

Examination Paper, Solutions and Examiner's Report

Paper:

**Certificate in Financial
Fundamentals for Business**

Business Law

October 2011

SECTION A - Answer TWO compulsory questions

QUESTION 1

Although Aba plc ('Aba') and Exem Ltd ('Exem') have traded with each other for a number of years, they have no written agreement about the terms on which they trade. Aba, with a view to formalising their arrangement, sent Exem a draft agreement to consider. Indeed, thereafter, Aba and Exem applied the terms of the draft agreement to their business dealings but they never actually signed any agreement.

When a dispute arose between the parties, Aba claimed that there was no binding agreement between it and Exem.

Required:

State whether a contract exists between Aba and Exem and explain, with reference to relevant case law, the rules on acceptance in relation to English contract law. Your answer should cover the general rules on acceptance and the postal rule.

(10 marks)

QUESTION 2

The creditors of Trex Ltd, a UK registered company, have presented a petition to the court to have the company compulsorily wound up on the grounds that it is unable to pay its debts.

Required:

Explain the circumstances in which a company will be deemed to be 'unable to pay its debts' for the purposes of presenting a compulsory winding up petition and describe the legal effects of a compulsory liquidation.

(10 marks)

SECTION B - Answer TEN compulsory questions

- 1) In relation to the UK's unregulated financial markets, describe the role and structure of the money market.
(3 marks)
- 2) State three responsibilities which apply to businesses operating under the Non-Investment Products Code (NIPS Code) in the UK.
(3 marks)
- 3) With reference to the French law of contract, explain the requirement to conform to the principles of good faith.
(3 marks)
- 4) Explain the effect of the Contracts (Rights of Third Parties) Act 1999 on the English law doctrine of privity of contract.
(3 marks)
- 5) In terms of the Criminal Justice Act 1993 how is the term 'inside information' defined in UK law?
(3 marks)
- 6) The role of the European Court of Justice ('ECJ') is to ensure that the Treaties are observed. Describe three situations in which the ECJ may become involved.
(3 marks)
- 7) With reference to UK business organisations, describe the key features of a limited partnership under the Limited Partnerships Act 1907.
(3 marks)
- 8) With reference to Chinese business ownership structures, describe the three main forms of business establishments in China which are available to foreign companies operating there.
(3 marks)
- 9) With reference to UK corporate insolvency, explain three advantages to a creditor of the statutory procedure for administration.
(3 marks)
- 10) In relation to corporate insolvency proceedings, state your understanding of the term 'forum shopping' and explain how the EC Regulation on Insolvency Proceedings attempts to stop this.
(3 marks)

(Total 30 marks)

Suggested Solutions for October 2011

This solution covers all of the points that the examiner had expected to see in answers to the examination paper. As such, the solution includes more than would be expected from an individual candidate in the time available to answer the question under exam conditions.

Although comprehensive, the solution is not intended to be exhaustive.

SECTION A

QUESTION 1

The facts in this scenario are similar to those in the case of *Brogden v Metropolitan Railway Company*. Based on the decision in that case, a contract would be formed between Aba and Exem as acceptance can be inferred from the conduct of the parties as is the case in this scenario.

In general terms, a contract is formed when an unqualified agreement to the terms of the offer takes place. Acceptance can be by express words, by action or it can be inferred from conduct of the parties, as in our scenario.

The acceptance must comply with any requirements as to the mode of acceptance. For example, the offer may specify that the acceptance should be in writing or sent by email. If the offer so specifies then the mode of acceptance needs to be by the means specified. Where no particular mode of acceptance is specified in the offer, as a general rule, the acceptance should take the same form as the offer.

In order for an acceptance to be binding and for a contract to come into existence, the general rule is that the acceptance must be communicated to the offeror ie the contract is made when the acceptance is received by the offeror. So, in relation to instantaneous communications, which include the telephone, fax and email, the contract is formed only when the acceptance is received by the offeror.

However, there are exceptions to this rule. For example, the *Carlill* case is an example of when implied acceptance occurs as, in that case, the court held that it was sufficient that Mrs Carlill had acted on the offer without notifying her acceptance of it.

Another exception to the general rule applies to the formation of contracts by post. The postal rule states that, where the use of the post is in the contemplation of both parties the contract is formed when the acceptance is posted, not when it arrives, even if it is delayed or lost in the post. This was illustrated in the case of *Adams v Lindsell* where the court held that the contract was formed when the acceptance was posted despite it being delayed in the post.

[Notes reference: Contract Law and Conflicts of Law 2.4]

QUESTION 2

'Unable to pay its debts' is defined as being where a creditor who is owed more than £750 has served a written demand on the company at its registered office and payment has not been made within 21 days of that demand.

The effects of compulsory liquidation include:

- The liquidation is deemed to have commenced on the date on which the petition was presented to the court not when it was granted. In other words the liquidation takes effect retrospectively.
- Any disposition of the company's property and any transfer of its shares subsequent to the commencement of liquidation is void unless the court orders otherwise.
- No legal action may be commenced against a company in liquidation without leave of the court.
- Any existing legal proceedings against the company are halted (again unless the court decrees otherwise).
- The employees of the company are automatically dismissed.
- Any floating charges crystallise.
- All business documents issued by or on behalf of the company must be amended to state that the company is in liquidation.

[Notes reference: Corporate Insolvency – UK, EU and US 3.4]

SECTION B

- 1) The money market is where short-term debt securities are issued and traded. It is a market for financial institutions and dealers looking to borrow or to lend for short periods which normally do not exceed twelve months and are often for much shorter periods, typically less than 90 days.

The money market is an informal network of dealers and institutional investors, rather than an organised market like the LSE. The key participants in the money market are the banks, who borrow and lend to each other using a variety of financial instruments.

[Notes reference: Financial Markets and Regulation 4.2]

- 2) The responsibilities which apply to businesses to which the NIPS Code applies include:
 - The responsibility to ensure proper staff training.
 - To identify areas where a conflict of interest might arise and to resolve any conflicts to ensure fair treatment of parties involved.
 - To have cognisance of the money laundering requirements and take great care to ensure that the wholesale markets are not being used to facilitate money laundering.
 - To ensure no misleading or misrepresentative information is presented.

[Notes reference: Financial Markets and Regulation 4.3]

- 3) In France, when forming a contract, there is an implicit obligation on the parties to act in good faith. This means that one party must disclose relevant information to the other party and must not put up unacceptable proposals which would confuse negotiations, resulting in the breakdown of negotiations.

In forming a contract in France, if one party knows that the other has made a mistake and does not tell him about the error he is making, then the law says that the parties have not consented to the contract and, without genuine consent, the parties do not enter into a legally binding agreement.

[Notes reference: Contract Law and Conflicts of Law 4.4]

- 4) The doctrine of privity of contract states that only a party to a contract has enforceable rights and obligations under the contract. However, the Contracts (Rights of Third Parties) Act 1999 has had a fundamental effect on the doctrine of privity of contract in that it changes this position and sets out circumstances in which a third party may now have a right to enforce a contract term or have it varied or rescinded, and a right to all the remedies that are available for breach of contract.

The Act provides that a third party may, in his own right, enforce a term of the contract if:

- the contract expressly provides that he may, or
- the term purports to confer a benefit on him, unless it appears that the parties did not intend the term to be enforceable by the third party.

In any event, the third party must be expressly identified in the contract by name, or as a member of a class or as answering a particular description, but need not be in existence when the contract is entered into.

[Notes reference: Contract Law and Conflicts of Law 2.8]

- 5) In terms of the Criminal Justice Act 1993, inside information is information which is 'price sensitive' and:
- Has not yet been made public, and
 - If it was made public would be likely to have a significant effect on the price of any securities, and
 - Is specific or precise, and
 - Relates to particular securities or a particular issuer rather than to securities or issues generally.

[Notes reference: Legal Regulation of Business 6.1]

- 6) The ECJ can become involved in a number of situations including:
- Hearing actions against Member States who fail to fulfill their Treaty obligations. These actions are usually brought by the European Commission in its role as 'guardian of the Treaties'.
 - A referral from a national court so that in a situation where a case is being heard in a national court of a Member State which includes an aspect of EU law, the judges in the national court may stay the domestic proceedings and refer a matter on EU law to the ECJ for a preliminary ruling. Once the ECJ has made its ruling that ruling is then applied by the national court to the facts of the case it is hearing.
 - The ECJ will also deal with appeals from the Court of First Instance.

[Notes reference: Legal Regulation of Business 4.3]

- 7) The key features of a limited partnership include:
- A limited partnership must consist of two or more persons.
 - At least one person must have the status of 'general partner' whose role it is to run the business and who has unlimited liability for the debts of the business.
 - There must also be at least one 'limited partner' who provides capital to the business but must not take an active role in running the business. The liability of the limited partner is limited to the capital contributions he has made to the partnership unless he becomes involved in management which would result in him becoming jointly and severally liable with the general partner for the business debts.
 - A limited partnership is created when it registers with the Registrar of Limited Partnerships and is formed on the date of registration.
 - A limited partnership is required to put the letters 'LP' or the words 'limited partnership' after its name to identify its status.

[Notes reference: International Business Organisations 2.2 (iii)]

- 8) The three main forms of business establishments available to foreign companies operating in China are:
- A representative office: The scope of activities which a representative office can carry out are very limited and, for example, they may not carry out direct business activities but are limited to undertaking market research and building relationships.
 - A joint venture ('JV'). This allows a foreign company to legitimately enter into profit-making business activities in China. There are two types of JV in China namely an equity JV and a cooperative JV. Once the JV is registered it becomes a Chinese legal entity subject to Chinese laws. As a Chinese legal entity, it may, for example, freely employ Chinese nationals and buy land.
 - A wholly foreign-owned enterprise ('WFOE'): This route is often the preferred route to carrying out business activities since it gives the foreign company control over their business rather than having to deal with a joint venture partner.

[Notes reference: International Business Organisations 4.4]

9) Three advantages to creditors of the administration process are:

- Floating charge holders can appoint an administrator without reference to the court.
- It is likely to be in the long term interests of creditors to keep the company in business particularly where the administrator manages to turn the business around.
- Any creditor can seek the appointment of an administrator whereas other types of recovery actions against a company have restrictions. For example, a creditor seeking to winding up a company must meet certain criteria.

Candidates who made reference to advantages to the company (which may coincidentally provide advantages to creditors as a whole or to particular creditors) were given credit for valid points made which would have included:

- As administration is subject to a time limit it is not an open-ended process so the creditors are not left in a state of uncertainty indefinitely.
- Administration provides a temporary relief from the creditors giving the company time to put a rescue plan together – ie a moratorium takes effect with the result that no liquidator can be appointed and no reclaim of assets subject to hire purchase can be achieved.
- The company does not necessarily cease to exist at the end of the administration process which, in the long term, may benefit creditors.
- Reference to administration being a less expensive process than, for example, liquidation, or a process whereby the sale of assets is more controlled.

[Notes reference: Corporate Insolvency – UK, EU and US 3.5]

10) Forum shopping applies in cross-border insolvency proceedings and is where a creditor seeks to open proceedings in a member state where the insolvency legislation is most favourable to their particular circumstances. The EC Regulation on Insolvency Proceedings attempts to stop forum shopping by requiring that main proceedings be opened in the member state where the debtor's 'centre of main interest' ('COMI') is situated.

[Notes reference: Corporate Insolvency – UK, EU and US 4.4]

Examiner's Report

Certificate in Financial Fundamentals for Business Business Law October 2011

General

This was the second diet of the new syllabus. 89 students sat the CertFin Business Law paper in October 2011. Of these, 48 passed, giving a pass rate of 54%.

The paper was for a total of 50 marks. The highest score was 43 and the lowest score was 2.5. The papers of students scoring in the range 21 – 26 (26 papers) were passed to the Moderator for double marking.

The breakdown of the results by overall mark is as follows:

Range	No. of candidates
45 – 50	0
40 – 44.5	2
35 – 39.5	5
30 – 34.5	14
25 – 29.5	27
20 – 24.5	13
15 – 19.5	12
10 – 14.5	7
0 – 9.5	9

SECTION A

Section A comprised two compulsory questions. Each question was worth 10 marks. Neither question was particularly well answered although Question 1 was better answered, generally, than Question 2.

QUESTION 1

This question was for 10 marks and examined English contract law and specifically the rules on acceptance.

Generally, this question was well answered by a number of candidates but no candidate scored full marks. Although a number of students did answer the question fully and knowledgeably and, as required, with appropriate reference to case law, many others did not answer the question asked. For example, a number of candidates wrote about the elements required to form a contract rather than focussing their answer on the rules of acceptance. Indeed, not answering the question asked is a comment that could be applied to a number of the questions attempted at this sitting.

Overall, 45% of candidates passed this question. The average mark for the question was 4.5 out of 10.

QUESTION 2

This question was also for 10 marks and examined candidates' knowledge of the UK compulsory liquidation rules.

A number of candidates did make a solid attempt at answering this question and scored good marks. However, a number of candidates wrote either about compulsory liquidation procedures or confused liquidation with administration. Another common mistake was to write about a company voluntary arrangement. Hence, by not answering the question the candidates failed to score the marks available.

The average mark for this question was 3.89 out of 10 with 37.5% of candidates passing.

SECTION B

Section B comprised 10 compulsory questions all for 3 marks. Generally, the standard of answers to the Section B questions was reasonable and apart from Questions 2 and 6, more candidates passed than failed. In particular, Question 10 on the EC Regulation on Insolvency Proceedings was well answered as was Question 7 on limited partnerships. However, the answers to the Question 2 on the NIPS Code were poor as were the answers to Question 6 on the European Court of Justice.

QUESTION 1

This question examined the role and structure of the money market. 57% of candidates passed this question with an average mark of 1.44 out of 3. Most answers demonstrated that candidates had a reasonable understanding of this topic.

QUESTION 2

This question asked candidates to state three responsibilities which apply to businesses operating under the NIPS Code. 24.6% of candidates passed this question with an average mark of 0.8 out of 3.

Somewhat surprisingly, a number of candidates' answers scored no marks and only a couple of candidates scored full marks. The answers generally demonstrated a lack of knowledge of this aspect of the course.

QUESTION 3

Question 3 asked candidates to explain the requirement of good faith in French contract law. 64% of candidates scored half marks or more with an average mark of 1.6 out of 3. This question was generally well answered and candidates demonstrated a good knowledge including the implications of not complying with the requirements of good faith.

QUESTION 4

This question examined the English law doctrine of privity of contract and the effect of the Contracts (Rights of Third Parties) Act 1999 on it. 68% of candidates scored half marks or more with an average mark of 1.62 out of 3.

The answers to this question were, again, generally good with a number of candidates scoring either 2.5 or 3 on this question. Where candidates failed to score full marks it was due to lack of detail.

QUESTION 5

This question also examined the definition of 'inside information', defined in UK law by the Criminal Justice Act 1993. The answers to this question were mixed. 59% of candidates scored half marks or above. The average mark was 1.54 out of 3.

This should have been a straightforward question but many candidates did not provide sufficiently detailed answers and others wrote about what constituted 'insider dealing' rather than stating what amounted to 'inside information' as required by the question.

QUESTION 6

This question required candidates to describe three situations illustrating the role of the European Court of Justice ('ECJ'). 26.4% of candidates passed this question with an average mark of 1 out of 3.

This question was generally poorly answered. Although most candidates made some reference to the European Commission (in its role as 'guardian of the Treaties') taking a case to the ECJ, most candidates were unable to provide any further detail.

QUESTION 7

This question examined limited partnerships and was generally well answered with a number of candidates scoring full marks. 75.2% of candidates scored half marks or above. The average mark was 2.1 out of 3.

Most candidates made a good attempt at this question and quite often wrote clear and detailed answers.

QUESTION 8

This question examined Chinese business ownership structures and was generally not well answered. 53.8% of candidates scored half marks or more with an average mark of 1.58 out of 3.

The answers to this question were very mixed and although a number of candidates scored full marks, many others provided answers which identified less than the three main forms which the question was asking for.

QUESTION 9

This question asked candidates to explain three advantages to a creditor of the statutory procedure for administration and most answers demonstrated a reasonable understanding. 69% of candidates passed this question with an average mark of 1.5 out of 3.

QUESTION 10

This question examined candidates' understanding of 'forum shopping' and was the best answered question in Section B, with most candidates showing a good knowledge of the EC Regulation on Insolvency and the rules relating to the COMI. Consequently, 81.7% candidates passed this question with an average mark of 2.39 out of 3.

SUMMARY

The pass rate of 54% is disappointing and is considerably lower than the pass rate in the April 2011 diet.

As a general comment, candidates need to answer the question asked in order to gain the marks. In some cases it appeared that candidates simply had not read the question, rather than not having the required knowledge and this resulted in a lower mark than might have been expected.

Around 31% of candidates made a very poor attempt at the exam paper, scoring less than 40%. However, this was a paper in which a candidate was able to score a high mark if properly prepared and there were a number of well written exam papers, with almost a quarter of candidates passing convincingly (scoring 60% or above). 2% of candidates scored more than 80%.