
**1997 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Friday, 31 October 1997



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TEST PAPER

31 October 1997

Instructions to Candidates

- 1. The duration of the examination is 3 hours and 30 minutes.**
- 2. This is an open-book examination.**
- 3. There are FIVE questions in this paper. ANSWER ANY FOUR QUESTIONS ONLY.**
- 4. Each question has the value noted on the question paper. You are urged to apportion your time in accordance with the relative value of each question. No marks can be awarded to a question for which there is no attempted answer.**
- 5. Do not take either this question paper or any answer booklets with you when you leave the examination room.**

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Head III - Commercial and Company Law**

Question 1 (25 marks)

A and B respectively carry on their garment manufacturing businesses as sole proprietors. A however focuses on garments for males while B specialises in garment for females. Both businesses serve the U.S.A. market and have been quite successful. For better synergy, A and B are considering merging their businesses into a single business. Both have sought your advice on how to proceed with the proposed merger. Both businesses operate on rented premises and use equipment which is on hire purchase with Good Bank Limited, a licensed bank in Hong Kong.

- a) **Prepare a short memo on the 2 common forms of co-operation commonly used in Hong Kong i.e. partnership and joint venture company and compare their differences (you must at least deal with 5 differences of practical importance). There is no need to discuss any necessary documentation.
(15 marks)**
- b) **As banker of A and B, Good Bank Limited has suggested that A and B should use a Hong Kong registered company limited by shares as the vehicle for the joint venture. A and B instruct you to form a new company and not to use a shelf company. Please list the documents and steps which will be required for the registration of the joint venture company and putting it into operation.
(10 marks)**

Question 2. (25 marks)

On the facts of Question 1, please advise on the following :

Both A and B intend to transfer their rented premises and hire purchase equipment to the joint venture company. You may assume that each of A and B will take the benefit of trade receivables not yet received and be able to assign any outstanding purchase orders to the joint venture company.

Please advise on the necessary steps to be taken :

- a) **to effect the transfer of the rented premises and hire purchase equipment;**
(5 marks)

- b) **under the Transfer of Businesses (Protection of Creditors) Ordinance and the purpose and consequence of such steps.**
(20 marks)

Question 3 (25 marks)

Mr. Pioneer owns 40% of each of the issued capital and subscription warrants of Risky Business Limited ("Risky Business"), the securities of which are listed on The Stock Exchange of Hong Kong Ltd. (the "Stock Exchange"). Vencap Inc. ("Vencap"), a U.S. venture capital corporation intends to invest in Risky Business. Mr. Pioneer and Vencap have decided to implement the following plan (the "Plan"):

- a) Mr. Pioneer shall incorporate a company ("Newco"). The board shall comprise Mr. Pioneer and two persons nominated by Mr. Pioneer and one other person nominated by Vencap;
- b) Newco shall be wholly-owned by Mr. Pioneer and will only be used as a holding vehicle for the securities of Risky Business;
- c) Vencap shall extend a 3-year loan to Newco which may be converted into 37% of the issued share capital of Newco at the option of Vencap at any time during the term of the loan;
- d) Mr. Pioneer will sell his present 40% of the issued capital in and subscription warrants of Risky Business to Newco at market price and Newco will use the convertible loan proceeds to pay for such sale;
- e) There will be no change to the board and management staff of Risky Business. Mr. Pioneer and three other existing directors nominated by him (not being the two persons nominated by Mr. Pioneer as directors of Newco) will remain as directors of Risky Business while Vencap will nominate its managing director as a non-executive director of Risky Business.

Advise Vencap on :

- i) the implications of the Plan under, and any steps to be taken to comply with, the Hong Kong Code on Takeovers and Mergers;
(5 marks)
- ii) the obligations of Mr. Pioneer, Vencap and Newco under the Securities (Insider Dealing) Ordinance on dealing in securities of Risky Business, and the Rules Governing the Listing of Securities of the Stock Exchange on publicity during the time from the initiation of discussions up to the implementation of the Plan; and
(5 marks)
- iii) the obligations of Mr. Pioneer, Vencap and Newco and their respective directors under the Securities (Disclosure of Interests) Ordinance after implementation of the Plan.
(15 marks)

Question 4 (25 marks)

Answer either question (a) or (b)

- a) Mr. Wai and Mr. Chan are the directors of Chan Wai Ltd now in liquidation. The Winding Up Order for compulsory liquidation of their company was made on May 1, 1997 and the Official Receiver is now investigating allegations against the two directors for misfeasance, fraudulent trading and repeated failure to register accounts.

Mr. Wai tells you that he was only a "compliance" director and was simply asked by his good friend Chan to sit on the Board as a favour to comply with the requirements of the Companies' Ordinance. Chan agrees that this is indeed the case and wishes to assume all responsibility for any blame or fault finding by the Official Receiver. Both directors also agree that the monthly \$10,000 director's fee paid to Wai was by way of a retainer.

Upon enquiry you discover that Mr. Wai did not in fact attend Board meetings, although he signed documents when asked to do so. You also discover that Mr. Wai holds four other directorships in companies managed by other members of his family for which he also receives a Director's fee of \$10,000 each per month for being what he calls a "compliance director" and signing documents as and when required. The two directors have now heard that the Official Receiver intends to apply for a disqualification order under section 168F of the Companies Ordinance against Mr. Chan for persistent failure to file returns, accounts notices and other statutory documents and against Mr. Wai himself under section 168H.

- i) **You are asked to advise Mr. Chan of the consequences of a Disqualification Order under section 168F and any mitigating factors that might be argued in his favour.**
(10 marks)
- ii) **You are also asked to advise Mr. Wai on whether, as a matter of Hong Kong law, his conduct is such that it makes him "unfit to be involved in the management of a company" and what if any mitigating factors might be raised in his favour.**
(10 marks)
- iii) **Are there any other issues on which you should advise Mr. Wai concerning the four other companies for which he is also a "compliance" director ?**
(5 marks)

OR

Please see next page for question 4 b)

- b) Wilcock Ltd, a Hong Kong registered company, is a wholly owned subsidiary of Tacock Ltd, a Bermudan registered company, which is listed on the Hong Kong Stock Exchange. A, B and C are directors of Wilcock Ltd and are also members of the board of directors of Tacock Ltd and are used to acting on the instructions of Tacock's board in relation to the affairs of Wilcock Ltd. The financial position of Wilcock Ltd has been precarious for some time due to production problems at its new truck manufacturing plant in China. In fact, the company has been insolvent for some time. In early 1996 Wilcock's bank insisted that it would not provide further overdraft or loan facilities to Wilcock without the benefit of guarantees from Tacock Ltd. Eventually Tacock Ltd agreed to letters of comfort to the bank and a further injection of capital by way of loan from Tacock Ltd to Wilcock Ltd. Despite continuing problems with its new production line Wilcock Ltd accepts advanced orders from several customers including China Development Co Ltd which pays millions of dollars in advance for a fleet of 200 trucks. Wilcock Ltd uses this money to repay the loan from Tacock Ltd. Shortly thereafter Wilcock Ltd is forced into liquidation.

You are asked to advise on :

- i) The possibility of an action against the directors of Wilcock Ltd and the board of Tacock Ltd and Tacock Ltd itself for fraudulent trading
(15 marks)**
- ii) Whether the repayment of the loan from Tacock Ltd is a fraudulent preference
(5 marks)**
- iii) The possible enforceability of the letter of comfort
(5 marks)**

Question 5. (25 marks)

Answer either question (a) or (b)

- a) You have been asked to draft a floating charge over the entire assets and undertaking of Fleecem Ltd a large private company. Fleecem is a manufacturing company whose assets include a factory and warehouse.

Draft the charge and include the following provisions :

- i) an all monies clause
- ii) a negative pledge clause
- iii) an appropriate automatic crystallisation clause including automatic crystallisation on breach of the negative pledge clause and on the giving of notice by the charge holder.

(13 marks)

In addition to drafting the floating charge and provisions in (i) to (iii) above, write a brief memorandum outlining the effectiveness of your clauses by reference to the relevant law and advise on any further clauses which you consider necessary. You may use or adapt any precedent which you feel is appropriate.

(12 marks)

OR

Please see next page for 5 b)

- b) X, Y and Z operated a partnership from 1986 to 1994 which they incorporated in June of that year. The business has been very successful and the company has grown considerably since then. All three were appointed as directors on the incorporation of the business. Y died of a heart attack in January of 1997 and X has suffered from a heart problem since 1996 which has severely curtailed his participation in the business. The shares are held as follows X 25 per cent, Y 25 per cent and Z 50 per cent.

For the last four years the company has not paid dividends despite being very profitable. The directors received fees of circa HK\$1.5 million per annum each, over the last four years and the company has accumulated large capital reserves amounting to HK\$150 million. Y died intestate and the remaining directors have refused to register his personal representative (Y's widow) as a member (X was not informed of the meeting at which this decision was taken). Since the onset of X's illness his relationship with Z has deteriorated and X alleges that Z has :

- i) Purported to appoint his son A as a director of the company.
- ii) Fabricated evidence of a board meeting to deceive X.
- iii) Used sham board meetings as a pretext for removing X as a director on the ground that he had failed to attend such meetings, under a provision in the articles which requires a director to resign when requested in writing by his fellow directors.
- iv) Refused to adopt a realistic dividend policy in the light of the company's profits and commercial needs

X and Y's widow seek your firm's advice as to whether they have any remedies and the appropriate course of action. You are required to write a memorandum for your senior outlining the relevant law and issues and a proposed course of action.

(25 marks)