

# Examiner's report

F4 Corporate and Business Law (CHN)

June 2011



## Specific Comments

### Question One

This question required candidates to explain the term *judicial interpretation* made by the Supreme People's Court, and state the rule of applicable law, which is contained in the Judicial Interpretation on the Application of the Contract Law.

*Judicial interpretation* refers to the interpretations made by the Supreme People's Court or the Supreme People's Procuratorate toward the general matters, or specific inquiries brought by the local courts relating to specific application of laws in their judicial practices. The legal basis for the Supreme People's Court to issue a judicial interpretation is the authorisation of the Standing Committee of the National People's Congress in a special resolution.

With respect to the rules on the application of the Contract Law, the particular judicial interpretation provides that, if a dispute brought to the court is relevant to a contract concluded before the implementation of the Contract Law, the former three contract laws shall apply, except that this Interpretation provides otherwise. Where there was no provision as contained in any one of the former contract laws, relative provisions prescribed in the Contract Law may apply.

No one candidate was able to give a full and correct answer to this question, especially in answering part (b) as to the rules of the application of the Contract Law. They merely pointed out that the current Contract Law should be applied after the date of the implementation of the Contract Law, even though a contract had been concluded before that date. If the answer were correct, candidates would have found the answer just from part (b) of this question itself. As a general rule for the application of law, a new law would not be applied by the court to deal with a contract concluded before the date of the implementation of the new law, since at the time of the conclusion of the contract, the parties were under the legal environment as set up by the previous law or laws. It is impossible for them to know the rules in a future law. Furthermore, some candidates misunderstood the judicial interpretation with the jurisdiction at different levels of courts. Therefore, although this was a question of basic knowledge, the performances of candidate were not satisfactory.

### Question Two

This question required candidates to explain the situations that create legitimate possession, state the right of claim of a possessor against various tortuous activities, and the rules of compensation to a right holder for his property under the Property Law.

- The answer could be found in the relevant provision of the Property Law directly. Most of candidates, however, did not understand the requirements of this question clearly. They confused this question with the creation of property rights or were confused with the requirement of registration for a transaction of immovable. Therefore, performances of part (a) of this question were unsatisfactory.
- Possession can be divided into two categories, legitimate one and illegal one. Legitimate possession can be created on the basis of a contract or on the basis of law if there is no express provision in the contract. Any use, proceeds and liability in relation to the possession of the immovable or movable shall be governed by the contract. Legitimate possession is very common in everyday life of ordinary people. For example, rental of

a car takes place every day in the big cities. By the rental contract a customer can legally possess a car from the owner and can use the car. According to the Property Law such a transaction does not require registration. Another example of legitimate possession is the relationship between a lesser and a lessee, based on a lease contract. Although the transaction is involved in the immovable, it is nothing to do with the registration of immovable as required for the transfer of property. By such a lease contract the lessee can legally possess and use the apartment or house of the lesser. It is obvious that the legitimate possession can be created by a contract, though possession constitutes one of the rights in relation to the property rights.

- Part (b) was relevant to the protection of the rights of a legitimate possessor. According to the Property Law, where a movable or immovable under possession is infringed upon, the possessor is entitled to take various legal remedies, such as: to request for the return of the original property, to request for the elimination of impairment or danger and to claim for damages.

Part (c) focuses on the protection of the rights of a right holder if his property right is damaged under a legitimate possession. For instance, a lessee can legally possess and use the apartment of the lesser by conclusion of a lease contract. He, however, damages the apartment during the period of the contract term. It is the property right of the lesser (a right holder) if damaged by the ill acts of the lessee which entitles the lesser to claim damages or take other legal remedies. Therefore, a right holder is entitled to request for returning any insurance proceeds, damages or indemnities paid on the damage to or destruction or loss of his property which is under a possession, as well as other legal remedies. Although some candidates were able to point out the claim of damages as a form of the legal damages, they failed to state any other legal remedies.

### Question Three

This question required candidates to explain the rules relevant to probation in a labour contract. Most of candidates were able to give a correct and full answer to this question and performed well in it.

- Part (a) relates to the circumstances under which a labour contract is not allowed to provide for a term of probation. In accordance with the relevant provision of the Labour Contract Law, they include a term of less than three months and a labour contract that will expire upon the completion of designated work.
- Part (b) requires candidates to state the time-limit for probation calculated on the basis of the terms of a labour contract. According to the Labour Contract Law the term of probation should not exceed a period of one month, two months and six months if the term of a labour contract is not less than three months but not more than one year, the term is more than one year and less than three years and the term of a labour contract is more than three years or non-fixed respectively.

### Question Four

This question required candidates to explain the terms *withdrawal of an offer* and *revocation of an offer*, make a comparison on these two legal terms and state whether a contract is formed the formation under the condition as given.

Offer and acceptance are two generally used legal terms in any contract law and the basic knowledge for understanding the rules in relation to the formation of contract or modification of contract. Relevant questions have been examined in the previous sessions and been familiarised by candidates. Therefore, performances of candidates were satisfactory.

- Most of candidates were able to state the term *withdrawal of an offer* and term *revocation of an offer* in part (a) and (b). They also could give a correct conclusion for part (d) by stating that no contract would be formed as an offer and the notice of withdrawal of an offer reaches the offeree simultaneously. The offer would not take into effect when a notice of withdrawal of an offer reaches the offeree.
- Part (c) required candidates to state the major differences between withdrawal of an offer and revocation of an offer. Most of candidates were able to state that one of the differences is the time of arrival of a notice, withdrawal or revocation of an offer. However, most of them omitted another major difference between the withdrawal of an offer and revocation of an offer. Under the Contract Law, any offer can be withdrawn by a notice of withdrawal even if the offer is an irrevocable one. On the other side, an offer cannot be revoked if the offer is an irrevocable one, or if it meets the conditions of irrevocability as set forth in the law. The circumstances of irrevocability of an offer include that the offer indicates itself to be irrevocable or sets forth a time- limit for acceptance. It is a much important difference to be known.

#### Question Five

This question required candidates to explain the major rights of a shareholder of a limited liability company under the Company Law of China. A shareholder of a limited liability company enjoys various rights under the Company Law and the articles of association the company. They include, but not limited, the following major rights:

- the right of access to the various legal or finance documents;
- the right to draw dividends in proportion to his equity in the company, the priority to subscribe for new shares if the company increase capital and the priority if other shareholders transfer their equity to a third party;
- the right to attend the shareholders' meeting and vote for any substantive matters of the company;
- the right to be distributed the remaining assets of the company in proportion to the shareholder's equity after the completion of liquidation.

This question required candidates to find answers from the different aspects of the Company Law. All the above-mentioned rights are quite common for a shareholder of a limited liability company. The difficulty is that candidates often pay no or very little attention on the differences between the rights of an individual shareholder and the rights of the shareholders' meeting composed of all shareholders. For example, to attend the shareholders' meeting and vote for the substantive matters of the company are the important right of a shareholder. However, to approve the major business plan or a merger proposal with other company belong the power of the shareholders' meeting which is composed of all the shareholders of the company. Therefore, a correct understanding of the coverage of the rights of a shareholder is a key issue to give a satisfactory answer to this question. Many candidates did not distinguish such a major difference between the rights of a shareholder and the rights of shareholders' meeting, which are of the collective rights in nature.

Other common errors for this question included:

- Failing to realise that to obtain the dividends is one of the most important rights for a shareholder and the initiative to invest into a company;

- Failing to point out that the right of obtaining the distribution of the remaining assets after the completion of liquidation;
- Confusing the rights of a shareholder with his fundamental obligations to make capital contributions.

### Question Six

This question required candidates to state various circumstances under which a creditors' meeting shall be held, and the major functions and duties of it under the Enterprise Bankruptcy Law.

Part (a) relates to the circumstances under which a creditors' meeting shall be held. According to the Enterprise Bankruptcy Law, the first creditors' meeting shall be held by the people's court within 15 days as of expiration of the term for declaration of creditor's right. Subsequent creditors' meetings may be held when the court deems it necessary or when the bankruptcy administrator, the creditors' committee or any creditor representing one-quarter or more of the total creditor's right proposes the chairman of the creditors' meeting to hold one.

Part (b) of this question required candidates to state the major functions and duties of the creditors' committee which include:

- supervising the management and disposal of the debtor's assets;
- supervising the distribution of the insolvent assets;
- making proposals to hold a creditors' meeting; and
- performing other functions and duties as entrusted by the creditors' meeting.

Candidates did not perform well in this question. Their common errors for this question included:

- Failing to state the circumstances under which a creditors' meeting shall be held;
- Failing to state correctly the major functions and duties of a creditors' committee;
- Confusing the circumstances under which the creditors' meeting to be held with the order of the distribution of the insolvent assets;
- Failing to distinguish the creditors' meeting with the creditors' committee.

### Question Seven

This question required candidates to explain the term controlling shareholder, state the civil liability of the controlling shareholder for illegal activities causing damage to the company.

Part (a) is relevant to the term controlling shareholder. *Controlling shareholder* refers to any shareholder whose equity accounts for 50% or more of the registered capital of a limited liability company, or any shareholder who holds 50% or more share of the total amount of share capital of a joint stock company. It also refers to any shareholder, whose equity or shares is less than 50%, who may have a major impact on the resolutions of the shareholders' meeting or the shareholders' general meeting through his or her voting powers. In answering this question, some candidates were able to state the requirements of 50% of equity or shares. However, most of them failed to state the other conditions to ascertain whether a shareholder should be regarded as a controlling shareholder, i.e. a shareholder who has a major impact on the resolutions of the shareholders' meeting or the shareholders' general meeting through his or her voting powers.

Part (b) is relevant to the abuse of the independent status of a corporate legal person and the rules of liability, especially the doctrine of disregard of corporate personality or piercing the corporate veil. Although most of

candidates were able to state that creditors of the company may bring a lawsuit against that shareholder and the company jointly, only very few of them could indicate that such kind of legal action is under the doctrine of disregard of corporate personality or the doctrine of piercing the corporate veil. Furthermore, some candidates had a misunderstanding on this part of question and held this part was relevant to the restrictions on the sale of shares by the controlling shareholder.

The abuse of the independent status of legal personality is very common in the current business activities of China. So it is necessary for any people in business community to know this doctrine.

Part (c) is in relation to the rule of subrogate litigation under the special situations. As a general principle a company should take any necessary measures to protect its lawful rights and interests. Under certain special situations, however, a company may be controlled by the controlling shareholder so that it loses its independent willing to protect its rights and interests. Obviously, this would directly damage the rights of a company and indirectly damage the rights of other shareholders of the company. The Company Law of China sets up the rule of subrogate litigation, which entitles other shareholders of the company to file a lawsuit, in the name of the company and for the interests of the company, against the controlling shareholder. It should be noted that no candidate was able to state the rule of subrogate litigation.

### **Question Eight**

This question required candidates to deal with the legal issues of the transfer of contract and the secured interests under the Property Law and the Contract Law.

Part (a) required candidates to give answer by taking the provisions from the different laws: the Property Law and the Contract Law into account. Under the Property Law, where a secured credit involving both guarantees of mortgage and pledge and the obligor fails to pay its due debts, the obligee shall realise the obligee's rights according to the relevant contract. In case the contract does not stipulate or merely stipulates an unclear provision, and where the obligor provides his/its own property as the security, the obligee's rights shall be realised firstly by the security in property. At the present case, Mr Ding provided merely a pledge of general liability. Based on the above provision of law, OAM, as a transferee of the loan agreement and the obligee of the secured credit, shall realise its right firstly by the security in property. Therefore, the defence of Mr Ding should be supported by the court.

Many candidates held that the defence of Mr Ding should not be supported by the court. The reasons rested with: firstly, Mr Ding provided a guarantee of pledge; secondly, Industry Bank has made a notice of transaction, i.e. transfer its rights of credit and pledge to OAM. However, they failed to pay attention to the fact that Mr Ding provided only a general pledge, not a several and joint pledge. The legal nature and the liability to pledge of a general pledge were different from those of a several and joint one. In addition, the notice by Industry Bank could not change the form of Mr Ding's liability as a general pledgor. Industry Bank did not make a notice with respect to the sale of the office building. As a matter of fact, Yado Steel and Industry Bank were involved in an illegal transaction by the sale of the mortgaged office building before Yado Steel went bankrupt. Both Industry Bank and Yado Steel intentionally concealed the information to the relevant parties, i.e. OAM and Mr Ding. Therefore, this transaction should be deemed as null and void.

In part (b) even though candidates were unable to make a correct determination to part (a) of this question, they could know very clearly that the only cause resulting in the present situation rested with the illegal sale of the office building as mortgaged between Industry Bank and Yado Steel. Therefore, performances of this part were quite satisfactory.

### Question Nine

This question required candidates to deal with the rule on the issuance of corporate bonds under the Securities Law.

Under the Securities Law, to issue the corporate bonds publicly one of the following conditions shall be satisfied by the issuer: The accumulated value of the bonds issued shall not exceed 40 % of the value of the net assets of the company. The net assets of Ronger Properties Joint Stock Co were RMB 80 million yuan and the accumulated value of the bonds issued previously was RMB 12 million yuan. This means that the bonds issued accounted for 15 % of the net assets of the company. Therefore, the maximum amount of the proposed issuance would be RMB 20 million yuan ( $80 \text{ m} \times 40\% - 12\text{m}$ ).

Common errors for this part included:

- Failing to state one of the conditions to issue the corporate bonds is that the accumulated value of the bonds shall not exceed 40% of the net assets of the issuer.
- Confusing the maximum amount of corporate bonds for the new issuance with the conditions to be met for a company to issue corporate bonds publicly.

Part (b) required candidates to state whether the proposed issuance should be underwritten by an underwritten syndicate. The correct statement of this part is based on a correct calculation in part (a). Under the Securities Law, not all the public issuance of corporate bonds should be issued by an underwritten syndicate. Only those securities to be offered to unspecific parties with a total face value exceeding RMB 50 million yuan should be underwritten by an underwriting syndicate. Since the maximum amount of the proposed issuance would be RMB 20 million yuan, Ronger Properties Joint Stock Co could issue the corporate bonds with a form other than that of underwriting syndicate.

A common errors for this part included failing to understanding that only the issuance of a total face value exceeding 50 yuan should be underwritten by an underwriting syndicate;

Part (c) required candidates to state the time limit for an underwriting. According to the Securities Law, the maximum period for any forms of underwriting shall not be more than 90 days. Many candidates performed unsatisfactorily in this question.

### Question Ten

This question required candidates to deal with the legal issue in relation to the revocation of giving up credit by a debtor before the application of bankruptcy against whom a bankruptcy application is accepted by the court.

Part (a) of this question required candidates to state whether the action of giving up the creditor's right was within the category of revocable one during the process of liquidation. In addition, candidates were required to ascertain whether the court should grant an order to revoke the action of giving up the creditor's right. Therefore,

this part of question included two separate but, to some extent, close connected issues. In accordance with Article 31 of the Enterprise Bankruptcy Law, a bankruptcy administrator is entitled to plead the court to revoke the action of giving up the creditor's right. It was undoubted, in terms of the nature of such an action; Jianshe Co's action of giving up its creditor's right was within the category of applicable acts by the bankruptcy administrator for revocation. On the other hand, the relevant court should not grant an order to revoke the creditor's right given up by Jianshe Co, since the action had taken place beyond the one limit as prescribed by the law.

Performances for this part of question were satisfactory. However, some candidates held that the action of giving up the creditor's right should not be revoked due to the above-mentioned reasons, they considered that the court should grant an order to revoke the action of Jianshe Co for giving up its creditor's right. There existed an obvious conflict between (i) and (ii) of part (a). Where the action of giving up the creditor's right should be revoked, the court should grant such an order; otherwise, the court should not do so and dismiss the application brought by the bankruptcy administrator. Such a way to deal with this question is in conformity with the relevant provisions of law.

Part (b) is relevant to the rule concerning the making up of the capital contributions during the bankruptcy process. According to the Bankruptcy Law, where the relevant court accepts an application for bankruptcy and found that the shareholders of the debtor fail to discharge their capital contributions, the bankruptcy administrator shall request these shareholders make full capital contributions as subscribed, irrespective of the term for capital contributions. Therefore, the bankruptcy administrator shall request shareholders of Jianshe Co make full capital contributions. The rule of prescription or time limitation is not applicable to the obligation of shareholders to make full capital contribution.

The answer to this part of question is quite clear, as anyone should be aware that the capital contributions are the fundamental obligation for shareholders of a limited liability company. Failure to discharge such a fundamental obligation would result in the shortage of operation capital for the company and decrease the ability of the company to settle its debts to creditors. Sometimes the failure to make full capital contributions by its shareholders would be the major cause for a company to go to bankrupt. Therefore, the law and regulations of any countries would set up the specific rule to protect the legitimate interests of creditors by authorising the bankruptcy administrator to request shareholders to make full capital contributions. Most of candidates were able to give a correct answer to this part.