

2024 OVERSEAS LAWYERS QUALIFICATION EXAMINATION

HEAD III: COMMERCIAL AND COMPANY LAW

Tuesday, 19 November 2024



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Question 1 (25 marks)

Part A

Happy Bakery Limited (“HBL”) is a private company in Hong Kong that produces bakery products for sale locally. HBL’s issued share capital is 80% owned by Angel Limited (“AL”), a private company in Hong Kong wholly owned by Amy, and 20% owned by Barbara. Amy and Barbara are the only directors of HBL. Amy, AL, Barbara and HBL have entered into a shareholders’ agreement regarding HBL. Amy is the sole director of AL.

Last month, Amy met Catherine at a social event. Amy confided in Catherine that she was not on good terms with Barbara and wanted to sell AL’s 80% shareholding in HBL. Catherine expressed interest in acquiring AL’s shareholding. Amy has not informed Barbara about the proposed sale of AL’s shareholding in HBL to Catherine.

Questions:

- (a) **Can Barbara block the proposed sale of AL’s 80% shareholding in HBL to Catherine? Explain the reasons and describe the mechanisms involved.**

(5 marks)

- (b) **Is there any alternative way for Amy to divest her interest in HBL? What should she consider?**

(3 marks)

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

Part B

After extensive discussions, Catherine has proposed to purchase 80% of HBL's share capital from AL. The signing of the share sale and purchase agreement by Catherine and AL is scheduled for 2 December 2024, with completion set for 2 January 2025.

During the legal due diligence, the following was discovered:

- The bakery licence of HBL is due to expire on 31 December 2024. Amy told Catherine that HBL has already submitted an application for the renewal of its bakery licence.
- HBL has entered into a loan agreement with Fortune Bank which has a "change of control" clause.
- A pedestrian, Peter, alleged that he was knocked over by an HBL employee who was pushing a trolley while delivering bakery products in October 2024. Peter has threatened to take legal action against HBL. Amy, however, claimed that Peter fell on his own and that his claim was frivolous.
- In October 2024, HBL renewed the lease of its premises for another 18 months, with no "break clause". The lease is non-assignable except with the landlord's consent.

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

Questions:

- (c) In addition to the share sale and purchase agreement, what agreement(s) is Catherine likely to sign in connection with the proposed purchase, and what Catherine should do in relation to the same?

(2 marks)

- (d) Based on the facts provided in Part A and Part B above, recommend the provisions Catherine should include in the share sale and purchase agreement to address the identified issues, including the matters discovered during legal due diligence.

(6 marks)

- (e) Briefly explain what a “warranty” and an “indemnity” are, and highlight their differences.

(2 marks)

- (f) AL has agreed to include certain warranties and indemnities in the share sale and purchase agreement to provide Catherine with some comfort. However, AL wants to limit its liability under these warranties and indemnities. Advise AL on the provisions it should negotiate to limit its liability.

(3 marks)

- (g) Catherine is concerned about having sufficient protection if she needs to enforce the warranties and indemnities in the share sale and purchase agreement. Advise Catherine on what she can do to enhance her protection.

(2 marks)

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

Part C

Catherine is worried that Amy might start another bakery business in competition with HBL after selling her interest to Catherine. She wants to include a clause in the share sale and purchase agreement prohibiting Amy, at any time during the period of 20 years from completion, in any geographic area in the world, from carrying on, being concerned or assisting in any way, a business which would be in competition with any part of the business of HBL as it was carried on at completion.

Question:

(h) Advise whether this clause is enforceable against Amy.

(2 marks)

[25 marks in total]

Question 2 (25 marks)

Part A

Mansfield Holding Limited (“Mansfield”) is a company listed on the Main Board of The Stock Exchange of Hong Kong Limited. Kizon Technology Company (“Kizon”), a Hong Kong incorporated company, proposed to make an offer to privatise Mansfield by way of a scheme of arrangement at the beginning of 2024 (the “Privatisation”). Ramsey Banking Group (“RBG”) was working on a loan transaction to finance Kizon to make such offer. Mr. Joe Fung (“Mr. Fung”) was a manager of business finance in RBG and attended meetings with Kizon regarding the loan application. The purpose of the loan (i.e. to finance the Privatisation) was mentioned in the loan application documentation and at the meetings.

Mr. Fung had access to a securities account opened and maintained in his wife, Ms. Fanny Wong’s (“Ms. Wong”) name at RBG. Mr. Fung started buying Mansfield’s shares through accounts in Ms. Wong’s name on the day when the credit committee of RBG approved the loan. He also passed the information related to financing the Privatisation to Ms. Wong. Ms. Wong also bought the shares of Mansfield through her other securities accounts at the same time. Prior to that, Mr. Fung and Ms. Wong did not trade in Mansfield’s shares. Mr. Fung finally purchased 1,000,000 shares through accounts in Ms. Wong’s name at an average price of HK\$6.2 and a total cost of HK\$6.2 million. Ms. Wong also purchased 500,000 shares through other accounts in her own name at an average price of HK\$6.4 and a total cost of HK\$3.2 million.

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

Trading in Mansfield's shares was suspended on 4 March 2024 and resumed on 8 March 2024, the day after Mansfield and Kizon issued a joint announcement in relation to the Privatisation. Between 11 March 2024 and 31 May 2024, Mr. Fung and Ms. Wong together sold 1,200,000 Mansfield's shares in the market and thereby gaining a profit in the amount of HK\$2.3 million. The remaining Mansfield's shares were cancelled pursuant to the Privatisation at the cancellation price on 3 September 2024.

Question:

- (a) **Are Mr. Fung and Ms. Wong liable under Part XIII of the Securities and Futures Ordinance, Cap.571? Give reasons.**

(13 marks)

Part B

Demir is a director of Great Glory A.S. ("GG"), which is currently holding a market making licence issued by the Capital Markets Board of Turkey to carry out the business of leveraged foreign exchange trading business ("LFET Business"). GG intends to set up a private company in Hong Kong called Great Glory Asia Limited ("GG Asia") and GG will hold the entire share capital of GG Asia. It is planned that GG Asia will carry on the following activities: (a) marketing the contracts related to LFET Business to potential clients, including Hong Kong and non-Hong Kong people, in its online platform; and (b) performing periodic market analysis related to the situation in global financial markets and trends in their online platform.

Demir asks you if GG Asia needs any licences for carrying out the above activities, and, if required, the legislative requirements, procedures and licensing requirements involved.

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

Questions:

- (b) Prepare a memorandum of advice for Demir to advise on the legislative, procedural and licensing requirements involved, if required.

(10 marks)

- (c) Would your advice above be different if Demir told you that GG Asia will only deal with “professional investors” as defined under the Securities and Futures Ordinance, Cap.571?

(2 marks)

[25 marks in total]

Question 3 (25 marks)

Piling King Group Limited (“Piling King”) is a company incorporated in the Cayman Islands, with its shares listed on the Main Board of The Stock Exchange of Hong Kong Limited. The core business of Piling King involves the construction of buildings, tunnels and roads in Hong Kong and Mainland China. Founded by Mr. Poirot in 1997, Piling King enjoyed considerable success until recent years. Mr. Poirot serves as the chairperson and an executive director of Piling King, holding 70% of the issued shares of Piling King. Despite the recent downturn in business, the financial position of Piling King remains robust.

In light of the anticipated continued decline in the construction industry, Mr. Poirot plans to raise funds through the issue of new shares in Piling King. This strategy aims to provide Piling King with greater flexibility in managing its cash flow and financial position, ensuring sufficient funds are available for any further challenges.

At its recent annual general meeting held on 30 April 2024, Piling King, like other listed companies in Hong Kong, obtained a standard general mandate from its shareholders. This mandate authorizes the directors to allot and issue new shares under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”).

Since its listing on the Main Board in 2007, Piling King has not been active in capital markets and has never raised any funds by the issue of new shares. Piling King has a total of 100,000,000 issued shares. Investor interest in Piling King has been low, with trading volumes remaining thin. Over the past 12 months, Piling King’s share price has been relatively stable at around HK\$10 per share.

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

Mr. Poirot's neighbour, Mr. Hastings, is an investment banker and the managing director of Trust Me Corporate Finance Limited. Over a couple of glasses of wine, Mr. Hastings suggested to Mr. Poirot that Piling King could issue new shares and raise funds through a private placing. This method is a common capital-raising exercise in Hong Kong, requiring no prospectus and allowing a swift completion. Mr. Poirot finds this idea appealing.

Questions:

- (a) Mr. Poirot intends for Piling King to appoint Trust Me Corporate Finance Limited as the placing agent and to issue 20,000,000 new shares at HK\$10 per share to a select group of investors through a private placing, utilizing its general mandate in accordance with the requirements under the Listing Rules.

Advise Piling King, with reasons and analysis, on whether the proposal is feasible under the Listing Rules, and on the disclosure and reporting requirements under the Listing Rules regarding the launch and completion of the private placing.

(12 marks)

- (b) Given that this proposed private placing is Piling King's first-ever corporate finance fundraising exercise since its listing, Mr. Poirot is keen to ensure its success. On the advice of Mr. Hastings, he believes that offering a reasonable discount to the current trading price per share will provide an incentive for potential investors to subscribe to the new shares under the proposed private placing. Mr. Poirot plans for Piling King to issue 20,000,000 new shares at HK\$6 per share.

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

Advise Piling King, with reasons and analysis, on whether issuing new shares under its general mandate at the proposed placing price is feasible under the Listing Rules.

(9 marks)

- (c) The private placing fails, and no investors subscribe to the new shares in Piling King. The business of Piling King deteriorates more rapidly than anticipated. Mr. Poirot now intends to make a personal loan to Piling King, the amount of which represents approximately 6% of the applicable percentage ratios under Chapter 14/14A of the Listing Rules. However, Mr. Poirot prefers that Piling King does not announce his provision of the loan to Piling King.

Advise Piling King, with reasons and analysis, on the nature of the loan under the Listing Rules, whether obtaining a loan from Mr. Poirot requires any announcement and shareholder approval under the Listing Rules, and what conditions would need to be met for the loan to justify Mr. Poirot's intention of not announcing it.

(4 marks)

[25 marks in total]

Question 4 (25 marks)

ABC Investments Ltd. (the “Company”) is a private company incorporated in Hong Kong by David Au (“David”) and Raymond Chan (“Raymond”) in 2015. It 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. The Company is engaged in catering business. It operates two Chinese restaurants in Hong Kong.

The share capital of the Company was initially HK\$10 million, comprising 100,000 shares. All shares were issued to the shareholders and were fully paid up. David and Raymond each had 50% shareholding. They were also the only directors of the Company.

David got married in 2016 but Raymond remains single all along. Since 2017, David’s wife, Ada, has also been involved in the running of the Company. She has been supportive and helpful and has made significant contributions to the operations of the Company. Until 2022, she was employed by the Company as a senior manager and received a fixed monthly salary.

In March 2022, Ada was admitted to the Company as an additional shareholder and appointed as the third director. Both David and Raymond transferred 5,000 shares to Ada. After the transfer, the respective shareholdings of the three shareholders are as follows:

David: 45,000 shares (representing 45% of the issued shares in the Company);
Raymond: 45,000 shares (representing 45% of the issued shares in the Company);
Ada: 10,000 shares (representing 10% of the issued shares in the Company).

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

Differences between the shareholders emerged recently. David and Ada are eager to expand the Company's business to the Greater Bay Area in Guangdong Province. Raymond, on the other hand, believes that Company should only focus on its existing business in Hong Kong.

To expand its business, the Company requires an additional funding of HK\$30 million. David and Ada wish to increase the share capital of the Company from HK\$10 million to HK\$40 million by creation of 300,000 new shares to be issued at HK\$100 each. When they floated this idea to Raymond informally at a lunch gathering, Raymond indicated that he would not subscribe additional shares. In response, David and Ada replied that they would take up all the new shares.

Questions:

Answer the following questions:

- (a) Raymond does not want to subscribe additional shares in the belief that **his rights as a shareholder** of the Company will remain unchanged after the allotments. **Advise him if this is the case.**

(6 marks)

- (b) A board meeting was held last Monday which was attended by David and Ada in the absence of Raymond. The board approved the allotment of the 300,000 new shares to David and Ada in equal shares. **Does the board have the right to approve the allotments?**

(12 marks)

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

- (c) After receiving some advice from an accountant friend, David decided to ask the shareholders to approve the allotments. Instead of convening a general meeting, David instructed the company secretary of the Company to circulate a shareholders' resolution to all shareholders on 2 October 2024 to authorise the allotments of 150,000 new shares to David and Ada each (the "Resolution"). The company secretary requested all shareholders to sign and return the Resolution by 7 October 2024. Only David and Ada signed and returned the Resolution to the company secretary. David and Ada take the position that the Resolution has been duly passed by the majority shareholders (their aggregate shareholdings in the Company amounts to 55%) even though it has not been signed and returned by Raymond. **Is it possible to pass a shareholders' resolution without convening a general meeting? If so, can Raymond challenge the position of David and Ada?**

(7 marks)

[25 marks in total]

Question 5 (25 marks)

Part A

Harold has just completed the purchase of the entire issued share capital of a company called Sham Mong Apartment SPV Limited (“SPV”), for a total price of HK\$15,000,000. At completion, the existing directors of SPV resigned and Harold was appointed as the sole director.

SPV’s only physical asset is an apartment in an old residential block in West Kowloon, Hong Kong. The apartment was purchased by SPV in 2023 for HK\$12,000,000. Harold is aware that developers are interested in purchasing the entire building where the apartment is located for redevelopment purposes and believes that he should be able to sell the apartment to an interested developer for approximately HK\$20,000,000.

In order to finance the purchase of SPV, Harold used HK\$10,000,000 of his own funds but also borrowed HK\$5,000,000 on an interest free basis from his friend, Peter. Harold has told Peter that he will be able to repay this loan within three months after completion. Harold has assured Peter that, if necessary, he will procure SPV to sell the apartment shortly after three months in order to raise funds to repay the loan, even though an early sale may result in a lower price for the apartment.

Two months after the completion of Harold’s purchase of SPV, Harold has agreed a term loan with XYZ Bank, whereby XYZ Bank will lend Harold HK\$5,000,000. As a condition of this loan, SPV is to guarantee payment of the loan to XYZ Bank. In addition, SPV is to grant security to XYZ Bank by way of a mortgage over the apartment. Following drawdown of the term loan, Harold will use the proceeds to repay Peter in full.

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

Question:

- (a) Explain, with reasoning, what procedures Harold and SPV need to comply with in connection with the loan from XYZ Bank and the security to be given by SPV. What are the consequences for non-compliance?

(12 marks)

Part B

One year after completion of the acquisition of shares in SPV, SPV sells the apartment to a developer for HK\$20,000,000. Upon this sale, SPV realises a profit of HK\$8,000,000. As part of this transaction, XYZ Bank releases the security over the apartment, SPV distributes a dividend of HK\$8,000,000 to Harold and Harold repays the loan to XYZ Bank. The dividend has reduced the distributable reserves to nil.

After paying various costs and expenses, SPV still has a cash balance of HK\$6,000,000. In looking through various paperwork of SPV, Harold came across a contract with the real estate agent who assisted SPV with the acquisition of the apartment for HK\$12,000,000 in 2023. Harold did not know about this contract when he bought the shares in SPV. The contract with the real estate agent provided that a fee was to be paid to the real estate agent upon the ultimate sale of the apartment by SPV. SPV agreed to pay the real estate agent a fee equal to 10% of the difference between the acquisition price and the sale price (i.e., 10% of HK\$8,000,000, being HK\$800,000).

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

Harold has no ongoing need to hold shares in SPV and would like the cash balance of HK\$6,000,000 to be paid to him and then for SPV to be deregistered. Harold has heard deregistration would be cheaper than liquidation. Harold believes that the real estate agent remains unaware of the sale of the apartment to the developer and as such does not believe that the real estate agent will claim the additional commission any time soon. Harold is hoping that by the time the real estate agent becomes aware of the sale of the apartment, SPV will already have been deregistered. Harold has indicated that he is willing to sign whatever papers are necessary in order for SPV to pay the cash balance to him and for SPV to be deregistered.

Questions:

- (b) **Given that SPV has no distributable reserves, explain the procedures that Harold and SPV need to go through in order for SPV to pay the cash balance of HK\$6,000,000 to Harold. What risk would Harold be taking if he refuses to acknowledge the liability to the real estate agent as part of that process?**

(10 marks)

- (c) **What are the requirements for deregistration of SPV? Does SPV qualify and what risk would Harold be taking if he proceeds with deregistration?**

(3 marks)

[25 marks in total]

END OF TEST PAPER