

**2022 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Tuesday, 15 November 2022



2022 Overseas Lawyers Qualification Examination

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Question 1 (25 marks)

Solar Panel Supreme Limited (“Company”), a Hong Kong private company, manufactures solar panels. The Company’s main clients are based in the United States, Europe and India. Sun God Incorporated and Sun Ray Incorporated, operators of solar power plants in the United States, are major clients of the Company.

On 18 May 2021, the Company entered into a five-year term loan facility (HK\$20,000,000) with Great Bank secured by a floating charge over all assets, book debts and undertakings of the Company (“Great Bank Debenture”). The Great Bank Debenture was duly registered under the Companies Ordinance (Cap. 622) (“Ordinance”).

On 20 May 2021, Mrs. Rain Kwan (“Rain”), a shareholder and director of the Company, lent HK\$5,000,000 to the Company.

Towards the end of May 2021, Sun God Incorporated decided to change its supplier to another solar panel company. As a result, the Company’s revenue dropped significantly.

On 18 June 2021, the Company borrowed HK\$6,000,000 (a four-year term loan facility) from Careless Bank secured by a fixed charge over all machinery owned by the Company (“Careless Bank Fixed Charge”). Due to an administrative error, the Careless Bank Fixed Charge was not registered under the Ordinance. Nothing was done to rectify the error.

(See over the page for a continuation of Question 1)

On 21 June 2021, Cheerful Bank provided a HK\$9,000,000 6-year term loan facility to the Company secured by a charge over the Company's book debts ("Cheerful Bank Debenture"), which was duly registered under the Ordinance. According to the terms of the Cheerful Bank Debenture, any assignment or disposal of the book debts requires Cheerful Bank's consent and the proceeds of the collected book debts must be paid into a designated account maintained with Cheerful Bank.

On 6 August 2021, the Company granted an "all-monies" floating charge over all of its assets, book debts and undertakings in favour of Rain to secure all personal loans provided by Rain to the Company. This charge was duly registered under the Ordinance.

On 27 August 2021, the Company sold its factory in Tsuen Wan, Hong Kong ("Factory") to Mr. Raymond Kwan ("Raymond"), the husband of Rain. The consideration was HK\$6,000,000, which was HK\$5,000,000 lower than the market value of the Factory (as valued by an independent valuation in July 2021). Rain explained that Raymond had contributed a lot to the Company and it is only right that "he gets something in return".

The Company suffered another financial hit in September 2021 when Sun Ray Incorporated decided not to buy from the Company anymore.

On 6 September 2021, Great Bank appointed a receiver upon an event of default, which is also an event that crystallized the floating charge pursuant to the terms of the Great Bank Debenture.

(See the next page for a continuation of Question 1)

On 14 September 2021, an unsecured creditor presented a winding-up petition against the Company.

The liquidator, Ron Kwok, has learned the following information:

- (i) The Company's main assets are its book debts (HK\$12,000,000), machinery (HK\$8,000,000), inventory (HK\$3,000,000) and cash (HK\$6,000,000).
- (ii) The Company owes 20 of its employees a total of HK\$800,000 for wages in arrears. It was also revealed that the Company has failed to pay profits tax (HK\$4,000,000) in the immediately previous year.
- (iii) The Company has 9 unsecured trade creditors, who are owed HK\$12,000,000 in total.
- (iv) On 3 September 2021, the Company used the proceeds of sale of the Factory to fully discharge the shareholder's loan (with interest) owed to Rain.
- (v) A trading partner of the Company, Sunburn Limited, initiated proceedings against the Company for breach of contract resulting in a loss amounting to HK\$8,000,000. The Court of First Instance gave judgment in favour of Sunburn Limited to the full extent of the claim. Sunburn Limited commenced enforcement action on 17 September 2021.
- (vi) Evidence shows that the Company was insolvent since early August 2021.

(See over the page for a continuation of Question 1)

The Company made no early repayment to any of the banks in connection with the term loan facilities.

For the purpose of this question, assume that there is no negative pledge clause in any of the debentures or charges.

Question:

You act for the Company's liquidator, Ron Kwok, who has drawn your attention to all of the above points. **Prepare a letter of advice to the liquidator, addressing the rights and priorities of all the creditors of the Company.**

(25 marks)

[25 marks in total]

Question 2 (25 marks)

Background information

Rich Resources Limited (the “Company”) is a private company incorporated in Hong Kong in 2016. Its shares are held by 5 shareholders, namely, Patrick Wong (“Patrick”) (60%), Kingston Cheung (“Kingston”) (20%), Eric Au (“Eric”) (10%), Wilson Chow (“Wilson”) (5%) and Fred Chan (“Fred”) (5%). The directors are Patrick, Kingston and Wilson.

Kingston plays a limited role in the management of the Company as he is busy with his family business. Day-to-day management and important decisions of the Company are mainly carried out by Patrick and Wilson. Wilson is the cousin of Patrick and usually agrees with Patrick on important issues in board meetings. Eric is a passive investor in the Company and never attends any general meetings of the Company.

The Company has not made any profit since its incorporation. By October 2022, it has accumulated huge trading losses. Kingston and Fred are not happy with the way that the Company was run under the stewardship of Patrick and Wilson. They are also dissatisfied with the fact that important information concerning the affairs of the Company has not been disclosed to all shareholders.

(See over the page for a continuation of Question 2)

Kingston and Fred decided to engage a firm of chartered accountants to conduct an independent review of the accounts and books of the Company. In order to have a full picture of the affairs of the Company, the accountants required to see all the relevant documents of the Company including books of accounts, audited financial statements, bank statements, written contracts, annual tax returns, minutes of all general meetings and board meetings (the “Relevant Documents”). Fred approached Patrick with a written request to inspect and make copies of the Relevant Documents. Fred’s request was denied by Patrick on the ground that Fred is not a director of the Company and therefore is not entitled to inspect any of the Relevant Documents.

For the purposes of this Question, you should assume that the Company adopts the Model Articles for Private Companies Limited by Shares set out in Schedule 2 to the Companies (Model Articles) Notice (Cap. 622H) as its articles of association.

Questions:

Answer the following questions:

(a) Is there any legal basis for Patrick to deny Fred’s request on the ground that Fred is not a director of the Company and therefore is not entitled to inspect any of the Relevant Documents?

(7 marks)

(b) Under what circumstances will Fred be entitled to inspect all the Relevant Documents?

(8 marks)

(See the next page for a continuation of Question 2)

- (c) Fred no longer wants to be involved in the Company's affairs and he asks Kingston to follow up. Kingston is now considering making an application to the court for an order under the Companies Ordinance (Cap. 622) to allow him (as a shareholder but not as a director) to inspect the Relevant Documents. **Would you advise him to do so? Why?**

(10 marks)

[25 marks in total]

Question 3 (25 marks)

Tina previously worked as a junior associate for a reputable Hong Kong law firm. During the coronavirus pandemic, work was scarce for Tina's firm and the partners decided that they needed to let some people go. Unfortunately, Tina was made redundant.

Tina decided that she didn't want to work as a lawyer any more, and wanted instead to pursue her dream of running a bakery with a focus on South American baked goods.

She rented a small property in Sai Ying Pun (a pleasant location on the west of Hong Kong island), signed contracts with suppliers to provide her ingredients, and purchased some second-hand freestanding baking ovens and equipment. She even hired an assistant, Turner, to help her run the bakery's front-of-house whilst she was busy baking in the kitchen, and signed a contract with a friend to supply her baked goods to the friend's hotel for their daily breakfast buffet. Tina called her bakery "Mexims Bakery".

On 1 December 2021, Mexims Bakery opened its doors to paying customers for the first time. Tina was ecstatic. All of her dreams were coming true.

Questions:

- (a) **When Tina started her business, what form of business organisation was she using? What steps should she take to register the business and in what timeframe?**

(2 marks)

(See the next page for a continuation of Question 3)

- (b) On 1 April 2022, Tina had decided she should set up a Hong Kong company to run the Mexims Bakery business. Tina bought an off-the-shelf company and changed its name to “The Mexims Bake Company Limited” (“MeximsCo”).

What documents does she need, who should sign and what steps should Tina take to complete the transfer of the Mexims Bakery business to MeximsCo? Assume that Tina’s lease contains a prohibition on transfer/sharing use, and that no public notices will be made.

(5 marks)

- (c) Tina completed the transfer in April 2022. All was going well for MeximsCo until June 2022, when Tina had a major argument with one of her suppliers. The supplier was upset because he had not been paid for a large order she had made in December 2021 shortly after Mexims Bakery opened. Tina thought she didn’t need to pay the supplier because she had ordered the wrong products by mistake. She had tried to return the supplies, but by that time, they had already spoiled.

The supplier was aware that Tina had no cash in hand, so he initiated legal proceedings against MeximsCo instead. Tina tried to argue that the supply contract was not with MeximsCo, and MeximsCo was not even in existence when she purchased the supplies, but her arguments failed and the court found in favour of the supplier.

Explain how this claim is possible and give details.

(3 marks)

(See over the page for a continuation of Question 3)

(d) Would the court’s judgment in (c) have been different if the supplier had waited until 2023 before commencing proceedings against MeximsCo?

(2 marks)

(e) What could Tina have done to prevent the supplier’s claim against MeximsCo?

(3 marks)

(f) Despite the dispute with its supplier, MeximsCo went from strength to strength, but there came a day when MeximsCo needed more funds in order to buy bigger ovens and expand the business. Tina now had some cash in hand, and wanted to use this to fund MeximsCo’s business.

What options does Tina have in order to inject funding into MeximsCo? Briefly outline the procedures for properly documenting and implementing each option.

(5 marks)

During the 5th coronavirus wave, many businesses went bust, but MeximsCo was a local favourite and came to be known for its extremely tasty egg tarts. Tina met a master baker named Tom at a culinary convention. Tom had also recently been made redundant but had some savings and was looking to start his own bakery too. Tina and Tom decided they wanted to go into business together. They reasoned that with Tom’s additional funds, they could open several more bakeries across Hong Kong Island and Kowloon.

(See the next page for a continuation of Question 3)

Tina and Tom signed a simple non-binding letter saying that Tom should be the 70% owner of MeximsCo, on the basis that he was putting in a lot of money for the expansion, and that funding should be provided to MeximsCo in exchange for new shares. Both Tina and Tom would be directors and agreed that they would try to make the business work for at least 3 years, and after that, either party could sell its shares to the other for whatever they were worth. Tom wanted to keep the terms of their agreement private to avoid competing bakeries in the cut-throat industry knowing the terms of their deal. Tina is excited, but unsure how to document Tom's investment in MeximsCo.

- (g) Advise Tina on the documentation and procedures required in a way that protects her interests and addresses Tom's concern.**

(5 marks)

[25 marks in total]

Question 4 (25 marks)

Meimei Group Holdings Limited (the “Company”) is an exempted company incorporated in the Cayman Islands whose shares are listed and traded on the Main Board of The Stock Exchange of Hong Kong Limited.

Mr. A holds 75% of the issued shares in the Company. On 30 June 2022, he sold 15% of the issued shares in the Company to Mr. B. The sale and purchase of shares was completed on the same day.

In July 2022, Company G, a company wholly-owned by Mr. B, entered into a sale and purchase agreement with a wholly-owned subsidiary of the Company in relation to the acquisition by the wholly-owned subsidiary of a property located in Hong Kong at a consideration of HK\$150,000,000.

As regards the acquisition, the highest applicable percentage ratio under Rule 14.07 of the Listing Rules is more than 5% but less than 25%.

Questions:

- (a) **Briefly explain the purpose of so-called connected transaction rules.**
(5 marks)
- (b) **Advise whether or not the sale and purchase of shares between Mr. A and Mr. B is a connected transaction under the Listing Rules.**
(2 marks)

(See the next page for a continuation of Question 4)

- (c) Advise whether or not Mr. B is a connected person under the Listing Rules upon completion of the sale and purchase of shares in the Company.**

(3 marks)

- (d) Advise the Listing Rules' implications regarding the acquisition of the property by the wholly-owned subsidiary of the Company from Company G.**

How should the sale and purchase agreement be drafted taking into account the Listing Rules' implications?

(15 marks)

[25 marks in total]

Question 5 (25 marks)

Jack and Jill are employed as brokers in a brokerage firm licensed by the Securities and Futures Commission in Hong Kong (“SFC”). They have been paying close attention to Balinese Resorts Limited (“BRL”) which is a relatively small company listed on The Stock Exchange of Hong Kong Limited. Trading in the shares of BRL is very light. The shares currently trade at around HK\$1.3.

Jack and Jill together incorporate five companies in the British Virgin Islands. In turn, each of these five companies owns a wholly-owned subsidiary company incorporated in Hong Kong.

Jack and Jill decide to use the Hong Kong companies to buy shares in BRL. They contact some clients of the brokerage firm saying they have some “hot tips” relating to BRL and also use the trading accounts of those clients to buy shares in BRL. Jack and Jill also arrange for the Hong Kong companies to buy and sell shares among themselves to drive up trading volume.

Jack and Jill then anonymously start to spread rumours on various social media platforms relating to the activities of BRL, and also suggest that the price of shares in BRL is undervalued and that buying shares would be a good investment. Among these rumours is one that BRL has recently acquired a plot of land in Bali at a price of US\$1,500,000. The rumour further goes on to say that at this time, planning restrictions are such that the land cannot be developed. However, based on inside information and connections at the relevant planning authorities in Bali, the planning restrictions are soon to be lifted and this would allow the land to be developed as a luxury resort. The enhanced value of the land with the permission to develop a luxury resort would be in the region of US\$20,000,000. There is no truth whatsoever to these rumours and BRL does not even own a plot of land which is the subject of the rumour.

(See the next page for a continuation of Question 5)

The rumours begin to attract some attention on the relevant social media platforms, but are not reported in any mainstream media. As a result, trading in the shares in BRL begins to gather pace and the share price starts increasing. As the share price increases, Jack and Jill use the trading accounts of clients to sell shares in BRL, realising a profit for these clients. The share price reaches a peak of HK\$115. At this time, Jack and Jill decide to sell all of the shares in BRL held by the Hong Kong companies and all remaining shares in BRL held in the trading accounts of clients. This realises further profit, but causes the share price in BRL to collapse to HK\$0.8.

The rapid rise and fall in the share price of BRL attracts the attention of the SFC who commence an immediate investigation. Following a tip off during this investigation, they are able to track the source of the anonymous rumours back to Jack and Jill and manage to uncover the ownership structure of the Hong Kong companies.

Questions:

(a) What compliance actions should have been taken by Jack and Jill for the Hong Kong companies to undertake the activities described above?

(4 marks)

(b) Describe, with reference to the facts outlined above, what offences Jack and Jill have committed.

(15 marks)

(c) What enforcement action might the SFC take against Jack and Jill and the brokerage firm for which Jack and Jill work?

(6 marks)

[25 marks in total]

END OF TEST PAPER