

**2009 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Friday, 6 November 2009



HEAD III: COMMERCIAL AND COMPANY LAW

TEST PAPER

6 November 2009

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. Start each question on a separate page of your answer book.

6. 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.

7. An examiner will be present for the first 30 minutes of the examination. Any questions relating to the paper must be raised in that period. Questions raised after the first 30 minutes will not be entertained.

8. Do not take either this question paper or any answer books with you when you leave the examination room.

2009 Overseas Lawyers Qualification Examination

Head III: Commercial and Company Law

Question 1 (25 marks)

Question 1(a)

Your client, Henry, has for many years been employed by Winstons Ltd. (“Winstons”), a Hong Kong incorporated trading company. Henry was recently promoted and appointed a director of Winstons.

Because of the global financial crisis, Henry is becoming increasingly concerned about the rising inventory and rapid depletion of cash flow in Winstons. He has also learnt from colleagues in the company’s accounts department that more and more bills are not being settled on time. Many of the company’s creditors are grumbling and some have been sending the company strongly worded payment reminders.

Keith, the chairman of Winstons, is considering securing loan finance for the company as a means to help the company through this difficult time. He realizes that, at a minimum, the company will need to create a floating charge over some of the company’s goods to secure the loan. Keith asks Henry to approach a few of Winstons’ banks to ascertain whether they would be in principle willing to extend a loan to the company.

Question:

Henry is worried about his duties as a director and his personal liability to creditors of Winstons. He asks you to explain to him how one determines whether a company is insolvent and whether there are any circumstances under which he (Henry) could be personally liable to the company’s creditors before and following the possible insolvency of the company, particularly if one of the banks makes a loan, secured by a floating charge, to Winstons.

(15 marks)

(See the next page for a continuation of Question 1)

Question 1(b)

Peter is the chairman of a company, the shares of which are listed on the Hong Kong Stock Exchange. Peter is considering hiring Donald as an independent non-executive director (“INED”) of the company.

Donald is a retired solicitor and Peter thinks Donald’s legal experience will be an asset to the listed company.

Peter will be meeting Donald tomorrow morning and he asks you to write down in point form your suggestions for the contents of an INED’s letter of appointment, which he may then use to prompt him in his discussions with Donald.

Question:

Prepare a note in point form explaining what provisions Peter should include in the letter of appointment of an INED.

(10 marks)

Question 2 (25 marks)

Great Success Holding Limited (“GSHL”) owns the entire issued share capital of each of Strike Rich Limited (“SRL”) and Make Famous Limited (“MFL”). All are private Hong Kong incorporated companies. MFL manufactures microchips and SRL undertakes research and development pertaining to microchips and other related high tech electronic equipment. The ultimate shareholders of GSHL are Henry, Allan and Samuel, who hold 40%, 30% and 30% respectively of the issued share capital of GSHL. Both Allan and Samuel are not actively involved in the business of SRL and MFL and have, since the establishment of the companies, been happy to leave the day-to-day operations to Henry, who is both the Managing Director and Chief Executive Officer of all three companies. Henry is assisted by his sister, Jane, a qualified accountant. She is also a Director of all three companies and attends to the companies’ administration. The companies have achieved moderate success and have a good relationship with The Lion Bank (“Bank”), with which Henry is the main contact.

Without informing Allan and Samuel, Henry established and has been operating a separate company, New Supply Limited (“NSL”), which manufactures microchips. MFL is one of its main customers. Due to the recent expansion of NSL’s plant in China, NSL is on the verge of insolvency. In an attempt to save NSL, Henry arranged for MFL to place a HK\$3 million order to purchase a large consignment of microchips (at greatly inflated prices) from NSL. In order to pay the purchase consideration, Henry arranged for MFL to borrow HK\$3 million from the Bank. In addition to the loan agreement, which Henry signed on behalf of MFL, the Bank required MFL’s repayment obligations to be guaranteed by GSHL. Henry also signed the guarantee on behalf of GSHL and presented to the Bank an extract (certified by Henry to be a true copy of the original) of board resolutions of GSHL and MFL approving the loan and the guarantee, respectively.

(See the next page for a continuation of Question 2)

By the time that Allan and Samuel learnt about what has happened, Henry had disappeared with the proceeds of the loan. After being informed of the situation, the Bank demanded repayment of the loan in full, which it was entitled to do under the loan agreement. The Bank also informed Allan and Samuel that if it did not receive repayment within 3 days, it would enforce its rights under the guarantee.

Question:

Advise Allan and Samuel:

(a) whether The Lion Bank will succeed in its action against MFL on the loan agreement and against GSHL on the corporate guarantee; and

(20 marks)

(b) on any rights which MFL and GSHL may have against Henry.

(5 marks)

Question 3 (25 marks)

Question 3(a)

Amy and Brian are the directors of Eagle Transport Company Limited (“Eagle”), which is a limited liability company that was incorporated in Hong Kong in June 1996. Eagle has two shareholders, Catherine and David, who each owns 10,000 ordinary shares of HK\$10 each. Eagle adopted the Table A Articles of Association without any amendment. Eagle has only one objects clause in its memorandum which states:

“The company’s object is the carriage of cargo in trucks between such places as the company may from time to time determine and the doing of all such other things as are incidental to or expedient for the furtherance of the company’s objects.”

Two days ago, Eagle expressed its willingness to execute a guarantee to secure a loan to be advanced by Kowloon Bank to Stunning Beauty Salon, a partnership established in 2005 between Catherine and her good friend, Edith.

Question:

- (i) **Advise Kowloon Bank on the following:**
- (a) **the capacity of Eagle to provide the guarantee;** (7 marks)
 - (b) **whether anyone could seek to prevent Eagle from providing the guarantee.** (2 marks)
- (ii) **If the guarantee is given, could anyone associated with the company be held liable for allowing the company to provide the guarantee, and, if so, explain the nature of such liability and the legal basis upon which such liability would arise.** (4 marks)

(See the next page for a continuation of Question 3)

Question 3(b)

Novelty Company Limited (“Novelty”), which is a limited liability company that was incorporated in Hong Kong, was ordered to be wound up by the Hong Kong High Court on 21 October 2009.

Novelty’s current bank account with Kowloon Bank was, in recent years, always overdrawn. Between 12 August 2009 (when the winding up petition was presented) and 21 October 2009 (the date of the winding up order), Kowloon Bank allowed Novelty to continue to withdraw money from, and pay money into, the overdrawn account. During this period Novelty continued to incur losses due to unprofitable trading.

In addition, Novelty sold some of its inventory on 13 August 2009. On 14 August 2009, Novelty paid \$200,000 to one of its suppliers for goods previously supplied (but not paid for) to Novelty on 8 August 2009.

Question:

Advise the liquidator whether the validity of the above transactions and dealings may be challenged and, if so, on what grounds.

(12 marks)

Question 4 (25 marks)

ACBC Ltd (“ACBC”) was incorporated in Hong Kong in the 1990’ s and proved to be a very successful trading business. It was subsequently listed in Hong Kong and its policy of paying a high proportion of its profits as a dividend attracted a large number of investors and drove its share price to more than \$150. ACBC was however badly affected by the Asian financial crisis in 1997 and its earnings, profits and share price all fell significantly.

ACBC did not declare a dividend during the period 2005-07 but during this time attempted to stream-line and consolidate its business. Its share price, although rising slightly, remained very low (\$2.70 to \$3.50) but given a return to profit, a small dividend was declared in June 2008. However, as a consequence of the more recent global economic turmoil, its share price fell more than 30 per cent in the month up to 13 November 2008. In response to this event, its board of directors proposed to privatise ACBC by way of a scheme of arrangement under s 166 of the Companies Ordinance. Trading in its shares was suspended pending the announcement of the Scheme. The closing price of ACBC immediately before trading in its shares was suspended was \$1.20.

The Scheme document, which indicates a cancellation price of \$2.50, gives the reasons for the Scheme and the benefits of the proposal for the shareholders who would be bought out (the “Scheme Shareholders” who together hold 53% of ACBC’s shares) as being:

“The Proposal provides Scheme Shareholders with an opportunity to realise their investment in ACBC for cash during sustained uncertain market conditions and at a significant premium to the market price prevailing on the Last Trading Date.”

(See the next page for a continuation of Question 4)

The meeting to approve the Scheme was scheduled to take place on 1 October 2009. Just 3 days before that meeting it was reported in the press that 500,000 ACBC shares had been given to staff in LL Ltd., a former subsidiary of ACBC, to induce them to vote in favour of the privatisation plan. Two of ACBC's directors are also directors of LL Ltd. The meeting was held and 83% of the number of shares held by the Scheme Shareholders, present and voting, either in person or by proxy, at the meeting, were voted in favour of the Scheme.

ACBC then petitioned the court to approve the Scheme but at the hearing the Securities and Futures Commission ("SFC") applied to intervene. Leave to do so was granted by the court and the SFC was directed to file evidence within 21 days.

Question:

Ardy, a minority shareholder who voted against the Scheme, seeks your advice on the following:

- (a) **What is the role of the court in a scheme of arrangement process ?**
(5 marks)
- (b) **If the SFC finds that (i) the shares given to LL Ltd.'s staff were registered in the names of the staff concerned, (ii) proxy forms were registered in their individual names prior to 1 October 2009 and (iii) they all voted in favour of the Scheme, discuss the implications of these findings in terms of the hearing of the Scheme petition.**
(8 marks)
- (c) **Whether the minority shareholders, who, like himself, opposed the privatisation, would have been better protected if the privatisation had proceeded under either the takeover provisions or the buy-back provisions of The Codes on Takeovers and Mergers and Share Repurchases.**
(7 marks)
- (d) **Besides the SFC findings, are there any other apparent grounds on which the court may not sanction ACBC's proposed Scheme?**
(5 marks)

Question 5 (25 marks)

You are consulted by Mr. Lam, an executive director and the chairman of Sleazy Limited (“Sleazy”), a company which was listed on the Hong Kong Stock Exchange during 2007. Mr. Lam tells you that approximately two weeks ago on 22 October 2009, the company secretary of Sleazy was contacted by the Hong Kong Stock Exchange, which had noted a significant increase in the trading volume of the shares of Sleazy during previous afternoon. The Stock Exchange asked whether or not Sleazy was aware of any reasons for such a sudden and sharp increase.

The company secretary contacted all the directors of Sleazy, including Mr. Lam, and asked whether they were aware of any reasons for the significant increase in the trading volume of the shares the previous day. All directors responded that they were not aware of any reasons for the sudden increase in trading of Sleazy’s shares.

After conveying this information to the Stock Exchange, on 23 October, 2009 Sleazy filed an announcement, in standard form, with the Stock Exchange for publication on the Stock Exchange’s website. The announcement stated in part:

“The Board of directors of Sleazy Limited has noted the increase in trading volume of the shares of Sleazy Limited yesterday and wishes to state that it does not know of any reason for such increase.

Made by the order of the Board of Sleazy Limited, the directors of which individually and jointly accept responsibility for the accuracy of this statement.”

(See the next page for a continuation of Question 5)

Mr. Lam tells you that he now realizes that the reason for the sudden increase in the trading volume of Sleazy's shares on 22 October was the result of a bank, to which Mr. Lam had some 2 years ago pledged 300 million shares in Sleazy, selling those shares on the market to pay down Mr. Lam's loan due to the bank. In fact, Mr. Lam now recalls authorizing the bank approximately two months' earlier to sell as many of the pledged shares as necessary in order to discharge the loan. In reliance on Mr. Lam's authority, the Bank apparently sold 200 million shares on 22 October. However, Mr. Lam tells you that he had forgotten about this arrangement when the Stock Exchange enquired about the sudden increase in trading of Sleazy's shares on 22 October, 2009.

Mr. Lam understands that the Securities and Futures Commission ("SFC") is investigating the matter and he understands further that he and Sleazy are likely to be prosecuted for contravening Section 384(1) of the Securities and Futures Ordinance ("SFO"). Mr. Lam has an extract of Section 384(1) of the SFO, which provides:

"(1) Subject to subsection (2), a person commits an offence if-

- (a) He, in purported compliance with a requirement to provide information imposed by or under any of the relevant provisions, provides to a specified recipient any information which is false or misleading in a material particular; and*
- (b) He knows that, or is reckless as to whether, the information is false or misleading in a material particular."*

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

Question:

- (a) Mr. Lam is very concerned about his potential criminal liability under the SFO. However, he understands that the announcement Sleazy filed with the Stock Exchange was not filed with or delivered to the SFC and so he doubts that the SFC will be able to secure a conviction against him or Sleazy under Section 384(1) of the SFO. Citing relevant case authority, prepare a detailed note explaining to Mr. Lam the possible basis upon which both he and the Company could be convicted for contravening Section 384(1) of the SFO. You should also discuss whether the fact that the announcement was not filed with the SFO is or could be relevant. You may ignore any obligations relating to the disclosure of interests to which Mr. Lam, Sleazy and/or the Bank may be subject under the SFO.

(20 marks)

- (b) Briefly explain the difference between an initial public offering (IPO) and a rights issue.

(5 marks)

END OF TEST PAPER