

PCLL Conversion Examination July 2008

Title of Paper : Business Associations
Date : 30 June 2008
Time : 2:30p.m. – 2:45a.m. (Reading Time)
2:45a.m. – 5:45p.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 3 pages, including five questions. Candidates are only required to answer any **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 July 2008

Business Associations

Question 1

Civil Engineers Ltd ('CEL') was incorporated in Hong Kong as private company in 1990. CEL's articles of association are in the form of Table A of the First Schedule to the Companies Ordinance (Cap 32). CEL's business is in the area of drainage consultancy.

After incorporation CEL had 3 shareholders and directors: Luk, Chan and Ho, each of whom held 10 shares in CEL. In 1995, Yeung was also appointed as a director and 10 shares in CEL were issued to Yeung. At all relevant times, prior to April 2008, Gammon HK was the single largest client of CEL and accounted for roughly 30% of CEL's business.

In 1999 CEL hired Zoe as a senior manager. In 2001, because Zoe was doing such a good job for CEL, Zoe was appointed as a director and 5 shares in CEL were issued to Zoe.

However, over the last few years, CEL has been trading at a loss. This has caused considerable tension amongst the directors. After a heated argument, on 31st March 2008, Luk resigned as a director of CEL with immediate effect. Luk has since started his own drainage consultancy business.

In early May 2008, Zoe made it known that she wanted to be made an equal shareholder in CEL, otherwise she might start looking for a new position with another firm. Chan and Ho were willing to accept Zoe's demand. Yeung, however, believes that Zoe's behaviour is unreasonable and he is not willing to give in to her demand. Recently, Chan and Ho have informed Yeung that they intend to convene a shareholders' meeting at the end of next month to vote on whether additional shares should be issued to Zoe.

Yeung has recently instructed your firm of solicitors. Yeung has also informed you that, since Luk's resignation, CEL has not received any new business from Gammon HK but that last week a \$3 million contract ('the Gammon contract') was awarded to Luk by Gammon HK. The Gammon HK contract was a new contract and was not known about by the industry until late April 2008.

Your senior partner has asked you to write a memorandum advising her as to: (i) Yeung's remedies, if any, in relation to the proposed issue of additional shares to Zoe; and (ii) whether CEL has any remedy against Luk in relation to any profit that Luk may make from the Gammon contract. (100 marks)

Question 2

In *Mason, French & Ryan on Company Law* (24th ed, 2007-08) at p.139 it is stated:

‘The wide divergence of views on the question of disregarding separate corporate personality reveals a fundamental uncertainty about its nature and effect. It is highly unlikely that a theory can be found which will reveal that all past cases are consistent.’

To what extent, if at all, do you agree with this comment? (Give reasons for your conclusions.) (100 marks)

Question 3

Alan and Betty have known each other since they were students together at the Vocational Training School in Pokfulam in the mid-1990s. Alan and Betty have each worked in the catering industry for over a decade. In 2006, Alan and Betty starting living together (and had plans eventually to marry). They decided they would each save \$200,000 and then set up and run a restaurant. Betty was to be the chef, whilst Alan would mainly take care of the business side of the venture.

By early 2008, Alan and Betty had each saved \$200,000 and they started detailed planning for the restaurant. By the end of February 2008, suitable premises had been identified which would become available as from 1 May 2008. Alan and Betty planned to lease the premises (as from 1 May 2008) and open the restaurant for the first customers on 1 July 2008. On 1 May 2008 Alan and Betty both signed a 12 month lease of the premises with the landlord. Thereafter the redecoration of the premises started and Alan and Betty began interviewing prospective staff.

Alan’s view was that the success of the restaurant venture depended upon good publicity. He wanted the publicity to be handled by Wong Kee Publicity (‘WKP’) at a cost of \$100,000 for a 3-month package. Betty, who at no time had direct dealings with the staff of WKP, thought the price was too expensive. However, without further consulting Betty, Alan signed a contract with WKP on 1 June 2008. Alan signed the contract in his own name. The contract price was \$100,000 and none of that price has been paid.

On 8 June 2008, Betty found out that Alan was having an affair with another woman. Betty was furious with Alan and swore she would never speak to him again. Betty went to live with her parents and has not communicated with Alan since. A week ago Alan left Hong Kong to take a job at a hotel in Taiwan.

Recently, Betty received a letter from WKP asserting that because Alan and Betty were in partnership together, Betty was under an obligation to pay the \$100,000 to WKP. Betty has now consulted your firm of solicitors.

(i) Your senior partner has asked you to write a memorandum advising him as to whether Betty is liable to WKP. (80 marks)

(ii) How would your advice be different if Alan and Betty had throughout intended to incorporate a limited liability company (to be called ‘AB Ltd’) to carry on the restaurant business and (a) Alan had signed the contract with WKP as a ‘director’ of ‘AB Ltd’; (b) ‘AB Ltd’ in fact was never incorporated; and (c) WKP did not know, on 1 June 2008, that ‘AB Ltd’ had not been incorporated? (20 marks)

Question 4

Reliable Books Ltd (‘RBL’) was incorporated in Hong Kong as a private company in 1987. At all relevant times, RBL’s issued share capital has consisted of \$100, made up of 100 shares of \$1.00 each. RBL’s articles of association are in the form of Table A of the First Schedule to the Companies Ordinance (Cap 32). RBL has, since its incorporation, carried on business as a publisher of cookery books. RBL has banked with the same branch of HSBC (Aberdeen branch) since 1987.

At all relevant times, RBL has had 10 shareholders, all of whom are related by blood or marriage. The last AGM (or EGM) of RBL was held in 2001 and at that meeting Rob (who owns 35% of RBL’s shares) and Susi and Tina (who each own 20% of RBL’s shares) were appointed as RBL’s directors. No meetings of shareholders have been held since 2001. At all relevant times, Rob has acted as RBL’s managing director. Eric has throughout been RBL’s company secretary.

As well as being a director (and managing director) of RBL, Rob also has a property development business run through a company called Z Ltd. Rob owns all the shares in Z Ltd. In May 2007 Z Ltd wanted to borrow \$1 million from HSBC to help finance a property development project. HSBC was willing to lend the \$1 million to Z Ltd but only if, *inter alia*, a suitable guarantee from a third party was forthcoming. Rob arranged with HSBC for a guarantee to be drawn up in the name of RBL. On 10 May 2007 the written contract of guarantee was signed by Rob as the managing director of RBL. The guarantee was also signed by Eric as RBL’s company secretary. At that time, Susi and Tina did not know anything about the guarantee.

Earlier this year Z Ltd went into insolvent liquidation without repaying any of the \$1 million to HSBC. HSBC has recently demanded full payment from RBL. Susi and Tina have recently instructed your firm of solicitors.

Your senior partner has asked you to write a memorandum advising him as to whether RBL is liable to HSBC under the guarantee. (100 marks)

Question 5

‘The Companies Ordinance provisions on unlawful financial assistance are excessively complex and an unnecessary obstacle to efficient business practices.’

To what extent, if at all, do you agree with this comment? What reforms do you think should be introduced in Hong Kong? (Give reasons for your conclusions.) (100 marks)

~ End of Examination Paper ~