

PCLL CONVERSION EXAMINATION JANAUARY 2011

Title of Paper : Business Associations
Date : 7 January 2011
Time : 9:30 a.m. – 9.45 a.m. (Reading Time)
9:45 a.m. – 12:45 p.m.

Instructions

1. Write your **candidate number** on the cover of each answer book. Do **NOT** write your name in the answer book.
2. Start each answer on a separate page of the answer book.
3. Write your answers only in the answer books provided.
4. This is a three-hour examination.
5. This is an open book examination.
6. Reading time for this paper is 15 minutes. Do **NOT** begin writing in your answer books during this period until you are instructed to do so.
7. This paper consists of 5 pages, including five questions. Candidates are required to answer **THREE** questions out of five. A total of 300 marks may be awarded.
8. Each question is worth 100 marks.
9. The passing mark for this paper is 150 marks.

**DO NOT OPEN THIS QUESTION BOOK
UNTIL YOU ARE TOLD TO DO SO**

PCLL Conversion Examination January 2011

Business Associations

Question 1 (100 marks)

X, Y and Z are partners in a law firm called XYZ & Associates. In an annual auditing exercise recently, it was discovered that HK\$5m was missing from the firm's trust account established to hold clients' funds. Further investigation showed that Y had been systematically stealing clients' money from the firm's trust account since last year. X and Z were not involved in the misappropriation.

Some clients have already commenced legal proceedings against X, Y and Z.

Furthermore, it was discovered that Y had purchased a residential flat as an investment property without the authority of X and Z, and with the partnership's funds.

Since the misappropriated funds and flat had been subsequently lost, so that no proprietary claims is available, and the only resort possible by the clients would be to go after X, Y and/or Z personally.

Advise X and Z as to their position and potential liability. Please focus your answer on partnership law principles rather than laws dealing with solicitors' duties to clients.

Question 2 (100 marks)

Octagon Ltd has 3 shareholders, A (40%), B (30%) and C(30%) who are also the only directors in the company. Table A is not adopted, and the company's articles do not contain any preemption clause. The following provisions in the Articles are relevant to this question:

- (1) The directors may, in their absolute discretion and without assigning any reason therefore, approve or refuse to approve any transfer of any share, whether or not it is a fully paid share.
- (2) No business shall be transacted at any general meeting unless a quorum of members is present. 3 members present in person or by proxy shall be a quorum.
- (3) The company may from time to time by ordinary resolution increase the share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe.

- (4) The Company may, by ordinary resolution, increase the number of directors.
- (5) Subject to Reg. (6) below, the quorum necessary for the meetings of the board of directors shall be 3.
- (6) If within 30 minutes of the time appointed for a meeting of the board of directors a quorum is not present, the meeting shall stand adjourned until the same time and place on the same day in the next week. At the adjourned meeting if a quorum is not present within 30 minutes from the time appointed for the meeting any 2 directors present in person or by their alternates shall constitute a quorum for that meeting.

Disputes arose between the shareholders, with A and B on one camp while C on the other. A and B, in a recent board meeting, passed a resolution for an EGM to pass the ordinary resolutions to (i) increase the share capital from HK\$1m to HK\$5m; and (ii) to authorize the allotment of the new shares to all existing shareholders on a pro rata basis, failing which, the allotment shall be made to those existing shareholders who are willing to subscribe for all the new shares (“1st EGM”).

C (who cannot financially afford subscribing any new shares) voted against the resolution. He was outvoted by A and B. However, it turned out that the notice for the 1st EGM was insufficiently given (less than 14 days for the notice period).

A and B intend to convene another EGM to pass an ordinary resolution to increase the number of directors from 3 to 5. The number of directors is not fixed in the Company’s Articles. A and B expected that C will refuse to attend the EGM to inquorate the meeting (the 2nd EGM”).

Advise A and B as to the validity of the resolutions passed at the 1st EGM and how they can validly convene the 2nd EGM and pass the proposed resolution without the presence of C.

Question 3 (100 marks)

A statutory demand was served on ABC Limited 2 weeks ago by one of its trade creditors and suppliers, LMN Ltd. Prior to that, there had been exchange of correspondences between the parties on the quantum of the LMN’s claims and statement of accounts were sent and received. ABC also believes that it may be able to challenge LMN’s claim on the basis that the goods supplied by LMN were defective. ABC is also of the view that LMN is trying to

pressure ABC into paying LMN's claims by serving the statutory demand.

ABC also informed you that it probably will receive a large payment from a customer in about 4 months.

Advise and explain to ABC as to the general grounds of opposition (**30 marks**) in a possible winding up petition of ABC to be presented by LMN, and the specific action or grounds (**70 marks**), if any, that it may take or rely on under the given facts.

Question 4 (100 marks)

A, B, C, D and E are all shareholders in Petro Ltd, a medium-sized private company importing oil and petroleum products and owning several gas stations. However, only B, C and D are directors of the company (the Board comprises of 3 directors only). The respective shareholdings of the shareholders are as follows:

- A 30%
- B 20%
- C 20%
- D 20%
- E 10%

- (a) A major petro company is negotiating with A to purchase his entire shareholding. The directors B, C and D were concerned with a possible takeover and therefore, using Section 57B of the Companies Ordinance at the previous AGM of the company, and allotted shares to F diluting A's shareholding to 24%. A contested the allotment, but at a recent EGM with B, C, D, E and F all voting in favour of ratification, the meeting ratified the allotment (A dissenting). **(30 marks)**
- (b) The company was recently negotiating for a valuable contract with a major international shipping line to provide services to the company, but the negotiation was put on hold because the company had insufficient funds to set up the necessary shore facilities. B then managed to secure the contract for himself. **(30 marks)**
- (c) C, who has a degree in petroleum engineering and is the only one of the directors expert in the business, persuaded the company to buy the bulk of its supplies from a company of which he is also a director. **(40 marks)**

Advise A in relation to all three matters above.

Question 5 (100 marks)

Premier Realty Ltd (“Premier”) was incorporated in Hong Kong over twenty years ago by 3 businessmen who are close family friends-Chan, Tam and Lee. Together with their wives, 6 of them own the entire shares of Premier in equal percentage. The three men all contributed by working at the company over the years and were the only directors since Premier’s incorporation. Premier carries on a business as a property agent and was successful in a modest way. The greater part of the profits had been taken out as director’s remuneration and the balance was left in the company for future development.

Since Mr. Chan’s death in 2010, disputes arose among the shareholders. His shares are now under the name of Mrs. Chan. At the recent AGM of Premier the two remaining directors Tam and Lee indicated that they intended to follow the previous policy of not paying any dividend and this was accepted by the meeting (with Mrs. Chan dissenting). At the same meeting the members (Mrs. Chan dissenting) agreed to increase the directors’ remuneration for the remaining two directors.

In the same meeting, a resolution was passed approving an issue of 12,000 shares pro rata to the existing shareholders at par value. Mrs. Chan’s financial position did not permit her to take up this offer and even if she had the money she would be unwilling to invest further in the company of which she has neither control nor opportunity to participate in its management. She was also suspicious that the purpose of the issue of shares is to dilute her shareholding.

Mrs. Chan has since been denied access to the books of the company. She has always been relying on her husband’s remuneration as a director as the main source of income. Since the said source of income had ceased, she has difficulties in providing and supporting her children’s education and other expenses.

The articles of Premier require an outgoing member to offer her shares to the directors of the company at a price fixed by the directors.

Advise Mrs. Chan as to what, if anything, she can do to extract some money from the company, preferably without having to sell her shares.

~ End of Examination Paper ~