

PCLL CONVERSION EXAMINATION JUNE 2022

Title of Paper : Business Associations
Date : 27 June 2022
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 2022

Business Associations

Part A (answer **BOTH** Question 1 and Question 2)

Question 1 (100 marks)

James, Stephen and Mary noticed a rise in the demand of home gym equipment in Hong Kong and decided to set up a business to sell such equipment online. They incorporated a Hong Kong private company, Noble Training Company Limited (“Noble”) in 2015. James owned 75% of Noble’s shares, and Mary and Stephen owned 15% and 10% of the shares respectively. They were also appointed as the three directors of Noble. To make sure that the shares would not be sold to a non-member, they inserted the following article in Noble’s Articles of Association (“AoA”):

Article 11 Every member who intends to transfer shares shall inform the directors who will take the said shares equally between them at a fair value.

Mary recruited a well-known trainer, Peter, to advertise the equipment online. Peter originally wanted to be a director of Noble, but Mary convinced him that he would get a more secured position by being appointed as the Chief Training Officer (“CTO”) permanently. The AoA contains the following article:

Article 20 Peter shall be appointed as the Chief Training Officer to the company so long as the company is in operation.

As such, Noble and Peter had never entered into any contract of employment.

James had significant disagreements with Mary over how to run Noble subsequently. Please advise the following scenarios:

- a. Seeing Peter as Mary’s ally, James would like to fire Peter as the CTO. **Advise Peter whether he could rely on Article 20. (30 marks)**
- b. James also knows that Mary is investing in a fitness center in Central and plans to force Mary out. He proposes to add a new Article 11A to the AoA as follows:

“In every case where shares are held by a person who carries on any business which is in direct competition with the business of the company, or who is a director of any company carrying on such business, the directors may at any time give to such person notice requiring him forthwith to transfer all such shares, and he shall thereupon be bound, upon payment of the fair value of the shares, to transfer the shares to such person or persons as the directors shall nominate.”

Advise James as to the viability of such an amendment. (40 marks)

- c. Stephen is disappointed with the never-ending disputes between James and Mary, and would like to compel James and Mary to buy out his shares. **Advise Stephen. (30 marks)**

Question 2 (100 marks)

Best Sauce Company Limited (“BSC”) is a Hong Kong incorporated private company. It was established in 1950 by Chan Senior., and has since been the leading hot sauce manufacturer in Hong Kong. After the death of Chan Senior., the business is now run by his oldest son, Chan Junior., who is the largest shareholder (40%), CEO and one of the three directors of BSC. The other two directors are his younger siblings, Adrian and Betty, each of them owning 30% of BSC’s shares.

Chan Junior. also owns another real estate company in Hong Kong (“CRE”). Last month, CRE entered into a loan with SHCB, a bank in Hong Kong, to finance the purchase of a shipyard in Lantau Island (the “Loan”). The borrowed amount is HK\$500 million. Chan Junior. executed a guarantee on behalf of BSC to secure the repayment of the Loan. This guarantee is the biggest transaction in BSC’s history. Advise SHCB in each of the following scenarios:

- a. After the execution of the contract, it is found that Adrian and Betty are against the guarantee and the board of BSC does not approve the guarantee. **(30 marks)**
- b. Despite there being a board meeting approving the guarantee, the board meeting did not have the necessary quorum. **(10 marks)**
- c. Despite there being a board meeting approving the guarantee, BSC’s Articles of Association (“AoA”) contains the following article:

“**Article 30** The directors may exercise all the powers of the company to borrow money (including the guarantee of debts), provided that the amount of moneys borrowed shall not at any time, without the previous sanction of the company in general meeting, exceed HK\$100 million.”

There is no relevant shareholders’ resolution. **(30 marks)**

- d. To what extent will your answer in (c) be different if the following article is provided in the AoA instead?

“**Article 30** The company may only borrow money (including the guarantee of debts) if the amount of moneys borrowed shall not at any time exceed HK\$100 million.” **(30 marks)**

Part B (answer **EITHER** Question 3 or Question 4)

Question 3 (100 marks)

In June 2018, Keung Fu Company Limited (“KFC”), a Hong Kong private company, entered into a loan agreement with Bank Ace to borrow HK\$100 million (the “Loan”). Repayment of the loan is scheduled to be made by KFC on 1 March 2021.

Due to the pandemic, KFC suffered significant losses and by January 2021, it was obvious that KFC would have difficulty to continue its operation for more than a month if KFC did not receive additional finance. It certainly could not make the scheduled repayment of the Loan.

KFC was wholly owned by Andrew while his father controlled Bank Ace. However, Andrew has never been involved in the management of Bank Ace. KFC subsequently negotiated a deal with Bank Ace under which:

1. The repayment of the Loan is to be extended to 1 March 2022;
2. Bank Ace will lend another HK\$50 million to KFC to fund its operating expenses (“Loan 2”). Loan 2 is to be repaid also on 1 March 2022; and
3. At the insistence of Bank Ace, both the Loan and Loan 2 are to be secured by a floating charge granted by KFC over all of its assets (the “Floating Charge”).

Andrew was not involved in the negotiation. Transactional documents for the above deal were executed on 20 February 2021. The Floating Charge was also duly registered.

However, the rescue effort proved to be futile and KFC’s performance did not improve. On 2 May 2022, one of KFC’s suppliers, Shishamo Corporation, filed a compulsory winding up in Hong Kong against KFC. **Advise whether the Floating Charge is effective against unsecured creditors such as Shishamo Corporation at liquidation.**

(100 marks)

Question 4 (100 marks)

“[An] agency problem involved the conflict between, on one hand, owners who possess the majority of controlling interest in the firm and, on the other hand, the minority or noncontrolling owners. Here the noncontrolling owners can be thought of as the principals and the controlling owners as the agents, and the difficulty lies in assuring that the former are not expropriated by the latter” Reinier Kraakman et al., *The Anatomy of Corporate Law* (Oxford, 3rd Edn. p.30).

Elaborate the agency problem described in the statement above under Hong Kong company law and critically assess the measures that are designed to deal with the problem.

(100 marks)

~ End of Examination Paper ~