

PCLL CONVERSION EXAMINATION JUNE 2023

Title of Paper : Business Associations
Date : 13 June 2023
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 4 pages, including Part A and Part B. A total of 300 marks may be awarded.
8. Part A contains two compulsory questions. Candidates must answer **ALL** questions. There is **NO** element of choice. Part A is worth 200 marks.
9. Part B contains two questions. Candidates are only required to answer **ONE** question out of two. Part B is worth 100 marks.
10. 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 June 2023

Business Associations

The following background facts apply to Questions 1, 2 and 3:

Background facts of Jolie Limited (the “Company”):

Amy, Betty and Candy are founding shareholders of the Company, a Hong Kong private company incorporated in July 2018 under the Companies Ordinance (Cap. 622). Amy, Betty and Candy are the only shareholders and directors of the Company. The Company adopts the Model Articles in the Companies Ordinance (Cap. 622).

The Company owns and operates a hair salon in Central which started its business on 1 July 2018. Amy and Betty, who are both experienced hair stylists, each own 40% of the issued share capital of the Company. They take part in the day-to-day management and operations of the Company’s hair salon in Central. Both Amy and Betty work full-time at the Company and receive remuneration from the Company. Candy owns 20% of the issued share capital of the Company. She does not take part in the day-to-day operations of the Company and is not remunerated.

When the Company was first set up, Amy and Betty have each advanced shareholder’s loans to the Company in the sum of \$400,000 individually and Candy advanced a shareholder’s loan to the Company in the sum of \$200,000.

Part A - Must answer BOTH Questions 1 and 2

Question 1 (100 marks)

Refer to the above background facts about the Company.

Before establishing the Company, Amy and Betty worked as hair stylists at Hair Lovely Limited (“HLL”) and they left HLL’s employment on 30 June 2018. In their employment contracts with HLL, there were legally enforceable restrictive covenants restraining Amy and Betty (whether personally or through another firm or company) from competing with HLL’s business in Central for a period of 6 months.

If HLL brought an action against Company for breach of the said restrictive covenant. Based on the current company laws applicable in Hong Kong, would the Company be liable for Amy’s and Betty’s breach of the restrictive covenant?

Question 2 (100 marks)

Refer to the above background facts about the Company but ignore the additional facts set out in Question 1.

The Company had distributed a small profit in 2019. It had been making a loss since 2021 as a result of the Covid pandemic.

In June 2022, Amy and Betty formed another Hong Kong private company (also incorporated under the Companies Ordinance (Cap. 622)), Shampoo Limited, which retails hair products. Amy and Betty are directors and shareholders of Shampoo Limited. The Company places all its orders for hair products with Shampoo Limited without informing Candy of the same. Since then, Amy and Betty have held board meetings without informing Candy of the same and in January 2023, Amy and Betty had increased their remuneration by 100%.

Last month, Amy and Betty asked Candy to invest further funds into the Company. Candy also finds out about Amy's and Betty's involvement in Shampoo Limited. Candy is unhappy about the situation and asks to be bought out by Amy and Betty. Amy and Betty refuse.

Advise Candy.

Part B - Must answer ONE question - Question 3 OR 4

Question 3 (100 marks)

Refer to the above background facts about the Company but ignore the additional facts set out in Questions 1 and 2.

The Company had distributed a small profit in 2019. It had been making a loss since 2021 as a result of the Covid pandemic.

The shareholders' loans which were advanced to the Company by Amy, Betty and Candy when the Company was first set up had not been repaid.

In May 2022, Amy advanced an additional \$400,000 as shareholder's loan to the Company and caused a floating charge to be created over the Company's business and assets, as security for her original shareholder's loan of \$400,000 and this additional loan of \$400,000. The loan and the creation of this floating charge were approved unanimously by all directors of the Company. Amy did not register this charge at the Companies' Registry.

Since the Company continued to be in financial difficulty, in February 2023, Amy negotiated an overdraft facility up to \$1 million with the Company's bank, Steady Charter Bank Limited ("SCB"). This overdraft facility was secured by a floating charge over the Company's business and assets upon demand by SCB. This overdraft facility and the creation of the floating charge were approved unanimously by all directors of the Company. SCB immediately registered this charge at the Companies' Registry.

The Company's business did not improve. The overdraft facility with SCB had quickly reached its limit. On 31 May 2023, an unsecured creditor of the Company petitioned to wind up the Company. Advise SCB whether the floating charges over (i) Amy's shareholder's loans and (ii) against the overdraft facility are effective against the unsecured creditor(s) of the Company.

Question 4 (100 marks)

Your friends, Fred and George are about to commence a start-up business. They had been advised: "Do not set up a private limited company because the doctrine of lifting the corporate

veil is unprincipled and you will never predict when you will be made personally liable for the company's conduct. Why don't you two set up a limited partnership. That is similar to a private limited company. There is less paperwork and you still enjoy limited liability."

Advise Fred and George whether the above advice is accurate and your view as to the business vehicle which they should adopt for their start-up business. Please explain your answer.

~ End of Examination Paper ~