

PCLL CONVERSION EXAMINATION JANUARY 2023

Title of Paper : Business Associations
Date : 6 January 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 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 January 2023

Business Associations

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

Question 1 (100 Marks)

James and Anthony are good friends. Hearing that the market rent had dropped substantially in Central, they decided to open a Japanese restaurant there. James would contribute the initial capital and Anthony who is a chef would serve as the executive chef of the restaurant. They agreed to split any profit by half. They opened a joint account with a bank to prepare for the setting up of the business. James was in charge of the incorporation of a company (“Two Friends Company Limited”) that was supposed to run the restaurant, and Anthony would be in charge of finding the right place in Central for the restaurant.

James engaged his lawyer Patrick to incorporate the company. However, Patrick was busy and never filed the incorporation form. Thinking that the company had been incorporated, Anthony went on to sign a lease on the behalf of Two Friends Company Limited as its director.

Just two weeks after the opening of the restaurant, they learned that a world famous Japanese chef would open a restaurant across the street from their location. They knew that they would not be able to compete against him and decided to shut down their restaurant.

- (a) **Donald is the landlord. Pursuant to the lease, the lessee would be liable to pay the full rent for a year even if the lessee decides to terminate the lease early. Which party will Donald have recourse against under Hong Kong company law? (50 marks)**
- (b) **James bought a large number of expensive abalones from Japan. They were intended to be used by the restaurant and are currently stored in the kitchen there. Now that the restaurant business is shut down, who owns these abalones under the law of business associations of Hong Kong? (50 marks)**

Question 2 (100 Marks)

Andrew, Ben and Carr were the shareholders and directors of Best Papa Company Limited (“BPC”), a private limited company incorporated in Hong Kong. BPC operated an elderly home in Taipo for many years. At the time of incorporation of BPC, Andrew, Ben and Carr owned 20%, 25%, and 55% of BPC’s shares respectively. Andrew was appointed the general manager and was in charge of running of the day-to-day business of the elderly home.

Carr’s brother, Matthew, owned a company, Ace Bed Company Limited (“ABC”), that sold bedsheets in Hong Kong. At the time of the incorporation of BPC, Carr managed to cause the following article to be included in the Articles of Association of BPC (“AoA”):

“The Company shall purchase bedsheets exclusively from Ace Bed Company Limited.”

Apart from this article, the rest of the AoA adopted the Model Articles of Association for Private Companies Limited by Shares prescribed in Schedule 2 of the Companies (Model Articles) Notice (Cap. 622H).

Last year, Carr transferred 3% (out of his 55%) of BPC's shares to Matthew, making him a shareholder of BPC.

However, the quality of bedsheets supplied by ABC had been terrible. Fed up with that, Andrew decided to make a substantive purchase of bedsheets from another company, Sleep Well Corporation ("SWC"). His concern was also shared by Ben. Earlier this week, they convened a directors' meeting to approve the purchase from SWC and authorized Andrew to sign the contract, notwithstanding the fierce protest by Carr. Andrew went on to sign the contract on behalf of BPC with SWC.

(a) Matthew argued that BPC must continue to purchase bedsheets from ABC in the future. Advise Andrew and Ben. (50 marks)

(b) Carr informed SWC that Andrew had no authority to enter into the contract with SWC. Advise SWC. (50 marks)

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

Questions 3 (100 Marks)

Pacific Solar Company Limited ("PSC") is a private company incorporated in the Cayman Islands. It manufactures and sells solar panels. It was founded by Davin in 1980, and has Hong Kong as its headquarters. To date, Davin is still the sole shareholder of PSC and his two daughters serve as the directors. As PSC's business expands, it now sells solar panels across Asia, but Davin and his daughters still reside in Hong Kong. Its major manufacturing facilities are in Taipo, owned and operated by Bright Sun Company Limited, a Hong Kong incorporated subsidiary wholly-owned by PSC.

After two terrible financial years, PSC is in very poor shape financially. It was clear to Davin and his daughters that PSC would not be able to make its loan repayment to One Bank, a Hong Kong based bank that has been the major creditor of PSC for many years, when the repayment is due by the end of 2023. Apart from loan with One Bank, PSC has previously entered into a shareholder's loan with Davin. The shareholder's loan is due in 2025.

(a) In January 2023, Davin plans to cause PSC to grant a fixed charge over all the properties of PSC to secure the shareholder's loan. Davin however will not advance any new loans to PSC. Advise Davin as to the validity of the proposed fixed charge. (50 marks)

(b) Meanwhile, One Bank is aware of the poor financial condition of PSC and has been considering to apply for a compulsory winding up of PSC. It is however not sure whether the Hong Kong court will entertain its winding up application since PSC is incorporated in the Cayman Islands. Advise One Bank. (50 marks)

Question 4 (100 Marks)

“[I]n my judgment the limited liability corporation is the greatest single discovery of modern man. . . . Even steam and electricity are far less important . . . and they would be reduced to comparative impotence without it.” 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS? 21 (1917).

“[O]wing to the ease with which companies can be formed in this country, and owing to the rigidity with which the courts applied the corporate entity concept ever since the calamitous decision in *Salomon v. Salomon s Co., Ltd.*, a single trader or a group of traders are almost tempted by the law to conduct their business in the form of a limited company, even where no particular business risk is involved, and where no outside capital is required.” O. Kahn-Freund, *Some Reflections on Company Law Reform*, 7 *The Modern Law Review* 54, 54 (1944).

Critically assess the statements above under Hong Kong company law. (100 marks)

- End of Examination Paper -