PCLL Conversion Examination
June 2023 Examiner's Comments
Commercial Law

PART A

Question 1

A well-structured answer to (a) should have considered the application of S15, S16 (2), s16 (3) SOGO, then the issue of acceptance and finally remedies. The main issue with many answers was that the application of the law to the facts was weak or indeed that the facts given were often ignored.

Breach of S15 SOGO impled condition as to description re fact machine specification was 800 mj not 1000 mj. The fact there was no difference in quality was irrelevant as S15 is concerned with identity and not quality. Applying Wilberforce's test in Reardon Smith v Hansen Tangen 1000mj would be a substantial ingredient of the identity. Gladys clearly relied on it as a reason for making the agreement Harlingdon & Leinster Enterprises v Chris Hull Fine Art. Also possible breach S15 re fact made in China not Germany but did G rely on this as this was not mentioned in any pre-contract discussion only in the agreement?

Breach of merchantable quality s16(2) SOGO. Answers should have referred to MQ definition in S2(5)SOGO and applied it to the facts . The fact that some customers treatment took longer than expected, does that mean machine was unmerchantable – took longer, rather vague, is this a defect? *c) as free from defects (including minor defects)……. as it is reasonable to expect*. Failure to treat 5 customers with especially bad skin . '*as fit for the purpose or purposes for which goods of that kind are commonly bought*'S2(5)(a) SOGO. Is this a common purpose? Common purposes 'minor to quite serious skin conditions'. Under HK law goods need only be fit for one of its common purposes Aswan Engineering v Lupdine.This could be the case here (compare English equivalent goods must be for all their common purposes). However the statutory definition of MQ makes it clear that the suitability of goods for one common purpose(functionality) of the goods is only part of the test and the court should also take into account other factors such as description and price. Does their skin condition come within the description 'quite serious'? SCT deny this –"very extreme ..not just serious." Also very relevant the big price difference between the contract price and the resale value of the machine supplied. Contract price HKD 500,000 resale value HKD 50,000 Case law says (Brown v Craiks; Grace Garments v Tajamahal) a big price difference is a very important factor to take into account (however is this low price a reflection of the poor quality or simply that second hands goods, in general, have a low resale value?). Would a reasonable buyer knowing the faults still be willing to take the goods without a substantial reduction in the price?

Breach of S16(3) SOGO re 5 customers. Problem must make known the particular purpose – Gladys has said the purpose was treating "quite serious conditions". SCT's defence is that the 5 customers' condition was more than this and was not disclosed Griffiths v Peter Conway , thus SCT had no opportunity to rely on their skill or judgment in selecting the best machine for Gladys. Therefore, everything depended on whether the particular purpose was sufficiently made clear. Reliance on S's skill / judgment can be partial , it did not matter Gladys relied on advice of John as well, if she still relied on SCT. There is a

presumption there was reliance if the particular purpose was disclosed.

Remedies if there was a breach . Can reject for breach of an implied condition if there has been no acceptance. Had a reasonable time for rejecting the goods expired S37(4)SOGO? The buyer has to have had a reasonable opportunity to examine the goods to check they are in conformity with the contract S37(5) SOGO. Applying this to the facts – this opportunity to examine ended in February when testing was completed but Gladys did absolutely nothing until April–reasonable time expired ? Many answers ignored this vital fact that even though Gladys had knowledge of the faults in February for no good reason (busy!) she made no attempt to reject until April. Also, if knowing the faults Gladys continued to use the machine is that an intimation of acceptance?

If there is breach and acceptance, the breach of a condition becomes a warranty S13(3)SOGO and G's only remedy is damages. The measure would be the difference between the value she should have had (normally taken as the contract price) HKD 500,000 and actual value HKD 50,000, S55(3) SOGO. Any other loss which was not too remote could also be recovered e.g. refunds given to dissatified customersc

(b) Breach of S14(1) SOGO implied condition if at the time of the sale the patent existed. SCT would have no 'right to sell' S14(1) (a) SOGO Niblett v Confectioners Materials .If the patent only came into effect after the contract was made, breach of the implied warranty of quiet possession S14(1) (b) SOGO Microbeads v Vinhurst Road Markings . Answers should have explained the significance between breach of a condition and warranty, cannot end the contract for the latter, the only remedy is damages. Credit was also given for reference to the fact there was no total failure of consideration, Rowland v Divall, as despite the patent infringement, Gladys becomes the owner of the machine.

Question 2

Parts a to b (iii) were concerned with the nemo dat exceptions. The better answers identified the correct exception(s) and applied it sensibly to the facts. Quite a large number of answers lost marks by identifying the correct exception but failed to give any significant amount of detail in their answers.

(a) You were required to identify that S25 SOGO voidable title , would give a good title to Betty as the contract has been rescinded (by informing the police Car & Universal Finance v Caldwell) after the sale to Betty, provided she takes in good faith as she is paying half the market value . Too many answers ignored the good faith issue. S27(2)SOGO resale by a buyer in possession should also have been considered but it should have been identified that for this provision to work Amanda must be acting like a mercantile agent, the 'notional mercantile agent' requirement, -this would normally mean selling from business premises, which is not the case on the facts as she is selling from her home. Therefore S25 SOGO is a better provision for Betty to rely on.

(b) (i)

Answers should have emphasized that the best exception for Betty to rely on would have been market overt S24 SOGO. The art gallery would likely come within the definition of 'a shop'. Good title would pass provided the good faith issue is overcome see (a) and as long as the painting was on display in the public part of the gallery.Credit was also given for considering S27 (2) SOGO.

(b) (ii)
S3 Factors Ordinance would be applicable here as goods are given to Amanda in her capacity as a mercantile agent and not as a buyer. However as in (a) the goods must be sold in the ordinary course of business of a mercantile agent – but where did sale take place, if in Amanda's gallery this would satisfy this requirement but not if the sale was in her own home? A frequent mistake that was made was a statement that this provision could not apply because Amanda has ignored David's instructions by selling below the agreed price, but that was wrong. As long as the owner originally placed the goods in the possession of the mercantile agent in that capacity –to find a buyer –it does not matter that the agent later ignored the instructions of the owner. Pearson v Rose &Young.

(b) (iii)
S27(1)SOGO resell by the seller possession was applicable .It did not matter that David's status has changed from seller to bailee, it was sufficient that he was in continuous possession of the goods.Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd. Title only passed to Betty if the goods were delivered to her and she took in good faith. The better answers identified the question did not make it clear whether delivery had occurred.

(c)
This question was concerned with the distinction regarding acceptance between a severable and non-severable contracts. If the contract was non- severable then provided there has been no acceptance Beta can end the contract for breach of the implied condition that goods must be of merchantable quality S13(2) "a condition, the breach of which may give rise to a right to treat the contract as repudiated." This would mean Beta could end the contract, return the goods , get a refund of any money paid and not have to take delivery of any further instalments

However if the contract was severable then S33 (2) SOGO applied. Unless there is repudiation of the entire agreement Beta could not end the agreement . Case law e.g. Munro v Meyer, says the court will look at the number of instalments which are defective and the likelihood that future instalments will be defective. On the facts here the breach does not seem sufficiently serious to allow Beta to end the contract and refuse to take delivery of future instalments Regent OHG Aisenstadt v Francesco of Jermyn Street. Beta therefore could only reject the first instalment for non-compliance.

Common mistakes 1. The assumption the contract was severable and not discussing non – severable contracts. Merely because the goods are delivered by instalments or there is a separate price allocation for each lens does not make the contract severable Kyocera Corp v W Haking Enterprises. However if each instalment is separately paid for this would most likely mean the contract is severable S33 (2) SOGO. 2. Failing to apply S33 (2) to the facts. 3. Lengthy discussion concerning the nature of merchantable quality when the question says clearly 100 lenses were not of merchantable quality (though the possibility of de minimis could have been discussed.)

Part B

Question 1

Students were generally able to define bailment as a limited possessory interest over a chattel and discuss its basic elements of intention, delivery and possession, consent, etc. They were also generally able to apply the elements to the facts given and discussed the bailment relationship between Eva and Will. In the facts, intention was clear, as Will and Eva agreed that Will would take possession of the car until Eva's return to Hong Kong from Europe. There was transfer of possession of the car to the parking garage of Will's residence, but ownership of the car remained with Eva. Unfortunately, some students wrote the entire essay on these basic elements when they are only the foundation for assessing the merits of Eva's claims against Will and Nick.

Most students neglected to discuss the change of nature of the bailment from gratuitous to non-gratuitous when Will requested (and Eva agreed) that the car be used as an Uber vehicle and part of the revenues generated would be shared with Eva.

Students should discuss the applicable duty of care and burden of proof with support from caselaw. A good answer should discuss both the traditional view and the modern view (Coggs v. Bernard; Houghland v RR Low), but credit is given to answers applying either the same standard of reasonable care or different standards for gratuitous bailment (gross negligence) and bailment for reward (negligence). Students should point out that the bailee bears the burden of proving the absence of negligence / gross negligence.

Students should discuss whether Nick is a sub-bailee. Nick took possession of the car, but does he have notice that the car does not belong to Will, that Will was only a bailee? Eva did not know about the car wash, so she cannot be said to have given express consent, but what about implied consent? By agreeing to the Uber arrangement, is it understood that Will would take the car to be washed and waxed from time to time? If there is no privity of contract and no notice / consent, Nick does not owe any duty of care to Eva. Principles in Pioneer Container are not likely to apply. Credit is also given to discussion on whether Nick owes a duty of care to Will.

Tyres and Stereo System
Students should use the facts to analyse whether Will was negligent (e.g., in leaving the car at Nick's shop overnight). Does his obligation become strict if leaving the car at Nick's shop is deemed a deviation from the terms of the bailment? Must Will (and Nick?) show that he was not negligent in taking care of the car? Was Nick negligent?

Scratch
Nobody knows how the scratch came about, but Will, as bailee, has the onus of disproving negligence. The fact that there is a scratch on the car is prima facie evidence of negligence. To avoid liability, Will has to show that he exercised reasonable care.

Luggage
Whereas the car became bailment for reward, the luggage remained a gratuitous bailment. Will agreed to store the luggage at his home for Eva's benefit only. Was Will negligent (e.g., he removed the luggage from the car as instructed and took it inside his home and stored it in his bedroom closet)?

Diamond ring
Will was not a bailee of the ring as there was no transfer of possession of the ring (it was locked in the glove compartment of the car and Will did not have the key). In fact, Will did not even know there was a ring in the car, so there was no consent to be a bailee or sub-bailee. Neither Will nor Nick can be held liable for the loss of the diamond ring. The ring is qualitatively different from the stereo and tyres which are parts of the car, the subject of the bailment.

Question 2

2(a)
The Lion Bank Debenture does not restrict DTK's ability to grant a floating charge over its book debts to other lenders.
Students should point out that Clause 4.01 is a negative pledge clause and explain what it is. Clause 4.01 only prevents the encumbrance of the assets charged to Lion Bank under the Lion Bank Debenture, i.e., those assets listed in Clause 3.01.
Clause 3.01 only covers machinery, vehicles, office and other equipment and chattels. It does not cover intangibles such as book debts**.**

2(b)
The drafter of the Lion Bank Debenture excluded stock-in-trade in Clause 3.01 because it is virtually impossible to grant a fixed charge over stock-in-trade.
Students should explain that stock-in-trade is inventory, i.e., what a company sells to customers to make a profit.

Student should also explain the key difference between a fixed charge and a floating charge: the element of control retained by the grantor of the charge in the latter. Floating chargors are able to deal with the charged assets in the ordinary course of business. Some students did not seem to understand what stock-in-trade is.

Application: Clause 3.01 grants a fixed charge over most of the company's tangible assets in its operation. A fixed charge gives the chargee control over the charged assets. For example, the chargor cannot sell or encumber the charged assets without the consent of the chargee. Therefore, if stock-in-trade were included in the list of charged assets in Clause 3.01, it would mean that DTK must seek Lion Bank's consent every time it sells a piece of its merchandise in its stores. That would make it extremely difficult, if not impossible, for DTK to operate its business.

Some students neglected to answer the last part of the question: If Lion Bank would like to have stock-in-trade as one of the charged assets, a floating charge should be granted over the stock-in-trade.

2(c)
Students should explain the elements of s267 – a floating charge created within the relevant time is invalid. Here, the relevant time is 12 months (as the bank is not a connected person) and the company was insolvent (unable to pay its debts) at the time of the grant or immediately thereafter under s267A(1). The 12-month period is calculated from the date of

petition (not the date of the winding up order). Students should discuss the facts that point to the company's financial difficulties as indications that the company may be insolvent at the time of the charge, but credit is also given for the conclusion that the company may not be insolvent.
Exception: s267(3)(a)(i) – new money injected into the company at the time of the grant or shortly thereafter.

Application: the floating charge over book debts granted in favour of Lion Bank will be invalidated (date of creation of floating charge within one year from date of winding up petition), except for the $1 million "new money" that came in at the time of the grant of the floating charge. The $10 million was only secured by the fixed charge granted earlier but not the new floating charge so it does not qualify as "new money".

In liquidation, Lion Bank, as a secured creditor, will be paid from the secured assets: the machinery, etc. listed under s3.01 of Lion Bank Debenture, and the book debts (but only up to 1 million as only 1 million qualifies under the new money exception under s267).

Preferential creditors (employees and statutory debts owed to the government, in that order) will be paid from the assets under the floating charge (up to 1 million from book debts) ahead of Lion Bank ONLY IF money from general assets is not enough.

The order in which the general assets should be distributed: liquidator's expenses and fees, preferential creditors (employees first, then government), unsecured creditors on a pari passu basis (including Lion Bank to the extent it is not fully paid from assets listed under 3.01 of Lion Bank Debenture and $1 million from book debts), and lastly, the shareholders of DTK.

2(d)
If the lender is a director of DTK, the answer to Q2(c) will be slightly different.
Students should re-do the s267 analysis: the look-back period will be 2 years instead of 12 months under s267A(1) when the charge was granted to a person who is connected with the company.
s265(A)(3)(b) – a person is connected with a company if it is an associate of the company.
S265(C)(2) – a person is an associate of a company if that person is a director of the company.
Significantly, s267A(2) does NOT apply, which means that insolvency is not an element.
Application: Ms. Lu. is a director DTK, therefore, she is an associate of DTK and hence a person connected with DTK. A floating charge was granted to Ms. Lu within two years of the winding up petition, so it will be invalidated under s267. There is no need to prove that DTK was insolvent at the time of or immediately after the grant. The analysis on the new money exception is the same.

Part C

Question 1

a) Most candidates discussed whether the guarantee was procured by undue influence by Suzie and did generally well. Credits were given if either actual or presumed undue influence was discussed and applied to the facts, in this case, either could be argued. The elements of actual or presumed undue influence should be set out and applied to the facts. For presumed undue influence, while the relationship between John and Suzie does not fall within one of the special relationships (*RBS v Etridge (No.2)*), it can be argued that they are in a relationship of trust and confidence and the transaction calls for an explanation as the guarantee is clearly disadvantageous to John. For actual undue influence, candidates should discuss whether Suzie had exercised actual pressure on John (in this case, by threatening to tell his wife about their relationship if John did not act as a guarantor for the loan) (*Bank of Montreal v Stuart*) but there is no need to show transaction calls for explanation or is disadvantageous (*CIBC Mortgages v Pitt*).

However, some candidates failed to identify and discuss the effect of undue influence inducing contract with a third party (ABC Bank in this case) as the question is concerned with whether ABC Bank can enforce the guarantee against John. Candidates should discuss whether ABC Bank was "put on inquiry" as to the possibility that the guarantee made was affected by undue influence (*RBS v Etridge (No 2)*, and applied in *Li Sau Ying v Bank of China*). Factors include whether the transaction calls for an explanation and whether the relationship between John and Suzie is non-commercial. Candidates should apply to the facts to analyse these issues (in this case, John just claimed to be a close friend with Suzie and the guarantee of a friend's debt is clearly disadvantageous to John while he has no financial interest in Suzie's business). If ABC Bank was put on inquiry, it should have taken reasonable steps to discharge its duty to reduce the risk of John entering into the guarantee as a result of undue influence. Not many candidates discussed the reasonable steps that ABC Bank should have taken in this case, more details are needed.

b) This question is concerned with whether the trustee in bankruptcy may apply to the Court to set aside the 2 transactions in question. Candidates generally did not do very well in this question. The facts involve 2 transactions – the sale of antique vase by John to Jacky; and the repayment of HK$200,000 by John to his mother.

Regarding the sale of the antique vase to Jacky, it could constitute a transaction at an undervalue (s.49(3)(c) Bankruptcy Ordinance (BO)). The vase was sold for an amount significantly less than its value by John to Jacky (at least 50% less than market value) at a relevant time (i.e. 5 years before day of bankruptcy petition – s.51(1)(a)). Jacky is a friend of John (so he is not an "associate" and there's no presumption of insolvency under s.51(2)), but from the facts, John was already insolvent (unable to pay his debts – s.51(3)) at the time of the transaction.

Regarding the repayment by John to his mother, it could constitute an unfair preference (s.50). The payment was an unfair preference made to his mother (as a creditor who lent John an amount of HK$200,000 last year) which puts her in a position which will be better than she would have been in if John goes bankrupt at a relevant time (i.e. 2 years before day of bankruptcy petition as his mother is an associate – s.51(1)(c))). There is a presumption that John was influenced by a desire

to prefer his mother as she is an associate – s.50(5) and John was insolvent at the time of the payment (s.51(2)).

Question 2

a) The clause concerned is an exclusion of liability clause by the bicycle rental shop "Bike X". The key issue here is to consider if this clause is enforceable. First, whether this clause was incorporated at common law should be discussed briefly, can argue that it was not as such a term would need to be brought to the customer's attention if it is excessively onerous or unusual.

The Supply of Services (Implied Terms) Ordinance (SSO) is relevant here as bicycle rental is a contract for the supply of services under the SSO. As against a party dealing as a consumer, a supplier cannot exclude or restrict any liability arising under the contract by virtue of the SSO (s.8(1)). Hence, if Ben is dealing as a consumer, Bike X cannot exclude its liability arising from the breach of the implied term under s.5 SSO (that supplier acting in the course of business will carry out services with reasonable care and skill - candidates should apply to the facts to discuss if there is likely a breach of such implied term by Bike X (there's a malfunctioning brake in a rental bicycle, did Bike X take reasonable care and skill to carry out checks on the bicycle before it was rented out)). In this case, need more information as to whether Ben rented the bicycle in the course of a business or in his individual capacity, but one may argue that Ben was not dealing as a consumer as he rented the bicycle with a few colleagues as team building activity (s.4 SSO).

CECO s.7 is also relevant, any clause that restricts a business liability for personal injury resulting from negligence would be void (regardless of whether Ben is dealing as a consumer) – can argue that Bike X is negligent in maintaining its bikes for rental in this case. Hence the clause concerned would not be enforceable. Unconscionable Contracts Ordinance (UCO) would also be relevant if Ben is dealing as a consumer in this contract for supply of services – if the Court finds that this clause is unconscionable in the circumstances, the Court may refuse to enforce the contract; enforce the remainder of the contract without the unconscionable part; or limit the application of any unconscionable part to avoid unconscionable result (s.5 UCO). The Court will consider the list of matters set out in s.6 of UCO to decide if the term is unconscionable, candidates should discuss and apply to the facts.

b) If the accident resulted in Ben's watch being broken instead, since it only involves property damage instead of personal injury, the difference is s.7(2) of CECO will apply instead of s.7(1) – the exclusion clause would not be void if it satisfies the reasonableness test under s.3 of CECO – whether the clause was fair and reasonable to be included in the circumstances when contract was made, candidates should apply to the facts to analyze if the reasonableness test is likely to be satisfied in this case.

c) This question concerns with the Money Lenders Ordinance. Candidates should discuss if Aunt Rachel is a money lender under the MLO - from the facts, Rachel is the wife of a tycoon and only reluctantly agreed to lend Peter money to do him

a favour, so it is unlikely that her business is that of making loans (s.2 MLO). Regardless of whether Rachel is a money lender, an interest rate of 52% p.a. was excessive (excessive if above 48% p.a. under s.24 MLO, commencing from 30 Dec 2022), and it is an offence to lend at such excessive rate. Agreement for the repayment of such loan or for the payment of interest on such loan shall be unenforceable s.24(2), and Rachel has committed an offence - summary conviction fine up to HK$500,000 and 2 years imprisonment, on indictment fine up to HK$5 million and 10 years imprisonment.