

## **PCLL CONVERSION EXAMINATION JANUARY 2015**

Title of Paper : Business Associations  
Date : 9 January 2015  
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 four questions. Candidates are required to answer **THREE** questions out of four. Where a question is in two or more sub-sections, all sub-sections must be answered. 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 January 2015

## Business Associations

### **Question 1 (100 marks)**

**Critically analyse whether the corporate veil was correctly lifted in each of the three situations stated below.**

- a) The claimant company sued its director Peter for an account of secret profits made by the director who exploited a corporate opportunity. Peter procured for the secret profit to be transferred to another company, Prosperity Ltd, under his control. The judge at the Court of First Instance found that Prosperity Ltd was Peter's nominee for the purpose of receiving and holding the secret profit. The judge observed that the introduction of such a company is insufficient to prevent equity's eye from identifying it with Peter. He said that Prosperity Ltd was in substance little other than Peter's offshore bank account held in a nominee name and was simply the alter ego through which he enjoyed the profit which he earned in breach of his duty to the claimant. The judge concluded that the corporate veil should be lifted and held against Peter and Prosperity Ltd. **(35 marks)**
- b) John was a director and shareholder of Happy Ltd. The other director and shareholder was his son who always acted on his instructions. John had unrestricted access to Happy Ltd's assets. He led an extravagant lifestyle and treated the company's cash balances and property as his own and drew on them as he saw fit. He used Happy Ltd's assets to fund his and his family's personal expenditure. Subsequently, he and his wife divorced and John was ordered by the court to pay a substantial sum to his wife. He had no more money. The wife sued him and Happy Ltd, arguing that John and Happy Ltd should be treated as one and the same entity. The judge at the Court of First Instance agreed and lifted the corporate veil and ordered the company to pay the dues owed by John to his wife. **(30 Marks)**
- c) Terry incorporated a company, Disposal Ltd to manage a waste disposal business. Environmental activists were angered by the actions of his company which disposed of waste near an area which resulted in the pollution of a lake, a world heritage site. He received a tipoff that the activists would commence legal action against his company in three weeks' time. He quickly formed a new company Roller Ltd, of which he was the sole director and shareholder, and transferred all the assets of Disposal Ltd to Roller Ltd. The judge at the Court of First Instance pierced the corporate veil and held that Terry and Roller Ltd were liable for breaching the environmental laws. **(35 marks)**

## **Question 2 (100 marks)**

Mary, Sara and Liz are directors and shareholders of Candy Ltd, a company that produces and sells pastries. Mary and Liz are executive directors and Sara is a non-executive director. Mary is very close to the son of one of the company's suppliers who asked her whether she would be interested to invest in a real estate business. Mary brought this potential business venture to the attention of Sara and Liz who dismissed it immediately. Mary then decided to invest in the business in July 2014 and make a handsome profit.

Since August 2014, Candy Ltd's business steadily deteriorated. Liz started to lose interest in the business and stopped being involved in the company's business since September 2014. She is thinking of setting up a café that serves Japanese cuisine. Since October 2014, Mary and Sara were considering diversifying Candy Ltd's business to include setting restaurants and cafes but they did not make any concrete plans. In December 2014, Liz resigned and opened the café.

As the business became from bad to worse, Mary arranged for several meetings involving the key investors of Candy Ltd to explore business strategies. However, Sara did not attend any of those meetings.

**Advise whether Mary, Sara and Liz have breached their duties. (You do not have to discuss issues concerning shareholders' remedies).**

## **Question 3 (100 marks)**

Brad, Peter and Ed are the only directors and shareholders of First Class Ltd, a real estate construction and development company. The articles of the company provide that no transactions in relation to any property in the New Territories are permitted. The articles further provide that transactions that exceed \$5 million require the signature of all three directors. Peter was appointed as the managing director.

In April 2014, Brad and Peter of First Class Ltd acquired a piece of property in Causeway Bay for \$4 million from a tycoon but the price paid for was well-above the market value. The difference between the acquisition price and the market price will be pocketed by Brad and Peter and the seller. Due to the negligence of the accountants, they failed to uncover the wrongdoing committed by Brad and Peter in connection with a report that the accountants were preparing for the shareholders in connection with the acquisition of the property. Ed subsequently discovered the actions of Brad and Peter and the accountants and commenced an action on behalf of the company against all three of them. The accountants argued that they could not be held liable to First Class Ltd because the company itself committed the wrongdoing and they were deceived by the company.

**a) Advise First Class Ltd whether it would succeed in its claim against the accountants. Please confine your answer to an analysis of the law on attribution. (30 marks)**

In June 2014, Peter signed an agreement with the government to construct and develop a piece of property in the New Territories. In that month, Peter granted a security interest of First Class Ltd worth \$1.1 million to HSBC as part of the bank's condition to lend him \$5 million in connection of his purchase of an apartment for his family. Peter did not obtain the approval of the other two directors.

**b) Advise First Class Ltd whether it is liable for (i) the agreement with respect to the property in the New Territories and (ii) the security interest. (70 marks)**

**Question 4 (100 marks)**

Prince, Lily and Francis are directors and shareholders of Purdue Ltd, a company that manufactures and sells cutleries (the "Company"). One of the articles of association of the Company provides that Francis will be appointed as the company's Chief Investment Officer. However, Francis was never appointed. Business was doing well. In April 2014, in light of the outstanding performance of Dan, the senior manager, the board decided to give him shares amounting to 20% of the issued shares, appoint him as a director and give him 20% of the profits. There were discussions between the board and Dan that he would eventually obtain 50% of the shareholding but no agreement was concluded.

Business deteriorated subsequently in September 2014 in part due to the mismanagement of the Company caused by Prince and Lily taking up a business opportunity in which the Company was interested, and in part because of the bad economy. The actions of Prince and Lily were however ratified subsequently at a general meeting. The Company decided that Dan would no longer receive 20% of the profits but would be paid only his salary and any dividends payable upon his 20% shareholding. Francis decided to lend money to the Company as additional capital in the hope of improving its financial condition but to no avail. Prince and Lily removed Francis as a director in October 2014. The Company went into liquidation in December 2014.

**Advise whether Francis and Dan have any remedies to address wrongs done to themselves and the Company. (You do not have to discuss issues concerning breaches of directors' duties).**

**~ End of Examination Paper ~**