Answers

1 The question invites the candidates to demonstrate their knowledge of the importance of the Basic Law.

The Basic Law ('BL') can be said to be the constitution of the Hong Kong Special Administrative Region ('HKSAR'). It defines and sets out the governmental structure and the legal system of the HKSAR. It lays out the powers and the framework for the administration of the legislative, executive and judicial arms of the government. The BL also details the appointment of the key personnel being involved in each of these three arms.

The BL has been promulgated by the National People's Congress of the People's Republic of China ('PRC'), which indicates that the governmental authorities of the PRC accept the special regime that exists in the HKSAR. To achieve this goal, the BL defines in detail the relationship between the governmental authorities of the HKSAR and those of the PRC.

Due to the BL, the HKSAR is able to preserve its capitalist economic system as well as its legal system, which is derived from English common law, in contrast to the socialist economic system and the civil law system that prevail there.

The BL imposes restrictions on the HKSAR by specifying certain things that the HKSAR cannot do, by setting out certain policies which the HKSAR may not contravene. It also confers to the people of the HKSAR certain social, economic and political rights as well as defining their rights to property. It further stipulates what laws of the PRC apply in Hong Kong.

Finally, the BL authorises the HKSAR to operate to a certain extent in the international arena by giving power to the government of the HKSAR to negotiate and enter agreement with other countries in specified fields.

Hence, the BL is the document that gives the HKSAR its special status as a special administrative region of the PRC and distinguishes the HKSAR from the other provinces of the PRC, which have a totally different governmental system.

To sum up, the BL implements the one country, two systems policy that defines the HKSAR's special position within the PRC.

2 The question invites the candidates to show their knowledge of circumstances under which a person owes a common law duty of care to others.

It should be noted at the outset that for any claim for breach of a tort, two separate issues will be considered by the courts in order to determine if the defendant in question should be liable for the damages being claimed for. The issues are: first, whether the defendant is liable for having committed the tort in question, i.e. the liability issue; and, second, whether the plaintiff has suffered from the damages being claimed for, i.e. the issue of quantum of damage.

To establish whether the defendant owes a duty of care to the plaintiff is the very first step to establish the issue of liability. In *Donoghue* v *Stevenson* (1932) UK, it was decided that one is 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.

Negligence therefore involves the breach of a duty of care owed by one party to the other, who is in law the neighbour of the party. In deciding whether the party owes to the other a duty of care, at issue is whether the other is a neighbour of the party in law. In answering the question, it is the view of a reasonable man that will be considered by the courts. Hence, the test adopted by the courts is an objective one. As such, the fact that the party did not actually consider the risk or the particular victim in question when the party performed the act in question does not affect the result of the issue of liability, i.e. whether the defendant was negligent. What matters most is what the defendant ought to have considered.

In addition, the following three conditions must also be satisfied for the existence of a duty of care:

(a) Foreseeability of harm;
(b) Proximity of relationship; and
(c) Fairness, justice and reasonableness: *Caparo Industries plc* v *Dickman* (1990) UK.

(a) Foreseeability of harm

The plaintiff must be able to establish that they belong to that class of persons who are likely to be affected by the defendant's negligent act or omission in question.

Hence, in *Bourhill* v *Young* (1943) UK, it was held that the plaintiff in that case failed to show that the defendant owed her a duty of care when a collision occurred by reason of the defendant's negligent act of driving, when the plaintiff was about 54 feet away from the scene of the accident, when the plaintiff, though she heard the noise created by the collision, did not witness the accident and when the plaintiff alleged that she suffered nervous shock as a result of the sound of the collision.

'[The Defendant's] speed in no way endangered [the Plaintiff] … I am unable to see how [the Defendant] could reasonably anticipate that, if [the Defendant] came into collision with a vehicle coming across the tramcar … , the resultant noise would cause physical injury by shock to a person standing behind the tramcar.': per Lord Roussel in the *Bourhill* case.

(b) Proximity

Foreseeability of harm by itself cannot establish a duty of care. The plaintiff must also prove that the relationship between the plaintiff and the defendant is so close and direct that the defendant ought reasonably to have the plaintiff in contemplation when the defendant directs the defendant's mind to the acts or omissions, which affect the plaintiff.

So, a bystander who witnesses the drowning of a child in the sea and does not rescue the child is not liable for negligence.

The fact that such a bystander should be blamed morally has nothing to do with the issue and does not create such a degree of proximity that a duty of care is rested upon the bystander to rescue the child.

However, school teachers will be liable for negligence if the drowning takes place during the school activities for which the school teachers are responsible. The reason being that the degree of proximity in the relationship between the teachers and the child, in such a case, is sufficient for imposing a duty of care upon the teachers to take proper security measures to prevent the occurrence of such an accident.

(c) Fairness, justice and reasonableness

Having established the elements of foreseeability of harm and proximity of relationship, the courts may still refuse to impose upon the defendant a duty of care if to do so is unfair, unjust or unreasonable.

3 The question invites the candidates to show their knowledge on the grounds upon which the contracting parties to an employment contract can terminate the contract upon its breach by the other.

It should be noted at the outset that an employment contract may be terminated either upon its breach, or by agreement between the parties. In the latter case, the party who wants to terminate the contract may serve the others with a notice to that effect. For the notice to be effective in law, the requirements lay down in the Employment Ordinance (Cap 57) ('EO') have to be complied with.

When a party to the contract breaches the contract, the innocent party can only terminate the contract upon the grounds stated in the EO. If the employee has breached the contract, then the termination is called summary dismissal. Where it is the employer who has breached the contract, the termination of the contract by the employee is called constructive dismissal. Such a termination is similar to the exercise of the right by an innocent party to accept the repudiation of a contract upon the breach of a condition to the contract by the other party.

It follows that both the employer and the employee are not at will to terminate the employment contract upon a breach of the contract by the others. To justify a summary dismissal or constructive dismissal, the breach must be one falling within the scope of grounds being stated in s.9 and s.10 EO respectively.

Summary dismissal

Summary dismissal refers to the termination of an employment contract by an employer without the need of any notice, or any payment in lieu of notice.

Under s.9(a) EO, an employer may terminate an employment contract without notice or payment in lieu of notice if an employee, in relation to his employment:

- Wilfully disobeys a lawful and reasonable order; or
- Misconducts himself with such conduct being inconsistent with the due and faithful discharge of his duties; or
- Is guilty of fraud or dishonesty; or
- Is habitually neglectful in his duties.

An employer may also terminate an employment contract by summary dismissal on any other ground on which he would be entitled to terminate the contract without notice at common law: s.9(b) EO.

An employee can claim for damage if the dismissal is wrongful. However, if the dismissal is justified, the employee is not entitled to any long-service payment or severance payment under the EO.

Constructive dismissal

Constructive dismissal refers to the termination by an employee of the employment contract without notice or payment in lieu of notice when the conduct of an employer is such that it presents to an employee no option but to terminate the contract.

Under s.10 EO, an employee may be treated as being constructively dismissed by the employer under the following circumstances:

- The employee reasonably fears physical danger by violence or disease, which was not expressly or impliedly contemplated by his contract of employment; or
- The employee is subject to ill-treatment by the employer.

Under the section, an employee may also terminate an employment contract by constructive dismissal if:

- A registered medical practitioner has certified that the employee is unfit for a particular job in which he has been engaged for at least five years.
- The employee's wage has not been paid within one month from the day the wage became due s.10A EO.

In addition, similar to summary dismissal, an employee may also terminate an employment contract on grounds being recognised by common law: s.10(c) EO.

Hence, it can be seen that while EO, i.e. the statutory law, provides grounds, which may be regarded as conditions to a contract, for the parties to an employment contract to terminate the contract immediately after those breaches under ss.9–10 EO, s.9(b) and s.10(c) also give the parties the right to terminate the contract on those grounds being recognised at law.

By reason of what has been mentioned earlier on about the nature of the grounds in ss.9–10, s.9(c) and s.10(c) may be regarded as an incorporation of those grounds upon which a contracting party may terminate a contract upon the breach of the other contracting party. At law, a party cannot terminate a contract upon the breach of the other contracting party unless the breach is about a breach of conditions to the contract. As such, all principles in contract law governing the acceptance of the repudiation of a contract by the party in default should also apply.

4 The question invites the candidates to show their knowledge of the liabilities of disclosed and undisclosed agents.

In a legal relationship, an agent is the person who is authorised by the principal to enter into the legal relationship with a third party. The agent in a contract is therefore just a middleman between the third party and the principal. The agent is not a party to the contract and the agent disappears from the picture after the formation of the contract in question.

However, what has been said is not always true and depends on whether the agent is a disclosed agent or an undisclosed agent and whether the agent acts within the scope of authority being conferred to the agent by the principal when the agent enters into the contract in question.

Disclosed agents are agents who disclose to the third parties the fact that they enter into the contracts on behalf of their principals. It is unnecessary for the agents to inform the third parties about the exact identity of their principals. It suffices if the information from the agents to the third parties is adequate to let the third parties know that, in the contemplation of the third parties, the third parties enter into the contract with the principals and not with the agents: *Luxor International Travel Items Inc* v *Tsui Hing Fat trading as Kar Lai Industrial Co* (1993) HK.

Hence, as far as disclosed agents are concerned, provided that the agents act within the authorities from their principals, the contracts so formed are binding on the principals. In other words, the principals may then sue and be sued by the third parties on the contracts. The disclosed agents are therefore not liable for the contracts.

However, what has been said only applies to disclosed agents and does not apply to undisclosed agents.

Undisclosed agents are agents who do not disclose the fact that they are agents when the contracts are concluded. In those cases, it is within the mind of the third parties that the third parties enter into the contracts with the undisclosed agents. As such, as long as the principals are concealed, the undisclosed agents are personally liable for the contracts. Nevertheless, the third parties may choose or elect to sue either the agents or the principals, once the third parties have knowledge of the existence and identity of the principals. The choice by the third parties, however, must be clear and unambiguous. Furthermore, the choice must be made within a reasonable time after discovering the existence and identity of the principals.

Hence, an agent may be personally liable for the contract if he, by reason of his neglectfulness, fails to disclose his identity of being an agent by the time the contract is concluded.

Furthermore, unless the contract in question is ratified by the principal, an agent is also liable personally for the contract if the agent acts outside the agent's scope of actual or implied authority when the agent enters into the contract.

5 The question invites the candidates to show their knowledge of matters relating to the capital of companies.

(a) A limited company being incorporated under the Companies Ordinance (Cap 32) ('CO') must state in the capital clause of the company's memorandum the total nominal value of the shares that the company may issue: s.5(4) CO. The value, which is a fixed amount, is called the authorised capital.

If a company issues shares the total nominal value of which is in excess of the company's authorised capital, the issue is void and the persons who are allotted the shares may recover the money they have paid from the company: *Bank of Hindustan, China and Japan Ltd* v *Ailson* (1871) UK.

Furthermore, for a company with share capital, the company shall have to pay a capital fee to the Hong Kong Special Administrative Region when it is registered with the Company Registrar. Subject to the ceiling of HK$30,000, the fee is calculated on the basis of the authorised capital: Sch 8 CO. Hence, the larger the value of the authorised capital means that more capital fee shall have to be paid by the company.

(b) Issued share capital is the nominal value of all the shares which have been allotted and issued to the shareholders. Normally, the issued share capital of a company is less than the authorised capital of the company.

(c) The nominal value of the share of a company is fixed. However, the market value of the share on the stock market normally keeps on changing from time to time.

When the market value is higher than the nominal value, the difference between the two is called the premium of the share.

Strictly speaking, premium cannot be regarded as the capital of a company. Hence, the rules applicable to premium are different from those of the capital of a company.

6 The question invites the candidates to show their knowledge of the insolvency of a company.

(a) The winding up, or liquidation, of a company refers to the process through which the life of the company is brought to an end. During the process of liquidation, the company continues to exist and all acts are still done under the name of the company. The life of the company will come to an end only after the whole process of liquidation is completed and the company is formally dissolved.

(b) Voluntary liquidation refers to the liquidation of a company by the company voluntarily.

Pursuant to Companies Ordinance (Cap 32)('CO'), a company may be wound up voluntarily under the following circumstances:

- When the period, if any, fixed for the duration of the company by the articles expires, or the event, if any, occurs on the occurrence of which the memorandum or articles provide that the company is to be dissolved, and the company in a general meeting has passed a resolution requiring the company to be wound up voluntarily;
- If the company resolves by special resolution that the company be wound up voluntarily;
- If the company resolves by special resolution to the effect that it cannot by reason of its liabilities continue its business, and that it is advisable to wind up;
- If the directors of the company, or in the case of a company having more than two directors, the majority of the directors, make and deliver to the Registrar a liquidation statement under s.228A(1) CO. In such a case, a special procedure for voluntary liquidation under s.228A CO applies.

(c) The liquidation of the company is said to be a compulsory one when the company is being ordered to be wound up by the court.

Under s.177(1) CO, a company may be liquidated by the court on the following grounds:

- The members by a special resolution agree that the company may be wound up by the court.
- The company does not commence business within one year from its incorporation or it has suspended business for a whole year.
- The company has no members.
- The company is unable to pay the company's debts.
- The memorandum or articles of the company provide that the company is to be wound up on the occurrence of an event and the event occurs.
- The court is of the opinion that it is just and equitable for the company to be wound up.

Tutorial note:
As far as voluntary liquidation of a company is concerned, there are two types of liquidation, viz., members' voluntary liquidation and creditors' voluntary liquidation.

7 The question invites the candidates to show their knowledge of both a fixed charge and a floating charge.

Both a fixed and a floating charge are security transactions. They represent assurances from a company to its creditor for the repayment of a loan borrowed by the company.

A fixed charge has been described as a charge which is fixed, ascertained and identified on specified property of the company. For example, land or machines are usually used as subject matters of a fixed charge.

Nevertheless, the property may also include those capable of being ascertained and defined in the future: see *Illingworth* v *Houldsworth* [1904] AC 355, the name under which the *Re Yorkshire* case below went to appeal. So a particular amount of debt which will become due sometime in the future can be the subject matter of a fixed charge.

For a fixed charge, once it is created, the company cannot dispose of the properties free of the charge unless the company has the consent from the charge holder, i.e. the creditor.

A floating charge is created if a company makes use of such assets as the company's stock or book debts as security for repayment of the loan.

A floating charge, as identified by Romer LJ in *Re Yorkshire Woolcombers Association Bank Limited* (1903) UK, is a charge on a class of present or future assets of a company, which keep on changing in the ordinary course of business of the company.

Further, by the time the charge is created, it is the contemplation of the parties that until the charge holder takes steps to enforce the charge, as far as the class of assets is concerned, the company may carry on its business in a usual way.

So, a floating charge acts like a cloud floating over the class of assets and will only attach or fix to the assets when it is crystallised. In other words, the exact particulars of the class of assets securing the repayment of the loan will only be identifiable upon the crystallisation of the charge and the company will lose its freedom to deal with the assets when the crystallisation takes place.

While there may be differences in the nature of the security between a fixed charge and a floating charge, the main difference between them lies mainly on the control over the use of the properties forming the subject matter of the charges in question.

In *Siebe Gorman* v *Barclays* (1979) UK, a charge was imposed on future book debts of a company. Under the charge, the company was prevented from disposing of the book debts without the consent from the charge holders. It was held by the court that the charge in question was a fixed charge. It follows that, in determining whether a charge is a fixed charge or a floating charge, what matters most is whether the company has the freedom to make use of the asset in the ordinary course of business of the company before the charge holder takes steps to enforce the charge. This aspect of a floating charge was confirmed by the Privy Council in *Agnew* v *Commissioner for Inland Revenue* (2001) UK.

8 The question invites the candidates to show their knowledge of the differences between a condition, a warranty and an innominate term.

From the problem scenario, it is clear that the supplier has breached the Term when 30 of the 1,000 apples are rotten, i.e. 30 of them were not in good condition.

In such a case, whether Jordan has the right in question depends on the nature of the contractual term being broken by the supplier, Andre Ltd.

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.

In the context of the problem scenario, if Jordan were to return all the apples to the supplier and ask for the repayment of the Price, this would amount to a termination of the contract and Jordan cannot do so unless the Term is a condition.

Innominate term
An innominate term is neither a condition nor a warranty. The remedy for the breach of an innominate term depends on the consequence of the breach.

Where the breach deprives the injured party 'substantially of the whole benefit of the contract', the innominate term will be treated as if it were a condition and the injured party will have the right to terminate the contract and claim for damages immediately.

However, if the breach does not touch on the root of the contract, the remedy available to the innocent party will be damages only.

The modern approach of the courts is to treat all terms in a contract as innominate terms unless the parties clearly indicate otherwise.

The Term in question probably is an innominate term. Given that the whole transaction involves 1,000 apples and only 30 of them are rotten, the breach of the Term by the supplier, Andre Ltd, cannot be said to have deprived Jordan 'substantially of the whole benefit of the contract'. In such a case, the court will only treat the Term as a warranty even though the word 'condition' appears in the Term.

It follows that Jordan does not have the right to terminate the contract. He has the right to ask for damages only. Possibly, he can only ask Andre Ltd to give him 30 apples, which are in good condition, to replace those that are rotten.

9 The question invites the candidates to show their knowledge of the fiduciary duties of the non-executive director of a company.

It should be noted that non-executive directors are also directors of companies. Nevertheless, as opposed to executive directors, non-executive directors do not usually have a full-time relationship with the companies. The role of the non-executive directors, at least in theory, is to bring outside experience and expertise to the board of directors. They are also expected to exert a measure of control over the executive directors to ensure that the latter do not run the company in their own interests.

As regards the fiduciary duties of non-executive directors, they are the same as those of the executive directors: *Dorchester Finance Co Ltd* v *Stebbing* (1989) UK. See also *Re Boldwin Construction Co Ltd* (2001) HK. It follows that the law governing the duties of executive directors applies equally to non-executive directors.

In relation to the issue of conflict of interest, the following three aspects call for consideration.

Contract between the company and a member of the board
'… [directors] have duties to discharge of a fiduciary nature towards their principal, and it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect ….': *Regal (Hastings) Ltd* v *Gulliver* (1942) UK.

Use of company's property or information
A director must not without the consent of the company use corporate property or information for his own profit. The principle holds true even if a director has ceased to be one but if the opportunity came to him when he was a director: *Industrial Development Consultants Ltd* v *Cooley* (1972) UK.

Declaration of interest

Under the Companies Ordinance (Cap 32) ('CO'), a director is under a statutory duty to declare the nature of his interest at the board meeting if he has an interest in a contract or proposed contract with the company: s.162(1) CO.

The interest may either be direct or indirect, and the disclosure has to be made at the first meeting at which the proposed contract is considered or when the director's interest first arises.

Given the facts mentioned in the problem scenario and by reason of what has been mentioned, the fact that the role of Angus in Trading Ltd is merely technical, i.e. just to ensure all the trading documents of the company are properly made, does not exonerate him from complying with his duty as a director of Trading Ltd by declaring his interest in Sport Ltd under s.162(1) CO when the board of Trading Ltd made the decision to enter into the contract with Sport Ltd. In such a case, Angus is advised that he has been in breach of the directors' duties he owes to Trading Ltd and he needs to account to Trading Ltd for the profit he earns under the contract.

Tutorial note:

Both an executive director and a non-executive director cannot take a neutral role in the board of a company. As a director, the non-executive director is duty bound to use such power as he has as a director to enable other directors to exercise their rights and perform their duties in the positions as directors: Re Boldwin Construction Co Ltd & Another *(2001) HK.*

10 The question invites the candidates to show their knowledge of insider dealing.

Under s.270 Securities and Futures Ordinance ('SFO'), in relation to a listed corporation, a person commits insider dealing under the following circumstances:

First, when a person connected with the company ('the connected person') either deals, or discloses relevant information knowing, or having reasonable cause to believe, that the recipient of the information would deal.

Second, when a person contemplating or has contemplated a take-over, either deals or counsels or procures another to deal, or discloses information knowing, or having reasonable cause to believe, that the recipient of the information would so deal.

Third, when a person receives relevant information from the connected person or the person contemplating or has completed take-over deals, or counsels or procures another person to deal.

By purchasing the shares of Land Ltd from the market after hearing from Maria matters relating to the meeting, it is clear that Amy has dealt with the Land Ltd shares.

Hence, under s.270 SFO, Amy has committed insider dealing if the information from Maria is relevant information and Maria is a connected person.

Connected persons include directors, employees, shareholders holding 5% or more of nominal value, which include the partners of those shareholders, and persons who may reasonably be expected to have access to relevant information by reason of their professional or business relationship with the company: s.247 SFO.

Being the secretary of a director of Land Ltd, Maria is clearly an employee of Land Ltd and hence a connected person under s.247 SFO.

As regards the issue of relevant information, relevant information refers to specific information about the company, a shareholder or officer of the company, or the listed securities of the company or their derivatives, which is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but which would, if it were generally known to them, be likely to affect the price of the listed securities materially: s.245 SFO.

Given that information relating to the negotiation had not been made known to the general public, which includes people engaging in share trading, and that the information relating to a negotiation of purchasing price from a majority shareholder of a company and that a takeover of Land Ltd would be triggered after such a purchase, it seems that s.245 SFO has been satisfied and the information relating to the meeting can be regarded as relevant information.

Hence Amy may well be advised that she has committed insider dealing.

1 The question invites the candidates to demonstrate their knowledge of the importance of the Basic 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.

2 The question invites the candidates to show their knowledge of circumstances under which a person owes a duty of care to others.

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3 The question invites the candidates to show their knowledge on the grounds upon which the contracting parties to an employment contract can terminate the contract upon its breach by the other.

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

5 The question invites the candidates to show their knowledge of matters relating to the capital of companies.

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

2–3 Less thorough treatment of the question.

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

(b) 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.

(c) 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.

6 The question invites the candidates to show their knowledge of the insolvency of a company.

(a) 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.

(b)–(c) 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.

7 The question invites the candidates to show their knowledge of both a fixed charge and a floating charge.

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

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2–4 Answers show some knowledge.

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8 The question invites the candidates to show their knowledge of the differences between a condition, a warranty and an innominate term.

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9 The question invites the candidates to show their knowledge of the fiduciary duties of a non-executive director of a company.

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10 The question invites the candidates to show their knowledge of insider dealing.

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.