

**2020 OVERSEAS LAWYERS
QUALIFICATION EXAMINATION**

**HEAD III: COMMERCIAL
AND COMPANY LAW**

Thursday, 19 November 2020



2020 Overseas Lawyers Qualification Examination

Head III: Commercial and Company Law

Question 1 (25 marks)

ABC Investments Ltd. (“Company”) is a private company incorporated in Hong Kong by Allan Au (“Allan”), Billy Bo (“Billy”) and Chris Chu (“Chris”) in 2015. The share capital of the Company was HK\$1,000,000, comprising 100,000 shares. All shares were issued to the shareholders and were fully paid up. Allan is holding 50% of the issued shares and each of Billy and Chris is holding 25% of the issued shares respectively. The three shareholders are also the only directors of the Company.

Things went smoothly since the incorporation of the Company and the three shareholders enjoyed a harmonious relationship for some years. However, disputes have arisen among them since September 2020. Allan and Billy are eager to expand the Company’s business to the Greater Bay Area in Guangdong Province, Mainland China. Chris, on the other hand, believes that the Company should focus only on its existing business in Hong Kong. If the Company decides to expand its business, it will require additional funding of HK\$3,000,000. For this purpose, Allan and Billy approached North Bank (“Bank”) for a term loan. The Bank agreed to provide a loan of HK\$3,000,000 repayable in 3 years on the conditions that the loan would be secured by a floating charge over the Company’s assets and that all directors execute a personal guarantee in favour of the Bank to guarantee the repayment of the loan by the Company.

The Company adopts the Model Articles for Private Companies Limited by Shares set out in Schedule 2 to the Companies (Model Articles) Notice (Cap. 622H) as its articles of association.

(See over the page for a continuation of Question 1)

Questions:

- (a) Allan wished to convene a board meeting to discuss the loan as soon as possible. He instructed the company secretary of the Company to convene the meeting that would take place within the next 7 days. Chris understood that he might well be outvoted at the board meeting and thus he attempted to delay the meeting. Chris informed the company secretary upon receipt of the notice that he could attend the board meeting only on 30 November 2020. Allan and Billy did not think that it was a good idea to wait until 30 November 2020. The meeting took place on 15 October 2020 without the attendance of Chris (although he had been fully informed of the time and venue of the meeting on 10 October 2020) and a resolution was passed to approve the loan on behalf of the Company.

Advise Chris whether there is any legal basis for him to invalidate the board resolution on the ground that the meeting was inquorate without his attendance.

(5 marks)

- (b) **Is it possible for Chris to invalidate the board resolution on the ground that the notice of the board meeting was too short?**

(6 marks)

- (c) **Would it have been possible for Chris to invalidate the board resolution if he was unable to attend the board meeting because Allan instructed the secretary of the Company to send out the notice for the board meeting to Allan and Billy only?**

(6 marks)

(See the next page for a continuation of Question 1)

- (d) The proposed loan from the Bank does not materialise because Chris refused to execute a personal guarantee in favour of the Bank. Allan and Billy now believe that the extra HK\$3,000,000 can only be raised by an increase of the Company's share capital. In a recent board meeting, Allan and Billy, outvoting Chris, resolved to convene a general meeting (other than an annual general meeting) of the Company to increase the share capital of the Company from HK\$1,000,000 to HK\$4,000,000 by the creation of 300,000 new shares.

Chris received the notice of the general meeting on 27 October 2020 which stated that the meeting would be held on 3 November 2020. The notice was sent to Chris by the company secretary who mistakenly believed that the minimum notice period of the proposed general meeting was not less than 7 days.

Is it possible for Chris to effectively challenge the holding of the general meeting on the basis that the notice is irregular?

(8 marks)

[25 marks in total]

Question 2 (25 marks)

Smart Screen Limited (“Company”), a Hong Kong private company, manufactures smartphone screens and displays. Its largest clients are Eggplant Incorporated and Robophone Incorporated, the two leading smartphone companies in the world.

On 8 April 2018, the Company entered into a three-year term loan facility (HK\$8,000,000) with Ignite Bank secured by a floating charge over all assets, book debts and undertakings of the Company (“Ignite Bank Debenture”). The Ignite Bank Debenture was duly registered under the Companies Ordinance, Cap. 622 (“Ordinance”).

The Company borrowed HK\$7,000,000 from one of its shareholders, Mr. Adam Ip (“Adam”), who is also a director of the Company.

Since June 2019, Eggplant Incorporated decided to change its supplier to another smartphone screen company. As a result, the Company’s sales dropped significantly and it desperately needed more cash. On 23 June 2019, Monopoly Bank provided a HK\$9,000,000 4-year term loan facility to the Company secured by a charge over the Company’s book debts (“Monopoly Bank Debenture”), which was duly registered under the Ordinance. According to the terms of the Monopoly Bank Debenture, any assignment or disposal of the book debts requires Monopoly Bank’s consent and the proceeds of the collected book debts must be paid into a designated account maintained with Monopoly Bank. On 29 June 2019, the Company borrowed HK\$3,000,000 (a five-year term loan facility) from Grand Bank secured by a fixed charge over all machinery owned by the Company (“Grand Bank Fixed Charge”). Due to an administrative oversight, the Grand Bank Fixed Charge was not registered under the Ordinance. Nothing was done to rectify the error.

(See the next page for a continuation of Question 2)

On 9 August 2019, the Company granted an “all-monies” floating charge over all of its assets, book debts and undertakings in favour of Adam to secure all personal loans provided by Adam to the Company. This charge was duly registered under the Ordinance.

On 29 August 2019, the Company sold its warehouse in Fanling, New Territories, Hong Kong (“Warehouse”) to Mrs. Chloe Ip, the wife of Adam. The consideration was HK\$6,000,000, which was HK\$4,000,000 lower than the market value of the Warehouse (as valued by an independent valuation in July 2019). Adam explained that the Company needed the money urgently and the sale price was actually “not too bad considering the downturn in the real estate market”.

The Company suffered further financial hardship in September 2019 when Robophone Incorporated decided not to buy from the Company anymore. On 7 September 2019, Ignite Bank appointed a receiver upon an event of default, which is also an event that crystallized the floating charge pursuant to the terms of the Ignite Bank Debenture. On 15 September 2019, an unsecured creditor presented a winding-up petition against the Company.

The liquidator, Amy Ho, has learned the following information:

- (i) The Company’s main assets are its book debts (HK\$7,000,000), machinery (HK\$3,000,000) and inventory (HK\$1,000,000).
- (ii) The Company owes 20 of its employees a total of HK\$400,000 for wages in arrears. It was also revealed that the Company has failed to pay profits tax (HK\$3,000,000) in the immediate previous year.
- (iii) The Company has 12 unsecured trade creditors, who are owed HK\$8,000,000 in total.

(See over the page for a continuation of Question 2)

- (iv) On 6 September 2019, the Company used the proceeds of sale of the Warehouse to discharge in full the shareholder's loan (with interest) owed to Adam.
- (v) On 5 June 2017, the Company borrowed a term loan of HK\$1,000,000 from Millennium Display Limited (a wholly-owned subsidiary of the Company) ("Subsidiary") repayable in full on 5 June 2021 ("MDL Loan"). The Company made an early repayment of the MDL Loan (with interest) in full to the Subsidiary on 2 September 2019.
- (vi) A trading partner of the Company, Smokescreen Limited ("SL"), initiated proceedings against the Company for breach of contract resulting in the loss of profits (amounting to HK\$6,000,000). The Court of First Instance gave judgment in favour of SL to the full extent of the claim. SL commenced enforcement actions on 17 September 2019.
- (vii) Evidence shows that the Company has been insolvent since August 2019.

The Company made no early repayment to Ignite Bank, Monopoly Bank and Grand Bank in connection with the term loan facilities.

For the purpose of this question, assume that there is no negative pledge clause in any of the debentures or charges.

Question:

You act for the Company's liquidator, Amy Ho, who has drawn your attention to all of the above points. **Prepare a letter of advice to the liquidator, addressing the rights and priorities of all the creditors of the Company.**

(25 marks)

[25 marks in total]

Question 3 (25 marks)

Sky Circle Limited (“Sky Circle”) is a listed company on the main board of The Stock Exchange of Hong Kong Limited. Sky Circle came to seek your advice on compliance matters under the Listing Rules. Sky Circle owns 51% of the entire issued share capital of Small Circle Limited (“Small Circle”). Moon Limited owns the balance of the 49% of the entire issued share capital of Small Circle. The financial year end date of Sky Circle is 31 December. Both Sky Circle and Small Circle are profit making and the profits of Small Circle were more than 10 percent of the profits of Sky Circle during the latest financial year of Sky Circle.

Sky Circle intends to enter into a contract with Moon Limited for the sale of its 51% interest in Small Circle to Moon Limited. The consideration will be satisfied by cash only and payable in full at completion of the transaction.

It has been determined that the transaction would not constitute a very substantial disposal.

Questions:

Describe generally:

- (a) The parameters for size tests and applicable size tests; (10 marks)**
- (b) Classification of transaction(s); (4 marks)**
- (c) Documentation and compliance requirements; (7 marks)**
- (d) Manner of approval by shareholders. (4 marks)**

[25 marks in total]

Question 4 (25 marks)

Part A

David is the account manager of Happy Ltd., a company listed on the Main Board of The Stock Exchange of Hong Kong Limited. Happy Ltd.'s principal business is manufacturing small-scale electrical appliances such as air purifiers. In view of COVID-19, there was a sudden increase in demand for air purifiers in the first six months of 2020. In the course of preparing the financial results of Happy Ltd. and its subsidiaries for the six months ended 30 June 2020, David noted that there would be a significant increase in net profit. He informed his wife Mandy of this confidential information. Mandy subsequently communicated this confidential information to her close friend, Betty, who had a great interest in investing in stocks. Both Mandy and Betty acquired shares of Happy Ltd. Immediately upon the release of the interim results for the six months ended 30 June 2020, the share price of Happy Ltd. went up by 30% because of the increase in profit. Both Mandy and Betty earned a profit as a result of the increase in the share price.

Question:

- (a) **Are David, Mandy and Betty liable under Part XIII of the Securities and Futures Ordinance, Cap. 571?**

(13 marks)

(See the next page for a continuation of Question 4)

Part B

Mirella and Stephen previously worked in the same asset management company for a few years. They recently met and discussed setting up their own asset management company ("Company") in Hong Kong to carry out the business of asset management and securities trading regulated activities as they see the potential in this. Both of them will be the shareholders of the Company. The day-to-day management and operations of the Company will be jointly carried out by both of them. The Company intends to serve professional clients in and outside Hong Kong.

Mirella and Stephen ask you to advise them on the legislative requirements, procedures and licensing requirements involved in setting up an asset management company.

Question:

- (b) **Prepare a memorandum of advice for Mirella and Stephen to advise on the legislative, procedural and licensing requirements involved.**

(12 marks)

[25 marks in total]

Question 5 (25 marks)

Part A

Gourmet Plus Limited (“GPL”), a private company incorporated in Hong Kong, operates a number of European gourmet casual restaurants. GPL’s issued share capital is 30% owned by Vera Li (“Vera”) and 70% owned by Jack Wong (“Jack”). Vera and Jack are the only directors of GPL. GPL was established by Jack and Vera about 10 years ago to operate an Italian restaurant. Since then it has expanded successfully and now owns five restaurants in Hong Kong serving different European cuisines. With the growth of GPL, Jack and Vera entered into a shareholders’ agreement (the “Shareholders’ Agreement”) three years ago to better protect their interests.

Due to the recent pandemic and the resulting social distancing measures, GPL has suffered huge losses since the beginning of the year. Vera would like to cut her losses and retire early by selling her shares in GPL. Vera has been in discussion with her friend, Percy Lim (“Percy”), who is keen to purchase Vera’s shareholding in GPL as she is still very optimistic with the food industry in Hong Kong. Vera has not told Jack about the proposed sale of her shareholding yet.

Before Percy spends more time and money on negotiations and legal due diligence on the proposed purchase of Vera’s 30% shareholding in GPL, she has some concerns and would like to seek your preliminary advice before she proceeds further with the negotiations.

(See the next page for a continuation of Question 5)

For the purpose of this question, since Percy is not able to provide you with a copy of the Shareholders' Agreement, you should assume that the Shareholders' Agreement is in a customary form containing typical provisions for a company in the nature of GPL.

Questions:

- (a) **Advise Percy, with explanations, on the possible barriers to her proposed share purchase which may arise from (i) the Shareholders' Agreement, and (ii) any corporate actions of GPL.**

(8 marks)

- (b) Assume that all the possible barriers that are discussed in Question 5(a) above are cleared, and that Percy has proceeded further with negotiating the proposed share purchase with Vera. Percy thinks some of the terms in the Shareholders' Agreement are unfair to a minority shareholder but is not sure if that matters to her. **Advise Percy.**

(3 marks)

Part B

For the purpose of Part B, now assume that Percy and Vera could not agree on the commercial terms of the proposed sale and purchase of Vera's shareholding in GPL and that the deal did not proceed. Percy came across another investment opportunity and is considering purchasing the entire issued share capital of another private company incorporated in Hong Kong, Bailey Limited ("BL"), which is wholly owned by Ken Bailey ("Ken"). BL was established by Ken four years ago to operate a vegetarian fine-dining restaurant, "The Bailey's", in Wanchai, Hong Kong which promotes innovative vegetarian food and has been

(See over the page for a continuation of Question 5)

making handsome profits. The success of “The Bailey’s” is largely attributed to its dedicated team of chefs and other staff. Last year, BL started another business to operate a juice bar, “Pop Juice”, selling nutritious fruit and vegetable juice in two different locations in Kowloon. Ken is selling BL to move back to Australia to spend more time with his family. With the increasing number of vegetarians and health conscious consumers in Hong Kong, Percy sees great potential in the growth of BL.

After some lengthy discussions, Percy has proposed to purchase the entire issued share capital of BL from Ken for a consideration of HK\$15,000,000. Percy will pay a 10% deposit upon the signing of the share sale and purchase agreement which is scheduled for 4 December 2020, with the balance to be payable at completion which will take place one month after signing.

Percy instructed you to act for her in the proposed share purchase. During the legal due diligence, you discovered the following:

- the liquor licence of “The Bailey’s” is due to expire on 20 December 2020, and according to Ken, BL has already submitted an application for the renewal of its liquor licence; and
- BL has started negotiating with its major supplier of local organic vegetables and fruits, Meng Kee Limited (“Meng Kee”), to renew their supplier contract which is due to expire in early February 2021. According to Ken, there should not be a problem in renewing the supplier contract on similar terms as the existing one, but the negotiation will probably take a while as Meng Kee is usually quite slow in responding.

(See the next page for a continuation of Question 5)

You are about to prepare a draft share sale and purchase agreement for the issued share capital in BL. Percy said she is happy to include the customary warranties.

Questions:

- (c) **What provisions would you recommend including in the share sale and purchase agreement to specifically address the two issues revealed in the legal due diligence? Provide reasoning to support your answer.**

(8 marks)

- (d) After the legal due diligence, it was also revealed that BL had recently received a number of complaints from customers alleging that they suffered food poisoning after their consumption of vegetable juices at “Pop Juice”. Percy is worried about these complaints and how they may adversely affect the business of “Pop Juice”. Percy is therefore considering whether she should just acquire the business of “The Bailey’s” instead of purchasing all the shares in BL, since she is mainly interested in acquiring “The Bailey’s”. **Explain to Percy (i) the key differences between a business purchase and a share purchase, and (ii) the advantages and disadvantages of a business purchase.**

(6 marks)

[25 marks in total]

END OF TEST PAPER