

**1999 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Monday, 1 November 1999



HEAD III : COMMERCIAL AND COMPANY LAW

TEST PAPER

1 November 1999

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)

Swiftly Bank is a licensed bank carrying on business in Hong Kong. It has two principal divisions: (i) a corporate banking division extending loans and trade financing facilities to corporations; and (ii) an investment banking division carrying on underwriting, brokerage and investment advisory businesses.

Its corporate banking division has extended a revolving loan facility to **Quick Profit Limited**, a company whose shares are listed on **The Hong Kong Stock Exchange Ltd.** Such division has from time to time received confidential financial information about Quick Profit Limited for the bank's review and monitoring of its revolving loan facility to Quick Profit Limited.

On the other hand, its investment banking division has granted to **John Wong** (managing director of Quick Profit Limited and the majority shareholder, holding approximately 55% of the issued share capital) a share margin financing facility to enable him to speculate on the Hong Kong stock market against a charge of his shareholding of 55% in Quick Profit Limited. Such charge was duly created by John Wong signing the standard form of Share Charge of Swiftly Bank. Both divisions of Swiftly Bank however have been run by separate staff reporting to two different and separate division heads. The two divisions have separate record systems and as a matter of Swiftly Bank's internal procedure, are not permitted to exchange confidential information on their respective clients.

As the market recently abounded with rumours that both Quick Profit Limited and John Wong himself had financial problems, the group credit officer of Swiftly Bank, **Mr Caretaker**, had reviewed the records of the bank's corporate banking division on Quick Profit Limited and those of its investment banking division on John Wong. He was of the view that repayment on the share margin facility to John Wong should be demanded immediately and if not repaid, John Wong's 55% shareholding in Quick Profit Limited should be sold immediately on the Stock Exchange and the proceeds of sale thereof be applied in repayment of the share margin facility.

Answer either question (1.1) or (1.2)

(1.1) Before taking any action, Mr Caretaker has sought your advice on the following:

- (a) What is Swiftly Bank's position on any sale or disposal of John Wong's shares comprising 55% of the entire issued share capital of Quick Profit Limited (the "Disposal") under the Securities (Insider Dealing) Ordinance Cap. 395? Please also comment generally on Swiftly Bank's position on possible conflict of interest.
(10 marks)

- (b) **What steps would you advise Swifty Bank to take in order to commence the Disposal? Is there any disclosure obligation on Swifty Bank under the Securities (Disclosure of Interests) Ordinance Cap. 396 before or after the Disposal?**
(7 marks)
- (c) **What are the duties and obligations of Swifty Bank vis-a-vis John Wong in relation to the Disposal under general law (you may ignore any obligations that may arise under the Rules Governing the Listing of Securities on The Hong Kong Stock Exchange Ltd.)?**
(8 marks)

OR

- (1.2) **Mr Caretaker** now intends to review the risk of the whole operation of Swifty Bank's investment banking division. In particular, he would like to receive your advice on the legal risks on accepting shares of companies listed or quoted on **The Hong Kong Stock Exchange Ltd.** as security for extending any loan or margin facility to its clients.

Please prepare a memo detailing such risks (you do not have to deal with the position of legal and equitable charges at common law). You may assume that a comprehensive Share Charge will be executed to create a charge over such shares which will also be registered in Swifty Bank's or its nominee's name.
(25 marks)

Question 2 (25 marks)

Mr Orange, Mrs Lilac and Miss Pink own a successful private limited company called **Colourful Limited**. To expand the business of the company to capitalise on its success, fresh funds are needed. Mr Orange, Mrs Lilac and Miss Pink do not have any more money to put into the company nor do they want to borrow. Instead, they propose to offer in Hong Kong the opportunity to invest by way of subscription for shares in Colourful Limited to third parties, that is, persons other than existing shareholders. They anticipate about 20 to 30 investors.

Mr Orange, Mrs Lilac and Miss Pink are meeting your partner/boss tomorrow. They want to know what are the Hong Kong regulatory implications of such a proposal. In essence, they want to find a path through the applicable statutory provisions without incurring a requirement either to register with or to seek any form of approval, consent or clearance from any governmental or regulatory authority in Hong Kong in respect of the proposed placement of shares in Hong Kong to third parties.

Your partner/boss asks you to write a short memorandum on this to help him at the meeting. For the purposes of this memorandum, you need only be concerned with the Companies Ordinance, the Protection of Investors Ordinance and the Securities Ordinance. You have not been told whether Colourful Limited is incorporated in Hong Kong or elsewhere and should be prepared to deal with it in either situation.
(25 marks)

Question 3 (25 marks)

Mr Yeast owns a private company called **Fantastic Bread Machines Limited** that manufactures bread making machines. Business is good. Profit after taxation has been not less than HK\$20 million for each of the last 5 years. Orders are arriving faster than the machines can be made. **Mr Flour** is very interested in Fantastic Bread Machines Limited and wants to buy the company. Mr Flour has come to you for advice on the following:

- (a) Mr Yeast is persuaded to sell the entire issued share capital to Mr Flour for cash. There would be a share purchase agreement. Mr Flour is interested in investing in the company on the basis that profit after taxation should not be less than HK\$20 million for each of the next 3 years. **Can you suggest what steps should be taken and what provisions should be included in the share purchase agreement to protect Mr Flour?**
(9 marks)
- (b) There will be warranties to be given by Mr Yeast in the share purchase agreement about the company and other related matters. Mr Yeast says that he will be sending Mr Flour a disclosure letter against all or some of those warranties. **Mr Flour asks you to explain what is usually included in such a disclosure letter. What purposes do they serve? How do they protect Mr Yeast and how can such protection be neutralized?**
(9 marks)
- (c) Mr Flour is concerned that Mr Yeast may after the sale set up in competition against Fantastic Bread Machines Limited. **What kind of provisions do you envisage are necessary for inclusion in the share purchase agreement to address this issue?**
(7 marks)

Question 4 (25 marks)

Net Electronics Limited ("Net") is a company listed on the Israeli Stock Exchange. Net is one of the leading high tech communication companies. Net is aware of the Hong Kong Government's intended plans for the Cyberport in Pokfulam. The board of Net would wish to consider establishing a presence in Hong Kong. They would wish to be in a position to take advantage of potential business that would be open to them. In the past Net has had dealings with **Wong Limited** (a Hong Kong company). The directors of Wong Limited ("**Wong**") would wish to consider assisting Net in their intended operations in Hong Kong. Initial discussions have taken place to consider the establishment of a joint venture with Wong. However nothing has been agreed. The Chairman of Net will be visiting Hong Kong and would wish to meet with you to seek your advice as to establishing a presence in Hong Kong. They are keen to open an office at the earliest opportunity. The chairman wishes to be advised on all potential options open to them in respect of the above issues.

- (a) **Prepare a memorandum which will assist Net in deciding the best way forward in establishing themselves in Hong Kong in light of the above matters.**
(10 marks)

- (b) **Discuss the major factors you would take into account in advising Net as to any intended joint venture with Wong.**
(15 marks)

Question 5 (25 marks)

Mr **Jerry Lee** is one of the directors of **Jerry Builders Company Ltd** ("JBCL"). JBCL sells and supplies bricks to many importers and construction companies in the world.

JBCL is controlled by Jerry Lee and his business partners. Jerry Lee owns 45% of the issued share capital. Evidence shows that it must have been obvious to the directors of JBCL that JBCL has been insolvent since January 1999. Yet nevertheless JBCL continued to trade and executed a debenture containing a floating charge on 15 March 1999 over all its assets to secure a previous loan of HK\$35 million made to JBCL by Jerry Lee. The loan was used by JBCL to repay a loan allegedly owed by JBCL to other companies controlled by Jerry Lee.

Jerry Lee advanced an additional HK\$30 million to JBCL after the granting of the floating charge on 15 March 1999. The floating charge granted by JBCL in favour of Jerry Lee therefore covered a total indebtedness of HK\$65 million. In July 1999, after JBCL had failed to pay the sums secured by the debenture, Jerry Lee, pursuant to his rights under the debenture, appointed a receiver and sold some of the assets covered by the debenture. The proceeds of HK\$35 million were applied in July 1999 towards partial repayment of the sums secured to him under the debenture.

In May 1998, **Mimi Lee**, wife of Jerry Lee, loaned JBCL HK\$700,000 while **Jolly Limited** also loaned JBCL HK\$2 million. Jerry Lee and JBCL are the only shareholders and directors of Jolly Limited. In January 1999, JBCL repaid HK\$850,000 to Jolly Limited. In May 1999, JBCL repaid HK\$500,000 to Mimi Lee.

(a) **One of your long-standing clients is Sand Supplier Ltd ("SSL"). SSL has just successfully obtained a summary judgment for HK\$22 million against JBCL. Advise SSL as to the various provisions in the Companies Ordinance which would affect or assist SSL in collecting the judgment debt.**
(10 marks)

(b) **Assuming that the court has made a winding up order against JBCL upon the petition of SSL, advise the liquidator in connection with:**

- **the validity of the floating charge and the receivership, and the partial repayment by the receiver of HK\$35 million to Jerry Lee; and**
- **the payments to Mimi Lee and Jolly Limited by JBCL of HK\$500,000 and HK\$850,000 respectively.**
(15 marks)

END OF TEST PAPER