



**THE LAW SOCIETY OF SCOTLAND
EXAMINATIONS**

BUSINESS ORGANISATIONS

Friday 9 February 2018

**1330 – 1530
(Two Hours)**

**Candidates should answer any THREE questions. Give
authority for all answers.**

Each question has 100 marks.

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Question 1

Henry has been invited to join, as a director, a small soft-ware company that has been recently started by two of his friends, Arthur and Betty, who are both directors and, so far, sole shareholders of their company, Marchmont Micro PLC (“MM”). Henry is an expert on certain aspects of IT that would be useful for MM. Henry has designed a computer program that he proposes to let MM use in return for a quarterly royalty. Henry is also a 5% shareholder in a company with which MM is in dispute over work that the other company did for MM. Henry would like to be a shareholder in MM since it would give him, as he puts it, “skin in the game” and more committed to his role. Unfortunately he is very short of money as he has been involved in an expensive divorce. He would therefore like to explore the possibility of MM lending him the money with which he could buy some newly allotted shares in MM. Henry has not indicated how large a shareholding he would like to have.

Arthur and Betty ask you if you would prepare a brief note on any specific issues that will arise for the company and indeed for them personally, from the matters raised by Henry. You are not expected to explain the actual process for the allotment of Henry’s shares.

Question 2

Donald, Effie and Fay were partners in a firm called DEF Quantity Surveyors (“DEF”). The firm had traded for sixteen years, the three partners having set the firm up together soon after they had qualified. Profits and management were shared equally between the partners, and they had each contributed £200,000 capital to the firm. There was no partnership agreement. In 2014 they decided to incorporate as DEF Ltd. All three partners became directors of the company, and the entire assets and liabilities of the partnership were transferred to the company, each now former partner receiving 1,000 shares in exchange for his or her partnership interest. In 2015, Effie died in a car crash. One of the company’s better employees, Guy, was encouraged by Donald and Fay to buy Effie’s shares from her executors. According to DEF Ltd’s articles the purchaser of any member’s shares must be approved by the other members. The executors were content to sell the shares to Guy, who was in due course made a director. In 2017 Guy and Fay noticed that Donald was no longer pulling his weight in the company. His lunches were getting longer and he was at odds with the staff. With some difficulty, it was suggested to Donald that he ought to resign. This he refused to do. Consequently, Guy and Fay convened an annual

general meeting at which Guy moved that Donald be removed as a director with immediate effect, having previously given the required special notice to Donald. Donald was asked if he wished to speak. He was so upset at Fay's apparent betrayal that he refused to do so. Guy and Fay duly voted in favour of the motion. "Resolution passed," said Guy. Donald did not move from the room. The next resolution on the notice of the AGM was that the existing directors' pension contributions should be substantially increased. This was passed. The following resolution was that no dividend would be payable that year. This too was passed. Donald then stumped out of the room.

Donald calls you to advise him of his rights. He is worried that now that he is longer a director he can no longer see the management accounts and so will not be in a position to tell if any offer he is made for his shares is a fair one. He is worried that he will be locked into the company unless he is willing to sell his shares for a ridiculously low price.

Advise Donald on his available legal remedies.

Question 3

Old Mrs MacTavish died, leaving three properties in her will to a charity. She had no heirs. The charity had no desire to own the properties, so the executors agreed to hire Ken, a local property and letting agent, specialising in urban properties, to sell the properties. The proceeds of sale would be remitted to the charity. One of the properties was a shop in the high street of a prosperous Stirlingshire country town, long associated with highland brigandry. The tenant's lease was coming to an end so Ken was able to offer a purchaser vacant possession. Ken showed various potential purchasers around and a closing date was set. Henbane and Co, a local firm of solicitors, put in a bid on behalf of their clients for the shop. The clients were said to be an unincorporated syndicate of investors, known as Larkspur. Larkspur's name was indicated on the offer. Its address was stated to be care of Henbane & Co. The offer was successful but Larkspur did not produce the funds to pay for the property. This was because the individual investors never had put Larkspur in funds nor taken any steps to formalise their relationship. The executors wished to sue Henbane & Co for the executors' loss on the eventual sale of the shop for less than the offer from Larkspur.

Ken's next property to sell was a field used for grazing, then without planning permission. Ken was approached by Simon who said he was acting for a local firm of builders, Hemlock & Co.. Simon expressed interest in the field and said that if planning permission were available for the field, he would arrange that his firm would buy it. Ken was surprised at this assertion, so asked his friends and professional colleagues about Simon. It appeared that Simon was a newly appointed contracts manager for Hemlock & Co. and had been carrying out work for them. At some inconvenience and expense, Ken, acting for the executors, managed to get planning permission for the field. He then went back to Hemlock & Co. and asked for Simon. Hemlock & Co. stated that they had indeed hired Simon but they had since had to dismiss him for fiddling his expenses. They also stated that he was a lowly employee with no authority to make such contracts, and, while they were about it, indicated that they would have had no intention of buying the field as it was north-facing and difficult to drain. Ken ruefully had to admit that agricultural property was not his strong point, and that they had a point. The executors now propose suing Hemlock & Co. for the cost of obtaining the now unnecessary and valueless planning permission, on the grounds that they were responsible for Simon's actions.

Ken's final property was a parking plot behind an old church in the same country town. Seeing the plot's development potential, Ken registered a company in the island of Jersey. Ken was the sole shareholder and he appointed a local person in Jersey to be the company's director. The company then successfully put in a bid to the executors' solicitors for the plot. Shortly afterwards, Ken sold his entire shareholding in the company to a local firm of property developers for a substantial profit. The executors only discovered Ken's involvement in this matter six years after the sale to the Jersey company.

Explain the law relating to these transactions.

Question 4

Molly, Nick and Oliver are partners in a small firm, known as Dechor, working in interior design. They have no partnership agreement. Oliver joined Dechor four years ago, long after Molly and Nick had set it up. Recently some matters have been causing concern.

Molly has a financial but non-managerial interest in an antique shop run by her husband. Oliver has recently noticed that some of Dechor's clients seem to have bought quite a number of antiques from Molly's husband's shop. Oliver wonders if Molly has been passing on information about Dechor's client list to her husband, and possibly even sharing in the commission for the sale of antiques to those clients.

Secondly, Oliver has found out that Nick had been having an affair with the wife of one of Dechor's clients. The client has found this out, and has posted a number of unfortunate messages about this on social media. This is losing Dechor other clients.

Thirdly, Oliver discovers that before he joined the firm, Dechor had a pension scheme for its few employees. By the time Oliver joined Dechor, Dechor no longer had employees, but it appears that Dechor at the time had not put enough into the employees' pension fund. That this matter was not apparent earlier was the fault of the pension fund, but the liability for the arrears appears to lie with Dechor.

Finally, Oliver was alone in Dechor's premises one day when sheriff officers came in and tried to attach the assets in the premises. They claimed that they were acting on behalf of a firm of stockbrokers. Unbeknownst to Oliver, Nick had been playing the stock market using Dechor's credit card, and had heavily shorted some shares which he had confidently expected to go down in value. They had instead risen and Nick had failed to make good his losses. Nick had concealed all this from his fellow partners. The sheriff officers explained that if they were not successful in carrying out an attachment, their client would sequestrate Dechor.

Advise Oliver.

[Please turn over]

Question 5

(i) Shaniah runs a number of nail clinics. Each one is a separate company, which does involve a great deal of paperwork, but her mother, who is an accountant, makes sure that each business is self-contained, hires its own staff and is operated separately. The shares in each company are held by Shaniah Holdings Ltd, whose two shareholders are Shaniah and her mother. The companies are profitable. Shaniah, despite her financial success, does not live a lavish lifestyle, at least within the United Kingdom. Such dividends as she receives are used to acquire properties in warm and pleasant climates.

Shaniah is not, however, a particularly agreeable individual. One night at a club she took offence at a comment made to her by another woman, Colleen, who thought Shaniah was taking too much interest in Colleen's husband. Shaniah saw fit to strike Colleen. Shaniah's jewelled rings severely injured Colleen's eye. Colleen successfully sued Shaniah for damages, but extracting the money from Shaniah is proving difficult. Shaniah's assets all appear to be situated abroad or owned by different limited companies. It is very difficult to find any assets clearly owned by Shaniah, other than the shares in her various companies and in particular Shaniah Holdings Ltd.

Colleen comes to you seeking advice on how, under Scots law, it may be possible to get the damages paid from Shaniah's companies.

(50%)

(ii) Back in 2011, Shaniah's father, Joe, lent Shaniah Holdings Ltd some money and secured his loan by means of a duly registered floating charge. From time to time he would lend more money, and from time to time he would be repaid some of his loan. In 2018, there was a fire at one of the nail clinics. The fire brigade and the police were called. One of the employees died in the fire. It turned out that she had been illegally employed and that there were no national insurance records for the victim. This led to an investigation, which uncovered various other matters. As a result of this HMRC put some of the individual companies and the holding company into liquidation. Having done so, it became apparent that the principal creditor of the holding company was Joe. Joe also appeared to have received many large payments from the individual companies for services for maintaining the premises of the various nail clinics.

The liquidator seeks your advice on what remedies there may be against Joe.

(50%)

Question 6

(i) Explain why a company might wish to reduce its capital and the advantages of doing so. Explain what the procedure for a public company reducing its capital is and what factors the court needs to take into consideration.

(ii) The allotment of shares in a public limited company is considerably more complex than the allotment of shares in a private company. Explain why this should be, in particular explaining the purpose of the rules relating to the allotment of shares for non-cash consideration.

(iii) Explain the purpose of the rules relating to pre-emption rights for the allotment of shares, and further explain why pre-emption rights do not automatically apply to all classes of shares.

(iv) Explain what procedures are required if an applicant wishes to obtain a list of a company's members. What is the purpose of these complex rules?

(25% each part)

Question 7

On 15 September 2015 Belladonna Ltd granted a standard security over its main business premises to Dalkeith Bank plc. The standard security was registered in the Land Register on 20 September 2015. The standard security was registered in the companies register on 1 October 2015.

Belladonna Ltd granted a qualifying floating charge for all sums due and that may become due to the Bank of Newbattle in 15th March 2016. The floating charge contained a negative pledge clause. It was registered in the companies register a week later.

Belladonna Ltd changed its solicitors. In 20 June 2016 Belladonna Ltd acquired a warehouse in Musselburgh. To buy the warehouse, Belladonna Ltd borrowed money from James, a private lender. Belladonna Ltd granted James a standard security over the warehouse. The disposition for the warehouse and the standard security were both registered in the Land Register on 25 June and the standard security was registered in the companies register a week later.

In December 2017 Belladonna Ltd became involved in a dispute with Monkshood Ltd. On 6th January 2018 Monkshood Ltd arrested Belladonna Ltd's bank account with the Bank of Scotland, its principal bankers.

On 17th January 2018 Nightshade Ltd was granted an inhibition on the dependence against Belladonna Ltd in respect of sums allegedly owed to Nightshade Ltd for the purchase of Nightshade Ltd's services.

On 31st January one of the directors of Belladonna Ltd drove one of the company's lorries to the garage for its regular check-up and MOT. These were duly carried out. Although the MOT was successful, it was completed too late in the day for the director to return to pick up the vehicle and to pay the garage's fee.

On 1st February 2018 Midlothian District Council successfully applied to court for Belladonna Ltd to be compulsorily wound up for its failure to pay business rates. At this stage several employees had not been paid for six weeks. A number of small trade creditors had also not been paid.

Somewhat to everyone's surprise, Belladonna Ltd appears to be the victim of poor management rather than the lack of realisable assets. It is agreed that an attempt should be made, so far as possible, to pay the creditors in full. Explain to the liquidator the order in which the various creditors ought to be paid.

END OF QUESTION PAPER