Lecture 3 Company Formation

Pre-incorporation contracts and promoters

Twycross v Grant (1877) 2 CPD 469

In describing the role and function of a promoter, Lord Cockburn said: " A promoter, I apprehend, is one who undertakes to form a company with reference to a given project and to set it going, and who undertakes the necessary steps to accomplish that purpose...and so long as the work of formation continues, those who carry on that work must, I think, retain the character of promoters. Of course, if a governing body, in the shape of directors, has once been formed, and they take what remains to be done in the way of forming the company into their own hands, the functions of the promoter are at an end."

Whaley Bridge Calico Printing Co v Green (1880) 5 QBD 109

A promoter negotiated the sale of a business from the seller to the company which he was intending to form. The seller agreed to pay a share of the profit he received from the sale to the promoter.
It was held that the promoter was accountable to the company for that profit.
In an attempt to define the term "promoter", Bowen J said:
"The term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence.

Erlanger v New Sombrero Phosphate Co (1878) 3 App Cas 1218

A syndicate headed by Erlanger acquired the lease of an island in the Caribbean for £55,000. The leaseholder was a nominee of the syndicate. The syndicate later incorporated the New Sombrero Phosphate Co. At a meeting of the directors (some of whom were members of the syndicate) it was agreed that the company would buy the lease from the nominee. The company issued a prospectus which did not mention that anyone other than the nominee had any interest in the lease. Held: As there had been no disclosure by the promoters of the profit they were making, the company could rescind the contract and recover the price from Erlanger and the other members of the syndicate.

Gluckstein v Barnes [1900] AC 240

A syndicate bought property intending to sell it to a company they were forming. They nominally bought it for £140,000 but actually got it at a discount, so that it cost them £120,000. They then sold it to the newly formed company, of which they had become directors, for £180,000. A prospectus issuing to the public disclosed a profit of £40,000, but not the £20,000 discount. The company later failed and the liquidator claimed repayment of the £20,000. The House of Lords upheld the liquidator's claim.

Almost complete control of the company's affairs will be necessary before a party will be deemed a shadow director

Re PFTZM Ltd [1995] 2 BCLC 354

PFTZM had operated a hotel but it was not as profitable as expected and its MD thought it would be unable to pay the rent. The landlord co. permitted PFTZM to continue trading provided that one of its directors attended PFTZM's weekly meetings and decided which of PFTZM's creditors should be paid. Judge Paul Baker, QC decided that there was not even a prima facie case that the landlord directors were shadow directors of PFTZM and almost complete control of the company affairs would be required for such a finding.

This may no longer be the case – see *SS v Deverrel* [2000] 2 BCLC 133 where the court held that complete control is no longer necessary; neither is it necessary that the director is 'lurking in the shadows'.

The controlling director of a co had given many year's service without having a service contract. He was then issued by the board of directors with a service contract which provided for payment of a pension to his widow if he died while still a director. He was in poor health at this time (which he failed to disclose) and died 2 months later. The pension was then paid for several years before the company went into liquidation. The director's executors put in a claim in the liquidation for the capitalised value of the pension. This was rejected by the liquidator. The court upheld the liquidator's view. The pension was not for the benefit of the company, nor was it incidental to the carrying on of the co's business. The director's sole intention had been to benefit his wife, irrespective of the effect on the company.

The Question of Good Faith is Subjective not Objective

Re Smith and Fawcett Ch 304

Directors had a right (set out in the arts) to refuse to register a share transfer. When exercising that right the courts would respect their subjective decision as to what was in the company's best interest. The court would not substitute its own view as to this question

Regentcrest plc (in liquidation) v Cohen and another [2001] 2 BCLC 80

Per Jonathan Parker J, (p120) "The duty imposed on directors to act bona fide in the interests of the company is a subjective one (see Palmer's Company Law para 8.508). The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest; but that does not detract from the subjective nature of the test"

Lecture 6 Case-notes on separate legal personality and piercing the veil

Separate Legal Personality Cases

The cases which set out the general rule :

The seminal case in the area is *Salomon v Salomon* [1897] AC 22.

S carried on business as a leather merchant and boot manufacturer. In 1892 as was becoming common at that time, he formed a limited company to take over the business – to take advantage of the idea of limited liability. The memorandum of association was signed by S, his wife, daughter and 4 sons. Each subscribed for one share. They met and made S and 2 sons directors. The co paid £39,000 to S for his business, and the mode of payment was to give S £10,000 in debentures (loans) secured by a floating charge over the co's assets and £20,000 shares of £1 each and the balance in cash. Less than one year later the company fell on hard times and a liquidator was appointed. If S's debenture was valid then he was a secured creditor entitled to be paid prior to unsecured creditors. The assets were sufficient to pay off the debentures but then the trade creditors would get nothing – they claimed on the ground that the company was a mere alias or agent of S. The Court held that the co was a separate and distinct person and that the debentures were perfectly valid and hence S was entitled to the remaining assets in payment of the debentures held by him.

Grierson, Oldham v Forbes Maxwell (1895) 23 R 18

Forbes Ltd entered into an agreement with Grierson, a firm of wine merchants, for a space in G's advertising wine-list for a period of 3 years at a rent of £20 per annum. Shortly after the agreement was entered Into, G's business was transferred to a new company Grierson Ltd, which in effect was the same business operated at the same premises and by the same people. When F Ltd failed to pay the rent to G Ltd, it was held that G Ltd had no title to sue for payment of the debt as this was because the debt was owed to Grierson (the old firm that was no longer in existence) and not G Ltd as G Ltd was a separate and distinct person in law from both G and those that comprised it and hence not a party to the contract between F Ltd and G.

Macaura v Northern Assurance Company Ltd [1925] AC 619

M was the owner of a timber estate in County Tyrone and he formed an estate co and sold the timber to it for £42,000. The purchase money was paid by the issue to M and his associates of 42,000 shares fully paid up of £1 each. M also financed the co, and was an unsecured creditor for £19,000. M effected an insurance policy on the timber in his own name and not in the name of the co and on Feb 23rd 1922 most of the timber was destroyed in a fire. M claimed under the policy but he was held not to have an insurable interest. He could only be insuring either as a creditor or a shareholder of the co and neither of which had an insurable interest since the assets belong to the co in its capacity as a separate entity.

Lee v Lee's Air Farming Ltd [1960] 3 All ER 420

In 1954, the appellant's husband formed a company which carried on the business of crop spaying from the air. In March 1956, Mr Lee was killed while piloting the aircraft during the course of top soil dressing, and Mrs Lee claimed compensation from the co, as the employer of her husband under the New Zealand Worker's Compensation Act 1922. Since Mr Lee owned 2,999 of the co's 3000 shares and since he was managing director, the question arose whether a relationship of employer and employee could exist between the co and him. One of his first acts as managing director had been to appoint himself the only pilot of the co at a salary set by

Woolfson v Strathclyde Regional Council 1978 SC (HL) 90
W ran a shop in Glasgow, which in 1966 was compulsarily purchased by the Council. Part of the shop premises was owened by W himself, the rest being owned by a company called Solfred Holdings Ltd, whose shares were owned by W and his wife. W and Solfred received compensation for the value of the land, but the Council refused to pay compensation for disturbance of the business, because the business was operated by M & L Campbell Ltd, another company owned by W and his wife. Campbell Ltd occupied the premises, but had no interest in the land. W tried to persuade the court that he and his two companies were, in reality, a single entity which both owned and occupied the land. The court did not accept this. It was held that W's case was distinguishable from the DHN case. Whereas, in that case, DHN had owned and totally controlled both its subsidiaries, W himself held only two-thirds of the shares in Solfred, and Solfred owned no shares in Campbell Ltd. The three were distinct entities.

Daimler Co Ltd v Continental Tyre and Rubber Co (GB) Ltd [1916] AC 307
After war broke out with Germany, the tyre company, which was registered in England and had its registered office there, sued Daimler for the cost of goods supplied before war broke out. Daimler claimed that, as the members and officers of the company were German, paying the debt would amount to trading with the enemy, therefore the matter should not be permitted to go to trial. Held: The action should not go to trial. Though the domicile and nationality of a company is normally determined by its place of registration and the situation of its registered office, the court was prepared to lift the corporate veil to determine who was in control of the company. If the company was controlled by enemy aliens, the company could also be regarded as an enemy alien.

Re a Company [1985] BCLC 333 (CA)
The case involved a complicated network of companies and trusts. The court allowed the veil to be lifted to establish exactly what the defendant owned and where it was located. The network of companies had been set up in an attempt to confuse and conceal. It was said that: "The court will use its powers to pierce the corporate veil if it is necessary to achieve justice."

Creasy v Breachwood Motors Ltd [1993] BCLC 480
C was dismissed from his employment with a company called Welwyn Motors Ltd. W Ltd carried on business from premises owned by Breachwood Motors Ltd. The two people who were the sole directors and shareholders of B Ltd were also the only directors and shareholders of W Ltd. C sued his employers for wrongful dismissal and was awarded over £60,000. Unknown to C, the directors of W Ltd had already transferred all its assets to B Ltd, and W Ltd had been struck off the register of companies. B Ltd paid all of W Ltd's trade creditors, so as to maintain creditworthiness, but it did not pay C's claim. B Ltd then carried on W Ltd's former business from the same premises as before. B Ltd claimed it was not liable to pay the compensation to C because W Ltd and B Ltd were separate legal entities. The court lifted the corporate veil and determined that W Ltd was part of B Ltd, thus B Ltd was prima facie responsible for payment of the compensation. The court felt that lifting the veil was necessary in the interests of justice.

creditor agreement providing for unrestricted use credit; in the second, it is a debtor- creditor- supplier agreement providing restricted-use credit. Again s. 18 requires that the agreement be treated as an agreement in each of these categories.]

Linked Transactions [s. 19]: where a regulated agreement is entered into, there may be an ancillary agreement: e.g. television is hired or bought on h.p. and the customer is encouraged to enter into a maintenance contract; buy a mobile phone from Car Phone Warehouse and you will be encouraged to enter into an insurance policy in respect of it, written by an associate company; sometimes in taking out a standard security the borrower is required to take out a life insurance policy with an associate company to the finance company. S. 19 provides in broad principle that where there is a regulated agreement, statutory rights in respect of that agreement (withdrawal, cancellation etc) apply equally to the linked agreement.

There are various situations in which an agreement will be treated as linked to the principal agreement: e.g. if the principal agreement requires the linked agreement to be made to comply with the principal agreement or where entering into a linked agreement is presented as an inducement for the creditor to enter into the principal agreement ('it would help us to

47 it was held that "business" was indeed restricted to a consumer credit or consumer hire business – with the result that an HP agreement entered into in the course of a car-dealing business was treated as a non-commercial agreement.

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Having looked at the terminology of the Consumer Credit Act 1974 we must now turn to the manner in which it protects the consumer……

The Consumer Credit Act 1974 regulates consumer credit business at all its stages:

- ***Seeking business*** (advertising; canvassing etc).
- ***Entering into an agreement*** (e.g. giving the debtor copies of the agreement; the right to cancel in 'cooling off' periods
- **Matters arising during the course of an agreement (e.g. the right to information)**
- ***Ending the agreement*** (e.g. formally terminating it; or defaulting on it)

….Now we will turn to look in a little more detail at some elements of each of these stages…..

SEEKING BUSINESS [Handbook, para 4.1]

1. ***Advertising*** **[ss. 43 – 46]**

1. ***The purpose of these provisions*** is to ensure that the advertisements indicating that the advertiser is willing to provide credit or hire facilities

If this is not provided, and an agreement is made, it will be treated as not properly executed, and the creditor will only be able to enforce it by an order of the court (s. 55(2)).

3. Antecedent Negotiations (s. 56)

This provision is designed to protect the consumer by making the creditor as well as the supplier liable for misrepresentation (where they are not the same person i.e. in debtor/creditor/supplier agreements) in antecedent negotiations.

1. ***What are antecedent negotiations?***

S. 56 defines 'antecedent negotiations' (in effect, pre-*contractual negotiations*)

They are any negotiations with the consumer debtor or hirer:

(a) *Conducted by the creditor or owner* in relation to making a regulated agreement (e.g. finance company supplying goods under an HP agreement) **or**

(b) *conducted by a credit-broker* [i.e. some-one who introduces those seeking credit to those offering credit] in relation to goods sold (or proposed to be sold by the credit-broker) before forming the subject-matter of a debtor-creditor-supplier agreement within s. 12(a) (e.g. a dealer selling goods to a finance house to be let out on hire-purchase to a person introduced by the dealer to the finance house) **or**

- *the creditor or owner*

  (or their agent – the agent is *deemed* to include:

  (a) a credit-broker or supplier who was an negotiator in the agreement **or**

  (b) also any person who in the course of their business acts on behalf of the creditor); **or**

  (c) *person specified to receive it in the statutory notice of cancellation* and this notice must be included in a cancellable agreement.

(ii) the notice of cancellation does not have to be in any particular form as long as it conveys the intention to cancel

(iii) the notice of cancellation is deemed to have been served on the creditor or owner on the date of posting – even if it is never received

(iv) with some exceptions, the cancellation notice cancels the agreement and any linked transaction and also serves to withdraw any offer to enter a linked transaction.

4. Time Frame for the Cancellation (s. 68)

(i) S. 64 requires that every copy of an agreement that is cancellable must have a notice in prescribed form indicating the right to cancel, the cancellation process and the name and address of the person to whom the cancellation notice may be sent.

(ii) S. 62(1) and S. 63(2) requires that where the creditor has not signed the agreement when the debtor signs (i.e. an unexecuted agreement) the

Lecture 9 – Consumer Credit 3

1. **One thing that the debtor consumer needs during the contract is information**, ***so*** the CCA ss. 77-79 and 97 combine *to require the creditor to supply on the demand of the debtor information on*:

    (i) the amount already paid

    (ii) the amount outstanding on the agreement and

    (iii) the amount required to settle the account (i.e. the capital and any early settlement charges)

2. The debtor has the same statutory rights under a regulated agreement which is a sale of goods, an HP agreement or a contract of hire in respect of implied terms as he or she would have in any way.

3. **The big issue is the scope of the connected creditor liability for breaches by the supplier (s. 75)**

(i) This parallels s. 56 [where the creditor is liable with the supplier for misrepresentations in the antecedent negotiations (pre-contractual negotiations)].

(ii) Under s. 75, in certain circumstances supply contracts and credit contracts are treated as interrelated – on the grounds that suppliers and finance houses are often closely connected.

(iii) s. 75: in a commercial debtor-creditor-supplier agreement (i.e. where there is an agreement between creditor and supplier) where the cash price of the goods under the agreement is between £100 and £30,000, if the debtor has a claim against the supplier for misrepresentation or breach of contract (including, of

24(Lord Mance)). ***So, despite the earlier debate on the matter, the debtor does have a claim against the credit card company where s. 75 applies.***

There remains one further issue here:

CCA 1974 only applies to regulated agreements made on or after 1 July 1977. So, *it is argued by some*, s. 75 does not apply to credit card agreements made before that date (and it does not matter how many "new" cards by expiry date have been issued since on the basis of the agreement – although if the agreement has been varied since July 1977 that would be treated as a new agreement and s. 75 would then apply). *An alternative argument is that a "debtor-creditor-supplier agreement" is created not when the credit card agreement is made but each time the credit card is used* – so s. 75 applies to each transaction and the date that the credit card agreement was made is irrelevant.

- This has not been tested in the courts but ***credit card companies*** that entered into pre-July 1977 credit card agreements ***have indicated that they accept s. 75 liability*** on cards issued under such agreements – to the extent of the credit used on each purchase with the card.

Lecture 10

PERSONAL INSOLVENCY – 1

1. INTRODUCTION

1. ***Personal insolvency*** [Handbook, p. 14ff] applies to virtually every legal entity other than a company registered under the Companies Acts – so includes living and dead natural persons, partnerships, trusts and companies that are not registered and it is principally regulated by the

Bankruptcy (Scotland) Act 1985

(as amended by the *Bankruptcy and Diligence etc (Scotland) Act 2007 Pt 1 – which was largely brought into force on 1 April 2008*).

2. ***This is the most formal insolvency process*** and its main *features are*: a third party takes control of assets of debtor and administers them in statutorily prescribed way to satisfy the debtor's liabilities. This is "sequestration" in Scots Law.

N.B. The process is complicated, so to help you there is a summary for general reference in the Handbook [pp. 14-16]

3. ***There are other less formal insolvency processes***, particularly ***the* granting of a voluntary trust deed** for creditors by which the debtor **conveys his estate to a trustee**, for the benefit of his creditors.

(i) the deed is delivered to the trustee (who must be a qualified insolvency practitioner)

(ii) the trustee published a prescribed notice in the *Edinburgh Gazette* and sends a notice to every known creditor within a week of publishing the notice

(iii) unless the trustee receives written objections within 5 weeks of publication of the notice from *either* a numerical majority of creditors *or* a third in value of the creditors, the trust deed becomes protected

(iv) a copy is then sent by the trustee to the Accountant in Bankruptcy

- ***Protecting the trust deed by this procedure has <u>three effects:</u>***

(i) an objecting creditor has no greater right to recover a debt than any other creditor: if the deed has been competently drawn this means that no creditor can sue or do diligence; *however* an objecting creditor can petition for sequestration within 6 weeks of the *Gazette* notice [thus the procedure forces action] [i.e. sequestration may be sought at any time on the grounds that the distribution of the estate is prejudicial to an individual creditor or a class of creditor)

(ii) <u>debtor</u> cannot petition for sequestration

(iii) the trustee or any creditor can challenge unfair preference or gratuitous alienation *and* the trustee can also challenge an order for payment of a capital sum on divorce (but cannot act against an extortionate credit transaction).

5. SOME GENERAL TERMINOLOGY

(i) "Insolvency"

* obviously in this last event, the exclusion that the debtor was shown to be able and willing to pay the debt does not apply.]

(ii) "Bankruptcy"

Again this is a rather loose term in Scots law without precise meaning and it is not used in the Bankruptcy (Scotland) Act – except in the title! The Scots law term for the personal insolvency process is "sequestration" (although it is commonly used by lawyers to describe the legal processes which place obligations on the insolvent debtor – so for example it is a sub-chapter heading in Cloag & Henderson).

It has a more formal meaning in English law where it is used for the insolvency processes related to personal insolvency (where the insolvent "person" is a "bankrupt" in Scots law the "debtor").

THE SEQUESTRATION PROCESS

[Handbook, *in outline:* pp. 16ff; *in more detail: pp. 19ff*]

(i) *Who can be sequestered?* ***[BSA ss. 5 & 6]***
Living natural persons; dead natural persons (or more accurately their estates); trusts; partnerships (including limited and dissolved partnerships (and also individual partners – but these must be separate petitions)); corporate bodies (other than registered companies under the Companies Acts) and unincorporated bodies.

(ii) Who can petition the court for sequestration? [s. 5 and 5A]:

- *The two principal categories of petitioner are:*[*personal note:*the remaining categories are set out in the previous *Personal Insolvency 1* lecture, pp. 18-21]:

I. *The living debtor* may personally apply for sequestration, *either*

BUT [and introduced by the 2007 Act] ***there is some flexibility in the system:***

The sheriff may continue the petition:

- *for 42 days*, if satisfied that – within that period – the debtor will pay or satisfy any debt: (a) by which the debtor became apparently insolvent *and* (b) owed by the debtor to the petitioning creditor (or a creditor concurring with the petition [s. 12 (3B)]
- *until he thinks fit*, if a debt repayment programme has been applied for (but not accepted or rejected) or will be applied for – in respect of the debt creating the debtor's apparent insolvency or the debt owed to the petitioning creditor (or a concurring creditor [s. 12 (3C)]

- Making the award of sequestration (once the conditions have been complied with) both in debtor applications and creditor petitions is peremptory in statutory terms ["forthwith" is the term used] and Sheriff Principal N D MacLeod observed that the Act "could scarcely be more peremptory or enjoin greater despatch [Sales Lease Ltd v. Minty 1993 SLT (Sh Ct) 52, 54]
- **N.B.**

Where the sequestration is not awarded there is a right of appeal.

Where it is awarded, there is right to seek a recall of the award (this in