
2010 OVERSEAS LAWYERS QUALIFICATION EXAMINATION

HEAD III: COMMERCIAL AND COMPANY LAW

Thursday, 4 November 2010



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TEST PAPER

4 November 2010

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.

2010 Overseas Lawyers Qualification Examination

Head III: Commercial and Company Law

Question 1 (25 marks)

Mr. & Mrs. Chan are the only 2 directors of X Ltd. Together, they own 85 per cent of the issued share capital of X Ltd.

X Ltd. is engaged in selling high-end women's fashion through a number of retail stores in Central and Causeway Bay.

Mr. Lee was until 9 months ago a director of X Ltd. but he resigned to devote his time to other business ventures. Mr. Lee owns 15 per cent of the issued share capital of X Ltd.

Mr. Lee has become increasingly unhappy with the way Mr. & Mrs. Chan have been running X Ltd. His complaints include that Mr. & Mrs. Chan no longer consult with him and they have not called any directors' meetings for many months. Also, X Ltd. has started opening retail stores in Guangzhou, China and selling menswear through those outlets. Mr. Lee is convinced that these diversions will cause X Ltd. to lose money and he wants them to focus on the core business of high-end women's fashion.

Mr. Lee has also discovered that Mr. and Mrs. Chan have, for the last 6 months, been drawing \$100,000 from X Ltd.'s bank account. When Mr. Lee confronted the Chan's about this, they told him that these were loans advanced to them by X Ltd.

There is no written shareholders' agreement between the parties.

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

Questions:

- (i) **Advise Mr. Lee whether he is legally justified in complaining that no directors' meetings have been convened for many months and also whether he has any legal entitlement to prevent X Ltd. from selling menswear in China?**

(15 marks)

- (ii) **Advise Mr. Lee whether he may challenge the propriety of the monthly loans or advances from X Ltd. to Mr. & Mrs. Chan. Would your advice differ if Mr. and Mrs. Chan are able to demonstrate that the monthly loans or advances are to reimburse the Chans for expenditure incurred in respect of X Ltd.'s business activities undertaken on behalf of X Ltd. in China?**

(10 marks)

[25 marks in total]

Question 2 (25 marks)

Great Fortune Ltd. (“**Company**”) is a private company that was incorporated in Hong Kong by Allan Au, Billy Bo and Chris Chu in 1995. The authorised share capital of the Company is \$3 million, comprising of 300,000 shares of \$10 each. All shares have been issued fully paid to the shareholders. Allan holds 51% of the issued shares and Billy and Chris hold 25% and 24% of the issued shares, respectively. The three shareholders are also the only directors of the Company.

Things proceeded well after the incorporation of the Company and the three shareholders enjoyed a harmonious working relationship for many years. However, disputes and divisions began arising among the three individuals from September 2009. Allan and Billy are eager to expand the Company’s business into the PRC market. Chris, on the other hand, believes that the Company should focus on its existing business in Hong Kong. If the Company decides to expand its business, it will be necessary to increase its share capital. The Memorandum of Association of the Company contains a set of objects clauses which restricts the Company’s capacity to expand its business. At a recent board meeting, Allan and Billy, outvoting Chris, resolved to convene an extraordinary general meeting (“**EGM**”) of the Company to pass resolutions to:

- (i) increase the share capital of the Company from \$3,000,000 to \$10,000,000 by the creation of 700,000 new shares of \$10 each;
- (ii) delete from the Memorandum of Association of the Company those objects clauses that restrict the Company from expanding its core business.

On 27 September, 2010, Chris received the notice (“**Notice**”) convening the EGM. It stated that the EGM would be held on 12 October, 2010.

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

The Articles of the Company contain the following relevant provisions (Table A is not applicable):

“21. The Company may increase its share capital by such sum, to be divided into shares of such amount as may be determined by all members unanimously...

25. An annual general meeting and a meeting called for the passing of a special resolution shall be called on not less than 21 days' written notice, and a meeting of the Company, other than an annual general meeting or a meeting for the passing of a special resolution, shall be called on not less than 14 days' written notice.”

Questions:

(i) What steps (if any) may Chris take to prevent the proposed resolution to increase the share capital of the Company from being passed in light of Article 21 of the Company's Articles? You must fully explain your answer with reasons (including, where applicable, making reference to relevant legislative provisions and case authority).

(14 marks)

(ii) Giving reasons and making reference to relevant case authority and legislation, explain whether it would be possible for Chris successfully to challenge the holding of the EGM, having regard, in particular, to the Notice convening the EGM.

(11 marks)

[25 marks in total]

Question 3 (25 marks)

Question 3(a)

Andy, Brian and Candy studied computer science together at a university in Canada. After graduating, Candy returned to Hong Kong to take over her family's software business. Andy and Brian commenced their own language-learning software business in Hong Kong under the name "Lingua Frame". In June 2006, Candy agreed to invest funds into Andy's and Brian's business, and a company ("**JV Company**") was formed for this purpose. The JV Company was incorporated in October 2006 and adopted Table A Articles.

On 1 September, 2006, immediately before the incorporation of the JV Company, Andy, Brian and Candy entered into a joint venture agreement ("**Agreement**"). It was agreed, amongst others, that the JV Company would be formed for the purpose of developing and marketing software under the brand-name of "Lingua Frame". Andy, Brian and Candy would be shareholders of the JV Company, holding respectively 30%, 30% and 40% of the issued share capital of the JV Company. The JV Company's issued share capital would be \$1,000 divided into 100 shares of \$10 each.

Pursuant to the Agreement, Candy invested \$2 million into the JV Company by way of an interest-free shareholder's loan. The loan is repayable on demand. Andy and Brian each assigned the intellectual property rights subsisting in the "Lingua Frame" software to the JV Company. It was also a term of the Agreement that Andy, Brian and Candy would act as the JV Company's directors, and that a director could only be removed by way of a special resolution at a general meeting. It was further agreed that Andy and Brian would be chiefly responsible for the day-to-day management of the JV Company, whilst Candy would not play any role in the management of the JV Company, and would be consulted only when major decisions were to be made. The entire sum of Candy's loan was spent on purchasing equipment for the JV Company.

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

To her great surprise, on 1 October, 2010, Candy received a notice issued by Andy and Brian advising her that they intended to remove her as a director of the JV Company pursuant to the Companies Ordinance. They invited Candy to attend a general meeting of the JV Company on 25 October, 2010. Despite Candy's protests at the meeting, Andy and Brian voted in favour of removing Candy as a director of the JV Company by passing an ordinary resolution to this effect.

Candy is very disappointed with both Andy and Brian. Not only does she no longer want to remain a shareholder of the JV Company but she wishes to recover her investment in the JV Company.

Question:

Prepare a letter of advice to Candy, explaining the various options she has to recover her investments - both the shareholder's loan and her equity investment - from the JV Company and/or any other parties.

(18 marks)

Question 3(b)

Candy discovers that in March 2008, Andy advanced by way of loan to the JV Company an amount of \$400,000. The terms of that loan provided that it would be repayable in one lump sum on 1 March, 2011. However, the JV Company repaid \$150,000 to Andy on 2 September, 2008, and a further payment of \$250,000 was made to Andy on 10 January, 2009.

Question:

Discuss the validity of the two repayments to Andy, assuming the JV Company is insolvent as at 31 October, 2010.

(7 marks)

[25 marks in total]

Question 4 (25 marks)

International Bafen Holdings Limited (“**IBHL**”), incorporated in the Cayman Islands, is proposing to list on the Stock Exchange of Hong Kong Ltd. (“**SEHK**”) pursuant to a Global Offering of 280 million shares. The number of public offer shares, subject to adjustment, will be 28 million and the offer price will not be more than \$3.09 (plus fees and levies). The nominal value of the shares will be \$0.10. IBHL’s core business is the manufacture of cotton textiles and the information prepared for inclusion in the prospectus states that growth, in terms of production, was at 10 percent per annum over the last 5 years. The prospectus also forecasts increased growth in each of the next ten years.

Local Company Limited (“**LCL**”), incorporated in Hong Kong, is also proposing to list on the SEHK. The number of public offer shares, subject to adjustment, will be 10 million and the offer price will not be more than \$4.49 (plus fees and levies). The nominal value of the shares will be \$0.10. LCL’s proposal to list is prompted by its invention of a new drug to fight influenza, which is a completely new class of antiviral. The way in which the drug takes effect involves a new concept, which can also be applied to other viruses. The researchers who developed the drug have prepared a detailed report on the drug and its impact on the influenza and other viruses. This report will be included in LCL’s prospectus.

Question:

Your advice is sought with respect to the following questions:

- (i) **IBHL and LCL each ask whether they are required to prepare a full prospectus and if so, which legal provisions will govern the content of such a prospectus and which authorities will vet the prospectuses.**

(6 marks)

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

(ii) IBHL asks whether its growth forecasts may form the basis of any legal action if the forecasts prove to be untrue. You must also explain the requirements, if any, as to forecasts in the Listing Rules.

(5 marks)

(iii) LCL asks you, assuming that its listing is successful, if it is subsequently discovered that the new drug had not previously been tested on humans, only on mice, and is found to have fatal consequences for humans: (i) whether shareholders would be entitled to terminate their purchase contracts; (ii) who may be liable to compensate the shareholders under the Companies Ordinance and/or otherwise; and (iii) whether criminal actions may be brought against anyone and, if so, against whom.

(10 marks)

(iv) To what extent would your answer to (i) above be different if LCL was not proposing to list on the SEHK but to offer 1 million shares for sale to the public?

(4 marks)

[25 marks in total]

Question 5 (25 marks)

Question 5(a)

The in-house lawyer of ABC Bank Ltd. (“**Bank**”) seeks your advice. He explains that the Bank has been approached by a Hong Kong trading company, Golfmagic Ltd. (“**Golfmagic**”), to provide it with a loan facility of up to \$30 million. Golfmagic distributes high-end golf bags to retailers in the U.S.A. It has a number of major blue chip customers in the U.S.A. who have long-term contracts with Golfmagic. The in-house lawyer tells you that Golfmagic has a very good business but that it has no assets other than its customer receivables that it can or will offer up as security for the loan facility. The vast majority of the receivables are the pipeline of regular payments due to Golfmagic from its customers. These receivables are an important source of cash flow to Golfmagic. The Bank is apparently willing to provide the loan facility provided it is able to take a fixed charge over Golfmagic’s receivables.

Question:

Prepare a memorandum of advice to the in-house lawyer of the Bank explaining, with reasons and reference to case authority:

(i) whether it is possible to create a fixed charge over Golfmagic’s receivables;
(6 marks)

(ii) what alternative(s) the Bank has to taking a fixed charge over the receivables and the practical issues the Bank will need to appreciate in connection with such other form(s) of security.

(7 marks)

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

Question 5(b)

You are consulted by John Upgive, an executive director of Gameover Limited (“Gameover”), a Hong Kong incorporated company that has been in business for over 20 years. Mr. Upgive tells you that at a directors’ meeting last week, all the directors, who are also the shareholders of Gameover, made known their desire to wind up Gameover, which has apparently suffered huge losses during the recent global financial crisis. Gameover has debts which far exceed its assets and none of the directors has the motivation to attempt to restore the company to its former profitable state.

Question:

Mr. Upgive asks you to address a memorandum to the board of directors of Gameover:

- (i) explaining, with reasons, what is the most appropriate way for the directors to wind up Gameover; and**

(4 marks)

- (ii) outlining the precise steps and procedures that will need to be followed as part of the winding up process that you have identified in (i) above.**

(8 marks)

[25 marks in total]

END OF TEST PAPER