

# CORPORATE LAWS & GOVERNANCE

## PROFESSIONAL 1 EXAMINATION - APRIL 2017

### NOTES:

**Two envelopes** must be used to enclose answers:

- Enclose answers to questions in **Section A in one envelope**, and
- Enclose answers to questions in **Section B in a second envelope**.

**Mark clearly on each envelope the Section to which the answers relate.**

### Section A:

You are required to answer **three** questions from this section, (Questions 1, 2 and **either** 3 or 4). However, should you provide answers to **both** Questions 3 and 4, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for each of these two questions will be marked.

### Section B:

You are required to answer **one** question from this section. However, should you provide answers to each question in this section, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for each of these two questions will be marked.

### TIME ALLOWED:

3 hours, plus 10 minutes to read the paper.

### INSTRUCTIONS:

During the reading time you may write notes on the examination paper, but you may not commence writing in your answer book.

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

**Start your answer to each question on a new page.**

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

# CORPORATE LAWS & GOVERNANCE

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Time allowed: 3 hours plus 10 minutes to read the paper.

**Section A:** You are required to answer **three** questions from this section.

**Section B:** You are required to answer **one** question from this section.

## SECTION A

**Answer both Questions 1 and 2 and either Question 3 or 4.**

1. *Huffam Publications Plc* was placed in compulsory liquidation in March 2017, on the grounds of insolvency. Pickwick was appointed as the company's compulsory liquidator. He soon discovered that the following debts were owed by the company:

- (1) €6,000 in respect of commercial property rates owed to the local County Council;
- (2) €25,000 secured by a charge against the company's stock in favour of *Barnaby Rudge Investment Bank*, created on the 19 December 2016 and registered on the 30 December 2016;
- (3) €75,000 arising from a judgment against the company by the High Court in respect of an occupational injury claim by a former employee, Dombey;
- (4) €20,000 arrears of salary due to the company's Chief Financial Officer (CFO), Sikes;
- (5) €100,000 in respect of a fixed charge registered on the company's main business premises in March 2010 in favour of *Cadville Investments* – unfortunately, due to an administrative error this charge was registered in the amount of €10,000. In addition, this loan was also personally guaranteed by the company's Chief Executive Officer, Wilfer;
- (6) €12,000 secured by a floating charge in favour of *Havisham Prudential Bank*, created on the 23 September 2015 and registered on the 27 September. Sikes, the CFO of *Huffam Publications Plc* has acted as a non-executive director of *Havisham Prudential Bank Ltd* since January 2014, and is a majority shareholder in this company;
- (7) €43,000 in respect of an overdraft with *Lammie Savings Bank*; and
- (8) €1,800 in declared, but unpaid, dividends in favour of Wren – dating from June 2010.

In addition, in 2012 *Huffam Publications Plc* issued 200,000 €1 ordinary shares, 25 cent payable and with the balance outstanding classified in the balance sheet as reserve capital. In February 2013, the company also issued 200,000 €1 units of debenture stock, secured by a charge on the furniture and fixtures of the company in favour of *Ledger Finances*. This charge was duly registered with the Companies Registration Office.

Pickwick is planning on charging a fee of €12,000 for effecting the liquidation of the company.

### REQUIREMENT:

- (a) Evaluate the nature of Debenture Stock, commenting specifically on the purpose of a Debenture Trust Deed vis-à-vis this Stock. (4 marks)
- (b) Review the prerequisite conditions that must be met in order for a Court to place a company into compulsory liquidation on the grounds of insolvency. (4 marks)
- (c) Some of the creditors of *Huffam Publications Plc* have petitioned the High Court to have a Committee of Inspection appointed to the company. Examine the composition and main functions of such a committee. (4 marks)
- (d) Assess the priority of payment of company debt upon liquidation, and analyse the validity and priority of all of the aforementioned debt. Comment also on any obligations imposed upon the liquidator in relation to the company's reserve capital. (13 marks)

**[Total: 25 marks]**

2. Dawkins commenced employment as a senior accountant and auditor with the firm of *Bamber and Bayham Accountants* in 2010. Last year, Dawkins and his wife separated and they are currently undergoing a difficult divorce, in which she is claiming significant maintenance from him for both herself and their three children. Should Dawkins concede to his wife's financial demands he will find it difficult to finance his own lifestyle. Desperate to improve his financial position, following completion of an audit of *Marwood Pharmaceuticals Plc*, which indicated a stronger profit than had been forecast, Dawkins decided to purchase shares in the company. He bought 20,000 shares at €4.60 and sold these shares after news of *Marwood Pharmaceuticals Plc's* profits became public, for €5.82 a share, making a personal profit of €24,400 on the transaction.

Realising how easy it was to make money based on information gained from his work activities – but knowing the potential liability that he could be exposed to, if caught, Dawkins decided that he would take the gamble one more time – but that he would invest a significantly greater sum – in the hope of making a significantly greater return. As Dawkins was a director of a company that operates a local charity for children with learning disabilities, *Sparkle Ltd*, he decided to use this company to disguise his actions. Dawkins withdrew €1,000,000 from the charity's bank and then used this money to purchase shares in *Harmon Technologies Plc*. Following a recent audit of this company, Dawkins became aware that it had recently been awarded a lucrative government contract that was likely to increase revenues. Dawkins purchased 200,000 shares in this company at €5 each, and later sold them for €7.20 each following the public announcement of their government contract – making a profit of €440,000. After this transaction, he lodged the €1,000,000 back into *Sparkle Ltd's* bank account.

Unfortunately, both transactions were discovered following a forensic review of his finances. This had been requested by his wife's solicitor and permission was granted by the Court. The review request was based on his wife's belief that he was concealing money and assets from her during their divorce negotiations. Since this discovery Dawkins' employment with *Bamber and Bayham Accountants* has been terminated and he has been removed as a director of *Sparkle Ltd* based on his alleged breach of duty. Last month, he was notified that he was criminally indicted on charges of insider dealing. He also received a letter from the Office of the Director of Corporate Enforcement requesting compliance with a disqualification undertaking. He has now contacted you for advice in relation to these matters.

**REQUIREMENT:**

- (a) Critically review the law in relation to insider dealing in Ireland. This review should encompass a definition of inside information and insider dealing – including a discussion of the various forms that it can take, those parties classed as an insider and the applicable penalties. In light of this review, assess the likelihood or otherwise of Dawkins being found guilty of this offence. (15 marks)
- (b) The removal of Dawkins as a director of *Sparkle Ltd* was undertaken arising from the allegation that he had breached his duty to the company by failing to act honestly and responsibly. Examine the various factors that are taken into consideration by the Court in determining whether a director has acted honestly and responsibly and advise Dawkins as to whether his actions were in breach of this duty. (5 marks)
- (c) Outline the nature of a disqualification undertaking (as outlined in Sections 849-851 of the Companies Act 2014) and advise Dawkins on the effect of such an undertaking. (5 marks)

**[Total: 25 marks]**

3. *Murdstone Financial Consultants* (MFC) was established in 2003 and since its establishment has grown considerably. The business now employs in excess of 500 people throughout Ireland. The company does not have a Human Resources Manager and consequently, it has traditionally been the policy that management deal with any employment law issues. A number of issues have arisen recently that have resulted in litigation being issued (and threatened) against the company. Consequently, MFC has now contacted you for advice regarding how to deal with these matters, outlined as follows:
- (1) Marley was employed as a trainee accountant in the Galway branch. Upon commencement of his employment, MFC agreed to pay €4,000 tuition in respect of his outstanding CPA accountancy examinations. In return for this benefit, MFC included a term in Marley's contract to the effect that he was required to remain there as an employee for a period of two years following completion of his accountancy studies, and that if he left the employment prior to the expiry of this two-year period he would reimburse MFC the €4,000 tuition fee paid on his behalf. Last February, Marley terminated his employment with MFC, two months prior to the expiry of the two-year term. When he received his last salary payment he noticed that MFC had deducted the €4,000 tuition fee from his wages. Since this event Marley has lodged a claim against *Murdstone Financial Consultants* with the Workplace Relations Commission for breach of the Payment of Wages Act 1991, on the grounds that this deduction was unauthorised.
  - (2) Manette is employed as a tax consultant in the Kilkenny office. In the Summer of 2016 (following her return to work after a period of maternity leave) she requested, and was granted, the right to job share her role with another employee of the company. As a consequence of this job share, Manette works every second week. She has raised a query in respect of her public holiday entitlements arising as a consequence of this job share arrangement. She has noticed that the majority of public holidays since the Summer of 2016 have fallen on weeks that she is not scheduled to work and, consequently, she has received no benefit in respect of these days. When Manette raised this matter with her manager, she told Manette that as she was not scheduled to work on these weeks, she has no entitlements in this regard. Manette is not satisfied with this answer and has threatened litigation against MFC for breach of its obligations under the Organisation of Working Time Act 1997.
  - (3) One of the managers in the company's Cork office has refused to provide a reference in respect of a former employee, Carton, whose temporary contract was not renewed due to an excessive number of non-certified absences. Following the non-renewal of Carton's contract, MFC discovered that he made an unauthorised copy of the company's payroll packages, and enticed one of the company's clients to transfer their business to him personally, in return for a 20% discount on the fees charged by MFC. Carton has since sent a solicitor's letter to MFC threatening legal action on the basis that it is required by law to provide employees (both present and past) with an employment reference.

**REQUIREMENT:**

- (a) Outline the various deductions from an employee's salary which are permissible under the terms of the Payment of Wages Act 1991, commenting also upon the penalties that arise in respect of a non-permissible deduction. Advise whether the €4,000 deduction from Marley's final salary payment is in compliance with the terms of the legislation. (7 marks)
- (b) Appraise the provisions of the Organisation of Working Time Act 1997 in relation to public holiday entitlements and advise *Murdstone Financial Consultants* as to its obligations in relation to Manette. (5 marks)
- (c) Review the law in relation to employment references, focusing specifically upon whether *Murdstone Financial Consultants* has a duty to provide Carton with a reference, and advise them whether or not an employer is permitted to provide a negative reference. (5 marks)
- (d) Briefly outline whether the actions of Carton in relation to the payroll package and client were in breach of his duty of fidelity as an employee, and the likely consequences for him if his actions are classed as such. (3 marks)

**[Total: 20 marks]**

## OR

4. Hunter is a minority shareholder in *Sedgwick Boutique Hotels Ltd*, holding 18% of the issued share capital of the company. Hunter recently received notice of a shareholders' meeting to approve a substantial transaction in respect of a non-cash asset involving a director. In effect, the meeting was to approve the purchase of a property owned by the son of Sedgwick Boutique Hotels Ltd's managing director and majority shareholder. Despite the fact that the majority of shareholders present at the meeting voted against this transaction, as the property was being acquired by the company for a price significantly in excess of its market value, the transaction was approved by an ordinary resolution following a poll vote – as the managing director held 51% of the company's shares. Furthermore, at this same meeting *Sedgwick Boutique Hotels Ltd* also passed an ordinary resolution to pay one of the company's former director's, the managing director's wife Eden, a €100,000 bonus payment upon her retirement. Again, this resolution was passed as a consequence of the managing director's majority shareholding.

Hunter is outraged at these events and is considering suing the managing director for losses arising to the company as a consequence of what he perceives to be a breach of duties. He is also considering notifying the Office of the Director of Corporate Enforcement (ODCE) of these events and requesting that this office asks the relevant Court to investigate the activities of *Sedgwick Boutique Hotels Ltd*.

### **REQUIREMENT:**

- (a) Critically analyse the common law protection afforded to minority shareholders, and advise Hunter as to whether he is empowered to sue the managing director personally or on behalf of the company in respect of the two matters referred to above. Justify your answer to Hunter.

**Note:** A review of Section 212 of the Companies Act 2014 in relation to minority oppression is NOT required.

(11 marks)

- (b) Examine the law in relation to the investigation of a company's affairs in Ireland, upon the request of the ODCE, as outlined in Section 748 et al of the Companies Act 2014. This examination should encompass a review of the grounds upon which a Court is likely to grant an investigation and the potential outcomes of any such investigation.

(9 marks)

**[Total: 20 marks]**

**SECTION B**  
**Answer either Question 5 or 6.**

- 5.** *“The way companies create and sustain value is directly linked to the debate about the role of business in society”*  
(Corporate Culture and the Role of Boards 2016: Financial Reporting Council)

**REQUIREMENT:**

- (a)** Critically evaluate how agency theory has influenced the role and responsibilities of the board of directors in developing effective corporate governance within an organisation. (15 marks)
- (b)** Discuss how the board of directors can develop an appropriate corporate culture at all levels of the organisation. (15 marks)

**[Total: 30 marks]**

**OR**

- 6.** You are a recently qualified CPA appointed to the company secretary’s office of a company that is considering applying for a listing on the Irish Stock Exchange. You have been asked by your line manager to prepare a presentation relating to Corporate Governance for the department training day.

**REQUIREMENT:**

Prepare the briefing notes for the presentation which:

- (a)** Critically evaluates the role of the Chairman, under the Corporate Governance Code 2016, in enhancing the effectiveness of the board of directors. (15 marks)
- (b)** Discusses how incentive packages should be designed by the remuneration committee to ensure the long-term sustainability of the business. (15 marks)

**[Total: 30 marks]**

**END OF PAPER**

## SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

# CORPORATE LAWS & GOVERNANCE

PROFESSIONAL 1 EXAMINATION - APRIL 2017

### SOLUTION 1

- (a) Debenture Stock: (1) this is where a large group of lenders subscribe for debentures and the loan is treated as part of the company's overall stock figure, (2) this type of debenture can be issued by a PLC or DAC to raise money from the general public, (3) each loan may be split into different amounts and all loans are transferable, and (4) irrespective of date of purchase all lenders are treated *pari passu* for the purpose of repayment of the loan (any 2 = 0-2 marks).

In relation to debenture stock the purpose of a Debenture Trust Deed is to appoint a trustee to act on behalf of all the debenture stock holders – in effect this is a legal document that bestows upon the trustee the power to enforce the security and appoint a receiver, if necessary, where there is default on the principal or interest due on foot of this debenture (0-2 marks).

- (b) Definition of Insolvency: in accordance with Section 570 of the Companies Act 2014 a company will be deemed to be unable to pay its debts where: (1) a creditor who is owed a sum exceeding €10,000 (or (2) two or more creditors owed an amount exceeding €20,000) has served on the company a demand in writing requiring the company to pay the sum due, and the company has failed to make this payment within 21 days of the service of the demand, or (3) where a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part, or (4) where it is proved to the satisfaction of the court that the company is unable to pay its debts, taking into consideration both the contingent and prospective liabilities of the company (0-4 marks).

- (c) Committee of Inspection: this Committee is composed of no more than 5 persons appointed by the creditors of the company – the company is empowered to appoint an additional 3 members – but the composition cannot exceed 8 (Section 666 CA 2014) (0-2 marks).

Role: the main functions of this Committee revolves around: (1) exercising control over the liquidator and protecting the rights of the company's creditors, (2) ensuring liquidator accountability in relation to the sale of assets and assisting them in the performance of their duties, (3) approving the liquidator's fees and their expenses, and (4) determining whether the liquidator should continue the business of the company during the liquidation process and whether the powers of the directors should continue (any 2 = 0-2 marks).

(d) **Priority of Payments on Liquidation:** these are as follows:

Debts	
A. Cost of Liquidation	€12,000 to Pickwick <b>(0-0.5 marks)</b>
B. Fixed Charges (in order of registration)	These debts are paid based on the date of registration as follows: (1) €10,000 to <i>Cadville Investments</i> dated March 2010 <sup>(see Note 1)</sup> <b>(0-2.5 marks)</b> and (2) €200,000 due to <i>Ledger Finances</i> dated February 2013 <b>(0-0.5 marks)</b>
C. Preferential Debts	These debts are all <i>pari passu</i> and include: (1) the €6,000 in respect of commercial property rates owed to Louth County Council <b>(0-0.5 marks)</b> (2) the €75,000 to Dombey arising from the judgment in respect of his occupational injury claim <b>(0-0.5 marks)</b> , and (3) the €10,000 arrears of salary due to Sikes <b>(0-0.5 marks)</b>
D. Floating Charges (in order of registration)	These debts are paid based on the date of registration as follows: (1) €12,000 to <i>Havisham Prudential Bank</i> , arising from a floating charge registered on the 27 <sup>th</sup> September 2015 <sup>(see Note 2)</sup> <b>(0-2.5 marks)</b> and (2) €25,000 in favour of <i>Barnaby Rudge Investment Bank</i> registered on the 30 <sup>th</sup> December 2016 <sup>(see Note 3)</sup> <b>(0-0.5 marks)</b>
E. Unsecured Debt	These debts are all <i>pari passu</i> and include: (1) the balance of €10,000 arrears of salary due to Sikes <b>(0-0.5 marks)</b> (2) the balance of the unregistered fixed charge in favour of <i>Cadville Investments</i> <sup>(see Note 1)</sup> <b>(0-0.5 marks)</b> (3) potentially the €12,000 due to <i>Havisham Prudential Bank</i> <sup>(see Note 2)</sup> and the €25,000 due to <i>Barnaby Rudge</i> <sup>(see Note 3)</sup> <b>(0-0.5 marks)</b> , and (4) €43,000 overdraft due to <i>Lammie Savings Bank</i> <b>(0-0.5 marks)</b>
F. Return to Shareholders	A portion of the €1,800 in declared, but unpaid dividends, in favour of Wren <sup>(see Note 4)</sup> <b>(0-1.5 marks)</b>

*Note 1:* if the company is not in a position to pay this debt from available assets on liquidation, then the CEO Wilfer becomes personally liable for any balance outstanding – as a consequence of his personal guarantee of this loan.

*Note 2:* there is a potentially validity issue with this charge, as it is created in favour of a connected person (Sikes) within two years of liquidation. The key issue therefore is whether the company was solvent when this charge was created – if it was, then the charge is valid. If there is no evidence of solvency then this charge will not rank as secured debt, and instead should rank as unsecured debt (Section 597(4) CA 2014).

*Note 3:* in accordance with Section 597 CA 2014, there is a potential issue with the validity of this charge, as it was created within 6 months of liquidation. The liquidator is empowered to invalidate it, unless there is evidence that the company was solvent when the charge was created. If invalidated, it will rank as unsecured debt.



*Note 4:* in accordance with Section 620(8) of the Companies Act 2014 the right to claim declared but unpaid dividends is limited to a period of 6 years from when they were declared – therefore Wren would only be entitled to unclaimed dividends from 2012-2017 – any payment in respect of 2010 and 2011 is not recoverable.

*Reserve Capital:* the Liquidator is obligated to call for the payment of reserve capital upon liquidation and to institute proceedings against any shareholders who fails to meet this call – therefore the Liquidator should generate €150,000 for the company arising from this call (0-1.5 marks).

## SOLUTION 2

- (a) Insider dealing: this offence occurs when a person or parties have price sensitive information about a company's performance and engage in prohibited actions in relation to company securities in order to make a profit (0-1 mark). For the purpose of insider dealing, Regulation 2 of the Market Abuse Directive Regulations 2005 (adopted under Part 23, Chapter 2, Sections 1365-1371 of the Companies Act 2014) inside information can be defined as confidential information – and (1) information that is of a precise nature, (2) that has not yet been made public, (3) that relates to the issuer of the securities or the securities themselves, and (4) that is price sensitive, in that if it is disclosed it is likely to materially affect the price of the securities being traded (any 3 = 0-3 marks). In accordance with Regulation 5(1)-(2) of the MADR 2005 insider dealing can take many forms and includes situations where: (1) the insider deals in shares and makes use of information which is not generally available, or (2) where the insider makes his knowledge known to an outsider who uses this knowledge to deal with shares, where the outsider should have known or ought to have known that the insider was precluded from dealing with the shares because of his access to the sensitive information, or (3) where the insider induces the outsider to use or disclose this price sensitive information (0-3 marks). Under the legislation a person may be defined as an insider as a consequence of: (1) their membership of professional bodies (especially those who issue financial instruments), (2) by virtue of their capital holding, (3) through employment or professional duties; or (4) through criminal activity (Regulation 5(3)(a) MADR 2005) (any 3 = 0-3 marks). Where this offence is proven then the criminal penalties for breach of the legislation include: (1) upon summary conviction a term of imprisonment not exceeding 12 months and/or a fine not exceeding €5,000 (subject to the Fines Act), (2) where prosecuted on indictment, a term of imprisonment not exceeding 10 years and/or a fine not exceeding €10m (subject to the Fines Act), and (3) a prohibition from any dealing for 12 months from the date of conviction (Regulation 49 of the MADR 2005 and Section 1368 CA 2014) (any 2 = 0-2 marks). In addition, Section 1369 CA 2014 creates civil liability for insider dealing – requiring the person in breach to compensate for losses caused, and account for profits made (0-1 mark)

Conclusion: the likelihood of Dawkins being found guilty of this offence is high – as he was an insider as a consequence of his professional duties as an auditor, he was aware that the information was price sensitive and precise enough to enable him to draw a conclusion as to its impact on the value of the respective companies shares, and he nonetheless dealt in these shares for profit (0-2 marks)

- (b) Duty to act Honestly and Responsibly: according to Justice Shanley in *La Moselle Clothing Limited v Soualhi* (1998) the Court should take the following factors into consideration in determining whether a director has acted honestly and responsibly in the performance of his duties: (1) the extent to which the director has or has not complied with any obligation imposed on him by the Companies Act, (2) the extent to which his conduct could be regarded as so incompetent as to amount to irresponsibility, (3) the extent of the director's responsibility for the insolvency of the company, (4) the extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter, and (5) the extent to which the director in his conduct of the affairs of the company has displayed a lack of commercial probity or want of proper standards (any 4 = 0-4 marks).

Conclusion: Dawkins actions in relation to First Steps Ltd were in breach of this duty as he breached his duties (by using company assets for personal purposes) and he acted in breach of the law and proper standards (0-1 mark).

- (c) Disqualification Undertakings: in accordance with Section 849-851 CA 2014 a disqualification undertaking arises where a person voluntarily submits themselves to be subject to a Disqualification Order, without the need for a Court hearing. This arises where the Director of Corporate Enforcement serves notice on the company officer alleging that their actions justify the Order and stating the period of disqualification applicable (0-2 marks). The effect of this Order is that a person is disqualified from being appointed or acting as a director or other officer, receiver, statutory auditor, liquidator or examiner or being in any way, whether directly or indirectly, concerned or taking part in the promotion, formation or management of a company, friendly society (within the meaning of the Friendly Societies Acts 1896 to 2014) or any society registered under the Industrial and Provident Societies Acts 1893 to 2014 for a prescribed period of time (0-3 marks).

### SOLUTION 3

- (a) Payment of Wages Act 1991: in accordance with this Act the following deductions are permissible from an employee's salary: (1) statutory deductions, such as PAYE and PRSI, levies and charges (Section 5(1)(a)), (2) deductions authorised by a term of the employment contract, such as, pension contributions (Section 5(1)(b)), (3) deductions to which the employee has consented in writing, for example, Trade Union deductions (Section 5(1)(c)), (4) deductions arising from Court Orders (attachment to earnings orders), for example, payment of a debt in accordance with the terms of a bankruptcy order, or maintenance payments in accordance with a family law order (Section 5(5)(g)) – or in accordance with a Government Order (such as to the Revenue Commissioners) (Section 5(5)(c)), (5) deductions as a consequence of over-payment of wages (Section 5(5)(a)), (6) deductions as a consequence of invoking disciplinary action against the employee (Section 5(5)(b)), and (6) deductions as a consequence of the employee's participation in a strike or an industrial action against the employer (Section 5(5)(e)) (any 5 = 0-5 marks).

Conclusion: although Marley agreed to the repayment of the tuition in his contract, if he terminated his contract before the expiry of the agreed term, he never specifically authorised them to make this deduction from his salary – therefore, the deduction is likely to be in breach of the Act – furthermore, for every month that Marley remained in the employment of Murdstone Financial Consultants they obtained a benefit in respect of the tuition they paid on his behalf, therefore, the proposed deduction is likely to be viewed as more than the cost/expenses incurred by the employer, and on this basis it is likely to be struck down as a penalty clause (0-2 marks).

- (b) Organisation of Working Time Act 1997: in accordance with the terms of the Act all full-time employees, part-time employees and day-to-day employees who have worked 40 hours in the preceding five weeks are also entitled to paid leave on public holidays (Section 21(4)). All employees who normally work or are scheduled to work on a public holiday are entitled to either: (1) a paid day off on the holiday, (2) an extra days' annual leave, (3) an extra days pay, or (4) a paid day off within the month (Section 21(1)). Although the employee may request which option will be used 21 days in advance of the public holiday, the employer retains the discretion as to which of the options will be exercised. In addition, those employees not scheduled to work are entitled to one fifth of a normal weekly rate for public holidays (0-3 marks).

Conclusion: as a consequence of Manette's job-sharing situation – she does not have normal daily weekly working hours per se – therefore under S.I. 475/1997, one fifth of Manette's weekly pay should be calculated over a period of 13 weeks prior to the public holiday to determine her entitlements in respect of public holidays with regard to any week on which the holidays falls, but during which she is not scheduled to work – therefore the actions of Murdstone Financial Consultants are in breach of the legislation (0-2 marks).

- (c) References: whether an employer has a duty to provide an employment reference is subject to debate. Section 4 of the Servants Act 1715 places an obligation on an employer to certify that a person was his employee. Generally, this has been interpreted to mean that an employer is required to confirm that: (1) the employee worked for the employer, (2) detailing the position held, including main duties and responsibilities, and (3) the dates of commencement and cessation of service. However, there is no legal obligation to provide an account of the employee's behaviour and performance during the period of employment. Therefore, Murdstone Financial Consultants has a duty to provide Carton with a reference (0-3 marks).

Negative References: all reference must be true, accurate and fair – therefore, there is no restriction upon an employer/Murdstone Financial Consultants providing a negative reference provided it is accurate and they are in a position to provide factual information to substantiate any statements included in the reference (0-2 marks).

- (d) Duty of Fidelity: this is a common law duty that requires an employee to act honestly and in the interests of their employer – potential breaches of this duty include: (1) making an undisclosed profit from the employment relationship, (2) setting up a business in direct competition to an employer using the employer's equipment, machinery or resources, (3) diverting business opportunities from the employer, and (4) disclosing trade secrets or confidential information (0-2 marks).

Conclusion: Carton's actions are in breach of this duty as he has established a business in competition to his employer, using their resources (the payroll system and details from the client database) to do so, and he has diverted business from them (0-1 mark).

## SOLUTION 4

- (a) Common Law Protection of Minorities: in order to preserve the concept of separate legal personality the general rule in company law is that when a company suffers a wrong then the proper plaintiff is the company itself. This rule is espoused in the case of *Foss v Harbottle* (1843), where the defendant directors/promoters sold land to the company at an excessive price, and made undisclosed personal profits from the situation. Two minority shareholders brought an action against these directors and asking them to make good on the losses caused to the company. The action failed on the grounds that the wrong committed was against the company and therefore the proper litigant was the company and not by the individual shareholders (0-3 marks). However, a number of exceptions to this rule have been recognised by the Courts in order to facilitate the minority bringing a legal action where the company officers who committed the wrong are those that control the company – in effect where the majority commit the wrong. The exceptions are constructed to ensure that the application of the rule does not result in unfairness or injustice. The exceptions are as follows: (1) where the transaction is one not capable of being ratified by the majority: the majority cannot sanction an act that is criminal or acts ultra-vires the company (where it is a PLC or DAC). In *Parke v Daily News* (1961) a majority shareholder objected to an ultra-vires gift of £1.5m to redundant employees. The Court allowed this action and restrained the directors from paying the gift, as the donation was ultra-vires the company, (2) the majority cannot approve a wrong where proper procedures are not followed. In *Byng v London Life Association* (1990) a member succeeded in obtaining a declaration that a purported meeting and special resolution were void because the correct procedure for adjourning the meeting had not been followed, (3) where there is a fraud on a minority, then the minority may bring an action against the company. Fraud in this context does not exclusively refer to dishonesty or criminality but is broad enough to embrace a simple misuse of power. In *Clemens v Clemens Brothers* (1976) resolutions of the majority that had the effect of reducing the overall percentage of the plaintiff's shareholding so that he was no longer able to oppose ordinary or special resolutions, was held by the Court to be oppressively, discriminatory and fraudulent. The Court ordered that the resolution be set aside, (4) the majority cannot deprive a member of a personal or individual right of membership. For example, upon buying shares the shareholder enters into a contract with the company giving him individual rights. These rights cannot be removed or varied, and (5) where the Court considers, in its absolute discretion, believes that the justice of the case requires it. In bringing an individual action the plaintiff may be representing himself and similarly affected shareholders, or he may bring a derivative action on behalf of the company (any 3 = 0-6 marks).

Conclusion: Hunter can bring a derivative action against the managing director on behalf of the company in respect of the two mentioned matters, as the actions of the managing director are likely to be classified as fraud on the minority based on a misuse of power (0-2 marks).

- (b) Grounds for a Court Ordered Investigation: in accordance with Section 748 such an investigation is likely to be granted where: (1) the company's affairs are, or have been, conducted with the intention to defraud the creditors, the creditors of any other person or the members, (2) the affairs of the company are being or have been conducted for a fraudulent or unlawful purpose, or in an unlawful manner, or in a manner unfairly prejudicial to some part of its members or creditors, (3) any actual or proposed act or omission of the company is unfairly prejudicial to some part of its members or creditors, (4) the company was formed for a fraudulent or improper purpose, (5) that persons connected with the formation or management of the company have been guilty of fraud, misfeasance or misconduct towards the company or its shareholders, (6) that the members have not been given all information regarding the company's affairs, which they might reasonably expect (any 4 = 6 marks).
- (c) Potential Outcomes of an Investigation: following completion of the investigation and the receipt of an inspectors report the Court can make any order that it deems appropriate. This may include: (1) an order for the liquidation of the company (Section 760(2)(a)), (2) an order remedying any loss suffered by any person whose interests were adversely affected by the conduct of the affairs of the company subject to the investigation, taking into consideration the interests of any other person who may be adversely affected by the order, (3) an order requiring the company or the applicant to repay the cost of the investigation (Section 762(2)), (4) an order for the disqualification of any person acting as an officer of the company, (5) the Court can also forward relevant papers to the Director of Public Prosecutions (DPP) for the purpose of considering whether criminal charges should be instituted (any 3 = 3 marks)

## SOLUTION 5

- (a) The agency theory identifies the relationship between the owners and the managers and recognises the conflict that exists between these two parties. The conflict is evidenced in the separation of ownership and control within the organisation. The challenge is to ensure that the managers are held accountable in their decision making. It is paramount that the decisions made are in line with the objectives of the shareholders and the wider stakeholders. The stakeholders expect the managers to have an appropriate mix of skills and knowledge and to apply them to the long-term sustainability of the business. The alignment of these issues is the challenge facing current day business. Increased transparency of the operations of the board and their decision making can lead to goal congruence.

The increased accountability and transparency needs will be met by higher agency costs in the form of increased supervision and information being given to stakeholders. The increased supervision manifests itself in the requirement under the corporate governance code to include non-executive directors on the board, the establishment of a nomination committee who nominate and appoint new directors and helps to ensure the appointment of new directors is objective and the new appointments will add value to the organisation. The audit committee is another opportunity for probity and the supervision of activities and will provide another control mechanism on the activities of the board of directors. Information on the Committees established by the board of directors must be provided to stakeholders in the annual accounts.

The establishment of a remuneration committee populated in the main by non-executive directors should lead to the establishment of incentive packages which motivate for a long term sustainable business.

The agency theory underpins the need for accountability to the stakeholders and transparency in decision-making by the directors and the need for the directors to establish a risk management and internal control systems to ensure the safeguarding of the assets and the long-term stability and growth of the business.

(15 marks)

- (b) The board of directors are responsible for developing and establishing an appropriate business culture within the organisation which illustrates the values of that organisation. Good governance underpins a healthy culture and board members should demonstrate good practice in the boardroom and promote good governance throughout the business. Culture which is open and accountable and deals constructively with shareholders and the wider stakeholders is fundamental to the long-term development of the business.

To enable the board to establish an appropriate culture it must first of all focus on the overall purpose and strategy and this strategy should reflect the values and culture that the company wishes to embed in the business. The board should encourage debate and frank exchange of views to avoid group-think

To ensure that employees are suitably motivated it is necessary to align the values to the incentive schemes to ensure that the actions of the individuals reflect the corporate values. Financial and non-financial incentives should be appropriate and should be linked to the behaviour that is expected of the employees.

The development of a healthy culture is a continuous focus rather than waiting for financial or a business crisis.

Openness and accountability matter at each level on how the company conducts business and engages with and reports to its stakeholders. It is very important to have an independent chairman who can apply their unique perspectives and expertise as leaders of the board. Leadership provided by the boardroom will influence behaviour throughout the organisation. The Chief Executive has the most influence over the culture and the tone within the organisation. Being open and transparent to the stakeholders is a necessary part of developing an appropriate culture. Shareholders also need to consider their behaviour and expectations with regard to the performance of the organisation.

Embedding and integrating the values is determined through the human resource process, through the recruitment, induction and training programmes, the work of the internal audit, ethics within the organisation, its compliance and its acceptable risk approach. The values that are recognised as evidencing the organisations culture include integrity, safety, excellence, respect and transparency. The board will consider reports which can illustrate employees' values in their day-to-day activities in relation to customer satisfaction surveys and reports, employee reports, safety reports, ethical or compliance reports.

(15 marks)

**[Total: 30 marks]**

## SOLUTION 6

- (a) The roles of specific members of the board are fundamental to good governance and in particular the importance is the chairman of the board. The chairman is responsible for leadership of the board and ensuring its effectiveness at all aspects of its role. The role of the chairman is to lead and create the conditions for the board and its committees to be effective.

The chairman runs the board not the company. There will be a clear division of responsibilities at the head of the company between the running of the board, in the role of the chairman and the executive responsibility for the running of the company, in the role of chief executive. The chairman should be independent and preferably not the previous chief executive. If the previous chief executive becomes the chairman of the board, the board must consult with the major shareholders and state its reasons in the annual accounts for such an appointment.

The chairman should ensure that the board undertakes an annual review of performance and effectiveness and review the effectiveness of the committees and individual directors. The Chairman is responsible for actioning the results of the annual performance evaluation. The chairman should ensure that there is succession planning and an appropriate recruitment process for directors. The Chairman should ensure that all directors receive a full, formal and tailored induction and provide an opportunity for the non-executive directors to meet with major shareholders. The chairman should ensure the directors continually update their skills, knowledge and familiarity with the company to be effective contributors to the decision-making process. The chairman should ensure that all information is provided on a timely manner with a suitable quantity for meetings which are scheduled as required.

The chairman should promote a culture of openness and debate by supporting and facilitating the contribution made by non-executive directors. The chairman should facilitate constructive and open relations between executive and non-executive directors. The chairman should discuss governance and strategy with major shareholders and ensure that the views of shareholders are communicated to the board as a whole. The board should develop and communicate a whistleblowing policy and support anti-bullying and harassment policies.

The chairman is expected to report personally in the annual statements on how the principles relating to the role and effectiveness of the board, as per sections A and B of the code have been applied. The chairman should arrange for the chairman of the audit, remuneration and nomination committees be available at the AGM and to ensure that all directors are available for questions.

(15 marks)

- (b) The remuneration committee's role is to design an appropriate remuneration package providing a balance between fixed and performance related, immediate and deferred remuneration to motivate and incentivise directors and management in the achievement of long-term goals. Performance measures should be relevant, stretching, challenging and designed to promote the long-term success of the business in the context of the board of directors risk appetite and the current operating and business environment.

Performance related elements should be transparent and schemes should be made known to stakeholders. Any new long-term incentive schemes which are being proposed should be approved by the shareholders and should be part of a well-considered overall plan incorporating existing schemes. For share based schemes, the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold them for a prolonged period.

In normal circumstances deferred remuneration should not be vested or be paid and the option should not be exercised in a time frame of less than three years. Share options and other long-term incentive schemes would normally be phased over a period of time and longer periods than three years would be appropriate. Clawback provisions and withholding of variable pay should be included in the design of these incentive programs. Consideration should be given when designing these incentive and performance related remuneration packages to salary changes of other levels within the organisation. Pension contributions should be based on basic salary.

(15 marks)

**[Total: 30 marks]**