PCLL Conversion Examination
June 2020
Examiner's Comments
Commercial Law

Part A
Question 1

The key to a good answer was sensible application of the relevant law to the facts. Whether the contract was a sale of goods contract or a work and materials contract should first have been considered and then consideration should have been given as to whether the implied conditions were broken.

On the facts there was a clear breach s15 description re wrong engine specifications –the description was clearly relied on by the buyer as it was an important ingredient of identity as it resulted in a significant difference in speed.

Surprisingly few answers identified there was a clear breach of S16 (3), the importance of the speed of the yacht was made very clear to the seller and the buyer relied on the seller's skill and judgment to ensure it would meet those specifications.

Many answers on S16 (2) merchantable quality were indifferent. Quite a few stated that any right the buyer had was lost under S16 (2) (b) because of his examination of the yacht BUT this provision only applies to an examination before the contract was made and the question stated quite clearly that a contract was made to purchase the yacht at a time when it was not even in existence! In considering whether there was breach of merchantable quality too many answers discussed each issue of quality in isolation from the others. The correct approach was to take all the faults together and then ask the question, taking all these faults together in the context of the contract description and price, would a reasonable buyer have been happy to take the goods without a substantial reduction in the price. Thus it was wrong to focus just on the scratches or paintwork or air con in isolation from the other faults and attempt to decide did this fault by itself mean the yacht was not of merchantable quality. The question the court would have to answer would be, given the fact that the yacht was much slower than it should have been given the description and has poor air conditioning and has cosmetic deficiencies, in the context of the fact the yacht is brand new and the high purchase price of HK$ 20 million, would a reasonable buyer be happy to take the yacht without demanding a significant reduction in the price? The answer would surely be 'no' reinforced by the fact that the question makes it clear in purely monetary terms the yacht is worth HK$ 5 million less than the price paid.

Too many answers focused just on the issue was there a breach of the implied conditions and spent little time on the remedies available if there was a breach. It should have been spelt out that if there was no acceptance the buyer would be entitled to as refund and damages for the extra needed to buy a replacement-HK $10 million (some answers said the damages would be HK $30 million which mean of course that a buyer would get a new yacht for nothing!). Acceptance should have been considered, given the yacht was delivered on 5th January and the rejection occurred sometime after 13th February it was surprising the many answers did not discuss whether a reasonable time for rejecting had expired S37 (4). Some answers correctly made the

point that it uncertain under HK law whether time runs against the buyer while repairs are being attempted.

Secondly, leaving the yacht with the seller for repair –incredibly many answers totally ignored this important fact! Clearly there is a danger that this constitutes intimation of acceptance S37 (1) (a) and is an act inconsistent with S's ownership S37 (1) (b)-it was not good enough just to say that in the UK this would not be acceptance because of their different legislation. The HK legal position should have been focused on and a good answer should at least have said this act might amount to acceptance unless SH made it clear, at the time, it was reserving its right to reject if the repairs proved unsatisfactory(it was wrong to discuss the visual examination of the yacht and the expression of satisfaction as having any relevance on acceptance as you cannot be deemed to have accepted the goods until you have a reasonable chance to examine them which did not take place until the sea trials after delivery S37(2)).

Finally damages if there had been acceptance should have been considered. Most answers just referred to S 55(3) and stated B's loss was the contract price- market price difference of HK $ 5 million. However few answers had the flexibility of thought to make the obvious point that this is only the prima facie rule and is really designed to provide certainty in commercial contracts where a buyer is buying for the purposes of resale and is totally inappropriate to a contract where a buyer is buying for enjoyment. Therefore there is a strong case for saying that that the reasonable thing for the buyer to have done in mitigation of loss was to carry out the repairs needed to put the yacht in the condition it should have been in, HK$ 2 million.

Question 2

a) Most answers correctly identified that this was a question concerning ownership and risk and that under S22 the risk of accidental loss or damage lies with the owner. Thus S18-20 SOGO should have been considered as to when ownership passes. Answers should have identified that Contract 1 was a contract for specific goods (not 'ascertained' goods as many answers stated). Therefore S 20 Rules 1 and 2 should have been considered with emphasis on the fact that these rules are the default position and subject to a contrary intention s19. Contract 2 was clearly unascertained goods and S20 R5 should have been applied to the facts to determine whether the goods were unconditionally appropriated and thus had become ascertained. Again it should have been clear that even if the goods had become ascertained post-contract S19 was the dominant provision, title passing when the parties intended it to pass.

b) It should have been made clear that under S22 SOGO the rule that the risk is with the owner only applies to accidental loss. "*Provided, also, that nothing in this section shall affect the duties or liabilities of either seller or buyer as a bailee of the goods of the other party.*" Even it ownership had passed to Moon, Star was in breach of its obligation to take reasonable care of the goods (failure to provide adequate security system) and Moon could claim back the price.

c) This part was not done well by many students. The main point should have been made that even if property has passed to Sun, as Sun had become insolvent, Star has an unpaid seller's lien S43 SOGO. S50 provides where the unpaid seller gives

notice to the buyer of his intention to re-sell, and the buyer does not within a reasonable time pay or tender the price, the unpaid seller may re-sell the goods. Where, as here, the seller resales at a profit, the seller can retain the full HK$700,000 Ward v Bignall. S by giving notice to B is making time of the essence. If B does not repay within the time period S can rescind the contract for breach of condition. The property is revested in S and S therefore resells as owner and not on behalf of B.

PART B

In Question 1, students are required to demonstrate an in-depth understanding of fixed and floating charges (creation, perfection, enforcement, and invalidation in a winding up) and rules of priority. Question 2 requires students to identify and discuss several real and quasi-securities. Students can pass this exam by demonstrating a thorough understanding of one topic (Question 1) or by a more basic understanding of a broader range of topics in the syllabus (Question 2).

Question 1

With respect to the fixed charge over inventory, students should analyze the language in clause 4.01 but also point out that the language in the charge document is not conclusive in determining the kind of charge being granted. They should discuss how granting a fixed charge over inventory is in reality almost impossible given its fluid nature. The better conclusion is that a floating charge over inventory was created despite the language in the charge document.

In comparing the floating charge granted to HK Bank and the subsequent fixed charge granted to Zen, most students were able to recite the general rule of a fixed charge having priority over a floating charge and the exception to that rule when the charge document creating the prior floating charge contains a negative pledge clause and the subsequent fixed chargee has notice of that clause. However, many students neglected to explain what a negative pledge clause is and that either actual or constructive notice would suffice.

Many students failed to apply the rules to the facts given in the question: clause 7.06 is a negative pledge clause, and Zen Bank had actual notice of the clause because its lawyers did a search and obtained a copy of the LSA. Similarly, some students failed to analyse and conclude that HK bank preserves priority despite Zen being a fixed chargee.

Also, some students did not seem to understand what inventory and book debts are and thought they are the same.

Charges must be registered within a month with the companies registry; otherwise, they would be void against the liquidator and other creditors. A good number of students seemed to rely on old notes and said that the registration period is 5 weeks instead of one month.

Amy is an unsecured creditor because the floating charge granted in her favour was invalid under s267 of Companies (WUMP) Ordinance. Many students missed this

analysis altogether. Of those who were able to identify this point, many failed to discuss some of the elements such as the new money exception (that it does not apply as the loan was from years ago). The relevant period is two years and not 12 months since Amy is a connected person. Insolvency is not a requirement given Amy is a connected person.

Question 2

a) Share pledge is a misnomer because it is actually not a pledge but an equitable mortgage. To be a pledge, the grantee has to be in possession of the goods or documentary intangible. Shares are choses in action and not choses in possession and therefore cannot be pledged. Share certificates are not documentary intangibles like a bill of exchange.

Also, in a pledge, only possession passes to the lender; the title remains with the borrower. The signed instrument of transfer is therefore not consistent with a pledge.

Bank of China (Hong Kong) Ltd. v. Kanishi: what's being pledged is only a piece of paper, not the share ownership. The intention of the parties must then be to create an equitable mortgage.

A good answer should point out that despite the misnomer, "share pledge" is common commercial practice.

b) Assignment of Debt: to be a legal/ absolute assignment, Art 9 of LARCO must be strictly complied with: the assignment must be in writing signed by the assignor, express notice in writing must be given to the debtor, etc.

Application: what Winnie gave Carrie was not an absolute assignment as one cannot assign only half of the debt and there was no written confirmation given to Judy; therefore, it is an equitable assignment. Note that Denise also did not give written notification to Judy.

Post-dated cheque: A cheque is a bill of exchange, a negotiable instrument that can be the subject of a pledge. A crossed cheque means that the cheque is no longer negotiable. It is marked "account payee only", so it can only be deposited into payee's account. The bank has an obligation to pay the payee on demand on or after July 2.

Application: Carrie may deposit the cheque after July 2 upon default to repay; funds will be deposited into her account. Students should also discuss how Winnie may give a countermand order to the bank.

Vase: a vase is a chose in possession and can be pledged. The title of the vase remains with Winnie while possession is delivered to Carrie. All pledges are bailments – possession of the vase is transferred as security for the repayment of the loan owed to Carrie. Accordingly, Carrie, as bailee, has a duty to protect the vase, and will be liable to Winnie if the vase is damaged/ lost during the time of the pledge.

Application: students should discuss whether Carrie was negligent in leaving window open and placing the vase next to it during typhoon.

PART C
Question 1

a) Whether Jane could set aside the agreement with KLB on the grounds of undue influence should have been addressed. There should have been an awareness of the fact that Tom was not a party to the Bank – Jane contract and for the Bank to be liable the constructive notice principle established in RBS v ETRIDGE ((No 2)(applied Hong Kong LI SAU YING BANK OF CHINA (HONG KONG) LTD) must apply.

For KLB to be liable Jane had to prove: 1. Relationship of trust and confidence between her and Tom (any sensible discussion of this would receive full credit) 2. The transaction was suspicious. Too many answers made little effort to apply 1 and 2 to the facts e.g. re suspicious transaction there were arguments both ways (normal for a family member to assist another but on the other hand Jane has no financial interest in her brother's business). 3. Failure by KLB to take reasonable steps to explain to Jane the nature of the agreement she was making and the risks that she was running, by having a private meeting with her or receiving the advice from a solicitor – there was no evidence this has been done.

Re guarantee law, the rule in Holme v Brunskill should have been explained and applied to the facts –there was clearly a material variation of the Bank –Debtor agreement without the guarantor's consent making the guarantee agreement void. However this can be contracted out. Amazingly many answers did not make the point that the term in the contract was clearly excluding the application of the rule. The better answers also referred to the fact that under the purview of the agreement principle a 300% increase in the amount of the loan would very likely amount to a new agreement TRIODOS BANK NV v DOBBS and was not covered by the wording in the agreement "*renew .. vary*"

b) The key point to make here was that this was an all-monies clause and was literally wide enough to cover the change even if it amounted to a new agreement, thus protecting KLB, unless the court concluded that such an extreme change was not within the contemplation of the parties at the time they made the agreement

Question 2

a) The issue as to whether the clause was incorporated at common law should have been addressed first – it could be argued that it was not, as such a term would need to be highlighted as it is a very harsh clause. The fact that the clause is an exclusion clause under S5 (1) (b) CECO should have been identified as it excluded remedies for breach of S16 SOGO – the right to a refund if no acceptance, a HK consumer has no right to repair or replacement. The clause was therefore void if Diana was a consumer S11 (2) CECO Answers should

then have made an effort in applying the wording of S4 CECO as to who is a consumer, as interpreted by R&B Customs Brokers v UDT, to the facts –presumption Diana is a consumer, is a PC ordinarily bought for private use, is Diana buying in the course of a business- is the PC integral to her business? Too many answers made no effort to consider this vital issue in any detail. The consequence if Diana was not a consumer, clause subject to the reasonableness test S11 (3) CECO, should also have been stated

Some answers only discussed the Unconscionable Contracts Ordinance. However this was the wrong emphasis as the CECO is far better for Diana (burden of proof is more favourable, potential effect on clause is more severe (void) and applies even if Diana not a consumer).

(b) There should have been an identification that the problem here is concerned with defective services and that Ace seems to be in breach of the implied term of care and skill under S5 SOS (IT) O. It should have been made clear that under S8 SOS (IT) O this cannot be excluded if Diana is a consumer (same test as for CECO). Was she? Many answers lost marks by making no or little attempt to address this vital issue. Some credit was given for reference to the tort of negligence and that the clause would be subject to the reasonableness test under S7 CECO but clearly the SOS (IT) O is a preferable route for Diana to take provided she is a consumer.

(c) It should have been first of all been identified that this was not an attempt to exclude liability for any breach of contract and consequently the main part of the CECO has no application. Answers therefore needed to focus on the Unconscionable Contracts Ordinance (UCO) which can apply to any term in a contract with a consumer which on the facts of (c) Diana clearly was. It should have been emphasised that the burden of proof was on Diana to prove the term was unconscionable S 5(2) and if this was established the court has wide powers e.g. could give her the partial refund she was requesting S5(1). Whether the term could be regarded as unconscionable should then have been considered and in particular it should have been highlighted that the main obstacle for Diana was S6 (2) (a) "*….the court shall not have regard to any unconscionability arising from circumstances that were not reasonably foreseeable at the time the contract was made…*" This surely would cover Covid-19. Some credit was also given for discussion of incorporation and S8 CECO, the one provision not covering in CECO an exclusion clause. Is Top providing "... a contractual performance substantially different from that which was reasonably expected of [it]"?