Examiner's report

F4 Corporate and Business Law (CHN)
June 2013

General Comments

The examination consisted of ten compulsory questions of 10 marks each.

The vast majority of candidates attempted all ten questions, and there was no evidence of time pressure. Where limited questions were left unanswered by candidates, this appeared to be due to a lack of knowledge, not due to the time pressure.

Candidates performed quite well on Question 8(a, b, c), Question 9 (a) and Question 10 (a, b, c). The questions candidates found most challenging were Questions 1, 3, 4 and 7. This is mainly due to candidates not understanding core syllabus areas well enough and also due to a failure to read question requirements carefully.

Specific Comments

Question One

This question required candidates to explain the rules that shall be followed by courts in dealing with the contracts signed by a sponsor, in the name of himself or in the name of the company respectively, during the process of setting up the company under the judicial interpretations by the Supreme People's Court (SPC). In practice such kind of contracts are very popular during the period of setting up a company, such as the lease contract for the office building of the proposed company. Since the proposed company has not yet set up, the sponsors will sign the relevant contract in their own name but for the interests of the company or in the name of the proposed company. Whether or not the company is established, the counterparty to such a contract is a bona fide party whose rights and interests should be protected.

Part (a) required candidates to explain the rule to be followed in dealing with the circumstances under which the counterparty to a contract, signed by sponsors in their name for the purpose of setting up the company, requests the sponsors to be responsible for the contract. In accordance with the Judicial Interpretations (III) on the Company Law, the sponsors shall be responsible for the contract by them, signed by the sponsors in their names for the purpose of setting up the company. The court shall uphold the request of the counterparty to such a contract.

The condition of Part (b) was different from that of Part (a), in which candidates were required to answer whether the company should be responsible for the contract, signed by its sponsors in their name for setting up the company. Obviously, when the sponsors signing the contract in question the company has not yet been established. Therefore, where the company acknowledges the contract after the company is established, the company enjoyed the contractual rights or performed the contractual obligations, the court shall uphold such a claim.

Part (c) was relevant to contractual liability of the company, requested by its counterparty, where its sponsor signed a contract in the name of the company. In accordance with Judicial Interpretation on Company Law (III), the court shall uphold such request by the counterparty to such a contract.

As a whole, performance for this question was not satisfactory due to the incorrect understanding of the requirement by candidates. They were confused by this question with the rules in relation to the jurisdiction over contractual disputes under the Civil Procedures Law. The rules of jurisdiction over particular disputes are to deal with the matters which court should be the adequate one to hear the case, while Question 1 are to test the rues to be followed by courts in dealing with the requests brought by the counterparty to contract which is signed by the sponsors of a company. Therefore, jurisdiction is a kind of procedural matter, but the rules on how to deal with certain contractual disputes are the substantive matter. There were no words in this question which required candidates to answer the jurisdiction of the contractual disputes. The relevant rules in this question can only be answered based on the Judicial Interpretation on Company Law issued by the SPC, as both Contract Law and Company Law did not contain such rules.

Question Two

This question requires candidates to state the rules relating to the transfer of mortgaged property during the period of mortgage, and the rules relating to the transfer of credit which is secured by a mortgage.

Part (a) was relevant to the transfer of the mortgaged property, by the mortgagor, during the period of mortgage. Most of candidates merely focused their attention on the mortgagee's consent as the condition to transfer the mortgaged property, but failed to understand that a mortgagor or transferee may transfer the mortgaged property if they pay off the debts so as to terminate the mortgage contract. According to the Property Law where the amount obtained from such transferring exceeds the value of the mortgagee's creditor's rights, the surplus shall belong to the mortgagor; where the amount is insufficient to settle the value of the mortgagee's creditor's rights, the deficit shall be paid by the debtor. In a word, although consent by mortgagee is a factor to be considered by the mortgagor to transfer the mortgaged property, but it does not mean that without such consent the transferring cannot be carried out. The purpose of setting up a mortgage stands for a guarantee for the creditor. If the mortgagor (or debtor) is willing to pay off the debts, there is no reason for a mortgagee to refuse. Due to the above-mentioned, most of candidates did not gain a satisfactory mark.

Part (b) of this question was in relation to the transfer of mortgage right together with the mortgage right. According to the Property Law when creditor's rights are transferred, the mortgage right thereof shall be transferred together, unless it is otherwise provided for by law, or otherwise agreed upon by the parties concerned. This rule is to protect the rights and interests of the transferee. Generally speaking many candidates did not understand the key point to this part and answer correctly.

Question Three

This question was to test candidates of the circumstances under which a labour contract terminates. Generally speaking, this question required only to explain four, out of many, circumstances under which a labour contract terminates.

Where candidates did not score full marks this was because they failed to read the question properly. The termination of a labour contract means the labour contract will no longer bind upon the parties to it under the various circumstances as prescribed by the law or parties' agreement.

Termination of a labour contract generally does not result from the breach of contract by one of the parities to the labour contract. Under any one of the circumstances, such as the expiration of the term of a fixed-term labour contract, the employee's beginning to enjoy their pension for retirement, the death of an employee or the

bankruptcy of the employer, the labour contract terminates automatically. Since the labour contract loses its basis for the continuous performance. However, many candidates were confused themselves with the dissolution of labour, which is resulted from the breach of a labour contract by an employer or employee. They described the various breaches by one of the party to the labour contract under such circumstances the other party may be entitled to declare the dissolution of the labour contract. Obviously they did not answer the question to the point. For this reason so many candidates fail to receive marks as expected. Candidates must read the question carefully.

Question Four

Part (a) of this question required candidates to explain the term specific performance. It is a rule of contract law and also the one of the legal remedies, conferred by the Contract Law, for breaches of a contract. In accordance with Article 107 of the Contract Law, where a party breaches the contract, the other party may request the breaching party to continue to perform their obligations under the contract. Therefore, specific performance is sometimes regarded as continuous *performance.*

Although specific performance is one of the legal remedies for breach of contract, its use is very limited or restricted in judicial practices. According to the Contract Law only if a party breaches their non-monetary obligation can the other party request for specific performance as a legal remedy. Therefore, part (b) of this question requires candidates to state at least two kinds of contractual obligation that are regarded non-monetary in nature. Handing over a set of apartment to the owner by a real estate developer or donating a painting to the museum by an artist shall be deemed as non-monetary obligations. However, very limited candidates were able to understand the non-monetary obligations and correctly point out any subject matters of a contract that shall be deemed as non-monetary obligations.

Based on the above reasons, Part (c) required candidates to state the various circumstances under which the request for specific performance cannot be upheld by the court even if the other party has breached the contract. According to the Contract law under any one of the following circumstances specific performance cannot be requested by a party or should not be upheld by the court even if a party such requested where the other party breaches contract: specific performance is impossible in law or in fact, the subject matter of the obligation is not suitable for a compulsory enforcement or the cost of performance is excessively high and the obligee does not request for specific performance within reasonable time. For instance, where an agent fails to perform their obligation under an agency agreement the principal cannot request the agent to continue the performance of the agency agreement (a specific performance). As a rule of law any person should not be forced to provide agency services. The principal can claim for damages or liquidated damages if the failure of the agent causes detriment to the principal.

The correct answer to this question stands for the proper understanding of the rule of specific performance. Only a few candidates could understand the meaning of the question and state the key points in part (c). As a whole, therefore, performance for this part was not satisfactory.

Question Five

This question was relevant to the forms of a company merger and the various procedural requirements to be taken by the parties involved in such transactions. Company merger has been examined in the previous sessions

and must be familiarised by candidates. Therefore, most of candidates were able to answer the question with high marks, especially the performance for part (a) in relation to the two forms of company merger.

With respect to part (b) candidates were required to state the necessary procedural matters to be taken by the parties for the purpose of completion of a merger transaction. These procedural matters include the formulation of a statement of financial position and inventory of assets, notification to the creditors within the statutory time limit, the announcement of the proposed transaction in newspaper as well as the registration of any changes in legal entity after the completion of company merger. Comparatively, most of candidates were able to state such procedural matters as the notification of the proposed merger to the creditors and preparing a statement of finance, but failed to state the other necessary matters to be taken. Especially they failed to point out the registration requirement with the Administration for Industry and Commerce after the merger completes. For this reason they did not receive full marks.

Question Six

This question required candidates to state the legal effect of the settlement of debts by a debtor against individual, the obligations as well as legal consequences for breach of such obligations when a people's court has accepted the application for bankruptcy.

In accordance with the relevant provision of the Enterprise Bankruptcy Law, the settlement of debts made by the debtor to an individual creditor after a people's court accepts an application for bankruptcy of the debtor shall be invalid. Since such a way would damage the rights and interests of other creditors against the debtor. Therefore, the law forbids the debtor to settle debts to an individual creditor when a court has already accepted an application for bankruptcy of the debtor. most of candidates were able to correctly understand this rule and answer quite satisfactory.

Part (b) included two aspects: the obligations of the debtors of the debtor (the enterprise against whom an application for bankruptcy is brought) or the property holder of such a debtor, and the legal consequences for breaching their obligations. According to the Enterprise Bankruptcy Law, relevant debtors shall settle the debts of the debtor and the property holders of the debtor shall deliver the relevant property to the bankruptcy administrator. These obligations are very important for the protection of the rights and interests of the creditors of the enterprise against which the court accepts an application for bankruptcy. For instance, the refusal or failure to deliver the property held by a party will affect the quantity of the assets of the enterprise for liquidation. Breach of such obligations by the relevant parties would cause liability for compensation.

A number of candidates were unable to answer part (b) (i) as regards the obligations of the debtors of the debtor and the property holder of the relevant debtor, but answered part (b) (ii) as to the legal consequences of breach.

Question Seven

This question was relevant to *banning access to the securities market* as an administrative penalty, the circumstances under which the relevant persons may be penalised and the activities committed by a sponsor that may be subject to *banning access to the securities market*. Therefore, the key issue to this question is to know the administrative penalty of banning access to the securities market.

To understand *Banning access to the securities market* one should catch three aspects: first, it is a kind of administrative penalty for violation of law by the relevant party; second, the violation of law must be in relation to the activities in securities market, not a violation in its general sense; thirdly, the penalty takes a form of banning to access to the securities market for certain person who violates the securities law. The correct understanding of the term banning to access to the securities market also constitute the basis for the adequate answer to the other two parts. However, some candidates did not catch the key aspects of the term banning access to the securities market which resulted in the dissatisfactory answer to this part and the following two parts.

Part (b) relates the circumstances that may be subject to the administrative penalty of banning access to the securities market. Some candidates were able to answer limited points to this part but failed to get full marks, because they did not point out the intention of the person in violation and the seriousness of the circumstances being the key factors to be considered by the government department in adopting such administrative penalty.

Part (c) was relevant to activities committed by a sponsor that may be subject to banning access to the securities market a penalty by the relevant government department. According to the Securities Law these activities include issuance of a letter of sponsorship containing a falsehood, misleading statement or major omission or failure to perform other statutory duties. Candidates normally were able to answer the false statement in a letter of sponsorship, but unable to state other illegal activities that might be subject to banning access to the securities market. Therefore, performance for this part was not satisfactory.

Question Eight

This question required candidates to deal with the legal issues in relation to the pledge of rights and the restrictions on the transfer of the right as pledged.

In part (a) candidates were required to determine the date on which the right to pledge was established and the institution the pledge should be registered with. Based on the scenario and in reference to the relevant provisions of the Property Law, the right to the pledge shall be established upon registration of such pledge. Since the two parties applied for registration of pledge on 16 June 2012, this day was the date of the establishment of the right to pledge. In addition, as TCL is a listed company, the registration of the pledge of its shares shall be registered with the China Securities Registration and Clearance Company Ltd. Most of candidates were able to give correct answer to this part as to the date of the establishment of the right and the adequate institution for registration. Even though, a few candidates did not read the question carefully by determining the date of the establishment of the right to be on 15 June 2012. They failed to understand the importance of the registration and the date of the establishment of such a right.

Part (b) required candidates to state the particular institution which the pledges should be registered with if TCL was a limited liability company. The relevant institution is the Administration for Industry and Commerce for registration. Since the shares of a limited liability company are not traded in the securities market, the Registration and Clearance Company is not the proper institution for registration. Performance of candidates for this part was satisfactory.

In part (c) candidates were required to determine whether City Bank was entitled to refuse the proposal of Drinking Co to sell the shares and make early repayment. In accordance with the Property Law, no fund units or equity interest may be transferred after the pledge, unless the pledgor and pledgee agree after a consultation. City Bank and Drinking Co were the pledgee and pledgor respectively. City Bank might agree with Drinking Co's

proposal but had no obligation to do so. Therefore, City Bank was entitled to refuse the proposal of Drinking Co to sell the shares under the pledge and make an early repayment. Most of candidates were able to answer this part correctly and receive full marks allocated to this part. However, some candidates considered that City Bank was not entitled to refuse the proposal. They failed to read the relevant provision of the Property Law and failed to understand the object of such a rule is to protect the interests of the pledgee. Furthermore, according to the Property Law where the pledgee agrees the pledgor may still to sell the shares under the pledge and make an early repayment.

Question Nine

This question requires candidates to deal with the legal issues in respect of the formation of contract. Formation of contract is a subject that has been examined frequently in previous sessions.

In part (a) candidates were required to determine whether there was a contract between Trading Co and Textile Company. In answering this part of the question candidates should know clearly the essential rule as to offer and acceptance, as well as make an accurate conclusion on the legal nature of actions taken by both parties. According to the scenario Trading Co sent an offer which had reached Textile Company. Therefore, the offer came into effect. Textile Company sent back a fax which should be regarded as a reply purported to be an acceptance but contained additions.

However, in accordance with Article 30 and 31 of the Contract Law, a package of goods contained in this fax was not a term that materially changes the term of the offer. Since Trading Co did not timely object to such non-material changes, the fax constituted an effective acceptance. Upon arrival of the acceptance to Trading Company, the contract was formed. Although most of the candidates could give a correct determination as to the existence of a contract, the reasons to support their answer were not strong enough. Moreover, some candidates failed to give a correct conclusion, because they did not understand accurately the legal nature of the reply by Textile Company which contained some changes with respect to the package of goods.

The nature of Textile Company's fax to Trading Company was a reply purported to be an acceptance but contained additions. Its legal nature depends on the following expression of Trading Co. In accordance with Article 30 of the Contract Law, where a reply purported to be an acceptance but contains additions or changes, unless the offeror objects timely upon receiving such a reply, the contract is still formed by the offer and the reply which contains an additional term. This means, therefore, the contract may not be formed if the offeror objects the additional term. Based on the above reasons, the legal nature of the fax sent by Textile Company depends on the action of Trading Company. Since Trading Company did not object to the change as to the package of goods timely, the contract was formed. Most of candidates did not distinguish between the acceptance and the reply purported to be an acceptance but contains changes or additions.

Question Ten

This question required candidates to deal with the legal issues concerning the registered capital of a limited liability company. Performance for this question was quite satisfactory, as most of candidates were able to answer all the three parts and received full marks.

Part (a) required candidates to discuss the initial capital contribution made by the sponsors. Under the Company Law, the amount of initial capital contributions made by all the shareholders of a limited liability company shall not be less than 20% of the registered capital of the company. Since the amount of initial capital contributions

to be paid by three sponsors was less than 20% (Mr Lee 20,000 + Mr Chan 90,000; 110,000 / total registered capital 600,000) of the registered capital of the company, it was not in conformity with the law.

Under the Company Law, the amount of capital contribution in currency by all shareholders shall not be less than 30% of the registered capital of the limited liability company. In this case, the amount of capital contribution in currency was RMB 340,000 yuan (Mr 70,000 + Mr Chan 270,000 / total registered capital 600,000), much more than the minimum requirement by the law. Hence, it was in conformity with the law.

Under the Company Law, all the capital contributions shall be paid by the shareholders of the company within two years upon the incorporation of the company unless otherwise provided for by the law. In this case, the time limit for making capital contributions for Mr Lee and Mr Wang was in conformity with the law. The time of making capital contribution by Mr Chan, however, was not in conformity with the law. Since the parties agreed that some of the capital contribution would be made in the third year upon the incorporation of the company.

As a whole performance for this question was satisfactory. Most of candidates were able to give correct answers to the three parts with the reasons to support their answer. Only a few candidates failed to state accurately the time limit for the sponsors to make their capital contributions after the incorporation of the company.