comply with this duty directors must do what they honestly believe to be in the interest of the Company as a whole. This includes the interests of the present and future members of the Company as well as creditors of the Company. Directors therefore must balance the best interests of the Company on the one hand and the interests of the members of the company on the other. However,where the directors are also shareholders, as is mostly the case, theyare perfectly entitled to act in their own interests as well, in their capacity as shareholders: <u>Mills v Mills</u>.

(ii) The Duty to Exercise Powers For Proper Purpose

To comply with this duty directors must exercise their powers for a purpose for which the power in question was conferred on them. Exercising the power for any other collateral purpose would constitute an abuse of the power. Whether the exercise of powers by the directors is for a proper purpose or not depends on the particular facts of the case on proof that the directors were motivated by a purpose that does not serve the company's interest. For example, directors issuing shares in order to mete out vengeance against any group of shareholders of the company could be seen as exercising their powers for an improper purpose. On the other hand directors issuing shares to avoid a takeover bid that they honestly believe would not be in the best interest of the company could be seen as exercising their powers for a proper purpose: Teck Corporation V Miller, Howard Smith Ltd v Ampol Petroleum Ltd.

(iii) The Duty to Avoid Conflict Of Interest

To Comply with this duty directors must avoid putting themselves in positions of conflict between their personal interests and those of the company.

Directors must therefore avoid making secret profits from their positions, and if they do they must disclose it to the Company: See Boston Deep Sea Fishing and Iceco vs Answell.

Another point is that the directors must avoid misappropriating the Company's property or opportunities. If for example a director who comes across a business in his capacity as director of a company diverts the opportunity to himself he will be in breach of his fiduciary duty: Cook vs Deeks.
In exercising these duties it must be noted that the directors' duty is to the company and not to the individual member of the company.Percival v Wright. The directors must also act with such care as is reasonable in a person of their knowledge. They must be reasonably diligent but can delegate some of the matters that can best be handled by other officials, unless there are suspicious circumstances.

7. (a) (i) A fixed charge is a charge on specified and identifiable property of the such as land, ship building, motor vehicles, etc. A floating charge is a charge on 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 a fixed charge 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 if:

(1) The principal or interest payable on it is in arrears or;

(2) the security is in jeopardy or;

(3) the company commences winding up proceedings or;

(4) the company ceases to operate – Re Woodroffes Musical Instruments Ltd. **s**

(b) A floating charge is quite advantageous on the part of the company because it allows the company to put up its 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 flows:

(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 debentureholders in respect of whom the charges are created.

(v) Generally 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.

(iv) 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 Indusatrie 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 debentureholders who 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 or the debenture (which may well be the entire business of the company) to the receiver. In Indefund v Manguluti and Manguluti Justice Mtegha said:

"Generally, the position is that a receiver will be appointed by a debenture holder in cases where the principal is in arrears or when interest is in arrears or when any other event has happened by which, under the terms and conditions of the debenture, the security has become enforceable. Again, it is normal to appoint a receiver where the security is in jeopardy".

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 Credit Bank Ltdis in jeopardy. The property of General Merchants Ltd.is about to the seized by the sheriff. This is an event which entitles the debenture holders (Credit Bank 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 a receiver because the imminent seizure of the company's assets had put his security in jeopardy.

8. (a) The auditor's principal duty is to make a report to the members of a company on the accounts and every balance sheet profit and loss account or saving accounts as laid down before the company in the general meeting.

(b) The statutory standard of skill and care required of an auditor in the exercise of his duties is that of a faithful, diligent careful and skillful auditor. He is not bound

to do more than take reasonable care and skill in making his enquiries and investigations.

(c) Au auditor would cease to act as such when the company passes an ordinary resolution to remove him from office and appoint another auditor.

(d) Only persons that are eligible as auditors under the Public Accountants and Auditors Act can be employed as auditors of a company.

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