



# Examiner's report

F4 Corporate & Business Law (CHN)

December 2009

## General Comments

The examination consisted of ten compulsory questions (10 marks each). The examination consisted of two parts, seven general questions plus three questions of case analysis.

The performance of candidates overall was unsatisfactory and below the expectation.

An obvious indication in this sitting represents that some of candidates were not familiarised themselves with the rules with respect to the judicial interpretation in the general legal system of China, the conditions, not the circumstances under which an employer can reduce its workforce, for an employer to reduce the work force the rule of the voidable contract under the Contract Law, etc.

## Specific Comments

### Question One

This question requires candidates to explain the term of *judicial interpretation*, and state the legal basis for the Supreme Court to make *judicial interpretation* and the role of judicial interpretation in the Chinese legal system.

*Judicial interpretation* refers to the interpretations, made by the Supreme People's Court, relating to general or specific issues of application of law in the judicial practices under the authorisation of the Standing Committee of the (National People's Congress) NPC. Judicial interpretations by the Supreme People's Court to give the guidance for the general application of laws should have an actual legal binding force upon local courts at various levels and secure the unified judicial practices throughout China.

Overall performances for this question were unsatisfactory. This is the first time to test candidates of the question in relation to judicial interpretation. Furthermore, the answer to this question could not be found from a particular legislation. Therefore, candidates had not familiarised themselves with this question. Some candidates were unable to give a single point to this question.

Common errors in this question included:

- Failing to explain the meaning of judicial interpretation, failing to state the legal effect of judicial interpretation, and the reasons why judicial interpretations are needed currently
- Confusion of the legal effect of judicial interpretation with the rule of jurisdiction, even though some judicial interpretation being relevant to the rules of jurisdiction;

Failing to state the legal basis on which the Supreme People's Court may make judicial interpretation to give the guidance to the courts at the various levels with respect to the application of law.

### Question Two

This question requires candidates to state the conditions to reduce the workforce by an employer and the persons to be retained in priority in the case of reducing the workforce.

Part (a) of this question required candidates to state the conditions to be met before an employer reduces its employees, it is to some extent confused by some candidates with the circumstances under which an employer may reduce its workforce. With respect to the conditions for an employer to reduce its workforce, it is required to state the procedural steps to be taken, such as the explanation of the

circumstances to reduce the workforce in advance, the collection of the opinions from the trade union, the duty of report to the government concerned. As to the circumstances under which an employer may reduce its workforce, it requires candidates to state the circumstances such as the enterprise being under restructure pursuant to the law, suffering serious difficulties in business operations, etc. Obviously these candidates could not gain the satisfactory marks for this part of question.

When an employer intends to reduce its workforce in the numbers as prescribed by the law, employees who have concluded fixed-term labour contracts, employees who have concluded open-ended labour contracts and employees who are the only workforce of their families shall be retained in the priority by the employer.

Common errors in this question included:

- Failing to state any one group of employees who shall be retained in case of reducing workforce in certain number of employees;
- Confusion of the employees to be retained in priority with the circumstances under which an employer may not terminate a labour contract.

### **Question Three**

This question requires candidates to state the rules with respect to the deposit of the subject matter. This rule became examinable contents this sitting. Therefore, some candidates were not familiar with it. On the other hand, to answer this question candidates are required to make a summary from several provisions of the Contract Law. Performances for this question were quite satisfactory and beyond the expectation.

Part (a) of this question is relevant to the circumstances under which a debtor may deposit the subject matter. This is a rule to protect the legitimate rights of a debtor and maintain a stable legal relationship between the debtor and creditor. Therefore a debtor may deposit the subject matter if the creditor refuses to accept the discharge of obligation by the debtor without justified reasons, or the creditor's whereabouts is unknown or the creditor is deceased but the successor is not yet determined or the creditor loses capacity for conduct but a guardian is not yet determined.

In part (b) since the subject matter has been deposited legally by the debtor, the legal consequences of the subject matter--risks and costs—shall be borne by the creditor. So the correct answer of this part relies on the correct understanding of part (a).

Common errors in this question included:

- Failing to understand the meaning of this rule;
- Failing to state the circumstances under which a debtor may deposit the subject matter;
- Confusion of this rule with the obligation of a seller to deliver the goods to a buyer;
- Confusion of this rule with the rule of priority in allocating the disputable assets under the guarantee system;
- Confusion of depositing the subject matter by a debtor with the registration of property under the Property Law.

This question requires candidates to explain the terms **registration of incorporation** and **registration of change**, and state the various circumstances under which a **registration of change** is required. This question is relevant to the basic rule of company law and is very important in the business operations of a company. As a whole the performances for this question were satisfactory.

In part (a) candidates are required to explain the term of **registration of incorporation**. It refers to an action where promoters apply, for the purpose of setting up a company, to the company registration authority and the latter registers the incorporation to issue the business licence. Therefore, the registration of incorporation includes two steps: application by promoters and issuance of business licence by a registration authority.

Part (b) of this question is related to the **registration of change**. It means such a procedure in which an established company applies to change any items as stated on the business licence, and the relevant registration authority reissues the business licence. Therefore, the registration of change shall be done when certain key items take place by an established company.

Part (c) of this question requires candidates to state the various circumstances under which an established company shall apply for the registration of change. The change of certain substantive items as stated on the business licence are frequent in the business operations of a company, so there are many provisions concerning these matters in different chapters of the Company Law. Hence, this part of the question is difficult for candidates, as they could not directly find the answers in a single provision of law. In accordance with the relevant provisions of the Company Law, registration of change is required in the following circumstances: if the name, business coverage of the company, address of the company or the name of the representative has changed; if a limited liability company is to be converted into a joint stock limited company, or a joint stock limited company is to be converted into a limited liability company; if the names or titles the shareholders or the amounts of equity of the shareholders have changed and if the company increases or reduces its registered capital.

Common errors of this question included:

- Failing to explain completely the meanings of the two terms;
- Failing to state most of the circumstances under which the registration of change shall be applied by an established company.

#### **Question Five**

This question requires candidates to state the statutory restrictions on the transfer or trading of stocks by the sponsors, director, supervisors and/or the senior executives of a joint stock company. It is one of the most important rules incorporated in the Company Law to protect the rights and interests of public investors. Since these persons have the inside information of a stock company, they may easily use the inside information to buy or sell the stocks of the company and obtain benefit if without the necessary restrictions on their trading.

Part (a) of this question requires candidates to state the restriction of trading on the sponsors of a stock company. Under the Company Law stocks held by the sponsors of a joint stock company shall not be transferred within one year upon the date of incorporation, and the stocks issued prior to initial public offer of securities (IPO) to the sponsors shall not be transferred within one year upon the date when the company's stocks are listed and traded at stock exchanges.

In part (b) of this candidates are to state the restrictions of trading on directors, supervisors and/or senior executives of a joint stock company, including the duty of report as the holding and change of stocks, the restrictions on the numbers of transfer of stocks by maximum 25% annually; the restriction of trading in one year from the date of listing and the restriction of trading in half a year after they leave their posts, etc. It should be noted that the articles of association of the company may also impose additional restrictions on these persons.

Common errors of this question included:

- Failing to state the restrictions on trading under the different situations: the restriction of transfer within one year from the date of incorporation and the restriction of transfer which one year from the date of listing;
- Confusion of the restrictions on trading with the prohibition of trading by the executives of a stock company;
- Failing to state the time limits in accuracy;
- Failing to state the special restrictions that may be imposed by the articles of association of company the executives serve, other than those of the statutory restrictions.

#### **Question Six**

This question requires candidates to state the rules on the implementation of a rectification plan during the process of enterprise liquidation. Comparatively speaking, it is a difficult question for candidates, as it requires candidates to pick up the points from several provisions of the Enterprise Bankruptcy Law. Furthermore, the answers to this question involve a lot of details, such as the relevant party or competent authority, the requirement of equity held by a party that is entitled to apply for the rectification and the various powers of a liquidation administrator, etc. Most of candidates were able to pick up the key points in this question. Meanwhile, the performances of other candidates were below the expectation by failing to give a single point to this question.

In part (a) of this question candidates are required to state the circumstances under which a rectification plan may be carried out during the process of enterprise liquidation. In accordance with the relevant provisions of the Enterprise Bankruptcy Law, a debtor or any creditors of an enterprise that is in a liquidation process may apply with a competent court for rectification against that enterprise; a debtor or any one of its shareholders that holds 10% or more of the enterprise's registered capital may also apply for the rectification if the relevant enterprise against whom an application for bankruptcy has been made by its creditor but the court has yet announced it bankrupt.

Common errors of this part included:

- Failing to state completely the circumstances under which a rectification plan may be carried out;
- Failing to state the approval requirement by a competent court if the relevant parties intend to carry out a rectification plan.

Part (b) of this question is relevant to the authority to approve the application for the rectification plan.

Part (c) of this question is in relation to the powers of a liquidation administrator during the process of the implementation of a rectification plan, covering the transfer of the assets and business operation to the debtor upon the approval by the court; the supervision of the implementation of the rectification plan and the submission of a report to the court upon the expiration of the terms of supervision.

Common errors of this part included:

- Failing to pick up completely the powers of a liquidation administrator in the course of liquidation of enterprise;
- Confusion of the powers in dealing with the rectification of the enterprise with the powers of a liquidation administrator in dealing with the bankrupt matters.

### Question Seven

This question requires candidates to explain two forms of initial public offer of securities (IPO) and the situation in which ***underwriting with best efforts*** shall be deemed as a failure and the statutory obligation of the issuer. Performances of this question were quite satisfactory, as many candidates were able to pick up the key points of each part. A few candidates did not answer this question as expected.

In Part (a) and (b) of this question candidates are required to explain the terms ***underwriting with best efforts*** and ***underwriting with firm commitment*** for an initial public offer (IPO) of securities. Answers to these two parts can be found directly from Article 28 of the Securities Law. What candidates should be aware is the difference between the two forms of IPO.

Common errors of these parts included:

- Failing to explain any one of the terms;
- Failing to point out the main character of each term in explaining them;
- Confusion of the underwriting for an IPO under the Securities Law with obligations of the parties under the Contract Law.

Part (c) of this question is relevant to the time limit and a special obligation for a securities company to underwrite securities by way of ***underwriting with best efforts***. The key point to this question rests with the special obligation for a securities company not to reserve any securities during the 90 days period of underwriting.

Common errors of this part included:

- Failing to state the time limit of underwriting by way of underwriting with best efforts;
- Failing to state the special obligation for a securities company not to reserve any securities within the period of 90 days.

Part (d) of this question requires candidates to explain the situation in which the ***underwriting with best efforts*** shall be deemed as a failure and the obligation if the underwriting fails.

Common errors of this part included:

- Failing to understand the meaning of this question;
- Failing to point out the specific number of securities unsold to the public investors that can be deemed as a failure;
- Failing to state the special obligation for a securities company to refund the money plus a bank deposit interest.

**Question Eight**

This question requires candidates to deal with the legal issue of voidable contract. Compared with the performances of the questions of case analysis in the previous sessions, overall speaking, performances in this question were not satisfactory as expected.

Part (a) of this question requires candidates to make a judgement on the validity of the contract. It is relevant to the rule of voidable contract under the Contract Law, which means that any party may apply to the court or arbitration body for amendment or cancellation if a contract is concluded due to a material mistake or is grossly unconscionable at the time of its conclusion. Such a contract is a voidable one, i.e. its validity has not been certain. It may be amended or cancelled by a court or an arbitration body. However, if no party makes such an application within time limit, the relevant contract should become a valid one. Taking the facts of the present case into consideration, candidates can certainly reach a decision that the agreement was concluded under a gross unconscionable situation. Artai Co was in an urgent situation, without any bargaining capacity but to accept the unfair price. The developer took advantage of Artai Co's distress to sell the construction materials at a materially unfair price. The agreement was fallen within the situation as provided for in the Contract. The validity of the agreement was to be determined by a court or arbitration commission.

Common errors of this part included:

- Failing to make a correct judgement as to the character of the agreement;
- Failing to state the reasons why the agreement is deemed as a voidable one;
- Confusion of a voidable contract with an invalid contract.

Part (b) of this question requires candidates to state the legal remedy if a party considers a contract to be a voidable one. In accordance with the Contract Law, the party should, within the statutory time limit, request a court or an arbitration body to amend or terminate the contract.

Common errors of this part included:

- Failing to state the authorities a party may request for remedy include litigation in a court or arbitration in an arbitration body;
- Failing to state two forms of legal remedies: application for amendment or termination.

In part (c) candidates are required to state the right of revocation. The right of revocation extinguishes under the following circumstances: where a party who is entitled to revoke the contract fails to exercise his right of revocation within one year from the date on which he knows or should have known the reason for the revocation; where a party who is entitled to revoke the contract expressly or through an act indicates that he gives up the right of revocation.

Common errors of this part included:

- Failing to state the one year time limit for claiming the right of revocation;
- Failing to state the circumstances for extinguishing of the right of revocation.

**Question Nine**

This question requires candidates to deal with legal issues in relation to the registration of immovable in accordance with the Property Law. Registration of immovable constitutes one of the major rules under the Property Law, and has been tested in the previous sessions, though in a form of general

question. Therefore, candidates should have been familiar with this rule and able to perform quite satisfactory. The result is, however, not satisfactory, as some candidates could not pick up a single point to this question.

In part (a), candidates are required to state the legal issues involved in this dispute. Taking into all the facts given into account, the legal issues involved in the present case included the effect of the registration of immovable, and the legal impact (or consequence) of the non-registration on the effect of the contract involved in the properties. Legal issue should be summarised from the facts in the question. A legal issue is a key or legal base to resolve the dispute between the parties. In the present case it is necessary to understand the effect of the registration of immovable which would directly affect how the court deals with the dispute in relation to the two contracts. Obviously, the effect of the registration of immovable constitutes one of the legal issues. However, some candidates did not pick up this point because they failed to understand this rule.

Common errors of this part included:

- Failing to state any legal issues involved in this dispute or state only one legal issue;
- Failing to understand the question at all.

In part (b) candidates are required to deal with the claim brought by Mr. Li as to the issuance of an order to declare the invalidity of the second contract and confirm his ownership on the apartment. It is important to distinguish the effect of property right and the effect of a property contract. For the former, the duly registration is the precondition to become effective; while for the latter the effect of a contract in relation to immovable does not rely on the registration, unless otherwise provided for by law or agreed in the contract.

In the present case the second contract between Mr Zhang and Mr Cao came into effect upon its conclusion. Although the second contract was signed later than the first contract, it was duly registered with the authority for property registration. The ownership to the apartment should belong to Mr Cao. Hence Mr Li should not hold the ownership on the apartment even though he entered into the contract first. Therefore, Mr Li's request to declare the invalidity of the second contract could not be supported by the court.

Common errors of this part included:

- Failing to give a correct judgement as to the validity of the second contract;
- Failing to distinguish the effect of immovable registration and the effect of a contract in relation to the properties;
- Failing to give a correct judgement as to the ownership of the apartment.

In part (c) candidates are required to deal with the situation in which Mr. Li concluded the contract first but failed to register with the authority for property registration; and his claim for the ownership has been dismissed by the court in part (b). In accordance with the Property Law, the mere fact of non-registration shall not affect the validity of such a contract. The contract between Mr Zhang and Mr Li should be an effective one. Since Mr Zhang failed to transfer the ownership of the apartment to Mr Li, he should bear the relevant liability for breach of contract. Under such a situation, the proper claims brought by Mr. Li should be the monetary damages. The assessment of the damages should be the difference between the original price of RMB 500,000 yuan and the second price of RMB

550,000 yuan. The correct answer to this part of question depends on both the correct understanding and correct judgement of the above two parts.

Common errors of this part included:

- Failing to understand the question, and thus failing to give an answer to the point;
- Failing to state the monetary compensation being the only legal remedy for Mr. Li;
- Confusion of a lawsuit against somebody as a procedural form of protection (compared with arbitration or conciliation, et.) with the forms of legal remedies, such as the specific performance or monetary compensation, that resulted in an incorrect answer.

### **Question Ten**

This question requires candidates to deal with the rules in relation to the credit offset during the process of liquidation. It is a difficult question as it is involved in complicated facts and rule of law. As a whole, performances in this question were not satisfactory.

Part (a) of this question is relevant to the rule of offset during the process of bankruptcy. In accordance with the Enterprise Bankruptcy Law, where a creditor is indebted with its debtor before the application for bankruptcy is accepted by the court, it may claim for debts offset to the bankruptcy administrator, unless the claim is fallen within the circumstances as prescribed in the law.

In the present case Owner's request for offset was in conformity with the Law. Since in January a sum of RMB 240,000 yuan was due by IT Company to Owner, while the remaining payment for the equipment occurred before the bankruptcy process was accepted by the court. There were no circumstances under which the offset should not be conducted. Therefore, Owner's debt of RMB 160,000 yuan toward IT Company might be offset from its credit.

Common errors in this part of question included:

- Failing to give a correct judgement as to the permissibility of offset;
- Confusion of the rule of offset with the priority of distribution of assets at the end of the liquidation process;
- Failing to understand the rule of offset during the process of liquidation.

In part (b) candidates are required to deal with the situation in which a contract is still in effect while one of the parties to it has been in the process of bankruptcy. In accordance with the Enterprises Bankruptcy Law, after the court accepts an application for bankruptcy, the bankruptcy administrator shall decide to terminate or continue to perform the contract that has been concluded before acceptance but has not been fully performed. It means that a contract shall generally be terminated because a party to the contract goes bankrupt and loses its civil capacity to perform the contract. Therefore, the conclusion should logically be that Owner's request was in conformity with the law.

Common errors in this part of question included:

- Failing to give the reasons to support their conclusion;
- Failing to give a correct answer to the question.