Examiners' report

F4 Corporate and Business Law (CHN)
December 2007

The examination consisted of ten compulsory questions (10 marks each). This was the first time for candidates to sit the paper F4, seven general questions plus three questions of case analysis. Candidates seemed to be time pressured, as some candidates gave up answering all the questions as required. Therefore, they should make time to familiarise themselves with the format of F4 so as to make an adequate time management in the future sessions.

Most candidates attempted all ten questions although there was some evidence of poor time management, particularly affecting Question 5, 6 and 8.

The performance of candidates overall continued to be as expected.

Workings were generally shown but were at times difficult to follow. Too many candidates continue to display their answers unsatisfactorily, with a lack of clear labelling to indicate which questions are being attempted. Each question should be started on a new page and candidates must give more thought to the layout and organisation of their answers. Valuable time can be easily wasted.

Specific Comments

Question 1
This question requires candidates to explain the meaning of a legal person and its capacity, as well as describe the differences between a legal person and a partnership in various aspects.

This question is concerned with the basic knowledge of civil law. Most of candidates were able to explain the meaning of a legal person, but failed to describe completely the capacity of a legal person. A legal person's civil capacity includes its capacity for civil rights and capacity for civil conduct. As every legal person is restricted by their articles of association and law, therefore, the legal person's civil capacity for civil rights is the special capacity for civil rights.

The major differences between a legal person and a partnership, in terms of their capacity for civil rights and the right to the property, can be summarised as the follows: A legal person shall set up its organisation to administrate its operation, no shareholder shall has the direct right to carry out the operations of the legal person without the due authorisation. The operational activities of a partnership may be carried out by every partner. Every partner shall bear joint and several liabilities toward the debts of the partnership. Furthermore, the property contributed by the founders to a legal person and accumulated in its operation shall belong to the legal person, while the property contributed by partners and accumulated in a partnership shall belong to all the partners.

Candidates should have the ability to summarise from the different provisions of the General Principles of the Civil Law. As a whole the performance should have room to improve.

Question 2
This question required candidates to explain the probation period of a labour contract and describe the conditions for employees or an employer to terminate a labour contract.

According to the Labour Law, parties to a labour contract may agree upon a period of probation not exceeding six months in their contract. An employee may terminate the labour contract at any time during the period of probation. As far as the employer is concerned, it may terminate a labour contract only under the circumstances that the employee cannot meet the terms and conditions for hiring in the period of probation.

The question did not require candidates to summarise from the different sections of law to give a complete answer. As a whole, the answers to this question were quite satisfactory. Many candidates could give a complete answer. This represented that candidates have been familiarised themselves with this part of the Labour Law.

Question 3
This question required candidates to explain the term acceptance, state the conditions to be met for an effective acceptance and describe the legal consequence of an effective acceptance with respect to the formation of a contract.

The performances for this question were quite satisfactory.

Generally speaking, the question was relevant to the basic knowledge of the contract system. Candidates were able to explain the term acceptance in part (a) and state the legal consequence when the acceptance takes effect (c), however, many candidates were unable to state all the points.

Under the relevant provisions of the Contract Law, an effective acceptance shall meet the following conditions: First, the acceptance shall be made by the offeree to the offeror who issues the offer. Second, the contents of the acceptance shall be in conformity with the contents of the offer, without any reservations, modifications or alternations. Third, the acceptance must reach the offeror within the time limit as fixed in the offer, or, if no time limit is fixed, an acceptance shall reach the offeror within a reasonable time limit.

Many candidates could only describe one or two points.

Question 4
This question required candidates to explain the term liability for fault in concluding a contract, and explain the major differences between the liability for the fault in concluding a contract and the liability for breach of contract.

Compared with other rules in relation to the Contract Law, it was a difficult question. Since candidates generally pay their attention to the rules relevant to the formation of a contract, but neglect the rule with respect to the liability for fault in concluding a contract by one of the parties. In business practices, it is not unusual that a contract is finally not formed and one party suffers a lot just because of the other party's fault during the course of negotiation of the contract. Marks for this question were not satisfactory .

Part (a) of this question required candidates to explain the term liability for fault in concluding a contract. It refers to such a liability of a party who, during the course of the negotiation of a contract but without a contract being formed, causes the losses of the other party in violation of the principle of good faith. Although there is no contract between the parties in negotiation, the nature of such a liability remains a liability under the contract law, not a tort.

Part (b) of the question was in relation to the conducts that may cause the liability for fault in concluding a contract. Article 42 of the Contract Law stipulates that the following conducts shall be liable for the losses caused to the other party: First, the party, under the guise of concluding a contract, negotiates with the other party so as to prevent the other party from concluding a contract with a third party. Second, the party intentionally conceals important facts for concluding a contract or supplies false information. Third, the party conducts any other activities in violation of the principle of good faith which cause the failure of two parties to enter into a contract.

Part (c) required candidates to state the major differences between the liability for breach of contract and the liability for the fault in concluding a contract. It was most difficult part in this question, as most of candidates

were unable to distinguish the liability for breach of contract from the liability for fault in concluding a contract. According to the Contract Law, the major differences include:

First, the liability for breach of contract is based on an effective contract between the parties. The liability for the fault in concluding a contract is based on the fact that the parties cannot reach an agreement between them because of the bad conducts, or on the fact that the contract is deemed as null and void.

Second, the liability for breach of contract can be borne by various forms, such as the specific performance, liquidated damages or damages. However, the party's *liability for the fault in concluding a contract* is a statutory liability and can merely be borne in the form of money compensation.

Question 5

This question required candidates to explain the rules relating to the purchase of its own shares by a company. This rule was introduced into the revised Company Law for the purpose of protecting the rights and interest of public investors.

This question was one of the most difficult questions in this sitting, as it required candidates to explain the objectives of the restrictions on a company to purchase its own shares, state the circumstances under which a company may purchase its own shares and state the limitations and conditions for a company to purchase its own shares.

As a whole, the answers to this question were not satisfactory.

Part (a) of this question required candidates to explain the objective of the rules as to the restriction on purchasing its own shares by a company. According to the relevant provisions of the Company Law, this rule is to protect the interests of public investors. As by purchasing its own shares it will confuse the legal relations between the company and its shareholders. Furthermore, the directors and managers of a company are able to easily use inside information to control the prices of the shares, which will certainly damage the interests of public shareholders and the creditors, and distort the order of the stock market. Finally, if a company holds the shares of its own company, the capital of the company will be false and violate the rules of capital under the company law.

Part (b) of this question required candidates to state the circumstances under which a company may purchase its own shares. Article 143 of the Company Law listed all the circumstances, such as where a company is to reduce its registered capital, a company merges with other company, a company is to offer its shares to its staff and workers as a reward, etc.

Part (c) of this question required candidates to state the limitations and conditions that apply to such purchase. According to the Company Law, if a company purchases the shares of its own shares, a resolution thereupon shall be adopted at the shareholders' general meeting. The amount of the shares bought by the company shall not exceed 5% of the total amount of the shares issued by the company. The funds for the purchase shall be paid from the after-tax profits of the company. The shares purchased shall be transferred to the employees or management within one year after the purchase.

The common reasons for the unsatisfactory answer included:

- Failing to explain the objective of the provisions of the Company Law to restrict a company on purchasing its own shares.
- Failing to state the circumstances under which the purchase of its own shares by a company is allowed.
- Failing to state the special limitations to be complied with and conditions to be met for a company to buy shares of its own company.

Question 6
This question required candidates to state the rules for providing a guarantee for a third party, its shareholders or the actual controller of the company by a company.

As a whole the performance to this question was below the expectation.. Few candidates were able to give a satisfactory answer to this question.

Part (a) of this question was relevant to the procedural requirement for a company to provide a guarantee for others. A resolution shall be adopted by the board of directors, the shareholders' meeting or the shareholders' general meeting according to the articles of associations of the said company. Clearly, this provision of the Company Law stands for protecting the interests of the company and preventing the management from abusing its power.

Part (b) of the question required candidates to state the conditions to be met if a company intended to provide a guarantee for its shareholders or the actual controller of the said company. According to the relevant provisions of the Company Law, a resolution of approval must be adopted by the shareholders' meeting or the shareholders' general meeting. To provide a guarantee for its shareholders or the actual controller of a company is regarded as an important issue to be decided by the shareholders' meeting or the shareholders' general meeting. Since this may result in the possible debts of the company as a guarantor.

The Company Law stipulates that the shareholder who is seeking the guarantee or the shareholder who actually controls the company and is seeking to receive the guarantee shall not participate in the voting for the matter in this regard. Such voting shall be passed on simple majority of the voting rights held by other shareholders attending the meeting. Obviously, this provision is very important and fair one, as the parties want to receive the guarantee from the company they shall not have a voting right for its own benefit.

The Company Law provides further that the resolution of approval and the restrictions on the parties concerned to participate in the voting are the compulsory requirements for a company to provide a guarantee to the shareholders or the actual controller of the company. No articles of association are allowed to provide for otherwise in contradiction to this rule.

The common reasons for unsatisfactory answers included:
- Failing to state the procedural requirements for a company to provide guarantee to the others
- Failing to distinguish the circumstances under which a resolution to be adopted by the shareholders' meeting or the shareholders' general meeting respectively.
- Failing to state the special voting restrictions when approving a resolution to provide guarantee to a shareholder or a controller of the company.

Question 7
This question was to test candidates of the knowledge of general suretyship guaranty and joint and several suretyship guaranty. Actually, it was a particular question that has been tested several times in the past sessions, both in the form of general question and case analysis, although the angle or the coverage of the question was different.

Part (a) of this question required candidates to explain the terms general suretyship guaranty and joint and several surety guaranty. The Guaranty Law stipulated quite straight and clear.

Part (b) of this question required candidates to state the major differences between a general suretyship and a joint and several suretyship. According to law, a general suretyship allows the surety to refuse to undertake the suretyship liability before the assets of the debtor are executed. While under a joint and several suretyship guaranty a surety may not refuse to undertake its suretyship liability within the scope of the suretyship agreement

on the ground that the assets of the debtor shall be executed before the creditor demands the surety to undertake the suretyship liability.

The performance in this question was acceptable.. Moreover, some candidates were able to answer with all the points to the question .

Question 8
This question requires candidates to deal with the legal issue as to the formation of a contract. Candidates were required to state the legal status of the three faxes and then to determine whether there was a contract between the two parties.

The formation of contract has been tested in the past sessions. It is relating to the basic rules of the contract law. However, the answers to this question were below the expectation.

In part (a) candidates should state the legal status of the faxes between the parties.
Based on the background the purchase order of Oriental Company on 1 July 2006 was an invitation to offer, as it did not contain the price of the wooden plate which constituted one of the necessary elements to consist an effect offer.

The fax of Wooden Company on 9 July 2006 constituted an effect offer. Since the fax indicated the manifestation of willingness to enter into a contract with Oriental Company and contained the necessary element for a valid offer, it is an offer.

The fax of Oriental Company on 11 July 2006 was a counter-offer, not an acceptance. As it requested a written confirmation letter signed by Wooden Company as the additional term, although the fax accepted the general terms and conditions. It meant that Oriental Company did not show its consent to the fax of Wooden Company without any reservation.

Part (b) of this question required candidates to make a judgement of the issue as to the formation of a contract. According to Article 30 of the Contract Law, the contents of the acceptance shall be in conformity with those of the offer. A substantial modification to the contents of the offer made by the offeree constitutes a new offer. Modifications on contract object, quantity, price or remuneration, time limit, place and method of performance, liabilities for breach of contract and methods of disputes settlement shall be deemed as substantial modifications to the contents of the offer. Wooden Company's confirmation letter dated 15 July 2006 contained the provision as to the liability for breach of contract, which represented a substantial modification to the contents of the offer made by Oriental Company. Therefore, it was not an acceptance, but a counter-offer. Since Oriental Company did not give a notification of acceptance, therefore, there was no a sales contract between the two parties.

The common reasons for the dissatisfactory answers included:
- Failing to understand the basic elements to be contained in an effect offer
- Failing to understand the nature of a notice purported to be an acceptance but contained restriction, reservation or modification
- Failing to make a correct judgment with respect to the formation of a contract.

Question 9
This question was to test the knowledge of candidates with respect to the some basic rules of company law and securities law. Candidates were required to answer the question based on the background as given in four parts. Candidates should answer this question under the different laws and the different rules.

The performances of candidates for this question were quite encouraging. Many of candidates were able to answer this question quite well.

Part (a) of this question required candidates to state the conformity of the incorporation agreement with the law. Under the relevant provision of the Company Law the capital contributions by Mr. A, Mr. B and Mr. C would be in currency and exceeded 30% of the registered capital. Their capital contributions were in conformity with the rule of the Company Law. However, Mr. D's capital contribution was not in conformity with the Company Law since his technology did not undergo the evaluation and verification process.

Part (b) required candidates to state the conformity of the incorporation agreement with the law. Under the Company Law, where a limited liability company has a small number of shareholders or is comparatively small in amount of registered capital, it may have one executive director instead of a board of directors. To incorporate a limited liability company all the shareholders shall designate the legal representative of the company in their articles of association. Therefore, the proposals to have one executive director and to appoint Mr. A as the legal representative of the company were in conformity with the Company Law.

In part (c) of the question candidates were required to determine the qualifications of a supervisor. According to the Company Law, directors and senior executives of the company shall not concurrently serve as supervisors. Hence, Mr. B could not concurrently be a supervisor while he was appointed as the chief finance officer.

In part (d) candidates were required to determine the lawfulness of issuing the corporate bonds upon the incorporation of the company. According to the relevant provision of the Company Law and the Securities Law, a limited liability company shall have the minimum assets of RMB 60 million yuan to apply for issuance of corporate bonds. Therefore, the company, with a proposed total registered capital of RMB 400,000 yuan, was not qualified to issue corporate bonds.

Although the performances were satisfactory, some candidates could not give a correct answer to this question. Their major reasons for having a dissatisfactory answer include:

- Failing to understand the rules as to the registered capital required by the revised Company Law, such as the minimum requirement of the capital in currency and the requirement for compulsory evaluation and verification of technology as a form of capital contribution
- Failing to state the qualification requirements for a person to be appointed as the member of supervisory board
- Failing to state the corporate structures of a limited liability company, such as the board of directors and the legal representative of the company.

Question 10

This question required candidates to deal with the legal issue as to the statutory requirement for the disclosure of information by a listed company. It was not a complicated question, but a straightforward one. Since the disclosure of information is one of the most important rules set up by the Securities Law and must be strictly followed by all the relevant parties in stock market.

The performance of candidates was acceptable. However, if candidates read the text of the Securities Law carefully, they would have performed much better.

According to Article 67 of the Securities Law, when a major event occurs that may considerably affect the price of a listed company's shares and that is not yet known to the investors, the listed company shall immediately submit an ad hoc report on the details of such a major event to the securities regulatory authority under the State Council and to the stock exchange and make the same known to the general public. This provision also listed the various matters which shall be deemed as the "major event".

Base on the above-mentioned provision of law, the matter as provided in part (a) in relation to the contract and the management fee should be a major event to be disclosed to the public. Since under this contract Stock Company would expand its scope of business and the compensation from the management of the instrument company would account for 10% of the net profit of Stock Company.

As to the matter in part (b), the litigation or arbitration involved in material interests of a stock company should be fallen within the major event and the Stock Company was under the statutory obligation to disclose it.

Part (c) of this question was in relation to the changes in the shares of a shareholder. Since the shares of a stock company are traded in the stock market, it is impossible for a stock company to make all the changes of shares by the shareholders. Therefore, the Securities Law merely provides that a considerable change in the shares of the shareholders holding not less than 5% of the company's shares or any of the company's actual controllers, or a considerable change in the situation that they control the company shall be deemed as the important information to be disclosed promptly. In the current case the shareholder holding 3% shares of Stock Company placed its shares as guarantee for a loan agreement, which did not reach the less than 5% requirement. Therefore, this information did not fall within the category of the statutory disclosure.