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**2000 OVERSEAS LAWYERS  
QUALIFICATION EXAMINATION**

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**HEAD III: COMMERCIAL  
AND COMPANY LAW**

Monday, 6 November 2000



# **HEAD III : COMMERCIAL AND COMPANY LAW**

## **TEST PAPER**

**6 November 2000**

### **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. IF YOU ATTEMPT MORE QUESTIONS THAN YOU HAVE BEEN INSTRUCTED TO ANSWER :**
  - (a) THE EXAMINERS WILL MARK ALL QUESTIONS THAT HAVE BEEN ATTEMPTED AND NOT DELETED; AND**
  - (b) IN COMPUTING YOUR FINAL MARK, THE EXAMINERS WILL COUNT THE MARKS FOR THE NUMBER OF QUESTIONS THAT YOU WERE INSTRUCTED TO ANSWER TAKING INTO ACCOUNT THE ANSWERS WITH THE LOWEST SCORES.**
- 5. 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.**
- 6. Do not take either this question paper or any answer books with you when you leave the examination room.**

## 2000 Overseas Lawyers Qualification Examination

### Head III : Commercial and Company Law

#### Question 1 (25 marks)

**MOVERS INC** (“Movers”) is a US multinational corporation specializing in a variety of transportation related business, including the leasing of containers to shipping companies for transporting goods. **SHAKERS LIMITED** (“Shakers”) is a regional company with headquarters in Hong Kong also specializing in container leasing. It operates in Hong Kong, Mainland PRC and other parts of Asia.

Movers is keen to get into the Mainland PRC market and believes that Shakers would be a good partner, given its connections in the PRC. For this purpose, the parties agree to set up a 60:40 joint venture company (Movers 60% and Shakers 40%), **MOVERS & SHAKERS LIMITED** (“JV Co”), to be incorporated in Hong Kong. Shakers has, in anticipation of the joint venture, bought a shelf company (“Shelf Co”) as the proposed JV Co and the two issued shares in Shelf Co are in the names of Shakers and one of its directors, Mr Coolcat, respectively. Shelf Co’s first directors on incorporation are Shakers and Mr Coolcat.

You are instructed to act for Movers and advise on a joint venture agreement and ancillary documentation with Shakers.

#### Questions :

- (a) The parties wish to increase the authorised share capital of Shelf Co from HK\$10,000 to HK\$5,000,000, with all shares being ordinary shares of par value HK\$1 each. Please discuss what internal corporate documentation is required for Shelf Co.  
(3 marks)
- (b) Movers and Shakers wish to hold 1,800,000 and 1,200,000 shares in JV Co respectively. Please discuss what steps and documentation are required from Movers and Shakers and for JV Co.  
(6 marks)
- (c) Shakers has a few containers which it wishes to transfer to JV Co as it will no longer engage in the container leasing business. How can this be done?  
(5 marks)

*(See over the page for questions (d) and (e))*

**(d) Please list at least four types of provisions that should appear in the draft joint venture agreement to govern the business relationship of Movers and Shakers and explain why you would include them. (You do not have to draft the provisions)**

**(8 marks)**

**(e) Movers is concerned that Shelf Co has been under the control of Shakers for some time. Please advise what protective provisions you would insert in the draft JV Agreement to protect Movers' initial investment into JV Co? (You do not have to draft the provisions)**

**(3 marks)**

## **Question-2 (25 marks)**

**Broker X** is registered with the Securities & Futures Commission as a dealer and an investment adviser under the Securities Ordinance. Pursuant to the Customer Agreement executed between **Client** and **Broker X**, **Client** maintains a Custody Account and a Collateral Account with **Broker X**. **Broker X** provides the following services to **Client** under the Customer Agreement:

- facilities for the execution and settlement of transactions in securities including securities trading on a discretionary basis;
- custody of **Client's** securities and cash in the Custody Account;
- a credit facility to **Client** who is required to maintain securities in the Collateral Account as margin for advances made to **Client** from time to time.

### **Questions :**

- (a) **What are the obligations of Broker X towards Client under the Securities Ordinance if Broker X wishes to dispose of Client's securities held in the Custody Account or the Collateral Account?**  
(10 marks)
- (b) **The Customer Agreement contains the following clause: "Broker X is free to use surplus cash balances in the Custody Account (including proceeds of sales of Client's securities and funds deposited with Broker X for ongoing trading activities of Client) for its own benefit, or for the benefit of one of its group companies." Is this clause enforceable?**  
(5 marks)
- (c) **The Customer Agreement contains the following clause: "Client hereby authorises Broker X to buy, sell, trade and otherwise deal in his securities on behalf of Client for Client's account. Client hereby consents to Broker X assigning and/or transferring its rights, benefits and obligations under this authorisation to such other person as Broker X deems fit. Client shall not assign his rights under this authorisation without the consent of Broker X." Is this clause enforceable?**  
(5 marks)
- (d) **The Customer Agreement contains the following clause: "Broker X is free to lend or deposit securities in the Collateral Account as security to any licensed bank which may from time to time provide financial accommodation to Broker X." Is this clause enforceable?**  
(5 marks)

**Question 3 (25 marks)**

**Bright Star Limited** (the “Company”), a company incorporated in Hong Kong, has an issued share capital of HK\$100,000 divided into 100,000 ordinary shares of HK\$1 each. The issued shares are held by:

**Emptyshell Limited**, as to 60%  
**Mr Anthony Brown**, as to 15%  
**ABC Limited**, as to 20% and  
**Ms Anna Leung**, as to 5%

Ms Chow is the sole shareholder and director of Emptyshell Limited, which is incorporated in the British Virgin Islands.

The directors of the Company are Ms Chow (being the managing director), Mr Brown and Mr Smith, a representative of ABC Limited.

The Company is engaged in manufacturing and selling wrist watches to retailers in the Asia Pacific Region. It is a profitable company, having declared and paid dividends consistently during the past 10 years.

Ms Chow informed you that she was recently approached by a Hong Kong subsidiary of a Swiss company, **Tick Tock Limited**, which has expressed an interest in acquiring a 51% interest in the Company. Ms Chow, who is personally experiencing financial difficulties, is keen to proceed with the sale transaction notwithstanding the fact that the purchase price proposed by Tick Tock Limited is slightly below the net asset value of the Company. Ms Chow also informed you that ABC Limited and Ms Leung were absolutely opposed to the sale but that Mr Brown had no objection to the proposed sale.

**Questions :**

- (a) Ms Chow has consulted you on whether she will be able to effect the transaction with Tick Tock Limited without the consent or co-operation of ABC Limited and Ms Leung. Please prepare a memorandum of advice to Ms Chow, which may include a request for further pertinent information from Ms Chow.

**(8 marks)**

- (b) Ms Chow has shown you a copy of the draft Share Sale and Purchase Agreement (including a Shareholders' Agreement) prepared by Tick Tock Limited's Hong Kong counsel. The draft Agreement contains various warranties, indemnities and a guarantee, all to be given by Ms Chow in favour of Tick Tock Limited. She has asked you to explain to her the differences and/or similarities between a warranty, indemnity and guarantee. Please explain the differences and/or similarities to Ms Chow.

**(4 marks)**

*(See over the page for questions (c) and (d))*

- (c) **Assuming the transaction with Tick Tock Limited proceeds, and Ms Chow remains a minority shareholder in Bright Star Limited, what kind of protective clause will you advise her to include in the draft Shareholders' Agreement in order to preserve her remaining interest in the Company? She has also asked you to draft a clause so that she can present it to Tick Tock Limited. Please advise Ms Chow and draft an appropriate clause.**
- (5 marks)**
- (d) **The proposed sale of 51% by Ms Chow to Tick Tock Limited is aborted. Ms Chow is still anxious to dispose of some or all of her shares in the Company to alleviate her financial predicament. However, none of the existing shareholders is prepared to purchase any of her shares, although they are quite happy for Ms Chow to dispose of some or all of her shares in the Company. No third party purchaser can, however, be identified. Please advise Ms Chow :**
- (i) **what other possibilities she has to realise some or all of her interest in the Company, apart from attempting to raise any loan from a third party lender;**
  - (ii) **what matters need to be considered on the feasibility of your proposal; and**
  - (iii) **the procedures or conditions that will need to be complied with in order to implement your proposal.**

**(8 marks)**

#### Question-4 (25 marks)

The Teddy Bear Company Group just celebrated its 50<sup>th</sup> anniversary as the biggest toy supplier in Hong Kong. Its main subsidiary which was incorporated in Hong Kong, **Golden Bear Company Limited** (the “**Company**”), wanted to set up a toy selling business via the Internet. To raise a total of \$40,000,000 for such expansion plan, it obtained various credit facilities from various banks, details of which are as follows:

- a \$10,000,000 one-year term loan from **Big Bank**

Prior to this new loan, Big Bank had already granted an earlier unsecured loan of \$3,000,000 to the Company for working capital. In order to induce Big Bank to extend this further loan of \$10,000,000, the Company granted a first floating charge over the general undertaking of the Company on 1 July 2000 to secure a total of \$13,000,000 outstanding loan. The charge was registered with the Hong Kong Registry of Companies on 2 July 2000;

- a \$20,000,000 five-year revolving term loan from **Rich Bank**

This term loan was secured by a first fixed charge executed on 5 July 2000 over the Company’s factory premises that was valued to be worth \$40,000,000 three years ago. \$5,000,000 of this term loan was used to repay an earlier unsecured loan of equivalent amount made by Rich Bank to the Company on 15 March 2000; and

- a \$5,000,000 standby letter of credit facility from **Great Bank**

This facility was secured by a charge over the book debts of the Company executed on 1 July 2000. Due to oversight on Great Bank’s part, the charge has remained unregistered with the Hong Kong Registry of Companies.

Prior to the making of the above financial arrangement, each of the major shareholders, **John** and **Sam**, had already lent \$2,500,000 totalling \$5,000,000 to the Company on the understanding that they would be repaid first prior to the repayment of any of the above loans obtained from outsiders.

Winding up proceedings were commenced on 1 August 2000 against the Company by its major supplier, **Plastic Limited**, as the Company had failed to pay for its raw material supply in the last 6 months amounting to \$15,000,000. Plastic Limited had supplied the raw material on credit to the Company with a usual retention of title clause in its invoice to the Company for all its delivery of the raw material. According to the Company’s last stocktake, only \$5,000,000 worth of raw material had been used. A winding up order was made on 1 October 2000 against the Company.

Plastic Limited is also holding a sum of about \$1,000,000 on account for the Company, being the deposit paid by the Company for its order of a new manufacturing machine to



be built and delivered by Plastic Limited's related company, **Machine Limited**, in November 2000. In fact, on closer investigation of the Company's accounting records, it was revealed that the Company has already been unable to repay its due debts since the beginning of this year and the above expansion plan was its last ditch attempt to salvage the Company's fortunes. It was further discovered that just immediately prior to the commencement of the winding up proceedings, the board of directors of the Company (which consisted of John and Sam) had authorized the repayment of \$2,500,000 to each of them on their earlier loans to the Company.

**Questions :**

(a) **Please advise Rich Bank, Big Bank and Great Bank on their respective rights against the Company in respect of the outstanding loans due by the Company to them.**

**(12 marks)**

(b) **Please advise the liquidator of the Company on the claims by :**

(i) **Plastic Limited for recovery of the remaining raw materials which were still in the Company's possession, the full amount of \$15,000,000 for the supply of the raw materials and the deposit of \$1,000,000 it is holding for Machine Limited; and**

(ii) **Machine Limited for the full price of the new machinery ordered by the Company for delivery in November 2000 which Machine Limited has not yet commenced building.**

**(8 marks)**

(c) **Advise the two shareholders and directors, John and Sam and their rights and potential liabilities in the above situation.**

**(5 marks)**

**Question 5 (25 marks)**

Jack and his friend respectively own 80% and 20% of the entire issued share capital of **Ping Pong Limited**, an investment holding company incorporated in Hong Kong. Jack intends to borrow from a bank in Hong Kong. **Cando Bank** has been approached and as a condition for granting the proposed loan to Jack, has required a guarantee from Ping Pong Limited to secure repayment of the proposed personal loan to Jack. Cando Bank knows the shareholding structure of Ping Pong Limited which has maintained cash and marketable securities deposited with Cando bank. The Memorandum of Association of Ping Pong Limited is set out below:

" **THE COMPANIES ORDINANCE (Chapter 32)**

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Company Limited by Shares

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**MEMORANDUM OF ASSOCIATION  
OF  
PING PONG LIMITED**

1. The name of the Company is "**Ping Pong Limited**".
2. The registered office of the Company will be situated in Hong Kong.
3. The objects for which the Company is established are:
  - (1) To carry on all or any one or more of the following businesses:
    - (a) general trading, importing, exporting, buying, selling and dealing in goods, materials, substances, articles and merchandise of all kinds in, from and to any part of the world, whether as principal or as agent;
    - (b) manufacturing, processing and/or extracting or taking goods, materials, substances, articles and merchandise of all kinds in any part of the world;
    - (c) investing, developing, dealing in and/or managing real estate, personal, tangible or intangible assets or choses in action or interests therein in any part of the world;
    - (d) providing services of any kind, financial or otherwise, in, from and to any part of the world;

- (e) acting as agents, managers, brokers, advisers and consultants in any part of the world;
  - (f) the business of a holding and/or investment company in any part of the world.
- (2) To carry on any other business of any nature whatsoever which may seem to the Directors to be capable of being conveniently carried on in connection or conjunction with any business of the Company hereinbefore or hereinafter authorised or to be expedient with a view to rendering profitable or more profitable any of the Company's assets or utilising its know-how or expertise.
  - (3) To purchase or otherwise acquire and hold any estate or interest any real or personal property or assets or any concessions, licences, grants, patents, trade marks, copyrights or other exclusive or non-exclusive rights of any kind and to develop, license out or otherwise deal with the same in such manner as may be thought fit and to make experiments and tests and to carry on all kinds of research work.
  - (4) To borrow or raise or lend money, to give any guarantee for the payment of money or for the performance of any other undertaking or obligation of the Company and generally to mortgage, charge or otherwise encumber all or any of the undertaking, immovable and movable property, present and future, and uncalled capital for the time being of the Company.
  - (5) To do all such other things as may be considered to be incidental or conducive to the attainment of any of the objects and the exercise of any of the powers of the Company.

And it is hereby declared that the objects of the Company as specified in each of the foregoing paragraphs of this Clause (except only if and so far as otherwise expressly provided in any paragraph) shall be separate and distinct objects of the Company and shall not be in any way limited by reference to any other paragraph or the order in which the same occur or the name of the Company.

4. The liability of the members is limited.
5. The share capital of the Company is HK\$5 million divided into 5 million shares of HK\$1 each.

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

In addition, Jack has been given Cando Bank's standard form of guarantee which provides as follows:

*"To Cando Bank,*

*In consideration of your making and/or continuing to make advances to **Jack** (the "**Principal**"), I/we, **Ping Pong Limited** (the "**Undersigned**"), as primary obligor and not merely as surety, hereby irrevocably and unconditionally guarantee the payment or discharge to you and undertake that the Undersigned will on demand in writing made on the Undersigned pay or discharge to you all moneys and liabilities which shall for the time being be done, owing or incurred by the Principal to you whether actually or contingently, solely or jointly with any other person and as principal or surety ....."*

**Questions :**

- (a) **Please advise Cando Bank if the Memorandum of Association of Ping Pong Limited permits an enforceable guarantee to be obtained from Ping Pong Limited to secure repayment of the proposed personal loan to Jack. If your answer is yes, please give reasons. If your answer is in the negative, please explain and draft any internal corporate document which may render the proposed guarantee enforceable (you are not required to draft any notice of directors' meeting or minutes of directors' meeting of Ping Pong Limited).**  
(20 marks)
- (b) **Jack has asked Cando Bank if Ping Pong Limited's liability under the proposed guarantee (given under Cando Bank's standard form) will be automatically set off against Ping Pong Limited's cash deposit being held by Cando Bank in the event Cando Bank goes into liquidation. Please advise Cando Bank.**  
(5 marks)

**END OF TEST PAPER**