PCLL Conversion Examination
June 2016
Examiner's Comments
Commercial Law

GENERAL COMMENT

The overall standard was very mixed. Some students had clearly prepared well and had the ability to identify the key legal issues to be discussed. However too many students had entered the examinations underprepared and as a result made fundamental mistakes which resulted in failure.

In between there were a number of students who clearly knew enough law to pass but were let down by poor answering technique –in particular failing to answer all the questions asked. For example in PART A Q1 concerning the legal position involving two contracts, one for chairs and the other for a sofa, many candidates just wrote about one of the contracts. In PART C Q1 where students were asked to explain the similarities and differences between a pledge and a lien, too many students simply wrote an essay on "Here is all I know about a pledge and here is all I know about a lien "and then expected the examiners to do their work for them by working out from their answers what the similarities and differences were! This is not acceptable.

PART A

Q1(a)

In the question goods had been destroyed before delivery. The main focus of the question was therefore on the rules concerning risk and the passing of property.

A good answer should first of all have referred to S22 –general rule risk of accidental loss lies with the party who has property in the goods and then considered the rules in SOGO for working out who has property in the goods S18, S19 and S20.

The application of these rules depends heavily on the distinction between specific and unascertained goods. Too many answers did not refer to this or applied the rules wrongly. On the facts the sofa was specific goods and the chairs unascertained goods.

Too many answers forgot that the default rules in S20 for working out who has property in the goods are subject to a contrary intention being found under S19 SOGO. Hong Kong does not have the equivalent of the English rule that risk of accidental loss only passes to a consumer on delivery. However it is likely Hong Kong would apply the English cases that state in a consumer contract the parties would not intend the property and therefore the risk to pass until delivery.

A good answer would have pointed out that the above rules apply to accidental loss only and if the fire had been caused by the seller's negligence, under S22 SOGO, the seller would have been liable as a bailee irrespective of who had property in the goods.

Q1(b)

Students either knew the answer or did not, there was no half way house! The question required an application of S22(2) - if delivery is delayed due to the fault of the seller or the buyer, the risk is with the party at fault irrespective of who has property in the goods.

Q2

Many students got into difficulty because they did not understand the nature of a hire purchase agreement i.e. there is only an agreement to hire the goods but the hirer has the option to buy the goods when all the instalments have been paid off. This crucially mean the hirer has not agreed to buy the goods and thus S27(2) SOGO- resell by the buyer in possession- does not apply to allow the hirer to pass good title to a third party.

Q2(a)

The nature of a hire purchase agreement should have been explained – a hirer cannot pass title in the goods to a third party. The answer should then have considered the exceptions created to the 'nemo dat' rule to ascertain if any applied. On the facts the answer was 'no'. As mentioned above too many answers falsely stated S27 (2) SOGO applied using Lee v Butler as the authority. However this was wrong. Lee v Butler involved a conditional sale agreement not a hire purchase one. In the case of the former but not the latter there is an agreement to buy.

Q2(b)

Too many answers stated that if the third party did not get good title his best remedy would be to claim for breach of S14 (1) SOGO . While some credit was given for this, it was not the best advice. The reason being that as the third party had had the goods for 9 months he would have been deemed to have accepted then under S37 SOGO –lapse of a reasonable time. The best and most correct solution was to claim under the common law principle of Rowland v Divall for total failure of consideration. This would mean that the third party could claim the full price back and return the goods with no allowance made for his use of them –the perfect remedy for him!

Rowland v Divall decided there is no sale of goods contract if no title passes and thus SOGO and the rules concerning acceptance in S37 do not apply.

Q 2 (c)

The facts here were very similar to Butterworth v Kingsway Motors – title had been fed. The only complaint the third party now had was that he got title but late. Thus S14 (1) SOGO applied and not Rowland v Divall. As he had accepted the goods by keeping them for longer than a reasonable time, his only remedy was to claim damages for being deprived of title for six months

PART B

Q 1(a)

As mentioned in the general comment too many candidates ignored the rubric and did not focus their answers on the similarities and differences between a lien and a pledge.

A good answer should have given a succinct definition of each type of security but then have focused on the question asked. Due a poor answering approach many candidates failed to clearly highlight the similarities –both dependent on possession; loss of possession means loss of interest; do not apply to purely intangible property; no title passes; pledgee and lienor are bailees

Answers were better on the differences in particular there is common law power to

sell on default by the pledgor but this does not extend to the lienee unless provided by contract or statute

Q1 (b)
This was generally well done, answers highlighting that the main advantages of a mortgage as a security over a pledge are: transfer of title; not dependent on possession ; applies to all assets tangible and intangible; right of foreclosure.

Q1(c)
This was generally poorly answered. The question asked what type of security was created over the shares. Many answers either ignored this and had long irrelevant discussions concerning assignment or were 'unthinking' saying a fixed or a floating charge was created without explaining how this conclusion was reached and then converted the question into a general discussion on fixed and floating charges and the registration procedure . This was not what was asked!

A good answer should have explained why the transfer was not a pledge -shares are intangibles (chose in action and not a chose in possession) and therefore cannot be pledged. A share certificate is **not** a documentary intangible (too many answers erroneously said it was). An instrument of transfer showing intent to pass title to the lender is inconsistent with a pledge where title is not transferred. (This also rules out a mere charge where again no title of any kind is transferred.)

The correct conclusion was an equitable mortgage was created. Not a legal one as a party only becomes the legal owner of the shares when the company formally registers the party as a shareholder which has not yet occurred. See the decision and very helpful judgment by Ma J in Bank of China (HK) Ltd v Kanisha.

Q 2
This was general well done

Most answers correctly identified the issue here was the legal effect of a retention of title clause. Though only a few mentioned it was an 'all monies' clause.

A good answer should have made it clear at the outset that such clauses are really only legally important if they do not create a charge as, if they do, it is not practical for most sellers to register the charge. It is thus void and the seller becomes merely an unsecured creditor with little hope of receiving payment on the buyer's insolvency.

Re clause retaining title to the unused wood - most answers correctly concluded that this was not a charge and valid but too many answers lost marks for not explaining why i.e. it is a simple application of S19/21SOGO, property is not to pass until the parties intend to pass –in this case when buyer pays off all he owes to the seller.

Re rights over the new furniture created - again most answers correctly stated this was likely to be a charge but many did not give a full explanation why – pre-1997 cases in England have taken the view that when the original goods lose their identity and become 'new goods' the buyer gets title in the goods and he then is transferring his equitable title to the seller until the seller has been paid. Thus a charge (in fact an equitable mortgage) is created.

The weakest part of the answers was the part of the clause dealing with the proceeds of the sale-many answers ignored this or were over optimistic in the view that it did not create a charge .However in the absence of a trust being created over the proceeds or the buyer selling as agent for the seller, again a charge is created according to the pre- handover English authorities which are still precedents in Hong Kong. So unless e.g. the clause clearly states a trust is being created and the money is put in separate bank account and cannot be used by the buyer in the ordinary course of his business –which in most cases is commercially unacceptable to a buyer- a charge is created.

Quite a few answers relied on the recent Australian case of Associated Alloys as support for the view a charge was not created but it was wrong to place total reliance on it. The case is merely persuasive authority in Hong Kong and very fact specific, for example, unlike the question, the clause in Associated Alloys required the proceeds to be put in a separate account, and the case seems out of step with the English approach in pre-1997 cases which are precedents in Hong Kong.

PART C

Q1 (a)

Most answers were content to merely explain the basic nature of a guarantee and an indemnity agreement without addressing directly the question asked, why it is more advantageous to be a guarantor? The fact that a guarantor incurs only secondary liability and can raise any defence that the debtor has, was therefore correctly stated under this approach, but other advantages were largely ignored, such as the material variation rule and the guarantor's right of subrogation.

Q1 (b)

Student either knew the answer and scored high marks or totally missed the point of the question. A good answer should have identified this was an agreement to pay part of a debt and applying Re SASS two consequences followed:

1. The guarantor can prove in the debtor's bankruptcy once he pays off the one million dollars. The creditor cannot rely on the double proof rule.

2. Once the one million is paid off the guarantor's right of subrogation kicks in and he is entitled to a pro tanto share in the securities the debtor has provided to the creditor.

Q1(c)

Again answers were very hit or miss. A good answer should have explained an agreement to pay early made between the creditor and debtor was a material variation of the guarantee agreement and discharges the guarantee under the rule in Holme v Brunskill unless the guarantor has consented. Many answers missed the point of the question but those who correctly identified the application of this principle simply assumed that the guarantor Tony who had negotiated the variation for the debtor company had also consented in his capacity as guarantor. Case law shows this is not certain, consent on behalf of the company as its MD is not necessarily the same as consent in his capacity as guarantor. However case law in Hong Kong in recent years has concluded that normally when a party is acting in two capacities, on behalf of the

principal debtor and as guarantor, when he gives his express consent on behalf of the principal debtor company to the change, he is also giving his implied consent to the variation in his capacity as guarantor.

Q 2

Many answers focused exclusively or mainly on the Unconscionable Contracts Ordinance (UCO).This was the wrong approach. The question concerned an attempt by a supplier to exclude implied terms in SOGO and SOS(IT)O which is expressly dealt with by two Ordinances CECO S11-12 and s8 SOS(IT)O.

There was therefore no need to refer to the UCO which is designed to cover other types of unfair terms.

A good answer should have worked through the facts of the question methodically. First of all Good Driver, and the attempt to exclude the implied condition of merchantable quality (*5 days to complain* is an exclusion clause within S5 (1) (a) CECO as it makes liability/enforcement subject to 'restrictive or onerous conditions'). The answer depended on whether Good Driver could be considered a consumer buyer in which case the exclusion clause was void or a business buyer in which case the clause was subject to the reasonableness test. Many answers failed to state this fundamental distinction.

The S4 definition of consumer and its interpretation in R&B Customer Brokers should have been explained and applied. Re the dual controlled car this was clearly a business to business contract –it is not the sort of goods ordinarily bought for private use. However the purchase of the car for the MD's private use is likely to be a business-consumer contract applying the narrow meaning given to 'in the ordinary course of a business' in R&B. It was totally wrong to apply the meaning given to this phrase in Stevenson v Rogers as that case was concerned with the meaning of the phrase under S16 SOGO where the court gave the phrase a wide interpretation to make sure as main sellers as possible where subject to the implied conditions as to quality but re CECO R&B gave the phrase a narrow meaning in order to maximise protection for buyers by making as many of them as possible consumers and thus able to take advantage of the rule that an exclusion of S16 made the clause void if the buyer was a consumer.

It was also totally wrong to say that Imelda bought the car. The question quite clearly said the company bought it. Remember a company is a separate legal entity!

Re Amanda most answers correctly identified that Motors were in breach of the implied term of care and skill in S5 SOS (IT) O and any exclusion of this was void under S8 in the case of a consumer, which Amanda clearly was. However few answers identified the fact that a repair contract is not one for the sale of goods. It is a contract for work and materials. This means that the implied condition that the brakes fitted were of merchantable quality is implied at common law not under SOGO and the rules concerning the effect of any exclusion clause are the same as for a sale of goods contract but governed by S12 CECO not S11 CECO.

A high number of answers only advised re Good Driver or only Amanda thus cutting down drastically the total marks that could be awarded.