

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

16304 – Commercial Law and Corporate Law

CA Professional (Strategic Level I) Examination
JUNE 2013

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

Part (a)

The clause in the receipt stating that, “The Chair Company will not be liable for accidents or damages caused as a result of using the company’s chairs”, is an exemption clause introduced by The Chair Company

An exemption clause is a term of the contract, by which one party to the contract, tries to escape or exclude itself from one or more of its liabilities under the contract.

Generally the conditions referred to in these exemption clauses, are deemed to be communicated to the other party, and he is bound by them whether or not he has read them.

But the law allows a party to the contract, to introduce such exemption clauses, subject to certain conditions.

One such condition is that such exemption clauses should be introduced to the contract prior to its conclusion. In other words, the exemption clause should be introduced to the contract at the time the parties enter into such contract.

In this case, Roxy received the receipt containing the exemption clause, after the conclusion of the contract to hire the deckchair.

Therefore the exemption clause does not form a part of the terms and conditions of the contract between The Chair Company and Roxy.

Hence, The Chair Company is not excluded from its liability envisaged under this exemption clause. Therefore The Chair Company is liable to pay damages to Roxy for the injury caused to him by breaking of chair.

(5 marks)

Part (b)

- Generally by nature domestic and social agreements, are not intended to be binding in law, but are intended to rely on bonds of mutual trust and affection.
- Eg : - Balfour Vs Balfour – The wife failed in her claim of her allowance from the husband. The courts held that the arrangement was made between the husband and wife, when they were living in amity, and hence it was a domestic agreement which was outside the realm of a legally binding contract.
- But it is essential to realize that the intention, not to create legal relationships, is only a presumption, and that as with all other presumptions it may be rebutted by the actual facts and circumstances of a particular case.
- Eg : - Merritt Vs Merritt – In this case, the Balfour decision was not considered and the wife was entitled to her claim from her husband. The reason being that the courts interpreted that the agreement between the husband and wife in this case was made at arm’s length as they had already decided to separate at that time. Therefore any reasonable person would regard their agreement as not a domestic agreement, as there was a clear intention to be bound by law.

(5 marks)

(Total 10 marks)

Answer No. 02

Part (a)

In this scenario, Sepala entered into the sole tradership agreement with IOC whilst the partnership was still not dissolved. Further it could be reasonably presumed that Sepala was trying to use the partnership's goodwill while operating the petrol shed only in Sepala's name.

Under the partnership law, every partner has to account to the firm, for any benefit derived by him from the partnership without the consent of the other partners from any transaction in relating to the partnership property, name or business connections.

Therefore Sepala was in breach of his duties as a partner, in entering in to a new agreement with IOC in his name under the given circumstances.

Therefore Gunapala can file action against Sepala to claim a share of the profit of the new operation of Sepala.

(5 marks)

Part (b)

Generally, 'partners' must share gross-returns according to their share in the partnership business. Thus at first instance, if persons share the gross-returns, one would be inclined to say that a partnership exists.

However sharing of gross returns in the following instances will not itself create a partnership.

- (a) Where a person receives a debt or other liquidated amount by installments out of the profits of a business
- (b) Where a servant or agent is engaged in a business and is remunerated by a share in the profits
- (c) Where a widow or child of a deceased partner receives a portion of the profits by way of annuity
- (d) Where a person has lost money to a person engaged or about to engage in business and receives a rate of interest varying with the profits or a share of the profits and such a contract is in writing signed by or on behalf of the parties thereto
- (e) Where a person has sold the goodwill of a business, and in consideration of the sale receives a portion of the profits

(5 marks)

(Total 10 marks)

Note: Any relevant alternative answers furnished by candidates would be considered in marking answers for part (b) of the Question No. 02

Answer No. 03

Part (a)

Before a person can obtain an insurance policy he must show that he has some “insurable interest” in the subject matter of the insurance.

An “insurable interest” means that the person seeking the insurance (the insured) will benefit from the preservation of the subject matter insured or be affected by its loss.

This requirement of an insurable interest has an important bearing on a policy for life insurance.

In the case of life insurance, an insurable interest means that the person effecting the insurance will sustain some pecuniary loss on the death of the person whose life is insured.

In the case of **Griffiths Vs Fleming [1909]1K.B. 805** the court decided that it was not necessary for the husband to prove any pecuniary interest in his wife’s life.

Therefore it could be said that a husband has an insurable interest in the life of his wife.

(5 marks)

Part (b)

Insurance, is a contract of *Uberrimae Fidei*. This means that full disclosure must be made to the insurer of every material circumstance which is known to the insured and which would influence the judgment of a prudent insurer in either fixing or determining whether to take the risk or not.

In the event of failure to disclose any such circumstance, the policy is voidable.

If between the date of the proposal and the forming of the contract there is a material alteration of the risk, disclosure of this alteration must be made, otherwise the contract will be voidable.

(5 marks)

(Total 10 marks)

Answer No. 04

(a) Money Laundering

- This is the process of concealing the source of money obtained by illicit means.
- The methods by which money may be laundered are varied and can range in sophistication. Many regulatory and governmental authorities quote estimates each year for the amount of money laundered, either worldwide or within their national economy.
- Today, anti money laundering measures are considered to be an extremely important aspect of the global war against narcotics, human trafficking, terrorism and other transnational crimes. Authorities worldwide have realized that they must make crime unprofitable and prevent criminals from recycling their money into the economy.
- Sri Lanka too has finally come to terms with this problem and enacted the *Prevention of Money Laundering Act 5 of 2006*. Presented by the Ministry of Finance and Planning, this Act seeks to prohibit money laundering and provide the necessary measures to combat and prevent it.
- This Act applies to:-
 - (a) a person who commits an offence under this Act whilst being resident in Sri Lanka;
 - (b) an Institution which is used for the commission of an offence under this act and
 - (c) an act which constitutes an offence which is committed in Sri Lanka.
- A person is guilty of the offence of Money Laundering, if he has engaged directly or indirectly in any transaction relating to any property which is derived or realized, directly or indirectly, from any unlawful activity or from the proceeds of any unlawful activity.

(5 marks)

(b) Bill of Lading

A bill of lading is a document signed by the ship owner, or by the master or the agent of the ship owner, which states that certain goods have been shipped on a particular ship, and sets out the terms on which those goods have been delivered to and received by the ship owner.

On being signed it is handed over to the shipper and it serves three purposes-

- (a) it is a receipt for the goods shipped, containing the terms on which they have been received;
- (b) it is evidence of the contract for the carriage of the goods;
- (c) it is a document of title to the goods specified therein.

Possession of the bill of lading entitles the holder to delivery of the goods, and the property in the goods passes to a transferee or an endorsee.

(5 marks)

(c) Main Features of Agency by Ratification

- The agent should have expressly contracted as an Agent. Eg:-Keighley, Maxsted & Co. v Durant.
- The contract can be ratified only by the principal who was named or ascertainable when the contract was made.
- The principal must be in existence at the time the agent makes the contract. Eg:-Kelner v Baxter
- The principal should have legal contractual capacity to make the contract himself at the time of making the contract, as well as at the time of ratification.
Eg:- Boston Deep Sea Fishing and Ice Co. Ltd. V Farnham.
- Void contracts cannot be ratified. Eg:- Ashbury Carriage Co. v Riche.
- The principal must have full knowledge of the terms of the contract and should have ratified voluntarily.
- The whole contract should be ratified.
- The third party would have believed that the agent had the authority to contract.
- Ratification must be done within a reasonable period of time.

(5 marks)

(4) Implied Warranties in a Sale of Goods Contract

Under Section 13 of the Sale of Goods Ordinance, the following warranties are implied in every contract of sale of goods, in the absence of any agreement to the contrary-

- (a) That the buyer shall have and enjoy quiet possession of the goods.

This means that the seller will be liable in damages if the buyer is disturbed in the enjoyment of the goods in consequence of the seller's defective title to sell.

- (b) That the goods are free from any charge or encumbrance in favour of any third party, not declared or known to the buyer before or at the time when the contract is made.

(5 marks)

(Total 10 marks)

Answer No.05

Part (a)

- (i) Mr. Sharp must immediately call a board meeting to consider whether the board should apply to court to wind up the company and to appoint a liquidator or administrator, or whether the company should continue its business.
- (ii) If Mr. Sharp, fails to do so and the company is subsequently placed in liquidation, a court may, on the application of the liquidator or a creditor of the company, order the directors be held liable for the whole or part of any loss suffered by the creditors as a result of the company continuing its business.

[Ref : Section 219]

(5 marks)

Part (b)

Before the decision of **Panaroma Developments (Guildford) Ltd. Vs Fidelis Furnishing Fabrics Ltd. [(1971) 2 Q.B. 711]**, the Secretary's position was considered to be that of an employee of the company and hence could not enter into any contract on behalf of the company for any purpose.

After the Panaroma case, this view has been reversed and it was recognized that the Secretary is an officer of the company and has ostensible (apparent) authority to bind the company in contracts entered into by him/her on behalf of the company.

In this case, Miss Kusum representing the company in her official capacity as the Secretary, entered into a contract on behalf of the company, to hire the equipment from the supplier. Thereafter she took the equipment home for her personal use.

Even though she has now resigned from the company, she entered into this contract during her term as the Secretary. Therefore in doing so, she has bound the company into a contract with the supplier.

Therefore the company is liable to pay the hiring charges to the supplier, because the supplier (third party) believed at the time of entering into the contract, that Miss. Kusum who held the position of Secretary (which was that of an officer having ostensible authority to bind the contracts entered into by her on behalf of the company in the capacity of Secretary) had the authority to bind the company in contracts entered into by her on behalf of the company.

(5 marks)

(Total 10 marks)

Answer No. 06

Part (a)

A company may alter its Articles subject to the provisions of the Act and any conditions contained in its Articles.

A company may amend the Articles of Association by passing a Special Resolution.

It shall give notice of such resolution to the Registrar within ten (10) working days, setting out in full, the text of the resolution and of the new Articles or alterations to the company's Articles.

[Ref : Section 15 – Candidates are not expected to quote the Section No.]

(5 marks)

Part (b)

After incorporation, a company is required by the Companies Act to give public notice of its incorporation.

This public notice must be given within 30 working days of its incorporation.

The notice should be published,

- (a) in at least one issue of the Gazette, and
- (b) in at least one issue of a daily newspaper in Sinhala, Tamil and English languages

Further, this notice should specify the following:

- (a) The name of the company
- (b) The registration number of the company
- (c) The address of the Registered Office of the company

(5 marks)

(Total 10 marks)

Answer No. 07

Part (a)

This company, Bat & Ball (Pvt.) Ltd., may be wound up voluntarily, when the period fixed for the duration of the company by its Articles, of four years, expires.

The procedure to be adopted in such a winding up would be as follows :

The company at a general meeting has to pass a resolution requiring the company to be wound up voluntarily.

When the company has passed a resolution for a voluntary winding up, it shall within fourteen (14) days from the date of the passing of the resolution, give notice of the resolution by publication in the Gazette.

A voluntary winding up shall be deemed to commence at the time of the passing of the resolution for voluntary winding up.

Subject to the specific provisions regarding preferential payments contained in the Act, the company's property must be applied equally in satisfaction of its liabilities in a winding up. After the liabilities are satisfied, the remaining property must be distributed between the shareholders according to their rights and interests in the company, unless the articles provide otherwise.

[Sections 319, 320 and 343]
(5 marks)

Part (b)

The liquidator in a winding up by the court shall have power, with the sanction either of the court or of the committee of inspection:

- (a) To bring or defend any action or other legal proceeding in the name and on behalf of the company.
- (b) To carry on the business of the company so far as may be necessary for the beneficial winding up of such company.
- (c) To appoint an attorney-at-law to assist him in the performance of his duties.
- (d) To pay any classes of creditors in full.
- (e) To make any compromise or arrangement with creditors or persons claiming to be creditors.
- (f) To compromise all calls and liabilities to calls, debts, and liabilities capable of resulting in debts and all claims, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or alleged to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company, and all questions in any way relating to or affecting the assets or the winding up of the company, on such terms as may be agreed and take any security for the discharge of any such call, debt, liability or claim and give a complete discharge in respect thereof.

- (g) To sell the movable or immovable property of the company.
- (h) To execute in the name of the company, deeds, receipts or other documents, and to use the seal of the company.
- (i) To claim for bankruptcy against the estate of any contributory, and to receive any dividends from this bankruptcy claim.
- (j) To draw, accept, make and endorse any bill of exchange or like instrument in the name and on behalf of the company.
- (k) To raise money on the security of the assets of the company.
- (l) To take in his official name letters of administration to any deceased contributory, and to do in his official name any act necessary to obtain payment of any monies due from the contributory to the company.
- (m) To appoint an agent on behalf of the liquidator.
- (n) To do all such things as may be necessary for the winding up of the affairs of the company and distributing its assets.

[Section 292]

(5 marks)
(Total 10 marks)

Answer No. 08

Part (a)

It is possible as per the Companies Act, to replace Senaka as the auditor of the company, by following the procedure laid down below :

- (a) At least twenty (20) working days written notice of the proposal to replace Senaka as the auditor, must be given to auditor Senaka.
- (b) Auditor Senaka, has to be given a reasonable opportunity to make representations to the shareholders, either in writing or through his representative speaking at a shareholders' meeting, on the appointment of another auditor in his place.
- (c) The company has to pay auditor (Senaka) a reasonable fee, for making these representations to the shareholders.
- (d) If auditor Senaka upon his resignation has delivered to the company a statement stating circumstances that ought to be brought to the notice of the shareholders or creditors of the company, then the company shall give copies of such statement to all the shareholders and the Registrar.

[Sections 160 & 161]
(5 marks)

Part (b)

- Corporate Governance is a somewhat flexible term based on responsible management.
- According to Sir Adrian Cadbury “Corporate Governance is the system by which companies are directed and controlled”.
- It covers a wide range of academic literature, from the debate as to who should own and control the corporation (shareholders or stakeholders such as employees, general public, environmental concerns etc.) to the more narrow issue of purely the relationship between shareholders and directors.
- The main idea of good governance is to maintain good relationship among all the stakeholders of the Company, for the company's growth. Therefore the directors should try to maintain a high level of governance.
- And it is the responsibility of the directors to have proper systems to maintain high levels of transparency, fairness, honesty, openness, and integrity, which are considered as some of the most important pillars of good corporate governance.
- In the Sri Lankan context there are some corporate governance codes that apply to the companies in Sri Lanka, some of them are Colombo Stock Exchange Rules on Corporate Governance, Securities on the Exchange Commission Corporate Governance Code and Institute of Chartered Accountants Voluntary Corporate Governance Code.
- Looking at the recent past collapses of USA **Leman Brothers and Golden Sacks** and in the Sri Lankan context Golden Key and Pramuka Bank, it is clear that the companies crashed due to bad governance of directors.

(5 marks)
(Total 10 marks)

Answer No. 09

Part (a)

The essential characteristics of a floating charge are that-

- it is a charge on a class of the company's present or future assets;
- it is a class of assets which is subject to change from time to time, in the ordinary course of business;
- it contemplates that the company can carry on its business in the ordinary course as far as it concerns that particular class of assets, until a future step is taken by or on behalf of those interested;
- a floating charge may apply to, property held at the time the charge was created or acquired later;
- it may include movable and immovable property, uncalled capital and circulating assets, including and calculating cash, stock in trade, raw materials, book debts.

(5 marks)

Part (b)

- (i) A receiver who exercises a power of sale of property in receivership owes a duty to the grantor to obtain the best price reasonably obtainable as at the time of sale.
- (ii) A receiver shall keep money relating to the property in receivership separate from other money received in the course of but not relating to the receivership, and from other money held by or under the control of the receiver.

(5 marks)

(Total 10 marks)

Answer No. 10

Part (a)

A company may by special resolution, reduce its stated capital to an amount it thinks necessary in compliance with the provisions of the Act. [Section 59(1)]

The Act requires that public notice of the proposed reduction be given at least sixty (60) days prior to the resolution being passed so that the persons dealing with the company are aware of the proposed reduction. [Section 59(2)]

However, if the company has agreed in writing to refrain from reducing its stated capital below a specified amount without the creditors prior consent or the satisfaction of specified conditions, a resolution passed without such consent or satisfaction of conditions, shall be invalid and of no effect.

When companies are obliged to redeem shares on a fixed date or upon the exercise of an option by the shareholder, or they are compelled to purchase their own shares under the minority buy out provisions, they may not sometimes have adequate profits or reserves out of which the redemption or buy back may be affected.

In such situations, the Act empowers the Board to obtain a Certificate of Solvency from the auditors and to resolve to reduce the stated capital of the company by the amount by which the company would fail to satisfy the Solvency Test.

Such a resolution shall have effect notwithstanding other provisions relating to the reduction of stated capital, and specified in Sections 59(1), (2) and (3) of the Act. [Section 59(4)]

A reduction of stated capital, with the amount of reduction and the amount of reduced stated capital, must be communicated to the Registrar within ten (10) days of such reduction. [Section 59(5)]

[Note : Section numbers are not expected from the candidates]

(5 marks)

Part (b)

A company may give direct or indirect financial assistance for the purpose of, or in connection with, the acquisition of its own shares, if it complies with the formalities set out in the Act. (Section 70)

In order to comply with the formalities set out in Section 70, the Board must resolve that such assistance is in the interests of the company; that the terms and conditions of such assistance are fair and reasonable to the company and those shareholders not receiving such assistance; and, that the company will satisfy the solvency test immediately after giving such assistance. [Section 70(2)]

If financial assistance, inclusive of other outstanding amounts so given, exceeds ten percent of the stated capital, the company must first obtain a certificate from the company's auditor, stating that he has inquired into the affairs of the company, and that the Board's belief that the company will satisfy the solvency test immediately after the giving of such assistance is not unreasonable.

[Note : Section numbers are not expected from the candidates]

(5 marks)

(Total 10 marks)

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