PCLL Conversion Examination
January 2017
Examiner's Comments
Commercial Law

General Comment

Too many students were clearly underprepared for the examination and had little or no knowledge of some of the key issues raised in the questions. Also the answering technique of many students was poor. It was very common in the problem questions for students to spend most of their answer on very obvious (or irrelevant) points, e.g. was a contract to sell scrap iron a sale of goods contract. As a result there was little time for addressing the key issues raised in the question.

Part A

Question 1

The answers to this question were generally disappointing with poor application to the facts. What was particularity surprising was that many answers began by discussing remedies before they discussed the buyer's rights. The examiner would not expect even a first year law student to approach a legal problem in this way. Also too many answers wasted time by avoiding getting to the heart of the question by discussing at length was the contract one for the sale of goods – if a point is very obvious there is no need to go into great detail about it.

A good answer should first have considered S15 breach of description–in particular focusing on whether there was in fact a problem with the identity of the goods as opposed to quality as obviously scrap steel would be expected to contain impurities (compare *Pinnock v Lewis*). Therefore if the only issue is the volume of these impurities this suggests more a quality problem than an identity one (*Ashington Piggeries*). The only satisfactory argument in favour of a breach of s15 would be that if there is expert evidence that scrap steel with 40% impurities is no longer regarded in the trade as scrap steel (*Peter Darlington* case).

Generally discussion concerning s16 was very short with poor application to the facts. Many answers spent most of their time explaining the exceptions to merchantable quality (pre–contract examination/faults specifically pointed out before the contract). However on the facts these did not have any relevance. Many answers were too 'mechanical' going through all relevant factors re merchantable quality when obviously freedom from minor defects and appearance have no application to a commercial product like scrap steel.

The better answers kept it simple focusing on the point that reselling for smelting is very likely to be a common purpose of scrap steel and if expert evidence reveals that 40% impurities is higher than can be reasonably be expected then the goods are not reasonably fit for one of its common purposes. If this approach was taken S16 (3) needed only to be mentioned briefly as it would add little to the buyer's legal position. The only situation where S16 (3) would be of importance would be where smelting is not a common purpose (which seems very unlikely) and the actual purpose was made

known to the seller before the contract was made, which does not appear to be the case on the facts.

Answers should then have considered, if there was a breach of S16, whether the first three instalments were accepted. Most answers stated the basic rules on acceptance correctly but applied them indifferently.

Clearly the act of B in delivering the goods for smelting purposes to B2 is an act inconsistent with S's ownership/ intimation of acceptance S37(1) and an acceptance provided that B had a reasonable chance to examine first S37(2). Most answers said he had not such a chance but the facts suggest otherwise. B had the goods delivered to him and could have checked if he wanted to but decided not to in order to keep B2 happy (this clearly is distinguishable from *Molling v Dean* where the goods were going to be sent directly from S to B2). Discussion of lapse of reasonable time was therefore irrelevant.

The fact that the goods were to be delivered by instalments raised the issue that if the instalments were to be separately paid for then the contract is a severable one. Many answers totally ignored this important aspect of the question as it had two significant consequences:

1. The rule in S13 (3) that if you accept part you cannot reject the rest does not apply. Therefore even if the three instalments were accepted this did not prevent the buyer rejecting future defective instalments.

2. The buyer wished to end the contract and take no more instalments. Under S33(2) he could do so if the seller was in repudiation of the contract . The test laid down in *Munro v Meyer* should have been applied to the facts – the ratio the defective goods bore to the total contract quantity and the likelihood future instalments would be defective. Any sensible discussion of this got full credit.

Finally damages, this was poorly done as the general rules were stated without linking them to the previous advice on repudiation.

If there was repudiation by S and B accepted it and ended the contract this would mean there was non – delivery of the remaining instalments. Where, as, here there appears to be an available market the measure of damages would be based on the CP – MP rule in S53 (3). A good answer would have highlighted that the loss of profit on the resale would not be taken into account unless there was no available market for the goods *Williams v Agius*. A good answer would make the point that B would be accepting S's anticipatory breach and the moment B accepted it and ended the contract B must mitigate and buy elsewhere if the MP is rising.

If there was no repudiation by S then B's refusal to take any more instalments would amount to non – acceptance by B and entitle S to damages again based on the CP – MP rule S52 (3).

Finally, in relation to the three instalments that B had accepted, damages there would be based on the S55 (4) formula the difference in value between the value the goods should have had (contract price) and their actual value (this would be

the market price in their defective condition, again loss of profit would not be taken into account – the facts are very different from the *Bence Graphics* case where there was no available market).

QUESTION 2

This was a less popular choice but those attempting it generally did better than those answering question 1.

a) Most students appreciated that as a hire purchase was not an agreement to sell goods then title cannot pass from the hirer until he has paid all the instalments and exercised his option to purchase.

   A good answer should therefore have highlighted that D's best remedy was to claim the price back with no allowance made for use of the car under the principle of *Rowland v Divall* (total failure of consideration) and that this was a far better remedy than relying on S14 SOGO where the rules on acceptance would then apply.

   Regarding the feeding of title by B, many answers correctly applied the principle of *Butterworth v Kingsway Motors* –if title was fed there is no total failure of consideration, only a breach of S14 but no right to reject the car as there was acceptance. However few answers considered the timing issue –did D terminate before or after the title was fed? This is not clear from the question. If before then D can rely on *Rowland v Divall*, it is only if termination was attempted after the feeding of title would the *Butterworth* principle apply.

b) Most answers correctly identified that the agreement was a conditional sale agreement and in Hong Kong S s27 (2) SOGO could apply to enable D to obtain good title. Hong Kong does not have legislation similar to the UK where it specifies a conditional sale agreement is to have the same effect as a hire purchase one.

PART B

Question 1(a)

Too many answers failed to focus on the actual question – involving issues of priority on a winding up and wrote general essays on the nature of a floating charge. This was a waste of time.

Most answers were sound on the issues of the fixed charge over the factory ranking first and on Tom's floating charge being void under S267 (CAP 32) as being created within one year before liquidation and neither exception applying. Answers were surprisingly poor on the position of the preferential creditors, the employees and the IR, and failed to make the key point that they rank before the holders of floating charges.

However the biggest weakness of most answers was the failure to address the attempt to create a fixed charge over receivables. A good answer had to make reference to cases such as *Re Agnew* and *Re Spectrum First* and the fact that unless the unpaid debts are paid into a 'blocked account' preventing ABC using the proceeds without the consent of the Bank, it will regarded as a floating charge irrespective of the label 'fixed" given to it and thus rank after the preferential creditors

Question 1(b)

Answers were generally sound on explaining what is a negative pledge clause and what is an automatic crystallisation clause and the intent behind them but were uniformly poor on how successful these clauses are in practice in enabling the floating charge holder to climb the priority ladder . A good answer would have made the point that such clauses do not enable the holder to climb above preferential creditors S265 (3B). However with the changes made by S335 CO (Cap 622) whereby the entire floating charge instrument now needs to be registered this will now mean that later fixed charge holders will have constructive notice of such clauses and therefore cannot take priority thereby altering the decision in *ABN AMRO Bank v Chiyu Bank*.

Question 2

Again too many answers were content to write general essay questions on retention of title clauses with insufficient reference to applying the law to the facts of the question.

A good answer would set the scene, if a seller is unpaid and the buyer is a company, the seller will rank as a unsecured creditor and on liquidation will usually obtain very little unless the seller can establish that he 'owns' the goods supplied, new goods created or proceeds of sale. If title has passed even for a second to the buyer then any clause giving S rights over the goods etc. is a charge and void for non – registration vis a vis the liquidator and other creditors (not practical for a seller of goods to register).

a) Most answers correctly concluded this was not a charge. But to get a good mark there was a need to give detailed reasons i.e. It was an a simple application of S19/21 SOGO – parties can agree as to when property is to pass and on the facts there was an all monies clause, so if Wong had never paid off all he owed, property in the 200 sheets never passed.

b) Answers either were totally correct or missed the point entirely. The fact that Wong had paid for the 100 sheets delivered did make the advice differ from a). As the clause was an all monies clause if Wong owes money in relation to any of the goods supplied property cannot pass even in the 100 sheets paid for. That is the whole point of an all monies clause – property cannot pass in any goods until the seller is paid all he is owed.

c) Answers should have made the point that despite dicta in cases such as *Clough Mill v Martin* that it is possible for the seller to obtain ownership in the new

product from its inception and therefore avoid creation of a charge, to date the cases consistently take the view that ownership is initially transferred to the buyer thus creating a charge which is void for non – registration.

d) Re proceeds of the sale. A good answer should have made the point that unless the buyer is acting as trustee or agent of the seller and thus, on receipt of the proceeds by the buyer, the seller has a beneficial interest in the proceeds, a charge is created and would be void for non – registration. The case law again shows that the courts normally construe such a clause as a charge as in order for e.g. a trust to be created the buyer would have to hold the proceeds in a separate bank account and not use the proceeds in the ordinary course of the buyer's business, which obviously would be commercially impracticable.

PART C

Question 1

The answers to this question on guarantee law were very mixed. Some students produced excellent answers whilst other missed the point of the questions.

The question provided extracts from four common clauses in a guarantee contract. A good answer should have explained the areas of guarantee law that the bank was attempting to protect itself from:

1. The answer to this was the weakest. Many answers failed to spot that the main objective of the clause was to exclude the *Holme v Brunskill* material variation rule. This rule should have been explained in some detail but few answers did so. A good answer should have also made the point the clause was also attempting to protect the Bank in case the alteration of the loan agreement was sufficiently fundamental to be more than a variation and amounted to a new agreement – see reference to 'new facility'. If the change was sufficiently fundamental to amount to a new agreement, and not agreed on by the guarantor, it would not be binding on the guarantor under the purview of the agreement rule (*Triodas Bank v Dobbs*) unless the clauses in the agreement are sufficiently wide to protect the Bank.

2. This was answered much better. This clause was a principal debtor clause which was changing G's liability from secondary liability to primary liability (the difference between a guarantee and an indemnity should have been explained) and thus the bank would not be subject to the co – extensiveness rule that if the agreement is void against the creditor it will also be void against the guarantor.

3. This cl was excluding the guarantor's rights of subrogation. Subrogation should have been explained.

4. This clause was excluding the guarantor's right of indemnity – G's right to recover from D any sum G has paid C under the guarantee.

Note that some answers spent a lot of time discussing CECO and exclusion clauses but there is no suggestion to date that such clause are covered by CECO which only applies where a bank excludes liability for breach of a term of the guarantee contract. As the material variation rule and subrogation are equitable rights (and not terms) which are given to the guarantor irrespective of what the contract says the CECO has no application.

Question 2

The main point of this question was to evaluate UCO. The weaker answers discussed CECO and SOS (IT) Ordinance, undue influence – anything but the UCO.

The better answers explained the key aspects of UCO and also critically analysed whether the UCO is effective in protecting Hong Kong consumers using case law examples of UCO in operation.

Most answers came down in favour of the view that the legislation was effective highlighting the wide powers given to the court regarding the offending clause if found unconscionable, such as the power of the court to rewrite it, as well as the fact that a wide definition has been given as to when a buyer does not buy in the course of a business and is therefore a consumer. However few answers highlighted the fact UCO only applies to consumers who purchase goods or services and one of the most important types of contracts, land, is excluded.

Negative points about UCO to make were that the burden of proof is on the consumer to prove the law is unconscionable and the consumer must bring the claim himself, the HK Consumer Council cannot bring the claim on his behalf, unlike other jurisdictions.

It was also essential to discuss the vague definition of unconscionability and <u>to give case examples</u> as to how UCO works in practice. Many answers concluded that its vagueness is a good thing as it is means judges have great flexibility. However the more perceptive answers should have looked at the alternative argument, vagueness +uncertainty and thus discourages consumers from bringing claims. This may partially explain why very few claims have been brought under the Ordinance.

The really good answers also made the point that as interpreted by the judges UCO cannot be infringed merely on the basis that the clause is unfair and for a clause to fall foul of UCO the judges will focus on whether there is procedural unfairness – lack of explanation of the term before the contract was made, combined with other surrounding circumstances such as the degree of pressure the consumer was under and lack of choice.