
**1998 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Monday, 2 November 1998



HEAD III : COMMERCIAL AND COMPANY LAW

TEST PAPER

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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 books with you when you leave the examination room.**

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Head III : Commercial and Company Law

Question 1 (25 marks)

David Smith is a Californian resident. He has recently established a company incorporated in California, Double Click Inc. This company has been able to make use of new technology to promote and provide Web pages on the internet and establish advertising banners. Double Click Inc has been very successful over the last 2 years.

David Smith has had several meetings with Patrick Wong, a Hong Kong resident who controls Web Pages (HK) Ltd. Patrick Wong wishes to make use of the technology of Double Click Inc to assist in increasing their sales in Hong Kong as well as entering the PRC market.

David Smith feels that perhaps more time is needed to see whether any agreement can be entered into with Patrick's company. He wishes however to establish a presence in Hong Kong and wishes to seek your advice as to the way forward in obtaining a presence in Hong Kong.

- 1) **Prepare a memorandum of advice addressing the above issues. (15 marks)**
- 2) **He also wishes to be advised as to the potential options open to him if he wishes to enter into an agreement with Web Pages (HK) Ltd., having had the opportunity to establish a presence in Hong Kong. Prepare a further memorandum for your client's consideration. (10 marks)**

Question 2 (25 marks)

Answer either question (A) or (B)

- (A) Sell-out Limited ("SL") is a company incorporated in Hong Kong with limited liability. It is a registered dealer under the Securities Ordinance, Cap 333. It has been carrying on a brokerage business of dealing in securities listed on The Stock Exchange of Hong Kong Limited (the "Exchange") for years and as such is a member and therefore registered shareholder of 1 fully-paid share in the Exchange (the "Share"). SL has 2 directors and shareholders: Victor and Sally Chan (who are husband and wife). Victor is the dealing director of SL and is registered as such under the Securities Ordinance. As both Victor and Sally are elderly, they wish to retire and sell their interests in SL.

The Exchange is a company incorporated in Hong Kong limited by shares with its (i) own memorandum and articles of association governing its operation and (ii) membership rules.

International Finance Group ("IFG") is an international financial conglomerate which principally engages in brokerage as well as fund investment and management businesses in various markets in the world except Hong Kong.

IFG wishes to establish in Hong Kong and has commenced discussions with Victor over the purchase of Victor's and Sally's brokerage right in Hong Kong.

Apart from a brokerage business, IFG also intends to commence the following additional businesses in Hong Kong:

- (i) providing discretionary portfolio management services whereby IFG will be placed with funds from its customers and exercise its discretion to invest in such investments as it deems fit;
- (ii) marketing or offering to its customers investment proposals or opportunities which IFG may receive from IFG's international network, providing investment advice to its customers and arranging for their purchase if its customers so decide.

It is not the intention of IFG to engage directly in any currency trading business in the foreseeable future and so any statutory requirements on currency trading in Hong Kong are not of IFG's immediate concern.

IFG now seeks your preliminary advice on the proposed acquisition of SL's brokerage right and on compliance with the statutory requirements under the Securities Ordinance, the Protection of Investors Ordinance Cap. 335, the Securities and Futures Commission Ordinance Cap. 24 and other securities-related legislation in relation to IFG's proposed businesses in Hong Kong.

- (a) You have advised IFG not to acquire the shares in SL, but only the 1 share in the Exchange held by SL to enable IFG to deal in securities as a member of the Exchange. Please discuss very briefly the steps which IFG must take to complete such acquisition and any statutory licensing requirements to conduct such brokerage business.
(7 marks)
- (b) What are the statutory licensing and operational requirements that must be observed by IFG in order to provide non-discretionary or discretionary portfolio management services?
(5 marks)
- (c) Assuming IFG has complied with the statutory requirements under paragraph (b) above and all IFG's existing and potential customers are unsophisticated individuals -
- (i) can IFG publicly market or offer the following investments to its customers in Hong Kong and if so, please give reasons and if not, please briefly describe any statutory requirements that must be observed by IFG in order to market or offer them:
- (1) units in unit trusts authorised by the Securities and Futures Commission under section 4(2)(e) and (f) of the Protection of Investors Ordinance;
 - (2) shares in a company listed on the Exchange;
 - (3) rented apartments in a residential tower in Honolulu with rental return guaranteed by the owner at 20% per annum;
- (5 marks) in total for (1), (2) and (3))
- and
- (ii) can IFG's staff call on its existing and potential customers by personal visits or telephone calls in order to offer to acquire or dispose of securities for its customers in relation to IFG's brokerage business and if there are restrictions, please briefly describe them?
(5 marks)
- (d) Would your answers to (c) above be different if the customers of IFG were professional fund managers in Hong Kong? Why?
(3 marks)

OR

Please see next page for question 2 (B)

- (B) Mr Chan a financial journalist had lunch with an acquaintance Ms Leung who is a financial adviser for Murrays Merchant Bank. Ms Leung inadvertently mentioned that she was very busy working on a possible takeover bid of a local listed company but did not mention the name of any of the parties involved. Mr Lee's own personal research in his capacity as a journalist had indicated that there was a possible takeover bid in the offing and this confirms his suspicions. The same day he notices a dinner meeting at an exclusive restaurant, at which Ms Leung is present, between the executives of a local listed company and some US businessmen and their lawyers.

As a result, Mr Chan told his wife Jean and her brother John Wong and together they purchased several million dollars worth of shares in the local target company. Two days later an official announcement of the takeover bid is made. Mr Chan and his associates made over HK\$ 4 million on selling their shares three days later.

Several weeks later Mr Chan is approached by officials of the Securities and Futures Commission (SFC) who seek to ask questions concerning his recent share dealings.

You are asked to write a memorandum advising Mr Chan on his duty, if any, to cooperate with the SFC, and his liability and that of any other party for insider dealing. (25 marks)

Question 3 (25 marks)

Answer either question (A) or (B)

- (A) "It has long been established that shareholders may agree *inter se* to exercise their votes in a particular way and that such an agreement may be enforced An unanswered question until recently was to what extent an agreement between shareholders that their unanimous consent is necessary to secure the passage of a statutory resolution would be struck down as an illegal restraint on the company."

Discuss.

OR

- (B) In 1996, Chan and Kim formed a company to run certain business. Each was a director and the shareholding was divided equally between members of Chan's family and members of Kim's family. The articles gave the chairman a casting vote at both directors' and shareholders' meetings.

During a meeting held in June 1998, Kim's daughter Jenny (who was a shareholder) claimed that an agreement had been made between all the shareholders in 1997 which provided (*inter alia*) that the chairman should cease to be entitled to use his casting vote, so that Chan (who was currently the chairman) did not have a decisive vote in the company's affairs. Chan ignored her protest and exercised his casting vote to pass a certain resolution in the meeting.

Advise Jenny.

Question 4 (25 marks)

Answer either question (A) or (B)

- (A) Glintlick plc is the holding company of a Hong Kong registered subsidiary, Plutonic Ltd, holding 78% of the company's share capital in the form of ordinary shares. The remaining 2% of the ordinary shares is held by a minority investor Jinx Ltd. The rest (20%) of the share capital of plutonic Ltd is in the form of cumulative preference shares with a priority to return of capital and a right to participate in surplus assets on a winding up. The preference shares are split equally between Jinx Ltd and Mutual Investments Ltd. The board of Plutonic Ltd have taken the view that it would be in the best interests of the company to get rid of its preference share capital and are considering a reduction of capital by replacing the preference shares with unsecured loan stock.

You are asked :

- (i) **To write a memorandum of advice outlining the procedures involved and the factors which a court will take into account when confirming a reduction of capital commenting on the appropriateness of the proposal and identifying any potential problems. (18 marks)**
- (ii) **Consider and suggest alternative methods to the board. (7 marks)**

OR

(Please see next page for question 4 (B))

- (B) On 8 July 1994 Princeps Ltd, a Hong Kong registered company, borrowed HK\$30 million from Leno Bank Ltd secured by a fixed charge over its factory and office block situated near Yuen Long, NT Hong Kong. The charge was duly registered in both the Companies and Land Registries.

On 8 April 1997, Princeps Ltd borrowed HK15 million from Kinko Bank secured by a charge over its book debts. The debenture was mislaid in the legal and company secretarial department and was rediscovered on 27 May, 1997. That date was entered on the debenture containing the charge and was immediately sent to the Companies Registry for registration. A certificate of registration of the charge was issued two weeks later on 12 June, 1997.

The charge over book debts was expressed to be subject to a fixed equitable charge. The receipts from book debts were to be paid into a specified account at Kinko Bank and the money in that account could only be dealt with on the instructions of Kinko Bank. In the event that no instructions were given, the monies in the account became subject to another clause which was expressed to be a floating charge. The debenture also contained an all monies clause, a negative pledge clause (the fixed equitable charge was exempt from this) and an automatic crystallisation clause expressed to be effective on the giving of notice of crystallisation by Kinko Bank.

In November 1997, Princeps Ltd experienced considerable financial difficulty and a third bank, Saviur Bank, agreed to lend a further HK\$ 22 million secured by a floating charge over Princeps Ltd's entire undertaking. Saviur Bank agreed to this only after entering into a priority agreement with Kinko Bank to the effect that Saviur Bank's charge would take priority over Kinko Bank's charge. Saviur Bank's charge was duly registered. The Saviur Bank charge also had all monies, negative pledge and automatic crystallisation clauses.

On 2 March 1998 Saviur Bank purchased the debenture from Leno Bank and one month later gave notice of crystallisation of its floating charge over Princeps Ltd's entire undertaking due to the worsening situation of Princeps Ltd. Kinko Bank never gave any instructions as to the use of monies received from book debts.

You are asked to write a memorandum of advice to your senior identifying the issues which arise from this scenario and advise on the priorities. (25 marks)

Question 5 (25 marks)

Leoden Ltd was incorporated from an existing partnership five years ago. The partnership had a history of twelve years before incorporation. Leoden Ltd has four shareholders Tan, Chan, Leung and Wong each holding 25 per cent of the company's issued shares and all of whom were partners at the time of the incorporation of its business. Tan, Chan and Leung are directors. Tan has approached your firm complaining of a breakdown in the relationship between himself and his fellow shareholders and in particular the following matters:

- (i) exclusion of Tan from participation in the company's affairs by deliberate failure to give Tan notice of board meetings.
- (ii) that the other shareholders have refused to purchase Tan's shares at a reasonable price.
- (iii) that the day before Tan consulted your firm Chan and Leung have called an extraordinary general meeting to remove Tan from his office as a director of the company.
- (iv) that Chan and Leung have transferred several properties of the company at prices well below their market value to another company which they control, Gentilus Ltd.
- (v) that Chan and Leung are currently diverting contracts offered to Leoden Ltd and negotiated by Tan with the help of Mr Wong who acts as general manager, to Gentilus Ltd.

Tan has recently discovered that Wong is also a shareholder in Gentilus Ltd and is likely to support Chan and Leung on the resolution to remove him from the board.

Write a memorandum to your senior outlining the remedies which may be available to Mr Tan and advise on the most appropriate remedy in the circumstances. (25 marks)

END OF TEST PAPER