# Answers

**1** The question invites the candidates to show their knowledge of the sources of law in the Hong Kong Special Administrative Region ('the HKSAR').

**(a)** Common law in this context refers to those common law principles the applications of which stress consistency.

Rules of equity are those principles of law the applications of which emphasise justice and fairness. Both the common law and equity are also referred to as case law in that they are formed by judgements from the judges. Central to the case law system is the application of the doctrine of precedent, which requires that similar cases should be treated alike.

Prior to the establishment of the Hong Kong Special Administrative Region ('the HKSAR'), the English common law and law of equity were made applicable to Hong Kong whenever appropriate under the Application of English Law Ordinance (Cap 88).

Now, under Article 84 of the Basic Law, the courts of Hong Kong are empowered to make reference to the precedents of other common law jurisdictions.

Under the High Court Ordinance (Cap 4), common law and equity shall be administered by the High Court of Hong Kong in civil cases; and that equity is to prevail over the common law whenever there is conflict between them.

**(b)** Ordinance and delegated (or subordinate) legislation constitute the statutory laws of Hong Kong. They have the advantage that they are easier to be assessed than the case law.

Ordinances are those laws being formally passed or enacted by the Legislative Council of Hong Kong ('the Legco') for the purposes of, first, codifying the existing case law; second, consolidating the existing law; and/or third, creating new law.

Delegated legislation refers to any proclamation, rules, byelaws or other instruments made by bodies with power conferred upon them by the enabling ordinance. They are usually more technical and experts' opinions are usually necessary in making them.

Delegated legislation has the advantage over ordinances in that it can be enacted in a more rapid way and that it can save much time of the Legco by having it changed at any time by the same body.

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

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

**(b)** The application of the general rule is subject to a number of exceptions.

First, the general rule only applies to an entire contract. If the contract in question is divisible or severable, i.e. the contractual obligations can be separated into parts, then, the party in breach may claim for payment in respect of those parts of the contract which he has performed. A typical example is a building contract which comprises different stages or parts. A subcontractor under a building contract may claim against the main contractor for payments regarding those stages of construction or parts of the building which he has performed under the contract.

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

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

Third, where a party is prevented from performing his contractual obligations by the other party, then the general rule that performance must be precise and exact cannot be applied. In such a case, the party being prevented from performing the contract may bring an action to claim for payment of the work done on a *quantum meruit* basis. Alternatively, he may sue the other party for breach of contract.

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

**3** The question invites the candidates to demonstrate their knowledge of the authorities exercisable by an agent under an agency contract.

**(a)** Express authority refers to the authority given by the principal to the agent under an agreement between them. In other words, it is the authority being explicitly given by the principal. The agreement may either be oral or in writing. The agreement sets out the obligation of the agent and the precise power being exercisable by the agent for the purpose of performing the obligation.

Where the authority is granted to an agent under a 'general power of attorney', the agent has the authority to do for his principal whatever 'he can lawfully do by an attorney': s.7 Power of Attorney Ordinance (Cap 31).

**(b)** Implied authority is the expansion of express authority. An agent having express authority also has implied authority. Implied authority refers to the authority of an agent to perform such acts as 'reasonably incidental to and necessary' for the performance of his duties as an agent.

Where the terms of the agent's authority are ambiguous or the agent is given discretion to act, the law implies authority to enable the agent to carry out the obligation. The scope of an agent's implied authority is determined by the service or the acts which are usually or necessarily done by the agent in light of the trade, business or profession to which the agency contract relates. For this reason, implied authority may also be referred to as usual authority.

**(c)** If an agent does not act within the agent's authority, the contract in question will not be binding on the principal. Since the third party has no intention to contract with the agent, there is also no contract between the third party and the agent. In such a case, the act of the agent to enter into the contract may be regarded as a warranty from the agent to the third party that the agent had the authority to act. If the third party suffers damages, the third party may sue the agent for breach of the warranty for recovering damages.

**4** The question invites the candidates to show their knowledge of the concept of corporate governance.

**(a)** Corporate governance refers to 'the system by which business corporations are directed and controlled'.

In its narrow sense, corporate governance refers to the relationships between the shareholder, directors and managers, i.e. the primary stakeholders of a company, in determining the directions and performance of the company.

In its broad sense, it refers to the setting down of the rules regarding the rights and responsibilities of each of the primary stakeholders and the design of institutions and mechanisms, which induce or control the board of directors and the management of the company, so that they can serve the best interests of the shareholders and other stakeholders of a company when they perform their duties.

**(b)** In the book entitled Hong Kong Financial System, Professor S. M. Ho identified four bases or sources from which the rules relating to the corporate governance of a company derive.

Those sources are: first, individual ethics and corporate cultures, second, internal control and incentive mechanisms, third, external monitoring mechanisms, and, finally, the law and regulations.

**Individual ethics and corporate cultures**

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

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

**Internal control and incentive mechanisms**

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

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

**External monitoring mechanisms**

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

**The law and regulations**

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

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

**5** The question tests the candidates on their knowledge about the appointment and the power of the company auditor.

**(a)** Under the Companies Ordinance (Cap 32) ('CO'), an auditor is given power to facilitate the auditor to discharge their duties being owed to the company. The auditors of a company have the power to access at any time the books, accounts and vouchers of the company. They also have the power to call for information and explanations from the related officers of the company, if it is necessary to do so.

The auditors also have the right to attend all general meetings of the company and have the right to receive all such notices and communications as the members of the company are so entitled. In addition, the auditors also have the right to be heard at general meetings in relation to any business which concerns them as auditors: s.141(7) CO.

For banking companies with branches outside Hong Kong, their auditors have the power to access all the copies and extracts of the books and accounts of those branches when such documents are transmitted to the head office of the companies in Hong Kong: s.141(5) CO.

As regards companies with subsidiaries incorporated in Hong Kong, the auditors of the companies have the power to require the subsidiaries and their auditors to supply such information and offer such explanations as necessary for them to carry out their duties. However, if the subsidiaries of such companies are not incorporated in Hong Kong, then, the auditors have the power to demand the companies obtain information and explanation from the subsidiaries: s.133(1)(b) CO.

**(b)** The procedure relating to the resignation of an auditor is governed by s.140A CO.

Under s.140A, an auditor of a company may resign from his office at any time by depositing a notice in writing to that effect at the registered office of the company. Any such notice shall operate to bring his term of office to an end on the date on which the notice is deposited or on such later date as may be specified in the notice: s.140A(1) CO.

An auditor's notice of resignation shall not be effective unless it is properly signed and contains either a statement to the effect that there are no circumstances connected with his resignation which he considers should be brought to the notice of the members or creditors of the company; or a statement of any such circumstances ('the Statement of Circumstances'): s.140A(1) CO.

Having received an auditor's notice of resignation, the company shall within 14 days send a copy of the notice to the Registrar. Where the notice contains the Statement of Circumstances, a copy of the notice must also be sent to all members of the company, be they so entitled or not, all debenture holders as well as all others so entitled: s.140A(3) CO.

Under s.140B(1) CO, where an auditor's notice of resignation contains the Statement of Circumstances, the auditor has the right to require the directors to call an extraordinary general meeting so that the auditor may address the meeting on those circumstances as stated in the Statement of Circumstances.

Further, the auditor is entitled to receive all notices or communications relating to the meeting which the other members of the company are so entitled. He also has the right to attend and address the meeting in matters connected to the circumstances: s.141(5) CO.

**6** The question invites the candidates to demonstrate their knowledge of the types of business vehicles being available to those who want to carry on business in the Hong Kong Special Administration Region ('the HKSAR').

**(a)** For people who want to conduct business in the HKSAR, they may consider to carry on their business in the form of partnership and company incorporated under the Companies Ordinance (Cap 32) ('CO').

A partnership is defined as the relationship which subsists between persons carrying on business in common with a view to profit under s.3(1) Partnership Ordinance (Cap. 38) ('PO'). All the partners are collectively referred to as a firm and the name of the partnership is called the firm-name: s.6(1) PO.

The essential feature of a partnership is the existence of a partnership agreement among all the partners. The agreement may be an oral agreement, an agreement in writing or an agreement being inferred from the conduct of the related parties. Hence, partnerships can be formed very quickly and cheaply.

In relation to outsiders to partnerships, partners are liable jointly, i.e. together, and severally, i.e. separately, for all the liabilities of the partnership: ss.12–14 PO. As opposed to companies incorporated under the CO (Cap 32), partnerships do not have separate legal entities. The liabilities of their partners are therefore unlimited in that their liabilities are the same as those of the partnership.

**(b)** Under s.3(2) Limited Partnership Ordinance (Cap 37)('LPO'), a limited partnership must have one or more persons called general partners and one or more persons called limited partners.

A general partner is one who shall be liable for all debts and obligations of the firm. A limited partner is one who shall, at the time of entering into the limited partnership, contribute to the firm a sum, as capital or property, valued at a stated amount, and who shall not be liable for the debts or obligations of the firm beyond the amount so contributed: s.3(2) LPO.

During the continuance of the partnership, a limited partner is not allowed, either directly or indirectly, to draw out or receive back any part of his contribution, and if he does so, he shall be liable for the debts and obligations of the firm up to the amount so drawn out or received back: s.3(3) LPO.

Subject to LPO, a limited partnership is the same as an ordinary partnership in law: s.6 LPO.

**7** The question invites the candidates to show their knowledge of the statutory control of bribery in the Hong Kong Special Administrative Region ('the HKSAR').

The statutory control of bribery in the HKSAR is governed by the Prevention of Bribery Ordinance (Cap 201) ('PBO').

Under s.9(1) PBO, an agent is guilty of an offence if they, without lawful authority or reasonable excuse, solicit or accept an advantage when conducting the affairs or business of the principal. The agent shall not be liable for the offence if the agent has the permission from the principal in so doing: s.9(4) PBO.

The permission must be given by the recipient's principal, not the offeror's principal. The permission may be sought from the principal by the agent as soon as reasonably possible after the agent's acceptance of the advantage so that the permission is to be effective for the purpose of the offence: s.9(5) PBO.

Within the context of PBO, the employer of a private organisation refers to the proprietor or the board of directors of a company. The 'employer' also includes an authorised person of the proprietor or the board of the company.

In PBO, an agent is a person who acts for or is employed by the principal. Any person being appointed by a company to act for the business of the company is also an agent under PBO. Such an appointment need not be a full-time one. It is immaterial whether the agent receives any salary or fee from the company.

An advantage, under s.2(1) PBO, means anything that is of value. Such thing includes money, gift, commission, employment, service or favour. It should be noted that the advantage does not include entertainment by way of the provision of food or drink for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as such a provision.

Pursuant to s.9(2) PBO, the offeror of the advantage is also liable for the offence when the advantage is given under circumstances being caught under s.9(1) PBO.

When the agent accepted an advantage, if the agent believed, suspected or had grounds to believe or suspect that the advantage was given as an inducement to or reward for or otherwise on account of the conduction of the affairs or business of the company, it shall not be a defence that:

– the agent did not actually have the power, right or opportunity so to conduct the affairs or business;
– the agent accepted the advantage without intending to do so; or
– he did not in fact do so: s.11(1) PBO.

Hence, the offence is completed once an agreement of corruption, be it verbal or not, is reached.

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

Under the Employment Ordinance (Cap 57) ('EO'), any term of a contract of employment which purports to extinguish or reduce any right, benefit or protection conferred upon the employee by this Ordinance shall be void: s.70 EO. Further, during the subsistence of an employment contract, which is also a continuous contract within EO, a female employee is entitled to have maternity leave: s.12(1) EO.

As far as the Maternity Leave Clause is concerned, it has the effect of extinguishing Beauty's right to have maternity leave under s.12(1) EO. As such, the Clause there violates s.70 EO and hence it is void, i.e. has no legal effect.

As regard the Working Clause, it is a clause in restraint of trade. A clause in restraint of trade is a clause which limits or restricts the freedom of a party to the contract to run his business, trade or profession in the future over time, geographic location or area of trade. Its purpose is mainly for preventing or regulating competition in the same or similar area of business.

In considering the validity of a clause in restraint of trade, the court presumes that such a term is void unless the party relying on the term has a legitimate interest to protect and that it is reasonable to the parties of the contract and the community.

In deciding the issue of reasonableness, restrictions over the period of time, geographic location, area of trade being imposed by the term and particular facts of the case will all be considered by the court. A clause in restraint of trade has been held to be void when the clause imposes excessive restrictions on employees over the duration of time, the geographic location and the area of trade.

In *Attwood* v *Lamont* (1920) UK, an employment contract restricting the employee from engaging in a long list of activities many of which were unrelated to the business of the employer was held to be void.

In *Buchanan* v *Janesville Ltd* (1981) HK, the terms in question provided that at the termination of employment contract, the employee was not to work in Hong Kong as a hairdresser or in any capacity connected with hairdressing in competition with La Coupe Salon for a period of one year. It was held by the court that though the term was reasonable in respect of duration of time, however, it was unreasonable in other aspects. As a result, the term was unenforceable and void.

The Working Clause imposes restrictions in time, i.e. three years, geographic location, i.e. Hong Kong, and area of location, i.e. within the territory of Hong Kong.

In light of the *Buchanan* case, the restrictions on both of the area of location and the geographic location are probably excessive and therefore unreasonable.

As regards the time, the Working Clause disallows Beauty to work for any other firm within three years. Beauty is just an account clerk and probably will not have direct contact with the firm's clients. The only thing that the firm needs to protect is some confidential information relating to the firm's clients. In the light of the *Buchanan* case and given that the term of the employment contract is just two years, the restriction of three years under the Clause is probably unreasonable and hence void.

Beauty may be advised that both the Maternity Leave Clause and the Working Clause are most probably not legally enforceable against her.

**9** The question invites the candidates to show their knowledge of some concepts in company law.

Since only the articles of association of the company mention the salary of the directors, the issue is therefore whether Allan could enforce the articles against the company when Allan is not a shareholder, when the contract between the company and Allan does not mention Allan's monthly salary and when the company had paid Allan his monthly salary in the manner as stated in the articles for several years until three months ago.

Under s.23 Companies Ordinance (Cap 32) ('CO'), once the memorandum and the articles of association are registered, they have the effect of binding on the company and its members to the same extent as if they have been signed by each of the members of the company. Provisions of the two documents impose duties on all the members of the company to observe all the terms in them.

Section 23 CO in effect turns the memorandum and the articles of association into contracts between the company and each of its members, and contracts among each of the members themselves.

Given the nature of the articles as stated in s.23 CO and that Allan does not hold any shares of the company, i.e. he is not a member of the company, Allan could not enforce the articles against the company.

Nevertheless, provisions in the articles of association of a company may be incorporated into the service contract of a director as the result of the conduct between the parties.

In *Re New British Iron Co, ex parte Beckwith* (1898) UK, the articles of association of the company provided that remuneration of the directors should be at a certain sum, there being no other document stating the remuneration of the directors. Upon liquidation of the company, the directors claimed for the arrears of their fees. It was held that the articles of association by itself was not a contract between the directors and the company. However, the claims by the directors were allowed on the ground that a contract between the directors and the company incorporating the articles of the company could be inferred from the parties' conduct.

Given that the company had paid Allan his monthly salary in the manner as stated in the articles for several years until three months ago, the provision of the articles of the company relating to the monthly salary of Allan has probably been incorporated into Allan's contract.

By failing to pay Allan's salary in the manner as stated in the articles, the company has probably breached the contract.

Allan may well be advised that he has the right to claim against the company for outstanding salaries under the contract, but not under the articles of the company.

**10** The question invites the candidates to demonstrate their knowledge of both fixed and floating charges.

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.

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. Identified by Romer LJ in *Re Yorkshire Woolcombers Association Bank Limited (*1903) UK, a floating charge 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.

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. This aspect of a floating charge was confirmed by the Privy Council in *Agnew* v *Commissioner for Inland Revenue* (2001) UK.

In relation to the first charge, while a charge being created with flats as security is usually regarded as a fixed charge by reason that a flat, being a real property, is fixed, ascertained and identified by the time the charge is created, this rationale cannot be applied in determining the nature of the first charge.

As the business of the company is to construct buildings for residential purposes and selling the flats in the buildings to the public and the flats, being the security for the first charge, are unsold property of the company in Building A, hence those flats are by nature the trading stock of the company. As such, the stock gives the first charge the nature of a floating charge as depicted by Romer LJ in the *Re Yorkshire* case in that it is a class of present or future assets of the company and will keep on changing in the ordinary course of business of the company. Accordingly, the first charge is a floating charge.

In relation to the second charge, the security for the charge is the same as the first charge. As such, had it not been for the Restriction Clause, the second charge would also have been a floating charge.

Under the Restriction Clause, the company is not allowed to sell the unsold flats in Building B without prior approval from the bank. The effect of the Restriction Clause is to deprive the company of the control over the unsold flats in Building B in the ordinary course of the company's business, i.e. selling the unsold flats in Building B which forms the trading stock of the company. Accordingly, the second charge is a fixed charge.

**1** The question invites the candidates to show their knowledge of the sources of law in the Hong Kong Special Administrative Region.

**(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.

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

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

**(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)** 7–8 At the top of this range are those providing a clear understanding and thorough treatment of the subject area being examined.

5–6 Towards the bottom of this range will be those showing some knowledge.

3–4 Answers show some knowledge.

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

**3** The question invites the candidates to demonstrate their knowledge of the authorities exercisable by an agent under an agency contract.

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

**(c)** 0–1 Extremely poor answers which show either no or very little knowledge of the area.

**(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 which show either no or very little knowledge of the area.

**4** The question invites the candidates to show their knowledge of the concept of corporate governance and the sources from which the rule relating to the corporate governance of a company derive.

**(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 which 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.

**5** The question tests the candidates on their knowledge about the power and resignation of the company auditor.

**(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.

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

**6** The question invites the candidates to demonstrate their knowledge of the types of business vehicles being available to those who want to carry on business in the Hong Kong Special Administrative Region.

**(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.

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

**7** The question invites the candidates to show their knowledge of the statutory control of bribery in the Hong Kong Special Administrative Region.

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

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

2–4 Answers show some knowledge.

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

**8** The question invites the candidates to show 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 which show either no or very little knowledge of the area.

**9** The question invites the candidates to show their knowledge of some concepts in company 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 which show either no or very little knowledge of the area.

**10** The question invites the candidates to demonstrate their knowledge of both fixed and floating charges.

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 which show either no or very little knowledge of the area.