ACCA

LW (ENG)

Corporate and Business Law (ENG)

Applied Skills

Integrated Workbook

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Chapter 1

English legal system

Chapter learning objectives

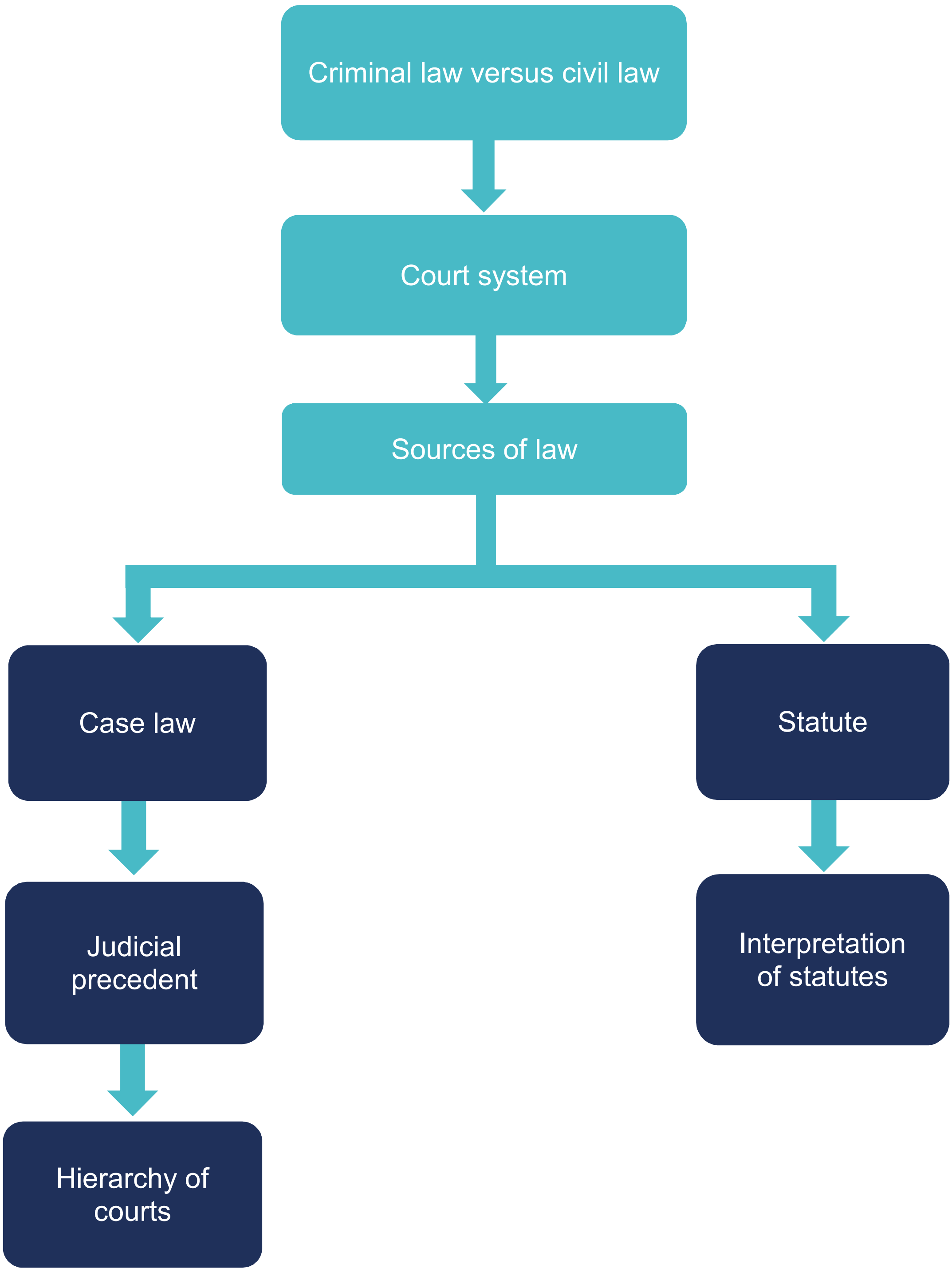
Upon completion of this chapter you will be able to:

- explain the difference between civil and criminal law
- explain the structure and operation of the civil courts and tribunal systems
- explain the meaning of judicial precedent, ratio decidendi and obiter dicta
- illustrate how the doctrine of judicial precedent works in relation to the civil courts
- explain how legislation is made and the doctrine of sovereignty
- set out the rules and presumptions used by the courts in interpreting statutes
- identify the concept of human rights as expressed in the Human Rights Act 1998 (HRA 1998).

The underpinning detail for this Chapter in your Workbook can be found in Chapter 1 of your Study Text

Chapter 1

Overview



1 Definition of law

The principles and regulations established in a community by some authority and applicable to its people whether in the form of legislation or of custom and policies recognized and enforced by judicial decision.

Notes

2 Types of law

The English legal system distinguishes several types of law. The ones we will look at are:

- Common law and equity
- Private law and public law
- Criminal law and civil law

Notes

Common law and equity

Following the Norman Conquest, English law has been described as a common law system. This was a system whereby a number of legal concepts from Norman law were incorporated into the English system.

Common law:

- developed from local customs
- introduced the system of precedent (see section 4)
- the only remedy is damages
- may be rigid and inflexible.

Judges would travel around the country and apply a mixture of precedent and common sense to build up a body of internally consistent law. However, this would sometimes result in harsh consequences.

To deal with the issue that damages are not always a suitable remedy, equity was developed two or three hundred years later after common law and introduced fairness into the English legal system.

Equity:

- developed as a petition by a party who felt the common law had led to injustice
- it is more flexible than the common law
- it introduced new discretionary remedies, e.g. injunctions and specific performance
- it is concerned with fairness and therefore will not be granted if there is undue delay in bringing the case or if the petitioner has himself acted unfairly, or where there is no mutuality (both parties should be able to bring a case).

Notes

Private and public law

Within the English legal system, two distinct areas of law operate: private and public law. They both aim to create social order, but have a number of distinct differences.

Within public law, different categories exist. These include criminal law, constitutional law, administrative law, social welfare law and all deal with matters relating to the whole country.

Private law is concerned with the law enforced between individuals. This can include contract law, family law and other areas which deal with intellectual property rights (copyrights, designs and patents), land law (and the way in which it is transferred), probate (dealing with wills and how property is distributed after someone dies) and company law (which deals with the ways in which companies are created and operated).

Notes

Criminal law versus civil law

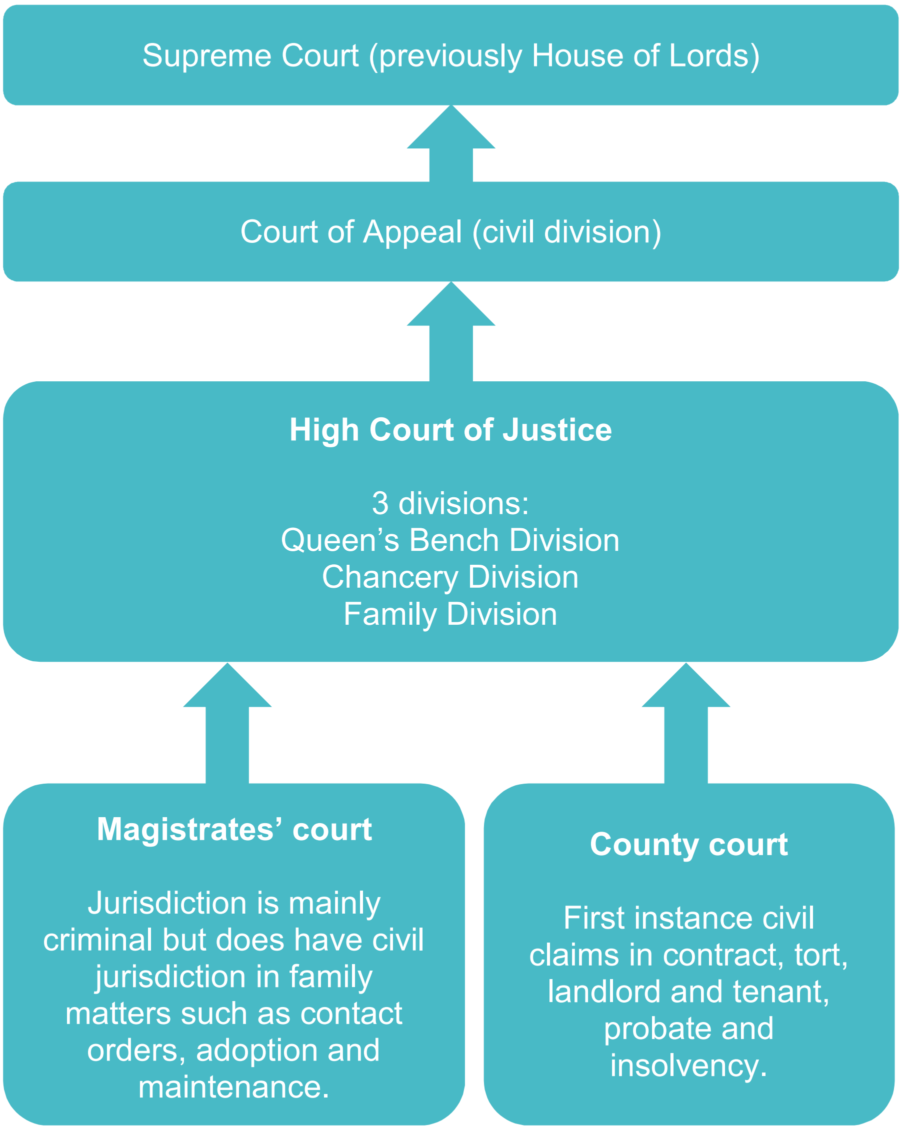
Criminal law	Civil law
Criminal law relates to conduct of which the State disapproves and which it seeks to control. It is a form of public law.	Civil law is a form of private law and involves the relationships between individual citizens.
Purpose – the enforcement of particular forms of behaviour by the State, which acts to ensure compliance.	**Purpose** – to settle disputes between individuals and to provide remedies.
In criminal law the case is brought by the State in the name of the Crown. A criminal case will be reported as Regina v ..., where Regina means the Latin for 'queen'.	In civil law the case is brought by the claimant, who is seeking a remedy. The case will be referred to by the names of the parties involved in the dispute, such as Brown v Smith.
Burden of proof – on the prosecution.	Burden of proof – on the claimant.
Standard of proof – guilt must be shown beyond reasonable doubt (high standard of proof).	**Standard of proof** – liability must be shown on the balance of probabilities (lower standard of proof).
Object – to regulate society by the threat of punishment.	**Object** – usually financial compensation to put the claimant in the position he would have been in had the wrong not occurred.
If found guilty the criminal court will sentence the accused and it may fine him or impose a period of imprisonment. If innocent the accused will be acquitted.	The civil court will order the defendant to pay damages or it may order some other remedy, e.g. specific performance or injunction.

Notes

3 The court system

The main English civil courts

The following diagram shows the main civil courts. The term ‘first instance’ refers to the court in which the case is first heard. Appeals are heard in a different court. The arrows show the way a case will progress through the court system.



The three-track system

When a claim is received, it will be allocated to one of three tracks for the hearing.

(1) The small claims track – deals with simple claims valued at no more than £10,000, an informal court.

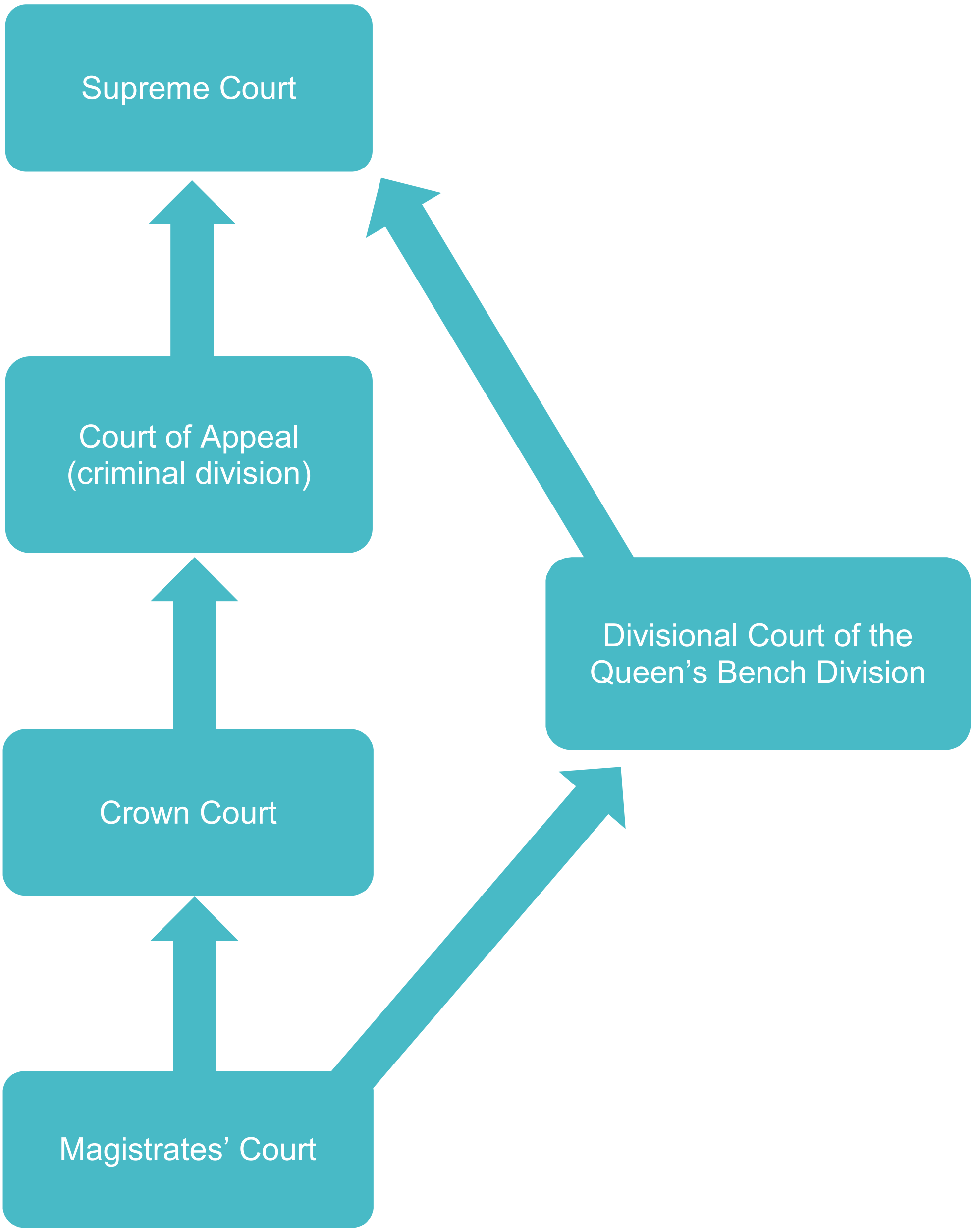
(2) The fast-track – deals with moderately valued claims of between £10,000 and £25,000, expected to last no more than one day.

(3) The multitrack – deals with claims of over £25,000 and/or complex claims.

Note: the County court deals with all cases allocated to the small claims track, the majority of fast track and some multi track cases. All other claims are dealt with by the High Court.

Notes

The main English criminal courts



Notes

Other courts

Court of Justice of the European Union (CJEU)	European Court of Human Rights (ECtHR)	Judicial Committee of the Privy Council (JPC)
CJEU deals with actions between EU institutions and the member states. It is the ultimate authority on the interpretation of European law.	The final court of appeal in relation to matters concerning HRA 1998.	The highest court of appeal for a number of Commonwealth countries, crown dependencies and UK overseas territories.
CJEU is therefore superior to the Supreme Court.	Proceedings in the English court must have been exhausted before ECtHR will hear a case.	Hears both civil and criminal appeals.
Cases are referred to the CJEU by national courts.	No appeal.	The right to appeal to the JPC is regulated by the constitution and legislation of the particular country.
No appeal.		Proceedings take place in the Supreme Court of the UK.
		No appeal.

Notes

Tribunals

Tribunals are also an important part of the English legal system and are an alternative to using the court system to settle a dispute.

Employment tribunals are established to hear disputes between an employee and their employer on certain statutory employment matters, such as unfair dismissal (see Chapter 4).

Employment tribunals are composed of one employment judge, plus two expert laymen who are drawn from panels representing both sides of the industry.

Appeals are to the employment appeal tribunal (EAT) and can only be made on a point of law.

The EAT is composed of one High Court judge, plus two or four expert laymen.

Court v Tribunal

	Court	**Tribunal**
Expertise	Case may not be heard by a specialist in that particular area of law.	Case will be heard by someone who has expertise in that area.
Speed	A slower process.	A much quicker process.
Cost	Legal aid maybe available but if not can be an expensive process.	Legal aid is not available (except for land tribunals and EAT's) but can be a much cheaper procedure.
Proceedings	Strict rules relating to evidence, pleading and procedure.	Much less formal and can be less intimidating.
Decisions	Are bound by the doctrine of judicial precedent, therefore making consistent decisions.	Not bound by the doctrine of judicial precedent, therefore risk of making inconsistent decisions.

Notes

4 Sources of law

Overview

European law takes precedence over all other sources.

Legislation takes precedence over case law.

Equity prevails over common law.

Notes

Case law

Throughout this text you will find examples of cases which have come before the courts. These cases illustrate the way in which the law is made. It should be noted that you will not be tested on the actual case law.

Case law can be divided into common law and equity (covered earlier).

Doctrine of judicial precedent

The system, adopted by the judges, of following the decisions in previous cases is called the doctrine of judicial precedent.

Some precedents are binding (meaning they must be followed in later cases). Others are merely persuasive (meaning that a judge in a later case may choose to follow it but he is not bound to do so).

There are three factors to be considered in deciding whether a precedent is binding or persuasive:

- the hierarchy of the courts
- ratio decidendi and obiter dicta
- the material facts of the case.

The hierarchy of the courts

As a general rule, the precedents of higher courts bind lower courts, but not vice versa.

Notes

Supreme Court – binds all lower courts. From 1966 does not bind itself.

Court of Appeal – binds all lower courts and itself in civil cases unless earlier decision overruled or is inconsistent with European law.

High Court – not bound by its own decisions, but strong persuasive authority.

The 1966 Practice Statement was made on behalf of himself and the House of Lords (now the Supreme Court) by Lord Gardiner. Lord Gardiner proposed that they could depart from a previous decision if it appeared right to do so. This would allow the law to develop in line with changes in society.

Although there have been a number of cases where the House of Lords (now the Supreme Court) has overruled or amended its own earlier decisions, it is also reluctant to exercise these powers too frequently.

Notes

Ratio decidendi and obiter dicta

The ratio decidendi is the legal reason for the decision. It is capable of forming the binding precedent. It is a statement of law which is carried down to later decisions.

Obiter dicta are statements which are not part of the ratio, they are other statements made by the judges such as hypothetical situations or wide legal principles. They are persuasive rather than binding. This means that the judge can take the statement into account (and usually will) when reaching his decision, but he does not have to follow it.

Facts of the case

In order for a precedent to be binding on a judge in a later case, the material facts of the two cases must be the same. If they are significantly different, the precedent will be persuasive rather than binding.

When is a precedent not binding?

A precedent is not binding where it:

- has been overruled by a higher court.
- has been overruled by statute.
- was made without proper care (per incuriam). This is where a decision of a court is held to be wrongly decided because the judge was misinformed of the law. A judgment per incuriam is not binding and has no authority.
- can be distinguished from the earlier case, i.e. the material facts differ.

A previous case is only binding in a later case if the legal principle involved is the same and the facts are similar. Where the facts are materially different then a previous decision does not need to be followed.

Notes

Advantages and disadvantages of judicial precedent

Advantages:

- Reaching decisions as a result of the doctrine of precedent makes the system consistent. It becomes easier to predict the result of litigation.
- It allows the English legal system to be flexible. Decisions can be adapted and extended to reflect changes in society.
- The law is clear. As it is only the ratio decidendi that is followed it is easy to see what law is being applied.
- Decisions arise from actual events, therefore the system is practical.

Disadvantages:

- The law is very complex because there are a vast number of cases, and inconsistencies can arise. The same judgement may contain differing and even conflicting, arguments making the precedent hard to understand and even harder to apply.
- The law can become rigid, leading to inflexibility and loss of development.
- Case law is reactive rather than proactive. Rather than dealing with issues in advance and stating the law, a case is considered and a decision made once a particular situation has arisen.

Notes

5 Legislation

Act of Parliament

Parliament consists of:

- The House of Commons
- The House of Lords
- The Monarch

In order to become an Act of Parliament, a Bill must go through the following stages in both Houses:

- first reading – the name of the Bill and the its proposer is read out
- second reading – debate takes place on the principles of the Bill and it is then voted upon
- committee stage – a smaller number of MP's consider the wording of the Bill. This stage can last several months depending on the contentiousness of the Bill
- report stage – the Bill as amended by the Committee is reported back to the full House
- third reading – the Bill is read for the final time.

At the end of this process in both Houses, the Bill must receive the Royal Assent.

Note that an Act does not necessarily come into force immediately. Its provisions may take effect on a piece-meal basis. An example is the Companies Act 2006.

Notes

Doctrine of sovereignty of Parliament

Parliament is sovereign. This means that, in theory, it is only Parliament that can make new law and it can make any law it wishes. However it cannot pass an Act which can never be repealed.

The courts cannot question the validity of an Act. However, they must refuse to apply an Act that contravenes EU law.

Delegated legislation

For many reasons, Parliament has delegated some of its legislative powers to other bodies. Usually, Parliament passes an 'enabling' Act setting out the policy involved and the objectives it wishes to achieve. The Act then delegates the task of filling in the details to some other body.

Rules enacted under such powers are called delegated legislation, and the following are examples:

- statutory instruments: made by Government Ministers
- bye-laws: made by local authorities
- Orders in Council: made by the Privy Council in the name of the Monarch on the advice of the Prime Minister.

Delegated legislation has a number of advantages:

- It saves Parliamentary time.
- It may benefit from access to technical expertise, thus leaving Parliament free to consider and debate the underlying principles.
- Flexibility – it is quick and easy to make and to change.

However, it also has a number of disadvantages:

- Its volume and lack of publicity means that it can be difficult to keep up with the changes introduced.
- It is criticised as being undemocratic as it is made without recourse to the elected House of Commons.

Notes

6 Rules of statutory interpretation

The process by which judges assign meanings to ambiguous words or phrases in statutes is called the interpretation of statutes.

Judges can use certain aids, rules and presumptions to help them assign meaning to a word.

Literal rule

Words must be given their ordinary dictionary meaning, even if this produces an undesirable outcome.

Illustration 1 – Literal rule

FISHER V BELL 1961

Facts:

The court had to consider the meaning of the wording 'offer for sale'. It was an offence to 'offer for sale' offensive weapons. A shopkeeper had flick-knives with price tags attached on display in his shop window.

Held:

The court applied the fundamental principles of contract law in a literal fashion, accepting that the display of flick-knives was an invitation to treat. It was the customer who made an offer to buy. In consequence, the shopkeeper was found not to be acting illegally. The aim of Parliament, however, had been to prevent sales of offensive weapons.

Notes

Golden rule

Where the literal rule gives more than one meaning or provides an absurd result, the golden rule is used to ensure that preference is given to the meaning that does not result in the provision being an absurdity.

Illustration 2 – Golden rule

ADLER V GEORGE 1964

Facts:

A conviction was challenged on the basis of what appeared to be a miswording in the Official Secrets Act (1920). This Act made it an offence to obstruct a member of the armed forces `in the vicinity of' particular locations, but not actually `in' those locations. The defendant was actually inside an Air Force base at the time of the incident, which he claimed was beyond the literal scope of the Act.

Held:

The words 'in the vicinity of' a prohibited place in the Official Secrets Act were held to cover the acts of the defendant which took place 'within' a prohibited place.

Mischief rule

Used to interpret a statute in a way which provides a remedy for the mischief the statute was enacted to prevent.

Notes

Illustration 3 – Mischief rule

GORRIS v SCOTT 1874

Facts:

The Contagious Diseases (Animals) Act 1869 provided that any ship carrying animals should contain them in pens. The defendant neglected his duty, and some of the claimant’s sheep were washed overboard and lost.

Held:

Since the purpose of the statute was to prevent the spread of contagious disease, and not to guard against the danger of the property being washed overboard, the claim failed.

Purposive rule

This is a more modern approach. Here the court is not just looking to see what the gap was in the old law, it is making a decision as to what they felt Parliament meant to achieve.

Illustration 4 – Purposive rule

GARDINER V SEVENOAKS RDC 1950

Facts:

The purpose of an Act was to provide for the safe storage of film wherever it might be stored on 'premises'. The claimant argued that 'premises' did not include a cave and so the Act had no application to this case.

Held:

The purpose of the Act was to protect the safety of persons working in all places where film was stored. If film was stored in a cave, the word 'premises' included the cave.

Notes

Eiusdem generis

General words mean the same kind of thing as the specific words they follow.

Illustration 5 – Eiusdem generis

POWELL v KEMPTON PARK RACECOURSE CO 1899

Facts:

Section 1 of the Betting Act 1853 prohibited betting in a ‘house, office, room or other place’. The issue was whether a ring at a racecourse was an ‘other place’ for the purposes of this statute.

Held:

The Lords decided that if the eiusdem generis rule was applied, the specific words such as ‘room’ and ‘office’ that preceded the general phrase ‘or other place’ created a class of indoor places. As a ring on a racecourse was outside it would not fall within this category.   Therefore the Act did not apply to restrict gambling here.

Expressio unius exclusio alterius

Where a statute seeks to establish a list of what is covered by its provisions, then anything not expressly included in that list is specifically excluded.

Notes

7 Human Rights Act 1998

What is its purpose?

HRA 1998 incorporates the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950 into UK domestic law.

What is Convention law?

Convention law means the Convention and the decisions of the ECtHR.

How does it affect judicial interpretation?

UK courts must take Convention law into account when deciding a question that has arisen in connection with a Convention right.

What if legislation is incompatible with the Convention?

Any existing legislation must be interpreted so it is compatible with the rights under the Convention.

If a court feels that legislation is incompatible with the Convention and it cannot interpret it in such a way to make it compatible, then it may make a declaration of incompatibility. However, the declaration does not make the legislation invalid. It is left to Parliament to remedy the situation through new legislation.

However, the courts do have the power to declare delegated legislation (e.g. statutory instruments) to be invalid.

Notes

Questions

You can now attempt the following from the Text:

Chapter 1 TYU's 1–3

Chapter 13 Questions 1–5

Chapter 2

Contract law

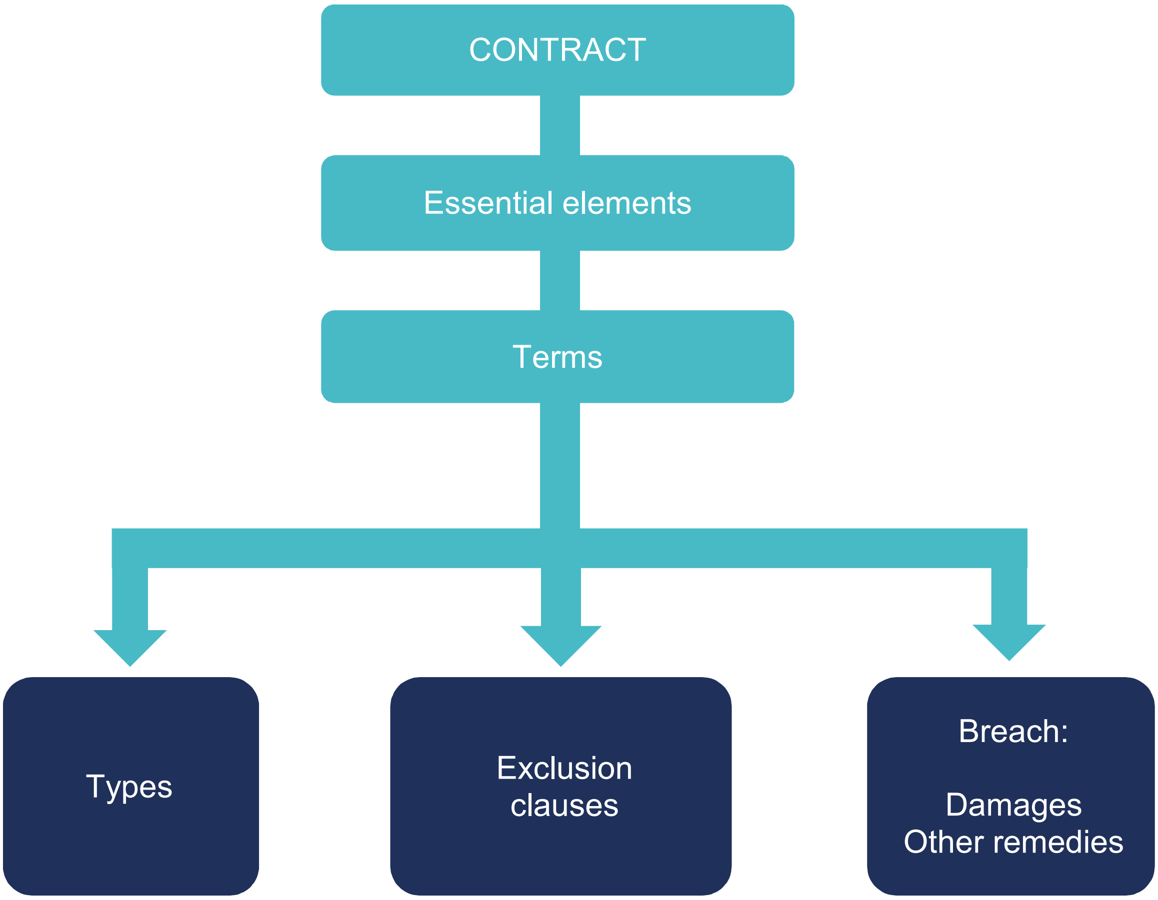
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain the essential elements of a contract
- explain what is and is not an offer
- explain the meaning and consequence of acceptance
- explain the meaning of consideration
- explain the doctrine of privity and the main exceptions
- distinguish the presumptions relating to the intention to create legal relations
- distinguish terms from mere representations
- define the various contractual terms
- explain the effect of exclusions and evaluate their control
- explain the meaning and effect of breach of contract
- explain the rules relating to the award of damages
- analyse the equitable remedies for breach of contract.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 2 of your Study Text

Overview


CONTRACT
Essential elements
Terms
Types
Exclusion clauses
Breach:
Damages
Other remedies

1 Essential elements of a valid contract

The following elements are needed to form a valid contract:

- Agreement i.e. offer and acceptance
- Consideration
- Intention to create legal relations
- Capacity
  - Each party must have the legal power to bind itself contractually. For example persons under the age of eighteen (minors) and persons of unsound mind or under the influence of alcohol have limitations on their power to contract.
- Legality
  - The courts will not enforce a contract which is deemed to be illegal.

Form of contract

Most contracts can be oral or in writing. For oral contracts, written evidence may be useful as proof that it was made and where the contract details are complex or involve some action in the future.

A contract which does not need to be in writing is known as a SIMPLE CONTRACT.

Certain types of contracts must be in writing to be valid and enforceable. These are:

- Bills of exchange
- Regulated Consumer Credit Agreements
- Transfers of land (must be evidenced by Deed, known as **specialty contracts**)
- Guarantees.

The limitation period for a contract made by deed is 12 years. For all other contracts, the limitation period is 6 years.

Subject to contract

Where the words 'subject to contract' are used this means the parties to an agreement are not legally bound until a contract has been executed. Even though the parties have agreed terms, the matter effectively remains in a state of negotiation. Furthermore, either party can withdraw from the transaction without liability.

Notes

2 The offer

An offer is the first part of the agreement.

What is an offer?

An offer is a **definite promise** to be bound on **specific terms** made by the offeror to the offeree.

The offer can be made in any form but must be communicated to the offeree. The offeree can be a particular person, a class of persons or even the whole world.

Illustration 1 – The offer

CARLILL v CARBOLIC SMOKE BALL 1893

Facts:

The manufacturers of a medicinal 'smoke ball' advertised in a newspaper that anyone who bought and used the ball as directed and still contracted influenza would be paid a £100 reward. Mrs Carlill used the ball in accordance with the instructions and still caught flu. The manufacturers said there was no contract with Mrs. Carlill because an offer could not be made to the whole world.

Held:

An offer could be made to the whole world, the wording of the advert showed a definite intention to be bound and as such it amounted to an offer. Mrs. Carlill had accepted the offer by using the ball correctly and as such was entitled to payment of the £100.

Notes

What is not an offer?

If an individual has not made an offer there can be no binding contracts. There are a number of items which have been held to not be an offer.

An invitation to treat

An invitation to treat is an invitation to someone else to make an offer to you.

Illustration 2 – The offer

Examples of invitations to treat:

- Most adverts (but remember Carlill mentioned earlier – an advert can be an offer only if it makes it clear no further negotiations are required)
- Shop window displays
- Goods on shop shelves
- Company prospectus
- Circulation of a price list or displays on a website
- Tenders (a person asking for tenders is making an invitation to treat, the person submitting the tender is making the offer).

Notes

A supply of information or a statement of intention

A statement made early in the negotiations is unlikely to be held to be a valid offer and a statement of an intention to sell is not an offer. This would cover when a possible selling price is given during initial discussions.

Illustration 3 – The offer

HARRIS v NICKERSON 1873

Facts:

An auction was advertised in a newspaper. A broker saw the advert and travelled some distance to attend. The items he was particularly interested in had been withdrawn from the sale. The broker claimed the advert was an offer for sale of the various items and his attendance was an acceptance of that offer.

Held:

The advert was not an offer as it was not clear and definite that the auctioneers wanted to sell the items.

If the auction is held without reserve, once the lot is put up by the auctioneer, it is an offer to sell to the highest bidder and if withdrawn after the bid has been made there will have been a breach of contract.

Notes

Vague statements

A statement cannot constitute an offer if it is not sufficiently specific. For example, an offer to sell someone a car for £5,000 is valid, but a statement that a person will sell '…one of my cars for about £5,000' is not an offer: it is vague and uncertain.

Termination of the offer

Once an offer has been terminated it cannot be accepted.

An offer can be terminated in the following ways:

- Rejection and counter offer
- Revocation
- Lapse of time
- Failure of a pre-condition.

Notes

Rejection

Rejection occurs when the offeree turns down the original offer. It can be express or by way of a counter offer. A counter offer is a new offer on different terms.

Illustration 4 – The offer

HYDE v WRENCH 1840

Facts:

Wrench offered to sell Hyde a farm for £1,000. Hyde made a counter offer by offering £900.

Wrench rejected this counter offer. Later, Hyde came back to Wrench and said that he now accepted the offer at £1,000.

Held:

Hyde could no longer accept the original offer as it no longer existed and as such was not capable of acceptance. Hyde's statement that he would pay the original £1,000 was a new offer, which Wrench did not accept.

A request for more information is not a rejection of the offer.

Notes

Revocation

Revocation occurs when the offeror withdraws their offer.

- Revocation can be made at any time before acceptance.
- Revocation can be made even if the offeror has agreed to keep the offer open.
- Revocation must be communicated to the offeree by the offeror or by a reliable third party.

There are two exceptions to the rules above:

- If the offeree pays the offeror to keep the offer open this creates a collateral contract and a revocation of the original offer would be a breach of that collateral contract. The offeree could claim damages (the most usual remedy for a breach of contract) for the loss of the opportunity to accept the original offer.
- In a unilateral contract.

A unilateral contract is one which is made to the whole world and as such it would be virtually impossible to notify everyone who saw the offer of the revocation. In addition acceptance of a unilateral contract always involves the performance of an act (such as using the carbolic smoke ball) and if an offeree has begun the act but not completed it a revocation would be unjust. Revocation is not, therefore, effective if the offeree is in the process of accepting a unilateral offer (has begun performance).

Lapse of time

An offer ceases to exist if not accepted within a specified time limit and, if no time limit is specified, then it will lapse after a reasonable time.

An offer will also lapse on the death of the offeree or of the offeror unless the offeree accepts in ignorance of the death.

Failure of a pre-condition

A 'conditional' offer is one which is dependent on a specified event or change in circumstances. A conditional offer may not be accepted unless and until the condition or change of circumstances is met.

Notes

3 Acceptance

Acceptance is the second part of the agreement; together with the offer the acceptance completes the first essential element of a valid contract. Acceptance is the **unqualified and unconditional** assent to all the terms of the offer.

Acceptance can be oral, in writing or by conduct

The acceptance can be express or implied by the conduct of the offeree (Carlill case). If an offeror stipulates the type of acceptance then that form of acceptance must be used. If a mode of acceptance is merely requested then other reasonable methods can form a binding contract.

Acceptance must be communicated

As a general rule acceptance must always be communicated to the offeror. Acceptance is not effective until this happens.

If a ‘fax’ is received during normal business hours then it is communicated when **received.** If a fax is received outside of normal business hours it is communicated once the business opens.

The law is unclear as to when a communication by e-mail is received but there seems little reason to distinguish between this form and other types of instantaneous communication such as fax or telex. The contract will be formed when the acceptance is received by the offeror’s e-mail system and is available to be read.

Notes

Acceptance must involve some act on the part of the offeree

There must be some act to indicate acceptance; silence cannot be presumed to amount to acceptance.

Illustration 5 – Acceptance

FELTHOUSE V BINDLEY 1862

Facts:

The claimant wrote to his nephew offering to buy his horse. In his offer he stated 'If I hear no more about him, I consider the horse to be mine'. The nephew did not reply.

Held:

The offer had not been accepted as the nephew's silence was not sufficient to give acceptance.

The Postal Rule

This is the exception to the rule that acceptance must always be communicated. The postal rule states that acceptance is complete as soon as the letter is posted.

The rule only applies where the letter is properly stamped and addressed and if it would not be unreasonable to use the post (it would be unreasonable, for example, during a postal strike).

The postal rule applies even if the letter is never received by the offeror but not if the offeror states he must actually receive acceptance.

Notes

4 Consideration

All simple contracts must be supported by consideration. However, contracts made by deed (specialty contracts) do not require consideration unless the terms of the agreement require it.

Consideration is an act or forbearance (or the promise of it) on the part of one party to a contract as the price of the promise made to him by the other party to the contract. **DUNLOP PNEUMATIC TYRE CO. v SELFRIDGE 1915**

Put more simply, it is the price by which one party bought the other party's act or promise.

Valid consideration

Both executed and executory consideration is capable of being valid consideration.

Executed consideration

Executed consideration is consideration provided at the time of the agreement. It is a performed act in exchange for a promise.

Executory consideration

Executory consideration is provided when the party agrees to do something in the future at the time of the agreement. It is a promise given in exchange for a promise.

Sufficient but not adequate

Consideration **must be sufficient but need not be adequate**.

- Sufficient consideration is consideration which is capable of being given a value.
- Inadequate consideration is unequal consideration. The parties have freedom to contract under any terms they wish and a court will not attempt to make a contract a fair bargain as long as there is some identifiable value.

Notes

Illustration 6 – Consideration

CHAPPELL & CO v NESTLE 1960

Facts:

A promotion by Nestle offered records for a sum of money plus three chocolate wrappers.

Held:

The wrappers were part of the consideration even though they had minimal value.

Illustration 7 – Consideration

THOMAS v THOMAS 1842

Facts:

A promise was made to convey a house to X for a rent of £1 per year.

Held:

The promise was binding as the consideration had value, even though it was inadequate.

Notes

Invalid consideration

Past consideration

Consideration is past if it involves something which has already been done at the time the promise is made. Past consideration cannot support a contract.

Illustration 8 – Consideration

RE MCARDLE 1951

Facts:

A husband and wife carried out improvements to a house. At a later date a promise was made to reimburse the couple.

Held:

The works had been carried out before the promise to pay had been made. Past consideration is no consideration.

If an act was done in response to a specific request and payment might be expected in such a situation then there is an implied promise to pay and this will constitute good consideration.

Notes

Existing statutory duty

Generally, performance of an existing statutory duty is not good consideration.

However, if it can be shown some extra service over and above that statutory duty is required this will constitute good consideration.

Illustration 9 – Consideration

GLASBROOK BROTHERS LTD v GLAMORGAN COUNTY COUNCIL 1925

Facts:

G Bros. required the police to provide protection over and above their statutory duty during a miners' strike.

Held:

The payment to the police for extra protection was additional to their statutory duty and therefore good consideration.

Existing contractual duty

Performance of an existing contractual duty will not normally be good consideration for a new contract with the same person.

Illustration 10 – Consideration

STILK v MYRICK 1809

Facts:

A captain promised to share the wages of deserting seamen with the rest of the crew if they completed the voyage.

Held:

The promise was not binding as there was no extra consideration from the seamen who, by completing the voyage, were doing no more than they were contractually bound to do.

Notes

Performance of an existing contractual duty can be good consideration in the following situations:

- If the existing duty is exceeded.

Illustration 11 – Consideration

HARTLEY v PONSONBY 1857

Facts:

A large number of seamen deserted from a ship making the ship undermanned and hence unseaworthy. The captain offered extra pay to the remaining seamen if they would complete the voyage.

Held:

The promise of more money was recoverable by the seamen as they were involved in a dangerous situation and were doing more than they had originally contracted to do.

Notes

- If both parties gain an additional practical benefit from the new contract not anticipated in the original agreement.

Illustration 12 – Consideration

WILLIAMS v ROFFEY BROS. 1990

Facts:

Williams agreed to do some work for Roffey Bros in a block of flats at a fixed price by an agreed date. The work ran late and R agreed to pay extra to have the work completed on time. If the work had overrun R would have suffered a penalty on his own contract with the owner of the flats.

Held:

Even though W was only doing what he was contracted to do the extra payment was good consideration as the new payment constituted a new contract from which both R and W benefited.

R benefited by not incurring penalties on his contract with the owner of the flats and by not having to find contractors to finish the work. Also R had approached W to offer extra payment, there was no pressure put on him. The court held it would have been inequitable for R to go back on his promise.

- Performance of an existing duty can be good consideration for a new contract with a third party.

The promise to do or the act of doing an illegal act is not good consideration

The courts will not enforce a contract for an illegal purpose and as such performance of an illegal act is not good consideration.

Notes

The part payment problem (waiver of an existing debt)

Payment of a lesser sum in satisfaction of a greater sum cannot be any satisfaction for the whole sum.

This is an extension to the rule that performing an existing contractual promise cannot be consideration for a further contract with the promisor.

Illustration 13 – Consideration

FOAKES v BEER 1884

Facts:

Foakes obtained judgment against Beer for a sum of £2,090 plus interest. She agreed to payment by instalments and that further proceedings on the judgment would not be taken. B paid the £2,090 but refused to pay the interest and F sued.

Held:

B had to pay the interest. Payment of the debt itself was not consideration for the whole amount owed which included the interest.

Notes

There are many exceptions to this rule:

- Alternative consideration. If the debtor offers some alternate type of consideration and the creditor freely accepts this it can be valid consideration.
- Bargain between creditors. When a group of creditors jointly agree to part payment in lieu of the full debt all creditors are bound to the specified terms.
- Payment by third party. If the payment is made by another party this can be good consideration.
- The doctrine of promissory estoppel (see below).

Promissory estoppel

The doctrine of promissory estoppel is based on the principles of fairness and justice. It prevents a person going back on his promise to accept a lesser amount.

Notes

5 Intention to create legal relations

If a contract is to be created both parties must intend to enter into a legal relationship. If the situation is not obvious there are two rebuttable presumptions which can be applied.

(A presumption means that the claimant in the action need not prove certain matters on a 'balance of probabilities' basis; the court assumes that they exist).

Domestic agreements

It is presumed there is no intention to be legally bound in a social or domestic arrangement.

This presumption can be rebutted or overturned by showing that there was clear evidence that the parties did intend to create legal relations.

Illustration 14 – Intention to create legal relations

BALFOUR v BALFOUR 1919

Facts:

Mr. Balfour, who was about to go abroad, promised to pay his wife £30 per month in consideration of her agreeing to support herself without calling on him for any further maintenance. The wife said the husband was contractually bound by the promise.

Held:

There was no legally binding contract between the parties. It was a domestic arrangement and it was presumed the parties did not intend to be legally bound.

The presumption is also rebutted if the agreement is between spouses where the parties were not living together happily at the time of the agreement.

Notes

Illustration 15 – Intention to create legal relations

MERRITT v MERRITT 1970

Facts:

A husband who was separated from his wife promised to transfer the house into her name if she paid off the outstanding mortgage debt. The wife paid off the debt but the husband refused to transfer the house.

Held:

In this case, the husband's promise was enforceable, the agreement having been made when the parties were not living together amicably.

Commercial agreements

It is presumed that there is an intention to enter into legal relations in a commercial agreement.

Again, it is possible to rebut this presumption if a contrary intention is clearly expressed in the agreement itself, but the courts are very reluctant to do so.

Notes

6 Privity of contract

The term 'privity of contract' means that only a person who is a party to a contract has enforceable rights or obligations under it:

Exceptions

- The Contracts (Rights of Third Parties) Act 1999 allows a person who is not a party to a contract to enforce it as long as the contract was for his benefit and he was identified expressly by name or description. In addition the contract must expressly allow the third party to enforce the term.
- A contract between two parties may be accompanied by a collateral contract between one of the parties and a third person relating to the same subject matter.
- Under the rules of land law, restrictive covenants run with the land to which they relate i.e. that a future owner will be subject to restrictions made in previous contracts.
- Insurance law allows a third party to take the benefit of a contract of insurance. For example where the policy is for life insurance which will pay out to a third party in the event of the policy holder's death.

Trust law allows a beneficiary to enforce a trust.

- Agency law allows an agent to make a contract between his principal and a third party, even though the third party may be unaware that he is acting as an agent. Agency is covered later in chapter 5.
- An executor can enforce contracts made by the deceased for whom he is acting.

Notes

7 Contractual terms

Contractual terms and representations

A statement made during negotiation may be a term or merely a representation:

- It is important to know whether the statement is a term or a representation because the remedies available to a wronged party will be different.
- If the representation is included in the contract as one of its terms and it is then found to be untrue the party misled has a remedy for breach of the term as well as for the misrepresentation.
- If the representation is not a term of the contract the party misled can only claim remedies for the misrepresentation.
- A term is part of the contract.
- A representation is something said by the offeror to induce the offeree to enter into the contract. It becomes a term once it is included in the written contract or is an important part of the contract i.e. one on which the other party relies.

Notes

Express terms

These terms are the elements of a contract which have been specifically agreed. They can be written, oral or a combination of the two.

Such terms are specifically inserted into the contract by either or both parties.

They must be clear for them to be enforceable.

Illustration 16 – The terms of the contract

SCAMMELL v OUSTON 1941

Facts:

An agreement provided for the balance of the price to be paid ....`on hire purchase terms over a period of two years'….

Held:

The words 'hire purchase terms' were considered too imprecise as the seller had a range of such terms.

Implied terms

These are terms which are not expressly included but are still part of the contract. They can be implied in the following situations:

Terms implied due to the type of contract

The courts will imply certain terms to certain types of contract because they are felt to be an implicit requirement of that type of contract.

Notes

Terms Implied by the courts in order to give business efficacy

If the parties have failed to cover a matter which, when addressed, would make the agreement unworkable, the courts imply a term to carry out the parties' presumed intentions.

Terms to comply with custom and usage

The courts will imply terms into contracts if they are felt to be usual in that type of agreement, but only if it will not create an inconsistency with the express terms.

Terms implied by Acts of Parliament

The Consumer Rights Act 2015 came into force on 1 October 2015 making consumer rights clearer and easier to understand. The legislation covers:

- what should happen when goods are faulty
- what should happen when digital content is faulty
- how services should match up to what has been agreed, and what should happen when they do not, or when they are not provided with reasonable care and skill
- unfair terms in a contract (more coverage in Section 8: Exclusion Clauses, which also explains which types of contracts are classed as "consumer contracts").

Sale of goods

When a product is sold it must be of satisfactory quality, fit for purpose and as described.

Goods shouldn't be faulty or damaged when you receive them. The test would be what a reasonable person would consider satisfactory for the goods in question. For example, bargain-bucket products won't be held to as high standards as luxury goods.

Notes

The goods should be fit for the purpose they are supplied for, as well as any specific purpose you made known to the retailer before you agreed to buy the goods.

The goods supplied must match any description given to you, or any models or samples shown to you at the time of purchase.

If goods which are purchased are faulty the following remedies are available:

- Up to thirty days – an immediate refund.
- Up to six months – the right to have the item repaired or replaced. If the attempt to repair or replace the item is unsuccessful the consumer has the right to a refund or a price reduction if they wish to keep the product. The goods are presumed to have the fault when they were purchased and the onus is on the seller to prove that the fault was not present at the time of purchase.
- Up to six years – if the goods do not last a reasonable length of time the consumer may be entitled to some money back. The burden is on the consumer to prove that the product was faulty at the point of purchase.

Sale of services

A service must be carried out with reasonable care and skill. In practice this means that a service must be carried out to the same or similar standard to that which is considered acceptable within their trade or profession. Industry standards within a particular service sector, relevant codes of practice and even the law (such as building regulations and credit legislation) are useful benchmarks to consider when deciding whether a service has been carried out with reasonable care and skill.

If a service has not been provided with reasonable care and skill the following remedies are available:

- Right to repeat performance – where a service is not carried out with reasonable care and skill then the service must be performed again so that it conforms with the contract. The repeat performance should be carried out within a reasonable time, without significant inconvenience and at no cost to the consumer.
- Right to a price reduction – if repeat performance of a service is impossible or it cannot be carried out within a reasonable time or without causing significant inconvenience, then the consumer is entitled to a price reduction. This can be a full refund, for example, where the consumer has had no benefit from the service and it will need to be started again. A price reduction can be calculated by comparing the difference between the contract price and the value of the service actually performed.

Sale of digital content

Digital content refers to data which are produced and supplied in digital form such as software, e-books, music, films and 'apps'.

As with goods there is a requirement that the digital content must be of satisfactory quality, fit for purpose and as described.

The remedies available under the Act are:

- Right to repair or replacement – this must take place within a reasonable time and without significant inconvenience to the consumer.
- Reduction in price – this is only triggered if the remedies of repair and replacement are not possible or the seller has not complied with the right to a repair or replacement within a reasonable time.
- Repair of damage – the consumer has a right to compensation or repair in respect of any damage caused by the faulty content to a device or to other digital content.

Notes

Illustration 17 – Terms implied to give business efficacy

THE MOORCOCK 1889

Facts:

There was an agreement by a wharf owner to allow a ship owner to unload his ship at the wharf. The ship was damaged at low tide when it hit a hard ridge on the bottom of the river.

Held:

The court implied a term into the agreement that the river bottom would be reasonably safe.

Illustration 18 – Terms implied due to legislation

The Partnership Act 1890 – in the absence of an express provision to the contrary profits will be shared equally between the partners.

Notes

Types of terms

There are three types of terms:

- conditions
- warranties
- innominate terms.

The distinction between the types of terms is important because it determines the remedies that may be available in the event of a breach.

Conditions

A condition is an important term going to the root of the contract.

Breach of the condition can result in damages or discharge or both. Discharge entitles the innocent party to repudiate the contract and claim damages.

Illustration 19 – Conditions

POUSSARD v SPIERS & POND 1876

Facts:

A soprano, Madame Poussard, agreed to sing in a series of operas for Spiers. She failed to appear on the opening night and Spiers refused her services for subsequent nights.

Held:

The obligation to appear on the opening night was a condition. Spiers was entitled to treat the contract as at an end and was therefore not himself in breach by refusing her services for the remaining nights.

Notes

Warranties

A warranty is a less important term, which is incidental to the main purpose of the contract.

Breach of warranty results in damages only.

Illustration 20 – Warranties

BETTINI v GYE 1876

Facts:

A tenor, Bettini, who agreed to sing in a series of concerts and to attend six days of rehearsals beforehand failed to appear for the first four rehearsal days. Gye in consequence refused Bettini's services for the balance for the rehearsals and performances.

Held:

The obligation to appear for rehearsals was a warranty and therefore Bettini's breach did not entitle Gye to treat the contract as at an end. Gye was accordingly in breach of contract when he refused Bettini's services for the remainder of the contract.

Innominate terms

An innominate term is neither a condition nor a warranty.

The remedy depends on the effect of the breach:

- if trivial – damages only i.e. term is treated as if it were a warranty.
- If serious – damages, discharge or both i.e. term is treated as if it were a condition.

Notes

8 Exclusion clauses

Often terms are included in written contracts in an attempt to exclude or limit liability for a breach of contract. These terms are known as exclusion clauses or exemption clauses.

The law has tended to look unfavourably on such clauses and has developed various rules to protect weaker parties from those in a stronger bargaining position whilst allowing freedom of contract.

Any exclusion clause will be interpreted strictly against the party seeking to rely on it.

In order for an exclusion clause to be valid it must pass tests which have been developed in two ways:

Common law tests

The exclusion clause will only be enforceable if has been properly incorporated into the contract and if the wording of the clause covers the loss suffered by the claimant.

Incorporation

The clause needs to be an integral part of the contract. An exclusion clause can be incorporated by:

- Signature

  If the claimant has signed a document containing the clause then they will be bound by the clause. This rule applies even if they have not read the document (as long as the other parties do not misrepresent what the clause covers).

- Notice

  If the defendant takes reasonable steps to bring the clause to the claimant's attention then the clause will be held to have been incorporated. This must have happened at the time of the agreement or before.

Notes

Illustration 21 – Incorporation

OLLEY V MARLBOROUGH COURT 1949

Facts:

Mr Olley and his wife booked a hotel room. When they got to the room there was a notice denying liability for loss or damages to personal belongings.

Held:

The clause was not incorporated as it was brought to the party's attention after the agreement was entered into.

- Previous dealings

  For an exclusion clause to be incorporated by previous dealings, there must have been a consistent course of dealings between the parties.

Interpretation

The defendant will only be able to rely on an exclusion clause of it covers the loss the claimant has suffered. In the case of any ambiguity the clause will be interpreted **against** the person trying to rely on it.

Notes

The statutory rules

If a clause passes the common law rules it must also satisfy the statutory rules namely under:

- The Unfair Contract Terms Act 1977
- The Consumer Rights Act 2015

The Unfair Contract Terms Act 1977 (UCTA) applies to exclusion clauses in contracts made in the course of a business.

It states that a clause exempting liability for

- Death or personal injury due to negligence is **void**.
- Other loss due to negligence is **void** unless reasonable.

The party seeking to rely on the clause has to prove that it is reasonable and to help the courts decide there are various matters to take into consideration such as the strength of the bargaining parties, whether the buyer received any inducement to agree to the term, whether the buyer knew or ought to have known about the term and the ability of the party to insure against liability.

The Consumer Rights Act works applies to terms in a contract where the seller is acting in the course of a business and the other party is a consumer. The Act states that terms in contracts between a consumer and a business must be 'fair'.

When considering whether a term is 'fair', a number of factors will be considered including:

- Does the clause put the consumer at a disadvantage?
- Were any relevant circumstances when the contract was signed?
- What is the nature of the contract itself?
- Is the clause stated in plain, intelligible language?
- Are any relevant terms prominent?

The test is whether an average consumer who is reasonably well-informed, observant and circumspect would be aware of the term.

If such a term is unfair it will not be binding on the consumer, though the consumer will still be able to rely on any such terms against the business.

Notes

9 Discharge of contract

A contract can be brought to an end in several ways:

- By Performance

This is the way in which most contracts are discharged: both parties perform their obligations under the contract.

- By Frustration

Where, after the contract is made, it becomes impossible to perform.

- By Breach of contract (see below)

Notes

10 Breach of contract

Actual breach of contract

Actual breach occurs at the time performance of the contract was due and happens when:

- One party fails to put forward any sort of performance.
- The performance put forward is so inadequate the injured party is substantially deprived of the whole benefit of the contract.

Anticipatory breach

This takes place where, before the due date for performance of the contract, one party states or shows by his actions that he will not be performing the contract.

Anticipatory breach occurs when:

- One of the parties declares before the date of performance that he has no intention of carrying out his duties. This is known as **express anticipatory breach**.
- One of the parties does something which makes the performance of the contract impossible. This is known as **implied anticipatory breach**.

Notes

- There are two options available to the injured party when an anticipatory breach takes place:
  - The contract may be treated as being discharged immediately and the injured party may sue for damages.

Illustration 22 – Breach of contract

HOCHSTER v DE LA TOUR 1853

Facts:

Hochster was engaged as a courier on a European tour. Before the contracted period was due to start he was informed that his services were no longer required.

Held:

Hochster was entitled to claim for payment as soon as he was aware of the anticipatory breach.

  - The injured party may continue with his obligations under the contract until such time as there is an actual breach of the contractual terms.

Illustration 23 – Breach of contract

WHITE & CARTER (COUNCILS) LTD V MCGREGOR 1961

Facts:

M contracted with the claimants to have advertisements put on litter bins. He then wrote to them asking them to cancel the contract. The claimants refused and displayed the adverts.

Held:

The claimants were entitled to carry on with the contract and did not have to accept the defendant's anticipatory breach. They could then claim the agreed price under the contract.

Notes

11 Damages

Damages are a common law remedy. They are the main remedy for breach of contract. If a contract has been breached they are available as a right. They are intended to put both parties in the position they would have been in **had the contract been properly performed**.

If there is no provision in the contract for damages the court will determine the damages payable on the basis of the principles below. Such damages are known as UNLIQUIDATED DAMAGES.

Remoteness

The basic rule is that damages are awarded to compensate the injured party for loss arising from the breach.

The first issue is 'remoteness' of damage since it may not be justifiable to blame the party at fault for all of the consequences of their actions. Damages will only be rewarded for losses which are not too remote.

Illustration 24 – Damages

HADLEY v BAXENDALE 1854

Facts:

C owned a mill. One of the mill parts had broken and C made a contract with D for the transport of the old part to London as a pattern for making a replacement. D was responsible for a delay in delivering the part and as a result the mill was closed for a longer duration than would have been necessary if there had been no delay. C claimed for loss of profits during the period of delay.

Held:

D did not know that the mill was inoperable without the part and whilst he was directly responsible for the delay itself, that stoppage was not a natural consequence of delay in transportation. C could have had a spare part and did not alert D to the fact that the mill would be inoperable until the new part was made. Accordingly, D was not liable for the loss of profit.

Notes

The rule in HADLEY v BAXENDALE

The case of Hadley v Baxendale established that there are two types of loss that can be recovered:

- Losses which are a natural consequence of the breach.
- Losses which were in both parties' contemplation as a possible consequence at the time of the agreement. Where losses are not reasonably foreseeable, the party in breach of contract will only be liable for them if he knew at the time of the contract that such losses could arise in these particular circumstances.

Illustration 25 – Damages

VICTORIA LAUNDRIES v NEWMAN 1949

Facts:

A delay in the delivery of a boiler caused the loss of the normal trading profit plus an extra-large profit on the loss of a government contract.

Held:

The loss of the normal profit could be claimed but not for the government contract since this was not made known to the defendant and was therefore too remote.

Damages are not usually recoverable for loss of enjoyment

On very rare occasions the court will award damages for mental distress where that is the main result of the breach. Recent decisions have shown that the court is prepared to recognise 'peace of mind' obligations in contracts.

Measure of damages

The second issue to be considered is the financial value of the claimant's loss. The courts will usually value damages as the cost to put the claimant back in the position they would have been if the contract had been properly performed. This is often referred to as protecting the 'expectation interest' of the claimant (injured party).

Notes

Damages for loss of bargain

If a buyer bought goods for £50 which the seller refused to deliver, the buyer's damages would be the cost to him of acquiring the same goods from someone else. So, if he had to pay £60 his damages would be £10.

If a buyer refused to accept the goods from the seller the seller's damages would be the difference between the contract price and the final selling price, if this were lower due to market forces.

If the claimant has suffered no actual loss he will be awarded only NOMINAL damages.

Reliance losses

These enable the claimant to recover compensation for expenses incurred in performing his part of the contract before the breach occurred. They may be claimed where such losses exceed any likely profit.

Illustration 26 – Damages

ANGLIA TELEVISION v REED 1972

Facts:

R was engaged to play a leading role in a T.V. play. The claimants incurred expenses in preparing for filming and R then pulled out at the last moment and the project was abandoned.

Held:

R was liable for the expenses. He was not liable for any projected profit since it is impossible to tell whether the film would have been a success or a failure.

Mitigation of Loss

When calculating the level of damages to be awarded, the court will assume that the claimant had taken all steps that could reasonably be expected to mitigate (reduce) his loss.

Notes

Liquidated damages and Penalty clauses

Where a contract provides for the payment of a fixed sum on breach it may be either LIQUIDATED DAMAGES or a PENALTY CLAUSE.

Liquidated damages are a genuine pre-estimate of the expected loss and are enforceable by the court.

A penalty clause imposes a sum which is arbitrary or excessive and it will not usually be enforceable. Instead the courts will act as if there is no provision in the contract and as with unliquidated damages they will value the claimant's losses.

A sum is presumed to be a penalty clause if:

- The amount is out of proportion to the potential losses
- The same amount is given for a number of potential losses.

Illustration 27 – Damages

FORD MOTOR CO (ENGLAND) LTD v ARMSTRONG 1915

Facts:

The defendant had entered into a contract with Ford within which they agreed to not sell Ford's cars at less than the list price. A £250 penalty was given in the contract for each breach of this provision.

Held:

As the same amount was given for a number of different breaches within the contract this was held to be a penalty clause and as such was not enforceable.

Notes

In recent cases the courts have been willing to grant the amount contained in what appears to be a penalty clause if they can prove there is a legitimate reason for charging the excess above the party's actual loss likely to be suffered. In this case the court will treat the amount as if it is not a penalty.

Illustration 28 – Penalty clauses

PARKINGEYE LIMITED V BEAVIS 2015

Facts:

ParkingEye managed a car park. At the car park signs were displayed stating that customers could have two hours free parking but if they stayed after that an £85 charge would be levied. Mrs Beavis stayed for almost three hours.

Held:

The charge was given as a deterrent, not a penalty. The court held the amount was given to allow the claimants to manage the car park in the best interests of all users by preventing visitors from overstaying. As such Mrs Beavis had to pay.

Notes

12 Other common law remedies

Action for the price

If the breach of contract arises out of one party's failure to pay the contractually agreed price, then the creditor should bring an action to recover that sum.

If the contract is for the sale of goods, the action may only be brought if the property has passed to the buyer, unless the price has been agreed to be payable in a specific date.

Quantum meruit

Under this remedy, the value of the contractual work which has already been performed is measured.

This remedy is likely to be sought where one party has already performed part of his obligations and the other party then repudiates the contract.

Notes

13 Equitable remedies

The court can decide whether or not to award an equitable remedy, unlike damages which must be paid if a party proves their case.

Equitable remedies are a discretionary remedy and will not be granted if:

- Damages are an adequate remedy
- The claimant has acted unfairly
- The claimant has unduly delayed bringing an action to court.

Specific performance	Requires someone to perform their contractual obligations. Not available for personal service contracts. It enforces positive covenants within the contract.
Injunction	Orders someone to do something or not to do something. It enforces negative covenants within the contract.
Rescission	Restores the parties to their exact pre-contractual position.

Notes

Questions

You can now attempt the following from the Text:

Chapter 2 TYUs 1–8

Chapter 13 Qs 6–16

Chapter 3

The law of torts

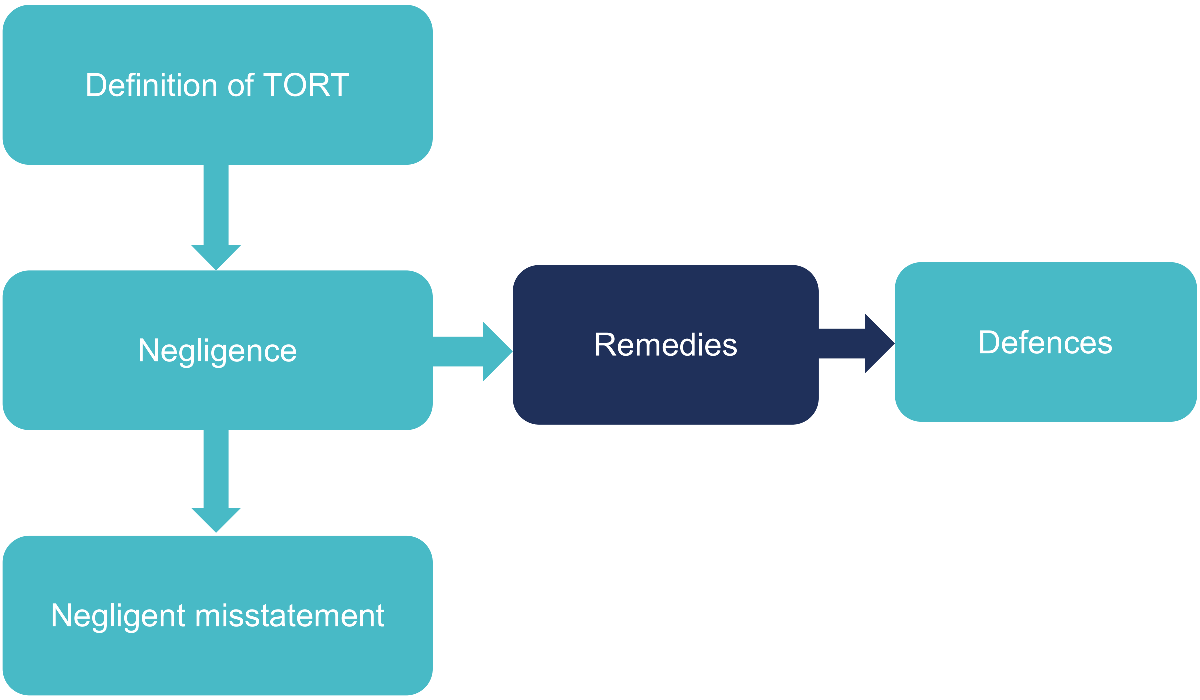
Chapter learning objectives

Upon completion of this chapter you will be able to:

- define a tort and show how it is different from a contract
- explain the elements of negligence
- discuss defences to an action in negligence
- relate the basic principles to accountants
- explain the basics of passing off.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 3 of your Study Text

Overview


Definition of TORT
Negligence
Remedies
Defences
Negligent misstatement

1 Understand the nature of the law of tort

What is a tort?

As a tort is a breach of a legal duty, there is no liability unless the law recognises that the duty exists.

Differences between contracts and torts

A contractual relationship does not have to be established for a claim in tort to be successful. Often the parties have never even met before. For example, in a claim for personal injury as a result of a road accident, the parties will often have had no previous relationship at all.

However, if a contract does exist and a tort has been committed, the claimant may choose the remedy most appropriate.

There are two options:

- Under a valid contract, the amount of damages awarded is intended to put the claimant back in the position he would have been in had the contract been properly performed.
- In tort, the amount of damages awarded is intended to put the claimant in the position he would have been in had the tortious act never taken place.

Limitation periods

- In contract the limitation period is six years from the breach of contract.
- In tort the limitation period is generally six years, but three years for personal injury.

Notes

The main elements of a tort

In order to be successful in an action for tort, the following conditions must be satisfied:

- There must be an act or omission by the defendant.
- The act or omission must have directly caused damage or injury to the claimant.
- The courts must be able to establish a legal liability as a result of the damage.

A claim will only be successful if the damage or loss suffered is not “too remote” i.e. the damage or loss must be as a direct consequence of something the defendant did or did not do.

Notes

2 Negligence

Negligence is the breach of a legal duty to take care, which results in damage to another.

In order for an action in negligence to succeed, the claimant must prove the following:

- That a duty of care was owed to him by the defendant
- The defendant breached that duty
- As a consequence of that breach, damage or loss has been suffered.

Notes

Duty of care

There is a duty to take reasonable care not to cause foreseeable harm to others.

The 'neighbour principle'

The case of Donoghue v Stevenson (below) was the first to establish that a duty of care may be owed to a person, even where no contractual relationship exists.

Prior to this case, the belief was that to allow an action to be taken where there was no contractual relationship would undermine the principles of contract law. The doctrine of privity states that only parties to a contract can sue or be sued.

Donoghue v Stevenson changed this principle and, as a result, manufacturers of goods owe a duty of care to the ultimate consumer of the product.

Illustration 1 – Negligence

DONOGHUE v STEVENSON 1932

Facts:

A bottle of ginger beer was purchased in a café. Donoghue drank part of it then discovered the remains of a decomposing snail in it. As a result she became severely ill. The manufacturer claimed that as there was no contractual relationship between himself and the claimant he did not owe her a duty of care.

Held:

Everyone owes a duty of care to their 'neighbour', to 'persons so closely and directly affected by my act that I ought to have reasonably have had them in contemplation as being so affected.' Thus a manufacturer owes a duty of care to a consumer of their product.

Notes

Economic or financial loss

The case of Donoghue v Stevenson established that an action could be taken if **physical damage was suffered**. However, prior to 1964, the law did not recognise any action if only economic or financial loss was suffered. Therefore, if negligent advice was relied upon and as a result of that advice a loss (other than a physical one) was suffered, no claim could be made.

The case of Hedley Byrne v Heller modernised the law in this area. The House of Lords refined the neighbour principle by acknowledging that a claim for financial loss suffered could be made if a “special relationship” existed between the claimant and defendant (see part 3).

Notes

The limits of the duty of care

In the case of **The Nicholas H (Marc Rich & Co v Bishops Rock Marine) 1995**, four tests were laid down which should be followed in determining whether a duty of care exists.

The issues to be considered are:

- Was the damage reasonably foreseeable by the defendant at the time of the act or omission?
- Is there a neighbourhood principle or sufficient proximity (closeness) between the parties?
- Should the law impose a duty of care between the parties i.e. is it fair and reasonable to do so?
- Is there a matter of public policy which exists or requires that no duty of care should exist?

The Nicholas H case focused on financial loss, but these tests should also be applied when determining the duty of care for physical damage cases.

Illustration 2 – Negligence

A was given an iPod for his birthday by his uncle. Due to a design defect, it set fire to his bedroom and caused damage to carpets and furniture. A was made ill by smoke inhalation. A is entitled to claim damages from the iPod manufacturer for:

- Pain and suffering caused by smoke inhalation
- Any loss of earnings whilst he recovers
- The cost of replacing furnishings and redecoration.

He is not entitled to claim the cost of replacing the defective iPod which would be pure economic loss.

The defect does not give rise to the liability: it is the resultant damage to person or property.

Notes

Breach of duty of care

In order for a claim to be successful, a claimant must not only prove that a duty of care existed, but also that the duty was breached by the defendant.

Was there a breach?

Establishing if there has indeed been a breach is a question of fact. Each case must be viewed separately on its own facts.

It is usually up to the claimant to prove that there has been a breach, or in other words that the defendant did not take reasonable care. In some circumstances, the facts of the case speak for themselves. This is referred to as the principle of **res ipsa loquitor**. In these situations it is felt that the fact there is a harm shows there must have been a breach.

The claimant will then have to show that the 'res' or 'thing' which caused the damage was in the control of the defendant and the defendant has to prove that the cause of the injury was not his negligence (in other words the burden of proof shifts from the claimant to the defendant).

Notes

The standard of care

This is a question of law. Basically, the claimant must show that the defendant failed to take the degree of care which a reasonable man would have taken in the circumstances (the 'man on the Clapham omnibus').

The reasonable man is not expected to be skilled in any particular trade or profession BUT if he acts or purports to act in a professional capacity he must show the care and skill of someone of that profession.

The following principles have been established by case law:

- Particular skill
  - As a general rule, the level of skill and care required is that which a reasonable man would possess. However, if the defendant possesses a particular skill, i.e. he is a qualified solicitor or a qualified surveyor, the standard of care expected will be that of a reasonable person with that skill.
- Lack of skill
  - Lack of training or the peculiarities of the defendant are not relevant. Therefore, the standard of skill expected from a trainee accountant is the same as that of any reasonable accountant.
- Lack of hindsight
  - The tests focus on the defendant's knowledge at the time. Therefore, hindsight or knowledge of facts at a later date is irrelevant.

Notes

Illustration 3 – Negligence

ROE v MINISTER OF HEALTH 1954

Facts:

A doctor administered an anaesthetic using all normal precautions at the time of his actions. The patient was paralysed due to contamination of the anaesthetic due to contamination in a way not discovered until later.

Held:

The doctor could not be judged against information that was not available at the time of his actions. He had followed proper practice at that time.

- Body of opinion
  - A professional is expected to follow the general practice and body of opinion in that area.
- Advantage and risk
  - When deciding if reasonable care has been taking the courts will weigh up the benefit and risk of the defendant's actions.
- Emergency
  - If an emergency situation caused the defendant to act negligently, this will be taken into consideration.
- Vulnerability
  - If the claimant is vulnerable and the defendant is aware of this vulnerability, then a higher standard of care is expected.

Notes

Illustration 4 – Negligence

PARIS v STEPNEY BOROUGH COUNCIL 1951

Facts:

Paris was employed by the council on vehicle maintenance. It was not normal practice to supply the workers with protective goggles when working. Paris was already blind in one eye. Whilst working a chip of metal flew out and hit him in his good eye rendering him completely blind.

Held:

Paris was especially vulnerable to injury and as such a higher standard of care was owed to him than to other workers.

Loss caused by the breach

A claimant must demonstrate that he has suffered loss or damage as a direct consequence of the breach. If he cannot prove this he will not be entitled to damages.

The claimant must establish a causal link between the defendant's conduct and the damage which occurred:

- If the damage was caused by something or someone else there will be **no liability** on the defendant's part.
- If the claimant would have suffered the loss regardless of the defendant's conduct then he has not caused the loss.

Notes

Illustration 5 – Negligence

BARNETT V CHELSEA & KENSINGTON HOSPITAL 1969

Facts:

Barnett attended the hospital complaining of severe stomach pains and vomiting. The doctor on duty didn't examine him but told the nurse to send him home and tell him to contact his GP the next day. Mr Barnett was suffering from arsenic poisoning and died during the night.

Held:

By the time Barnett attended the hospital his symptoms were too advanced and there was nothing the hospital could have done to prevent his death. There was no causal link between the hospital's breach and his death and as such they were not liable to his wife.

- If something happened after the defendant's breach that caused or contributed to the damage then the defendant's liability will cease at that point.

The following losses are normally recoverable:

- Loss as a result of personal injury
- Damage to property
- Financial loss directly connected to personal injury (i.e. loss of wages).

Pure financial loss is very rarely recoverable.

Notes

Illustration 6 – Negligence

SPARTAN STEEL ALLOYS v MARTIN CO CONTRACTORS 1972

Facts:

The claimant was halfway through smelting a steel ingot when a cable was damaged by the defendant, causing the electricity supply to be cut off.

Held:

The claimant was entitled to damages for the damaged ingot (physical harm) and the loss of profit on that ingot (financial losses due to physical harm). However, they were not entitled to damages for the lost profits due to the general disruption to the business as these were purely financial in nature.

- Even where the claimant is able to show the loss was suffered as a result of the defendant's breach the court will not allow recovery of that loss if it is considered to be too remote (see part 4 below).

Notes

3 Professional advice and negligent misstatement

In practice there is no difference between liability arising from negligent misstatement and liability arising from negligent acts. A party can suffer damage by reliance on incorrect advice just as he can be injured by any other negligent conduct.

With respect to a negligent statement however, the consequences of this could be far-reaching and affect countless people. Because of this the law had been reluctant to impose a duty of care in the making of statements.

This situation changed in 1963 when the landmark case set out below marked a new approach to the law of negligent misstatement.

Illustration 7 – Professional advice and negligent misstatement

HEDLEY BYRNE & CO LTD v HELLER & PARTNERS LTD 1963 Facts:

The claimant, an advertising agency, acted for E Ltd. The claimant requested information from E Ltd's bank on the creditworthiness of E Ltd. The bank gave favourable references but included a disclaimer (exclusion clause) saying the information was given without responsibility.

The claimant extended credit to E Ltd and lost money when the company went into liquidation. The claimants sued the bank for negligence.

Held:

The bank's disclaimer was adequate to exclude a duty of care.

The House of Lords went on to consider whether there could ever be a duty of care to avoid causing loss by negligent misstatement where there was no contractual or fiduciary relationship.

They decided that the bank was guilty of negligence, having breached the duty of care, because a 'special relationship' existed. Had it not been for the exclusion clause they would have been held liable (it is likely that the clause would nowadays have fallen foul of the UCTA 1977).

Continued

Lord Morris said the following: ‘If someone possessed of a special skill undertakes….to apply that skill for the assistance of another person who relies on that skill, a duty of care will arise…if, in a sphere in which a person is so placed that others could reasonably rely on his skill…a person takes it upon himself to give information or advice to…another person who, as he knows or should know, will place reliance on it, then a duty of care will arise.’

The effect of HEDLEY BYRNE

The above case created a new duty situation by recognising liability for negligent misstatement causing economic loss in circumstances where there exists a ‘special relationship’ between the parties.

Cases involving negligent misstatement are usually concerned with establishing whether or not a duty arises and it is difficult to establish clear principles to apply as the law has evolved on a case-by-case basis.

Notes

The meaning of special relationship

For an action in negligent misstatement to succeed there must be a special relationship. The considerations outlined in the **NICHOLAS H** case will still be relevant.

To identify if there is a special relationship between the parties three elements must be considered:

- Was the defendant in the business of giving professional advice?
- Was the advice given in a business context rather than a social context?
- Did the defendant know (or should they have known) that the claimant in particular would rely on the advice? This requires the court to consider the purpose for which the statement was made.

Where there is no special relationship

If there is no special relationship between the parties there is no duty of care.

This concept has been particularly considered when looking at the audit of a company. As a general rule, however, unless the defendant had prior knowledge that a certain bidder would rely on the statement made, no duty of care would exist. The duty is owed to the shareholders as whole and not individual bidders.

Notes

Where there is a special relationship

- If advice is given or financial statements prepared for a specific purpose, then a duty of care is owed to those who are relying on them for that specific purpose.

Illustration 8 – Professional advice and negligent misstatement

MORGAN CRUCIBLE v HILL SAMUEL BANK LTD 1991

Facts:

MC made a bid for X Ltd. X Ltd issued circulars containing profit records and forecasts recommending that its shareholders reject the bid. MC increased its bid and on the board of X Ltd's recommendation the bid succeeded.

MC discovered the issued circulars grossly overstated the profits and X Ltd was in fact worthless. MC sued X Ltd, their bank, directors and accountants for negligence in respect of the circulars.

Held:

The claim succeeded:

- The bidder had been identified to the defendant
- It was intended the bidder should rely on the accounts
- Express representations had been made to the bidder by the defendant
- Where a statement is made confirming the veracity of audited results or auditors give specific assurances to a third party they are liable to that third party if the assurance is given negligently.

Notes

4 Remedies and defences in negligence

Remedies in an action in negligence

The principal remedy in any case involving negligence will be an award of damages.

The damage caused to the claimant must be of a type that is ‘reasonably foreseeable’.

If the type of damage is reasonably foreseeable the defendant is liable. It is irrelevant that the defendant might not have been able to foresee its cause or its severity.

Notes

Defences to a claim in negligence

There are four main defences to a charge of negligence:

Contributory negligence

If the claimant is partly responsible for his own injuries, the defendant can plead the defence of contributory negligence. The court may then reduce any damages it awards to the claimant depending on the degree to which he is judged responsible for his loss.

Many of the cases on this defence involve road accidents where for example the claimant was not wearing a seat belt or a crash helmet.

Volenti non fit injuria

This applies where the claimant has freely consented to the risk of loss or damage due to the defendant's actions. It amounts to an agreement by the claimant to exempt the defendant from a duty of care that he would otherwise owe.

Volenti does not apply merely because the claimant had knowledge of the risk. They must have taken action to show that they consented to having no legal redress.

Notes

Novus actus interveniens

Where there is a new intervening act this may break the chain of causation removing liability from the defendant. There are three types of intervening act that will break the chain of causation.

1 Act of the claimant

Where the new intervening act is that of the claimant, the test is whether the claimant acted reasonably in the circumstances. If the claimant's actions are deemed reasonable the chain of causation remains intact and the defendant is liable for the actions of the claimant. If, however, the claimant's actions are unreasonable in the circumstances the chain of causation is broken and the defendant is not liable for the actions of the claimant.

2 Act of a third party

Where the new act is of a third party, the test is whether the act was foreseeable. If the act of the third party is foreseeable, the defendant remains liable and the chain of causation remains intact. If the act of the third party is not foreseeable this will break the chain of causation and the defendant is not liable for the actions of the third party.

3 Natural events

An intervening natural event will normally break the chain of causation unless it can be shown that the defendant's breach has either increased the likelihood of further damage from a natural event or has made the claimant more susceptible to damage.

Notes

Exclusion clauses

An exclusion clause is a provision within a contract which seeks to exclude or limit liability for negligence. An exclusion clause may fall within the provisions of the Unfair Contract Terms Act 1977 (See Chapter 2).

If an exclusion clause is found be valid, this constitutes a viable defence against any action for negligence.

In addition, liability is excluded if it is possible to say that the act occurred in the course of nature i.e. that it was an ‘act of god’; something beyond human foresight which the defendant could not have been expected to provide against.

Notes

5 The tort of passing off

This tort protects the goodwill, reputation and profits of a business.

The tort of passing off arises:

- where one business uses a name which is similar to that of an existing business, and
- it misleads persons into believing that they are the same business, and
- it causes actual damage to that business or will probably do so.

Illustration 9 – The tort of passing off

EWING v BUTTERCUP MARGARINE CO LTD 1917

Facts:

Ewing who traded under the name Buttercup Dairy Company sued to restrain a newly registered company called Buttercup Margarine Company Ltd from using the name on the grounds that the general public might reasonably believe that there was a link between the two businesses.

Held:

The court held that the word 'Buttercup' was so closely associated with Ewing dairy products as to be likely to cause confusion if used by the similar margarine business. An injunction was granted to prevent the defendant company from trading under its name.

If passing off is proved, the court may restrain the business from trading under that name and order that damages be paid to the person whose business has suffered loss.

If a company feels than another company has a name which is too similar to its own, it may object to the Company Names Adjudicator under CA 06. The Adjudicator will consider the case and then make their decision. In most cases the Adjudicator will require a name change, and in some cases the Adjudicator may state the new company name.

Notes

Questions

You can now attempt the following from the Text:

Chapter 3 TYUs 1–6

Chapter 13 Qs 17–21

Chapter 4

Employment law

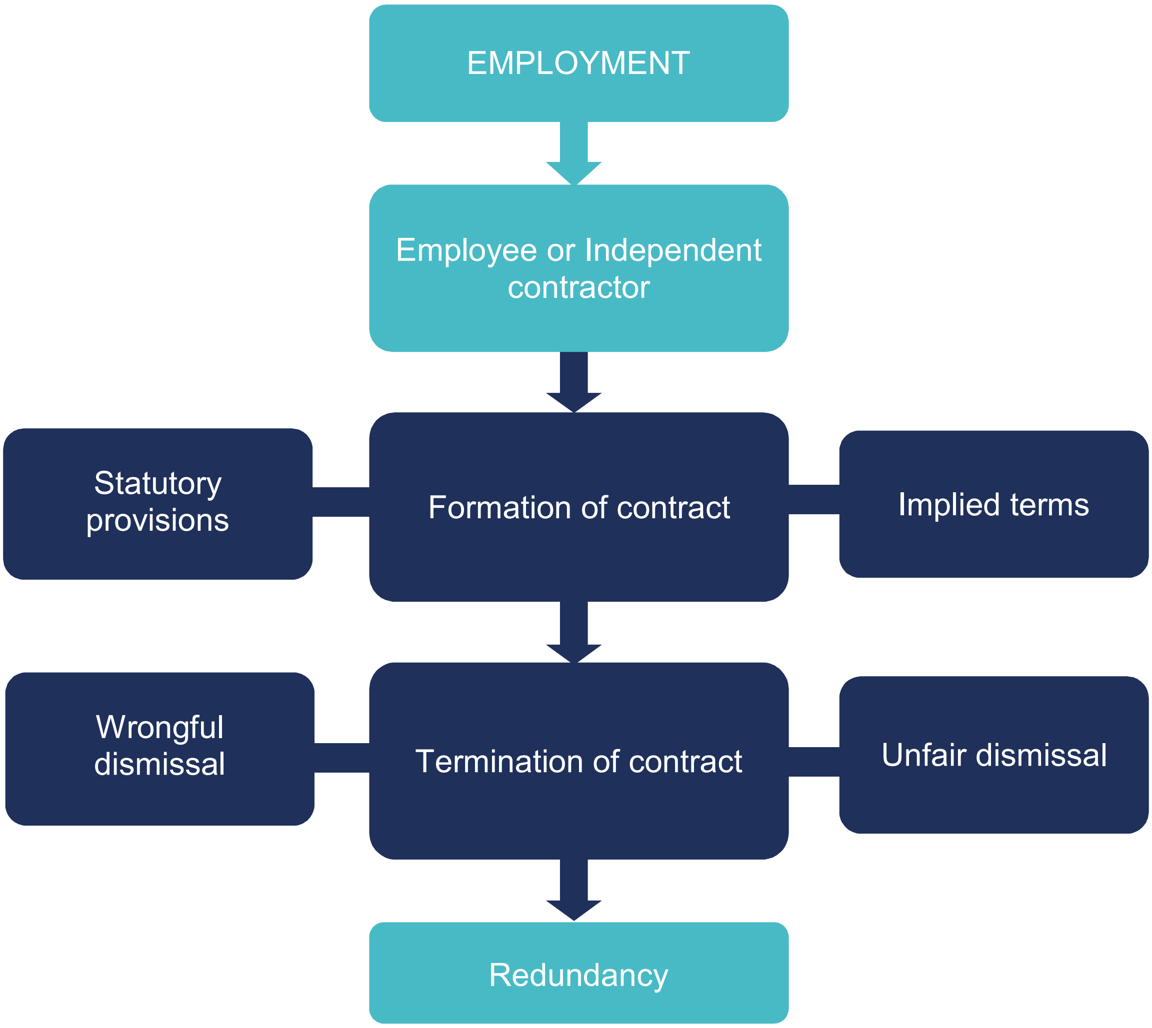
Chapter learning objectives

Upon completion of this chapter you will be able to:

- distinguish between employees and the self-employed
- explain the nature of the contract of employment and give examples of the main duties placed on the parties to such a contract
- distinguish between wrongful and unfair dismissal, including constructive dismissal
- explain what is meant by redundancy
- discuss the remedies available to those who have been subject to unfair dismissal or redundancy.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 4 of your Study Text

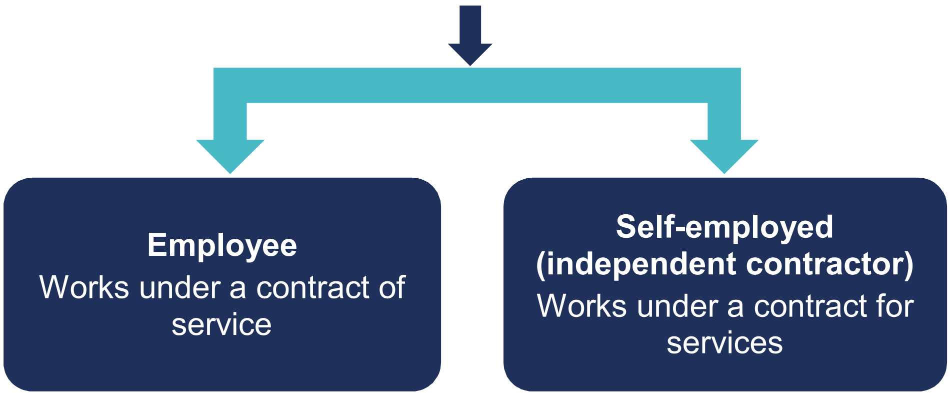
Overview


EMPLOYMENT
Employee or Independent contractor
Statutory provisions
Formation of contract
Implied terms
Wrongful dismissal
Termination of contract
Unfair dismissal
Redundancy

1 Employed or self-employed

Introduction

There are two types of working relationship:



1.2 Tests used to determine the worker's status

The courts apply a multiple test in determining if an employment relationship exists. There are three essential elements that must be present for a contract of service:

- The worker must have agreed to perform the work himself unless the employer expressly agrees to delegation.
- There must be an element of control exercised by the employer.
- There should be mutuality of obligations; the employer must be obliged to provide work (or payment if no work is available) and the employee should be obliged to perform said work when provided.

Notes

If these are not present there cannot be an employee/employer relationship. But even if the three elements are present it does not necessarily follow that the worker is an employee. To determine this, the courts will consider further factors:

- If the worker is free to delegate he is more likely to be held to be self-employed.
- If the employer provides the tools and equipment or a uniform used by the worker this suggests an employment relationship.
- If the worker can use the employer's support staff he is more likely to be classed as being employed.
- If the worker is paid net of tax this is indicative that he is an employee.
- If the worker suffers a degree of financial risk as hours and payment are irregular, this suggests the worker may be held to self-employed.
- If the employee is expected to have a level of exclusivity in their contract (they cannot work for other employers) it is more likely that they will be held to be an employee.

The court may also consider whether the parties consider the worker to be employed. However, the label applied by the parties does not by itself define the relationship.

Notes

Illustration 1 – Employed or self-employed

MARKET INVESTIGATIONS LTD v MINISTER OF SOCIAL SECURITY 1969

Facts:

A market researcher worked on a series of contracts following instructions issued by the company. She had to complete the work in a specified time but had no specified hours of work and was not given holiday or sick pay. She was free to work for others if she wished.

Held:

The Company did have some control over the manner in which she did her work and the terms of the contract were consistent with a contract of service. She did not provide her own tools and took no risk.

She was not in business 'on her own account' and was thus an employee not an independent contractor.

Notes

The importance of the distinction

The type of working relationship has a number of consequences:

- Employees receive statutory protection (e.g. unfair dismissal/redundancy).
- There are implied terms in a contract of employment (e.g. duty of obedience).
- An employer is vicariously liable for the acts of employees when they act in the course of the employer's business. The employer is not liable for the acts of independent contractors.
- On the insolvency of the employer, an employee is a preferential creditor, whereas someone who is self-employed ranks as an ordinary unsecured creditor.
- Employees receive their pay net of income tax and national insurance under the PAYE system. Independent contractors are taxed under the trading income provisions.
- Certain state benefits (e.g. statutory sick pay) are only available to employees.

Notes

2 The contract of employment

An employment contract is like any other contractual relationship. The basic rules of contract will apply. As such if a term of the employment contract is breached the parties may sue. The terms can be express or implied.

Express terms

Express terms are those agreed by the parties themselves. Their agreement may be written or oral.

A change in terms generally requires the consent of both parties, unless it is introduced by new legislation.

Sometimes an express term will give the employer the right to vary the terms of employment. For example, a mobility clause allows the employer to change the location of the employment. Such changes must, however, be reasonable.

Notes

The written particulars

The Employment Rights Act 1996 requires an employer to provide an employee with a written statement of certain particulars of their employment within **two months** of the commencement of employment.

The statement must include details of:

- The names of the employee and employer
- Pay rates and interval (i.e. weekly, monthly, etc.)
- Job title
- Hours of work
- Length of notice
- Holiday and sick pay entitlement
- Details of any pension entitlement
- Details of disciplinary or grievance procedures, and
- The date the employment commenced.

The statement does not constitute a contract, but it does provide evidence of the contents of the contract.

Terms implied by the courts

The courts imply terms into a contract of employment even if they have not been specifically agreed. These terms give additional contractual duties to the employee and the employer.

Notes

Implied duties of the employee

- Faithful service
  - The duty of fidelity is of fundamental importance. It is breached if an employee works for a competitor.
- To obey lawful and reasonable orders
  - If the employer asks him to do something and it is legal and reasonable for his job role, then he would be in breach of his employment contract if he did not do so.
- Duty to exercise reasonable care and skill
  - The employee must act with reasonable care in performing his duties. A single act of negligence will not usually justify dismissal, unless it is gross negligence.
  - An extension of this duty of care is a duty to indemnify the employer for any damages incurred as a result of the employee's negligence.

Illustration 2 – The contract of employment

LISTER v ROMFORD ICE 1972

Facts:

An employee ran over another employee (his father!) with a fork-lift truck.

Held:

The employee was liable in damages to his employer for breach of contract.

Notes

- Not to misuse confidential information
  - An employee must not disclose trade secrets to a third party nor misuse confidential information he has acquired in the course of his employment. This duty can continue even after the employment has ended.
- To give personal service
  - The employee must carry out his duties personally unless he has express or implied permission to delegate.
- Mutual co-operation
  - This is a mutual obligation imposed on both parties and is based on respect and consideration for each other.

Implied duties of the employer

An employer owes the following common law duties:

- To pay reasonable remuneration.
- To indemnify employees for properly incurred expenses.
- To take reasonable care for the safety of their employees.
- To not disclose confidential information.
- To provide work (though as long as the employer pays the employee this will usually be classed as good enough).
- To maintain mutual co-operation, trust and confidence.

Note that there is no general duty to:

- Provide work, unless payment is dependent on output, or the employee relies on publicity or needs to maintain their skills
- Provide references (but, if they do so, they must be truthful).

Notes

Terms implied by statute

ERA 1996	Gives employees certain rights, such as a right not to be unfairly dismissed, a right to a redundancy payment if made redundant and a right to a minimum period of notice to terminate the contract.
Working Time Regulations 1998	Limit the hours of work to an average of 48 a week. It also gives the right to four weeks' paid leave a year and one day off each week.
Employment Act 2002	Gives parents of children under seventeen or disabled children under eighteen the right to request flexible working arrangements. The employer must give serious consideration to such a request and can only reject it for clear business reasons. The Act also introduced paternity and adoption leave.
Equality Act 2010	Deals with protecting people from discrimination in the workplace (and in wider society). Recognises 'protected characteristics'. In terms of remuneration deals not only with pay, but other terms, e.g. holiday and sick leave. Implies an equality clause into all contracts of employment if workers of the opposite sex do the same job or a different job of equal value.
National Minimum Wage Act 1998	Imposes minimum levels of pay.

Notes

3 Wrongful and unfair dismissal

Notice

It is usually a matter of negotiation between the employer and employee how much notice is to be given in order to terminate the contract. This will usually be an express term stated in the employment contract.

The Employment Rights Act 1996 lays down certain minimum periods which apply in the employment contract. The express terms of the contract can increase these notice periods but the notice given can never be less than the statutory minimum.

The minimum notice an employer must give depends on the continuous employment period:

Continuous Employment	Minimum notice
4 weeks to 2 years	Not less than one week
From 2 years to 12 years	Not less than one week for each year of continuous employment
Over 12 years	12 weeks

The minimum notice an employee must give their employer once they have worked for them for four weeks, is at least one week.

Notes

Unfair dismissal

Unfair dismissal occurs when an employer terminates the contract without justifiable reason.

The law on unfair dismissal is governed by The Employment Rights Act 1996 as updated by the Employment Act 2008. It provides statutory protection for employees.

Litigation commences in an Employment Tribunal and on appeal on a point of law to the Employment Appeal Tribunal ('EAT'), then to the Court of Appeal and finally to the Supreme Court.

What must the employee show?

In order for a claim for dismissal to succeed, an employee must show that:

- He is a qualifying employee (he was continuously employed for more than 2 years)
- He was dismissed.

What must the employee do?

- Serve a grievance notice on the employer.

When to make the claim?

A claim must be made to an Employment Tribunal within three months of the date of termination.

What is 'dismissal'?

Dismissal can be any one of the following:

- Termination of a contract by the employer (with or without notice).
- Expiration of a fixed term contract.
- Constructive dismissal.

Notes

Constructive dismissal

Constructive dismissal occurs where an employee terminates the contract, with or without notice, by reason of the employer's conduct.

The employer's conduct must be sufficiently serious for the employee to leave at once. If he continues for any length of time without leaving, he may be regarded as having affirmed the contract. Affirmation results in him losing the right to treat himself as discharged.

Illustration 3 – Constructive dismissal

DONOVAN v INVICTA AIRWAYS 1970

Facts:

The employer put pressure on the employee, a pilot, to take abnormal risks on a flight. The employer did this three times in quick succession. Each time the employee refused. Relations with the management deteriorated and he resigned.

Held:

The employer had committed a serious breach of contract and the employee succeeded in his claim for constructive dismissal.

Illustration 4 – Constructive dismissal

SIMMONDS v DOWTY SEALS LTD (1978)

Facts:

S had been employed to work on the night shift. When his employer attempted to force him to work on the day shift he resigned.

Held:

He could treat himself as constructively dismissed because the employer's conduct had amounted to an attempt to unilaterally change an express term of the employment contract.

Notes

Automatically unfair reasons for dismissal

If a dismissal is deemed to be automatically unfair, it is not necessary to have two years continuous employment. A dismissal will be automatically unfair in the following circumstances:

- Victimisation of health and safety complainants or whistleblowers
- Pregnancy or exercise of maternity leave rights
- Trade union membership/non-membership/activities
- Assertion of a statutory right
- Unfair selection for redundancy.

Potentially fair reasons for dismissal

In order for a dismissal to be fair the employer has to show:

- The principal reason for the dismissal
- That the reason was one or more of the statutory fair reasons (see below)
- That he acted reasonably.

Notes

The statutory fair reasons for dismissal

- Capability or qualifications of the employee
- Conduct.

Illustration 5 – Unfair dismissal

STEVENSON v GOLDEN WONDER LTD 1977

Facts:

A manager took part in an unprovoked assault on another employee at a company social event held outside working hours in the company canteen.

Held:

This was a fair reason for dismissal.

- Redundancy
- Statutory restriction
- Some other substantial reason
  - If there is some other substantial reason such as an employee being married to a direct competitor or an employee in a position of trust being convicted of a criminal offence involving dishonesty.

Notes

Reasonableness

Once the Employment Tribunal has found that the dismissal was for a potentially fair reason they must then decide whether 'on the basis of equity and the substantial merits of the case' the employer acted 'reasonably'. This will be a question of fact depending on all the circumstances.

Case law shows that this 'reasonableness test' involves two questions:

- Whether the reason given was sufficiently serious to justify dismissal.
- Whether the employer adopted reasonable procedures both in coming to the decision to dismiss and in the manner of dismissal.

Illustration 6 – Unfair dismissal

The following examples would not be considered reasonable:

- If an employee was dismissed without warning (except in the most flagrant cases)
- If the dismissal was on the grounds of capability or qualifications and the employer did not allow time for improvement, training and consultation to discuss areas of difficulty
- If the employer is relying on the grounds of ill health there must be proper medical evidence
- In the case of misconduct where the employer did not fully investigate the complaint and did not listen to what the employee had to say by way of explanation or mitigation.

Notes

Remedies for unfair dismissal

The remedies for unfair dismissal are wide-ranging and will be more advantageous to an employee than an action for wrongful dismissal.

The remedies are:

- Reinstatement
- Re-engagement
- Compensation

Reinstatement

This is an order that the employee may return to their old job without any break in continuity. This would usually only be granted if it was in line with the employee's wishes.

Re-engagement

This is an order to the employer to give the employee a new job with comparable terms and seniority. This would not be given if there has been a breakdown in confidence between the parties.

Compensation

This is the usual remedy in a case of unfair dismissal. There are three types of payment: the basic award, the compensatory award and the additional or special award.

- The basic award depends on: employee's age, weekly pay and length of continuous service.
- The amount is reduced if a redundancy payment has been made or the employee caused or contributed to their dismissal.
- The award is made regardless of loss suffered by the employee and there is no duty to mitigate.

Notes

- The compensatory award
  - This is discretionary and will be an amount that is just and equitable having regard to the employee’s losses up to a statutory maximum. The losses will be assessed on the usual principles of damages for breach of contract.
- The additional award
  - This award is made if an order for reinstatement or re-engagement is ignored, the dismissal was on the grounds of discrimination or the reason for dismissal was an automatically unfair one.

Notes

Wrongful dismissal or unfair dismissal?

Unfair dismissal provides statutory protection for employees. Wrongful dismissal, however, is a common law concept that gives employees the normal protection and remedies afforded by the common law, such as an action for breach of the employment contract.

Cases are commonly brought in the County or High Court but an Employment Tribunal will have jurisdiction if the claimant is an employee (claim must be made within 3 months of dismissal and it must be for £25,000 or less).

In certain cases a claim for damages for wrongful dismissal might be preferable to a claim for compensation for unfair dismissal.

Illustration 7 – Wrongful dismissal

Examples of when wrongful dismissal claim might be preferable to a claim for unfair dismissal:

- Where the damages sought exceed the statutory maximum for unfair dismissal.
- Where the deadline for commencing an unfair dismissal claim has passed. (An unfair dismissal claim must be brought within three months of the effective date of termination; a wrongful dismissal claim can be brought within six years of the breach).
- Where the dismissal was fair, but insufficient notice was given.
- Where the employee lacks two years' continuous service.

Notes

What is wrongful dismissal?

Wrongful dismissal occurs when the employee is dismissed in breach of the employment contract. The most likely examples of this are discussed below.

Termination without notice by the employer

Dismissal without the required notice period is known as summary dismissal. Summary dismissal will be held to be wrongful unless:

- It was due to a fundamental breach by the employee
- The employee accepted shorter notice.

Illustration 8 – Wrongful dismissal

Examples of serious breaches of the contract of employment:

- Wilful disobedience of a lawful order
- Gross misconduct, for example assault on another employee. The misconduct must usually be carried out at work although, if sufficiently serious, misconduct outside work would be sufficient
- Dishonesty, where the employee is in a position of trust
- Gross or persistent negligence
- Breach of an express term of the contract or work rules where the employee has been warned that such a contravention will not be tolerated.

Whether or not summary dismissal is justified is a question of fact based on:

- The standards of ordinary people, and
- The standards prevailing at the time.

Summary dismissal also occurs where an employer is unable to continue to employ the employee, for example where:

- A personal employer dies
- An employing partnership is dissolved, or
- An employing company is wound up.

Termination without notice by the employee

This occurs where the employee repudiates the contract by leaving. This would be a breach of contract by the employee unless the employer has wrongfully repudiated the contract and the employee 'accepts' the breach by leaving (the common law equivalent of constructive dismissal).

Expiry of a fixed term contract or for a specific task

If a fixed term contract expires without notice at the end of the term there is no breach by either party. The contract has simply been performed.

If an employee is employed under a fixed term contract and is dismissed before the expiry of that term they may claim wrongful dismissal.

If an employee is employed to perform a specific task and is dismissed before the completion of the task he may claim for wrongful dismissal.

Remedies for wrongful dismissal

As wrongful dismissal focuses on a breach of the contract of employment, the normal remedy will be damages. The quantum of damages is normally based on the loss of earnings suffered as a result of the dismissal.

An employee is under a duty to mitigate the loss. Therefore, alternative work must be sought in the intervening period.

If damages are deemed not to be an adequate remedy, the court may award an injunction to prevent the breach of contract. However, this only happens in extremely rare cases.

Notes

4 Redundancy

What is redundancy?

Under s139 ERA 1996, an employee is treated as dismissed by reason of redundancy if the dismissal is wholly or mainly attributable to the fact that:

- The employer has ceased, or intends to cease, to carry on the business for the purposes for which or in the place where the employee was employed.
- The requirements of that business for employees to carry out work of a particular kind or in a particular place have ceased or diminished or are expected to cease or diminish.

Illustration 9 – Redundancy

European Chefs v Currell

Facts:

A pastry cook was dismissed because the requirement for his speciality (éclairs and meringues) had ceased. He was replaced by a new pastry cook whose speciality was the new requirement (continental pastries).

Held:

It was held that the dismissed pastry cook had been dismissed for redundancy as the need for the particular work he contracted to do had ceased.

Notes

Illustration 10 – Redundancy

Vaux and Associated Breweries v Ward (1969)

Facts:

A quiet public house was modernised by installing a discotheque. The 57 year old barmaid was dismissed in order to make way for a younger more glamorous barmaid.

Held:

Mrs Ward had not been dismissed for redundancy as there was no change in the nature of the particular work being done.

The place where a person is employed means in this context the place where he is habitually employed and any place where, under his contract, he can be required to work. There will not, therefore, be a redundancy situation where the transfer of location is reasonable or where the contract gives the employer an express or implied right to move the employee in question from one place to another.

Who is entitled to a payment?

In order to claim a redundancy payment, a person must:

- Have been continuously employed for **two years**.
- Apply to the Employment Tribunal within **six months** of dismissal.
- Prove he was dismissed, laid off or kept on short time for at least four consecutive weeks. (Laid off means that the employee earned nothing in that particular week; short time means he earned less than half of a normal week's pay).

Notes

There is no entitlement to a redundancy payment if the employee is:

- Guilty of misconduct which would justify dismissal
- Made a reasonable offer of a renewed contract which he refuses
- Made an offer of suitable alternative employment in the same capacity, which he unreasonably refuses.

Illustration 11 – Redundancy

Taylor v Kent County Council (1969)

Facts:

T was headmaster of a school. The school was amalgamated with another school and a new head appointed to the combined school. T was offered employment in a pool of teachers, standing in for short periods in understaffed schools. He would retain his current salary.

Held:

T was entitled to reject this offer and claim a redundancy payment: the new offer was substantially different, particularly in regard to status.

If an offer of alternative employment is made, the employee is entitled to have a four week trial period in the alternative employment, from the end of his employment under the previous contract.

Notes

Questions

You can now attempt the following from the Text:

Chapter 4 TYUs 1–5

Chapter 13 Qs 22–27

Chapter 5

Agency law

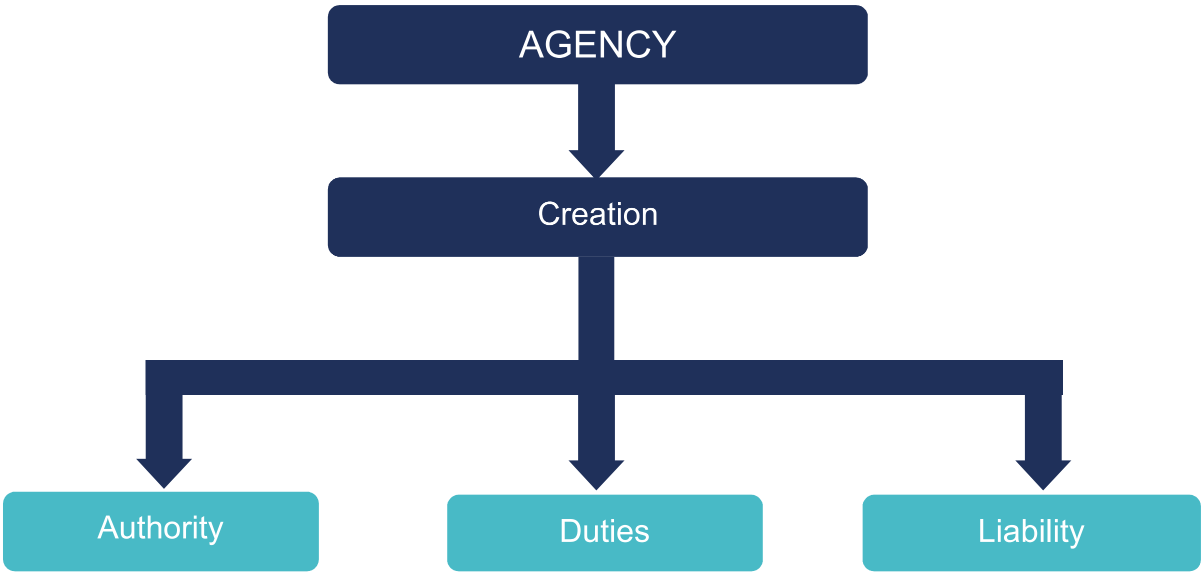
Chapter learning objectives

Upon completion of this chapter you will be able to:

- define the role of the agent and give examples of such relationships, paying particular regard to partners and company directors
- explain how the agency relationship is established
- define the authority of the agent
- explain the potential liability of both principal and agent.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 5 of your Study Text

Overview



1 The meaning and importance of agency

Agency refers to a relationship which exists where one party acts as an agent for another.

The most familiar situations where an agency relationship can arise are where an estate agent or travel agent acts as an intermediary. The party for whom the agent acts is known as the 'principal'. Therefore, the holiday company which the travel agent represents will be the principal. The customer booking the holiday will be the third party.

The resulting contracts are made between the principal and the third party, and not directly with the agent.

The most important type of agency relationships in the law syllabus are those seen in partnerships and companies.

- A partner within a partnership is an agent of the business.
  A partner can enter into transactions on behalf of the business. These transactions will be binding upon the business, and thus all the other partners.

- A director is an agent of a company. They can enter into contracts on behalf of the company which are binding on the company itself, rather than the directors.

Notes

2 Creation of agency

An agency relationship can be created in the following ways:

Express agreement

This occurs where the principal actually appoints the agent as his agent and the agreement can be in writing or oral.

It is usual for commercial transactions to be in writing so that the terms and rights and duties of the agent are clear.

Where an agent is given a power of attorney the appointment must be made by deed. A power of attorney gives the agent full authority to deal with all of the principal's property as defined in the deed.

Implied agreement

In this situation the principal has not expressly agreed to appoint an agent but the agreement can be implied from the parties' conduct or relationship.

The extent of the implied authority is indicated by all of the circumstances in which the agency arose such as the relationship of the parties, the usual authority of an agent in that business and the nature of the principal's orders.

Notes

Agency by estoppel

This arises where the principal implies that there is an agency relationship. This is also called 'estoppel by holding out' where the principal by his words or his conduct holds out another as having the authority to make contracts on his behalf. The principal is then prevented from denying that the person has this authority and is bound by such contracts as if he had expressly authorised them. The authority here can also be known as 'apparent' or 'ostensible' authority.

Estoppel arises:

- Where the principal fails to notify third parties who have dealt with his agent that the agent's authority has been terminated.
- Where the principal allows his agent to appear to have more authority than he actually has.

To create agency by estoppel:

- There must be a representation by the principal either expressly or impliedly to a third party who relies upon it and believes that the agent has authority to enter contracts of that type.

It is important to note that it is the principal's actions which can create agency by estoppel, not the agent's actions.

Agency by estoppel is an equitable doctrine developed by the courts, giving protection in court, to a third party who acted in good faith, if the "principal" is responsible for creating or not correcting the third party's mistaken belief that an agency really existed.

When agency by estoppel is found to exist, it means the "principal" is denied the use of any defence in court that the agency was invalid in law.

If these facts were unknown to the good faith third party then the third party may succeed in court in claiming for breach or specific performance against the "principal" (rather than only against the "agent").

Notes

Illustration 1 – Creation of agency

FREEMAN & LOCKYER v BUCKHURST PARK PROPERTIES LTD 1964

Facts:

D had four directors; none of them had ever been appointed as managing director. One director effectively managed the business and entered into contracts. On previous occasions, the board of directors had honoured the contracts. On this occasion they refused, saying the director had no authority to make the contract as he was not the managing director.

Held:

The director had no express authority but he had acquired ‘authority by estoppel’. The company had honoured contracts in the past and had given the impression that the director had the authority to deal with this sort of contract. The claimants had relied on this representation when dealing with the director. They were bound to honour the contracts.

Notes

Agency arising from necessity

This is also known as agency 'by operation of law' and occurs if each of the following requirements is met:

- There is an emergency situation.
- It is not possible for the agent to communicate with the principal.
- The agent is acting good faith in the best interests of the principal.

The courts will only usually imply agency by necessity if there is an existing contractual relationship between the agent and the principal.

Illustration 2 – Creation of agency

GREAT NORTHERN RAILWAY v SWAFFIELD (1874)

Facts:

GNR contracted to deliver the defendant's horse to a particular railway station for collection by the defendant. When the defendant failed to turn up, the stationmaster made arrangements for the horse to be stabled overnight. GNR sued to recover the costs.

Held:

GNR was entitled to the costs of stabling as it had become the agent of the defendant by necessity.

Nowadays, ease of communication has meant this is a very rare type of agency and of little practical importance.

Notes

Agency by ratification

If a properly appointed agent exceeds his authority, or a person having no authority purports to act as an agent, the principal has no liability on that contract unless the principal 'ratifies' the contract.

If the contract is ratified:

- Principal becomes liable and entitled under the contract
- The ratification operates retrospectively and principal is bound from the date the contract was actually made
- Agent is relieved from liability to principal for acting beyond his authority
- No authority is given for future acts.

A principal can only ratify if each of the following conditions are met:

- The principal is in existence at the time of the agent's act.
- The principal had the legal capacity to make the contract himself, both at the time of the contract and at the time of ratification (see pre-incorporation contracts in company law chapters).
- The agent, at the time of the contract, named or otherwise sufficiently identified the principal.
- The principal is made aware of all the terms of the contract.

Notes

In order to ratify the principal must:

- Ratify the whole contract; a purported ratification of part will operate as a ratification of the whole
- Ratify the contract within a reasonable time
- Communicate a sufficiently clear intention of ratifying such as refusing to return goods purchased for him by an agent who lacked authority.

Illustration 3 – Creation of agency

KELNER v BAXTER 1866

Facts:

The promoters of a company entered into a contract on behalf of the company before its incorporation but did not pay (a 'promoter' in this context meaning someone who sets up a company).

Held:

The promoters were personally liable as the company did not exist at the time the contract was made.

A void or illegal contract cannot be ratified.

Notes

3 Authority of agents

The authority of an agent is a central issue in the concept of agency. It determines the powers that the agent has on behalf of the principal and the acts for which the principal is liable. If the agent exceeds his powers the principal may still be liable to the third party, but he may have rights against the agent for breach of contract.

Authority can be given in various ways:

- Actual express
- Actual implied
- Apparent or Ostensible

Actual express authority

Express authority is stated expressly, specifically and explicitly by the principal to the agent.

Whether express authority existed or not can be determined by a number of factors. If the appointment was made in writing then look at the document and if oral then look for other evidence.

Notes

Actual implied authority

Even if authority has not been expressly given it can be implied in a number of circumstances.

In determining if an agent has implied authority, a number of factors must be taken into consideration:

- Behaviour which is customary or usual in the circumstances
- Past conduct/authority.

For example, a partner will have implied authority to undertake a number of things such as enter into contracts, attend meetings on behalf of the business, execute contracts and employ staff.

Illustration 4 – Authority of agents

WATTEAU v FENWICK 1893

Facts:

The principal owned a hotel and employed the previous owner as a manager to run it. Against his employer's express instructions the manager entered into a contract to buy some cigars on credit.

Held:

Such a contract was usual for a manager of a hotel and as such when the contract was entered into it was within the manager's implied authority. The third party was unaware of any restrictions on the manager's actual authority and as such he could enforce the contract against the owner.

Notes

An agent can also do all things incidental to actions expressly authorised and all things usually done by an agent.

Apparent or ostensible authority

Apparent or ostensible authority arises where the principal, by words or conduct, holds out to another party that the agent has authority to act on his behalf.

An agent may have limited actual express authority but, by virtue of the conduct of the principal, has that authority extended.

Apparent authority is therefore not restricted and is determined by the actions of the principal. The extent of authority differs according to individual circumstances and cannot be defined generally.

If a third party enters into a contract with an agent in these circumstances, relying on the original conduct of the principal, then the contract is binding.

Breach of warranty of authority

As discussed earlier if an agent has no authority or exceeds it the principal may ratify the contract and become liable. However, if the principal does not ratify, then the agent will be liable to the third party for breach of warranty of authority because he warranted or promised that he had authority which he did not possess.

Notes

4 Liability and duties

A contract entered into by an agent binds the third party and the principal for whom the agent has acted. The circumstances differ depending on whether the principal is disclosed or undisclosed.

Where the principal is disclosed

A principal is disclosed where his existence has been made known to the third party. It is not necessary for the principal to be identified to the third party.

As a general rule, the contract is made between the principal and the third party and the agent is neither liable nor entitled under the contract. However the agent will be liable in the following circumstances:

- The agent has shown an intention to undertake personal liability e.g. by signing a contract in his own name.
- Trade usage or custom.
- Where the agent refuses to identify the principal.
- Where the agent is acting on behalf of a fictitious principal.

Notes

Where the principal is undisclosed

An undisclosed principal is where the principal's existence has not been made known to the third party; in other words, the third party thought he was dealing with the agent on his own behalf.

When the third party discovers the true position he can elect to treat the principal or the agent as being bound by the transaction.

Agent's fiduciary duty

An agent has a fiduciary relationship with his principal. This is a position similar to that of a trustee. It has the following consequences:

- A must not allow his personal interests to conflict with those of P.
- A must always act in the best interests of P.
- A must not make a secret profit.
- A has a duty to account to P for all money and property received.

Where an agent is in breach of his fiduciary duty, the following remedies are available:

- P can repudiate the contract with the third party.
- A can be dismissed without notice.
- P can refuse to pay any money owed to A or recover any money already paid.
- P can recover any secret profit made or any bribe.

Notes

Principal's liability to the agent

Indemnity	➢ The agent is entitled to be repaid expenses properly paid. ➢ He is also entitled to be indemnified by his principal against losses and liabilities, provided his acts are done properly within the limits of his authority.
Remuneration	➢ The agent is also entitled to be paid any agreed remuneration for his services by his principal. ➢ The entitlement to remuneration may have been expressly agreed or may be inferred from the circumstances. ➢ If it is agreed that the agent is to be remunerated but the amount has not been fixed, the agent is entitled to a reasonable amount.
Lien	➢ The agent has the right to exercise a lien over property owned by the principal, i.e. a right to retain and hold goods pending payment of sums owed to him.

Notes

Questions

You can now attempt the following from the Text:

Chapter 5 TYUs 1–2

Chapter 13 Qs 28–31

Chapter 6

Types of business organisation

Chapter learning objectives

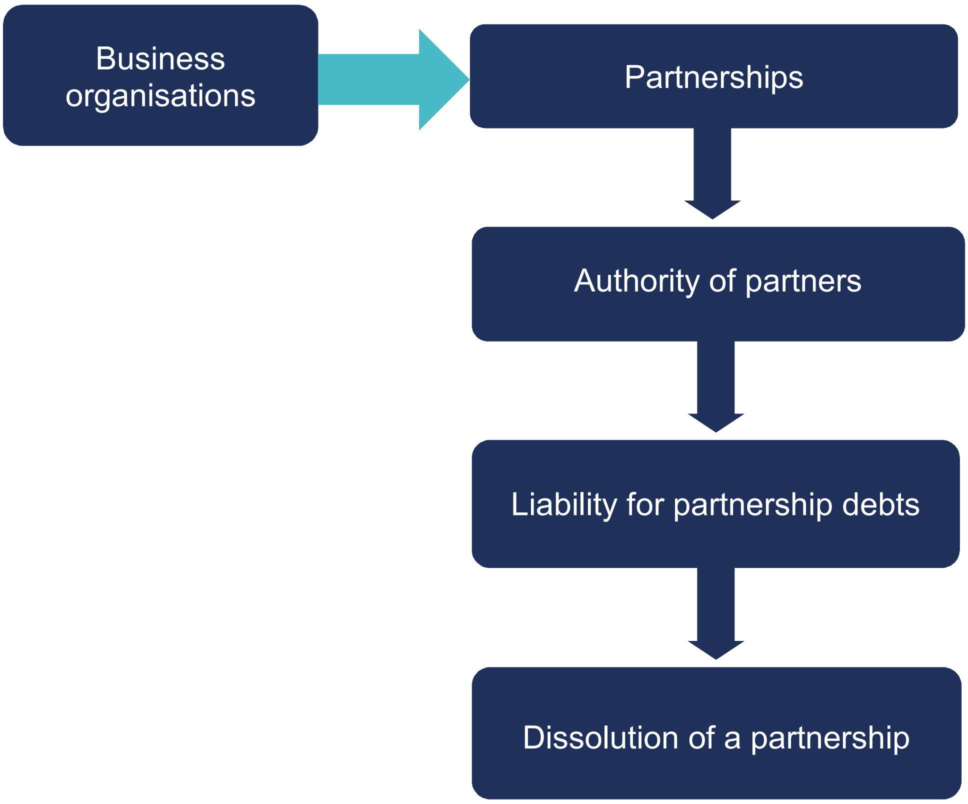
Upon completion of this chapter you will be able to:

- distinguish between different types of business organisation
- explain the meaning of the different types of partnership
- in relation to general or ordinary partnerships:
  - discuss how they are established
  - explain the authority of the partners in relation to partnership activity
  - outline the liability of the partners for partnership debts
  - explain the ways in which they can be brought to an end.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 6 of your Study Text

Chapter 6

Overview



1 Types of business organisations

Different forms of business organisation

Sole trader	The owner 'is' the business – owns the assets and is liable for all the debts. No legal formalities are required to set up a sole trader business. This form of business is inappropriate for large businesses or those involving a degree of risk.
General partnership	Defined by Partnership Act 1890 as the relationship which subsists between persons carrying on a business in common with a view of profit (see below).
Limited liability partnership	An artificial legal entity with 'perpetual succession'. It can hold property in its own right, enter into contracts in its own name, create floating charges, sue and be sued. The liability of the members of a limited liability partnership (LLP) is limited to the amount of capital they have agreed to contribute. Requirements similar to that of a company (see Chapter 7).
Limited partnership	Formed under the Limited Partnerships Act 1907 (see below).
Company	A corporation is an artificial legal person (see Chapter 7).

The rest of this chapter will focus on partnerships.

Notes

2 Partnerships

Definition of partnership

A partnership is 'the relation which subsists between persons carrying on a business in common with a view of profit' (s1 Partnership Act 1890).

A partnership can be a small operation or as with some large firms of solicitors and accountants partnerships with several hundred partners.

Types of partners

General partner	Actively involved in the day-to-day business.
Sleeping partner	Takes no active part in the running of the business. However, is jointly and severally liable for the debts and contracts of the business.
Limited partner in a limited partnership	Contributes a specific amount of capital. Liability limited to that amount. Cannot take part in the management of the firm.
Salaried partner	Will received a fixed amount in income. Not a real partner unless he also receives a share of the profits.

Notes

Characteristics of a general partnership

A business must be carried on with a view to profit. This means that persons involved in the partnership intend the business to yield a profit.

- A business includes 'every trade, occupation or profession'.
- The business can be a single transaction.
- There must be some joint business activity; merely sharing revenue is not enough.
- Joint ownership of property that happens to produce revenue is insufficient to establish a partnership. The term 'business' necessarily implies some activity.
- A partnership begins as soon as the partners start their business activity.

Notes

How a partnership is formed

The partnership agreement

A partnership can be entered into informally; people can merely agree to run a business together and then do so. Alternatively they may choose to have a partnership agreement. If they have such an agreement it acts like a contract between the partners.

The Partnership Act 1890

In addition to any agreement, the Partnership Act 1890 sets out the rights and duties of the partners and if the provisions of the agreement do not deal with a particular issue the Partnership Act will apply. These rights and duties can be overruled by any express agreement already made between the partners.

Limited partnerships under Limited Partnership Act 1907

A limited partnership is a partnership in which the liability of one or more partners is limited to their capital contribution.

A limited partnership must fulfil the following conditions:

- There must be at least one partner with unlimited liability.
- The partnership must be registered with the Registrar of Companies as a limited partnership.
- Limited partners may not participate in the management of the business. If they do, they forfeit their limited liability.
- A limited partner has no power to bind the firm to contracts, i.e. unlike the unlimited partners, he is not an agent of the firm.

Notes

3 Authority of partners

When entering into a contract to carry out the business, each partner is acting as the agent of all the partners.

Express or actual authority

This is set out in the partnership agreement.

Implied or apparent authority

The implied authority of a partner can exceed their actual authority. The implied authority of partners is set out in s.5 Partnership Act 1890.

S.5 states that every partner is an agent of the firm and of the other partners. This means that each partner has the power to bind all the other partners in any transaction entered into in the course of the partnership business. A partner will be acting within their authority if they enter into transactions that are usual for a partner.

In addition in a trading partnership the partners have the implied authority to enter into contracts to borrow money on behalf of the firm.

In a question it is important to think about the type of business involved to determine if the partner is acting within their implied authority. So, for example, in an accountancy partnership if a partner in an accountancy partnership entered into a contract to sell auditing services it is likely that this would be held to be within their implied authority even if they do not have the express authority to do. It is usual for that type of business.

Notes

4 Liability for partnership debts

The firm is liable for contracts made by a partner if he was acting within his express or implied authority.

If a partner acts in a way that is within the usual business of the partnership it is likely that the partnership will be bound by their actions (even if they are acting beyond their actual authority) unless

- He has no actual authority **and**
- The third party **either** knows he has no actual authority for the transaction **or** does not believe him to be a partner.

Liability of partners

Every partner is responsible for the full amount of the firm's liabilities.

Outsiders have the choice of taking action against the partners collectively, or against individual partners. This is referred to as joint and several liability.

If damages are recovered from one partner only, the other partners are liable to contribute equally to the amount paid.

Holding out

A person who, by his words or conduct, represents himself (or let's himself be represented) as a partner, is liable as if he is a partner to anyone who gives credit to the firm as a result of that representation.

Notes

Who is liable?

- Generally, every partner is jointly and severally liable for debts and contracts.
- New partners are not liable personally for debts incurred before they became a partner.
- Retiring partners remain liable for debts incurred while they were partners. If no notice of retirement is given, the firm continues to be bound by the retired partner as he is being held out as a partner.
- In addition the partner will continue to be liable for the ongoing debts of the business until notice of his retirement is given.
- If there is a change of partners and a third party deals with the partnership after the change, the partners of the old firm remain liable unless the third party has notice of the change.
- A 'novation' occurs where a creditor agrees the liability on the debt will be that of the continuing or incoming partner, not the outgoing partner.
- The incoming or continuing partners may agree to indemnify the outgoing partner against any debts incurred prior to retirement.

Notes

5 Dissolution

How does a partnership come to an end?

According to the Partnership Act 1890 a partnership will automatically end in the following situations:

- Death or bankruptcy of a partner (unless the partnership agreement states otherwise)
- Expiry of a fixed term
- Completion of a single joint venture if stated that this will happen in the partnership agreement
- Continuation of the partnership would be illegal
- A partner gives notice for the firm to be dissolved
- Order of the court.

In addition the partnership agreement may include other situations which would lead to the dissolution of the partnership.

Illustration 1 – End of a partnership

HUDGELL, YEATES AND CO v WATSON 1978

Facts:

Practising solicitors are required by law to have a practising certificate. One of the partners in a firm of solicitors forgot to renew his certificate which meant it was illegal for him to practise.

Held:

The failure to renew the certificate brought the partnership to an end, although a new partnership continued between the other two partners.

Notes

In addition, under s.35 Partnership Act 1890 the court can bring a partnership to an end in the following situations:

- Partner has mental disorder or permanent incapacity.
- Partner engages in activity prejudicial to the business.
- Partner persistently breaches the partnership agreement.
- Business can only be carried on at a loss.
- It is just and equitable to do so.

Distribution of assets

In the event of dissolution the assets of the partnership will be used to pay off the debts of the partnership. As a partnership does not have the advantage of limited liability status, if the proceeds on the sale of the assets does not cover the debts then the partners' personal wealth will be called upon to make up the shortfall.

The proceeds from the sale of the assets will be applied in the following order:

i paying debts to outsiders:

ii paying the partners any advance they made to the firm beyond their capital contribution i.e. a loan

iii paying the capital contribution of the partners.

If there is a residue remaining this will be divided between the partners in the same proportion in which they share the profits of the partnership.

In the event that the assets are insufficient to meet the debts to outsiders then profits held back from previous years or partners' capital will be used to make good the shortfall. If these are also insufficient then the partners will individually contribute in the proportion to which they shared in the profits.

Notes

Questions

You can now attempt the following from the Text:

Chapter 6 TYUs 1–2

Chapter 13 Qs 32–34

Chapter 7

Corporations and legal personality

Chapter learning objectives

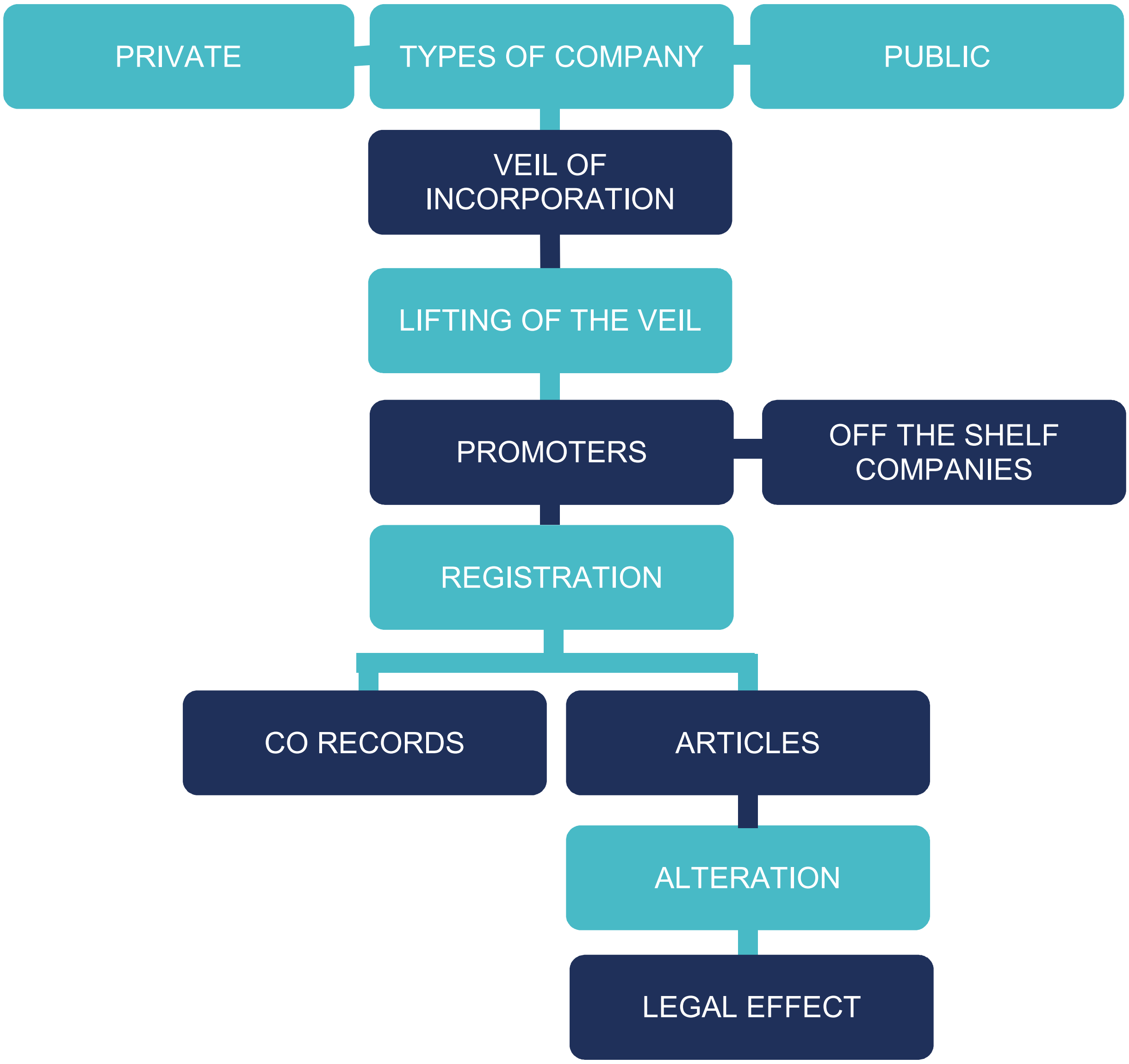
Upon completion of this chapter you will be able to:

- explain the meaning and effect of limited liability
- explain meaning of LLPs and compare companies and partnerships
- analyse the different types of companies, especially public and private companies
- illustrate the effect of separate personality
- recognise instances where separate personality will be ignored
- explain the role and duties of company promoters
- describe the procedure for registering companies, both public and private
- describe the contents of model articles of association
- analyse the effect of a company's articles
- explain how articles of association can be changed
- describe the statutory books, records and returns that companies must keep or make.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 7 of your Study Text

Chapter 7

Overview



1 The doctrine and veil of incorporation

Meaning

The term 'veil of incorporation' refers to the fact that a company is separate legal entity (i.e. separate from its shareholders). This separates the legal identity of the company from that of its members, and also its liability from that of the members.

Illustration 1 – The veil of incorporation

Salomon v Salomon (1897)

Facts:

S transferred his business to a limited company. He was the majority shareholder and a secured creditor. The company went into liquidation and the other creditors tried to obtain repayment from S personally.

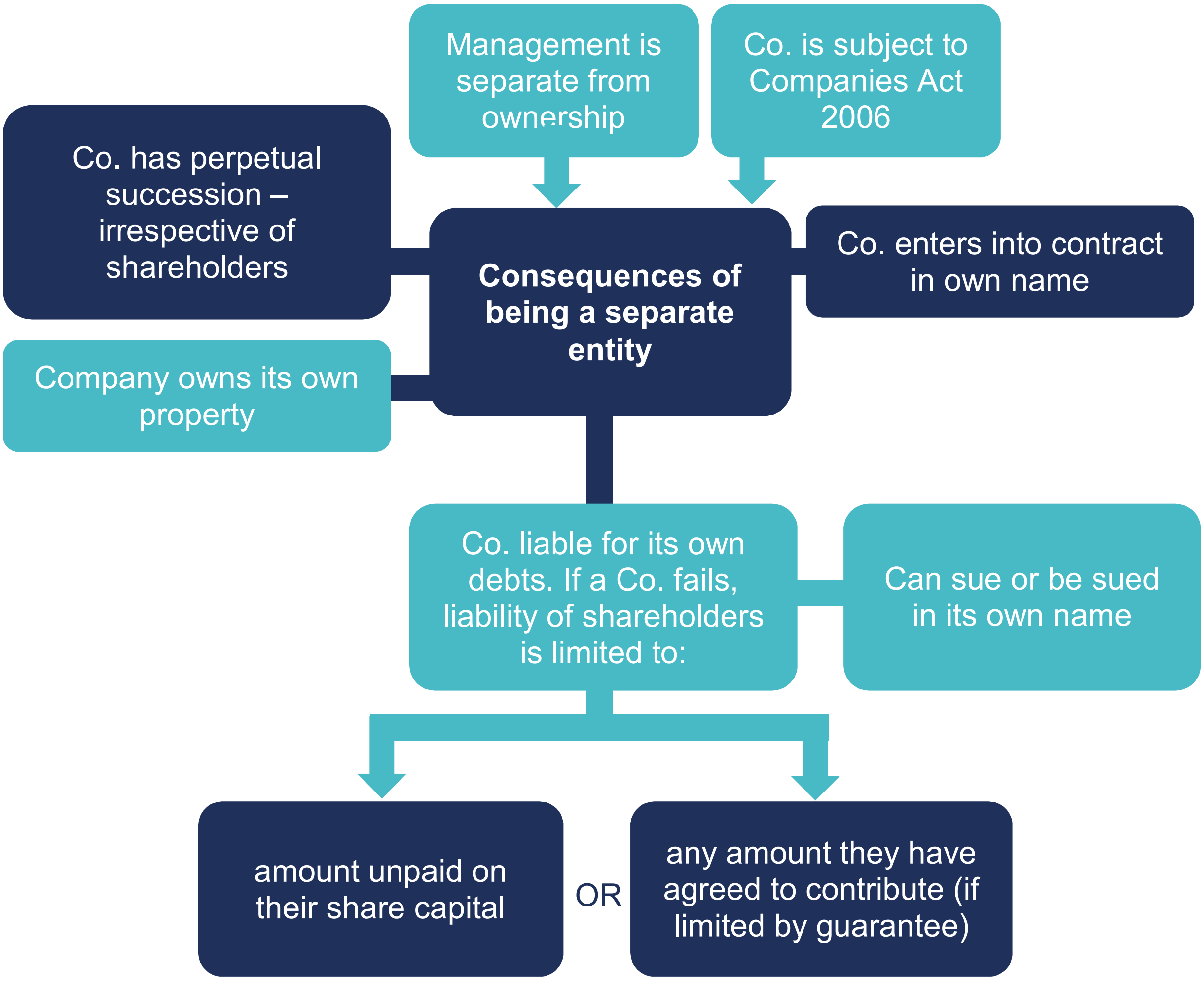
Held:

S as shareholder and director had no personal liability to creditors, and he could be repaid in priority as a secured creditor. This enshrined the concepts of separate legal personality and limited liability in the law.

Notes

Consequences of Incorporation

There are a number of consequences of being a separate legal entity:



Notes

Illustration 2 – The veil of incorporation

Macaura v Northern Assurance Co. Ltd. (1925)

Facts:

An individual had incorporated his business but insured the premises (now belonging to the company) in his own name. The property was destroyed by fire.

Held:

The company should have insured its own assets; as an individual there was no insurable interest (either as a creditor or a member).

Lifting the veil of incorporation

'Lifting the veil of incorporation' means that in certain circumstances the courts can look through the company to the identity of the shareholders. This is intended to prevent inequitable results and expose the commercial reality of the situation.

The usual result of lifting the veil is that the members or directors become personally liable for the company's debts.

The veil will be lifted only where 'special circumstances exist indicating that it is a mere facade concealing the true facts': Woolfson v Strathclyde (1978). There are common law instances arising from cases coming before the courts as well as statutory provisions for 'lifting the veil'. Examples of where the courts have been willing to lift the veil of incorporation and lift the veil are as follows:

Groups of companies

This has been done in cases where the court felt where the subsidiary may be regarded as an agent of the parent. It should be noted that in most cases, subsidiaries retain their separate legal status from that of their parent or holding company.

Notes

To reveal national identity

In times of war it is illegal to trade with companies located in countries we are at war with. If although the company is registered in the UK the funds are being used in an enemy country the veil may be lifted.

Illustration 3 – The veil of incorporation

Daimler Co Ltd v Continental Tyre & Rubber Co 1916

Facts:

Although the company was registered in the UK all of the shareholders but one was German.

Held:

The veil would be lifted; the true facts were that this was a German company as such an English company should not be trading with them at this time.

Notes

Sham companies

A sham company is not a company at all. It is a company which has been registered for an illegitimate purpose, for example, to evade a legal obligation or to hide the national identity of a business.

Illustration 4 – The veil of incorporation

Gilford Motor Co Ltd v Horne 1933

Facts:

H formed a company to run a business in competition with G. H had a personal contract with G restraining competition.

Held:

The veil was lifted to restrain the company from competition, as H had set it up to evade his own legal obligations.

Notes

There are a number of occasions where statute will intervene to lift the veil. The following are examples of these where a director is also a member of the company (but be aware that there are other provisions):

Legislation:	Applies when:	Effect
Company Directors Disqualification Act 1986	A director who is disqualified participates in the management of a company.	Director will be jointly or severally liable for the company's debts.
Insolvency Act 1986	Wrongful or fraudulent trading.	Directors may be personally liable for losses arising as a result.
S.767 CA06	Public company trades without first obtaining a trading certificate.	Directors can be made personally liable for any loss or damage suffered by a third party.

Notes

2 LLPs

Ordinary (or general) partnerships lack the characteristics of a company in the sense that they do not have limited liability or separate legal personality. Over time the government was pressurised to recognise the needs of some partnerships (especially professional partnerships such as solicitors, accountants and auditors) to limit their liability and have separate legal personality without having to form a company. This resulted in the Limited Liability Partnerships Act 2000 (LLPs).

LLPs have similar features to private limited companies, for example, their members (i.e. not called partners) are not directly responsible for the debts of the partnership.

Incorporation	➢ Incorporation document must be delivered to Registrar stating name of LLP, location and address of registered office, names and addresses of members (minimum two). ➢ Must send a declaration of compliance that LLP satisfies requirements of the Limited Liability Partnerships Act 2000. ➢ Registrar issues a certificate of incorporation.
Membership	➢ First members sign incorporation document. Later members join by agreement with the existing members. ➢ Membership ceases on death, dissolution or in accordance with agreement with other members. ➢ Rights and duties are set out in membership agreement. If no agreement then governed by Limited Liability Partnership Regulations 2001. ➢ Each member acts as an agent of the LLP.
Designated members	➢ Perform the administrative and filing duties of the LLP. ➢ Incorporation document specifies who they are. ➢ Must be at least two designated members. If there are none, all members will be designated members.
Name	➢ Must end with Limited Liability Partnership, llp or LLP. ➢ Rules on choice are the same as for companies.

Taxation	➢ Members are treated as if they are partners carrying on business in a partnership, i.e. they pay income tax, not corporation tax.
Registers	The LLP must maintain the following registers: ➢ Register of members ➢ Register of members usual residential addresses ➢ Register of people with significant control. The LLP can keep these registers at its registered office or choose to send the information to the Registrar of Companies to be kept on the public register at Companies House.
Liability for debts	The liability of a member of an LLP to contribute to its debts is limited to his capital contribution. However, there is no requirement for a capital contribution, and any contribution made can be withdrawn at any time. ➢ If an LLP goes into liquidation, the court can order the members to repay any drawings made in the previous two years if it can be shown that the member knew or had reasonable grounds to believe that the LLP: – was unable to pay its debts at the date of withdrawal, or – would become unable to pay its debts because of the withdrawal: s214A Insolvency Act 1986 (IA 1986). The fraudulent and wrongful trading provisions of IA 1986 apply to members of LLPs in the same way as they apply to directors of companies (see chapter 12).
Differences between LLP and partnership	The liability of the members of an LLP is limited to the amount of capital they have agreed to contribute. ➢ The LLP must file annual accounts and an annual report with Companies House. ➢ LLP is an artificial legal entity with perpetual succession. It can hold property in its own right, enter into contracts in its own name, create floating charges, sue and be sued.

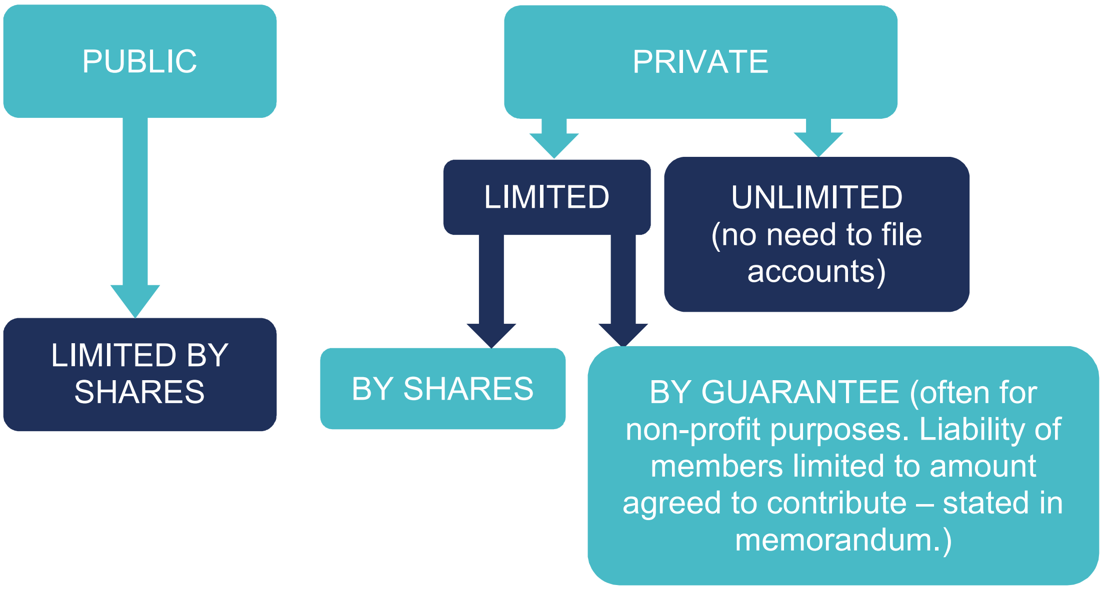
Notes

Company versus partnership

Company	General Partnership
Separate legal person, i.e. can own property, sue or be sued, and contract in own name.	Not a separate legal person – the partners own any property, are liable on contracts and are liable if sued.
The company is liable for its debts. (No personal liability for shareholders beyond any unpaid portion of the nominal value of their shares or the amount they have agreed to contribute.)	The partners are personally liable for the debts of the firm. Their liability is joint and several.
Created by registration – with a written constitution.	No special formality required to create.
Shares are transferable.	Limits on transfer of share (may require dissolution of partnership or consent of other partners to enable partners to realise their share).
Can create both fixed and floating charges as security for borrowing.	Can only create fixed charges as security for borrowing.
Managed by directors, who may or may not also be shareholders.	Managed by partners, who are also the owners of the business.
The company cannot usually return capital to its members (except on dissolution).	Partners may withdraw their capital.
Must make information about financial affairs and ownership publicly available.	Private business. No disclosure of results.
The business is run by the directors. Members have no right to participate.	Every partner has the right to take part in the management of the business.
Must comply with Companies Act requirements concerning meetings.	No administrative requirements regarding meetings.
Formal dissolution procedure (known as liquidation). Death/bankruptcy of any member/director do not dissolve the company.	May dissolve by agreement. Automatically dissolved on the death/ bankruptcy of any partner.
Companies pay corporation tax.	Partners pay income tax.

3 Types of company

Limited and unlimited companies



Notes

Private company v public company

	Public companies	**Private (limited) companies**
Definition	Must be registered as a public company under CA06.	Any company that is not a public company.
Name	Ends with ‘plc’ or ‘public limited company’.	Ends with ‘Ltd.’ or ’limited’ (or same in Welsh) but some companies (including charities) may be exempt from this.
Capital	Must not be less than the authorised minimum (currently £50,000) and, in order to trade, must have allotted shares of at least that amount.	No minimum requirements.
Raising capital	May raise capital by advertising its securities (shares and debentures) as available for public subscription and can be listed on the Stock Exchange or similar institution.	Prohibited from offering its shares to the public.
Start of trading	Must obtain trading certificate from Registrar before commence trading.	Can begin from date of incorporation.
Directors	Minimum of two.	Minimum of one.
Secretary	Required; must be qualified.	Optional: need not be qualified.
Accounts	Must file accounts within 6 months.	Need not lay accounts before general meeting. Must file within 9 months.
AGM	Must be held each year.	Need not hold an AGM.
Resolutions	Cannot pass written resolutions.	Can pass written resolutions instead of calling meetings.

Notes

Unlimited companies

An unlimited company is a separate legal entity and, if it has assets, it will have the benefits arising from separate legal personality. However, if the company's assets are insufficient to meet its liabilities, all members are liable to contribute without limit towards paying its debts and the cost of liquidation.

Such companies do have the advantage that they need not have their accounts audited, and need not deliver annual copies to the Registrar of Companies.

Community interest companies

Since 2004 it has been possible to form a 'Community Interest Company' for those wishing to establish social enterprises. The company's object must be considered by a reasonable person to be of benefit to the community and any surpluses made by the company should be reinvested for the purposes of the company.

Such a company must first be registered as a company limited by guarantee or as a company limited by shares and then apply to the Regulator of Community Interest Companies for Community Interest Company status.

These companies may be used as vehicles for community interests such as a local crime prevention group. The company name must end in C.I.C.

Notes

4 Promoters

There is no statutory definition of a promoter. A promoter is anyone who makes **business preparations** for a company or as stated in the case of Twycross v Grant (1878), a person who, 'undertakes to form a company and who takes the necessary steps to accomplish that purpose.'

The definition excludes people acting in professional capacity.

A promoter is under a fiduciary duty to:

- Exercise reasonable care and skill
- Disclose any interest in transactions with the company and not to make a 'secret profit', and
- Disclose any benefit acquired to an independent board and/or to the shareholders.

Remedies available to the company if a promoter makes a secret profit:

Remedy	**Problems**
Rescind the contract.	Not always possible e.g. if a third party has rights under the contract.
Obtain damages.	Must prove loss.
Recover the profit.	Must prove that the promoter failed to disclose profit.

Notes

Pre-incorporation contracts

A pre-incorporation contract is a contract made by a person acting on behalf of an unformed company. The position at common law is that a company, prior to its incorporation, does not have contractual capacity and the promoter is therefore personally liable. (This is because a company does not legally exist until it is incorporated.)

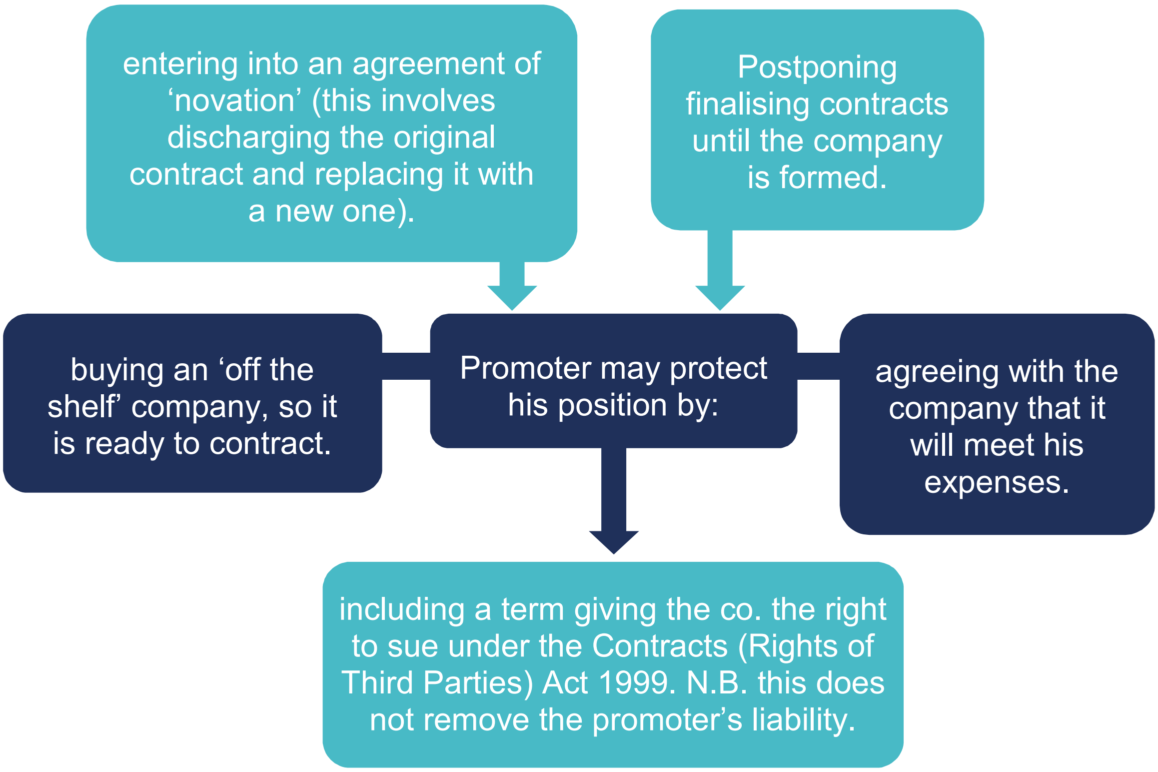
In summary, with a pre-incorporation contract:

- The company **cannot ratify** the contract.
- The company **is not bound** by the contract.
- The company **cannot enforce** the contract against a third party.

S.51 CA 2006 reinforces the common law position by providing that, subject to any agreement to the contrary, the person making the contract is personally liable. Clear and express words are needed in order to negate liability: **Phonogram Ltd v Lane (1981)**.

Notes

Protection for the promoter



Off-the shelf companies

An ‘off-the-shelf’ company is one that has already been formed. Buying off the shelf has a number of advantages and disadvantages:

Advantages	**Disadvantages**
Cheap and simple to buy.	The Articles of Association may be unsuitable (e.g. name, share capital and structure).
Can trade immediately.	Altering the Articles will incur costs and may be inconvenient.
No problem of pre-incorporation contracts.	Need to change officers.

Notes

5 Registration

Registration documents

The following documents must be submitted to the Registrar in order to form a company:

Memorandum of association

Signed by all subscribers and stating that they wish to form a company and agree to become members of the company

Application

The application form must include:

- The proposed name of the company
- Whether the members will have limited liability (by shares or guarantee)
- Whether the company is to be private or public
- Details of the registered office (whether in England and Wales, Wales, Scotland or N. Ireland) and intended address of the registered office (see below)

Articles

The model articles apply if no articles are supplied

Statement of capital and initial shareholdings

This must state:

- the number of shares
- their aggregate nominal value
- details of each class of share
- how much has been paid up on each share
- a contact address for each subscriber

Statement of guarantee (if applicable)

This states the maximum amount each member undertakes to contribute

Statement of consent to act

The company confirms that the director or secretary has given their consent to act

Statement of compliance

This provides confirmation that CA 2006 has been complied with

Registration fee

On receipt of the above documents the Registrar must: **Inspect** documents and ensure Companies Act requirements fulfilled.

Issue certificate of incorporation which is conclusive evidence that Companies Act requirements fulfilled: s.15 CA 2006.

The company exists from the date on the certificate of incorporation.

Notes

Trading certificate – Public Companies only

A plc cannot commence trading until the Registrar has issued a trading certificate.

To obtain a trading certificate, must apply to the Registrar stating:	If it trades before the certificate is issued:
Nominal value of allotted share capital at least £50,000.	The company and any officers in default are liable to a fine.
At least ¼ of the nominal value and all of the premium have been paid up.	It is a criminal offence to carry on business, but any contracts are still binding on the company.
The amount of preliminary expenses and who has paid or is to pay them.	The directors are personally liable if the company defaults within 21 days of due date.
Any benefits given or to be given to promoters.	Ground for winding up if not obtained within one year: s.122 Insolvency Act 1986.

Notes

Name of company

Must have limited (Ltd) or public limited company (plc) at end as applicable

Cannot be the same or virtually the same as another in index of names

Cannot use certain words which are illegal or offensive

Must have Secretary of State's consent to use certain words (e.g. England, Chartered, Royal, National, University, Insurance, etc.) or any name suggesting a connection with the government or any local authority

It must avoid the tort of passing off.

Note: Most companies trade under their registered name, but there is nothing to stop a company trading under a different 'business' name. If a company chooses to do this, the business name will be subject to the same rules as the registered name as regards offensive words, names suggesting a prohibited connection etc.

Notes

Changing the company's name

A company can change its name by passing a special resolution and notifying the Registrar.

The Secretary of State can require a company to change its name in the following circumstances:

Reason	Period
The name is the same as, or too like, an existing registered name.	12 months
The name gives so misleading an indication of the nature of the company's activities as to be likely to cause harm to the public.	No time limit
Misleading information or undertakings were given when applying for a name that required approval.	5 years

Notes

6 Articles of association

Introduction

The articles of association form part of the company's internal constitution, along with any other agreements or special resolutions (s.17). They:

- Set out the manner in which the company is to be governed, and
- Regulate the relationship between the company and its shareholders.

Model Articles

For companies incorporated under CA06, model articles will be prescribed by the Secretary of State.

There are three model articles which cover the following companies:

- private companies limited by shares; or
- private companies limited by guarantee; or
- public companies.

These model articles will apply where a company is formed without registering articles or where the articles registered do not exclude or modify the model articles.

A company:

- May adopt the model articles) in full or in part
- Is deemed to have adopted the model articles if there is no express or implied provision to exclude them, or
- May draft its own unique articles.

Notes

Contents of Articles

Companies Act 2006 states that the articles should be contained in a single document which is divided into consecutively numbered paragraphs.

Articles should contain rules on a number of areas, the most important of which are as follows:

- Appointment and dismissal of directors
- Powers, responsibilities and liabilities of directors
- Director's meetings
- Member's rights
- Dividends
- Communication with members
- Issue of shares
- Documents and records

Notes

7 Legal effect of a company's constitutional documents

Contractual effect of a company's constitution

The company and its members are bound by the articles as if they had signed and sealed covenants to that effect: s.33 CA 2006.

The articles bind:

- The company to its members
- The members to the company, and
- The members to one another.

They do not bind:

- The company to non-members, or
- The members in any other capacity, e.g. if a member is also a professional adviser to the company, that relationship will not be governed by the constitution.

Illustration 5 – Articles of association

Eley v Positive Government Security Life Assurance Co 1876

Facts:

The articles of association of the company stated that Eley was to be the only solicitor of the company and could only be dismissed for gross misconduct. The company employed another solicitor and Eley tried to sue for breach of the articles.

Held:

Eley was trying to protect his rights as a supplier to the company not in his capacity as a member. As such the articles were not enforceable.

Notes

8 Alteration of articles

General rule

The articles can usually be altered by special resolution (75% majority).

Copies of the amended articles must be sent to the Registrar within 15 days.

Exceptions

1 Entrenchment

It is possible to entrench some of the articles. This means that a specified procedure (e.g. unanimous consent) may be required to change them.

2 Members increase liability

S25 CA06 prevents a member being bound by any alteration made after he becomes a member that requires him to increase his liability or contribute further to the company.

3 Common law restriction

Any change to the articles must be 'bona fide in the interests of the company as a whole': Allen v Gold Reefs of Africa (1900).

Notes

9 Statutory books, returns and records

Registers

Register of:	Contents:
Members	Names, addresses, date became/ceased, number of shares, type, amount paid up.
Directors and company secretary (if applicable)	Name, occupation, nationality, other directorships within the last five years and date of birth. Addresses of directors are maintained but are not publicly disclosed.
Charges	Name of chargee, type of charge, property charged, amount and date created.
Persons with significant control	A person with significant control (PSC) is anyone in the company who: ➢ owns more than 25% of the company's shares ➢ owns more than 25% of the company's voting rights ➢ has the right to appoint or remove a majority of the board of directors ➢ has significant influence or control over the company ➢ has significant influence or control over a trust or firm. The register should have details of name, service address, residential address, country and state of residence, nationality, date of birth, date they became a PSC and the nature of company control.
Other documents	Resolutions and minutes of general meetings must be kept for ten years.

Notes

The registers must be:

- Kept at the company's registered office (although the register of members and register of directors' interests can be kept where they are made up), and
- Must be available for public inspection.

Requests for inspection must provide details about the person seeking the information, the purpose of the request and whether the information will be disclosed to others. The company may apply to the court for an order that it need not comply with the request.

The register of directors' addresses should now contain service addresses rather than details of the directors' residential addresses. The service address can be simply 'the company's registered office'.

The company must also keep a separate register of the directors' residential addresses. Both the service and the residential addresses will need to be supplied to the Registrar of Companies.

The residential addresses will be withheld from the public register. However, they will generally remain available to the Registrar and certain specified public bodies and credit reference agencies.

Under the SBEEA 2015 private companies can opt out of maintaining separate private registers and instead keep certain information on the public register at Companies House.

Notes

Accounts and reports

Confirmation Statement	Can be sent at any time but no more than 12 months can pass between each Statement. The Statement contains that no changes to key information have happened during the year. If changes have been made it states what they are.
	Changes need to be communicated on: ➢ address of registered office ➢ type of company ➢ principal business activities ➢ details of officers ➢ details of issued shares and their holders ➢ particulars of those who have ceased to be members since the last return.
Accounting Records	The company must keep accounting records containing sufficient information to show and explain the company's transactions. In particular the records must show: ➢ details of all money received and spent ➢ a record of assets and liabilities ➢ Statement of stocks at end of year. Accounting records need to be kept for three years in the case of a private company and six years for a public company.
Annual Accounts:	Companies are required to produce annual accounts including: ➢ balance sheet and profit and loss account showing true and fair view ➢ directors' report stating the amount of any dividend and likely future developments. The annual financial statements must be approved and signed on behalf of the board of directors and a copy filed with the Registrar.

Non-compliance with any of the provisions above may result in the company and any relevant officer being fined. In some circumstances the officer may be imprisoned.

Notes

Questions

You can now attempt the following from the Text:

Chapter 7 TYUs 1–10

Chapter 13 Qs 35–40

Chapter 8

Capital and financing

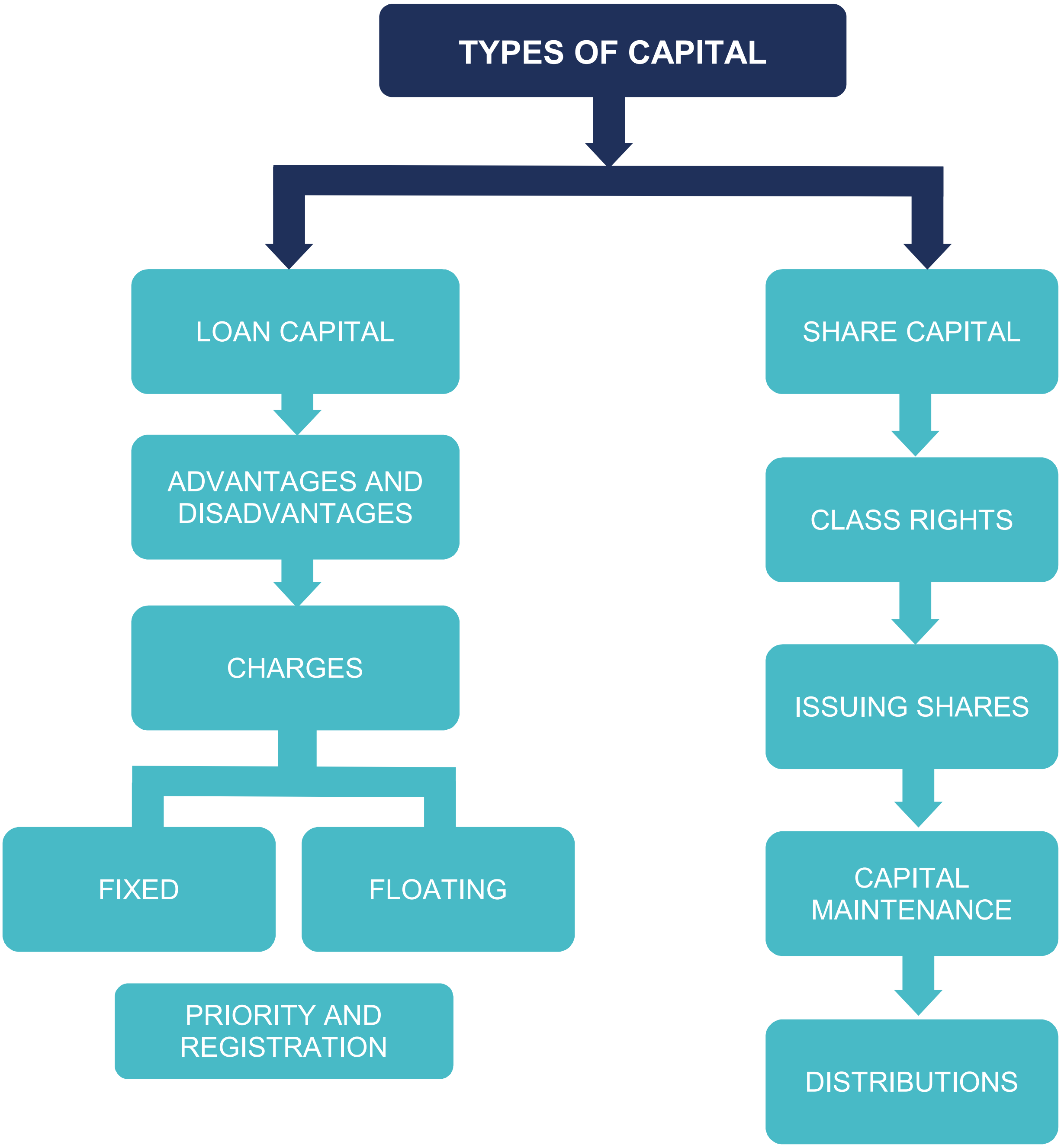
Chapter learning objectives

Upon completion of this chapter you will be able to:

- examine the different meanings of capital
- illustrate the difference between various classes of shares
- explain the procedure for the variation of class rights
- define companies' borrowing powers
- explain the meaning of debenture
- distinguish loan capital from share capital
- explain the concept of a company charge and distinguish between fixed and floating charges
- describe the need and the procedure for registering company charges
- explain the doctrine of capital maintenance and capital reduction
- examine the effect of issuing shares at either a discount or a premium
- explain the rules governing the distribution of dividends in both private and public companies.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 8 of your Study Text

Overview


TYPES OF CAPITAL
LOAN CAPITAL
ADVANTAGES AND DISADVANTAGES
CHARGES
FIXED
FLOATING
PRIORITY AND REGISTRATION
SHARE CAPITAL
CLASS RIGHTS
ISSUING SHARES
CAPITAL MAINTENANCE
DISTRIBUTIONS

1 Share capital

A share is the interest of a shareholder, or member, in a company measured in monetary terms, with rights and liabilities and contractual relationships as provided by the Companies Acts. The share capital of a company is divided into units, or shares, which define each member's proportion of interest in the company.

Notes

2 Types of shares

	Preference shares	Ordinary shares (equity)
Voting rights	None, or restricted.	Full.
Dividend rights	Fixed dividend normally paid in priority to other dividends, usually cumulative.	Paid after preference dividend. Not fixed.
Surplus on winding up	If issued with preferential rights to return of capital will have the right to be repaid their capital first, but cannot participate in any surplus.	Entitled to share surplus assets after repayment of preference shares.

Notes

3 Class rights

What are they?

Class rights are the special rights attached to each class of shares, such as dividend rights, distribution of capital on a winding up and voting. (See section above concerning the different rights that normally attach to ordinary shares and preference shares.)

How can they be varied?

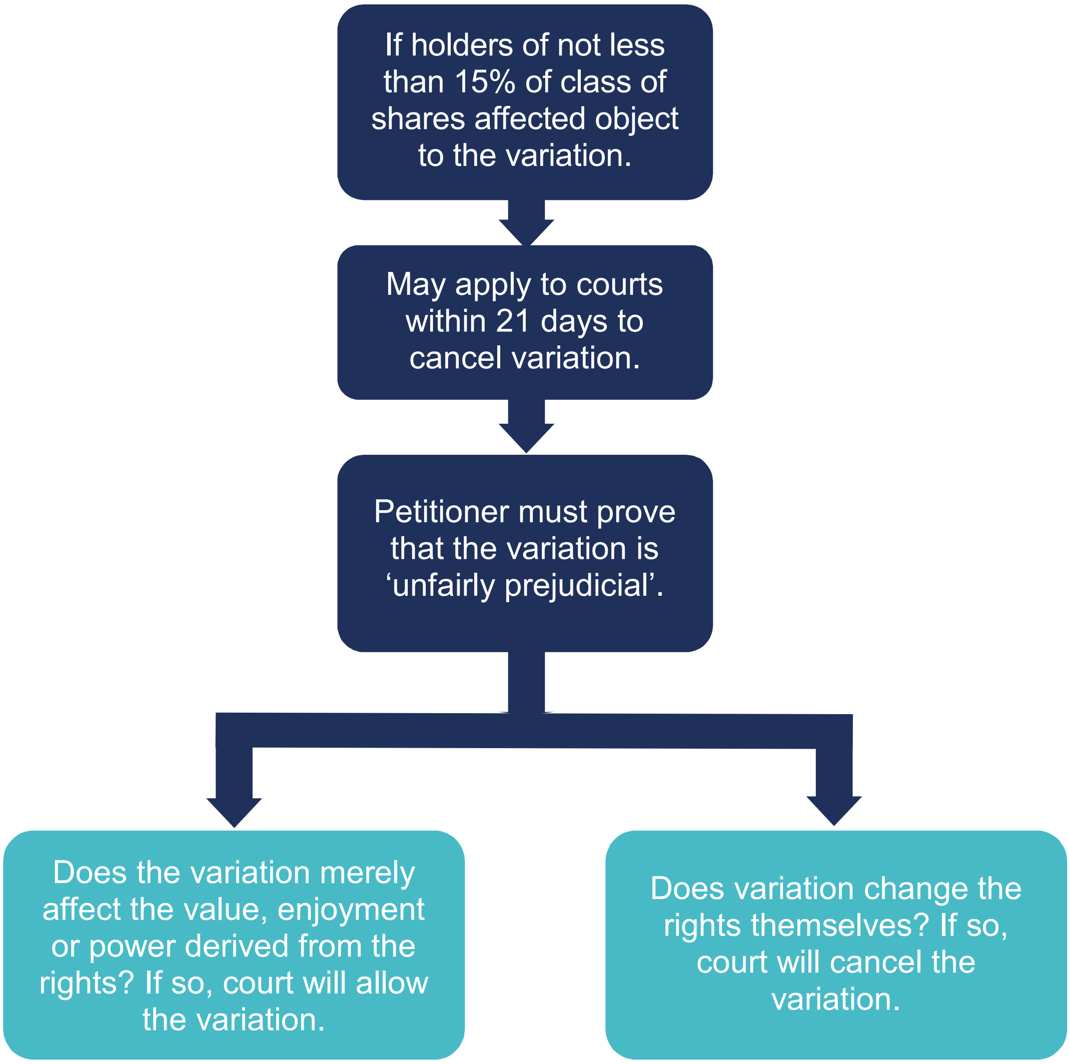
The procedure for varying class rights depends on whether any procedure is specified in the articles:

Is procedure to vary specified?	Method of variation
Yes	Procedure set out in articles must be followed.
No	Variation needs **special resolution** or written consent of 75% in nominal value of the class: s.63 CA06.

Notes

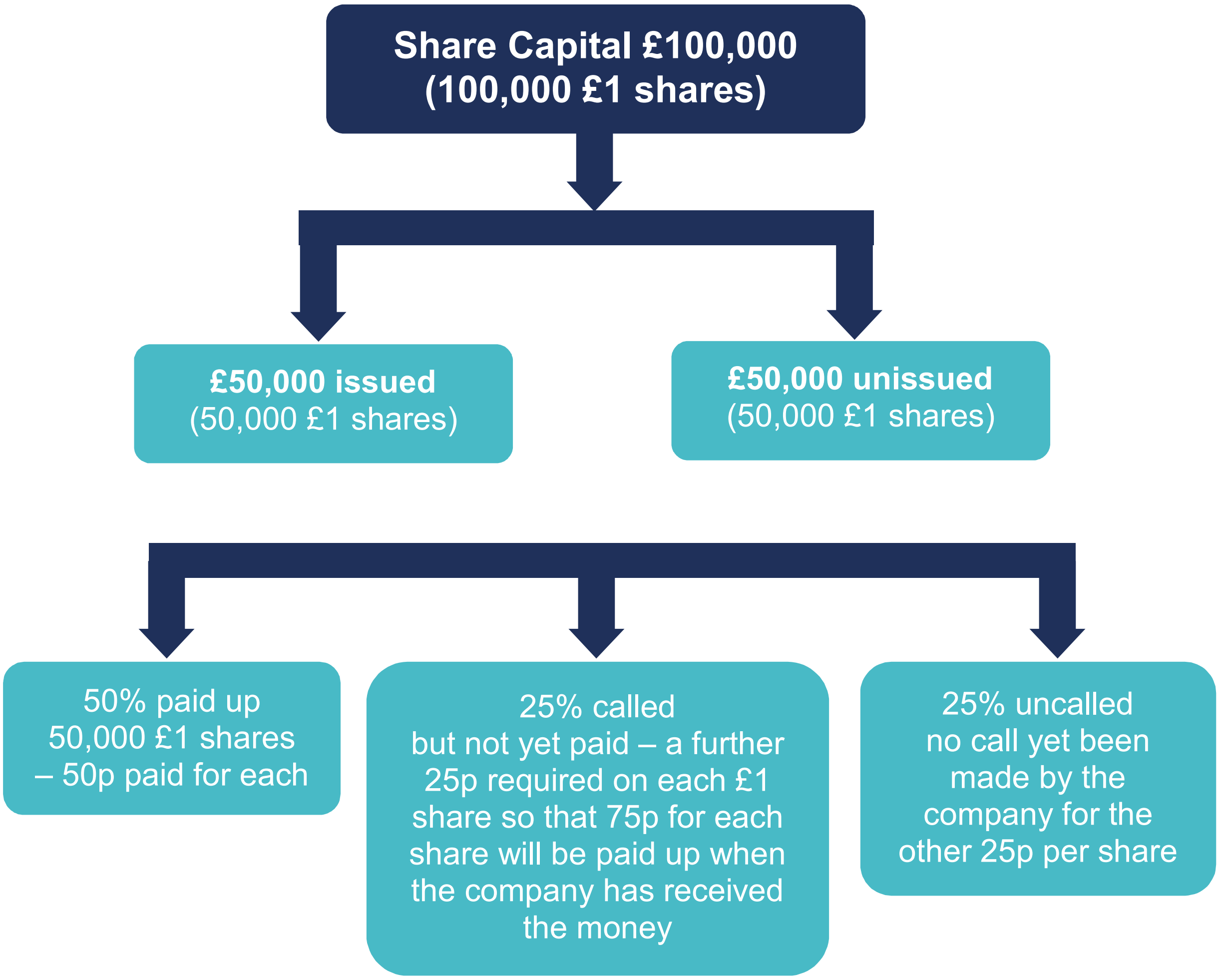
Minority protection

Minority protection concerning the variation of class rights is provided in s.633 CA06:



Notes

4 Terminology



Notes

Other issues of shares

Bonus issues	Rights issues
➢ Carried out by using some of the company's reserves to issue fully paid shares to existing shareholders in proportion to their shareholdings. ➢ Does not raise new funds.	➢ New shares offered to existing shareholders in proportion to their shareholdings. ➢ Raise new funds. ➢ Shares usually offered at discount to current market value (but not at discount to nominal value).

Pre-emption rights

Pre-emption rights are rights of first refusal. If shares have pre-emption rights this means a new issue must be offered to them first. A company cannot allot equity securities without first offering them to existing shareholders.

Only applies to ordinary shares which must be paid for in cash.

The shareholders then have 21 days to accept the offer.

Pre-emption rights can be disapplied by provision in the articles of association or by a special resolution being passed by the members.

Notes

5 Issue of shares

Allotment of shares

This is where the shares are allocated to a person under a contract of allotment. Once the shares are allotted and the holder is entered in the register of members, they become a member of the company.

Authority, discounts & premiums

The directors need authority to allot shares. This may be given by:

- The articles, or
- **Ordinary** resolution.

The authority must state:

- The maximum number of shares to be allotted, and
- The expiry date for the authority (max. 5 years).

The directors of a private company with only one class of shares may allot shares of that class unless it is prohibited by the articles: s.550 CA 2006.

Issue at a discount	**Issue at a premium**
➢ Shares **cannot** be issued at a discount on **nominal** value (s.580 CA06). ➢ If this rule is breached, issue is still valid but the shareholder is liable to pay the company the discount, plus interest. ➢ Debentures may be issued at a discount if no immediate right to convert to shares.	s.610 CA06 requires any premium to be credited to a share premium account, which may only be used for: ➢ writing off the expenses of the issue of those shares ➢ writing off any commission paid on the issue of those shares ➢ issuing bonus shares.

Notes

Paying for shares – private companies

Private companies may issue shares for non-cash consideration. The value of such consideration can be determined by the directors. The court will interfere with the valuation only if there is fraud or the consideration is 'illusory, past or patently inadequate'.

Paying for shares – public companies

There are a number of additional rules relating to the issue of shares in public companies contained in CA06:

s.584	Subscribers to the memorandum (the first shareholders in the company) must pay cash for their subscription shares.
s.585	Payment for shares must not be in the form of work or services.
s.586	Shares cannot be allotted until at least one-quarter of their nominal value and the whole of any premium have been paid up.
s.587	Non-cash consideration must be received within **five years**.
s.593	Non-cash consideration must be **independently valued** and reported on by a person qualified to be the company's auditor.

Notes

6 Capital maintenance

Purpose

The capital of a limited company is regarded as a 'buffer fund' for creditors. This doesn't mean that the creditors can withdraw funds from the share capital directly. Note that the creditors' buffer is an accounting fund, not real money. The actual cash or assets subscribed can be used by the company.

The rules on maintenance of capital exist in order to prevent a company reducing its capital by returning it to its members, whether directly or indirectly. A member of the company cannot simply withdraw their capital from the company.

Loan capital is not subject to the maintenance rules.

Reduction of capital

Under s.641, a company can reduce its share capital at any time, for any reason.

Reduce or cancel liabilities on partly-paid shares, i.e. the company gives up any claim for money owing.

Return capital in excess of the company's needs, i.e. the company reduces its assets by repaying cash to its shareholders.

Cancel the paid-up capital that is no longer represented by the assets, i.e. if the company has a debit balance on reserves it can write this off by reducing capital and thereby does not need to make good past losses.

Notes

Procedure for public companies:

Pass a special resolution.

Apply to the court to confirm the special resolution.

If reduction involves one of the first two methods above, court must require company to settle a list of creditors entitled to object.

The court must not confirm the reduction until it is satisfied that all creditors have either consented to the reduction or had their debts discharged or secured.

The company must file documents with the Registrar. If the share capital of a public company falls below £50,000, it must re-register as a private company.

Simplified procedure for private companies:

Pass a special resolution supported by a solvency statement.

The solvency statement is a statement by each of the directors that the company will be able to meet its debts within the following year.

A solvency statement made without reasonable grounds is an offence punishable by fine and/or imprisonment.

Copies of the resolution, solvency statement and a statement of capital must be filed with the Registrar within 15 days.

Notes

7 Treasury shares

Definition

These are created when a company purchases its own shares from distributable profits. The shares do not have to be cancelled. Up to 10% of the shares can be held 'in treasury' which means they can be re-issued without the usual formalities.

Previously treasury shares could only be created by public companies but since 30 April 2013 they can be created by private companies as well.

General rule

Shares which are purchased by a company must be cancelled and the amount of the company's share capital account reduced by the nominal value of the cancelled shares.

Exception

Under S724 CA 2006, companies can buy, hold and resell their shares.

The shares must be purchased from distributable profits and the company can cancel or sell them at any time.

Under S726 CA 2006, the shares will not give the company any voting rights in respect of those shares. In addition, no dividend or other form of distribution can be made in respect of them.

Notes

8 Distributions

Introduction

A company can only make a distribution (e.g. pay a dividend) out of profits available for that purpose i.e. distributable profits.

The model articles that dividends should be made as follows:

- The directors recommend the payment of a dividend.
- The general meeting declares it by passing an ordinary resolution.
- The amount paid cannot exceed the amount recommended by directors.

Distributable profits

Distributable profits are:

- Accumulated realised profits (which have not previously been distributed or capitalised), less
- Accumulated realised losses (which have not previously been written off in a reduction of capital): s830 CA 2006.
- **Profit/loss –** trading or capital.
- **Accumulated –** overall profit/loss, not just one year in isolation.
- **Realised –** not revaluation reserve. However, provisions (e.g. depreciation) are deemed realised.

Notes

Additional rules for a public company

A public limited company can only declare a dividend if, both before and after distribution, its net assets are not less than the aggregate of its called-up share capital and undistributable reserves (s.831 CA 2006).

Undistributable reserves are:

- The share premium account
- The capital redemption reserve
- Unrealised profits (i.e. revaluation reserve), and
- Any reserves that the company is forbidden to distribute.

The latest audited accounts are used as the basis of the calculations.

Consequences of an unlawful dividend

The company can recover the distribution from:

- Shareholders who knew or had reasonable grounds to know the dividend was unlawful
- Any director unless he can show he exercised reasonable care in relying on properly prepared accounts
- The auditors if the dividend was paid in reliance on their erroneous accounts.

Notes

9 Loan capital

All companies have the implied power to borrow for the purpose of business.

Loan capital comprises all the longer term borrowing of a company such as:

- permanent overdrafts at the bank
- unsecured loans either from a bank or other party
- loans secured on assets either from a bank or other party.

Companies often issue long-term loans in the form of **debentures**.

A debenture is a document issued by a company containing an acknowledgment of its indebtedness. The loan may or may not be secured on the company's assets.

All trading companies have the implied power to borrow for the purpose of their business.

Advantages	**Disadvantages**
➢ The board does not (usually) need the authority of a general meeting to issue debentures. ➢ As debentures carry no votes they do not dilute or affect the control of the company. ➢ Interest is chargeable against the profit before tax. ➢ Debentures may be cheaper to service than shares. ➢ There are no restrictions on issuing debentures at a discount or on redemption.	➢ Interest must be paid out of pre-tax profits, irrespective of the profits of the company. ➢ Default may precipitate liquidation and/or administration if the debentures are secured. ➢ High gearing will affect the share price.

Notes

10 Fixed v floating charges

Characteristics

If a debenture is issued with a charge the creditor is given security for their loan.

Characteristic	Fixed charge	Floating charge
Type of asset charged	Charge relates to a **specific** asset.	Charge relates to a **class** of assets, and refers to these assets present and future.
Must the asset be retained	**Yes:** intention is to retain the asset permanently in the business e.g. trading premises.	**No:** the assets within the class may change from time to time e.g. stock.
Freedom to deal with the asset	The company has **no general freedom** to sell the asset. If it does dispose of it, it must either repay the debt or transfer the charge to the purchaser.	The company **has freedom to deal** with the charged assets in the ordinary course of its business.

Crystallisation

A fixed charge attaches to an asset as soon as the charge is created. However, a floating charge does not attach to any particular asset until crystallisation.

Crystallisation means the company can no longer deal freely with the assets. It occurs in the following cases:

- On liquidation
- When the company ceases to carry on business; or
- On any event specified in the debenture (e.g. the company is unable to pay its debts; the company fails to look after its property; the company fails to keep stock levels sufficiently high).

Notes

Advantages and disadvantages of floating charges

Advantages – for the company	**Disadvantages for the chargee**
➢ The company can deal freely with the assets. ➢ A wider class of assets can be charged.	➢ The value of the security is uncertain until it crystallises. ➢ It has a lower priority than a fixed charge. ➢ A liquidator can ignore it if it was created within 12 months of winding up.

Notes

11 Priority and registration of charges

Priority

The priority of a charge depends on the type of charge and whether or not it has been registered:

Equal charges – first created has priority.

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Fixed charge has priority over a floating charge.

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An unregistered registerable charge has no priority over a registered charge.

A charge-holder can prohibit the creation of a later charge with priority, but the prohibition is only effective if a subsequent chargee has notice of the prohibition as well as the charge.

Notes

Registration

The company must notify the Registrar within **21 days** of the charge's creation.

Registration can be undertaken by:

- The company, or
- The charge holder.

Failure to register:

- Renders the charge void against the liquidator
- Results in a fine on the company and every officer in default, and
- Renders the money secured immediately repayable.

If the charge relates to land it must also be registered with the Land Registry.

The company must also include the charge in its own register of charges. However, failure to include the charge in the company's own register does not invalidate the charge.

Notes

12 Loan capital versus share capital

	Loan capital	Share capital
Definition	A debenture is a document issued by a company containing an acknowledgment of its indebtedness.	A share is the interest of a shareholder in a company measured by a sum of money. It is a bundle of rights and obligations.
Voting rights	A debenture is a creditor of the company and therefore has no voting rights.	A shareholder is a member (owner) of the company and therefore has voting rights, depending on the class of shares held.
Income	A debenture has a contractual right to interest, irrespective of the availability of profits.	Dividends depend on the availability of profits.
Liquidation	A debenture has priority with respect to repayment.	Shareholders receive repayment after creditors, but can participate in surplus assets.

Notes

Questions

You can now attempt the following from the Text:

Chapter 8 TYUs 1–7

Chapter 13 Qs 41–46

Notes

Chapter 9

Directors

Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain the role of directors in the operation of the company
- discuss the ways in which the directors are appointed, can lose their office or be subject to a disqualification order
- distinguish between the powers of the board of directors, the managing director and individual directors to bind the company
- explain the duties that directors owe to their companies
- demonstrate an understanding of the way in which statute law has attempted to control directors.

PER

One of the PER performance objectives (PO4) is to contribute effective governance in your area. You evaluate, monitor and implement risk management procedures, complying with the spirit and the letter of policies, laws and regulations. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 9 of your Study Text

Overview

TYPES OF DIRECTOR

↓

APPOINTMENT, REMOVAL AND DISQUALIFICATION

↓

DUTIES

↓

POWERS

1 Directors

Definition of director

The term 'director' includes every person occupying the position or fulfilling the role of director, whatever he is called: s.250 CA06.

Every company must have at least one director and a public company must have at least two directors: s.154 CA06.

Generally, a director must be at least aged 16 (but there are some exceptions).

The decision as to whether someone is a director is therefore based on their function, not their title.

Under SBEEA 2015 all directors must be natural persons.

De Jure Director

A person who is formally and legally appointed or elected as director in accordance with the articles of association of the company and gives written consent to hold the office of a director.

De Facto Director

A person who is not a de jure director but performs the acts or duties of a director.

Any person, who is not technically a director, but according to whose directions and instructions other directors and employees are accustomed to act, is legally deemed a de facto director.

A de facto director owes the same duties to the company as a de jure director, i.e. he is subject to both statutory duties and prohibitions, and he also owes fiduciary duties to the company.

Notes

Types of director

Shadow director	➢ 'A person in accordance with whose directions or instructions the directors of a company are accustomed to act' s.251 CA06. ➢ Not a shadow director if directors only act on advice given by him in a professional capacity.
Alternate director	➢ A director may appoint an alternate director to attend and vote at board meetings. ➢ The alternate director may be another director or an outsider. ➢ Some articles provide for such an appointment to be subject to the approval of the board.
Executive director	➢ Likely to be a full-time employee involved in management. ➢ Usually has a specific role, e.g. marketing director.
Non-executive director	➢ Usually part-time. ➢ Brings outside expertise to board. ➢ Not an employee. ➢ Exerts control over executive directors.
Managing director ('MD')	➢ The board usually delegates to the MD the day-to-day management of the company's business.
Chairman	➢ Responsible for ensuring procedure in meetings is followed. ➢ Usually a non-executive director.

Notes

2 Appointment, disqualification and removal

Appointment

Appointment procedure	➢ Usually appointed by the existing directors or by ordinary resolution (see later in this chapter). ➢ Directors of public companies should generally be voted on individually: s.160 CA06. ➢ A director's actions are valid notwithstanding that his appointment was defective: s.161.
Publicity	➢ The company must notify the Registrar within 14 days of new appointments and any changes in particulars. It must also enter details in the Register of Directors.

Removal

A director might leave office in any one of the following ways:

- Death of the director or winding up of the company
- Removal
- Disqualification (seen later in the chapter)
- Resignation
- Not offering himself for re-election, where the articles provide for retirement and re-election of directors.

Notes

The procedure for the removal of a director is as follows:

Special notice (28 days) is required of the resolution by persons wishing to remove a director; s.168 CA 2006. The company must forward a copy of the resolution to the director concerned.

↓

Notice of the meeting goes to the director and all members entitled to attend and vote.

↓

The director in question can require the company to circulate written resolutions to members (s.169).

↓

At the meeting, the director can read out representations if there was no time for prior circulation. The director must be allowed to attend the meeting and to speak. An ordinary resolution is needed to remove the director: s168.

The removal of an executive director may be held to be breach of his service contract and he may be able to sue for such.

The power of the members to remove a director may be limited:

- A director who is also a member may validly be given weighted voting rights in respect of a decision to remove them (see Illustration below).
- A shareholder agreement may state that shareholders holding each class of shares must be present at a meeting for the decisions to be valid. Thus would mean that if there is only one shareholder in a class, by not attending a meeting he could prevent the director from being removed.

Notes

Illustration 1 – Directors

BUSHELL v FAITH (1970)

Facts:

A provision in the articles tripled the number of votes of shares held by directors on a resolution to remove them. Statute only required an ordinary resolution and made no provision as to how it could be obtained or defeated.

Held:

The weighted voting rights provided in the articles were valid.

Note that the removal of a director may result in the breach of his service contract and may entitle him to sue for compensation.

Disqualification

Under the Company Directors Disqualification Act 1986, a disqualified director cannot be concerned in the management of a company, directly or indirectly, or act as a liquidator, receiver or promoter.

Grounds for disqualification:

- Persistent breaches of the Companies Act e.g. failure to file returns (maximum 5 years' disqualification). Three convictions for default in five years is conclusive evidence of persistent breach.

- Conviction of a serious offence in connection with the management of a company (max. 15 years' disqualification).

- Fraudulent or wrongful trading (max. 15 years' disqualification).

- An investigation by the Department for Business, Innovation and Skills (formerly the Department for Business, Enterprise and Regulatory Reform) finds the director to be unfit to be concerned in the management of a company (max. 15 years' disqualification).

- Liquidator's report finds the director to be unfit to be concerned in the management of a company (min. 2 years' and max. 15 years' disqualification).

Breach of a disqualification order:

- This is a criminal offence, which could result in a fine and imprisonment.
- The disqualified director (or any person who acts on his instructions) is personally liable for the debts of the company while so acting.

Notes

3 Duties

3.1 General duties

Prior to the Companies Act 2006, common law rules and 'equitable principles' made up the law on directors' duties. These have now been replaced by the specific statutory duties provided in the Companies Act 2006.

It should be noted that there are specific legal duties given in the legislation to directors such as the duty to prepare a directors report, and as such these may be referred to as the **general duties** of the directors.

s.171 To act within powers	➢ A director must act in accordance with the company's constitution and only use his powers for the purpose which they were given. ➢ If this rule is not adhered to the transaction will be void, unless it is approved by shareholders in a general meeting.
s.172 To promote the success of the company	➢ A director must act in good faith, in a way which promotes the success of the company and for the benefit of the members as a whole. ➢ The Act requires directors to have regard to: (a) the likely consequences of any decision in the long term (b) the interests of the company's employees (c) the need to foster the company's business relationships with suppliers, customers and others (d) the impact of the company's operations on the community and the environment (e) the desirability of the company maintaining a reputation for high standards of business conduct; and (f) The need to act fairly as between members of the company.

s.173 To exercise independent judgment	➢ This duty is not infringed by a director acting: (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or (b) In a way authorised by the company's constitution.
s.174 To exercise reasonable care and diligence	➢ The standard expected of a director is that of a reasonably diligent person with: (a) the general knowledge, skill and experience that could reasonably be expected of a director, and (b) The actual knowledge, skills and experience held by the director.
s.175 To avoid conflicts of interest	➢ A director must avoid any situation which places him in direct conflict with the interests of the company or the performance of any other duty. ➢ This duty is not infringed if the matter has been authorised by the directors, provided the articles do not invalidate the authorisation (in the case of a private company) or expressly allow the authorisation (in the case of a public company). ➢ The relevant director does not count towards a quorum and his votes are not included in determining whether authorisation has been given.
s.176 Not to accept benefits from third parties	➢ A director must not accept any benefit from a third party which arises by reason of him being a director or performing/not performing an act as a director, unless acceptance cannot reasonably be regarded as likely to give rise to a conflict of interest.
s.177 To declare an interest in a proposed transaction or arrangement	➢ A director must declare the extent and nature of such an interest to the other directors. ➢ This declaration can be made in writing, at a board meeting or by a general notice that he has an interest in a third party.

Notes

Illustration 2 – Duties

Duty to act within powers

HOGG v CRAMPHORN (1967)

Facts:

The directors issued further shares and gave financial assistance for their purchase in an attempt to fight off a takeover bid, believing it to be in the best interests of the company.

Held:

The directors were in breach of the duty to act within their powers; however it was open to the members to ratify their actions, which they did.

Illustration 3 – Duties

Duty to exercise reasonable care and diligence

DORCHESTER FINANCE CO. LTD v STEBBING (1989)

Facts:

The company was a money-lending company and had three directors, Parsons, Hamilton and Stebbing. All three had considerable accountancy and business experience (Parsons and Hamilton were chartered accountants). No board meetings were ever held and Parsons and Hamilton left all the affairs of the company to Stebbing. Parsons and Hamilton did, however, turn up from time to time and signed blank cheques on the company's account which they left Stebbing to deal with. Stebbing loaned the company's money without complying with statutory regulations applying to money lending, such that the loans were unenforceable.

Held:

All three were liable in negligence. If a director has a special skill (e.g. as an accountant) he is expected to use it for the benefit of the company.

Notes

Illustration 4 – Duties

Duty to declare any interest in a proposed transaction or arrangement

IDC v COOLEY (1972)

Facts:

Cooley, the managing director of IDC, had been negotiating a contract on behalf of the company, but the third party wished to award the contract to him personally and not to the company. Without disclosing his reason to the company (or its board) he resigned in order to take the contract personally.

Held:

He was in breach of fiduciary duty as he had profited personally by use of an opportunity which came to him through his directorship: it made no difference that the company itself would not have obtained the contract. He was therefore accountable to the company for the benefits gained from the contract.

The IDC case illustrates that an individual may still be subject to the duties even after he ceases to be a director.

Notes

Breach of directors' duties

Directors owe their duties to the company as a whole. This has traditionally been taken to mean to the shareholders as a collective body, which includes present and future shareholders.

The directors owe no general duty to individual members: Percival v Wright (1902).

If a director breaches their duty that breach may be subsequently ratified by the members, subject to the rules regarding ratification seen in Chapter 4 (agency law).

Breach of duty may carry the following consequences:

- The director may be required to make good any loss suffered by the company.
- Contracts entered into between the company and the director may be rendered voidable.
- Any property taken by the director from the company can be recovered from him if still in his possession.
- Property may be recovered directly from a third party, unless that third party required it for value and in good faith.
- An injunction may be an appropriate remedy where the breach has not yet occurred.

S.232 provides that any provision to exempt a director from or indemnify him against any liability for breach of duty or negligence is void.

Notes

4 Powers

The division of power within a company

The legal theory is that all decisions about the running of the company's business should be taken by the members in general meeting. However, the members usually delegate the power to manage the business to the directors and they exercise all the powers of the company on a day-to-day basis.

Directors are required to exercise their powers in accordance with the company's constitution.

Note that the power to manage the business of the company is given to the board as a whole, not to the individual directors. Where a company's articles delegate the management of the company's business to the board, the members have no right to interfere in decisions made by the board. Directors are not agents of the members and are not subject to their instruction as to how to act.

Restrictions on the directors' powers

Although the directors are given the power to run the company once they are appointed by the members there are some restrictions put on this power.

General statutory restriction

The Companies Act 2006 states that directors must only use their powers 'for the purpose for which they are conferred'. A director using their powers for any other reason would be held to be in breach of their duties.

Specific statutory restrictions

When running the company the Companies Act states that there are certain decisions for which the directors must gain shareholder approval by way of an ordinary or special resolution, for example alteration of the articles and reduction of share capital (seen in the previous chapter).

Notes

Restriction of powers made by the members

If the members are unhappy with the way a company is being run they have two additional courses of action open to them:

- A director can be removed at any time by an ordinary resolution of the members and they may see fit to exercise this right should their views be ignored.

- The members can alter the articles by passing a special resolution. This power could therefore be used to restrict the directors' powers.

Notes

Approval of directors' actions

Certain matters require the approval of the members in a general meeting in order to be valid. For example:

Service contracts (s.188)	➢ Approval is required if the contract is for a guaranteed period of two years or more. ➢ If not approved, the contract is deemed to include a term allowing the company to terminate it **by reasonable notice** at any time.
Substantial property transactions (s.190)	➢ This is where a director acquires from the company (or vice versa) a substantial non-cash asset. ➢ An asset is 'substantial' if its value either exceeds £100,000 or exceeds 10% of the company's asset value and is more than £5,000. ➢ Failure to obtain the members' approval results in the following consequences: – the transaction is **voidable** by the company, unless the members give approval within a reasonable period – The director is **liable to account** to the company for any gain or indemnify it against any loss.
Loans to directors (s.197)	➢ Any loan by a company to a director or for any guarantee or security by a company in connection with a loan made by another party to a director. ➢ A written memorandum setting out the details of the transaction proposed must be given to the members. ➢ Failure to obtain the members' approval results in the following consequences: – the transaction is **voidable** by the company, unless the members give approval within a reasonable period; and – The director is **liable to account** to the company for any gain or indemnify it against any loss.

	➢ The following loans do not require approval: – expenditure on company business, defending proceedings or regulatory action or investigation – minor transactions or any in the ordinary course of business – intra-group transactions; and – Where the business of the company is money-lending.
Payments for loss of office (s.217)	➢ Payments or benefits to be made on loss of office or retirement. ➢ A written memorandum of the proposed payment (or other benefit) must be sent to all members. ➢ Payment will be held on trust for the company where approval is not sought. ➢ Any director who authorised the payment is liable to indemnify the company for any loss.

Notes

Authority of directors

Transactions by individual directors

Individual directors cannot bind the company without being given authority to do so. There are three ways in which this authority may be given:

Express	➢ Where authority is expressly given, all decisions taken are binding.
Implied	➢ Authority flows from a person's position. ➢ The person appointed as the managing director has the implied authority to bind the company in the same way as the board. ➢ The managing director is assumed to have all powers usually exercised by a managing director.
Apparent/ Ostensible	➢ Such authority arises where a director is held out by the other board members as having the authority to bind the company. ➢ At common law, if a third party acts in good faith on such a representation, the company is 'estopped' from denying its truth: Freeman & Lockyer v Buckhurst Park Properties (1964). ➢ For these purposes the third party is deemed to be acting in good faith unless the contrary is proved, i.e. unless he had **actual** knowledge of the lack of authority.

Transactions beyond the board's powers

- Where the directors of a company acting together purport to have authority to bind the company, legislation provides that this will be given effect to, even where they have exceeded the board's authority under the articles of the company.
- To this effect, s.40 CA 2006 states that the power of the directors to bind the company, or to authorise another to bind the company, will not be limited by anything in the company's constitution, **provided** the other party is acting in good faith.
- Having said that, s.40 then goes on to state that even where there is **actual knowledge** of the lack of authority this is not enough to count as lack of good faith (in contrast to the position re individual directors at common law, outlined above) so on the face of it, any contract entered into by the board of a company will be binding.

- It should be noted that even under these provisions, there is nothing to stop a member from acting to restrain the directors from entering a transaction that is beyond their powers (s.40 (4)).
- Where, however, the third party to the transaction is also a director of the company or a person associated with a director, the transaction becomes **voidable** at the company's instance (s.41 CA 2006).
- Moreover, the third party director or associate, and any director who authorised the transaction, is then liable to **compensate** the company for any profit made or to indemnify the company for any loss or damage arising, whether the company chooses to avoid the contract or not.

Notes

Questions

You can now attempt the following from the Text:

Chapter 9 TYUs 1–2

Chapter 13 Qs 47–52

Notes

Chapter 10

Corporate administration

Chapter learning objectives

Upon completion of this chapter you will be able to:

- discuss the appointment, duties and powers of, a company secretary
- discuss the appointment, duties and powers of, the company auditors
- distinguish between types of meetings: general meetings and annual general meetings
- explain the procedure for calling such meetings
- detail the procedure for conducting company meetings
- distinguish between types of resolutions: ordinary, special, and written.

PER

One of the PER performance objectives (PO1) is to always act in the wider public interest. You need to take into account all relevant information and use professional judgement, your personal values and scepticism to evaluate data and make decisions. You should identify right from wrong and escalate anything of concern. You also need to make sure that your skills, knowledge and behaviour are up-to-date and allow you to be effective in your role. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 10 of your Study Text

Overview

Company Secretary

↓

Auditor

↓

Types of meetings

↓

Resolutions

1 Company secretary

Every public company must have a qualified company secretary. Private companies may choose to appoint a secretary, but are not obliged to do so. The company secretary is the chief administrative officer of the company.

The secretary is usually appointed and removed by the directors.

The secretary of a public company must be qualified under one of the following conditions:

- Is a solicitor, barrister or member of ICAEW, ACCA, CIMA, ICSA, CIPFA, or
- Appears capable of discharging the functions by virtue of another position or qualification.

There are no statutory duties; therefore the duties will be whatever the board decides. The company secretary will typically undertake the following:

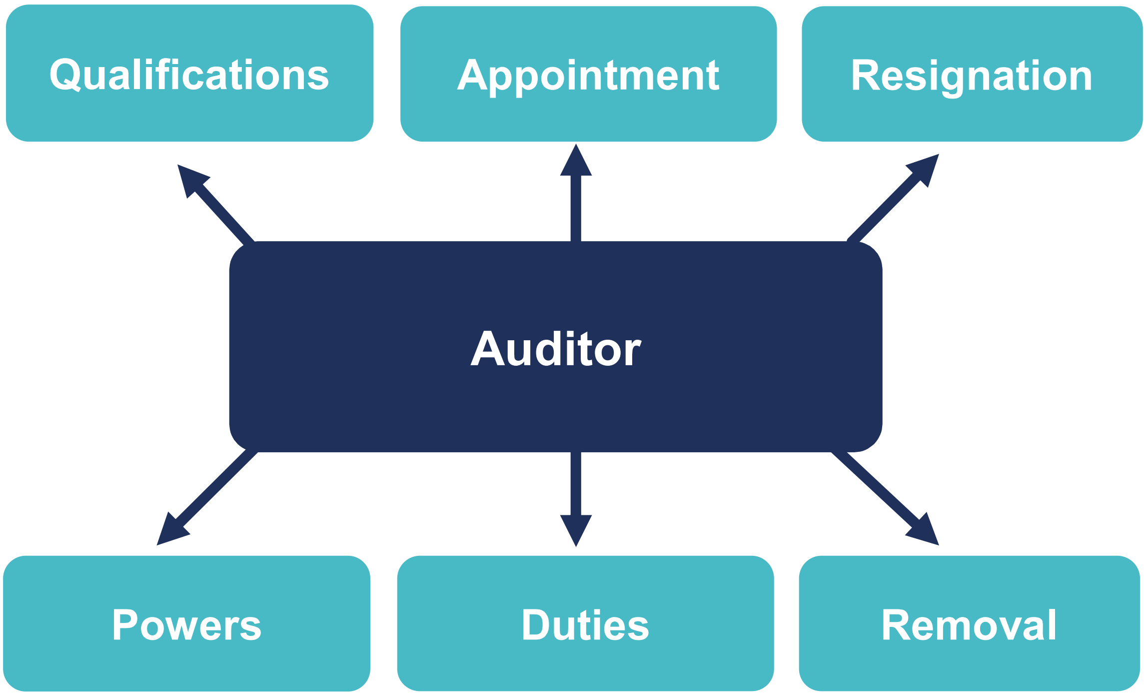
- Make returns to the Registrar
- Keep registers, and
- Give notice and keep minutes of meetings.

The company secretary has the authority to bind the company in contract. Authority may be:

- Actual – this is the authority delegated by the board; or
- Implied – this usually involves contracts of an administrative nature. It does not extend to making contracts of a commercial nature or to borrowing money.

Notes

2 The auditor



Notes

3 Meetings

Annual General Meeting (AGM)

Timing	Held **once a year,** within the 6 months following the accounting reference date: s.336.
Failure to hold	The company and every officer in default can be fined.
Private companies	Private companies are **not required to hold an AGM**.
Notice	**21 days' notice** is required unless every member entitled to attend and vote agrees to a shorter period. Must state that the meeting is an AGM.
Business	Usual business includes: ➢ consider accounts ➢ appoint auditors ➢ elect directors ➢ declare dividends.
Resolutions	Members can force the inclusion of a resolution on the agenda of the AGM if they: hold 5% of voting rights, or 100 members each hold an average of £100 of the paid up share capital: s.338 CA 2006.

Notes

General Meetings (GM)

Timing	Held whenever required. Must be held by a plc if a **serious loss of capital** has occurred, i.e. net assets have fallen to less than half of the called up share capital.
Notice	At least **14 days**.
Business	The person who requisitions the meeting sets the agenda.

Class meetings

Purpose	Meeting of a class of shareholders (or debenture holders), usually to consider a variation of their class rights.
Procedure	Notice, etc. as for general meetings.
Quorum	Two persons holding or representing by proxy at least 1/3 in nominal value of the issued shares of the class in question.

Notes

4 Calling a meeting

Who can call a meeting?

Directors	Articles usually delegate power to directors.
Members	Members may require the directors to call a GM if they hold: ➢ at least 5% of the paid up voting capital, or ➢ at least 5% of the voting rights (in a company with no share capital). Directors must call a meeting within **21 days** of receiving a requisition. The meeting must take place within **28 days** of the notice convening the meeting. If the directors do not call a meeting, the members who requested the meeting (or any members holding over 50% of the total voting rights) may themselves call a meeting to take place **within three months** of the initial request and recover expenses from the company.
Resigning auditor	Auditors may require the directors to convene so they can explain the reasons for their resignation.
Court	A court can call a meeting on the application of a director or member where it would otherwise be impracticable e.g. to break a deadlock.

Notes

Notice

Who must receive notice?	Every member and every director: s.310.
Failure to give notice	Accidental failure does not invalidate the meeting: s.313.
Contents of notice	Date, time and place of the meeting. The general nature of business to be transacted. The text of any special resolutions.
Length of notice period	**AGM – 21 days** Less if every member entitled to attend and vote agrees. **GM – 14 days** Less if the majority of members holding at least 90% of the shares agree (this can be increased to 95% by the articles).
Special notice	Requires **28 days' notice**. Required for the removal of a director or auditor. During this time the person in question can submit written representations and require them to be circulated.

Notes

5 Resolutions

Type:	% required to pass:	To Registrar?	When used?
Special	≥75%	Yes – within 15 days	When the law or the articles state a special resolution should be used. For example ➢ Alter name. ➢ Wind up company. ➢ Alter articles. ➢ Reduce share capital.
Ordinary	>50%	Only if required by statute	Used whenever the law or the articles do not require a special resolution.
Written (private companies only)	Same majority as required in GM	Yes if a 75% majority is required	Can be used for any decision apart from resolutions requiring special notice. Members cannot revoke their agreement. The date of the resolution is the date when the necessary majority has been reached. The resolution must be passed within 28 days of its circulation.

Notes

6 Procedure at meetings

A quorum is the minimum number of members that needs to be present at a meeting in order to validate business. It is generally two persons, members or proxies. If a quorum is not present the meeting is often described as being **inquorate**.

Voting is by a show of hands initially, unless a poll is demanded.
A show of hands means one member one vote, irrespective of the number of shares held.

A poll may be demanded by members holding at least 10% of the total voting rights. A poll means the member get the number of votes they are entitled to by their shareholding. The result of a poll replaces the result of the previous show of hands. Quoted companies must publish the results of polls on their website: s.341 CA 2006.

Members of companies have a statutory right under s.324 to appoint one or more persons as their ‘proxy’. A proxy can attend meetings, vote and speak on behalf of the member for whom he is acting.

Notes

Questions

You can now attempt the following from the Text:

Chapter 10 TYUs 1–3

Chapter 13 Qs 53–56

Notes

Chapter 11

Insolvency

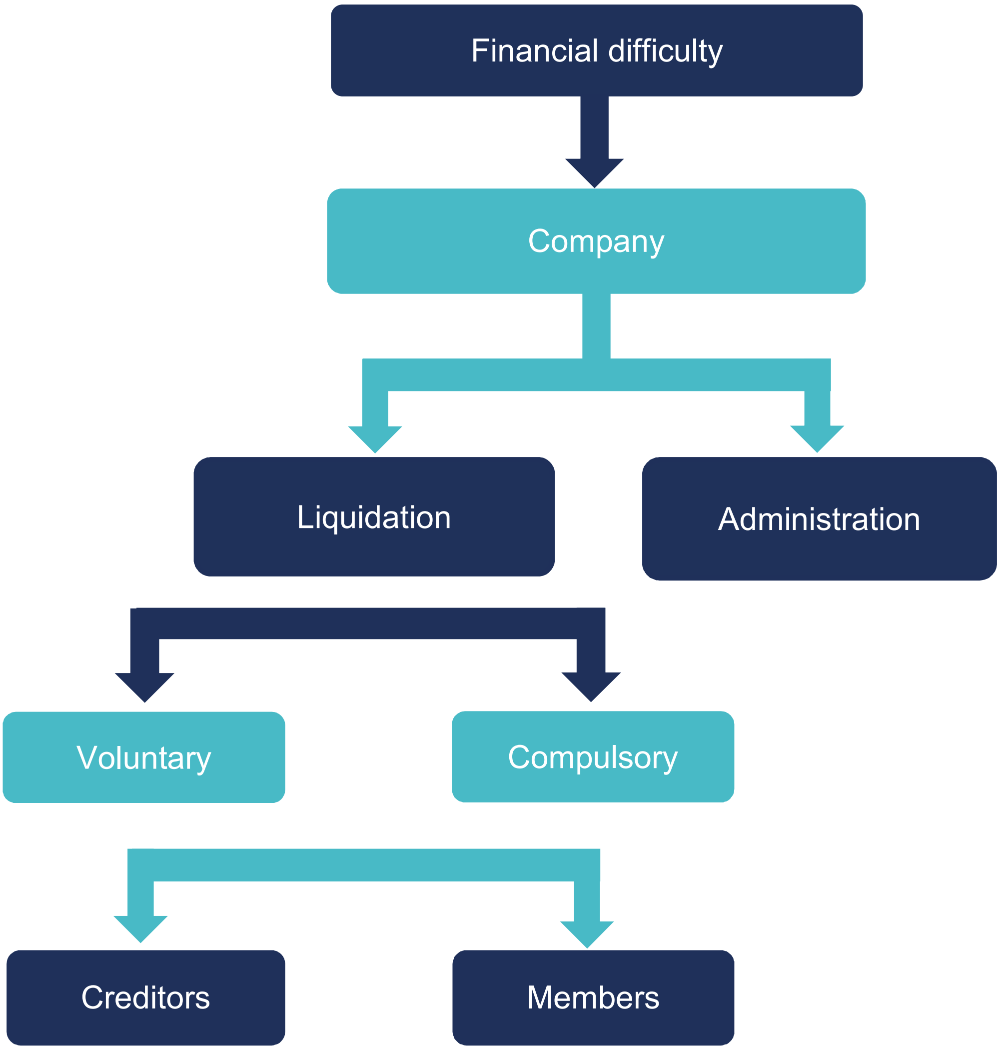
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain the meaning of and the procedure involved in voluntary liquidation
- explain the meaning of and the procedure involved in compulsory liquidation
- explain administration as an alternative to liquidation.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 11 of your Study Text

Overview


Financial difficulty
Company
Liquidation
Administration
Voluntary
Compulsory
Creditors
Members

1 Voluntary liquidation

Liquidation is the formal process of ending the life of a company. Unlike a partnership, the company continues to exist when the trade is ceased and will remain in existence until the process of liquidation is completed.

Liquidation can be described as:

- Voluntary
- Compulsory (see below)

A voluntary liquidation occurs where the members pass a resolution to go into liquidation.

The type of resolution needed depends on the circumstances:

- Where the period fixed for the duration of the company expires or an event occurs upon which the articles provide that a company should be wound up, an **ordinary resolution** must be passed.
- A **special resolution** must be passed if the company is being wound up for any other reason.

Once the resolution has been passed, notice of the liquidation should be posted in the London Gazette within 14 days.

There are two types of voluntary liquidation:

- A members' voluntary liquidation is used where the company is **solvent**.
- A creditors' voluntary liquidation is used where the company is **insolvent**.

Notes

Chapter 11

Members' voluntary winding up

The directors make a **declaration of solvency** stating that they are of the opinion that the company will be able to pay its debts within 12 months. It is a criminal offence to make a false declaration. The declaration must be made not more than five weeks before the resolution to wind up is passed and must be delivered to registrar within 15 days.

↓

Winding up commences from the date of passing of the appropriate resolution.

↓

The members appoint a named insolvency practitioner as liquidator by passing an ordinary resolution.

↓

The liquidator is responsible for realising the assets and distributing the proceeds.

↓

The liquidator presents his report to a **final meeting** of the members.

↓

The liquidator **informs the Registrar** of the final meeting and submits a copy of his report.

↓

The Registrar registers the report and the company is **dissolved three months later**.

Notes

Chapter 11

Creditors’ voluntary winding up

Winding up commences from the passing of the appropriate resolution.

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The members appoint a liquidator. The directors must then deliver a notice to the creditors seeking their decision on the liquidator. The directors must also send to the creditors **a statement of the company’s affairs** within 7 working days.

↓

The creditors can approve the liquidator either by virtual meeting or by the ‘deemed consent’ process. Under this process approval is deemed unless 10% of the creditors of the company raise objections to the proposed liquidator. The members and creditors may appoint up to five persons to serve on **a liquidation committee**.

↓

The liquidator is responsible for realising the assets and distributing the proceeds.

↓

The liquidator submits his final report to the members and creditors.

↓

The liquidator submits a copy of his report to the Registrar.

↓

The Registrar registers the report and the company is **dissolved three months later**.

Notes

2 Compulsory liquidation

Grounds for winding-up: s122 IA 1986

A compulsory winding up commences when a petition for a winding up order is presented to and approved by the court. The court then passes an order that the company is to be wound-up.

The possible grounds for the petition are set out in s122 Insolvency Act 1986. The main ones of these are:

- A public company has not been issued with a trading certificate within a year of incorporation and a petition has been.
- The company is unable to pay its debts. A company is deemed to be unable to pay its debts where a creditor who is **owed at least £750** has served a written demand for payment and the company has failed to pay the sum due **within three weeks**.
- It is **just and equitable** to wind up the company. However, the court will only make an order under this ground if no other remedy is available.

Petitioners

The following persons may petition the court for a compulsory liquidation:

- The DBEIS
- A member (to claim for just and equitable winding-up they must have been a registered shareholder for at least six of the last 18 months)
- A creditor who is owed at least £750.

Notes

Effect of winding-up

The winding-up petition has the following effects:

- All actions for the recovery of debt against the company are stopped.
- Any floating charges crystallise.
- Any legal proceedings against the company are halted, and none may start unless leave is granted from the court.
- The company ceases to carry on business except where it is necessary to complete the winding up, for example to complete work-in-progress.
- The powers of the directors cease, although they still continue in office.
- The employees are automatically made redundant, but the liquidator can re-employ them to help him complete the winding-up.

Notes

Subsequent procedures

On the making of the winding-up order, the Official Receiver becomes liquidator.

↓

Within three months, the Official Receiver will summon meetings of the contributories in order to appoint a licensed insolvency practitioner to take over the job of liquidator. Creditor approval of the liquidator is sought via the 'deemed consent' process. If 10% or more object an alternative decision making procedure such as virtual meeting should be used.

↓

The liquidator is responsible for realising the assets and distributing the proceeds.

↓

The liquidator returns to the court and the court passes an order dissolving the company.

↓

The liquidator **files the order and their final report with the Registrar**.

↓

The Registrar registers the report and the company is **dissolved as from the date of the order**.

Notes

Application of assets

The liquidator must repay debts in the following order:

- Fixed charge-holders
- Expenses of liquidation
- Preferential creditors
    - Wages or salaries due to employees in the four months preceding the commencement of winding up
    - All accrued holiday pay
    - Employee's occupational pension contributions

  (All preferential creditors rank equally amongst themselves)
- Floating charge-holders (However, a certain percentage of assets are ring-fenced for unsecured creditors)
- Unsecured creditors – rank equally amongst themselves
- Post-liquidation interest
- Members – declared but unpaid dividends
- Members – return of capital (in accordance with class rights)
- Any surplus to be distributed to members.

Notes

3 Administration

Introduction

If a company finds itself in financial difficulty, the two main options available to it are:

- Administration. This aims to rescue the company so that it may continue trading as a going concern.
- Liquidation. (As seen above)

Purpose

Administration involves the appointment of an insolvency practitioner, known as an administrator, to manage the affairs, business and property of a company. It was first introduced by Schedule 16 Insolvency Act 1986, but has subsequently been amended by the Enterprise Act 2002.

Administration is often used as an alternative to putting a company into liquidation, for example to:

- Rescue a company in financial difficulty with the aim of allowing it to continue as a going concern
- Achieve a better result for the creditors than would be likely if the company were to be wound up
- Realise property to pay one or more secured or preferential creditors.

Notes

Who can appoint an administrator?

An administrator can be appointed by any of the following persons:

- The court in response to a petition by e.g. a creditor, the directors or the company itself.
  - The court will only agree to appoint an administrator if it is satisfied that:
    - The company is or is likely to become unable to pay its debts, and
    - The administration order is likely to achieve its objectives.
- The holder of a qualifying floating charge over the company's assets.
- The company or its directors provided that winding up has not already begun.

Consequences of administration

The appointment of an administrator has the following effects:

- The company enters into a 'moratorium' period during which:
  - The rights of creditors to enforce any security over the company's assets are suspended
  - Any petition for winding up is dismissed
  - No resolution may be passed to wind up the company
  - No other legal proceedings can be commenced
  - No property which the company has under an HP/leasing agreement can be recovered without consent of the administrator or the court.
- The directors still continue in office, but their powers are suspended.

Notes

Carrying out the administration

The administrator has a number of tasks:

- He is the company's agent, but must act in the best interests of all the company's creditors.
- He takes on the powers previously given to the directors. Therefore he may manage the business and property of the company, and has the power to bring and defend legal proceedings, sell assets and borrow money.
- He has the power to remove and replace directors and employees.
- He must file notice of his appointment **within 7 days**.
- He must draw up a statement of his proposals **within eight weeks** of his appointment.
- The proposals must be approved by the creditors of the company. This approval can be given by:
  - Deemed consent process
  - Virtual meeting
  - Some other reasonable method.
- The creditors have the right to form a creditors meeting of between 3 to 5 creditors. If formed the administrator must hold a meeting of the creditors within 6 weeks of its establishment.
- If the creditors do not approve the proposals, the court may dismiss the administrator or make such provisions as it sees fit.
- If the creditors approve the proposals, the administrator can carry them out.

Notes

Ending the administration

The administration will end when it is completed or when the administrator is discharged by the court:

The administration must normally be completed **within 12 months** of the date on which it commenced. However, this term can be extended with the consent of the court or by a majority of the creditors.

Notes

Questions

You can now attempt the following from the Text:

Chapter 11 TYUs 1–3

Chapter 13 Qs 57–60

Chapter 12

Corporate and fraudulent behaviour

Chapter learning objectives

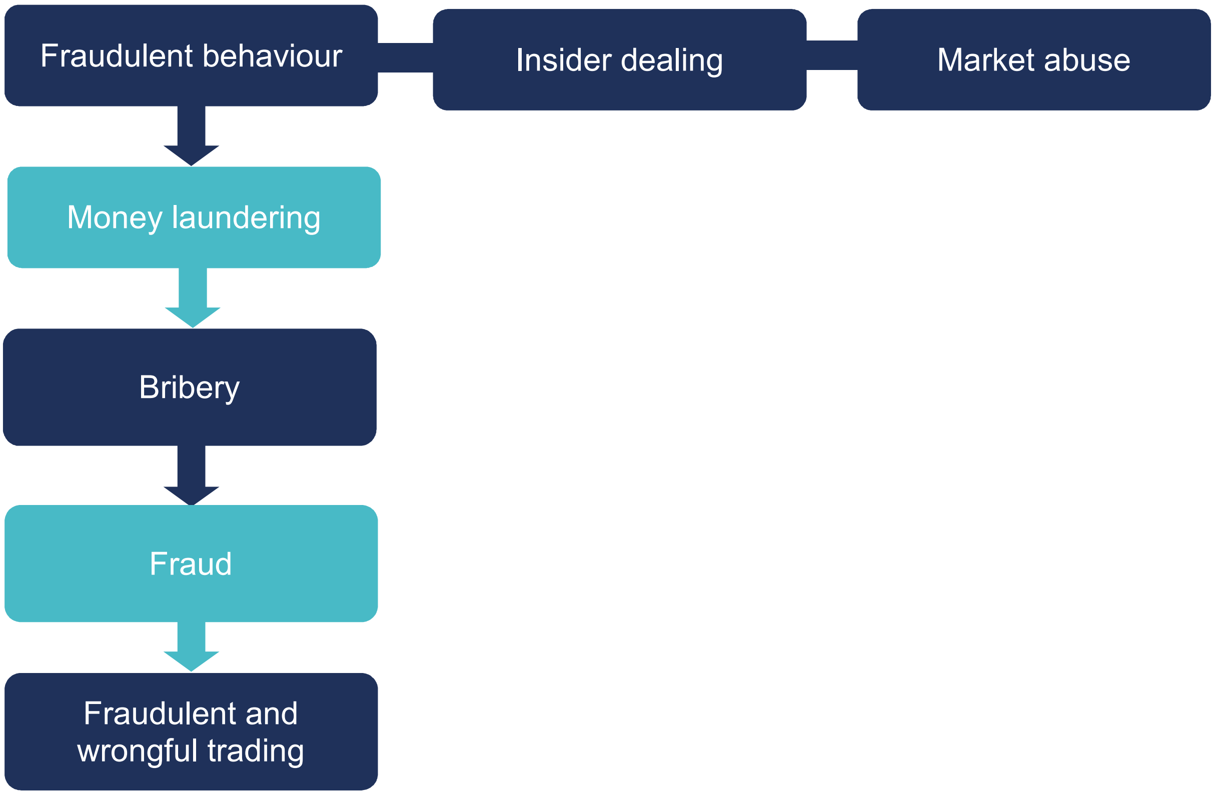
Upon completion of this chapter you will be able to:

- recognise the nature and legal control over insider dealing and market abuse
- recognise the nature and legal control over money laundering
- recognise the nature and legal control over bribery
- discuss potential criminal activity in the operation, management and winding up of companies
- distinguish between fraudulent and wrongful trading.

The underpinning detail for this Chapter in your Workbook can be found in Chapter 12 of your Study Text

Chapter 12

Overview



1 Insider dealing

Insider dealing

Insider dealing is an offence whereby a person deals in securities, whilst in possession of information about those securities which is not commonly available and which would affect the price of those securities were it commonly known.

The legislation governing insider dealing is contained in the Criminal Justice Act 1993.

The offences

An individual who has information as an insider is guilty of insider dealing if:

- He deals in securities on which he has inside information
- He encourages someone else to deal in securities on which he has inside information
- He discloses inside information.

Notes

Explanation of terms

- Dealing
  - Dealing is acquiring or disposing of, or agreeing to acquire or dispose of relevant securities whether directly or through an agent or nominee or a person acting according to direction.
- Encouraging another to deal
  - If someone with information encourages another to deal knowing or having reasonable cause to believe the dealing will take place and the deal actually takes place with the person encouraged knowing the securities are price-affected.
- Securities
  - Shares, debts securities and warrants traded on a regulated market, such as the Stock Exchange.
- Inside information
  - Relates to particular securities or to a particular issuer of securities
  - Is specific or precise
  - Has not been made public
  - If made public would be likely to have a significant effect on the price.
- Insider
  - An insider has is someone who is an employee or officer of the company, or someone who gains information from such a person.

Notes

Defences to the offence

The individual has a defence regarding dealing and encouraging others to deal if he can show that he:

- Did not expect the dealing to result in a profit (or avoidance of a loss) attributable to the fact that the information in question was price-sensitive
- Had reasonable grounds to believe the information had been widely disclosed
- Would have done what he did even if he did not have the information
- Reasonably believed that the recipient of the information would not act upon it.

If the information is disclosed in the course of an employment or profession, no offence is committed. For example, if an auditor passes information to a review partner and the partner then acts upon it, no offence has been committed by the auditor. (However, the partner may have committed an offence).

Penalties

The maximum penalties imposed by the statute are seven years' imprisonment and/or an unlimited fine.

The transaction itself remains valid and enforceable.

If the individual is a director he is in breach of his statutory duties under CA06 and may be liable to account to the company for any profit made.

Notes

2 Market abuse

Civil offence

The Financial Services and Markets Act 2000 introduces concept of market abuse.

Under s118 (1) market abuse is defined as:

- behaviour in relation to any qualifying investments
- likely to be regarded by regular users of the market as falling below the standard reasonably expected of a person in that position; and
- that falls within at least one of three categories:
    1. Based on information not generally available to users of the market which, if available to a regular user, would be likely to be regarded by him as relevant in regard to the terms on which to deal in those investments.
    2. Is likely to give a regular user a false or misleading impression as to the market value of such investments.
    3. Is regarded by a regular user as likely to distort the market in such investments.

Qualifying investments are those which are traded on the UK's 'prescribed markets', as well as those traded on other European regulated markets.

The Financial Conduct Authority have also drawn up a Code of Market Conduct to detail the ways in which market abuse can occur.

There are seven types of behaviour which can amount to market abuse.

Notes

3 Money laundering

Introduction

Money laundering covers any activity by which the apparent source and ownership of the proceeds of crime are changed in such a way that the cash or other assets appear to have been obtained legitimately.

The two relevant pieces of legislation on money laundering are the Proceeds of Crime Act 2002 and the Money Laundering Regulations 2007.

The legislation imposes important obligations on professionals, such as accountants, auditors and legal advisers to report money laundering to the authorities and to have systems in place to train staff and keep records.

The money laundering process

Money laundering covers any activity by which the apparent source of money or property is changed and the process usually involves three phases:

- Placement
- Layering
- Integration

Notes

The offences

The Proceeds of Crime Act 2002 sets out three offences:

Money laundering

Under s.327 it is an offence to conceal, disguise, convert, transfer, or remove criminal property from England, Wales, Scotland or Northern Ireland.

Concealing or disguising criminal property includes concealing or disguising its nature, source, location, movement or ownership.

Under s.328 an offence is committed when a person enters into or becomes concerned in an arrangement which he knows or suspects will facilitate another person to acquire, retain, use or control criminal property.

Under s.329 an offence is committed when a person acquires, uses or has possession of property which he knows or suspects represents the proceeds of crime.

It is also an offence to incite another person to commit a money laundering offence. Inciting means knowingly encouraging or assisting another person.

It is a defence to show that:

- A report was made to the National Crime Agency (NCA) or the firm's Money Laundering Reporting Officer (MLRO), or
- It was intended to report, but there was a reasonable excuse for not having done so.

The maximum penalty for this offence is an unlimited fine and up to fourteen years' imprisonment.

Notes

Failure to report

Under s330 it is an offence for individuals carrying on a `relevant' business to fail to disclose to the NCA or the business's MLRO any knowledge or suspicion of money laundering where they know or suspect, or have reasonable grounds for knowing or suspecting, that another person is engaged in money laundering.

Defences – again it is a defence to say there was a reasonable excuse for not making the report and it is also a defence to say the person does not know or suspect money laundering and that his employer has not provided him with appropriate training.

This offence only relates to individuals, such as accountants, who are acting in the course of business in the regulated sector.

The maximum penalty for failure to report is five years' imprisonment and an unlimited fine.

Tipping off

Under s.333 it is an offence to make a disclosure likely to prejudice a money laundering investigation. It covers the situation where an accountant informs a client that a report has been submitted to the NCA.

Defences – there is a defence that the person did not know or suspect that the disclosure would be likely to prejudice the investigation or that the person had lawful authority to make the disclosure.

The maximum penalty for tipping off is five years' imprisonment and an unlimited fine.

Notes

The Money Laundering Regulations 2007

The Money Laundering Regulations 2007 (MLR) require certain firms to introduce internal reporting systems to seek to identify any risk of money laundering.

The MLR apply to 'relevant persons'. This is a broad concept including, for example, auditors, tax advisers and insolvency advisers as well as businesses such as estate agents or casinos.

The regulations cover the following:

- Customer due diligence
- Record keeping, procedures and training
- Supervision and registration
- Enforcement.

Money laundering and terrorist financing risk assessment

A written risk assessment must be carried out to identify and assess the risk of money laundering. The risk assessment must take into account information provided by the supervisory authority on risk factors in the sector. The following risk factors must also be taken into account:

- The firm's customers
- The countries or geographic where the firm operates
- The firm's products or services
- The firm's transactions, and
- The firm's delivery channels.

Notes

The risk assessment should be used to:

- Develop policies, procedures and controls to mitigate the risk of money laundering.
- Apply a risk based approach to detecting and preventing money laundering.
- The firm must establish and maintain written policies, controls and procedures to effectively manage and mitigate the money laundering and terrorist financing risks identified in the risk assessment. These must be proportionate to the size and nature of the business, approved by senior management, regularly reviewed and updated and communicated internally within the firm.

Officer responsible for compliance

Firms must appoint a Money Laundering Compliance Principal (MLCP) and this person must be on the board of directors or a member of senior management. Sole practitioners with no employees are exempt from this requirement.

Firms must also appoint a nominated officer, Money Laundering Reporting Officer (MLRO), to receive internal suspicious activity reports and assess whether a suspicious activity report should be made to the appropriate regulatory body. The MLRO and MLCP may be the same person if the MLRO is sufficiently senior.

Employees

Firms must assess the skills, knowledge, conduct and integrity of employees involved in identification, preventing or detecting money laundering.

Staff training must be provided on an ongoing basis in how to recognise and handle transactions and activities which may be related to money laundering.

Notes

Customer due diligence

Accountants are required to establish that new clients are who they claim to be by obtaining satisfactory evidence of identity from the client. This is often referred to as 'customer due diligence' or 'know your customer' procedures.

Customer due diligence is an essential part of the anti-money laundering requirements. It ensures that accountants:

- know who their clients are, and
- do not unknowingly accept clients which are too high risk.

Customer due diligence must be performed as soon as is reasonably practicable after contact is first made between the two parties.

Office for Professional Body Anti-Money Laundering Supervision

The Office for Professional Body Anti-Money Laundering Supervision (OPBAS) was established by the Government in 2018 under the OPBAS Regulations 2018. The Regulations give OPBAS duties and powers to ensure that the 22 accountancy and legal professional body anti-money laundering supervisors meet the standards required by the Money Laundering Regulations 2017 and they have powers to investigate those that do not.

Notes

4 Bribery

Introduction

Bribery is covered by the Bribery Act 2010 which came into force in July 2011. The Act gives three bribery offences:

- Bribing another person
- Being bribed
- Bribing a foreign official.

In addition the Act also gives corporate liability for an organisation which fails to prevent bribery.

The bribery offences

Bribing another person

This offence is committed when one person gives or offers a financial or other inducement to a person to perform a relevant function improperly. It is irrelevant whether the person offered the inducement is the same person who performs the function.

Being bribed

The offence by which a person accepts or requests a financial or other advantage to perform a relevant function improperly. It is irrelevant if the inducement is received directly or indirectly.

A relevant function

In both of these offences the term 'a relevant function' is taken to mean a function of a public nature, or any function of a business nature where the person performing it is in a position of trust or is expected to perform it in good faith or impartially.

Notes

Bribing a foreign official

This offence is committed where a person offers or promises to give a financial or other inducement to an official with the intention that this will influence the official in his professional capacity and allow the individual a business advantage.

The penalties and defences

A person charged with bribery may have a defence if he can prove that his conduct was necessary for proper exercise of an intelligence service or of any function of the armed forces when engaged on active service.

The maximum penalty is ten years imprisonment and/or an unlimited fine.

Corporate liability

Any commercial organisation can be sued for failure to prevent bribery. This action can be taken against an organisation when a person within the business has committed a bribery offence.

The organisation has a defence if it can prove that it had in place 'adequate procedures' to prevent bribery. It should be considered what the potential risks of bribery are before deciding if the procedures taken are adequate.

Notes

5 Potential criminal activity in the operation, management and winding up of companies

Introduction

There are a number of criminal offences that could be undertaken by individuals concerned in the operation, management or winding up of a company that we have already covered, such as the failure to file accounts or providing misleading information to an auditor.

Phoenix companies

S216 and s217 Insolvency Act 1986 (IA 1986) are aimed at so-called 'phoenix companies'. They apply where a person was a director or shadow director of a company at any time in the period of 12 months ending with the day before the company went into liquidation.

The provisions apply for the five years following liquidation. They prevent the person being a director of a company with a similar name, or a name which suggests an association with the previous company, without leave of the court.

It is a criminal offence to contravene the provisions, punishable by imprisonment and/or a fine. In addition, the director will be personally liable for any debts of the new company which are incurred when he was involved in its management.

Notes

Chapter 12

Fraud

Historically, both common law and statute attempted to deal with the offences of defrauding and deception but it was not until The Fraud Act 2006 that the specific offence of fraud was recognised.

To bring a successful action for fraud the prosecution needs to prove

- Dishonesty
- Intention to make a gain or to cause a loss to another.

The maximum penalty for fraud under the Act is 10 years' imprisonment and an unlimited fine.

The single offence of fraud can be committed in three ways:

- Fraud by false representation
- Fraud by failing to disclose information
- Fraud by abuse of position.

Fraud by false representation

This offence is committed where the individual makes false statements of fact or law with the intention to make a gain or cause a loss to someone else.

Fraud by failing to disclose information

This covers where the individual has a legal duty to disclose information but doesn't do so with the intention of making a gain or causing a loss to another.

Fraud by abuse of position

An individual can be prosecuted here if they were in the position where they were expected to safeguard the interests of another person and they abuse that position with the intention of making a gain or exposing the other person to a loss.

Notes

Failure to prevent tax evasion

The Criminal Finances Act 2017 sets out the corporate offence on failure to prevent the criminal facilitation of criminal tax evasion.

The offence can make a 'relevant body' criminally liable if it fails to prevent the facilitation of UK or non-UK tax evasion by an employee or 'associated person'. The offence applies to both UK and non-UK companies as well as partnerships, as if they were corporations.

An 'associated person' can be an individual, corporate entity or an employee of a corporate associated person, carrying out services on behalf of the 'relevant body'.

A 'relevant body' is defined in the act as a company or a partnership.

The offence is of strict liability and no knowledge or intention is required. There is no requirement for the tax evader to have been prosecuted for evasion, or for the facilitator to have been prosecuted for facilitation.

The legislation focuses on the procedures that should be in place to prevent the criminal facilitation of tax evasion by an employee or associated person.

There are three stages to the offence:

- Stage one: The criminal evasion of tax.
- Stage two: The criminal facilitation of this offence by an associated person.
- Stage three: The relevant body failed to prevent the associated person from committing that facilitation.

There is a statutory defence where at the time of the offence the relevant body had reasonable prevention procedures in place to prevent tax evasion facilitation offences or where it is unreasonable to expect such procedures. The reasonable prevention procedures are judged by six guiding principles:

1. Risk assessment
2. Proportionality of risk-based prevention procedures
3. Top level commitment
4. Due diligence
5. Communication
6. Monitoring and review

The penalty is an unlimited fine for the relevant body and potential reputational damage.

Notes

6 Transactions at an undervalue and preference

A liquidator may apply to the court to set aside company transactions at an undervalue (s238 Insolvency Act 1986) or where the company gives a preference (s239 Insolvency Act 1986).

Undervalue

A company enters into a transaction at an undervalue if the company makes a gift or otherwise enters into a transaction on terms that the company receives no consideration or insufficient consideration.

The transaction would not be set aside if it was entered into in good faith on the reasonable belief that it would benefit the company.

Preference

A company gives a preference if it does anything to put a creditor in a better position in the event of the company's insolvent liquidation than they would otherwise be.

The court will not make an order unless the company was influenced by a desire to prefer the creditor. Therefore, a payment or charge created in favour of a creditor who is threatening legal proceedings might be a defence. However, if the preference was given to a connected person it is presumed that the company was influenced by its desire to give a preference.

Notes

7 Fraudulent and wrongful trading

	Fraudulent trading	Wrongful trading
Definition	The company's business is **carried on with intent to defraud** creditors and other persons or for fraudulent purpose. The offence may be criminal or civil and could involve just a single transaction. Note: there is a high burden of proof involved in proving dishonesty.	On winding-up it appears to the court that the company has gone into insolvent liquidation and, before the start of the winding up, a director knew or ought to have concluded there was **no reasonable prospect that company could avoid insolvent liquidation** and did not take sufficient steps to minimise potential loss to creditors: S.214 Insolvency Act 1986 (IA86). Is a civil offence.
Who is liable?	Any persons knowingly party to the carrying on of the business. This applies to persons taking the decisions or playing an active part in the business.	Directors and shadow directors. Standard applied is that of a reasonably diligent director taking the steps expected of a reasonable director.
Consequences	Must contribute to the company's assets on a winding up: s.213 IA86. Up to 15 years' disqualification under the Company Directors Disqualification Act 1986 (CDDA86). Fine and/or imprisonment for up to 10 years: s.993 CA06.	Contribute to company's assets. Up to 15 years' disqualification under CDDA86.

Notes

Questions

You can now attempt the following from the Text:

Chapter 12 TYUs 1–4

Chapter 13 Qs 61–65