**SUMMARY QUESTIONS**

**ESSAY QUESTIONS**

1. ‘Salomon v Salomon was wrongly decided. Its implications have allowed corporations to defraud innocent customers and suppliers, and it has facilitated the creation of sham companies with the protection afforded by the veil of incorporation. Corporations should not possess a legal personality distinct from those who subscribe to it.’

Critically assess the above statement.

**Indicative content outline answer:**

* The question is asking for a critique of the ruling in *Salomon* and the implications of a company possessing a legal personality separate from the owners and shareholders.
* The effects of a company possessing its own legal personality is that it may enter into contracts, sue and be sued, and commit offences (e.g. corporate manslaughter).
* The facts of *Salomon* should be discussed as should its authority – i.e. When correctly formed and registered (therefore in accordance with the statutory requirements) a company possesses its own legal personality. This is legally recognized and is separate from the members / directors of the company.
* This case established the importance of the limited company, limiting the liability of the members of the company to the shares/money owed to the company. Whilst it may have appeared unfair, the company was correctly registered, and the creditors had been informed of the new status and hence the potential implications for trading with a limited company.
* You may wish to raise wider implications of the ruling such as the veil of incorporation separating the company from its shareholders.
* Separate legal personality affords a distinction between the corporation as an entity and its directors and shareholders.
* The single biggest feature of the *Salomon* judgment was of the shareholders’ limited liability.
* The metaphor of the ‘veil’ identifies a cloak of secrecy / shield of the people behind it – the members of the company are protected from liability for the company’s debts.
* Further, it transpires that due to the company’s separate legal personality, the courts have often been unwilling to ‘lift the veil’ and find out what the directors actually did in running the business (what decisions were taken, and by whom and so on).
* Due to this demarcation, it has been said that the veil of incorporation protects the members of the company.
* Whilst the veil is effective, to continue the metaphor, it has been ‘raised’ by the courts where it has been deemed relevant. The courts have been notoriously unwilling to establish clear rules as to when the veil will be lifted, and they have stated that they will not do so ‘merely’ in the interests of justice. Further, where one company owns shares in another (subsidiary companies), insofar as the companies are legally distinct then the courts will not seek to lift the veil (Adams v Cape Industries Plc).
* However, the company must not be established to commit some fraud (Jones v Lipman) or to attempt to circumvent contractual agreements or the veil will be lifted to identify the true nature of the undertaking (for example a ‘sham’ company - Gilford Motor Co. Ltd v Horne).
* You may wish to explain the problems arising from separate legal personality when the company goes into liquidation and the creditors attempt to recover monies. The shareholders’ liability is limited to their investment, and the directors may have established some creditors as secured, whilst other are unsecured with very little scope of recovering money owed. This can have disastrous financial consequences (particularly for smaller companies).

2. Identify the rights and duties imposed on partners, and assess how effective they are in maintaining trust and good faith.

**Indicative content outline answer**

* A crucial aspect of partnerships is of joint and several liability (*Hamlyn v Houston and Co.*). This means that if one partner commits a tort (*Mair v Wood*) or crime (*Dubai Aluminium Co. Ltd. v Salaam*) in the course of the business, the partnership will be liable (including each partner) if this was within the offending partner’s actual or apparent authority. This results in the partners being held responsible for any losses incurred whilst as partners.
* If the partnership owes a debt to a creditor and there are no resources of the organisation to pay this, then under the concept of unlimited liability, the partners have to satisfy the shortfall from their own resources. This liability will be shared equally between the partners based on their respective percentage ownership. However, if one partner has resources and the other partner(s) does not have the resources to satisfy the debt, the partner with funds is responsible for the full debt. They then have the responsibility / option to seek the money owed from the defaulting partner(s).
* This liability cannot be imposed to a partner on acts that occurred before he/she entered the partnership, however, the liability continues even when the partner has left the partnership for acts conducted whilst he/she was a partner.

## *Duties on Partners*

* The Partnership Act 1890 creates duties on the partners in the following ways:

## Duty of Disclosure: Section 28 obligates partners to submit full information to the other partners or his/her legal representatives in matters affecting the organisation and to submit true accounts.

## Duty to Account: Section 29 obligates partners to account for any benefit they have obtained without consent from any transaction on behalf of the firm (*Bentley v Craven*).

## Duty not to enter into Competition with the Organisation: Section 30 obligates a partner, who is competing with the partnership without the consent of the other partners, to account to those partners for any profits or benefit produced in the course of that business.

* Relationship based on Good Faith: The partnership agreement is a contract based on the utmost good faith. As such partners must disclose relevant details to other partners (and prospective partners) that could affect the partnership. As such, a person’s silence can amount to a misrepresentation.

## *The Rights of Partners*

* The Partnership Act 1890 provides the following rights:
* The right to share equally in the capital and profits of the firm;
* The right to be indemnified by the firm for any liabilities or losses made in the normal course of business;
* The right to take a role in the management of the firm (but not ‘sleeping partners’);
* An entitlement to inspect the partnership’s accounts and to have these available when requested;
* The right to veto the entry of a new partner to the partnership or to change the partnership’s business.

**PROBLEM QUESTIONS**

1. Delia Smythe runs a small catering service from her home, providing hot lunches for the management of three firms in Sheffield. She has two employees—a driver and an assistant cook. She would like to bid for catering contracts at more firms and possibly expand into catering for private dinner parties, but could not do all this from her home. She is worried about how she would manage the operation. One of her worries is that she has no experience beyond institutional catering.

Advise Ms Smythe about alternative forms of business organization available to her, explaining the advantages and disadvantages as they apply to her situation. Which form of business would you advise her to adopt? (Visit the Online Resource Centre where a completed IN01 form is provided if Ms Smythe intended to form a private limited company.)

**Indicative content outline answer:**

* It is important to note that in such a conclusion, it does not really matter which form of business organization you choose as there would have to be clear guidance from Delia as to what she wishes to do with the business in the long and short terms. However, conclude with your own opinion and justify it.

## *Sole Traders*

* There is no legal distinction between the sole trader as an individual and the person running the business.
* The sole trader is a very simple business organization with very little internal or external regulation.
* The sole trader business can be formed and dissolved easily, and it does not require any special formalities other than informing the relevant government departments.
* The benefits of running a business as a sole trader include –
* It is simple to establish.
* The sole trader is responsible to themself and their customers.
* The sole trader has autonomy in how they run the business, when they work, and how profits are disposed of (subject to HMRC rules).
* They can begin trading immediately.
* The disadvantages of running a business as a sole trader include –
* The sole trader has unlimited liability.
* Succession. The sole trader often trades under their own name, however, when the sole trader dies, their business may also die.
* They have complete responsibility for the business - to fulfil contracts; to invest money into the business; to employee replacement if they are ill or on holiday and so on.

## *Partnerships*

* A partnership involves two or more people coming together to establish a business.
* A partnership can be ‘simple’; ‘limited’; or a ‘limited liability partnership.’
* Partners may be ‘typical / general’; ‘salaried’; or a partner by estoppel.
* Many rights and obligations exist for partners in simple and limited partnerships including good faith, disclosure and to account.
* Partners generally have the right to participate in the management of the firm and may bind the partnership through the exercise of actual or apparent authority.
* Bringing a partnership to an end is a relatively simple procedure, and the Partnership Act 1890 identifies specific reasons for its dissolution.
* The benefits of running a business as a partnership include –
* Partners often ‘buy into’ a partnership, therefore capital is often introduced.
* Partners may offer expertise in an area or provide the ability to enter into new markets.
* Partners may share the work of the business and share the liabilities.
* The disadvantages of running a business as a partnership include –
* Partnerships have unlimited liability and the partners’ personal assets may be at risk for debts / losses.
* Partners may create liabilities for the other partners and the firm.
* Partners share in the profits of the firm therefore the individual partner’s share may be reduced.
* Partners may be jointly and severally liable for losses.

## *Limited Liability Partnerships*

* Unlike sole traders and simple partnerships, LLPs have a separate legal personality and limited liability for members.
* They are regulated in similar ways to a company and are subject to some aspects of the CA 2006.
* The benefits of running a business as a LLP include –
* The LLP has its own legal personality and limits the liability of its members.
* The partnership continues despite the internal membership of the firm.
* The disadvantages of running a business as an LLP include –
* It is subject to registration procedures with the Registrar of Companies.
* It must file accounts and tax returns to the Registrar.
* It has many features in common with limited companies, some of these are positive to the members and many have negative implications.

## *Companies*

* Companies are artificial things that have their own legal personality.
* Companies may be limited or unlimited.
* PLCs require a minimum of £50,000 allotted share capital on registration.
* There are exemptions from certain administrative duties for small / medium sized companies.
* Limited companies may be formed by Royal Charter, statute, but most commonly through registration.
* Companies can be re-registered to reflect changes in their circumstances.
* Rather than forming the limited company, one may be bought ‘off-the-shelf’ through an agency.
* Regulations exist regarding the choice of business name.
* Businesses must ensure the name of the company is not too similar / the same as another company or they may be guilty of the tort of ‘passing-off.’
* The benefits of running a business as a limited company include –
* Limited liability for the members.
* It has perpetual succession and only ‘dies’ when formally wound up.
* It is generally easier to raise finance than through a sole trader / partnership business organisation.
* It can make contracts in its own right.
* Tax benefits are available for corporations compared to other business organisations.
* The disadvantages of running a business as a limited company include –
* It has much greater administration requirements than other forms of business organisations.
* It is subject to external and internal regulation.
* There is no automatic right to participate in the management of the company.

2. Paula has been approached by Jackson and Taylor Estates to join the partnership operating a property development and rental business. Jeffrey (Jackson), one of the partners, speaks with Paula about the offer and Paula agrees. She does not invest money into the business, but rather she says that she has expertise of negotiating good deals with builders, and has ‘contacts’ in the local Council which will assist on development applications, and advance knowledge of policies and plans likely to be adopted by the Council. Both existing partners—Jeffrey and Barbara (Taylor)—welcome Paula to the partnership and amend the partnership agreement to account for her addition to the business.

Sometime after her arrival, Paula approaches her fellow partners with a business opportunity. There is a somewhat dilapidated building which would be prime for development and she has heard from her contacts that once developed, the Council would provide permission to convert its use to residential accommodation. This would dramatically increase its value, but a quick sale was essential to obtain the premises for fear the owner could decide against selling. The partners agree and the property is purchased. It transpires that the property is in very poor repair, to such an extent that it is dangerous. It contains a structural fault so severe that no valuation expert will provide a quote as to its insurable value. Further, unknown to Jeffrey or Barbara, Paula owns the property, she knew of its condition, and had been trying (unsuccessfully) to sell it for years.

When approached, the Council refuse permission to convert the building to residential accommodation. This has nothing to do with its condition or repair, but simply that any such application in that area would be refused. Paula had essentially misled the partners as to her ‘contacts’—which is actually a receptionist on the front desk who occasionally hears gossip (usually about members of staff rather than secret plans or policies).

Finally, when the partnership applies for a loan to fund the purchase of the property, they are refused due to failing a credit check. They had never experienced this before Paula’s introduction, and upon further investigation, they discover Paula has County Court Judgments against her and some quite serious criminal convictions. Paula never disclosed this information because ‘she was never asked’.

Advise the parties as to their legal rights and duties under partnership law.

**Indicative content outline answer:**

* This question focuses on the requirements imposed through statute and the common law on partners.
* You should identify the Partnership Act 1890 and explain the implications of the following:

## Duty of Disclosure: Section 28 obligates partners to submit full information to the other partners or their legal representatives in matters affecting the organisation and to submit true accounts.

## Duty not to enter into Competition with the Organization: Section 30 obligates a partner, who is competing with the partnership without the consent of the other partners, to account to those partners for any profits or benefit produced in the course of that business.

* Relationship based on Good Faith: The partnership agreement is a contract based on the utmost good faith. As such partners must disclose relevant details to other partners (and prospective partners) that could affect the partnership. As such, a person’s silence can amount to a misrepresentation.
* It is especially important to discuss the disclosure and good faith requirements which appear to have been breached.
* Further, by selling land which is already owned by one party to prospective partners this is not only a breach of good faith but would also raise some issues relating to competing with the partnership.