

**2014 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Friday, 7 November 2014



HEAD III: COMMERCIAL AND COMPANY LAW

TEST PAPER

7 November 2014

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.**

2014 Overseas Lawyers Qualification Examination
Head III: Commercial and Company Law

Question 1 (25 marks)

Answer the following questions:

Part A

- (a) **What is a collective investment scheme? What are the elements that constitute a collective investment scheme?**

(5 marks)

Part B

X and Y intend to set up a company in Hong Kong (the “**Company**”) to engage in asset management services to clients. They intend to provide asset management services to clients based overseas and in the People’s Republic of China only.

- (b) **In these circumstances, please advise X and Y if the Company is required to obtain a licence under the Securities and Futures Ordinance (“SFO”). If so, prepare a memorandum of advice for X and Y to advise on the regulatory procedures involved.**

(10 marks)

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

Part C

Z is a former colleague of X and Y and works in a company that provides corporate finance advice to listed companies. Z is a licensed person under the SFO. Z is working on a project relating to a potential takeover of a listed company (“**Company A**”) in Hong Kong by a conglomerate. Foreseeing that the price of shares in Company A will go up a lot if the takeover deal is announced, Z discloses such information to X and Y. X and Y acquire shares in Company A and also acquire shares for their clients before the takeover deal is announced to the public. When the takeover deal is announced, the share price of Company A increases by more than 50%. X, Y and the Company gain substantial profit from the acquisition of shares of Company A.

- (c) Would the acts of X, Y and Z contravene any provisions of any legislation? If so, which provisions, and what sanctions may be imposed against X, Y and Z?**

(10 marks)

[25 marks in total]

Question 2 (25 marks)

Answer the following questions:

Part A

Kitchenware Forte Limited ("**Company**"), a Hong Kong private company, manufactures kitchenware for sale in Hong Kong. On 9 March 2013, the Company entered into a three-year term loan facility (HK\$5,000,000) with Open Bank secured by a floating charge over all assets, book debts and undertakings of the Company ("**Open Bank Debenture**"). The Open Bank Debenture was duly registered under the Companies Ordinance.

The business of the Company was suffering due to fierce competition from a rival company, Kitchen Super Expert Limited. On 17 March 2014, in view of its cash flow problems, the Company borrowed HK\$2,000,000 (a three-year term loan facility) from City Bank secured by a fixed charge over all machinery in the Company's factory and other fixed assets of the Company ("**City Bank Fixed Charge**"). Due to an unfortunate administrative error, the City Bank Fixed Charge was not registered under the Companies Ordinance (Cap 622). Nothing was done to rectify this error.

The Company's business did not improve as its major manufacturing line was broken down for months, affecting overall production and sales. On 1 May 2014, in a final attempt to turn around its business, the Company raised further funding by entering into a three-year term loan facility (HK\$3,000,000) with Island Bank secured by a floating charge over all assets, book debts and undertakings of the Company ("**Island Bank Debenture**"). Soon afterwards, there were rumours that the Company had difficulties paying its suppliers on time.

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

The finances of the Company deteriorated further in June 2014. On 6 June 2014, Open Bank and Island Bank appointed receivers pursuant to their respective debentures (each being an event that crystallized the floating charge pursuant to the terms of the Open Bank Debenture and Island Bank Debenture respectively). On 7 July 2014, an unsecured creditor presented a winding-up petition against the Company.

According to the latest credit report (which was made available by City Bank around the time of the presentation of the winding-up petition), the Company has the following assets: (a) machinery (worth HK\$2,500,000); (b) other fixed assets (worth HK\$2,400,000); (c) account receivables (worth HK\$1,100,000); and (d) cash at bank (worth HK\$1,300,000).

The credit report reveals that the Company owes 30 of its employees a total of HK\$4,500,000 for wages in arrears. The credit report also shows that the Company has failed to pay profits tax (HK\$3,500,000) in the immediately preceding year. The Company has 15 trade creditors (mostly suppliers to the Company), who are owed HK\$2,300,000 in total.

Evidence shows that the Company was insolvent during April 2014. The Company made no early payment to the three banks (Open Bank, City Bank and Island Bank) in connection with the term loan facilities.

The credit report further reveals that on 5 June 2012, the Company borrowed a term loan of HK\$500,000 from Kitchenware Plus Limited (a wholly-owned subsidiary of the Company) (“**Subsidiary**”) repayable in full on 5 June 2015 (“**KPL Loan**”). The Company made an early repayment of the KPL Loan (with interest) in full to the Subsidiary on 5 June 2013.

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

For the purpose of this question, you are to assume there is no negative pledge clause in any of the debentures or charges.

Question:

- (a) Prepare a letter of advice to the Company’s liquidator addressing the rights and priorities of all the creditors of the Company.

(16 marks)

Part B

Jackpot Toys Limited (“JTL”) is a Hong Kong company specialising in the manufacturing of plastic toys for infants. JTL has for many years benefited from an overdraft facility provided by Jubilee Bank (“Bank”) with a pre-approved standby credit limit of up to HK\$1,000,000. In June 2010, it became apparent that JTL was experiencing cash flow problems. The Bank was willing to provide a further overdraft facility to JTL (with pre-approved standby credit limit of up to HK\$2,000,000) provided that some form of security is given. On 2 July 2010, JTL granted an “all-monies” floating charge over all of its assets, book debts and undertakings in favour of the Bank (“Debenture”) to secure the previously unsecured loan of HK\$1,000,000 and the new HK\$2,000,000 overdraft facility that was provided to JTL at the same time as the execution of the Debenture.

The table below shows movements of funds in JTL’s overdraft (“OD”) facility account with the Bank from 3 July 2010 onwards:

Date	Deposit (HK\$)	Withdrawal (HK\$)	Balance (HK\$)
3 July 2010			1,000,000 OD
7 February 2011		200,000	1,200,000 OD
9 January 2012	100,000		1,100,000 OD
17 April 2013		900,000	2,000,000 OD
7 March 2014	200,000		1,800,000 OD

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

On 17 May 2014, an unsecured creditor of JTL presented a winding-up petition against JTL.

Question:

- (b) **The Bank's in-house counsel is of the view that the previous unsecured loan of HK\$1,000,000 would remain unsecured as the loan was made available to JTL before the execution of the Debenture. You are the external counsel to the Bank. You are asked to confirm whether the view of the Bank's in-house counsel is correct and advise the Bank in relation to the extent of security under the Debenture.**

(9 marks)

[25 marks in total]

Question 3 (25 marks)

Answer the following questions:

Part A

Andrew is a property surveyor by profession. He is acquainted with Brian, chairman of Cherry Property Development Limited, a real estate development company whose securities are listed on the Hong Kong Stock Exchange. Brian has invited Andrew to be an independent non-executive director of Cherry Property Development Limited.

In his private capacity, Andrew is a keen investor of securities listed on the Hong Kong Stock Exchange (including those of Cherry Property Development Limited) and their derivatives.

Questions:

- (a) Andrew does not know if he would qualify to act as an independent non-executive director of Cherry Property Development Limited. **How would you determine whether Andrew is qualified or not?**

(2 marks)

- (b) Andrew is concerned that, as an independent non-executive director of a listed company, one has to perform extra duties or carry out extra tasks sitting on the board of directors of the company. **Clarify the position for Andrew.**

(3 marks)

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

- (c) Andrew has heard that, as an independent non-executive director of a listed company, there may be restrictions and filing requirements on him and his family in dealing in the securities of that company pursuant to the Listing Rules and the Securities and Futures Ordinance. **Set out in detail any restrictions and filing requirements to which Andrew and his family may be subject and the consequences of failing to observe them.**

(8 marks)

Part B

- (d) Private toy company, EFG Ltd., has recently designed and patented a new board game. To raise money for the mass production of the board game, the board of directors of EFG Ltd. intends to invite the public in Hong Kong to subscribe for shares in EFG Ltd. by putting an advertisement in the local newspapers. **Will this breach any Hong Kong laws and what will be the consequences and remedies?**

(12 marks)

[25 marks in total]

Question 4 (25 marks)

Answer the following questions:

Fantastic Limited (“**Fantastic**”) is a company incorporated in Hong Kong with limited liability and is engaged in, amongst other things, the business of garment manufacturing through its holding of 8% of the shares in Wonderful Limited (“**Wonderful**”), which is also a company incorporated in Hong Kong with limited liability.

Upon establishment of Wonderful, a shareholders’ agreement was signed amongst the 3 shareholders. The two other shareholders are holding 56% and 36%, with the remaining 8% held by Fantastic. The shareholders’ agreement contains a pre-emptive rights clause which allows the remaining shareholder(s) to purchase the interests of any outgoing shareholders under which a 2-month period is allowed for the remaining shareholder(s) to consider and exercise the pre-emptive rights.

Fantastic is negotiating a sale of its 8% interest in Wonderful. In the process of negotiation, Fantastic requires that the purchase price is to be paid upfront upon signing of the relevant agreement. The purchaser objected to this idea, and would prefer to pay only on completion, which is to occur at a time after signing.

Questions:

- (a) **List 3 areas and the corresponding method of confirming the information concerned that you would advise to be covered in a due diligence exercise concerning the good standing of Wonderful to be conducted by the purchaser.**

(3 marks)

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

- (b) List 5 of each of the (i) representations and warranties and (ii) the undertakings that are expected to be contained in a sale and purchase of shares agreement.**

(10 marks)

- (c) Make suggestions as to how to resolve the conflict between Fantastic (being the seller of shares) and the purchaser on timing of payment of the purchase price.**

(2 marks)

- (d) Identify the commercial conditions precedent to completion that may be required by each of (i) Fantastic and (ii) the purchaser in the sale and purchase agreement.**

(3 marks)

- (e) Identify the documents required at completion of the sale and purchase of the 8% interest in Wonderful.**

(7 marks)

[25 marks in total]

Question 5 (25 marks)

Answer the following questions:

For the purpose of this Question, you should:

- (1) assume that the Company (as defined below) adopts the Model Articles for Private Companies Limited by Shares set out in Schedule 2 to the Companies (Model Articles) Notice (Cap. 622H) as its articles of association.
- (2) fully explain your answers with reasons for each part (including where applicable the relevant legislative provisions and necessary steps involved).

Long River Company Ltd. (the “**Company**”) is a private company incorporated in Hong Kong in 2006 by Mr. and Mrs. Cho. Initially the couple were the only shareholders and directors of the Company which is engaged in the business of providing shipping and associated services between Hong Kong and Mainland China. The initial share capital of the Company was HK\$2,000,000. The total number of issued shares was 20,000 (each of Mr. and Mrs. Cho subscribed 10,000 shares at \$100 per share). All issued shares were fully paid up.

The Company performed quite well in the first two years after its incorporation. However during the financial crisis in 2008, it experienced serious cash flow problems. In order to keep the business of the Company afloat, Mr. and Mrs. Cho approached their uncle, Jimmy Cho, a wealthy businessman. Jimmy eventually invested HK\$3,000,000 in the Company by subscribing for 30,000 new shares (at the price of \$100 per share) in the Company. As a result, the issued share capital of the Company was increased to HK\$5,000,000. Jimmy became a 60% majority shareholder of the Company and Mr. and Mrs. Cho jointly hold the remaining 40%. Mr. and Mrs. Cho

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

remain the only directors of the Company as Jimmy was not interested in running the Company. During the period from 2009 to 2013, the Company was successful and Jimmy received handsome dividends. In July 2014, Jimmy transferred all his shares in the Company to his son, Jacky.

Soon after Jacky became the majority shareholder of the Company, he expressed his intention to be more involved in the management of the Company. In early July 2014, Jacky orally requested Mr. and Mrs. Cho (in their capacity as the directors of the Company) to convene an extraordinary general meeting of the Company (the “EGM”) to appoint, by way of ordinary resolution, himself and his wife, Jenny as additional directors of the Company. Mr. and Mrs. Cho did not proceed to convene the EGM as they were unwilling to share the management power with Jacky and Jenny.

Questions:

(a) Advise Jacky whether there is any mechanism under the Companies Ordinance Cap. 622 to enable him to convene the EGM in his capacity as a shareholder of the Company.

(6 marks)

(b) Mr. and Mrs. Cho eventually agreed to convene the EGM at the request of Jacky and the EGM is scheduled to take place on 11 November 2014 with a proposed ordinary resolution that Jacky and Jenny be appointed as additional directors of the Company. Would Jacky be able to pass the proposed resolution if both Mr. and Mrs. Cho attend the EGM and vote against the proposed resolution?

(8 marks)

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

(c) Jacky comes to be aware that Mr. and Mrs. Cho will not attend the EGM on 11 November 2014. If that is the case, advise Jacky:

(i) whether their absence will have any impact on the EGM.

(6 marks)

(ii) the steps that Jacky should take in order to enable him to pass the proposed resolution.

(5 marks)

[25 marks in total]

END OF TEST PAPER