
**2012 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Thursday, 8 November 2012



HEAD III: COMMERCIAL AND COMPANY LAW

TEST PAPER

8 November 2012

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.**

2012 Overseas Lawyers Qualification Examination

Head III: Commercial and Company Law

Question 1 (25 marks)

Wealthy Prospects Limited is a company incorporated in the British Virgin Islands. It owns 100% of the shares of KT Developments Limited, which is a company incorporated in Hong Kong. In turn, KT Developments Limited owns a plot of land in Kwun Tong, which is approved for redevelopment as a mixed use hotel and retail complex. KT Developments Limited has no borrowings and there is no mortgage over the land. KT Developments Limited does not have any distributable reserves.

Wealthy Prospects Limited has signed a non-binding heads of agreement pursuant to which it has agreed, subject to contract, to sell the entire share capital of KT Developments Limited to a newly incorporated Hong Kong company called New Hotels Limited. New Hotels Limited is owned as to 70% by NH Holdings Limited, and as to 30% by ABC Ventures Limited (both of which are companies incorporated in Hong Kong). NH Holdings Limited and ABC Ventures Limited intend to hold their shares in New Hotels Limited (and indirectly, KT Developments Limited) during the development phase of the land, and will enter into a joint venture agreement with each other to set out the terms upon which they will hold their shares in New Hotels Limited.

The heads of agreement contemplates that Wealthy Prospects Limited and New Hotels Limited will negotiate a binding sale and purchase agreement for the entire issued share capital of KT Developments Limited in customary form and sign this after New Hotels Limited has satisfied itself as to title to the land. On the basis that New Hotels Limited has agreed to satisfy itself as to title to the land, it has been agreed that there will be no warranties on this issue. The consideration for the shares is HK\$200,000,000. The purchaser is to pay all stamp duty on the transaction, and completion will occur immediately following signing.

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

NH Holdings Limited will inject HK\$70,000,000 into New Hotels Limited by way of share subscription, and ABC Ventures will inject HK\$30,000,000, also by way of share subscription. ABC Ventures Limited has agreed to make a loan of HK\$100,000,000 to New Hotels Limited. In turn, New Hotels Limited will use HK\$200,000,000 to pay the purchase price of the shares in KT Developments Limited to Wealthy Prospects Limited. In order to secure the loan owing by New Hotels Limited to ABC Ventures Limited, it has been agreed by both NH Holdings Limited and ABC Ventures Limited that KT Developments Limited will guarantee payment of the loan and, as security for the guarantee, will grant a mortgage over the land in favour of ABC Ventures Limited.

Questions:

- (a) **Explain why New Hotels Limited should negotiate warranties in the sale and purchase agreement. Although title to the land is not being warranted, list out other warranties that New Hotels Limited would require.**
(6 marks)
- (b) **What documents will New Hotels Limited expect to receive as part of the completion process?**
(3 marks)
- (c) **How much ad valorem stamp duty will be payable, assuming that the consideration is reflective of the value of the shares passing?**
(1 mark)

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

- (d) Is it lawful under the Companies Ordinance for KT Developments Limited to grant a mortgage over the land in favour of ABC Ventures Limited? What procedural steps should be followed (assuming that these are to be taken immediately following completion of the transfer of shares rather than prior to completion)?**

(5 marks)

- (e) Explain, with reasoning, the key features which ABC Ventures Limited, as a minority shareholder, would expect to see in a joint venture agreement with NH Holdings Limited in respect of New Hotels Limited and, indirectly, KT Developments Limited?**

(10 marks)

[25 marks in total]

Question 2 (25 marks)

X, Y and Z have recently set up a newly incorporated company in Hong Kong (the “**Company**”), which carries on a business to give advice on whether and which securities should be acquired or disposed of (which is the responsibility of X and Y), and to give advice concerning any offer to dispose of securities to, or to acquire securities from, the public (which Z is responsible for). X and Y are directors of the Company. The three founders of the Company have hired some investment bankers of various levels to join the Company. The senior bankers attend meetings with clients, give them investment advice and execute transactions between the clients and the Company. The junior bankers do the groundwork at the office, such as research and preparation of documentation. They also discuss with the senior bankers regarding their research reports, including taking a view on the performance of prospective clients as well as general news in the market, so as to brief the senior bankers before they meet a client.

X and Y, on behalf of the Company, won a mandate (“**Project Waterloo**”) to act as an independent financial adviser of a listed company in Hong Kong (the “**Listco**”) in relation to the disposal of shares and assets of its subsidiaries in various jurisdictions to raise funds for the Listco. Knowing that the sale may result in a prospective rise of the share price of the Listco, X purchases some of its shares on his own account. In addition, a client of Y purchases 50,000 shares of the Listco through Y in the morning trading session. Shortly after the afternoon session started, Y suggests that his client buy a further single board lot of 2,000 Listco shares at four times the prevailing market price and the client agrees to do so. The price of the Listco shares rises four-fold as a result of the purchase. The client then sells the 50,000 shares for a profit.

Due to the expansion of the Company’s business, X, Y and Z intend to hire a legal adviser to advise them on the legislation applicable to the Company’s business and operations. If you are the legal adviser, please address and advise X, Y and Z on the following issues:

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

Questions:

- (a) **What are the regulatory procedures regarding the application of a licence under the Securities and Futures Ordinance which need to be put in place before the commencement of the Company's business of the abovementioned activities?**

(10 marks)

- (b) **How would your advice differ from (a) above if there is a team in the Company advising only overseas clients and who frequently travel overseas to meet with their clients? Are there any constraints on such practice?**

(5 marks)

- (c) **Would X's acquisition of shares of the Listco in Project Waterloo contravene any applicable law?**

(5 marks)

- (d) **Would the act of Y and his client relating to the purchase and sale of the shares of the Listco contravene any applicable law?**

(5 marks)

[25 marks in total]

Question 3 (25 marks)

Parklane Furniture Co. Ltd. (the “**Company**”) is a private company incorporated in Hong Kong in 2000 by Billy Chan (“**Billy**”) and his wife Betty Chan (“**Betty**”). Over the years, the Company has successfully grown into one of the best-known companies in Hong Kong in the furniture manufacturing business although Billy and Betty have not registered any trademark for the Company.

The Company started as a family company with Billy holding 80% of the issued shares and Betty holding the other 20%. They were also the only directors of the Company. In 2010, they admitted a new member, Peter Ho (“**Peter**”), to the Company. Peter joined the Company in 2003 and proved himself to be a competent and diligent employee. He was promoted to the position of general manager of the Company in 2008.

To reward his continuous contribution, Billy sold 30% of the issued shares in the Company to Peter and made him a shareholder and a director of the Company in September 2010. As a result of Peter’s involvement in the management, Betty resigned as a director.

The decision to invite Peter to join the Company turned out to be a mistake. Billy and Peter were unable to agree on many issues at the board level. The relationship between the Chans and Peter turned sour quickly. Billy and Betty finally offered to buy back Peter’s 30% shares in the Company in May 2012. Peter accepted the offer and ceased to be a member and director of the Company.

On 4 July 2012, Billy and Betty discovered that Peter had started his own furniture manufacturing business under the name of Partlane Furniture Co. Limited, a company incorporated in Hong Kong (“**Partlane**”). Peter also successfully solicits business for Partlane from the clients of the Company probably because they are unable to distinguish between Partlane and the Company.

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

A company search reveals that Partlane was incorporated on 1 July 2012 by Peter and his wife, Pamela Ho. Each of them is holding 50% of the issued capital and they are also the only directors of Partlane.

Question:

Both Billy and Betty find that the name “Partlane Furniture Co. Ltd.” is strikingly similar to the name of the Company (Parklane Furniture Co. Ltd.) and will inevitably confuse the public. At this stage, they do not wish to consider any legal proceedings against Partlane but they would like to know if there is any possible course of action under the Companies Ordinance that they may take to remedy the situation. You should fully explain your answers (including where applicable relevant legislative provisions and necessary steps involved).

(25 marks)

[25 marks in total]

Question 4 (25 marks)

Question 4(a)

“When a chargee appoints a receiver, the general rule is that self-interest prevails, so that neither it nor its receiver is required by the law to have any concern for the interests of the charger or the holder of a junior-ranking security.”

Question:

Discuss the extent to which you agree with this statement, with reference to the relevant legal principles.

(7 marks)

Question 4(b)

Emma Company Limited (“**ECL**”) is a Hong Kong incorporated company established in 2005 with Table A Articles. ECL is in the business of jewellery design and manufacturing. Andrew and Bonnie are the only directors and shareholders (50% each) of ECL.

ECL reported a significant operating loss in 2010/11. ECL has, over the years, borrowed from OLQE Bank (“**Bank**”) to finance its operation. After several rounds of negotiation, the Bank entered into a facility letter with ECL on 2 August 2011. The facilities comprised:

- Tranche A: a term loan facility of HK\$800,000 to refinance an outstanding loan of HK\$1,000,000 owing to Kowloon Bank Limited; and
- Tranche B: an overdraft facility of HK\$1,200,000 to finance ECL’s general working capital.

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

On 29 August 2011, ECL executed a debenture containing a floating charge over all of its assets and book debts in favour of the Bank (“**Debenture**”). According to the recital of the Debenture, as at the date of the Debenture, ECL was indebted to the Bank in the sum of HK\$1,000,000 under a separate facility letter dated 15 June 2008. The loan of HK\$1,000,000 was a three-year unsecured term loan facility provided by the Bank to ECL. The recital goes on to state that the Bank was agreeable to provide ECL with the additional HK\$2,000,000 facilities (under Tranche A and Tranche B as described above), subject to ECL executing the Debenture in the Bank’s favour. The Debenture was duly authorized, executed and registered.

Unfortunately, ECL has still failed to turn around the deficit despite the Bank’s facilities. The Bank appointed a receiver under the Debenture on 12 August 2012. A winding-up petition was presented against ECL by an unsecured creditor on 25 August 2012.

According to the Bank’s latest credit report, ECL’s main assets are book debts and the diamond-cutting machines. The book debts now stand at HK\$600,000. The current value of the machines is HK\$1,200,000. ECL owes its 15 employees a total of HK\$250,000 for arrears of wages. ECL has 20 other creditors, who are owed HK\$1,000,000 in total. Evidence shows that ECL was insolvent during August 2011.

The credit report also shows that on 5 January 2011, ECL borrowed a two-year term loan of HK\$200,000 from Catherine repayable in full on 5 January 2013. ECL made an early repayment of her loan (with interest) in full on 5 February 2012. Catherine is the sister-in-law of Andrew. In addition, on 5 January 2012, ECL made an early repayment of a \$300,000 term loan to Hayman Engineering Limited (“**HEL**”) 10 months earlier than the original maturity date. HEL’s sole director is ECL, and HEL’s sole shareholder is Bonnie.

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

Question:

Prepare a letter of advice to ECL's liquidator addressing the rights and priorities of all the creditors of ECL.

(18 marks)

[25 marks in total]

Question 5 (25 marks)

Billy Suen (“Suen”) is a client of your law firm. He is an entrepreneur and owns various companies engaged in the manufacture and sale of cooking equipment including cookers, fryers, ice-cream makers and liquidizers.

Suen has decided that the next stage of business development would be for these companies to be re-organised and listed on the Main Board of the Hong Kong Stock Exchange.

Some of Suen’s companies are very profitable but others are loss-making. That said, the profit of the whole group in the most recent year did exceed HK\$20 million, notwithstanding one company making fryers called Reliable Fryer-maker Limited lost nearly HK\$10 million in dealing in listed securities in the same period. On the other hand, the aggregate profit of the group in respect of the previous 2 years fell below HK\$30 million, even though Reliable Fryer-maker Limited profited from securities dealing in each of those 2 years.

In addition, some of these companies were founded and are wholly owned by Suen whilst others were acquired by Suen from third parties slightly over 2 years ago. That said, each of these companies has had the same management for 4 to 5 years.

Suen has also told your supervising partner earlier that the head office from which he commands the operations of all these companies is leased from his wife. He also sources all the electric motors with unique design for his ice-cream makers and liquidizers from a company owned by his brother.

Suen will attend the law firm in the morning.

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

Questions:

Given the above information, your supervising partner has asked you to prepare him a short memorandum to advise -

- (a) whether Suen's companies fit the criteria for listing on the Main Board of the Hong Kong Stock Exchange under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules") and, if not, is there an alternative to a Main Board listing under the Listing Rules for Suen's companies; and**

(13 marks)

- (b) whether the head office lease from Suen's wife and the supply of motors from the company owned by Suen's brother warrant special attention and/or treatment under the Listing Rules for Suen's companies to be listed on the Hong Kong Stock Exchange?**

(12 marks)

[25 marks in total]

END OF TEST PAPER