

THE LAW SOCIETY OF SCOTLAND EXAMINATIONS

BUSINESS ORGANISATIONS

Friday 11 February 2022

**1300 – 1600
(Three hours)**

You are required to answer **THREE** questions.

You are expected to provide legal authority for all your assertions.

You are expected to write your own answers, and you must neither share your answers with any other candidate nor copy another candidate's work. Use your own words in your answers, not merely transcribing what you may find in textbooks, solicitors' blogs or other law-related websites.

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Question One

Jim, a property agent and former surveyor, acts for a wealthy ex-patriate, Alex, who for tax reasons lives most of the time in Monaco. Alex is wealthy, difficult, and mercurial. Alex returns to Scotland from time to time, but when he is in Monaco, he expects Jim to sort out any problems relating to the country house he owns in Scotland, to ensure that his property is insured, the house and garden maintained, and that the house is in a fit state to be reoccupied by Alex whenever Alex wants to return home to Scotland. Jim is also expected to look after Alex's Aston Martin that is kept in the garage at the back of the house. Jim is given a budget each year by Alex, and provided he keeps within budget, Alex does not too closely examine Jim's accounts for Alex.

Jim notices that there is a leak in the roof at the back of the house. He obtains quotations from three potential firms of slaters. The best quotation is from a company called Roof-fix Ltd. Jim gives Roof-fix Ltd the contract. The directors of Roof-fix Ltd are in fact Jim's sister (using her married name) and her husband, and one of the major shareholders in the company is Jim's wife, using her maiden-name. As Roof-fix Ltd was the best quotation and within the budget, Jim does not see the need to trouble Alex with the details of the management or control of Roof-fix Ltd.

One day, Jim receives an email from Alex saying that Alex wishes to purchase a painting that is in a neighbour's house. Alex has heard that the neighbour has been in some financial difficulty, having unwisely backed his son's business. The neighbour might be willing to sell some of his pictures. There is one that Alex particularly would like, as it is a picture of one of his ancestors, a general in the Crimean war. Alex tells Jim to visit the neighbour to see if the neighbour would be willing to enter in a cash sale of the picture. Jim is told on no account to reveal that he is acting for Alex lest the neighbour put up the price, knowing of Alex's wealth and personal interest in the picture. Jim duly does as instructed, and obtains the picture, paying for it with money from Jim's own bank account. The neighbour thinks that he was dealing with Jim. But somehow, later on, the neighbour discovers that Jim was merely the frontman for Alex, and that the picture is now hanging in Alex's house. If the neighbour had known that Jim was merely the frontman for Alex, he would never have sold to Jim. This is because the neighbour has had a particular dislike of Alex ever since Alex bullied him at school. The neighbour wants to sue Jim for deceiving him as to the identity of the true purchaser.

Some time later, Alex instructs Jim to sell the Aston Martin. Jim takes the vehicle to the auctioneer's and instructs the sale of the vehicle at the next occasion a vehicle auction is taking place. The auction is due to take place on the last Friday in the month. The day before the auction is due to take place, Alex emails Jim to say that he has changed his mind and does not want the sale of the vehicle to go ahead. Unfortunately, there is a power-cut in Jim's location and he never sees the email until late the following day. In the meantime, the auction takes place, and a purchaser makes a successful bid. Only after the gavel has gone down on the purchaser's bid does Jim arrive at the auctioneer's, apologising for not having got there earlier, and saying that the sale should not go ahead. "It's too late," says the auctioneer. "Well, you can't sell the car unless you have the vehicle documentation, and I am now not going to hand it over," says Jim.

The auctioneer is very unhappy about this and the purchaser even more so. The purchaser knew he was being denied a significant opportunity. The purchaser wishes to sue Jim.

Alex asks to see Jim's accounts. He notices that the self-employed part-time gardener, whom Jim is supposed to supervise, seems to be receiving a surprising amount of money for what he does. Closer inspection reveals that Jim appears to have been taking a slice of the gardener's fee.

Discuss the points of law arising in the above scenario.

Question Two

Two brothers, Ben and Doug, have set up a café and bakery together. They get up very early each morning. Ben makes the cakes and the pastries, and Doug makes and serves the beverages. Although they do not have a partnership agreement, they agree to be equal partners, each putting the same amount of capital into the partnership, and each being entitled to the same share of drawings and responsible for the same share of liabilities. Their father, Alan, has lent his sons' partnership a substantial sum of money for a period of five years to get it going. He also agrees that the interest on the loan will vary according to the profitability of the partnership. In addition, he has also acted as guarantor for the rent of the premises. The rent is payable by the partnership, but the landlord insisted on there being a guarantor as well.

Ben and Doug have a bad experience with supplying some of their products to another café, known as Café Jaune. There had been a big row with Café Jaune over the alleged state of some cakes, so Ben and Doug agree between each other that they will not do business with Café Jaune again. But by an oversight, next time a junior assistant at Café Jaune places an order with them by email, Ben, who was distracted by a problem with their oven, accepted the order without checking his paperwork as closely as he should have done. By the time Ben had checked his paperwork, the deadline for delivery had passed. Café Jaune was not impressed when their order was not fulfilled, and wants to claim for the loss of business occasioned by Ben's and Doug's failure to produce and deliver the required goods on time. Doug tells Café Jaune that Ben and Doug had agreed with each other not to deal with Café

Jaune again and so they were not liable. Furthermore, said Doug, Café Jaune should have realised from their past experience with Ben and Doug that Ben and Doug would no longer wish to deal with Café Jaune. It was Café Jaune's fault for not managing their assistant properly.

Doug, on behalf of the partnership, offers to supply the cakes and pastries for a celebration that is going to take place for a retiring member at a local bowls club. He insists on payment in advance because of the large quantity of ingredients. On the morning of the celebration he manages to send a bogus message through an untraceable source suggesting that some Covid-infected people, who ought to be self-isolating, were proposing to come to the celebration when they ought not to be. This is not true, but it is sufficiently convincing that at the last minute the celebration is cancelled. The partnership keeps the advance payment, claiming that it was not their fault that the event was cancelled and that they had done the work. When asked what had happened to the food, Doug airily explained that they had given it all to a charity that feeds the homeless, though in fact no food had been prepared. The bowling club's insurance company refunds the bowling club the advance payment. The advance payment is used to pay the partnership's rates bill. A clerk in the insurance company has his misgivings about the whole episode.

Sadly, there is a falling out between Ben and Doug after a couple of years. Ben can be a bit temperamental, and takes offence at something Doug said about Ben's girlfriend. One day, while Doug is out, Ben decides he is going to set up on his own. Ben packs up his belongings at the bakery, takes the client list, his recipes, most of the partnership paperwork and half the money in the till. He takes out half the money in the partnership bank account, and some time later sets up a new business on his own. He leaves a note for Doug, saying the partnership is over. Ben sends a note to the landlord and to Alan saying that the partnership is finished. He pays his share of the rent up to the date of the termination of the partnership.

Doug is understandably upset at all this and asks for the client list and partnership paperwork back. Ben ignores him. In the meantime, next month's rent needs to be paid. Doug, without Ben's acumen, has trouble finding the money to pay the rent and defaults. The landlord then asks Alan to honour his guarantee and to pay the rent. Alan replies that that he is not liable as there has been a change to the constitution of the partnership. The landlord retorts that Alan is in fact a partner in the partnership and hence personally liable for the rent.

Discuss the points of law in the above scenario.

Question Three

Alim is a 40% shareholder in a company controlled by Saqib. The company is called Safeguard Ltd and supplies security systems to offices, factories, car parks and retail units. The company installs surveillance cameras and operatives in the company's head office monitor screens, looking for any unusual activity at those sites. It is a reasonably successful company, but it needs hefty insurance, and constant checking of the equipment, not least because thieves try to destroy the cameras by shooting at them with air rifles. Relations between Alim and Saqib are not, sadly, good. Saqib treats the company as if it were entirely his own. He is not good at showing Alim the company accounts on a regular basis. Alim keeps asking that the accounts be audited but Saqib keeps refusing this on the grounds that it is expensive, and the Registrar of Companies does not require audited accounts for a small company. Alim suspects that some of the company's clients are paying cash for the surveillance, and that this is not going through the company's accounts. The accounts seem to show sums being paid to Saqib personally as "expenses", though it is not clear what those expenses are. Recently Alim has noticed that there is a new company with documentation and a website that is strikingly similar to Safeguard Ltd's own documentation. The new company is called Safeward Ltd. Safeward Ltd appears to be trying to branch out into surveillance in certain Middle Eastern countries, and pitching its business at the sort of clients that Safeguard Ltd worked for; – many of those clients do not really care who is providing their surveillance as long as it is cheap, reliable and well-insured. When challenged by Alim about this, Saqib says that he is not a director and not a shareholder of Safeward Ltd, and it is nothing to do with him. He does not deny that his wife is both a director and a shareholder of that company. Alim, having met Saqib's wife, is not aware that she has previously shown any inclination towards management or business, but Alim makes no comment on this. Alim has a strong suspicion that Saqib is trying to run down Safeguard Ltd, mainly because he does not want to give 40% of its profits to Alim, and he wants to divert Safeguard Ltd's business to Safeward Ltd.

What points of law are shown here and what remedies, if any, are available to Alim?

Question Four

Abacus Ltd, a company making electronic tills, is reorganising its share structure to take account of the need to bring in new shareholders and hand over control to the next generation. The company was originally set up by Jane and Ken, who have run the company successfully for many years. The company has the standard articles for a private limited company. Jane and Ken are currently the sole shareholders, holding 50 shares of £1.00 nominal value each, and are both directors. They wanted to transfer their shares to their children, Liam and Maisie, but both Liam and Maisie could not afford to buy the parents' shares from them. As the company has substantial reserves, built up from many years of successful trading, the company will instead buy the parents' shares for the sum of £500,000. Before the sale takes place, the company will allot 50 £1.00 nominal value ordinary convertible shares in equal quantities to Liam and Maisie. These are a new type of share for the company, but Liam and Maisie want their shares potentially to have the benefit of being convertible into bonds. This is the first time shares will have been allotted for over ten years.

Once the parents' shares have been bought back by the company, Jane and Ken will appoint Liam and Maisie as new directors, and Jane and Ken will resign their own directorships. Liam and Maisie wish the company to allot 20 £1.00 preference shares to Nicola in exchange for her making over to the company the design rights for one of the functions within the tills. Liam and Maisie also propose that the company lend Oliver, the technical manager of the company, £10,000 so that he may attend general meetings as a member of the company and to give him a stake in the business he works in. He is to be allotted 10 non-voting ordinary shares of £1.00 nominal value each.

You are the company secretary of Abacus Ltd. Explain what procedures will need to take place for this all to happen.

Question Five

Black Helmet Ltd is a company importing motor-cycle helmets and other types of crash-helmet from China and elsewhere for sale to the biking community. It was a good business until the arrival of Covid-19 when the restrictions on travel meant that people were using motor-cycles less and buying fewer helmets. The fact that increasingly customers were buying crash-helmets on line was also something that Don, the company's managing director and founder shareholder, had not really appreciated. Black Helmet Ltd leases three show rooms and a warehouse, and holds a good deal of stock. Despite his accountant's warning, Don continues to run his business as though times had not changed. Don enjoys the good things in life, and sees no reason to change his ways. He is involved in the motor-cycle racing community (where he put large bets on some of the competitors, particularly the ones he sponsors), and the company does some trading in motorcycles as well. For many years Don and the company had relied on his excellent and formidable book-keeper who quietly prevented him taking too much money out of the business. She has retired. None of her replacements last long, driven out by Don's brash behaviour and reluctance to be told what to do.

The paperwork of running the business is not Don's finest skill, and he starts to be slow to pay the company's bills. The money coming in is not what it used to be, and the rent for the showrooms still needs to be paid. The company has no bank borrowings. On 1st May 2021 Don arranges for the company to grant him a floating charge over the company's assets. The charge is stated to be in security of a new loan to the company of £100,000, but Don had in fact only lent the company £50,000 and that was three years ago. On 1 December 2021 Don arranges for the uninsured theft of one of the company's motorbikes, but in fact friends of Don's take away the motorcycle in an unmarked van. the motorcycle is now in Don's son's possession, but with a new numberplate. On 10 January 2022 HMRC successfully petitions for the company's winding up on the grounds of failing to pay outstanding VAT.

The liquidator discovers all the above information, but also notices that Don had been assuring the company's landlords and HMRC that the company would be perfectly able to pay its next quarterly rent and the VAT when this was clearly not the case. Don had also made substantial drawings from the company's bank account which were not accounted for as dividends, salary or reimbursement of expenses. Don had apparently diverted a company

business opportunity to his son. Don had accepted substantial hospitality from a crash-helmet manufacturer in the form of meals, accommodation and attendance at boxing and wrestling matches.

Advise the liquidator on the points of law relating to the above.

Question Six

(A) Pran is a shareholder in a medical charity company, set up to promote vegetarianism. The objects clause in the company's articles specifically state that the purpose of the company is to encourage the adoption of vegetarianism, to help vegetarian businesses (such as cafés and restaurants), and to promote the benefits of vegetarianism in a world without enough food to feed everyone. He is therefore sceptical of attempts by the company's directors to encourage prospective vegetarians to adopt a vegetarian life-style by the promotion of imitative foodstuffs that to some extent taste, have the texture of and indeed look like meat. Pran felt that this was missing the point of vegetarianism and felt that the company should not be encouraging this. In the meantime, the directors have made the company enter into an agreement whereby the company would underwrite the publication of a cookery book full of recipes for imitation meats. He also noted that one of the directors was using the company money to pay him to test various recipes for these imitation meats. Pran is aware that not everyone in the company may feel as strongly as he does about these matters.

Pran consults you to ask what may be done about this.

(B) Pran also notices that there is something else unusual. Another director of the charity company appears to have bought from the charity company a vehicle that the company stated was surplus to requirements. The transaction is evident from the company accounts. The value of the vehicle seems to be surprisingly low. Pran asks to see the board minute, or indeed any other minutes approving this, but is told that the board minutes are not available to members. Pran asks if the auditors noticed this transaction and is told that the auditors made no comment on the matter.

Pran consults you as to what should have been done to ensure that the sale of the vehicle by the company was properly carried out. He also asks about the auditor's role in this matter.

(C) Pran is concerned that some of his fellow shareholders are not taking his concerns as seriously as he thinks they should be. He wants to be allowed access to the current list of shareholders so that he may alert them to the failings that he perceives the directors are inflicting upon their company. He writes to the managing director to be asked to be allowed access to the current list of shareholders, but the managing director refuses his request.

Pran asks you to explain what the law on this matter is and whether or not he would be able to obtain access to the current list of shareholders.

END OF QUESTION PAPER