PCLL Conversion Examination
June 2018
Examiner's Comments
Business Associations

General comments

The standard of papers in this sitting of the Business Associations Conversion Examination was, overall, relatively high, with many candidates capable of providing coherent legal analysis.

As examiners, we expect candidates to be able to identify the legal issues in questions. Then they should identify the law that is relevant to the issues. They should also ask what the law means for their clients or advisees base on the facts as set out in the questions. The examination questions are designed to resemble as closely as possible what candidates may come across in practice.

Most Candidates finished the paper. I will now give some comments on how candidates answered each question. I will also describe where they did well and where they did less well.

Question 1

Almost everybody identified that the question was about directors' duties. Those candidates who did well for this question were able to subdivide the question into three separate legal issues relating to directors' duties. On the issue of delegation of director's duty, candidates who gave good answers not only pinpointed the relevant cases and statutory provisions, but also discussed whether the delegation to Mr. Chester was reasonable given Mr. Chester's professional knowledge. Yet those who gave average or below average answers did not identify the relevant statutory provision (Section 465(2)) of the Companies Ordinance regarding the objective and subjective tests and nor did they discuss that despite the delegation, the directors still have a duty to ensure that Mr. Chester and the other geologist were acting reasonably and monitor their action at arm's length supervision.

On the issue of the no conflict rule, those candidates who did well were able to identify the relevant statutory provision relating to disclosure of material interests by the relevant director, and how this kind of contract becomes voidable merely by existence of such conflict based on case law. However, those who did relatively poorly simply mentioned that this was a conflict of interest but did not go on to elaborate their answers with reference to cases and statutory provision.

On the issue of using corporate information to make profit, candidates who did well were able to identify most of the relevant case laws and used those principles well to elaborate their analysis of the facts. A few even mentioned that if found liable, the company can hold the director accountable for the amount of profit made as a constructive trustee. Yet those who gave average answers did not provide coherent legal analysis with reference to relevant case laws. Some of those who answered poorly did not even identify or discuss this issue and jumped straight to the point that shareholders may resort to shareholders' remedies.

Question 2

Almost all candidates identified that once registered a company becomes a separate legal entity and is distinguished from the shareholders. Majority of candidates also discussed the importance of the *Salomon* case in developing this legal principle. Candidates who got higher marks for the first part of the question were able to discuss that commercial companies developed as a means of allowing a number of people to pool their resources to undertake an enterprise too large for a single individual. Creating a separate legal person to hold and incur the rights and obligations of the enterprise simplified dealings between the enterprise and those with whom it conducted business. While most candidates mentioned that the major advantage of forming a company is limited liability yet those who got lower marks did not go on to elaborate the meaning of limited liability.

With regards to part b of this question, majority of the candidates were able to identify that this was a "lifting the corporate veil" issue. However, candidates who scored higher marks were able to refer to cases such as *Adams v. Cape Industries, Daimler Co. v. Continental Tyre* and *Smith, Stone & Knight Ltd v Birmingham Corporation* and provided a coherent legal analysis as to under what circumstances would the court lift the veil and hold the parent company liable for the action of the subsidiary.

Exceptional candidates even discussed the possibility that a company could be the agent or partner of its controller. Therefore, if a company (such as a subsidiary) were treated as the agent of a person who controlled it (such as the holding company), any rights or obligations of the company arising under the scope of the agency would be treated as rights or obligations of the controller.

Question 3

Most candidates identified that the question was about the articles of association and its enforceability. Those who did well for this question were able to differentiate members and outsiders of the company. Good answers pointed out that as an outsider, Casper, cannot enforce the terms of the article of association just as the rule of privity applies by referring to the relevant cases. Yet those candidates who did relatively poorly did not discuss this issue adequately, with a few of them unable to even spot this issue.

On the issue regarding the enforceability of the articles amongst shareholders themselves, candidates with good answers cited the relevant statutory provision and case law to support their arguments and how this is related to the factual problem. Yet those who gave poor answer simply mentioned that a shareholder can enforce the term against other shareholders based on "fairness", which has never been the legal test. Some candidates mentioned that the term is enforceable between shareholders but did not cite the relevant statutory provision and case law to support their arguments.

On the issue relating to the alteration of articles, some candidates failed to identify this in the answer and were not discussed at all. Those who gave average or below average answers did identify the issue but argued that shareholders could resort to unfair prejudicial remedy to

challenge the validity of the alteration. Although this may be relevant yet not the gist of the answer. Those who answered well for this part were able to cite the relevant statutory provision and explained that a company may by special resolution alter or add to its articles, providing that the power to alter is exercised "bona fide for the benefit of the company as a whole" (Section 88(2) Companies Ordinance) and supported its argument with reference to case law (*Sidebottom v. Kershaw)*.

Question 4

Few candidates attempted this question but majority of those who did answered it relatively well. Almost all the answers were able to identify the relevance of section 267 (Cap 32), where a company is being wound up, a charge which, when created, was a floating charge on the undertaking or property of the company and which was also created within 12 months of the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate specified in the charge or at the rate 12% per annum, whichever is the less. Those who gave very good answers were also able to discuss that if the company was solvent at the time the charge was created, then the charge would be beyond the reach of section 267 and valid.

On the issue of ordering of the expensive materials, some candidates gave good answer by discussing that directors would be liable under section 275 (Cap 32) for fraudulent trading if, at the material time, they caused the company to incur new liabilities or they knew that the company had no reasonable prospect of repaying. Those who gave relatively poor answer simply mentioned that this was a director misconduct without referring to the statutory provision.

Those attempting this question could have done even better if they discussed that court will not impose a liability under section 275 unless it is proven that the directors did know there was no reasonable chance of repaying those new debts. In other words, what has to be proved is the directors' actual dishonesty (*Aktieselskabet Dansk Skibsfinansiering (body corporate) v Brothers* [2000] 1 HKC 511).