

**PCLL Conversion Examination
January 2011
Examiner's Comments
Business Associations**

Overall Comments

1. Overall the candidates performed satisfactorily in the exam and showed average understanding of the applicable substantive/academic legal principles and the ability to apply them to the relevant facts in the questions.
2. Relatively few candidates chose to answer Questions 1 (on partnership/partners liability) and 5 (on minority shareholders' reliefs).
3. Candidates did not perform well in answering the relatively more straightforward Question 3 on winding up.
4. It should be noted that quite a number of candidates had given very similar answers, in particularly answers to Question 2, and had made similar mistakes to Question 3(a). They could have been reading from the same source and/or preparing the exam with same reading materials

Question 1

5. Questions 1 tests the general knowledge of the candidates regarding partnership/partners' liability to third parties and among themselves. Quite a number of candidates merely recited sections of the Partnership Ordinance and laws on partnership (beyond liability of partners and partnership) without applying the relevant principles to the facts given.
6. In relation to the misappropriated funds, Y would be liable to X and Z as they owe fiduciary duties to each other. Relevant authorities include Kao Lee &

Yip v Koo Hoi Yan [2003] 2 HKC 113 and Section 31 of the Partnership Ordinance.

7. As to their clients or outsiders, the liability of Y and Z is covered under Section 13(b) of the Partnership Ordinance. Liability of the firm under Section 13(b) applies regardless of whether the wrongful conduct was authorized by the other partners or irrespective of whether the wrongful conduct was authorized by the other partners or the partnership. See Hebei Enterprises Ltd v Livisari & ORS [2008] HKEC 1164 (CFA). And the candidates should also discuss Section 14 of the Partnership Ordinance.
8. About the purchase of the flat, candidates should refer to and discuss Section 7 of the Partnership Ordinance and the issue of apparent or ostensible authority. Section 7 of the Partnership Ordinance also states that a partner can bind the partnership to any act done in the usual way of business of the kind carried on by the partnership. In this case, the candidates should consider whether buying of the residential flat clearly was an act done in the usual way of the business of a law firm.
9. In relation to the flat, Section 11 of the Partnership Ordinance is also relevant.

Question 2

10. Candidates did very well on this question and showed good understanding of the relevant legal principles.
11. In relation to the 1st EGM, the candidates should spot the defect in notice, which cannot be cured by Section 114(3) and/or Section 116B of CO.
12. However, the defect maybe rectified easily by A and B re-serving a proper notice, and at that new meeting, the same resolutions can be passed.

13. The principles in *Foss v Harbottle* should be discussed. Candidates may also argue that since C was at the meeting, he might have consented to the short notice.
14. As to the 2nd EGM, the refusal of C to attend the meeting rendering it inquorate should be raised. Candidates should be able to resolve the deadlock by suggesting the addition of shareholders by the existing shareholders (and to point out that there was no preemption clause).
15. Candidates should suggest A and B to apply to the court for a court-ordered meeting under Section 114B CO.

Question 3

16. For Part (1), astoundingly quite a number of candidates gave grounds of petition for winding up instead of general grounds of opposition. A lot of marks were hence lost. However, most candidates did better on Part 2.
17. The usual grounds of opposition are:
 - (i) defect in form or service of SD and/or Petition;
 - (ii) disputed liability;
 - (iii) challenged quantum;
 - (iv) Set off/counterclaim;
 - (v) restructuring feasible; and

- (vi) abuse of process (i.e. petition was for some improper or ulterior motives)
18. The candidates should identify the principle that a dispute on the debt must be bona fide and on substantial grounds, and the burden is on the company to satisfy the court.
19. In this case ABC is likely to challenge liability as well as quantum (as evident by the pre-action exchange of correspondences between the parties). It is also possible to challenge the petition on the ground of abuse of process, that the petition was laced with ulterior motives.
20. ABC may also simply ask for time from the Court to make payments owed to LMN, as it is expected that a large payment from a customer would be received within 4 months.
21. Candidates should advise of the requirement to reply within 21 days of the statutory demand.

Question 4

22. Question 4 involves mainly fiduciary duties of directors and breaches thereof. Part (a) has not been answered well as a number of candidates failed to understand the question and discuss minority reliefs in length here. However, they fared better in Parts (b) and (c).
23. As with Part (a), the issue here is whether B, C, D and E have breached their fiduciary duties as directors in allotting the shares. Specifically, the candidates should discuss whether they acted in good faith for the benefit of the company and exercised powers for proper purposes. Issuing shares for the purpose of diluting shareholders' shareholding is an improper exercise of the

power to issue shares. However ratification of directors' breach of duty is possible.

24. As with Part (b), the candidates must be able to identify the issue that directors must not profit from their position as director, and whether B took advantage of the contract for himself to earn a profit. The mere fact that the company could not have itself benefited from the business opportunity is irrelevant. The candidate should understand that the safest course for B would be to disclose to the other shareholders at the general meeting.
25. As with Part (c), once again the director must disclose his interest in the transaction to the general meeting if there is potentially a conflict of interest. Even though the contract may be for the benefit of the company, there could still be a breach of the no conflict rule.
26. The candidates should be able to understand the effect of failure to disclose will be that the transaction can be rendered voidable at the election of the company, however, ONLY if the other contracting party had knowledge of the facts giving rise to C's breach.
27. Section 162 of the Companies Ordinance should also be discussed. However, candidates should be aware that the section only covers contract involving the company as a party.

Question 5

28. This is a relatively straightforward question on minority protection and reliefs, if the candidates could identify the issues and matters involved. Only a handful of candidates chose to answer this question.

29. The candidates should discuss both common law and statutory derivative actions (Section 166BB), as well as the relief under Section 168A of the Companies Ordinance.
30. Facts given should be analyzed in accordance with the respective legal principles under said reliefs.