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**2005 OVERSEAS LAWYERS  
QUALIFICATION EXAMINATION**

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**HEAD III: COMMERCIAL  
AND COMPANY LAW**

Monday, 7 November 2005



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

## **TEST PAPER**

**7 November 2005**

### **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.**

## 2005 Overseas Lawyers Qualification Examination

### Head III: Commercial and Company Law

#### Question 1 (25 marks)

Adrienne Company Limited (ACL) owns 75% and 80% respectively of the shares of Boyle Company Limited (BCL) and Cedric Company Limited (CCL). Peter Chan and Ross Turner are ACL's only directors. CCL owns 80% of the shares of Danny Investments Company Limited (DICL). All these companies are incorporated in Hong Kong

DICL is a licensed dealer in commodities and futures in Hong Kong. On 22 March 2003, it opened a trading account with Nelson Investments Inc. (Nelson), which trades in various commodities. As a direct result of DICL failing to adhere to certain undertakings it made in favour of Nelson, Nelson sustained losses in the amount of US\$1 million. Evidence shows that on 22 March 2003, CCL issued a letter to Nelson containing the following terms:

- “(1) DICL is a substantial and financially strong company.  
(2) We confirm that we approve of these facilities under the Trading Account and are aware of the fact that they have been granted to DICL because we control DICL indirectly;  
(3) We will not reduce our current financial interest in DICL until the above facilities have been repaid fully; and  
(4) It is our policy to exercise sufficient control over the management of DICL to ensure that it is able to meet all its liabilities.”*

On 7 December 2004, PNG Bank advanced a loan of HK\$2 million to ACL. Shortly before PNG Bank advanced the loan, ACL executed a debenture in favour of PNG Bank containing a fixed charge over its shares in BCL and CCL, and a floating charge over, amongst others, a current account maintained by ACL with PNG Bank.

In addition to the fixed and floating charges, Mrs. Susan Turner (Ross Turner's wife) executed an unlimited and continuing guarantee for the repayment of the loan advanced by PNG Bank to ACL. Two hours before the execution of the guarantee, PNG Bank's solicitor, Mr. Broadbrush, explained to Mrs. Turner over the telephone that “the total amount of the bank loan advanced to ACL is covered by the guarantee you are being asked to sign”. No further conversation or contact between Mr. Broadbrush and Mrs. Turner took place until Mrs. Turner signed the guarantee at PNG Bank's branch on 7 December 2004. Mrs. Turner is neither a shareholder nor a director of ACL, BCL, DICL or CCL.

On 8 May 2005, before granting a new loan to ACL, SAR Bank obtained a floating charge from ACL over all its assets and undertaking. On the same day, SAR Bank and PNG Bank entered into a subordination agreement. SAR Bank's floating charge contains an “automatic crystallisation clause” to be triggered by a breach of the negative pledge clause. PNG Bank's floating charge does not contain any automatic “crystallisation clause”. It only has a negative pledge clause.

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

All documents requiring registration at the Companies Registry were duly authorized, properly executed and filed on time.

ACL went into liquidation on 18 September 2005 with HK\$1 million standing to the credit of its current account with PNG Bank. The creditor who filed the winding-up petition against ACL now threatens to wind-up DICL.

### **Questions:**

**Answer Questions 1(a), 1(b) and 1(c)**

#### **Question 1(a)**

**Advise Nelson, giving reasons and citing authority, whether and to what extent it will be able to rely on the letter addressed to it by CCL to recover its loss or any part of its loss from CCL.**

**(10 marks)**

#### **Question 1(b)**

**Advise Mrs. Turner on her liability under the guarantee she provided in favour of PNG Bank.**

**(7 marks)**

#### **Question 1(c)**

**List the order of priorities under which payments will be made by the liquidators of ACL. How would your answer differ if the subordination agreement was not signed by SAR Bank and PNG Bank?**

**(8 marks)**

## **Questions 2 (25 marks)**

Answer **both** Questions 2(a) and 2(b)

### **Question 2(a)**

The Code on Corporate Governance Practices, Appendix 14 of the SEHK Listing Rules, is now divided into five parts. Part E concerns communication with shareholders. Without merely summarising Part E, explain the guiding principle and code provisions contained in Part E and provide a critical analysis, in particular, of the extent to which they extend relevant provisions (which you should specifically identify) of the Companies Ordinance.

(12 marks)

### **Question 2(b)**

The Companies (Amendment) Ordinance 2004, Schedule 1, which concerns amendments relating to prospectuses, was brought into force in December 2004. Explain the implications of the following amendments to a client of yours which is a public company looking to expand its investor base. Your answers should include a comparison of the position both before and upon the 2004 Ordinance coming into operation.

- (i) the new definition of “prospectus” contained in s 2(1);  
(6 marks)
- (ii) the subsections added to s 40 and s 40A, namely s 40(6) and s 40A(4), both of which provide that: “This section shall apply to a publication falling within s38B(2) as if the publication were a prospectus”; and  
(4 marks)
- (iii) the new 22nd Schedule to the Companies Ordinance, which sets out the “Persons Specified for the Purposes of Section 40 of this Ordinance”.  
(3 marks)

### **Question 3 (25 marks)**

Baltic Computers Holdings Limited (**BC**), a company incorporated in Hong Kong is listed on the Hong Kong Stock Exchange. BC wishes to branch out into the business of running coffee cafés and has identified Atlantic Coffee Limited (**AC**) as a possible acquisition target. AC already operates some 30 cafés in Hong Kong and another 3 in the Philippines. All these cafés are housed in rented properties and AC buys its coffee from two suppliers in Vietnam. Notwithstanding that AC is apparently being sued in the Philippines (the exact details of which are not yet known), rumour has it that an international coffee chain is also interested in buying Atlantic Coffee. BC's directors have already approached AC's owners but cannot decide whether to proceed by way of a purchase of the shares in, or the café business of, Atlantic Coffee. In any event, BC's directors want to complete the acquisition as quickly as possible to beat off the international coffee chain.

#### **Questions:**

**Your firm's senior partner asks you to write him a brief memorandum to help guide him during his meeting with BC's directors tomorrow. Prepare a memorandum for the senior partner covering:**

- (a) (i) the principal similarities and differences between a share and asset acquisition; and (5 marks)**
- (ii) having regard to the above facts, the principal advantages and disadvantages of each from the perspective of BC. (8 marks)**
  
- (b) the procedures BC should follow in order to avoid any liabilities of AC migrating to BC, if the transaction is structured as an asset acquisition. Your answer should include an analysis of the purpose and effect of following these procedures; and (8 marks)**
  
- (c) the issues that might affect the timing of any proposed acquisition based on the currently known facts. (4 marks)**

#### **Question 4 (25 marks)**

Sam, John and John's wife, April are equal shareholders (each holding 500,000 ordinary shares of HK\$1.00 each) in Hotcomputer Private Limited (**HPL**). HPL is incorporated in Hong Kong and was originally set up by John and Sam as equal partners in 1996 to capitalize on the internet technology boom and John's skills as a software expert in developing and tailor making software programmes for engineering companies. HPL has a cash surplus of about HK\$2,000,000 on deposit with the Lion Bank (HPL's main banker). In 2001, April became its third shareholder. John and April are both full-time working executive directors of HPL whilst Sam is a non-executive director. HPL has the standard memorandum and articles of association that incorporates Table A in full, with no express provision on the giving of security for third party liability.

Unbeknown to Sam, April set up a company, Supercomputer Private Limited (**SPL**), in 2002 with her brother, Jack, to sell ready made computer software packages. April describes SPL as her own "little side business". At April's request, John has been quietly giving her information on HPL's clients since late 2002 so that Jack may call on those clients to promote SPL's business. In return, SPL is paying John a commission of HK\$100 for each package sold and so far John has been paid a total of HK\$10,000.

Unfortunately business has become very sluggish for SPL and it has incurred substantial losses. To save SPL, April succeeded in persuading the Lion Bank to grant a loan of HK\$1,000,000 to SPL (**Loan**) by getting HPL (which April told the Bank was also owned by her and her husband) to execute a corporate guarantee and a first fixed charge over one half of HPL's HK\$2,000,000 deposit (i.e. HK\$1,000,000) as security for the Loan. Although John was initially reluctant to get HPL involved, in January 2004 he eventually agreed (without Sam's knowledge) to execute the corporate guarantee and the first fixed charge together with April as directors of HPL in favour of the Bank. Sensing a further decline in SPL's fortunes, the Lion Bank required SPL execute a first floating charge over all its assets and undertaking as additional security for the Loan. The first floating charge was executed in May 2004.

Winding up proceedings have been initiated against SPL by one of SPL's creditors for an unpaid debt of HK\$200,000. SPL is found to have been insolvent since December 2004. It has unpaid debts exceeding HK\$2,000,000 with assets of approximately HK\$600,000.

#### **Questions:**

**Prepare a legal analysis of the rights and obligations of each of:**

**(i) HPL; and**

**(10 marks)**

**(ii) the Lion Bank;**

**(15 marks)**

**in light of the above facts.**

**Question 5 (25 marks)**

The principal objective for establishing a company is for shareholders to minimise the potential liability of the company and themselves to creditors.

**Question:**

**Prepare a note explaining, with reasons, whether or not you agree with the above statement. Your note should also include an analysis of whether and to what extent the Companies Ordinance and the common law thwart this objective. Where appropriate, you should cite briefly some relevant authorities as examples in support of the common law exceptions that you identify.**

**(25 marks)**

**END OF TEST PAPER**