

**2017 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Tuesday, 14 November 2017



2017 Overseas Lawyers Qualification Examination

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Question 1 (25 marks)

Part A

Adam is a director of a private company incorporated in Hong Kong and limited by shares. He tells you that lately he finds himself continuously at variance with other members of the board.

Questions:

- (a) What should he do under these circumstances and from whom (both within the company and externally) can he seek help?**

- (b) If he were to requisition a general meeting of the shareholders of the company, what technicalities are involved and what hurdles might he face in the requisitioning of such a general meeting?**

- (c) Should he resign as a director and what are the consequences?**

(13 marks)

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

Part B

X Holdings Limited (the "Purchaser"), a direct wholly-owned subsidiary of Y Holdings Limited ("Listco") whose issued shares are listed and traded on the Main Board of the Hong Kong Stock Exchange, is contemplating entering into an acquisition agreement with two individuals (the "Vendors") to acquire the entire issued shares of Z Limited (the "Target Company") and the aggregate amount of the loans due and owing by the Target Company to the Vendors (in their capacity as shareholders and directors of the Target Company) at the initial consideration of HK\$255,000,000 (subject to adjustment).

The Vendors are Mr. Lee (an executive director of Listco) and Mr. Chan (a past director of Listco who retired 7 months ago). Mr. Lee has 40% of the voting control of Listco, whilst Mr. Chan has 30% of the voting control of Listco. As regards the acquisition, the highest applicable percentage ratio under Rule 14.07 of the Listing Rules is more than 5% but less than 25%.

The Target Company, a company incorporated in Hong Kong also with limited liability, owns the entire building known as XYZ Group Centre situated in Kwun Tong (the "Property"). The Target Company does not have any business other than the holding of the Property. The Property is free of mortgage.

Question:

- (d) **Given the above facts, what are the Listing Rules implications for the acquisition? Can the acquisition take place immediately upon the signing of the acquisition agreement? If not, why not and how should the acquisition agreement be structured and what kind of conditions precedent would one expect to be in that agreement?**

(12 marks)

[25 marks in total]

Question 2 (25 marks)

Cromwell Elite Toy Limited ("Company"), a Hong Kong company, is a leading plastic toy distributor in Hong Kong. Matthew Hope and Lawrence Baker are the directors and shareholders of the Company. The Company banks with Grand Bank Limited ("Grand Bank") and Bail-Out Bank Limited ("Bail-Out Bank"), both of which are Hong Kong licensed banks. The Company relied heavily on the shareholders' loans provided by Lawrence Baker (HK\$10,000,000 in total) and Matthew Hope (HK\$5,000,000 in total).

The Company's business suffered as mobile games became very popular among Hong Kong children. Parents were buying less plastic toys. The Company was in desperate need of capital to develop new types of toys to win back the market. On 24 February 2017, Grand Bank provided a HK\$5,000,000 3-year term loan facility to the Company secured by a charge over the Company's book debts. In the debenture that documents this charge, there is clear provision that prohibits the assignment of the Company's book debts without the prior written consent of Grand Bank. Proceeds of the collected book debts must be paid into a separate designated bank account maintained with Grand Bank. Grand Bank is of the view that this is clearly a fixed charge over the book debts, as Grand Bank has control over both the uncollected book debts and the proceeds of the collected book debts.

On 21 April 2017, the Company sold a warehouse in Fanling ("Warehouse") to Julia Hope, wife of Matthew Hope. The consideration was HK\$3,000,000, which was HK\$2,000,000 lower than the market value of the Warehouse (as valued by an independent valuation in April 2017). Matthew said this is justified as Julia had contributed a lot to the success of the Company. He sees this as a legitimate reward for Julia.

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

On 24 April 2017, the Company granted an "all-monies" floating charge over all of its assets, book debts and undertakings in favour of Lawrence Baker to secure all personal loans provided by Lawrence Baker to the Company.

It was revealed that Bail-Out Bank has for many years provided an overdraft facility to the Company with a pre-approved standby credit limit of up to HK\$2,000,000. Bail-Out Bank provided a further overdraft facility to the Company (with pre-approved standby credit limit of up to HK\$3,000,000) provided that some form of security is given. On 21 February 2017, the Company granted an "all-monies" floating charge over all of its assets, book debts and undertakings in favour of Bail-Out Bank ("Bail-Out Bank Debenture") to secure the previously unsecured loan of HK\$2,000,000 and the new HK\$3,000,000 overdraft facility that was provided to the Company at the same time as the execution of the Bail-Out Bank Debenture. The table below shows movements of funds in the Company's overdraft ("OD") facility account with Bail-Out Bank from 22 February 2017 onwards:

Date	Deposit (HK\$)	Withdrawal (HK\$)	Balance (HK\$)
22 February 2017			2,000,000 OD
11 March 2017		400,000	2,400,000 OD
19 March 2017	1,000,000		1,400,000 OD
8 April 2017		1,100,000	2,500,000 OD
21 April 2017		700,000	3,200,000 OD
1 August 2017	300,000		2,900,000 OD

On 2 August 2017, the business of the Company suffered a fatal blow as a fire broke out in the warehouse in Tsuen Wan. On 4 August 2017, Bail-Out Bank appointed a receiver in accordance with its debenture (an event that crystallized the Bail-Out Bank Debenture).

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

On 15 August 2017, a trade creditor filed with the court a petition to wind up the Company.

The liquidator, Teddy Young, has learned the following information:

- (i) The Company has the following assets: book debts (worth HK\$3,000,000), inventory (worth HK\$2,500,000), delivery trucks (worth HK\$500,000) and cash at bank (worth HK\$200,000).
- (ii) The Company owes 10 employees a total of HK\$4,000,000 for wages in arrears.
- (iii) The Company has 3 unsecured trade creditors, who are owed HK\$2,000,000 in total.
- (iv) Evidence shows that the Company was insolvent and unable to pay its debts during April 2017.

The Company made no early repayment to Grand Bank in connection with the term loan facility.

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

Question:

You act for the Company's liquidator, Teddy Young, who has drawn your attention to all of the above points. **Prepare a letter of advice to the liquidator, addressing the rights and priorities of all the creditors of the Company.**

(25 marks)

[25 marks in total]

Question 3 (25 marks)

Grand Resources Holdings Limited (the "Company") is a private company incorporated in Hong Kong in 2012 with an issued share capital comprising 10,000 shares. The Company is engaged in the business of property development on the Mainland. It has four members, three of whom are also directors. The respective shareholding and directorship of each member are set out below.

Mr. A (also a director)	3,000 shares
Mr. B (also a director)	3,000 shares
Mr. C (also a director)	3,000 shares
Mr. D	1,000 shares

Article 16 of the articles of association of the Company provides:

"The Directors may at any time in their absolute discretion and without assigning any reason therefor, decline to register any transfer of any share in the Company..."

Question:

- (a) In early 2017, Mr. D agreed to sell his 1,000 shares in the Company to Mr. E (an outsider) for HK\$10 million. Mr. E is eager to replace Mr. D as a member of the Company as soon as possible, but he does not understand what steps and procedures that should be taken in order to give effect to the transfer of the shares and to enable him to become a member of the Company. **Advise Mr. E on these steps and procedures.**

(10 marks)

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

On 15 April 2017, Mr. E's solicitors (Fu & Co.) issued a letter to the Company on the following terms:

"...Mr. D is currently holding 1,000 shares in the Company (the "Shares") and he intends to transfer the Shares to our client (Mr. E) at the price of HK\$10,000,000. Accordingly, Mr. D and our client hereby jointly request the Board of the Company to confirm in writing within two months from the date hereof whether the Board agrees that the Shares be registered in our client's name after the transfer is duly completed.

If the Board agrees to the proposed transfer, we shall arrange for the execution of the relevant transfer documents by Mr. D and our client and submit the duly executed documents to the Company for registration in due course"

The Company did not respond to Fu & Co. until 8 July 2017. In its written reply, the Company stated that:

"Please be informed that the Board of Directors of the Company held a Board meeting on 4 July 2017 to discuss the transfer of 1,000 shares from Mr. D to your client. The Board came up with an unanimous decision that the Company would refuse to register such a transfer...."

On 11 July 2017, Fu & Co. wrote to the Company to request for a statement of reasons for the refusal and demanded that the statement be furnished within 28 days. The Company did not respond to this request.

On 4 September 2017, Fu & Co. made an application to the court pursuant to section 152 of the Companies Ordinance (Cap. 622) for an order to compel the Company to register the transfer of the 1,000 shares from Mr. D to Mr. E.

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

Questions:

(b) Advise the Company the possible legal basis of the application.

(8 marks)

(c) Advise the Company whether it has any ground to resist the application made by Fu & Co.

(7 marks)

[25 marks in total]

Question 4 (25 marks)

Part A

Andrew is a good friend of Billy. Billy is a senior finance manager of ITC Limited. ITC Limited is a controlling shareholder of ABC Limited which is a listed company. ITC Limited intends to privatise the shares of ABC Limited. Billy was involved in this privatisation proposal. He informed Andrew of ABC's privatisation proposal and procured him to trade in shares of ABC Limited. The share price of ABC Limited rose by about 20% on the day after the privatisation was announced. Andrew sold the shares of ABC Limited and obtained a substantial amount of profit.

Question:

- (a) **What are Andrew's and Billy's liabilities under Part XIII of the Securities & Futures Ordinance, Cap.571?**

(13 marks)

Part B

Alan and Tim have recently set up a new company (the "Company") which is incorporated in Hong Kong and intends to carry out the business of advising clients on securities trading and providing advice on securities services. Alan and Tim will be involved in the day-to-day management of the Company. They intend to be the directors and shareholders of the Company. The Company intends to mainly serve clients in and outside Hong Kong as they are optimistic about the economic development of the Asia Pacific region.

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

Alan and Tim want to know about the legislation procedure and licensing requirements.

Question:

- (b) Prepare a memorandum of advice for Alan and Tim to advise on the regulatory procedures involved.**

(12 marks)

[25 marks in total]

Question 5 (25 marks)

Part A

Sally owns 100% of the shares in Quality Meats (Hong Kong) Limited ("Quality Meats").

Quality Meats has two lines of business. The first line (the "Meat Business") is the importation of meat and seafood products from Japan and Australia for supply to restaurant chains in Hong Kong. Quality Meats has recently won a long-term supply contract with a major hotel chain operating in Hong Kong. The second line (the "Pet Business") is the importation of pet foods and accessories from Australia for sale in the Hong Kong market. Both businesses are supported by 10 head office staff operating from leased premises in Aberdeen. In addition, the Pet Business has two leased retail outlets in Kennedy Town and Wanchai.

As a result of the new long-term supply contract in respect of the Meat Business, Sally wishes to devote her time and attention to this. She wishes to sell the Pet Business and has started reorganising her operations (the "Reorganisation"). She set up a separate limited liability company called Pet Supplies Limited ("Pet Supplies"), which is a wholly-owned subsidiary of Quality Meats. In August 2017, Sally transferred the Pet Business and all assets in the Pet Business to Pet Supplies and transferred all relevant contracts to Pet Supplies other than the leases in respect of the two retail outlets. She has not yet transferred any employees to Pet Supplies as she wants to ensure that a binding sale and purchase agreement is in place before informing employees of a pending sale. However, Sally is confident that all relevant employees (who comprise all the employees at the retail outlets and three of the head office staff) will move over to Pet Supplies once a sale has been agreed.

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

Jane is interested in buying Pet Supplies and has completed a due diligence exercise. In this regard, Sally relied very heavily on her financial controller, Adrian, to provide all relevant information to Jane and in doing so, Adrian has put in long hours outside of normal business hours. It is intended that Adrian will transfer to Pet Supplies.

Quality Meats and Jane have entered into a non-binding memorandum of understanding setting out the main terms of the proposed transaction. The main terms include the following:

- completion is due to take place within one month of signing a binding sale and purchase agreement in order to allow offers of employment to be made to and accepted by the relevant transferring employees
- consideration of HK\$3,250,000 is to be paid on completion. A further payment of consideration will be made in February 2018, the amount of which will be calculated based on the profit made by the Pet Business for the financial year ended 31 December 2017
- Quality Meats and Jane agree that Adrian will continue to be employed by Pet Supplies for at least one year following completion (and in this regard, note that Sally is keen on him remaining in the position as financial controller for Pet Supplies, both out of reasons of loyalty and in order for Adrian to be able to monitor the financial position and verify further consideration payable)
- the sale and purchase agreement will contain customary warranties and limitations
- the retail outlets will transfer to Pet Supplies, however, Jane will lease a small office to accommodate the head office employees transferring.

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

Sally's solicitors have prepared a draft sale and purchase agreement consistent with the above points. The only parties to this agreement are Quality Meats as seller and Jane as buyer. Adrian has also entered into an employment agreement with Pet Supplies, which is terminable by either party on three months' notice.

Jane has come to ask for your advice. However, she has a limited budget and does not want you to go into too much detail on the basis that the memorandum of understanding has been signed, the main commercial points have been agreed and that she would like this to be a very simple and quick deal.

Questions:

- (a) Advise Jane on four main seller protection limitations that she could expect to see in the sale and purchase agreement which would give the seller, Quality Meats, protection in respect of the warranties which the seller is giving.**

(4 marks)

- (b) Advise Jane on the two main conditions precedent which she should insist are included in the sale and purchase agreement.**

(2 marks)

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

Part B

It is now April 2018. Completion proceeded smoothly at the end of September 2017, and Jane was appointed as the sole director of Pet Supplies with effect from completion. Under the sale and purchase agreement, an additional HK\$200,000 consideration became payable. In order to finance this, Pet Supplies took out a bank loan of that amount and paid it to Quality Meats in February 2018. Apart from Pet Supplies signing the loan agreement, no further procedures were undertaken.

Quality Meats had a major problem under its supply agreement with the major hotel chain. As a result, the supply agreement was terminated and Quality Meats became insolvent and ceased trading.

After the additional consideration had been paid, Jane felt that Adrian was not working well and arranged for Pet Supplies to give him three months' notice of termination in accordance with the terms of his employment contract. The notice period is due to expire at the end of April 2018. Adrian is very upset about receiving notice of termination of his employment contract. He believes that Jane should honour the commitment in the sale and purchase agreement that he would be retained for at least 12 months following completion. As such, he is looking to claim damages in the amount of HK\$300,000 which is the salary he would have received for the period between the end of April 2018 and the end of September 2018 (being the anniversary of completion).

Pet Supplies has also recently received notice from a former supplier, Kwai Chung Wholesale Limited, that a number of invoices (from July 2017) totalling HK\$400,000 have not been paid. The original debtor under these invoices is Quality Meats, and the relevant products were supplied to the Pet Business. These are valid unpaid invoices.

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

Questions:

- (c) **Is Pet Supplies liable to Adrian for the HK\$300,000 claimed? Is Jane liable? Is Quality Meats liable? Provide reasoning.**

(6 marks)

- (d) **Explain whether Pet Supplies is liable to Kwai Chung Wholesale Limited for the HK\$400,000 claimed. What steps, if any, could have been taken at or around the time of the Reorganisation to prevent a claim like this? If Pet Supplies is liable, does it have any recourse?**

(9 marks)

- (e) **Explain, with reasoning, if it was lawful for Pet Supplies to make the second payment of consideration using the proceeds of the bank loan. What are the possible consequences for Jane?**

(4 marks)

[25 marks in total]

END OF TEST PAPER