

**THE LAW SOCIETY OF SCOTLAND  
EXAMINATIONS**

**BUSINESS ORGANISATIONS**

**Friday 10 August 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**

Liam, Margo, Neil and Olive are in partnership in Glasgow in a profitable metal-trading firm, known as LMNO. They have no partnership agreement. Each takes one quarter of the profits and shares equally in the management of the firm. The firm has many clients who value the firm's services. The firm is deliberately unincorporated, not for reasons of secrecy, but to reassure their clients of their professionalism.

Liam has an expensive hobby, which is motorboat racing. He wants to buy a new motorboat, but at present lacks the cash to do so. However, his father has recently died, and he expects to inherit enough money to pay for the motorboat. Liam asks his boat broker to arrange a bridging loan for him with a marine lender. This will enable Liam to buy the motorboat now, before the opportunity passes. The marine lender is willing to lend the money to Liam, but wants security from LMNO. As Liam expects his father's money to be available imminently, he signs a guarantee in LMNO's name in favour of the marine lender. He does not disclose the guarantee to his partners as he knows they would not approve; furthermore he does not expect the guarantee to have to be honoured. There is a delay in the confirmation to his father's estate and the loan is not repaid on the agreed date. The marine lender asks LMNO to honour the guarantee.

One of Margo's clients tells Margo of a particular business opportunity. Though she should declare this to her partners, she chooses not to do so, and keeps the profits that she gained through it. Subsequently the client falls out with Margo and tells the other partners what Margo has done.

Neil is approached by a client to help him prepare some paperwork for the forward sales of tantalum from a central African state. He is familiar with the paperwork, but less so with his client. Neil nevertheless produces the paperwork as a result of which his client manages to defraud the government of that state, the funds arising from the fraud going through the firm's bank account and from there to the client. The state sues LMNO for knowing receipt of the funds and knowing assistance of the fraud. LMNO defends the action on the ground that that the firm had no reason to believe that the money that passed through its account had originally come from the defrauded state, and that carrying out frauds cannot be a normal course of business for LMNO.

Olive is asked by Liam to fetch him a mug of coffee. On the way over to his desk, she trips on a loose cable by his desk, and inadvertently scalds him with the hot coffee. His nice linen suit is ruined, and the hot coffee damages his eye. The firm's insurance by chance happens to have lapsed, so Liam chooses to sue the firm for his injuries, on the grounds that Olive was the agent of the firm and so the firm is liable.

*Consider the law relating to these four matters.*

## **Question 2**

Nenjo Ltd is a private limited company with standard articles, and an issued share capital of £100, consisting of 100 ordinary shares of £1.00 nominal value, each fully paid. 50 shares are held by Jeremy and 50 held by Norman, each of whom are directors. The net asset value of the company is £250,000. The company was founded in 2010 and has issued no shares since. The company has ample reserves of undistributed profits. There is no share premium account.

The directors intend the company to carry out the following transactions:

- a) The issue of 20 high-yield, non-voting preference shares each of £1 nominal value to Thomas, a proposed new shareholder, in exchange for payment to the company of £50,000.
- b) The issue of 25 ordinary shares to Jeremy in exchange for his transferring to the company the licence for a computer programme he has developed, the value of which is independently estimated to be £30,000.

Assume that each of these transactions is separate and non-consequential on the other transaction. Explain the procedures that would be needed to carry each one out. Are there any commercial or practical implications arising from these transactions?

## **Question 3**

Lovelace Ltd is a garment-making company which has collapsed as a result of reduced demand for its clothes. HMRC successfully petitioned for the company's compulsory liquidation in August 2018. The liquidator prepares his report and highlights the following matters:

- a) The wife of the managing director in December 2017 obtained the benefit of a floating charge over the company's assets on the occasion of her paying off a debt owed by the company to a supplier of £50,000;
- b) The directors agreed to assign the design rights attaching to certain garments and fabrics to a company registered in Malta 18 months before the company's liquidation. It is not clear who has the underlying ownership of the shares in the Maltese company, though there is a suspicion that it may be the finance director.

- c) Up until two weeks before the liquidation of the company the directors of the company were still accepting pre-payment orders from customers even though the company was not in a position to deliver the ordered goods to the customers;
- d) A debt management company has approached the liquidator with an offer to acquire the liquidator's rights in (a), (b) and (c) in exchange for a lump sum payment for the benefit of the creditors.
- e) The local council successfully carried out an attachment of the company's goods in one of its warehouses in May 2018. The attachment has not proceeded to a sale, though some steps have been taken to arrange this. The council has written to ask for the release of the garments to the liquidator.

Explain the law relating to these five matters.

#### **Question 4**

If advising a client who was unhappy with the way that he, as a relatively insignificant shareholder in a company, was being treated by certain other shareholders who were both directors and the recipients of large interest-free loans from the company, what would you recommend as appropriate litigation for your client both (a) in his personal capacity and (b) in his capacity as a concerned member who was anxious about the long-term prospects of the company's shareholders collectively under its present management? Explain to your client the procedures relating to (a) and (b), advising your client on the advantages and drawbacks of each set of procedures.

#### **Question 5**

Your client, a director of and shareholder in a small but prosperous company, comes to see you to ask about the following matters:

- a) How can the members get rid of an incompetent director?
- b) How complicated would be it be for the company to buy out one of your client's fellow shareholders who is becoming cantankerous? And what would happen to the capital structure of the company if that happened?
- c) Your client was supposed to have taken out workplace insurance and failed to do so. He pleaded guilty to this and was fined, which he accepted. While the insurance was missing, one of the employees injured himself in the course of work. Because of the lack of insurance cover, there was no insurance payment possible, so the employee wants to sue your client personally.
- d) The director is worried about his address being revealed to the public from information at the Registrar of Companies.

Advise your client.

### **Question 6**

Recent corporate collapses have called into question the genuine independence of auditing firms, poor corporate governance, the effectiveness of the rules relating to directors' duties (in particular s.172), the high rate of executive pay in certain quoted companies, and the apparent reluctance of the authorities to enforce higher standards of behaviour on directors. Does British company law provide any realistic solutions to these problems?

### **Question 7**

While the position of an agent for an undisclosed principal is reasonably clear, the position of an agent for a principal who may not exist, who is not who he seems to be, or who has not given his permission for the agent to act for him, is less so. Explain the law relating to this, in particular as it affects solicitors in Scotland.

**END OF QUESTION PAPER**