

Examiner's report

F4 Corporate and Business Law (CHN)

December 2013



Specific Comments

Question One

This question requires candidates to explain the term *jurisdiction*, state the general jurisdiction for a contractual dispute, the rules to be complied by the parties to choose the jurisdiction of court over a contractual dispute and the various courts, other than those under the general jurisdiction, that can be chosen by the parties to hear their contractual dispute.

The key issues should be taken into consideration when candidates answer this question:

The first key issue is the term *jurisdiction*, which refers to a judicial power (a court) to exercise authority over all persons and things within its territory. However, most of candidates were unable to explain this term in part (a).

In part (b) the second issue relates to the general jurisdiction of the court over a contractual dispute. In judicial practices contractual disputes are the most common disputes between companies in their business transactions. Therefore, a lawsuit brought on a contractual dispute shall generally be under the jurisdiction of the court located in the place where the defendant is domiciled or where the contract is performed. Some candidates were able to state the jurisdiction of the court located in the place of the defendant, but failed to state the place of the contract being performed that should also be regarded as the general jurisdiction over a contractual dispute.

Part (c) and (d) were relevant to the rules with respect to the choice of jurisdiction by the parties to a contract. Under certain circumstances the parties may choose the jurisdiction over their possible contractual disputes. In doing so they should comply with some compulsory rules. Parties shall not violate the statutory rules as to the jurisdiction of level and the exclusive jurisdiction. Furthermore, parties to a contract may agree to choose the jurisdiction among the courts in the place, other than those under the general jurisdiction, where the contract is signed or where the object of the action is located to hear their contractual dispute. The right of the choice of jurisdiction is also deemed as a kind of party's autonomy in civil relations.

Most of candidates were unable to give a satisfactory answer to this question. It seems that they were not familiar themselves with the general jurisdiction over a contractual dispute as well as the rules in relation to the party's choice of the jurisdiction over a contractual dispute. Some candidates incorrectly stated the exclusive jurisdiction of the court over a certain dispute, such as the disputes over harbour operations and dispute over real estate. This question was nothing to do with the exclusive jurisdiction, except the rule to be complied with by the parties in choosing the jurisdiction over a contractual dispute.

Question Two

This question requires candidates to explain the meaning and legal nature of the right to the use of construction land, state the forms of the creation of such right for the commercial purposes.

The right to the use of construction land is a kind of usufructuary right in legal nature, not a right of ownership. Therefore, the holder of the such a right has the right to possess, use and seek proceeds from the land owned by the state, and shall be entitled to erect buildings, architectures and their auxiliary facilities on such land.

Part (b) of this question required candidates to the use of construction land that shall be created by the form of assignment for the commercial purposes. According the Property Law, any use of construction land for the commercial purposes shall be assigned by means such as auction, bid invitation or any other public bidding methods. This means that the assignment of this right for commercial purposes shall adopt a competitive and public way.



Part (c) of this question requires candidate to state the necessary procedure to be taken to create the right to use of construction land. Most of candidates were able to point out that the registration of such a right is the only procedure to create such a right. However, some candidates failed to state that the right shall be created by the completion of such registration.

The common errors of this question included:

- Failing to understand the legal nature of the right to the use of construction land to be a kind of usufructuary right;
- Failing to state the competitive and public way to assign the right to use of construction land for the commercial purposes;
- Failing to describe the registration as the statutory procedure to create the right to the use of construction land.

Question Three

This question requires candidates to state the conclusion of the collective labour contract, the compulsory requirements for a collective labour contract, and the condition for a collective labour contract to come into effect. The contents of collective labour contract have not often been examined in past sessions. However, it is one of the important aspects in the Labour Contract Law and will become popular in the labour market.

According to the Labour Contract Law, a collective contract shall be concluded by the trade union, on behalf of the enterprise's employees, and the employer. Where the enterprise does not have a trade union, the collective contract shall be concluded by the employer with a representative chosen by the employees under the guidance of the trade union at the next higher level. Many candidates failed to state the function of the trade union in concluding a collective labour contract and therefore did not pick up the marks as expected.

Part (b) of this question was relevant to the statutory requirement for a collective labour contract, including the rates for wages or salaries and standards for working conditions that should not be lower than the minimum rates and standards for working conditions. Some of candidates were able to state these conditions, even though not very accurately.

Part (c) of this question related the submission of the collective labour contract to the government. According to the law a collective labour contract shall be submitted to the labour administration department after it has been concluded. The collective contract shall become effective upon the expiration of 15 days from the date of receipt thereof, unless the labour administration department raises any objections to the contract. Most of candidates did not give a correct and accurate answer to this part. Some candidates were able to state the requirement for the submission, but unable to state when it becomes effective.

Question Four

This question required candidates to state the rules with respect to a third party that is involved in the performance of a contract, as well as its major difference with the rule of force majeure. This rule with respect to a third party in the performance of a contract has not been examined in the previous sessions. The rule as to force majeure has been examined several times and must be familiar with candidates. However, most of candidates failed to state the core content of force majeure, although they gave a correct answer part (c) as to whether a debtor can claim force majeure.

In part (a) candidates were required to state the rule with respect to a contract to be performed by a third party. According to the Contract Law, where a contract to be performed by a third party as designated by the debtor, the debtor shall be responsible to the creditor for the breach of contract if the third party fails to perform, or the performance fails to conform to the agreement.

With respect to the rule of force majeure in part (b), it means any objective circumstances which are unforeseeable, unavoidable and insurmountable. By invoking force majeure a party may exempt their liability from the breach of contract caused by the above-mentioned circumstances. Hence, force majeure does not mean that a party is not in breach of contract due to force majeure, but means that a party may be exempted from their liability from the breach of contract caused by force majeure. Force majeure is a rule of exemption. However, most of candidates were unable to accurately state the meaning of force majeure as well as the core of this rule.

In part (c), candidates were required to distinguish the rule as to the breach of contract caused by force majeure and the breach of contract caused by the failure of a third party who was designated by the debtor to perform the contract. According to the Contract Law, the debtor shall take the liability for breach of contract to the other party where the breach of contract is caused by a third party. The third party's failure is not force majeure, which takes place due to an objective circumstance. Most of candidates gave a satisfactory answer to this part, though some of them did not accurately state the objective factor to be a key element for a force majeure.

Question Five

This question required candidates to state the various illegal activities, relevant to the use of the funds of a company, committed by a director or a senior executive that will damage the interests of the company and the conditions to be met for a shareholder of a stock company to protect the interests of the company.

Part (a) was relevant to the various illegal activities committed by a director or a senior executive, in terms of the abuse of the funds of a company. Therefore, candidates were not required to state the general illegal activities, but the illegal ones in relation to the abuse of the funds of a company. Under the Company Law, the following activities shall be fallen within such kind:

- (i) misappropriate the company's funds;
- (ii) deposit the company's funds in their own personal accounts or in personal accounts of other individuals; or
- (iii) in violation of the company's articles of association and without the consent of the shareholders' meeting or the board of directors, lend company's funds to others or use the company's property to provide guarantee for others.

This part of question was not satisfactorily answered by candidates because they failed to pick up the key point in this part, namely the illegal activities with respect to the abuse of the funds of a company.

Part (b) of this question required candidates to explain the conditions to be met for a shareholder of a stock company who intends to bring a lawsuit in their own name but for the interests of the company. The relevant provision of the Company Law stipulates quite strict conditions for a shareholder to take such a legal action as follows:

- (i) the shareholder(s) shall hold, individually or jointly, 1% or more of the company's shares for no less than 180 consecutive days;
- (ii) the said shareholder(s) have requested, in writing, the supervisory board to bring a lawsuit against the relevant persons before the court;
- (iii) the supervisory board refused to file such a lawsuit or failed to file a lawsuit within 30 days upon its receipt of such request.

With regards to this part, most of candidates were able to state the point as to the request, in writing, to the supervisory board to bring a lawsuit against the persons who committed the illegal activities, but failed to accurately the requirements as to the shares held by the shareholders for no less than 180 consecutive days and the supervisory board refusing to take legal action. Therefore, they were unable to get a satisfactory mark for this part.

Question Six

This question required candidates to state the costs or fees to be repaid in priority before the insolvent assets can be liquidated, and the orders of liquidation for the insolvent assets at the end of bankruptcy procedure. Candidates could simply pick up all the points from the relevant provision of the law. Furthermore, the distribution of the insolvent assets, the order of payment of cost and community liabilities have been examined several times, candidates should be familiar with this rule. However, many were unable to answer this question correctly. Some candidates considered incorrectly that the community liabilities as a kind of debts that resulted from the previous business transactions. Obviously, such debts were the common debts and should be settled in the last order of liquidation of the assets. Therefore, performance of this question was unsatisfactory.

The key point to this question was that the cost for bankruptcy procedure and the community liabilities shall be repaid prior to the liquidation of the insolvent assets at the end of the bankruptcy procedure. After the payment of these items, the insolvent assets shall be liquidated according to the following sequence:

- (i) The wages and subsidies defaulted by the enterprise; the pension and fundamental medical insurance premiums owed as well as the statutory compensation for employees;
- (ii) The social insurance premiums and taxations as defaulted by the bankrupted enterprise other than those prescribed by the aforesaid provisions;
- (iii) The common credit of bankruptcy.

As to the above-mentioned sequences, most of candidates were able to pick up only one or two points, failing to give a full and accurate answer.

Question Seven

This question required candidates to explain the term *inside information* in securities transactions, and describe the various information that shall be deemed as *inside information* in relation to the capital and assets of a stock company. This question was not answered with a satisfactory manner.

Part (a) of this question related to the meaning of the term *inside information*. The term *inside information* refers to the information that is not disclosed to the public investors which, in the course of securities trading, concerns the business operations and financial affairs of a company or the information having a material impact on the market price of a company.

The key points to this part include: first, the inside information being not disclosed to the public investors but having to disclose under proper circumstances; second, the inside information having some commercial value to the public investors and a material impact on the market price of a company. Some candidates held that inside information to be the information that should be kept confidential. This is not correct. The inside information should not be disclosed to individuals until it was disclosed by the proper way and time, e.g. by the secretary of the board of directors of the company through press conference or other proper ways. This was the reason why candidates received marks below expectations.

Part (b) of this question related to the inside information relevant to the capital and assets of a stock company:

- (i) plans concerning distribution of dividends or increase of capital;
- (ii) material changes in the equity structure of the company;
- (iii) any mortgage, sale or write-off of a major asset used for the business of the company that the value of a single transaction of which exceeds 30% of the asset,
- (iv) the plan for the acquisition of a listed company;
- (v) major changes in guaranty of the company's obligation.

Candidates were required to describe specifically the information in relation to capital and assets of a stock company, not the inside information in general sense. Most of candidates described a series of information but few of them mentioned the inside information relevant to the capital and assets of a stock company.

Question Eight

This question required candidates to deal with the legal issues relevant to the dissolution of a contract, the date of dissolution, and the legal procedure for a party to take who objects the dissolution.

Performance for this question was, as a whole, quite satisfactory, since most of candidates were able to give the correct conclusions and also provide some reasons to support their conclusion. However, some candidates still failed to give the correct conclusion or provide adequate reasons to support their conclusion.

The correct answer to part (a) was that Ms Chan was entitled to dissolve the contract. In accordance with the relevant provision of the Contract Law, where one party explicitly expresses or demonstrates through the party's own act that the performance of the contractual obligation is not intended, the other party may declare the dissolution of the contract before the expiration of the period for performance. Therefore, Ms Chan was entitled to dissolve the contract, as Mr Lee explicitly refused to handle the registration matters by taking back the Certificate of Property. Under such circumstances Ms Chan was entitled to dissolve the contract. However, some candidates held that Ms Chan was not entitled to dissolve the contract, since the time limit for the registration of the transfer of property did not expire. It was known to everybody that the registration of the transaction concerning a real estate was a statutory procedure to complete a real estate transaction. The refusal of registration, under any circumstances, indicated Mr Lee's refusal to perform his substantive obligation.

Part (b) related to the notification of dissolution. A party shall notify the other party as to their decision to dissolve the contract. The contract is dissolved at the time the other party receives the notice. Therefore, 28th January was the date on which the contract was dissolved. Most of candidates were able to give a correct conclusion to this part. However, some candidates failed to indicate the date of dissolution and considered the particular date of despatching the notice to be the date of dissolution.

Part (c) of this question related to the objection to the dissolution by the other party. Mr Lee might apply to the people's court or an arbitration institution for affirming the effect of the dissolution of the contract. According to the Judicial Interpretations on the Contract Law by the Supreme People's Court, the party shall submit their objection within three months from the date of receipt of the notice for dissolution. Beyond such a time limit, the party shall lose their right to objection. Limited candidates were able to state such a legal procedure in an accurate manner. A few candidates stated only the people's court being the authority to confirm the effect of dissolution, without stating an arbitration institution as a proper authority too.

Question Nine

This question required candidates to deal with the legal issues concerning the contribution of the capital and the establishment of a limited liability company. Just as in the previous session, most of candidates were able to answer this question satisfactorily and received a high mark.

With respect to part (a) of this question, candidates were required to make a judgement about whether the limited liability company could be established. To answer this question candidates should be familiar with the rules as to the capital of a limited liability company. According to the Company Law, the amount of initial capital contributions shall not be less than 20% of the registered capital; the capital in the form of cash shall not be less than 30% of the registered capital. In this case the initial capital contribution paid by Yolo Co was more than 20% of the registered capital and the capital in cash provided by Mr Wang met the requirement of no less than 30% of the registered capital of the company, therefore the company would be legitimately established. Although most of candidates could give a correct conclusion on this part, some of them failed to give detailed reasons with accurate figures for the capital of the company as stipulated by the Company Law.



Part (b) of this question related to the capital contributions in the form of technology. Technology was a kind of intangible property. According to the Company Law, any non-currency property contributed as capital shall undergo an appraisal, valuation and verification, and shall not be overvalued or undervalued. Therefore the capital contribution in the form of technology by City College should be appraised before it was actually put into the company. This question was answered satisfactorily by most of the candidates.

Part (c) of this question related to the legal liability for a shareholder failing to make capital contributions. According to the Company Law a shareholder shall not only make up the remaining amount of capital but also be liable for breach of contract towards the shareholders who have made their capital contributions in full and on time. Hence, Mr Wang should make up the remaining RMB 500,000 yuan and pay damages to City College and Yolo Co.

Candidates were required to answer two points on this part: making up the remaining capital and paying damages to the other shareholders. Most of candidates were only able to pick up one of the points on this part.

Question Ten

This question required candidates to deal with the legal issue of the declaration of credits during the process of liquidation. As a whole most of the candidates were able to give answers to this question, but did not give the satisfactory reasons to support their conclusion.

In part (a) Huadong Holdings Co should be a qualified creditor and was entitled to declare its credit even though it has not yet borne the guarantor's obligation. Under the provision of the Enterprise Bankruptcy Law, where the guarantor of a debtor or any other related joint and several debtor has not yet cleared the liabilities on behalf of the debtor, it may declare its creditor's right on the basis of its future right to recourse against the debtor. Some candidates failed to give a correct conclusion as to Huadong Holding Co as a qualified creditor on the grounds that it did not bear its guarantor's obligation. Since its obligation toward Materials Co still existed. Where Materials Co came to request to discharge its obligation, it had to pay the price under the guarantee agreement.

Part (b) of this question was related to the legal status of Huadong Holding Co where Materials Co has declared the creditor's rights to the bankruptcy administrator. According the Enterprise Bankruptcy Law, Huadong Holdings Co could not declare its credit during the process of liquidation under such a circumstance. Since General Contractor owed an amount of RMB 6 million yuan to Materials Co and this debt was guaranteed by Huadong Holdings Co. Where General Contractor failed to pay the price, Materials Co might have an alternative to claim its credit against Huadong Holdings Co or General Contractor. Once Materials Co has chosen to declare its credit to the bankruptcy administrator, it would not be entitled to request Huadong Holdings Co to bear its guarantor's obligation. Under such a circumstance Huadong Holdings Co would not bear any guarantor's obligation in the future, therefore, is not a qualified creditor against the debtor.

Although this part was more complicated than part (a), the answer to this part was very clear. Whether or not Huadong Holding Co, as a guarantor, should be a qualified creditor to declare its credit depended on the choice of Materials Co. Most of candidates were able to give a correct conclusion but fail to give adequate reasons to support their conclusion.