# Answers

**1** The question invites the candidates to show their knowledge of the importance of Basic Law over the interpretation of statutes and the concept of human rights as expressed in the Bill of Rights Ordinance (Cap 383) ('BRO')

**(a)** The intention for the enactment of BRO is to incorporate provisions of the International Covenant on Civil and Political Rights ('ICCPR') into the laws of the Hong Kong Special Administrative Region ('HKSAR').

BRO was enacted before 1997. Article 39 of the Basic Law ('BL') provides, among others, that the provisions of ICCPR shall remain in force after 1997. As such, BRO is still the law of the HKSAR. The importance of BRO lies in that it sets out the human rights, in terms of civil and political rights of the residents of the HKSAR ('the residents') by reason of the provisions of ICCPR.

The following is a description of the rights of the residents being protected under BRO.

To begin with, the residents are entitled to the rights stated in BRO regardless of their colour, race or creed. The residents have the right to life, the right not to be deprived of their liberties, the right to have the liberty of movement, the right of peaceful assembly, the right of the freedom of peaceful assembly and association, the right to have the freedom of thought, conscience and religion, the right to have the freedom of opinion and expression, and the rights of the minority shall be protected.

Under BRO, the residents have the liberty and security of person, i.e. there shall be no arbitrary arrest or detention. There shall be no slavery or servitude. The residents enjoy the right of persons being charged with, or convicted of, criminal offences, e.g., right to maintain silence. The residents shall not be subject to torture or inhumane treatment. There shall be no criminal offences or penalties which take effect retrospectively. Every resident is equal before the law and the courts and have equal protection under the law. The residents are entitled to have their case to be dealt with in a fair and public hearing. There shall be no imprisonment for breach of contract.

BRO also gives residents the right of marriage, family and of children. It also provides for the protection of privacy, family, home, correspondence, honour and reputation, etc.

**(b)** Article 8 of the Basic Law ('BL') provides that the laws in force in the HKSAR prior to 1997 shall be maintained, except for those which contravene BL, and subject to any amendment by the legislature, i.e. the Legislative Council, of the HKSAR. The laws mentioned in BL are the common law, rules of equity, ordinances, subordinate legislations and the customary law. It follows that BL is the highest form of law in the HKSAR in that where laws from other sources are in conflict with BL, BL is to prevail.

As said in part (a), the legal status of ICCPR, which forms the substance of BRO, is expressly recognised in BL. BRO may therefore be said to have the same status as BL.

By reasons of the foregoing, during the process of statutory interpretation, whenever the courts have the view that a piece of legislation is in conflict with the articles of BL or BRO, the courts will give effect to BL or BRO. The same also apply to the application of common law and customary law.

**2** The question tests the candidates' knowledge of the terms of a contract.

For the purpose of determining the right of an innocent party upon the breach of a contract, contractual terms are divided into three types. They are warranties, conditions and innominate terms.

Warranty

A warranty is a term of lesser importance in that the subject matter of the term is only incidental to the main purpose of a contract.

As such, the breach of a warranty does not destroy the whole purpose of the contact. Upon the breach of such a term, the contract is still alive and the only remedy available to the innocent party is to claim against the party in breach for damages.

Condition

A condition refers to an important term of a contract in that it forms the fundamental part or the root of the contract. When a condition is breached, the innocent party has the right to terminate the contract, refuse to perform its outstanding contractual obligations and claim against the party in default for damages immediately.

Alternatively, the injured party may choose to keep the contract alive and sue the party in default for damages. In such a case, the injured party is still under a duty to perform the outstanding obligations under the contract and the term is treated as if it were a warranty.

As can be seen from what has been mentioned, upon the breach of a contractual term, if the innocent party chooses only to sue for damages against the party breaching the term, it would be unnecessary to decide if the term in question is a condition or a warranty for the effect of such a choice is that the innocent party simply regards the term as a warranty. Hence, the party chooses to waive his right to terminate the contract which is available to the party when the term is in fact a condition.

Only when the innocent party decides to terminate the contract and sue for the damages he suffers immediately after the breach, will the issue of whether the term is a condition or warranty arise. For in such a case, the innocent party treats the term being broken as a condition. Under such circumstance, it is valid to say that whether a contractual term is a condition or warranty depends very much on the choice of the party suffering from the breach of the contract. Where the party in breach does not dispute the act of terminating the contract by the innocent party immediately after the breach, then the term could be regarded as a condition by reason of the consent of the party in breach when such consent can be implied from the conduct of not disputing the nature of the term in question.

To sum up, if the party having breached the contractual term in question does not dispute the act of the innocent party to terminate the contract and sue for damages immediately after the breach, then it is valid to say that whether a contractual term is a condition or a warranty depends very much on the choice of the innocent party.

**Tutorial note:**
*There are terms which are regarded as conditions in either common law or statutory law. For example, it is a standard term in a formal contract for the sale and purchase of a real property that time is of the essence. In such a case, the date as stipulated in the contract for the completion of the transaction is a condition at law. There are also conditions being implied into a contract for the sale of goods under the Sales of Goods Ordinance (Cap 26).*

**3** The question invites the candidates to demonstrate their knowledge of some concepts in employment law.

An employee is a person being hired to provide service under a contract of service or employment contract. Between the employer and the employee, there exists a master and servant relationship. A self-employed person is a person running a business on their own. Self-employed persons are hired under a contract for services. Self-employed persons are usually referred to as independent contractors.

When a dispute arises out of an employment contract, under Labour Tribunal Ordinance (Cap 25), the Labour Tribunal shall have the exclusive jurisdiction to handle the dispute. The jurisdiction of the Labour Tribunal includes the power to transfer the hearing of the case to the court when the tribunal thinks fit. Where claims arise out of a contract for services, the claims shall be dealt with by the Small Claim Tribunals or the court.

The Employment Ordinance (Cap 57) ('EO') only applies to a contract of service, which deals with wages, holidays, rest days, sickness allowances and maternity, as well as offering protection to the employees in the event of the termination of the contract either by choice, i.e., agreement between the parties, or by breach, on those grounds being stipulated under ss.9–10 of EO.

An employer is vicariously liable for the tort committed by the employee if the tort is committed in the course of carrying out the employee's duties under the employment contract. However, a party to a contract for services is normally not liable for the tort committed by the other independent contractor.

By reason of the master and servant relationship being created under a contract of service, terms are implied into the contract by the courts in the form of duties and obligations on the contracting parties. For example, an employee is under a duty to comply with the lawful and reasonable order from the employer whereas the employer has the obligation to indemnify the employee the expenses incurred by the employee in the course of discharging the employee's duties.

An employee needs to pay tax calculated under the salary tax scheme provided for under the Inland Revenue Ordinance (IRO). For a self-employed person, the person has to pay profit tax under the IRO.

In the case that an employer company is insolvent and wound up, employees are priority creditors of the company. Where a party to a contract for service is a company, which becomes insolvent and is wound up compulsorily, the other contracting party, i.e., the independent contractor is just an unsecured creditor of the company.

**Tutorial note:**
*Under the Mandatory Provident Fund Schemes Ordinance (Cap 485) ('MPFSO'), an employee is also entitled to contributions from the employer under the ordinance when any condition stipulated in the MPFSO is satisfied. Where a person is an independent contractor, the person is not entitled to those benefits provided for under EO and MPFSO.*

*If employees suffer personal injuries in the course of carrying out their duties, they are entitled to employee compensation under the Employees' Compensation Ordinance (Cap 282) ('ECO'). One important aspect of the compensation under ECO is that the employees' entitlement does not depend on the existence of fault on the part of the employer. Where the compensation under ECO is not adequate, the employees may commence legal action in tort against the employers to recover the appropriate amount of compensation. ECO is not available to an independent contractor. So, to recover the damages suffered, the independent contractor has to commence legal action against the other independent contractor for the commission of such torts as negligence or occupier's liability, etc, which imposes a legal burden or legal duty on the independent contractor to prove the existence of fault of some kind on the part of the other contracting party.*

**4** The question invites the candidates to show their knowledge of the tort of negligence in general and negligent misstatements in particular.

To begin with, to be liable for the damages suffered by the victim, there must exist a neighbour relationship between the parties. In the tort of negligence, one is only required to '… take reasonable care to avoid acts or omissions which [one] can reasonably foresee would be likely to injure [one's] neighbour': per Lord Atkin in *Donoghue* v *Stevenson* (1932) UK. The question to be asked is: who is in law your neighbour? According to the neighbour principle, which is laid down in the *Stevenson* case, the neighbours in law '… are the persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question…': per Lord Atkin in the *Stevenson* case.

As can be observed from the principle, in determining whether a defendant owes to the plaintiff a duty of care, the test adopted by the courts is an objective one, i.e., the reasonable man test. As such, the fact that the defendant did not actually consider the risk or the particular victim when the defendant performed the act in question does not affect the outcome of the issue of liability, i.e., whether the defendant was negligent. What matters most is what the defendant ought to have foreseen.

The neighbour principle, as developed from the *Stevenson* case, focuses mainly on liability arising from damage resulting from a physical act and the damage being caused is either physical by nature or economic loss which is a result of the physical damage, i.e., the loss is not purely economical.

Regarding the nature of damage arising from a negligent misstatement, the loss is usually pure economical. As far as the misstatement maker is concerned, the scope of neighbour would be too wide if the neighbour principle mentioned before were to apply squarely. An obvious example is the writer of an article in a newspaper expressing his view over the investment potential of the share of a company. With the application of the neighbour principle, all readers of the newspaper will be the writer's neighbour. Hence, the court has chosen to narrow down the scope of neighbour when the tort of negligence is committed by the making of a negligent statement.

In *JEB Fasteners Ltd* v *Marks Bloom & Co* (1983) UK, in the context of negligent misstatements being made by auditors, the court held that between the misstatement makers, i.e., the auditors and the victim. '... [T]he appropriate test ... [is]... whether ... [the auditors] knew or reasonably should have foreseen at the time the accounts were audited that a person might rely on those accounts for the purpose of deciding whether or not to take over the company and therefore should suffer loss if the accounts were inaccurate. Such an approach does place a limitation on those entitled to contend that there has been a breach of duty owed to them. First of all, they must have relied on the accounts and, second, they must have done so in circumstances where the auditors either knew that they would or ought to have known that they might. If the situation is one where it would not be reasonable for the accounts to be relied on, then, in the absence of express knowledge, the auditor would be under no duty ...': per Woolf J in the *JEB* case. The relationship as established in the *JEB* case sometimes is referred to as a special relationship. Once the relationship is held to have been in existence between the misstatement maker and the victim, provided other conditions are satisfied, the misstatement maker will be liable for the loss of the victim even though the loss is purely economical.

Hence, in the context of negligent misstatements, the misstatement maker will not be liable for negligence unless the reliance on the misstatement by the victim is in those circumstances where the misstatement maker knew, i.e., the requirement of knowledge on the part of the misstatement maker. Where the court finds that the misstatement maker ought to have known the victim might so rely upon the information, the burden rests on the victim to show that it was reasonable for the victim to have relied upon the misstatement.

Hence, compared with negligent act or omission to act, in so far as 'negligent misstatement' is concerned, the scope of neighbour is much narrower.

**5** The question tests the candidates' knowledge of the appointment, power and duties of a company secretary.

**(a)** Pursuant to Article 112 of Table A of the Companies Ordinance (Cap 32). The directors of a company may appoint the company's secretary for such term, at such remuneration and upon such conditions as they may think fit; and any secretary so appointed may be removed by the directors. There is no special procedure needed to be complied with for the appointment of the secretary.

However, where a company has no directors, then the appointment of the company secretary shall be void and of no effect. In *Ong Kim Yim* v *Sheecon Trading Co Ltd* (1996) HK, a company failed to hold its first annual general meeting within the period of time as required by the Companies Ordinance (Cap 32) ('CO'). The appointment of the company secretary by the shareholders who purported to be the first directors of the company was held to be void and had no legal effect.

**(b)** In general, a company secretary is responsible for ensuring that the company complies with all of the company's obligations under CO, which includes the filing of necessary returns with the company registrar. In addition, the secretary, or the secretary's department, is also responsible for handling such matters as share and debenture transfer and registration and to keep the related registers and the books of the company.

The secretary attends all meetings of the shareholders and the directors of the company and makes proper minutes of the proceedings. Under the directors' direction, the secretary is also responsible for issuing notices to the company's shareholders whenever necessary.

As an officer of the company, the secretary also owes to the company fiduciary duties and a duty of care in common law. A company secretary is also required to perform all the duties imposed on the company's officers by CO.

The articles of a company usually state the authority to be exercised by the secretary. In practice, it is usual for the articles to give authority to the secretary to countersign on deeds on which the company's seal is affixed. In such circumstances, the deeds may have no legal effect should the related deeds does not have the signature of the secretary. Furthermore, it was held in *Panorama Developments (Guildford) Ltd* v *Fidelis Furnishing Fabrics Ltd* (1971) UK that a company secretary also has apparent authority to enter into contracts binding on the company.

**6** The question tests the candidates' knowledge of matters relating to the management, administration and regulation of a company.

**(a)** To change the name of the company, a special resolution has to be passed by the shareholders in a general meeting: s.22 Companies Ordinance (Cap 32) ('CO'). A special resolution is a resolution being passed by a majority of not less than three-fourths of those members who are entitled to vote and do vote in a general meeting: s.116(1) CO.

**(b)** Pursuant to s.116(1) CO, a general meeting to pass a special resolution has to be passed by not less than 21 days' notice. The notice must be in writing and specifying the intention to propose the resolution to be passed in the meeting as a special resolution. The notice has to be duly served on those entitled to receive the notice.

Apart from matters relating to creditors' voluntary winding up, which requires at least seven days' notice period, a resolution may be proposed and passed as a special resolution even if the notice given is less than 21 days, if the resolution is agreed by shareholders holding 95% of the nominal value of the shares having the right to attend and vote at any meeting s.116(1)(a)–(b). Otherwise, a special resolution shall be ineffective if it is passed with notice of the meeting being less than 21 days as required by s.116 CO.

In this context, '21 days' means 21 clear days. The 21 clear days period excludes the day the notice is posted, the day the notice is deemed to have been received and the day of the meeting itself. Therefore, a special resolution is ineffective if it is passed with notice of the meeting being less than 21 clear days as required: *The Securities and Futures Commission* v *The Stock Exchange of Hong Kong Ltd* (1992) HK.

A notice shall be regarded as defective if it fails to specify that the proposed resolution is a special resolution. In such a case, the resolution being passed shall have no binding effect: *Hong Kong Racing Pigeon Association Ltd* v *Lam Koon Nam* (2002) HK.

**(c)** Where a special resolution has been validly passed, a printed copy of the resolution has to be sent to the company registrar within 15 days after the day the resolution is passed: s.117 CO.

**7** The question invites the candidates to demonstrate their knowledge of the concept of corporate veil and to distinguish the liabilities of the shareholders of a limited company and the company itself.

**(a)** Corporate veil is a concept in law which separates a company from its members, i.e. shareholders, regarding the acts done or liabilities incurred, under the name of the company. It should be noted that a company in this context refers to those corporations being incorporated under the Companies Ordinance (Cap 32) ('CO').

Under the law, '… [a] company is at law a different person altogether from the subscribers to the memorandum; and although it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the [CO].': *Salomon* v *Salomon & Co Ltd* (1897) UK.

A duly incorporated company is therefore a persona at law. Its existence is independent of the death or change in the identities of its shareholders. The company, with its own name, may enter into contract, hold property, take legal action, commit crime and tort; and therefore can sue and be sued. A company is therefore treated as a natural person: s.5A CO.

Nevertheless, under circumstances being provided for in common law or statutory law, the courts will disregard the separate personality of a company, i.e. lift the corporate veil of the company and treat the company as the same person as the company's members or directors. In such a case, members or directors of the company may be liable for the acts done under the company's name.

**(b)** Regarding a limited liability company, the phrase 'limited liability' does not refer to the liabilities of the company; it only refers to the liabilities of the members of the company.

The liability of the company is always unlimited. Should the company be insolvent and unable to settle the liabilities incurred by the company, the company's creditors may petition to the court to wind up the company compulsorily. All the properties of the company will then be made use of for settling the liabilities.

Liabilities of members to a limited liability company may either be limited by shares or limited by guarantee.

Where a company is registered as a company limited by shares, the liabilities of its members are limited to the total nominal values of the shares being held by them when the company is wound up by its creditors.

If a company is one of limited by guarantee but without share capitals, when the company is wound up, the liabilities of its members are limited to the amount they agreed to contribute to the company. Such an amount is usually stated in the memorandum of the company.

**8** The question invites the candidates to demonstrate their knowledge of agency law.

It should be noted at the outset that when an employee acts within his actual authority, the employee is an agent of the employer for any act done by the employee in the course of the employee's employment. The actual authority to be exercised by the employee is the same as an agent, i.e., it may either be express authority or implied authority. Where the employee acts outside the employee's authority, in the absence of any apparent authority from the employer, the act will not be binding on the employer, i.e., the principal, and the employee will be liable for the act. The actual authority of an employee depends very much on the terms of the employment contract in which the position of the employee is stated.

As far as Bob is concerned, as an account clerk, his express authority included all that being expressed in the employment contract. The scope of Bob's implied authority included all authority reasonably incidental to, and necessary for, the performance of his duties as an account clerk.

The scope of Bob's authority could be regarded as having been widened when Andy told Bob to take care of all the accounts matters of the business until he came back. While the question does not make it clear as to the exact scope of what 'all the accounts matters' covers, it seems quite clear that the authority cannot extend to cover the making of a decision by Bob to sell the goods of the supermarket when such decision, on the face of it, has nothing to do with accounts matters.

As such, Bob would be liable for compensation unless he had authority by reason of other arrangements between Andy and himself.

From the facts of the problem scenario, Bob may be able to establish his authority from Andy to sell the goods by relying on the creation of an agency relationship between Andy and him by necessity. If Bob was such an agent, then Bob's decision to sell the goods would be binding on Andy. That is to say, Andy will not be able to claim against Bob for compensation.

The following requirements have to be fulfilled for an agency relationship to be created by necessity:

First, there must be a pre-existing relationship between the parties.

Second, there is an emergency.

Third, it is impossible for the agent to communicate with the principal.

Fourth, the agent is acting for the best interests of the principal.

In *Great Northern Railway* v *Swaffield* (1874) UK, by a contract between the parties the plaintiff agreed to transport the horse of the defendant to a particular station for the collection by the defendant. It was held that the plaintiff was an agent of the defendant by necessity when the plaintiff needed to take care of the defendant's horse by reason that the defendant failed to turn up at the station to pick up the horse and could not be located by the plaintiff.

Immediately before the sale, there had already been an employment relationship between Bob and Andy. So the first condition is satisfied for the creation of an agency relationship between Andy and Bob by necessity.

As can be seen from the facts of the problem, given that the goods sold by the supermarket were perishable, there existed an emergency, viz, that the goods would be totally perished if they were not sold as soon as possible.

Given that Andy had not given Bob the means to contact him, Bob had not been able to contract or communicate with Andy to ask for his instruction regarding the treatment of the goods and thus the decision by Bob was to minimise the loss of Andy, which was to serve the best interest of Andy.

By reason of what has been mentioned, Bob probably was an agent by necessity of Andy. As such, his decision to sell the goods at much lower prices would be binding on Andy, who was the principal to this agency relationship. The advice to Andy is that, probably, he cannot claim against Bob for the compensation.

**9** The question invites the candidates to show their knowledge of the operation of the doctrine of *ultra vires* before, and after, 1997.

The main issue, as stated in the question, is whether the First and Second Mortgage Loans are legally enforceable against the company when they were created in 1996 and 2007 respectively, when the company has an object clause in its memorandum of association and when the objects clause disallows the company to run business other than garment trading.

From the problem scenario, since both the First and Second Mortgage Loans are related to real properties investment, both of the loans are obviously forbidden by the objects clause. In such a case, the operation of the doctrine of *ultra vires* has to be considered before any advice can be given.

Under the doctrine, a company acts beyond its capacity when the company enters into a contract the subject matter of which is outside the scope specified in the objects clause of the memorandum of the company. Should the transaction be in breach of the

objects clause, the transaction is said to be *ultra vires* and void. A transaction being void for *ultra vires* is unenforceable by the parties concerned and nor can it be ratified by the company for, when the transaction took place, the company did not have the required capacity to do so.

Prior to 10 February 1997 ('the Date'), an objects clause had to be inserted in the memorandum of a company which was incorporated in Hong Kong. There were substantial amendments to the Companies Ordinance (Cap 32)('CO') after the Date. The amendments, among others, are that except for companies which apply under s.21 CO for licences to dispense with the word limited or its Chinese equivalent in its name, a company has the right of choosing not to insert an objects clause in its memorandum: s.5(1A) CO. Under the law, such a company has the same capacity, rights, powers and privileges as a natural person: s.5A(1)(a) CO. In effect, provided that the company exercises its power in a manner which conforms with its memorandum or articles of association, the company may now enter into whatever transactions it likes: s.5B(1)(a) CO. So, in short, subject to those mentioned in the following paragraph, the doctrine of *ultra vires* may be said to have been abolished since the Date.

Where a company chooses to state its objects in the memorandum, the capacity of the company to transact business is still governed by its memorandum: s.5B(1)(b) CO. However, the mere fact that an act of such a company is outside the company's objects will not render the act invalid: s.5B(3) CO.

What has been said relating to ss.5A–5B is equally applicable to companies registered before 10 February 1997: s.367(1) CO. However, the doctrine of *ultra vires* shall still be applicable to contracts being entered into by the companies prior to the Date: s.367(2)(b) CO. Hence, a contract that is outside the objects clause of a company and entered into by the company before the Date is still void.

So the advice to the bank is that regarding the First Mortgage Loan, it is void and unenforceable against the company for it was created prior to the Date. In such a case, the bank may sue against the directors responsible for entering into the loan agreement for breach of warranty. As regards the Second Mortgage Loan, the bank could enforce the loan against the company.

**Tutorial note:**
*The issue of knowledge of the bank about the objects clause in question may need to be considered. The consideration is that, in the case of a contract the subject matter of which is outside the scope of the objects clause, should there be any difference in the treatment between a contracting party who has knowledge about the objects clause and one which has not? The factor to consider is about fairness. Regarding the contracting party who has knowledge about the objects clause, it would not be unfair to the party for the doctrine of* ultra vires *to apply. But, how about a party who has no knowledge about the clause?*

*Under the doctrine of constructive notice, a party who transacts with a company is deemed to have knowledge about the content of the memorandum and articles of association. So for contracts entered into prior to the Date, the issue of unfairness does not arise.*

*However, the doctrine of constructive notice has been abolished ever since the Date: s.5C CO, which provides that a third party having business dealing with a company is not deemed to know the content of the memorandum and articles of association of the company. The question then is whether a third party having actual knowledge of the memorandum or articles of a company may still rely on ss.5A and 5B CO. It is submitted that the doctrine of* ultra vires *should still be applicable against such a third party for the argument of fairness does not apply to such a party.*

*To sum up, the examiner's view is that for a contract which was entered into before the Date and is outside the objects of a company, the doctrine of* ultra vires *should still be applicable. In other words, the contract is void against the parties and unenforceable by the parties. For a contract entered into after the Date, it is submitted that whether the contract is void depends on the knowledge of the party enforcing the contract against the company. In this context, the word knowledge is not related to the knowledge which comes into being by virtue of the doctrine of constructive notice. What concerns us is whether the bank had actual knowledge about the objects clause or whether there were circumstances under which the bank ought to have made enquiry as to the contractual capacity of the company in question but failed to do so.*

*In such a case, as regards the Second Mortgage Loan, if the bank has no knowledge about the objects clause, the Second Mortgage Loan should be enforceable against the company. Where the bank had actual knowledge of the objects clause, or there existed circumstances under which the bank ought to have made enquiry as to the contractual capacity of the company in question but failed to do so, the examiner's view is that the bank could not enforce the Second Mortgage Loan by reason of the doctrine of* ultra vires*.*

**10** The question invites the candidates to show their knowledge of 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) Companies Ordinance (Cap 32) ('CO'). In other words, the persons have committed fraudulent trading.

'Defraud' and 'fraudulent purpose' connote actual dishonesty: *Re Patrick and Lyon Ltd* (1933) UK. The test for the existence of dishonesty is that the defendant must have been dishonest personally. Hence, in the absence of dishonesty, the mere preference of one creditor to another alone cannot constitute fraud within the meaning of the provision: *Re Sarflax Ltd* (1979) UK. One transaction may constitute fraudulent trading: *Re Gerald Cooper Chemicals Ltd* (1978) UK.

To establish the commission of fraudulent trading, it must be able to show, either, that the defendant actually intended to defraud creditors or to achieve a particular fraudulent purpose, or, that the defendant was reckless as to whether the carrying on of the business would result in the creditors being defrauded: *ADS* v *Wheelock Marden & Co* (1990) HK.

In *Re White and Osmond (Parkstone) Ltd* (1960) UK, Buckley J had the following observation: '… There is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine on them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time …'

From the facts of the problem, there is no doubt that Collins had knowledge about the Rearrangement when it was he who was principally running the company's business and solely responsible for the re-negotiation with Money Bank about the Rearrangement. The fact that there was just one transaction, i.e. the re-negotiation, also amounts to business in the context of s.275(1) CO: see the *Gerald* case.

The main issue is, therefore, whether Collins was dishonest by the time of the arrangement. By reason of the observation by Buckley J in the *Wheelock* case, the test is whether Collins '… genuinely [believed] that the clouds would roll away and the sunshine of prosperity would shine on [the business of the company] again and disperse the fog of [the financial problem]…'

It is given in the problem scenario that by the time of the re-negotiation, Collins genuinely believed that the company would have a promising future by making the Rearrangement. It seems that Collins has passed the test. Given that the winding up order was made almost a year after the Rearrangement, it is advised that Collins probably would not be liable for committing fraudulent trading.

**Tutorial note:**
*As stated in s.271(1) CO ('the provision'), the provision only applies in the course of the winding up of a company. 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.*

*Whether a defendant was dishonest is a question of fact, which depends on an assessment of all the facts. The defendant was not allowed to shelter behind some private standard of honesty not shared by the community, i.e., a person could not escape a finding of dishonesty simply because he saw nothing wrong in his behaviour. In other words, the standard of a reasonable man has to be considered in determining the issue of dishonesty:* Aktieselskabet Dansk Skibsfinansiering *v* Brothers *(2000) HK. As such, as far as the question is concerned, the proximity in point of time between the Rearrangement and the time the winding up order was made could be an important factor in determining the honesty and hence the liability of Collins.*

**1** The question invites the candidates to show their knowledge of the importance of Basic Law over the interpretation of statutes and the concept of human rights as expressed in the Bill of Rights Ordinance (Cap 383) ('BRO').

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

3–4 Less thorough treatment of the question.

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

**(b)** 3–4 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined.

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

**2** The question tests the candidates' knowledge of the terms of a contract.

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.

**3** The question invites the candidates to demonstrate their knowledge of some concepts in employment law.

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.

**4** The question invites the candidates to show their knowledge of the tort of negligence in general and negligent misstatements in particular.

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.

**5** The question tests the candidates' knowledge of the appointment, power and duties of the company secretary.

**(a)** 2–3 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined.

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

**(b)** 6–7 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

3–5 Less thorough treatment of the question.

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

**6** The question tests the candidates' knowledge of matters relating to the management, administration and regulation of a company.

**(a)** 2–3 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined.

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

**(b)** 4–5 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

2–3 Less thorough treatment of the question. Towards the bottom of this range are those answers which have only a very brief explanation of the subject areas being examined.

0–1 Very weak answers with inadequate information or answers show little understanding of the topic being examined.

**(c)** 0–2 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.

**7** The question invites the candidates to demonstrate their knowledge of the concept of corporate veil and the difference in the liabilities between the shareholders of a limited company and the company itself.

**(a)–(b)** 4–5 Answers provide a clear understanding and thorough treatment of the subject areas being examined.

2–3 Less thorough treatment of the question. Towards the bottom of this range are those answers which have only a very brief explanation of the subject areas being examined.

0–1 Very weak answers with inadequate information or answers show little understanding of the topic being examined.

**8** The question invites the candidates to demonstrate their knowledge of agency law.

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.

**9** The question invites the candidates to show their knowledge of the operation of the doctrine of *ultra vires* before and after 1997.

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 of 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.