SUGGESTED SOLUTIONS

16304 – Commercial Law and Corporate Law

CA Professional (Strategic Level I) Examination
June 2014

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

(a) Whether a term in a contract is a condition or warranty, is a question of the intention of the parties to be deduced from the circumstances of the case.

Conditions
A condition is a vital term of a contract, going to the root of the contract, a breach of which entitles the injured party, either to treat the contract as repudiated and terminate the performance of the contract and claim damages for the termination, or to affirm the contract and claim damages for the breach.

Warranties
A warranty is not a vital term in a contract, but one which is merely subsidiary. If a warranty is breached the innocent party may claim damages, but cannot end the contract.

(b) The scenario described in the question is similar to the case of **Bettini vs Gye** (1876) 1 Q.B.D.183; where it was decided that the stipulation was not a condition, and the contract could not be rescinded on its breach.

Therefore in the given scenario, it could be inferred that the non-attendance of all four rehearsals by Banda, amounts to a breach of a warranty, as it did not go to the root of the contract.

Whereas the actual condition in this scenario, could be inferred to as the attendance at the concert.

Therefore in this scenario, Gurun, cannot rescind the contract he has with Banda, as there is no breach of a condition.

Answer No. 02

(a) Even if a drawer crosses a cheque, as "Not Negotiable", the payee may still transfer the cheque to someone else.

However, if the cheque gets stolen, the one who stole does not get a good title to the cheque.

Similarly anyone else who gets the cheque from him, has no better title than him. (Nemo dat quod non habel)

That means that the drawer can stop payment on the cheque, and no one can successfully sue him for payment if the cheque has been transferred through an illegal transaction.

In the given scenario, Raju had a bad title for this cheque, since it was a stolen cheque.

Therefore Sudath will not get a better title than what Raju had, which means that Sudath too gets a defective title to this cheque. Hence he will not be able to encash this cheque.

(b) "Stoppage in transitu", refers to the right given to an unpaid seller in stopping the goods while they are in transit, and regaining possession until payment of the selling price.

A seller may exercise this remedy in two instances, namely, where the debtor is insolvent or where the buyer repudiates or fails to pay prior to delivery**.**

Since Ajith is bankrupt, Ronald may not be able to collect his selling price. Therefore Ronald has a right to seek relief under "stoppage in transitu or "stoppage in transit".

Answer No. 03

(a) Life insurance, like all other forms of insurance, is a contract of "uberrimae fidei".

That 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 fixing the premium, or determining whether to take the risk.

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

In the given scenario there is no concealment of material information by Maxi and therefore the insurer cannot avoid the policy

The facts in the given scenario are similar to the case, **Mutual Life Insurance Company of New York vs Ontario Metal Products Co.** (1925 - A.C. 344)

(b) An incoming partner is liable for the debts and acts of the firm from the date of his admission into the firm. However, the incoming partner may agree to be liable for debts prior to his admission. But such agreeing will not empower the previous creditors to sue the incoming partner. The creditors of the firm, will get this right to sue the incoming partner, only if there is ***novation,*** which is an agreement between the creditor, the old firm and the new firm, where the original contract between the creditor and the old firm is discharged by the new firm accepting that liability.

In this given scenario, Sisil will be liable only for the liabilities from the date he joins to the partnership, and he will not be liable for the previous liability of Rs. 10 million unless he agrees to enter into novation.

Answer No. 04

(a) **Duties of an agent towards the principal**

(1) **To act in the best interests of the principal** - When an agent is appointed to facilitate or negotiate a transaction on behalf of the principal, the agent owes a duty to the principal to act in the principal's best interests within the authority of the agent.

(2) **No conflict of interest** - An agent who has accepted an appointment to act for a principal ("A") should not thereafter accept appointment to act for another principal ("B") if the interests of principal B conflict with the interests of principal A. However, if the agent fully discloses to each principal the agent's interests under the two appointments, and the fact that he acts for both principals at the same time and obtains the consent of each principal to the dual agency, he may still act for the two principals. Accordingly, an estate agent who acts for both the vendor and purchaser in a sale and purchase property transaction must disclose the fact to both the vendor and the purchaser and obtain their consent for so acting.

(3) **Not to make secret profit -** Common Law requires that an agent shall not make any profit or acquire any benefit in the course and in the matter of his agency without the knowledge and consent of his principal. Such profit, generally known as secret profit, is not restricted to money but may include anything of value, for example, an interest-free loan, a club membership, etc. An agent who has made secret profit is liable to account to the principal for such profit in addition to any other remedies available to the principal for the agent's breach of duty.

(4) **Duty of confidentiality** - Owing to the fiduciary relationship between a principal and his agent, the agent shall not disclose any information concerning the principal or any confidential information entrusted to him by the principal to any third party in the absence of the principal's consent.

(5) **Duty to care and skill** - Common law requires an agent to act with due care and skill in performing his duties. He has a duty to exercise due diligence in the performance of his duties and to apply any special skill which he professes. An agent who fails to meet this standard are prima facie negligent.

(6) **Duty to account** - An agent who receives any property for his principal or from his principal is bound to keep such property separate from his own and he is to be treated as a trustee of such property. Even after the agency relationship has ceased, the agent's duty to account to the principal may continue. Hence, the agent is obliged to return to his principal all documents and property originally given to the agent by the principal and documents prepared by the agent on the instruction and at the expense of the principal.

(7) **Duty not to delegate** - The general rule is that an agent may not delegate his authority or duty in whole or in part except with the authority and consent of the principal.

(8) **Duty of obedience** - Generally, agents are under a duty to obey the lawful and reasonable instructions of the principal. Where the principal's instructions are clear, the agent does not normally have any discretion and must follow those instructions, unless an agent is a professional and the principal relies on the agent to exercise his professional skill and discretion in accomplishing the tasks he has been appointed to accomplish.

(9) Not to become principal, as against his employer.

(b) Incoterms

In the international sale of goods, special trade terms which may have different meanings in different countries, are used by the buyers and sellers.

Incoterms are designed to create a bridge between buyers and sellers in different countries, by acting as a uniform language they can use.

Incoterms have been published by the International Chamber of Commerce (ICC).

They are a set of universally accepted terms, relating to international trade.

Each Incoterm refers to a type of agreement for the purchase and shipping of goods internationally.

Incoterms also deal with the documentation required for global trade, specifying which parties are responsible for which documents. Determining the paperwork required to move a shipment is an important job, since requirements vary so much between countries.

(c) The objects of the Consumer Affairs Authority are as follows:

- To protect consumers against the marketing of goods or the provision of services which are harmful to life and property of consumers.

- To protect consumers against unfair trade practices and guarantee that consumers interest shall be given due attention.

- To ensure that wherever possible consumers have sufficient access to goods and services at competitive prices.

- To seek damages against unfair trade practices, restrictive trade practices or and other form of manipulation of consumers by traders**.**

[Ref : Section 7 of the Act]

Answer No. 05

The facts are similar to the case **Salomon Vs Salomon Company Limited**. In this case the important principle of separate legal entity was laid down. This decision was later accepted by the courts in **Lee v. Lee's Air Farming Ltd** and **Macaura v. Northern Assurance Co Ltd.**

The ruling in Salomon Vs Salomon, declared that all lawful companies existed separately from its owners.

Further the liability of the shareholders, is limited to the capital they have invested/contributed.

Therefore the company's creditors are prevented from suing or claiming their dues from the shareholders or the owners of the company.

The company has a legal obligation to first settle its secured creditors, including the secured debentures.

Thereafter, since the company has no assets remaining to settle the unsecured creditors, such as Praveen, the legal implication would be that Praveen will have to bear up his loss.

Therefore in looking at the above scenario, it can be reasonably argued that, Praveen will not be able to initiate a successful action against Ravi to recover from Ravi's personal assets since Ravi and the company are two different legal entities.

Further, the company will not be able to settle Praveen, who is an unsecured creditor, before it settles its secured creditors.

Answer No. 06

(a) The following provisions which are listed out in the Third Schedule of the Companies Act No. 7 of 2007 shall not apply to Companies Limited by Guarantee:

(i) Shares and Debentures. *[Part IV of the Act]*

(ii) Minority buy-out rights. *[Sections 93 – 98]*

(iii) Interest groups. *[Sections 99 – 101]*

(iv) Company to maintain share register. *[Sections 123(1)(b) and (c)]*

(v) Place of share register. *[Sections 124(1) and (3)]*

(vi) Disclosure of director's interest in the shares. *[Sections 198 - 200]*

(vii) Duty of directors on serious loss of capital. *[Section 220]*

(viii) Amalgamations. *[Part VIII of the Act]*

(ix) Matters to be included in Annual Return. *[sub paragraphs (b),(e) and ((j) of the Fifth Schedule]*

Note: Candidates are not expected to write section numbers.

(b) (1) First, the company has to pass a special resolution with the prior approval in writing of the Registrar in order to change its name.

(2) After passing this resolution, the company has to, within ten working days of the change of name, give notice of the change to the Registrar in the prescribed form.

(3) Thereafter, once the Registrar has accepted the name change, and issued the fresh certificate of incorporation in the prescribed form indicating the change of name, Aravinda will have to collect this certificate.

(4) Thereafter, he has to publish a press notice in all 3 languages, and a gazette notice (informing the public of this name change), within 20 working days of such change.

Answer No. 07

(a) A company may be wound up by the Court in the following instances:

(i) If the company has by special resolution resolved that the company be wound up by the court

(ii) If the company does not commence its business within a year from its incorporation or suspends its business for one year

(iii) If the number of members falls below the minimum number required under subsection (2) of section 4 of the Companies Act

(iv) If the company has no directors

(v) If the company is unable to pay its debts

(vi) If the court is of opinion that it is just and equitable that the company should be wound up.

[Ref: Section 270 of the Act]

(b) (i) As soon as the affairs of the company are fully wound up, the liquidator shall make up an account of the winding up showing how the winding up has been conducted and the property of the company has been disposed of, and thereupon shall call a general meeting of the company and a meeting of the creditors, for the purpose of laying the account before the meetings and giving an explanation thereof.

(ii) The meetings referred to above shall be called by notice published in the Gazette, specifying the date, time, place, and object thereof and published at least one month before such date.

(iii) Within one week from the date of these meetings, or where such meetings are not held on the same date, from the date of the later meeting, the liquidator shall send to the Registrar a copy of the account and shall make a return to him of the holding of the meetings and of their dates.

(iv) But when a quorum is not present at either such meeting, the liquidator shall in lieu of the return referred to in the preceding provisions, make a return that the meeting was duly summoned and that no quorum was present thereat, and upon such a return being made the provisions of this subsection as to the making of the return shall, in respect of that meeting, be deemed to have been complied with.

(v) The Registrar on receiving the account in respect of each of these meetings, and either of the returns referred above, shall forthwith register them and on the expiration of three (3) months from the date of registration thereof, the company shall be deemed to be dissolved:

(vi) But the court may on the application of the liquidator or of any other person who appears to the court to be interested, make an order deferring the date at which the dissolution of the company is to take effect for such time as the court thinks fit.

(vii) It shall be the duty of the person on whose application an order of the court under the provisions of this section is made, within seven days from the date of the making of the order, to deliver to the Registrar a certified copy of the order for registration.

[Ref : Section 341 of the Act]

Answer No. 08

The Board must pass a resolution stating the following:

(i) That such assistance is in the interests of the company.
(ii) That the terms and conditions of such assistance are fair and reasonable to the company and those shareholders not receiving such assistance.
(iii) That the company will satisfy the solvency test immediately after giving such assistance.

Further if the amount of the financial assistance resolved as above, together with the amount of other outstanding financial assistance already given by the company, exceeds 10% of the company's stated capital, the company must first obtain a certificate from the company's auditor or if there is no auditor, a person qualified to act as the auditor,

A certificate to the effect that:

- he has inquired into the state of affairs of the company and
- he is not aware of any thing to indicate that the opinion of the board that the company will immediately after giving the assistance satisfy the solvency list is unreasonable in all the circumstances

[Ref: Section 70 of the Act]

Answer No. 09

(a) The proposed transaction between Lakseva (Pvt) Ltd and Blue Chips is one in which Victor, as a director of the company, is an "interested" party within the meaning of the Companies Act.

Victor must therefore cause this interest to be entered in Lakseva (Pvt) Ltd's interests register.

Further, he should also disclose this interest to the board of directors of Lakseva (Pvt) Ltd if the company has more than one director**.**

This disclosure must set out the nature and extent of the interest.

A general notice in the interests register or to the board, that he is connected to the person with whom the company wishes to enter into the transaction [i.e. his wife as the owner of the restaurant Blue Chips], will be treated as a sufficient disclosure for the purposes of discharging this obligation.

(b) However, the failure by Victor as a director to disclose this particular interest, will not affect the validity of the transaction. Instead, it will make him personally guilty of an offence and he will be liable on conviction to a fine not exceeding Rs. 200,000.

[Ref : Section 192 of the Act]

Answer No. 10

(a) The documents that must be sent to the shareholders under specified information mentioned, shall include:

(i) The amalgamation proposal.
(ii) Copies of the certificates given by the directors of each amalgamating company.
(iii) Statements setting out rights of shareholders to invoke the buy-out provisions contained in Section 93 of the Act.
(iv) Statements of any material interests that any director has in the proposal in whatever capacity.
(v) All other information and explanations that may be necessary to enable a reasonable shareholder to understand the nature and implications from the proposed amalgamation for the company and shareholders.

(b) The Board of each amalgamating company must send the specified information to their shareholders, twenty (20) working days before the amalgamation is proposed to take effect.

The Boards must also give public notice of the proposed amalgamation along with a statement that the copies of the amalgamation proposal are available for inspection by any shareholder at the registered office of the amalgamated companies and other specified places during normal business hours .

The amalgamation proposal must thereafter, be approved by a special resolution of the shareholders of each amalgamating company, in accordance with section 92 of the Act.

[Ref : Section 241]

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