

Examiner's report

F4 Corporate and Business Law (CHN)

December 2010



Specific Comments

Question One

This question required candidates to explain the term exclusive jurisdiction, and state the major legal characteristics of the exclusive jurisdiction under the Civil Procedures Law.

Exclusive jurisdiction means a territorial jurisdiction under which the court of place shall have the exclusive jurisdiction over the particular disputes, even if such jurisdiction is in conflict with the jurisdiction based on the common territorial jurisdiction. Therefore, it is a special territorial jurisdiction normally is adopted in dealing with the disputes arising out of real estate, harbour operations and succession. The major legal characteristics of this jurisdiction include: First, this jurisdiction shall be specially prescribed by the law and shall be strictly complied with by the parties to the disputes and the courts hearing the case. Second, any judgements based on the jurisdiction in violation of the rule of exclusive jurisdiction shall be refused to be enforced by the court in the place on which the exclusive jurisdiction is based.

Most of candidates were able to give a correct answer to part (a) of this question. However, only very limited candidates pointed out the legal characteristics of this jurisdiction in part (b), especially the legal effect of a court judgement that is in conflict with the rule of exclusive jurisdiction. Therefore, although this was a question of basic knowledge, the performances of candidates on this part were not satisfactory.

Question Two

This question required candidates to state the term right of lien, and state the conditions to be met for a party to claim the right of lien.

Right of lien refers to such a property right where an obligor fails to pay off its debts due, the obligee may take lien of the movable that is owned by the obligor but lawfully in the obligee's possession and has the right to seek compensation in priority from such movable. It should be noted that the right of lien is a statutory right that cannot be established by a contract between the parties concerned. Therefore, parties to a contract cannot establish such a right by a contract or agreement. Whenever parties agree upon that the obligee may possess the movable of the obligor and be repaid in priority if the obligor fails to pay off the debts due, such a right is not the right of lien in nature. In practice the right of lien would often be claimed by a party when the other party put a movable (such as a car or TV set) for repairing but fails to pay off the repairing cost, this party (repairing shop) may possess the relevant movable. The repairing shop is entitled to be repaid in priority if the said movable is converted into money by auction. In such a circumstance the two parties merely enter into a repairing contract, no lien contract at all. The customer delivers the things for repairing to the repairing shop, and the latter possesses the things lawfully under the repairing contract. If the customer fails to pay the repairing fees, the repairing shop's claim for the right of lien is not based on the repairing contract but the relevant provisions of the Property Law. Another common example is the circumstance under which a shipper fails to pay off the freight and the carrier possesses the goods delivered to the carrier for carriage.

Part (a) of this question was not answered as expected. The common errors in Part (a) were that many candidates did not distinguish the rules as to lien and mortgage and failed to state directly the right of lien being a statutory right. Of course, mortgage is also a form of guaranty and is generally used in business transactions, it is established on the contract between the parties who are involved certain business transaction. Without a mortgage contract or agreement, the obligee of the transaction can claim the right of lien.

Part (b) of this question required candidates to state the conditions to be met by an obligee intending to claim the right of lien. According the relevant provision of the Property Law, three conditions shall be satisfied **simultaneously** where a party intends to claim such a statutory right: First, the obligee shall lawfully possess the



movable of the obligor. Secondly, the movable taken by the obligee and obligee's right shall fall into a same legal relationship, except for the lien between enterprises. Thirdly, the obligor fails to settle its debts due.

Most of candidates were able to state only one or two conditions but failed to point out all three conditions to be met. Only a few candidates were able to state the particular condition as to the same legal relationship. It means that an obligee can only take the movable, which is a subject matter of a contract and lawfully possessed by the obligee, as the subject matter of lien. The obligee is not allowed to take other properties of the obligor to claim the right of lien for satisfying its credit.

Question Three

This question required candidates to state the various powers of the labour administration in exercising its supervisory and examining functions, and state any FOUR kinds of situations under which the labour administration may issue administrative orders to an employer for its activities in violation of the Labour Contract Law.

On the whole, the performance of candidates in this question was unsatisfactory.

Part (a) of the question required candidates to state the powers of the labour administration. The answer to this part of question could be found directly from the relevant provisions of the Labour Contract Law which includes the authority to review any documents relating to labour contracts, conduct an on-the-spot inspection of the work premises, etc. Most of candidates were unable to state the power of conducting an on-the-spot inspection of the work premises, and the obligation of the employer to provide truthfully relevant information and materials.

Part (b) of the question required candidates to state some situations that violate the Labour Contract Law and will be ordered to rectify by the relevant labour administration. Most of candidates were able to state two or three points. They mainly focused on the relevant provisions of labour contracts that should be deemed as a violation of the Labour Contract Law, but did not state various illegal activities in the process of operation of labour contract. For instance, all the following activities conducted by an employer shall be regarded as the illegal activities and be ordered for rectification by the labour administration: an employer illegally detains the ID cards of the employees; an employer collects the personal properties as security or under some other guise; or an employer fails to issue a certificate of dissolution of labour contract or certificate of termination of labour contract to the employees, etc. Many candidates merely stated the illegal activities committed by the enterprises, failed to state relevant orders for rectification issued by the labour administration.

Question Four

This question required candidates to explain the term termination of contract, and state the major differences between dissolution of contract and termination of contract.

Part (a) of this question required candidates to explain the term termination of contract. Under the Contract Law termination of contract refers to such a situation or a state where the rights and obligations arising out of a contract dissolve due to various circumstances as prescribed by the law or agreed upon by the parties to the contract. For instance, a contract is terminated when it is fully performed by the parties; a contract is terminated if one party declares the dissolution of contract under the condition of the other party's fundamental breach; a contract is terminated if the two parties to the contract merge which results in the right and obligation absorbed by one party; or a contract is terminated if the two parties to the contract mutually agreed upon, etc. Therefore, the key point to termination of contract rests that the legal consequence of the termination is of no any contractual right and obligation between the two parties. The contract should have no binding force upon the two parties.



Performance on this part was not as expected. The common errors for this part of question included:

- Failing to explain correctly the term;
- Failing to state the legal consequence of the termination of contract;
- Confusing the termination of contract with the dissolution of contract.

Part (b) of this question required candidates to distinguish the dissolution of contract with termination of contract. Comparatively speaking, it was a quite difficult question requiring candidates to make necessary comparisons from the relevant provisions of the Contract Law. In summary, termination of contract is a much wider concept than dissolution of contract, i.e. termination of contract includes the situation in which a contract is claimed dissolution by a party. Therefore, to discuss termination of contract people pays attention to the state of contract, which does not legally bind the parties as prescribed by the law or agreed upon by the parties. To discuss dissolution of contract, however, people focuses on the legal action or a declaration of dissolution of contract taken by a party to the contract. Therefore, if a party intends to dissolve a contract it must give a notice to the other party and such a notice of dissolution of contract must be based various conditions as prescribed by the law (Article 94 of the Contract Law) or contained in the relevant contract. Without such a notice there will be no dissolution of contract.

Performances on this part were not satisfactory. Common errors for this part of question included:

- Failing to understand the meaning of dissolution of contract or confusing dissolution of contract with termination of contract;
- Failing to state the statutory requirement of give a notice for a party intending to dissolve a contract;
- Failing to state that termination of contract covers the circumstances under which a party may dissolve a contract.

Question Five

This question required candidates to state the basic rules regarding the shareholders of a general limited liability company and a sole-person limited liability company, as well as a wholly state-owned company. Candidates were also to state the requirements for capital for these three kinds of limited liability companies.

As a whole, answers to this question were satisfactory. Most of candidates were able to answer the basic rules regarding the shareholders and the capital requirements for three kinds of limited liability companies.

Common errors for this question included:

- Failing to state accurately the number of shareholders of a general limited liability company;
- Failing to state the capital requirements for three kinds of limited liability companies.

Question Six

This question required candidates to state the legal effect on the following three kinds of judiciary actions when a court accepts an application for bankruptcy: the preservative measures against the assets of the debtor, the enforcement procedure against the debtor and the pending legal actions against the debtor.

It is known to everyone when a court accepts an application for bankruptcy, this judiciary action will give rise various legal effects on the debtor and its creditors, as well as on the other procedures of court (judiciary actions). It means that the acceptance for bankruptcy of an enterprise will have some direct impacts on other procedures of court, and the bankruptcy procedure will result in the suspension or dissolution of other procedures of court.

Candidates were required to state the legal effect of the bankruptcy procedure on the relevant procedures of court. According to the relevant provisions of the Enterprise Bankruptcy Law, whenever a court accepts an

application for bankruptcy, the relevant measures against the debtor's assets shall be dissolved, the enforcement procedures against the debtor and the pending legal actions against the debtor shall be suspended. The reasons for setting up these rules are that bankruptcy of an enterprise will give rise to very complicate legal relations among the enterprise (debtor) and the government, the enterprise and its employees, the enterprise and its creditors or other debtors, and so on. The preservative measures against the assets of the debtor are commonly taken by the plaintiff in the civil litigations of China. The purpose of such measures is to get the favourable judgement to be enforced if the plaintiff wins the case or to avoid the escape of liability by the defendant. Should the preservative measures be not dissolved upon the acceptance of application for bankruptcy by a court, the bankruptcy administrator could neither fix the assets of the bankrupted enterprise nor allocate the assets after the liquidation process. Therefore, the preservative measures against the assets of the debtor must be dissolved under such a circumstance.

The performances on this question were unsatisfactory. Many candidates did not correctly understand the question. Most of them confused the legal effect of the application for bankruptcy with the order of priority in allocating the assets of the debtor. That's why they wrote a lot but did not gain the satisfactory marks as expected.

Other common reasons for unsatisfactory answers included:

- Confusing the legal effect of the enforcement procedure against the debtor with the illegal transactions conducted by the debtor before its going to bankruptcy, such as giving up its credits or selling the properties with an unreasonable price;
- Failing to state that a pending legal action against the debtor shall be suspended until a bankruptcy administrator to be appointed by the court in part (c) of this question.

Question Seven

This question required candidates to explain the term sponsor in underwriting securities, and state the objective of setting up such a system as well as the liabilities of the sponsor in providing professional services.

The performances of this question were also unsatisfactory, since many candidates did not understand clearly the functions of a sponsor in underwriting securities.

Part (a) was relevant to the explanation of the term sponsor. According to the Securities Law, sponsor is a qualified person or institute who is responsible for verifying cautiously the application documents and information disclosure materials of any issuer, and supervising as well as urging the issuer to operate normatively the offering of the securities. Therefore, the functions of a sponsor are different from those of a security underwriter. This was the common error for candidates when they were answering this part of question, and also constituted the major reasons which resulted in the incorrect answers to part (b) and (c) of this question. Since the correct understanding of a sponsor in underwriting securities is the basis for candidates to state the objective of setting up such a system (part b) and various liabilities for wrong doings or failure to perform his duty in providing professional services (part c).

Part (b) of this question was relevant to the objective of setting up such a sponsor system in underwriting securities. Generally the objective is to prevent the market risks from occurrence, regulate the operation of the listed companies and protect the lawful rights and interests of investors through the joint legal liability of the issuer and sponsor. Most of candidates who gained limited marks in this part of question failed to state that one of the important objectives is to protect the rights and interests of investors.

Part (c) of this question required candidates to state various legal liabilities by a sponsor for his wrong doings or failure to perform his duty in providing professional services. The legal liabilities include: The sponsor may be ordered to make a rectification and be imposed a fine not less the amount of but not more than five times of the



business incomes; the illegal incomes may be confiscated; the business permission may be suspended or cancelled; the sponsor in charge may be given a disciplinary warning and fine; the sponsor may be disqualified. Performances of this part were comparatively better than those of the other two parts. On the other hand, many candidates still failed to state such legal liabilities as the suspension or cancellation of business permission, which are commonly used in practices.

Question Eight

This question required candidates to deal with the legal issue in relation to the usufructuary right and ownership under the Property Law.

Performances for this question were satisfactory. Most of candidates were able to give a correct answer to the three parts of this question and gained high marks.

In part (a), candidates should describe the category of property right Mr. Lee has held regarding the mountain. It was obvious that Mr. Lee held the usufructuary right which belongs to one category of the property rights. According to the relevant provisions of the Property Law, a holder of usufructuary right is entitled to possess, use and collect proceeds from the immovables or movables owned by someone else. Mr. Lee, through the contract for the management of land, just held all these rights under the contract in question. However, some candidates did not describe the category of the property right as the usufructuary right, merely describing that Mr. Lee held the right of management of land. Such an answer actually was a copy of the question.

Part (b) was to test a basic rule with respect to the ownership of the natural resources and other categories of rights under the Property Law. According to the Property Law all the natural resources, such as mineral resources and water, shall be in the ownership of the State. Therefore, although Mr. Lee obtained a right to manage a piece of land in light of a contract, this right could not extend to the natural resources under the land. In other words, the usufructuary right of Mr. Lee could not prevail over the ownership of the natural resources exclusively owned by the State. However, some candidates did not understand this particular rule and consider incorrectly that the coal under the land should be held by Mr. Lee or by the villagers.

Part (c) of the question was to test the legal relations between the ownership of the natural resources and the right to the management of land. Almost all candidates were able to answer this part of question and gained high marks. Although some candidates failed to give a correct answer to part (b), they were still able to answer part (c) correctly, by stating that the ownership of coal did not affect Mr. Lee's usufructuary right. Obviously, Mr. Lee's usufructuary right should be protected by the Property Law. If the State wants, as an owner of the coal under the Mr. Lee's land, to exploit the coal mine, it shall make a reasonable compensation to him. The villagers were neither the legitimate holder of the usufructuary right over the land, nor the owner of the coal under the land. They should make compensation to Mr. Lee for the destroyed trees.

Question Nine

This question required candidates to deal with the legal issues in relation to the rules of deposit and the legal remedies under the Company Law.

Part (a) of this question required candidates to explain the legal nature of the deposit given to Gas Company, and state whether a claim for a refund of twice the amount of the deposit should be supported. With respect to the nature of deposit as a guarantee for performing the contract, most of candidates gave a correct answer, even though some of them failed use an accurate legal term to describe the term "guarantee". If candidates were able to give a correct judgement as to the legal nature of deposit, logically they could give a correct answer as to the claim for a refund of twice the amount of the deposit. Since Gas Company failed to supply the natural gas under the contract, it was a breaching party and should be liable for such breach. However, some candidates held that the claim should not be supported, as Yaowa Company intended further to request for the specific performance of

the supply contract. Obviously, it was a misunderstanding of the rules regarding deposit and legal liability for breach of contract. The refund twice the amount of the deposit is a form of liability for a breaching party to bear if it breaches a contract. Due to Gas Company's short supply or sudden stop providing natural gas, Yaowa Company suffered a lot. Therefore, Yaowa was entitled to claim for the refund twice the amount of deposit. Unless otherwise provided for in the contract, Yaowa Company's claim for the refund twice did not constitute a statutory obstacle for its claim for the specific performance of contract.

Part (b) was relevant to the specific performance as a form of legal remedy. According to the Contract Law, the party who fails to discharge its contractual obligations shall be liable for the breach of contract in various forms, such as specific performance of contract, adopting remedial measures or making compensation for losses, etc. Furthermore, according to Article 110 of the Contract Law, the party who suffered losses due to the other party's breach of non-monetary obligations shall be entitled to request for specific performance of the contract, unless under the particular circumstances as provided for by law. In this case Gas Company failed to discharge its obligation to supply certain quantity of natural gas daily, such a breach was a non-monetary breach in nature. In addition, the full supply of gas was also a substantive condition for Yaowa Company to carry out its business operations. Yaowa Company, to some extent, was able to find other substitute supplier for its operation. Hence, the request for specific performance should be supported by the court.

The common errors of this part included:

- Failing to give a correct determination as to the claim for the specific performance;
- Failing to state the non-monetary breach of contract being a condition for the adoption of specific performance;
- Failing to understand the relations between the claim for a refund twice of the deposit and the claim for specific performance.

Question Ten

This question required candidates to deal with the legal issue concerning the voting requirement for a resolution to approve the merger proposal, the requirement for disclosure of information and the way to deal with the debts of the target company.

This question required candidates to have some basic knowledge of the Company Law. Candidates did gain marks as expected.

In Part (a), candidates were required to state the voting requirement by the general shareholders' meeting. Since the merger transaction involved in an amount of money exceeding 30% of the total amount of its assets within one year, this proposal should be resolved at a general shareholders' meeting and adopted by two-thirds of the voting rights held by the shareholders attending the meeting. Most of candidates were able to point out this statutory requirement for a resolution of the general shareholders' meeting.

Part (b) of this question was relevant to the disclosure requirement for the parties that were involved in a merger transaction. According to the relevant provisions of the Company Law, the relevant companies should inform its creditors of the intended merger plan within 10 days following the date on which the merger resolution is adopted by its general shareholders' meeting, make announcement in newspaper within 30 days. Most of candidates were able to answer this part of question correctly with the accurate days prescribed by the law.

Common errors of this part included:

- Failing to state either the notice to the creditors or the announcement in the newspaper;
- Failing to give the accurate time limit for the parties to issue notice to its creditors and the announcement in local newspaper.

In Part (c), candidates were required to state how to deal with Dahua Company's debts owed to the electricity plant. This question was on basic knowledge of company law. Since the merger took a form of absorbing Dahua Company, the electricity plant (the creditor of Dahua Company) might request Dahua to settle the debts or provide a guarantee before the merger plan to be executed; it might also request Kingmart Company to bear Dahua Company's debts due after the completion of the merger. Most of candidates answered this part of question satisfactorily.

Even though the performances of this part were quite satisfactory, there was room to improve. For example, some candidates merely indicated that the electricity plant might request Kingmart Company to bear Dahua Company's debts, omitting another form as above-mentioned.