

**PCLL Conversion Examination**  
**June 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. It is worthwhile to note that with the change from choosing 3 out of 5 questions to 3 out of 4 questions, the number of candidates that appeared to have run out of time at the end of the exam had reduced. Apparently, time was saved from not have to read the 5<sup>th</sup> question, together with less time spent on deciding which questions to answer.
3. Rather surprisingly, most candidates who chose to answer Question 3 did not perform well in relation to part (A) (a straightforward “corporate veil” question). It could be the result of predicting questions before the exam by candidates, a practice that should be avoided. Candidates should try to be well-versed with all the topics listed in the exam syllabus.

*Question 1*

4. Candidates generally did well on Part (a) in setting out the advantages and disadvantages in forming a limited company versus a partnership. Under the facts of the case, a limited company should be a more appropriate business vehicle, as Tim and John were unable to contribute much funds to the business, they should consider a limited company that could create floating charges as financing. Moreover, it is anticipated that the business would be

risky, and the product liability issue that should be a concern. Having said that, the best answer would be to form a partnership first to take advantage of the tax position (i.e. allowing John to offset the initial losses against the income from his full time job) and to convert the partnership later into a limited company.

5. Part (b) is also straightforward. Bob may participate either as a lender or a partner, basically depending on whether he wishes to participate in management of the business. His contribution would be treated different in the event of dissolution of the partnership. In relation to Tim, candidates should seek further information such as whether his house will be used exclusively for partnership purposes. There are different treatment to partnership properties and non-partnership properties upon winding up of a partnership or bankruptcy of individual partners.
6. For Part (c) the starting point is Section 11 of the Partnership Ordinance on partners' liability. The principles in *Khan v Miah* [2000] 1 WLR 2123 should be discussed, as to whether the parties intended to operate their business as a partnership, and the test whether there were significant steps taken by the parties to conduct the business. Candidates should be able to argue that the purchases by John in this case will likely be construed by the Court as a significant step done with a view of ultimate profits as intended for the partnership.

### *Question 2*

7. Candidates generally did not do very well on this question, and showed a lack of understanding in the relevant legal principles.

8. In relation to Part (a), Section 23, in particular the new Subsection (1A), of the Companies Ordinance should be discussed. Under the section, the articles of a company operate as a contract between the company and the members and the between members inter se. As such members apparently can enforce the articles against the company. In this case however, Horace may not enforce Clause 7 against the company even as a member since his termination is not a matter pertaining to the membership. The case of Eley v Positive Life Assurance Co. Ltd should be discussed.
  
9. As with Part (b), the basic rule is that the power to alter company's articles is subject to the general principles of law and equity applicable to all powers conferred on majorities and enabling them to bind minorities, and that the power must be exercised bona fide for the benefit of the company as a whole. The candidates should then identify the company's interest in the case and whether the new Clause 8 appears to benefit the company. It is significant to point out that "benefit of the company" has been defined as "benefit or interests of the shareholders as a whole" (Greenhalgh v. Ardenne Cinemas Ltd), and it would be necessary to examine what would be in the interest of the hypothetical shareholder in the company. The conclusion is that the new Clause 8 does not benefit the company as the hypothetical shareholder who wants to sell is placed at a disadvantageous position.

### *Question 3*

10. As mentioned above, Part (A) involves the issue of "corporate veil". Numerous candidates mistakenly treated it as a winding up question. Under the facts, it can be argued that the setting up of Blue Taxi was set up to evade liability of Yellow Cabs. More instructions would be required to ascertain the true motives. Candidates should be able to distinguish setting up a company

to avoid future liabilities and one to evade existing liabilities. (See *Liu Hon Ying v. Hua Xin State Enterprises (Hong Kong) Ltd.*)

11. Most candidates did well on Part (B). They are expected to address the “no-conflict” rule, and consider specifically issues such as conflict of interest, loans to directors, carrying on business in competition with the company, using corporate properties etc.

#### *Question 4*

12. Question 4 primarily involves Section 168A Companies Ordinance, and the candidates should then analyze the facts given and argue how they may support the Section 168A petition.
13. Candidates should mention that usually the minority’s shares would be bought out by the majority in a case such as the present one, instead of the company being wound up. Mediation should be raised under Practice Direction 3.4H(16).
14. Credit would also be given for discussion of the procedural aspects of the petition, i.e. filing of a petition supported by a verifying affirmation. Also credits would be given to candidates who discussed other possible remedies such as a derivative action under common law and statute (Part IV AA of the Companies Ordinance), and actions against B, C and D for breach of fiduciary duties etc.
15. Facts that support the petition in this case would be:
  - (a) A is a minority shareholder.

- (b) KWL was initially run as if it was a partnership based on mutual trust and confidence.
- (c) Exclusion of A from management.
- (d) No notice given to A for the Board meeting.
- (e) A was denied access to company's books and accounts.
- (f) A's shareholding diluted.