

Examiner's report

F4 Corporate and Business Law (CHN)

June 2010



General Comments

As a whole, candidates' performance at this sitting has been poor in producing quality answers.

1. Some candidates did not read the questions and requirements carefully and misunderstood the real meaning of the questions and requirements. Irrelevant answers were given to the questions. This situation could be reflected from the performance in questions 3, 4 and 7. Therefore, though these candidates attempted almost all ten questions and wrote a lot on the scripts, they did not receive marks as expected.
2. Some candidates did not familiarise themselves with the relevant rules of law and were unable to give any points to certain questions. This could be seen in the answers in relation to *compromise* under the Enterprise Bankruptcy Law, *taking effect of a contract* under the Contract Law.
3. A few candidates were unable to make the correct determinations with reasons to questions 8-10. Generally speaking, the answers to these questions involving case-analysis, are always better than general questions, since candidates are merely required to make determinations with simple reasoning. However, a few candidates were only able to pick up about half of the marks because of failure to make a correct determination to certain requirements.

Overall, few candidates performance showed they had been well prepared for the examination and clearly understood the relevant rules of law. Therefore, they were able to answer every question in a comparative accurate manner, especially in dealing with questions 8-10 in relation to case analysis. They were granted quite high marks for their excellent performance.

Specific Comments

Question One

This question requires candidates to state the different levels of the Chinese law and regulations, and the hierarchy of the effect of law and regulations enacted by the different law-making authorities.

Candidates were required to state the relevant laws, regulations and their law-making authorities. Candidates were also required to state the hierarchy of the effect of the laws and regulations.

Overall performance for this question was satisfactory. However, some candidates were unable to give a single point to this question. Their major errors in this question included:

- Confusion of the different levels of the Chinese law and regulations with the judicial system of China, by stating the four levels of court system;
- Failing to understand clearly the relevant law or regulations and their law-making authorities.

Question Two

This question requires candidates to explain the terms *tenancy in common* and *joint tenancy* with respect to co-ownership for property, as well as the external and internal debtor-creditor relations in connection with co-owned properties.

A large number of candidates were able correctly to explain the legal terms as well as state the external and internal debtor-creditor relations in connection with co-owned properties.

Common errors in this question included:

- Failing to distinguish the tenancy in common with respect to co-ownership and the joint tenancy with respect to co-ownership;

- Failing to understand the meanings of external and internal debtor-creditor relations in connection with co-owned immovables or movables;
- Failing to state the exception as to the external debtor-creditor relations in connection with co-owned properties, i.e. if it is otherwise provided by law or the third party knows that there is no joint and several relationship, the co-owners shall not assume joint and several debts;
- Failing to point out one of the key aspects for the internal relations in which a co-owner who has paid debts in excess of his proportion is entitled to recover from other co-owners if the form of co-ownership is tenancy in common.

Question Three

This question is relevant to the monetary compensation and statutory procedural obligations by an employer under the Labour Contract Law. Performance for this question was not satisfactory.

The key issue to be resolved is the legal status of the labour contract. Part (a) of the question states that “.....where a labour contract expires or is terminated.” It is obvious that the said labour contract becomes ineffective because its duration expires or because it is terminated by various reasons. Therefore, candidates were required not to state the circumstances under which an employer or the employees allowed to dissolve a labour contract, but to state the monetary compensation for an employer to make monetary compensation although there is no any default by the employer to the expiration of the labour contract. However, most of candidates answered on the basis that the employer wants to dissolve the labour contract within the term of the labour contract. Such an understanding results in the incorrect answer that the employer should give a prior notice before it dissolves the labour contract as a condition.

Therefore, in part (a) candidates should state that the compensation shall be based on the years of employment of the employees at the rate of one month’s salary for each full working-year. In addition, candidates should deal with other circumstances, such as the working-year being less than 6 months or more than 6 months but less than 12 months and the limitation of the monetary compensation, etc. In part (b) candidates were to state the relevant procedural measures that include the issuance of a certificate of termination or expiration of the labour contract, the transfer of the employees’ personal files and social security account. No single candidate was able to state full points of part (b). That is why the performance for this question was below the expectation.

Question Four

This question requires candidates to explain the meaning of taking effect of a contract, and explain the rules regarding the time or condition of taking effect of a contract.

Taking effect of a contract means that a contract, upon the satisfaction of certain substantive conditions, takes effect and binds legally upon the parties to it.

As a general rule, a contract takes effect when it is signed by the parties to it. Where laws or administrative regulations require a procedure of approval, registration, etc., those provisions shall be followed. Therefore, under such circumstances a contract takes effect upon the relevant approval and/or registration procedures being completed. Also, parties may agree upon the conditions of taking effect of a contract. A contract becomes effective when such conditions are satisfied. Parties to a contract may also agree upon the time limit for a contract to take effect. Therefore, a contract subject to time limit for taking effect becomes effective when the time limit is mature.

The performance for this question was unsatisfactory, just because almost all of candidates confused the formation of a contract and taking effect of a contract. According to the Contract Law, formation of a contract takes a form of offer and acceptance. When an offer is accepted by the offeree a contract is formed. Generally

speaking, where a contract is formed it takes effect and binds upon both parties. In addition, the Contract Law also stipulates other conditions for a contract to take effect. For example, the approval or registration requirements, the conditions agreed upon by the parties to the contract, etc. However, a large number of candidates did not know clearly the question and requirements. The evidence is that they stated merely taking effect of an acceptance, not taking effect of a contract; the time of an acceptance, but not the time of a contract to take effect. On the other hand, no one candidate was able to point out the special conditions for a contract to take effect. These are the reasons why the performance for this question was unsatisfactory.

Common errors in this question included:

- Failing to understand the meaning of taking effect of a contract;
- Confusion of the formation of a contract with taking effect of a contract;
- Failing to state the special requirements for taking effect of a contract and the conditions and time for taking effect of a contract by parties.

Question Five

This question requires candidates to explain the registered capital of a limited liability company and the special requirements for a sole person limited liability company and liability of such company towards its debts.

In part (a) candidates were required to explain the meaning of the registered capital of a limited liability company. The registered capital of a limited liability company refers to the amount of capital contributions subscribed for by all of its shareholders as registered with the company registration authority.

In part (b) candidates were required to state the rules of the registered capital for a sole-person limited liability company. According to the Company Law, the minimum amount of registered capital for such a company shall be no less than RMB 100,000 yuan. The shareholder shall, in a lump-sum, contribute in full the amount of capital. In addition a sole-person limited liability company is not allowed to reinvest to establish another one-person limited liability company.

Candidates were required further to state the liability of the shareholder toward the debt of a sole-person liability company in part (c). It is a special but very important rule to understand this form of a limited liability company. According to the relevant provisions of the Company Law, if the shareholder of a sole-person limited liability company cannot prove that the property of the company is independent from those of the shareholder's own property, the shareholder shall bear joint and several liabilities for the company's debts. The purpose of this special rule stands for the protection of the creditors of a sole-person limited liability company. Since the special corporate structure of such company would give rise to difficulties for its creditors to distinguish the company's assets from those of its sole shareholder. Without such a restriction the shareholder of a sole- person limited liability company may easily avoid the liability of the company by the general rules of limited liability of a company.

Most of candidates were able to explain the registered capital and the minimum requirements for a sole-person limited liability company as well as the way of making capital contribution. Therefore, performance for this question was satisfactory. It should also be noted that some candidates did not understand the special rule as to the liability of a shareholder toward the debts of such company. They failed to state the possible personal liability of a shareholder toward the debts of such a company and the reasons why the Company Law provides for such a special liability, as it is against the general rule of limited liability in modern company system. Some candidates stated that the purpose of such a rule of liability stands for the protection of the sole-person liability company itself, not for the creditors of the company.

Question Six

This question is relevant to the special procedure-compromise during the process of liquidation.

Compromise may be filed by the debtor directly or after the court has accepted an application for bankruptcy but before the announcement of bankruptcy; a compromise proposal shall be along with a draft of compromise, examined and approved by the court and adopted by the creditors' meeting during the liquidation procedure; it shall be confirmed by the court. By this way the debtor (a company that is declared bankruptcy by itself or by its creditors) may avoid to be actual bankruptcy. Common errors in this question include:

- Failing to understand the meaning of compromise;
- Failing to state the key role of the court for a compromise proposal;
- Failing to state the duration of a compromise to be carried out, i.e. after the acceptance of bankruptcy but before the actual announcement of bankruptcy by the court.

Part (b) of this question is relevant to *creditor in compromise*, which refers to a party who enjoys a creditor's right, but without any property guaranty, against its debtor when the court accepts a relevant application for bankruptcy. The key point to this part of question is to understand that the creditor is not a creditor in general sense but a creditor without any property guaranty when the compromise takes place. A large number of candidates were unable to state this key point.

Part (c) of this question requires candidates to state the legal effect of a compromise on the rights of a creditor in compromise against the guarantor of the debtor. According to the Enterprise Bankruptcy Law, the legal effect of the compromise does not extend to the guarantor of the debtor and other joint and several debtors. Although the compromise provides for the contents with respect to the exemption or delay of the rights of the creditor in compromise, the creditors shall exercise their right based on the original agreement or the relevant provisions of law against the guarantor.

Common errors in this part included:

- Failing to understand the question and requirements;
- Failing to state the legal effect of the compromise does not extend to the guarantor of the debtor.

Question Seven

This question requires candidates to state the transaction limit of the stocks purchased by a purchaser during the process of taking over a listed company, and the afterwards obligations towards the target company as well as the report requirement of the purchaser after the completion of takeover of a listed company.

However, most of candidates were unable to give a correct answer to this question, since they misunderstood the question and requirements. Most of them stated the disclosure obligation and limit for further purchase if a purchaser obtains 5% of shares of a listed company through the stock exchange. Some other candidates stated the ways of takeover a listed company, namely takeover by offer and takeover by agreement. If they read the question carefully, they would understand that the question requires candidates to state and explain the transaction limit (not the disclosure obligation) on the stocks purchased (not the limit for further purchase of stock). Therefore, the correct answer to this part is that the stocks purchased and held by a purchaser through the process of takeover of a listed company shall not be transferred for 12 months following completion of the takeover. The purpose of such limit is to prevent the purchaser from abusing the power to control the securities market, so as to protect the rights and interests of small and medium shareholders of the listed company and public investors.

In part (b) candidates were required to state the obligations towards the target company as well as the report or approval requirements, including the report of the particulars of the takeover to the securities regulatory authority and the stock exchange and make the same known to the general public, the obligation to get the necessary approval from the competent government authority where the takeover of a listed company involves shares held



by an investment organisation authorised by the State. Generally candidates were able to state the obligation of the purchaser to report to the securities regulatory authority and stock exchange, but failed to mention the obligation of getting approval if necessary.

Performance for this question was not satisfactory.

Question Eight

This question requires candidates to deal with the legal issues in relation to *force majeure*.

Force majeure constitutes one of the major rules in the Contract Law of China. Candidates must familiarise themselves with this rule of law. Therefore, as a whole, most of candidates were able to make at least two correct determinations among the three parts and obtained satisfactory marks. In terms of average marks for an individual question, it is the highest of the ten questions.

Part (a) of this question requires candidates to state whether the contract may be dissolved by a party to a contract if it met a force majeure. In the present case the chickens were destroyed due to bird flu spreading. It was obviously in conformity with the condition of a *force majeure* and the condition for dissolving a contract by parties under the Contract Law is satisfied. Therefore, Wanfa Co was entitled to dissolve the sales contract.

Part (b) of this question is relevant to the liability of a party for its failure to discharge contractual obligation due to force majeure. According to Article 117 of the Contract Law, if the non-performance is caused by a *force majeure*, the liability shall be relieved in whole or in part, in accordance with the effect of the *force majeure*. Since the failure to ship the goods was a result of *force majeure*, not caused by fault of Ludao Poultry, therefore it should be exempted from the liability for failure to deliver the goods. However, some of candidates could not make a correct judgement to this part.

Part (c) of this question requires candidates to determine whether Wanfa Co is entitled to recover the advance payment or Ludao Co is under an obligation to return the advance payment it received. In accordance with Article 97 of the Contract Law, after termination of the contract, the parties to the contract shall take any reasonable measures to settle the contractual obligations, whether performed or non-performed. The measures include the restitution or other remedial ones. In the present case Wanfa Co's declaration to dissolve the sales contract shall not affect its right to claim for restitution. On the other hand, the exemption of non-performance by Ludao Poultry did not grant it the right to retain the advance payment paid by Wanfa Co. Therefore, Ludao Poultry was under an obligation to return the advance payment to Wanfa Co. However, some candidates held that Ludao Co could not return the advance payment because the sales contract was dissolved by Wanfa Co, the buyer. They did not clearly understand that the dissolution of a contract is the right of a party if the purpose of the contract cannot be realised. On the other hand, Ludao Co could be exempted from the liability for its failure to ship the goods due to force majeure. This means that Ludao Co would not bear the civil liability, such as monetary compensation, for its failure to discharge the contractual obligation to ship the goods. However, this rule does not mean that Ludao Co had a right to retain the advance payment paid by Wanfa Co even though it did not ship the goods.

Question Nine

This question requires candidates to deal with the legal issues with respect to the pledge of right and the transfer of shares. Candidates were required to have a solid understanding of rules of pledge under that Properties Law and compulsory transfer of the shares of a limited liability company by a court order under the Company Law.

In part (a) candidates were required to deal with the legal issue in relation to pledge. According to the Property Law, in the case where the debtor defaults on the debts, the pledgee may negotiate with pledgor to take the pledged property at its estimated value to set off the debt, or by getting paid in priority from the proceeds by the auction or sale of the pledged property. However, parties are not allowed to agree in the contract that the pledgee

may take the pledged property where the pledgor defaults its contractual obligation. So the correct answer to this part should be that Ms Lee's request should not be supported by the court, as it was against the rule of law. Some candidates did not know this rule clearly restricted on a party's autonomy, so that they could not gain the marks for this part.

Part (b) of this question is relevant to the transfer of shares under an enforcement procedure in light of the Company Law. Therefore, through the special conditions the pledged shares may be transferred to the pledgee. In order to complete the transfer of the shares pledged, the following conditions should be met: First, the court shall notify the company and all of its shareholders. Second, other shareholders of the company shall express their intention to exercise the priority to purchase the shares under equal conditions. Thirdly, Ms Lee might acquire Mr Kong's shares if other shareholders fail to exercise their priority within 20 days upon the date of the notice. Some candidates held that Ms Lee could not acquire Mr Kong's shares under any circumstances. Their conclusions just came from an inference based on the answer to part (a) of this question, because the answer to part (a) is that Ms Lee's request should not be supported by the court. However, the circumstance was substantively changed in part (b), in which the shares of Mr Kong were the subject matter of the enforcement of a judgement. In the process of enforcement if other shareholders of the company exercise their priority to purchase Mr Kong's shares upon receiving the notice, Ms Lee was still unable to acquire the shares. Therefore, the enforcement procedure to acquire the pledged shares merely provides a conditional opportunity for the pledge, i.e. other shareholders give up their priority to purchase.

Question Ten

This question requires candidates to state the rules with respect to the declaration of the creditor's right where a company is insolvent.

Part (a) requires candidates to deal with the supplementary declaration of the creditor's right. According to the Enterprise Bankruptcy Law, where a creditor fails to claim its creditor's right within the term as decided by the people's court, it may still make a supplementary declaration before the final distribution of the insolvent assets. In the present case Spring Travel Services came to claim its creditor's right after the first distribution of the insolvent assets but before the final distribution of the assets. Therefore, though this declaration was made beyond the time limit of 60 days, it was an effective one.

Many candidates were aware of the general rule for a creditor to declare his creditor's right within the time limit when the debtor was in the insolvent process, but failed to understand a creditor might make a supplementary declaration before the final distribution of the insolvent assets. Therefore, a large number of candidates did not give a correct answer to this part.

Part (b) requires candidates to deal with the matters of the distribution of the insolvent assets, which included three points: First, Spring Travel Services was merely entitled to the following distribution of assets. Second, Spring Travel Services should bear any extra fees and cost, as it claimed its creditor's right after the first distribution of the insolvent assets. Thirdly, it was not entitled to have a supplementary distribution to the first distribution of the insolvent assets, since it was a party making the supplementary declaration after the first distribution of the insolvent assets. Common errors in this part included:

- Failing to state the limitation of the right of Spring Travel Services to the first distribution of the insolvent assets;
- Failing to correctly state the party who should bear the extra fees and cost.