Fundamentals Pilot Paper – Skills module

Corporate and Business Law (Hong Kong)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL TEN questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F4 (HKG)

ACCA

ALL TEN questions are compulsory and MUST be attempted

1 'The constitution of a state or territory can be defined as one which establishes the basic institutions of government, distributes governmental authority amongst them, defines the relationship between them …' ('the Definition'). P Wesley-Smith: An Introduction to the Hong Kong Legal System.

Required:

Given the Definition, discuss the constitutional nature of the Basic Law in the Hong Kong Special Administrative Region.

(10 marks)

2 In relation to the law of contract, explain the discharge of the contractual obligations of the contracting parties by:

(a) performance (4 marks)

(b) agreement, and (3 marks)

(c) breach. (3 marks)

(10 marks)

3 In relation to the law of tort:

(a) Distinguish the law of tort from the law of contract. (4 marks)

(b) Explain the rule governing 'remoteness of damage' being laid down by the court in *Oversea Tankship (UK) Ltd* v *Morts Dock & Engineering Co Ltd, The Wagon Mound* [1961] AC 388. (6 marks)

(10 marks)

4 In relation to employment law, explain the following:

(a) The termination of an employment contract:
(i) By choice. (4 marks)
(ii) By breach. (4 marks)

(b) Wrongful termination. (2 marks)

(10 marks)

5 In relation to corporate governance:

(a) Explain what is meant by corporate governance. (3 marks)

(b) Describe the sources of forces that shape the corporate governance of a company. (7 marks)

(10 marks)

6 In relation to company law, explain the nature of the memorandum of association and the articles of association of a company, the interrelationship between them, and the legal effects of both of them.

(10 marks)

7 In relation to company law:

(a) State the scope of borrowing power of companies adopting Table A of the Companies Ordinance (Cap 32) as their articles of association. (2 marks)

(b) Explain what a debenture is. (2 marks)

(c) Explain what a floating charge is and state the statutory requirement for the registration of a charge. (6 marks)

(10 marks)

8 Some years ago, Allan, Beauty and Collins formed a trading partnership for trading computer hardware.

Collins has retired from the partnership. Before Collins's retirement, he entered into a contract with Computer Ltd on behalf of the partnership for purchasing computer hardware at a price ('the Purchase Price'). Computer Ltd delivered the computer hardware to the partnership after Collinss's retirement .

The partnership has been in financial difficulty ever since Collin's retirement. Two months ago, in order to help Beauty, David, who is Beauty's father, took out a loan from a bank for the partnership by representing to the bank that he was a partner to the partnership ('the Loan').

It is now clear that the partnership cannot settle the Purchase Price and repay the Loan.

Required:

In relation to partnership law:

Advise

(a) Collins as to whether he is liable for the payment of the Purchase Price. (4 marks)

(b) David as to whether he is liable for the repayment of the Loan. (6 marks)

(10 marks)

9 Peter, Paul and Mary are the sole directors of Property Ltd. They are also the sole shareholders holding one third of the issued shares of the company. Before the incorporation of the company, they had been partners of a partnership running business similar to that of the company.

Two months ago, there was a dispute between Peter and Paul on the one hand and Mary on the other hand. Ever since the dispute, Mary has not been on speaking terms with Peter and Paul. Last week, despite Mary's strong objection, it was resolved in a properly convened shareholders' meeting that Mary was to be removed from her directorship with immediate effect.

Required:

In relation to company law, advise Mary about her chances of successfully obtaining an order from the court demanding Peter and Paul to purchase her shares in the company.

(10 marks)

10 Garment Trading Ltd ('the company') was incorporated five years ago. Florence and Geoffrey are the sole directors and shareholders of the company. Geoffrey has been appointed as the managing director of the company and is solely responsible for the day to day running of the company's business ever since the company's incorporation.

Geoffrey has knowledge that the company has been insolvent ever since December of last year. In January this year, Geoffrey obtained an order for garment from T-Shirt Ltd in the sum of HK$1million ('the Price') on advance payment terms ('the Garment Order') on behalf of the company. Having received the Price from T-Shirt Ltd in February, the company repaid the debt owed by the company to Money Bank ('the Loan') by making use of the Price. The company went into liquidation immediately after repaying the Loan. The company has not fulfilled the Garment Order so far.

Required:

In relation to company law, advise the liquidator of the company whether Geoffrey and Money Bank were liable for fraudulent trading under section 275(1) of Companies Ordinance (Cap 32).

(10 marks)

End of Question Paper

Answers

1 The question invites the candidates to demonstrate their knowledge in the nature of the Basic Law ('BL') of the Hong Kong Special Administrative Region ('HKSAR').

The constitution of a state or territory can be defined as one which establishes ('constitutes') the basic institutions of government, distributes governmental authority amongst them, defines the relationship between them …" ('the Definition'). P Wesley-Smith: An Introduction to the Hong Kong Legal System.

In its broad sense, the word 'government' means the functions exercisable by the executive, the legislature and the judiciary of a state or a territory. However, in its narrow sense, 'government' refers only to the executive body, which has with her the primary duties of formulating the policies and administrating or enforcing the law. It is the broad sense of the word 'government' that the question is referred to.

BL is enacted by the National People's Congress of the People's Republic of China ('PRC'). The preamble to BL stipulates that after 1 July 2000, under the principle of 'one country, two systems', the socialist system and policies of the PRC will not be practised in the HKSAR. Hence, the HKSAR has her own system, and the system and way of life of the HKSAR prior to 1997 shall remain unchanged for another 50 years: Art 5 BL.

Under BL, the HKSAR retains a high degree of autonomy and enjoys executive, legislative and independent judicial power, including that of final adjudication, in accordance with the provisions of BL: Art 2 BL.

The Executive Authorities
Under BL, the Government of the HKSAR shall be the executive authorities and be headed by the Chief Executive of the Region: Arts 59–60 BL.

Among other things, the Government has the power and functions of formulating and implement policies. She is also responsible for conducting administrative affairs, drafting and introducing bills, motions and subordinate legislation: Art 62 BL.

Further, the Chief Executive has the power of appointing and removing judges of the court of all levels in accordance with legal procedures: Arts 48 BL.

Regarding the relationship between the Government and the Legislative Council of the HKSAR, BL provides that the Government must abide by the law. It must be accountable to the Legislative Council by, among others, implementing the laws passed by the Council, presenting regular policy addresses to the Council and answering questions raised by members of the Council.

The Legislature
Under BL, the Legislative Council of the HKSAR shall be the legislature of the Region: Art 66 BL. Among others, the Legislative Council shall have the powers and functions of enacting, amending or repealing laws in accordance with BL and legal procedures: Art 73(1) BL. Nevertheless, the bills passed by the Legislative Council of the HKSAR may take effect only after it is signed and promulgated by the Chief Executive: Art 76 BL.

It is the Legislative Council that is to examine and approve budgets introduced by the Government, receive and debate the policy addresses of the Chief Executive, raise questions on the work of the Government and debate any issue concerning public interests, and endorse the appointment and removal of the judges of the Court of Final Appeal and the Chief Judge of the High Court: Art 73 BL.

Where the Chief Executive refuses to resign when he is in serious breach of law or dereliction of duty, the Legislative Council has the power requesting the Chief Justice of the Court of Final Appeal to form and chair an independent investigation committee to look into the matter and report to the Legislative Council. The Legislative Council may then pass a motion of impeachment by two-thirds of its members and report the matter to the Central Government for decision: Art 73(9) BL.

The Judiciary
The Court of Final Appeal, the High Court, District courts, Magistrates' courts and other special courts shall be established in the HKSAR, and the High Court shall comprise the Court of Appeal and the Court of First Instance. All these courts shall be the judiciary of the Region and shall exercise the judicial power of the HKSAR: Arts 80-81.

The structure, powers and functions of the courts of the HKSAR at all levels shall be prescribed by law, and with the power of final adjudication of the HKSAR shall be vested in the Court of Final Appeal of the Region, which may as required invite judges from other common law jurisdictions to sit on the Court of Final Appeal. Arts 82-83.

The courts of the HKSAR shall adjudicate cases in accordance with the laws applicable in the Region as prescribed by BL and may refer to precedents of other common law jurisdictions. Further, the courts shall exercise independent judicial power and free from any interference: Arts 84-85.

From what has been said of, BL comprises those elements being referred to in the Definition. To that extent, BL can be said to be the constitution of the HKSAR, though it has not been formally recognized by the PRC as such.

2 The question invites the candidates to demonstrate their knowledge in the ways through which a contract comes to an end.

While the question only requires the candidates to show their knowledge in the discharge of contractual obligations by performance, by agreement and by breach, the candidates should note that contractual obligations may also be discharged by frustration.

(a) Performance

Contractual obligations may be discharged by performance. The general rule is that the performance must be precise and exact: *Re Moore & Co and Landauer Co. (1921) UK*. If the performance of the contract by the contracting parties is not precisely and exactly in the same manner as they have promised, then, they will be in breach of the contract.

There are exceptions to the application of the general rule.

Firstly, the general rule only applies to an entire contract. If the contract in question is divisible or severable, ie, the contractual obligations can be separated into parts, then, the parties having performed parts of the contract may claim for payment in respect of the parts that they have performed. The typical example is a building contract that comprises different stages or parts. A subcontractor under a building contract may claim against the main contractor for payments regarding those stages of construction or parts of the building that he has performed under the contract.

Where a contract does not state expressly that whether it is a divisible one, then, there is a presumption that the contract is not divisible.

Secondly, the general rule is inapplicable if the party in breach has substantially performed the contract in question. In such a case, the party in breach may claim for the balance between the agreed contract price and the amount of damages that the innocent party has suffered from the incomplete performance: *Hoening* v *Issacs* (1952) UK.

Thirdly, where other contracting parties prevent the contracting parties from performing their contractual obligations, then the general rule that performance must be precise and exact is inapplicable.

In such a case, those parties being prevented from performing the contract may bring an action to claim for payment of the work done on a quantum merit basis. Alternatively, he may also sue the other party for breach of the contract.

Finally, the general principle is inapplicable if, by exercising a genuine choice, the innocent parties accept partial performance of the contract by the other contracting parties: *Sumpter* v *Hedges* (1898) UK. The acceptance of partial performance in such a case is in fact a variation of the original contract by the contracting parties.

(b) Agreement

Before the complete performance of a contract, parties to the contract may discharge their contractual obligations by cancelling the contract with a new agreement between them. However, since the agreement itself is also a new contract, for the agreement to be binding on the parties, it must be by deed or supported by considerations from the parties. If the agreement is not by deed or not supported by considerations, the agreement is not binding on the parties unless the doctrine of equitable estoppel applies.

Where all the parties to the contract still have outstanding contractual obligations to perform, then the considerations for the new agreement from the parties are the promises from them to release the other from the original contract.

If one of the parties has completed performance of the contract, then the agreement by this party to release the other from obligations must be supported by fresh consideration, for example, payment of a cancellation fee, and this is called accord and satisfaction. Accord refers to the agreement under which the outstanding obligations are discharged. Satisfaction refers to the fresh consideration that makes the agreement effective. A unilateral discharge is ineffective unless it is given by deed.

Where a debtor has not made full repayment to the creditor, a third party may substitute the debtor by novation. In such a case, the duty of the debtor to repay the debt under the original contract is discharged.

Parties to a contract may also agree on the condition precedent or subsequent, and the occurrence of such a condition automatically discharges the parties from their performance of the contract. A condition precedent is one that prevents the operation of the contract unless the condition is satisfied. A condition subsequent is one that discharges the parties from performance of the contract upon the later happening of an event.

(c) Breach

Where parties to a contract breach a condition of the contract, the innocent parties may claim that their obligations under the contract have been discharged as a result of the breach. However, for a term to be a condition, the term must be an essential term to the contract.

The contractual obligations of the contracting parties may also be discharged by the anticipatory breach of the contract by the other contracting parties. Anticipatory breach occurs when the other contracting parties express an intention that they will not perform the contract or renders them unable to perform the contract at the time the performance of the contract arrives. In such a case, the innocent parties may treat that there was an actual breach of the contract by the other parties: *Hochster* v *de la Tour* (1853) UK.

In either case, the innocent parties may affirm the contract or treat the contract as discharged. The innocent parties affirm the contract when they permit the contract to continue.

3 The question invites the candidates to show their knowledge in the difference between tort and contract and the rule governing the remoteness of damage in tort.

(a) It should be noted at the outset it is impossible to define a 'tort' or tortious liability with great precision. Besides, both the breach of contract and the commission of tort are civil wrongs, which usually results in the commencement of civil actions for the recovery of damages. The aim of criminal law, however, is mainly to punish the offenders who are found guilty for the commission of crimes.

In general, torts involve the breach of duties being owed to the whole world, and with the duties are imposed by law. The primary purposes of torts are mainly about, firstly, the protection of rights or interests being recognised and protected by law, and, secondly, the compensation for the harm being done when such rights or interest are infringed.

As regard the object of an award of damages for the breach of tortious duties, it is to place the plaintiff in the position he would have been in had the tort not been committed.

On the other hand, the law of contract aims at enforcing those promises or obligations which are generally the result of the agreement between the parties involved. Hence, such promises or obligations are usually not fixed by law but by virtue of the consents from the contracting parties.

Principally, it falls within the domain of contract law to enforce those agreements being recognised by law and those promises or obligations being imposed by the agreements.

The purpose of awarding damages, when there is a breach of contract, is to put the injured party, in monetary terms, in that same position as if the injured party would have been in had the contract not been breached.

(b) In tort, the purpose of the rule governing the issue of remoteness of damage is to ascertain in respect of what consequences from the breach that the injured parties can recover. The aim of the rule is therefore not to determine the amount of compensation to be awarded, ie, the quantum of the damages, which is a question that will only be needed to be dealt with after the issue of remoteness of damage has been answered positively.

Under the rule, even the plaintiffs can establish successfully that damage has been caused to them by reason of a breach of duty by the defendants; they cannot recover their losses unless they can prove that the type of damage was not too remote,

In *Oversea Tankship (UK) Ltd* v Morts Dock & Engineering Co Ltd*, The Wagon Mound* (1961) UK ('the Wagon Mound case'), the Privy Council laid down the rule for determining the issue of remoteness of damage. Under the rule, the damage in question is not too remote if the damage is of such a kind that a reasonable man should have foreseen it. In the Wagon Mound case, the Privy Council emphasized that it was the foresight of the reasonable man which alone could determine responsibility.

In the Wagon Mound case, the plaintiff carried out the business of, among other things, ship building and repairing at Sydney Harbour. The plaintiff used a timber wharf for the purpose of the plaintiff's business. The defendant was the charterer of the Wagon Mound, which was an oil-burning ship being moored in the Harbour at a distance of about 600 feet from the wharf for taking on fuel oil.

By reason of the negligence of the defendant's servants, a large quantity of fuel oil was spilt onto the Harbour and spread to the plaintiff's wharf, where another ship under repair and welding operation was being carried out. The plaintiff did stop the operation and inquired the defendant's engineers as to whether it was safe to carry on the operation. The engineers, according to the best scientific opinion available to them, told the plaintiff that the fuel was unlikely to ignite over cool water. All precautions to prevent inflammable material from falling into the oil were made, and the plaintiff continued with the operation.

Two days later, the oil caught fire, which caused damage to the plaintiff's wharf and the ship being repaired.

It was found by the court as facts, firstly, that it was unforeseeable that the fuel oil would catch fire when the oil spread on water, and, secondly, that damage to the plaintiff's wharf from the spillage of oil was foreseeable in that the oil had got onto the spillways and interfered with their use.

The Privy Council held that in deciding whether the defendant should be liable for the damage to the plaintiff when the damage was caused by the fire, the proper question to ask was whether a reasonable man would have foreseen such damage.

On the facts of the case, it was held by the Privy Council that a reasonable man would not have been able to foresee the damage, and the defendant was therefore not liable for the damage to the plaintiff's wharf and the ship when such damage was caused by the fire though the negligence of the defendant's servants was the direct cause of the damage. In order words, in the view of the Privy Council, the type of damage to the plaintiff, ie, the damage caused by fire, was too remote from the negligent act of the plaintiff's servants.

From the finding of the court, it might have been otherwise if the plaintiff had sued on the damage from spillage of oil that had got to the spillways and interfered with their use, which was a type of damage being different from that caused by fire.

4 The question invites the candidates to demonstrate their knowledge in the termination of an employment contract by different ways.

(a) The termination of an employment contract may either be by choice or by breach.

(i) An employment contract is terminated by choice if the parties to the contract terminate the contract by due notice or wages in lieu of notice. The notice may either be orally or in writing. Where an employer gives the notice to the employee, the employee is said to have been dismissed.

Subject to the Employment Ordinance ('EO'), the parties to an employment contract that is continuous within the definition of EO may agree for a minimum period of notice for the purpose of terminating the employment. In such a case, the parties have to comply with the related contractual term.

If the contract does not have such a provision, whether the period of notice is sufficient has to be determined by referring to the nature of the contract and the particular facts of the case in question.

However, any term of an employment contract which purports to extinguish or reduce any right, benefit or protection conferred upon the employee by this Ordinance shall be void: s 70 EO.

Where an employment is subject to probation, either party may terminate the contract without notice during the first month of the probation period. After the first month, either of the parties may terminate the contract by a minimum period of seven days notice: ss 6(3)–6(3A) EO.

If an employment is not subject to probation, then the minimum notice period shall not be less than seven days if the parties have an agreement in that regard. Where the parties have not come to an agreement over the length of notice for the termination of the contract, then the length shall not be less than one month: s 6(2) EO.

An employment contract may be terminated without notice. In such a case, the party seeking to terminate the contract is required to pay to the other a sum representing the wages that the employee would have received during the notice period: ss 7(1)–7(2) EO.

(ii) An employment contract is terminated by breach if the contract is terminated by either summary or constructive dismissal.

Employers may terminate contracts of employment without notice or payment in lieu, ie, dismiss the employees summarily, if the employees, in relation to their employment, willfully disobey a lawful and reasonable order, misconduct themselves and with such conduct being inconsistent with the due and faithful discharge of their duties, are guilty of fraud or dishonesty, or is habitually neglectful in their duties. In addition, the employers may also terminate the contracts on any other grounds that they may terminate the contracts without notice or payment in lieu at common law: ss 9(a)–9(b) EO.

Constructive dismissal refers to the termination by an employee of an employment contract without notice or payment in lieu of notice when the conduct of an employer is so wrongful or unreasonable that the employee could not reasonably be expected to continue working for the employer: *Western Excavation (EEC)* v *Sharp* [1978] UK.

Whether the conduct of an employer amounts to a constructive dismissal is a question of fact and depends on the particular circumstances of each case.

The following are statutory grounds under which an employee may terminate the employment contract without giving notice or payment in lieu to the employer:

- the employee reasonably fears physical danger by violence or disease which was not expressly or impliedly contemplated by the contract of employment: s 10(a) EO; or
- the employee is subjected to ill-treatment by the employer: s 10(b) EO.

(b) In the case of the termination of an employment contract by choice, wrongful termination of the contract occurs when the required length of notice or payment in lieu has not be given by the parties terminating the contract.

Where a termination is by breach, then the termination is a wrongful one if either the employer or the employee cannot establish a justifiable ground for a summary dismissal or a constructive dismissal respectively.

5 The question invites the candidates to show their knowledge in some basic concepts about corporate governance.

(a) According to the Organisation for Economic Co-operation and Development, corporate governance is 'the system by which business corporations are directed and controlled'. In its narrow sense, it refers to the relationship between various primary participants in determining the directions and performance of the company. In its broad sense, corporate governance delineates the rights and responsibilities of each primary stakeholder and the design of institutions and mechanisms that induce or control board directors and management to serve best the interests of shareholders and other stakeholders of a company.

Primary participants or stakeholders refer to the shareholders, directors and managers of a company. Other participants or stakeholders include employees, customers, creditors, suppliers, market intermediaries, auditors, regulators, and the government, as well as members of the community: the Hong Kong Financial System – A new Age, Simon S.M. Ho, Robert Haney Scott & Kie Ann Wong, Oxford ('the Hong Kong Financial System').

(b) According to Professor S.M.Ho, there are four sources of forces shaping the corporate governance of a company. These forces are, firstly, individual ethics and corporate cultures, secondly, internal control and incentive mechanisms, thirdly, external monitoring mechanisms, and, finally, the law and regulations.

Individual ethics and corporate cultures
For a capital market to be efficient and effective, all participants in it must play their roles diligently and support each other with integrity. Hence, a high individual ethical value means that it would be easier for a company to achieve a high standard of corporate governance and the company would be more sustainable.

Ethical guidelines and good communication channels may be set by a company in order that all the staffs of the company may share the same set of value and cultures with the company.

Internal control and incentive mechanisms
The internal control and incentive mechanisms of a company serves to ensure the accountability of the board of directors or management to shareholders or other stakeholders of the company.

The common internal governance mechanisms include the functions of ownership structure, the shareholders' general meeting, the composition of the board of directors and its committee, independent directors, board-management interaction, financial reporting and disclosure policies, internal auditing, and other internal codes, rules and procedures.

External monitoring mechanisms
External monitoring mechanisms refers to those guidelines and standards prescribed by regulators, managerial monitoring by creditors, large institutional shareholders, external auditors, the stock market, the financial analysts, the executive labour market, the market for corporate control, and individual shareholders.

The law and regulations
As the last resort, law enacted by the legislature and regulations set by various professional bodies are required to ensure those participants in the capital market to strike a proper balance between the interest of their own and that of the public at large.

In the Hong Kong Special Administrative Region, the law and regulations include the Companies Ordinance (Cap 32), the Securities and Futures Ordinance (Cap 571) together with those regulations and guidelines from the Stock Exchange of Hong Kong Limited, from the Hong Kong Institute of Certified Public Accountants and those being enforced by the Securities and Futures Commission: see The Hong Kong Financial System.

6 The question invites the candidates to show their knowledge in the memorandum and articles of association of a company.

A company incorporated under the Companies Ordinance (Cap 32) ('CO') has two constitutional documents, viz., the memorandum of association and the articles of association of the company.

Both the memorandum of association and the articles of association are the constitutional documents of a company. As far as the memorandum of association is concerned, it is the charter of the company. It has provisions regulating the external matters of company, ie, governing the relationship between the company and the outsiders to the company. As regard the articles of association, it provides for rules determining the internal arrangements and management of the company. Both of the two documents are not static in their contents in that their contents can be altered by the company to the extent that is permitted by law.

Between the two, the memorandum of association is the dominant document. Hence, when there is a conflict between the two documents, the memorandum of association must be followed.

After the registration of the two documents, the documents have the legal effect of binding upon the company and its members to the same extent as though both the documents have been signed by each of the members of the company, and they contain covenants imposing duties on all the members to observe all the terms of the two documents: s 23(1) CO. Hence, s 23 CO creates two contracts. The first is a contract between the company and each of the members, and the second is a contract between the members themselves.

The contracts only relate to members in their capacities as such and may therefore be enforced by the members. Directors of the company therefore cannot sue the company, in the capacities as the company's directors, for breaching the articles of association of the company when some of the terms of their employment are stated in the articles but not referred to in their contracts: *Re New British Iron Co, ex parte Beekwith (1898) UK*.

7 The question invites the candidates to demonstrate their knowledge in the borrowing power of a company, in debentures and in floating charges.

(a) For companies adopting Table A of the Companies Ordinance (Cap 32) ('CO') as their articles of association, borrowing power of such companies is stated in article 81 of the Table A. Under the article, the directors of the companies may exercise all the power of the companies to borrow money, to charge all or part of its property, undertaking and uncalled capital, and to issue debentures, debenture stock, convertible debentures, and other securities provided that the amount borrowed does not exceed the nominal value of the companies' issued share capital.

The approval from the company in a general meeting is required if the amount borrowed by the companies exceeds the nominal amount of the share capital of the companies being issued.

(b) A debenture is a document being used by companies for evidencing the indebtedness and loans of the companies. The CO does not define what a debenture is. Nevertheless, under section 2 of CO, a debenture includes debenture stock, bonds and other securities of the company whether they constitute a charge on the assets of the company or not.

(c) There is no statutory definition for a floating charge. Nevertheless, a floating charge has been identified as a charge on a class of present or future assets of a company; and with the class of assets are those that keep on changing in the ordinary course of the business of the company. Further, by the time the charge is created, it is in the contemplations of the parties that until the holder of the charge take steps to enforce the charge, as far as the class of assets is concerned, the company may carry on its business in its usual way: *Re Yorkshire Woolcombers Association Bank Limited (1979) UK*.

A floating charge is therefore just like a cloud floating over the class of assets being charged and it only attaches or fixes to the assets when it is crystallized. When crystallization of a floating charge occurs, the exact particulars of the class of assets become identifiable and the company loses its freedom to deal with them immediately.

Hence, a floating charge is created if the officers of a company offer such assets as the company's stock or book debts as security for the repayment of a loan. It should also be noted that the label given to the charge in question by the parties creating the charge is not conclusive evidence as to the real nature of the charge: *Siebe Gorman* v *Barclays* (1979) UK.

S.80 of CO provides for statutory requirement for the registration of a charge. Under the section, every charge created by a company to which the section applies must be registered. Particulars of the charge, together with the instrument creating the charge must be delivered to the Registrar within five weeks after its creation. Failure to do so will render the charge void against the liquidator and every creditor of the company.

8 The question invites the candidates to show their knowledge in the liabilities of a retiring partner and the creation of partners by holding out.

(a) The issues raised in this part of the question is whether Collins should be liable for the settlement of the Purchase Price when the contract in question was entered into by him for the partnership, when the performance of the contract was after his retirement from the partnership, and when the Purchase Price remains unsettled up until now.

In general, every partner is liable for the full amount of the liabilities of the partnership. The outsiders have the choice of commencing legal action against individual partners or the partners collectively. Where damages are recovered from one partner only, the other partners are liable to contribute equally to the amount paid. Besides, an action against one partner does not bar the outsiders to take other action against the other partners for the repayment of the same debt or damages: ss.12–14 of Partnership Ordinance (Cap 38)('PO') and s.5 of Civil Liability (Contribution) Ordinance (Cap.377).

While a person who is admitted as a partner into a firm does not become liable to the creditors of the firm for anything done before he became a partner, a partner who retires from a firm does not thereby cease to be liable for partnership debts or obligations incurred before his retirement: ss.19(1)–(2). A retiring partner remains liable for any debts due at the time of his retirement. The date of the contract determines the responsibilities of the retiring partner. If a person was a partner by the time the contract was made, that person will be liable for the contract price even if the goods purchased under the contract are delivered after he has retired.

Nevertheless, partners of a firm may protect themselves by an agreement with other partners to the effect that when the partners retire, the remaining partners will indemnify the retiring partners against such claims: s.19(3) PO.

Since the question is silent as to whether there was any agreement between Collins and the other partners of the firm, and with such an agreement having the effect that when Collins retired, the remaining partners would indemnify him against any debt or obligation incurred by the partnership during the time when he was a partner, it can safely assume that there was none. However, it should be noted that even if there was such an agreement, the agreement would only be enforceable by Collins against the other partners. As far as the outsiders to the partnership are concerned, Collins is still liable for the contract in any event.

The contract in question was entered into by Collins for the partnership when he was a partner. Though the contract was fulfilled only after the retirement of Collins from the partnership, by reason of what has been said of, Collins remains liable for the Purchase Price.

(b) This part of the question raises the issue of the creation of partners by holding out. Under s.16 PO, every one who, by words spoken or written or by conduct, represents themselves or who knowingly suffer themselves to be represented, as a partner in a particular firm is liable as a partner to any one who has, on the faith of any such representation, given credit to the firm. Hence, under the section, a person is liable as a partner whether he or she makes the representation himself or herself or whether the representation is made by someone else.

However, for a person to be liable under the section, the claimant has to prove the existence of the following elements, namely, a holding out, ie a representation, which is sufficiently clear and unambiguous, reliance on the representation, and the provision of credit to the firm as the consequence: *Nationwide Building Society* v *Lewis* (1998) UK.

By representing to the bank that he was a partner of the partnership, David has made himself a partner under s.16 PO. Since the Loan was granted to the partnership by the bank after David represented to the bank that he was a partner to the partnership, hence it is clear that the bank did give credit to the partnership in reliance upon David's representation. Accordingly, David is liable for the repayment of the Loan to the bank. It should be noted that David will only be treated as a partner of the partnership in relation to the Loan only.

9 The question invites the candidates to show their knowledge in the concept of unfair prejudice.

The issue raised the question is whether there was any unfair prejudicial act being done by Peter and Paul against Mary.

Where the court is satisfied that a petitioner has proved unfair prejudice under s.168A of the Companies Ordinance (Cap 32) ('CO'), the court may make an order, among other things, for the shareholders of the company to buy the shares of other members of the company.

Hence, in order for Mary's application to be successful, Mary must show that the conduct of both Peter and Paul are an unfairly prejudicial act within the meaning of s.168A ('the Section').

Pursuant to the Section, any member of a company may petition to the court for an order to be made under the Section if the affairs of the company are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including the petitioner).

An application under the Section is by way of petition and the conduct in question may consist of an isolated act or a series of acts. It is essential that the petitioner commencing an action under the Section must contemplate that the company should continue trading: *Re Bondwood Development Ltd (1990)* HK.

The CO does not define unfairly prejudicial conduct. Hence, the common law must be considered in determining the issue. To establish unfair prejudice, the petitioner has the burden to show that '… the majority shareholders are using their greater voting power in a manner which does not enable the minority to enjoy a fair participation in the affairs of the company. The emphasis is on the unfairness of the conduct complained of. It must be conduct which departs from the accepted standards of fair play, or which amounts to an unfair discrimination against the minority … the circumstances of each case must be examined in order to decide whether it is such conduct entitling the court to intervene …'. Donaldson Investment v Anglo-Transvaal Collieries [1979] 3 SA 713 per Priess J.

The courts have adopted an objective approach in determining whether the acts complained of amount to unfairly prejudicial acts. The courts will decide the issue by asking the question that, given the consequences of the conduct, whether a reasonable bystander would hold the view that the interests of the petitioner have been unfairly prejudiced: *Re Tai Lap Investment Co Ltd (1999)*.

Where there is a basic understanding between the shareholders over the manner with which the company is to run its business, a breach by the majority shareholders from the understanding in conducting the company's business amounts to an act, which is unfairly prejudicial against the minority shareholders of the company.

In *Re Taiwa Land Investment Co Ltd (1981)* HK, it was held by the court that a breach in the basic understanding between the shareholders, that the company in question was to be developed by borrowed money and out of its accumulated income and not by the issue of new shares, could amount to unfair prejudice within the meaning of the Section. In that case, the petitioner's application under the Section was failed when the court ruled that the petitioner had failed to establish the existence of such an understanding.

For a petition under the Section to succeed, the petitioner must show the existence of both unfairness and prejudice.

An exclusion from management could be an unfairly prejudicial act. However, it would be otherwise if it were the petitioner himself substantially to be blamed for the exclusion by reason of his own disinterest: *Re RA Noble and Sons (Clothing) Ltd (1983)* UK. An application under the Section again cannot be made when the conduct in question applies to all members and is not intended to discriminate between them: *Re a Company, ex parte Glossop (1988)* UK. In both of the two cases, the petitions failed for want of unfairness.

By reason that Peter, Paul and Mary had been partners of a partnership before the incorporation of the company, the company is one of a quasi-partnership by nature. Hence, it is the basic understanding between the three that they would manage the company together.

The fact that Mary was removed from her directorship during the shareholders' meeting despite her strong objection suggests that Peter and Paul had decided to exclude Mary from the management of the company.

The next issue to consider is whether it was Mary herself substantially to be blamed for the exclusion by reason of her own disinterest. The fact that Mary has not been on speaking terms with Peter and Paul after the dispute tends to suggest that there may have problem of communication of some kind between the three only. The question is silent as to whether Mary had done any thing before the shareholders' meeting during which she was removed from her directorship indicating that she did not have an interest in managing the company, and it can be safely assumed that there was none.

By reason of what has been said, it is highly probable that Mary will be able to establish the exclusion of her involvement in the management of the company by Peter and Paul, who are the majority shareholders of the company, and such an exclusion amounts to an unfairly prejudicial act within the meaning of the Section. As such, provided that it is Mary's contemplation that the company should continue trading, she may well be advised that there is a high chance for her to be granted with an order demanding Peter and Paul to buy her shares of the company.

10 The question invites the candidates to show their knowledge in fraudulent trading.

Where in the course of the winding-up of a company, if it appears that any of the business of the company has been carried on with the intent to defraud creditors or for any fraudulent purpose, the court may declare that the persons who were knowingly parties to carrying on the business with the fraudulent intent are personally liable for all debts and other liabilities of the company: s.275(1) of the Companies Ordinance (Cap 32)('CO').

'Defraud' and 'fraudulent purpose' connote actual dishonesty: *Re Patrick and Lyon Ltd (1933)* UK. In *Aktieselskabet Dansk Skibsfinansiering* v *Brothers* (2000) HK ('the Brothers case'), the Court of Final Appeal held that though the further a person departs from objective standards of honesty, the more likely it becomes that the person is dishonest, the test for the existence of dishonesty is subjective in that the defendant must have been dishonest personally. The preference of one creditor to another alone cannot therefore constitute fraud within the meaning of the provision: *Re Sarflax Ltd (1979)* UK.

The question of whether a person carrying on the business was dishonest depends on the particular circumstances of the individual case. Where fraud is inferred, there is almost always 'something else', such as a misrepresentation to creditors of the company's position or their prospects of payment or a dishonest intent to gain some personal advantage: the *Brothers* case.

As stated in s.271(1) CO ('the provision'), the provision only applies in the course of the winding-up of a company. In order to find that a person is liable under the provision, the courts need to be satisfied that the person is so liable on the balance of probabilities, ie, the standard of proof being adopted by the courts in civil proceedings.

The phrase 'carrying on business' in the provision was not the same as actively carrying on trade. Hence, the collection of assets acquired in the course of business and the distribution of the proceeds of those assets in the discharge of business liabilities could constitute 'carrying on business': the *Re Sarflax* case. One transaction may constitute fraudulent trading: *Re Gerald Cooper Chemicals Ltd* (1978) UK ('the Gerald case').

To be liable under the provision, a person must be knowingly a party to the carrying on of the business in question. "… [T]he expression "party to" must on its natural meaning indicate no more than "participate in" or "takes part in" or "concurs in"… [It] involves some positive steps of some nature…": per Pennycuick V-C in *Re Maidstone Building Provisions Ltd* (1971) UK. It is necessary to show an act which could be described as carrying on the business of the company: *Re Augustus Barnett Son Ltd* (1986) UK. Further, the person liable under the provision must have knowledge of the particular transaction in question: *Rossleigh Ltd* v *Carlaw and Carlaw* (1985) UK ('the Rossleigh Ltd case').

Geoffrey

Given that Geoffrey was the managing director of the company, that Geoffrey was the one being solely responsible for the day to day running of the company's business ever since the company's incorporation, and that it was Geoffrey who personally obtained the Garment Order in January for the company, there is no doubt that Geoffrey is the person who was knowingly a party to carrying on the business of the company, which is the acquisition of the Garment Order by the company, within the meaning of the provision.

The next issue to consider is whether the business was carried on with the intent to defraud T-Shirt Limited, or for any fraudulent purpose. The facts that the company has been insolvent ever since December of last year, that the company made use of the Price for the repayment of the Loan immediately after the company received the Price, that the sum of the Loan was the same as that of the Price, that the company went into liquidation after repayment of the Loan and that the Garment Order has not been fulfilled so far suggest that when the company received the Price from T-Shirt Ltd in advance, it seems clear that the only reasonable inference can be drawn is that the company had already known that it could not fulfill the Garment Order and would not be able to repay the Price when the company obtained the Garment Order. Hence, on the balance of probability, there should be no problem for the liquidator to establish that the business of the company has been carried on with the intent to defraud a creditor of the company, ie, T-Shirt Ltd.

Further, by reason of what have been said, it is highly probable for the court to find, on the balance of probability, that Geoffrey sought to have been dishonest personally when he obtained the Garment Order.

Accordingly, Geoffrey will probably be liable for fraudulent trading under the provision.

Money Bank

In the *Gerald* case, it was held that a creditor was a party to the carrying on of a business with intent to defraud other creditors of a company if the creditor accepting the payment of money knew that the money had been procured by carrying on the business with the intent for the purpose of making the payment.

While it was the fact that the company in question could only repay the Loan after the company received the Price from T-Shirt Limited, the question was silent as to whether Money Bank knew that, when the company obtained the Garment Order, the company carried out the business with the intent to defraud T-Shirt Ltd for the purpose of obtaining the Price for the repayment of the Loan. On this fact alone, it is difficult to draw the inference, on the balance of probability, that Money Bank had such knowledge. Accordingly Money Bank probably will not be liable for fraudulent trading under the provision.

1 The question invites the candidates to demonstrate their knowledge in the constitutional nature of the Basic Law in the Hong Kong Special Administrative Region.

8–10 Answers provide a thorough treatment of the question.

5–7 Answers show an understanding of the question area but with little explanation.

2–4 Answers show some knowledge.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

2 The question invites the candidates to demonstrate their knowledge in the ways through which a contract can be discharged.

(a) 3–4 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–2 Extremely poor answers that show either no or very little knowledge of the area.

(b) and (c) 2–3 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

3 The question invites the candidates to show their knowledge in the difference between tort and contract and the rule governing the remoteness of damage in tort.

(a) 3–4 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–2 Extremely poor answers that show either no or very little knowledge of the area.

(b) 5–6 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

3–4 Less thorough treatment of the question. Towards the bottom of this range are those answers which have only very brief explanation of the remedies.

0–2 Very weak answers with inadequate information or answers show little understanding of the topic being examined.

4 The question invites the candidates to demonstrate their knowledge in the termination of an employment contract by different ways.

(a)(i) and (ii) 3–4 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–2 Extremely poor answers that show either no or very little knowledge of the area.

(b) 0–2 At the top of this range are those providing a clear understanding and thorough treatment of the subject areas being examined. Towards the bottom of this range will be those which are very weak or those showing some knowledge but with little detail.

5 The question invites the candidates to show their knowledge in some basic concepts about corporate governance.

(a) 2–3 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

(b) 6–7 Answers provide a thorough treatment of the question.

4–5 Answers show an understanding of the question area but with little description.

2–3 Answers show some knowledge.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

6 The question invites the candidates to show their knowledge in the memorandum and articles of association of a company.

8–10 Answers provide a thorough treatment of the question.

5–7 Answers show an understanding of the question area but with little explanation.

2–4 Answers show some knowledge.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

7 The question invites the candidates to demonstrate their knowledge in the borrowing power of a company, in debentures and in floating charges.

(a) and (b) 0–2 At the top of this range are those providing a clear understanding and thorough treatment of the subject areas being examined. Towards the bottom of this range will be those which are very weak or those showing some knowledge but with little detail.

(c) 5–6 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

3–4 Less thorough treatment of the question. Towards the bottom of this range are those answers which have only very brief explanation of the remedies.

0–2 Very weak answers with inadequate information or answers show little understanding of the topic being examined.

8 The question invites the candidates to show their knowledge in the liabilities of a retiring partner and the creation of partners by holding out.

(a) 3–4 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined. Towards the bottom of this range will be those showing some knowledge but with little detail.

0–2 Extremely poor answers that show either no or very little knowledge of the area.

(b) 5–6 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

3–4 Less thorough treatment of the question. Towards the bottom of this range are those answers which have only a very brief explanation of the remedies.

0–2 Very weak answers with inadequate information or answers show little understanding of the topic being examined.

9 The question invites the candidates to show their knowledge in the concept of unfair prejudice.

8–10 Answers provide a thorough treatment of the question.

5–7 Answers show an understanding of the question area but with little explanation.

2–4 Answers show some knowledge.

0–1 Extremely poor answers that show either no or very little knowledge of the area.

10 The question invites the candidates to show their knowledge in fraudulent trading.

8–10 Answers provide a thorough treatment of the question.

5–7 Answers show an understanding of the question area but with little explanation.

2–4 Answers show some knowledge.

0–1 Extremely poor answers that show either no or very little knowledge of the area.