PCLL Conversion Examination
January 2022
Examiner's Comments
Commercial Law

Part B

Question 1

Answers for this question were in general weaker and, therefore, scored lower than Question 2. The main faults were (a) insufficient discussion of the general rules which applied, (b) omission of discussion on specific points and (c) giving rote answers without application of the legal rules to the facts.

Candidates should have discussed the nature of the charges that arose from the question's facts. The Company gave three charges to (1) James, (2) Smart Bank and (3) Silly Bank. The law is clear that the label or description given to the charge is not conclusive in determining the kind of charge being granted, adopting a substance over form approach through examination of aspects relating to control of the underlying asset by the charge holder. Application of the relevant caselaw to the facts would have shown that James' charge is one in which he likely has little control over the underlying assets (inventory). Therefore, a court would probably construe the charge as a floating charge despite its label as a fixed charge (a point generally discussed well by candidates).

The language in the Smart Bank and Silly Bank charges is identical and can therefore be dealt with collectively. Although the subject matter of their charges is somewhat similar to James' (also relating to the inventory), the clauses in their charges demonstrate robust control over specific / identified assets. They therefore are more likely to be held to be fixed charges per their label. Note that if candidates could provide a cogent argument to the contrary using relevant caselaw, their answers were also given marks as what is being assessed is their understanding. Notwithstanding the flexibility offered, candidates often assumed the charges had to be a floating charge simply because it was over inventory (not recognizing that the inventory here was unusual as they were small in number, high value and relatively easier to track and control) and rarely discussed the core concept of control.

Having identified the existence of floating and fixed charges, candidates have to discuss their key aspects such as priority between the two categories as well as intra-category (generally, fixed over floating and first in time prevails). Registration of the charges as required under the Companies Ordinance must also be discussed (deadline for registration and effect of non-registration). As the floating charge predates the fixed charges of the banks, exceptions to the general rule of fixed charges having priority to floating charges should be mentioned by candidates. There should therefore be a discussion about crystallization of floating charges and whether the floating charge has a negative pledge clause of which the banks have notice of. Candidates generally scored poorly on the discussion here.

Candidates should then wrap up by answering the question through summarizing the order of priority based on their preceding analysis and mentioning that Kelly being unsecured would be last in line (together with other unsecured creditors).

Question 2(a)

Candidates should have identified that the clause is a retention of title ("ROT") clause and discussed its legal effect. ROT clauses are permissible under s.19 and s.21 of the Sale of Goods Ordinance and better answers would also include a discussion of relevant cases as appropriate.

The ROT clause in the question has several elements which candidates must cover in turn. Clause 1.1 is a standard ROT clause that candidates should explain in further detail, in particular, that it does not create a charge with the positive consequences that follow (no requirement of registration to be effective, does not yield to preferential creditors, etc.). Candidates often missed this point. Applying the legal principles to the $800,000 worth of bottles of wine present at Fantastic's bars, Bacchus should fully recover these, noting that the clause is an all monies clause and that full payment has not been made.

Clause 1.2 is an extended ROT clause, and candidates should discuss the relevant caselaw which shows an unwillingness by courts to find a trust (especially where the facts show funds received from the sale of the wines are not put in a ringfenced account and Fantastic can use the funds in the course of his business). As such, Fantastic does not collect the proceeds as Bacchus' trustee, but instead, Fantastic obtains the proceeds as the beneficial owner who is charging these proceeds as security for the debt owed to Bacchus. Thus the charge will be void if not registered. Marks will also be given to candidates who argue that the facts suggest instead that courts will follow the Australian caselaw where a trust is more likely to be found.

Clause 1.3 is an enlarged ROT clause, and again the relevant caselaw must be reviewed and applied by candidates. The general position is that no matter how clear the wording may be in Clause 1.3, title in the cocktails and other bar drinks passed to Fantastic at some stage, and thus a registrable charge is created. Applying to the facts of the question, the cocktails and bar drinks would have belonged to Fantastic from the moment the wines are mixed with the other cocktail components since, from that point, the original identity of the wines is permanently lost and cannot be recovered.

Candidates should end their answer by concluding that unless Bacchus has registered the charge each time it contracts with Fantastic (unlikely to be the case), Clauses 1.2 and 1.3 will generally not be effective to reclaim the $500,000 sale proceeds or the $600,000 worth of cocktails and other bar drinks. In respect of those, Bacchus will rank merely as an unsecured creditor of Fantastic.

Question 2(b)

The question requires a discussion of assignments and how Express' and Newcomer's assignments compare from a priority standpoint. Candidates must refer to s.9 of the Law Amendment and Reform (Consolidation) Ordinance, which sets out the requirements for a legal assignment. When applied to the Express assignment, we can see that it is likely to be compliant with s.9 (assignment of the entire interest, done in writing and signed and with express written notice to Excellent) and therefore held to be a legal assignment. In contrast, Newcomer's assignment is likely to be an equitable assignment only since it does not meet the s.9 requirements (assignment of half interest only and done over a call / verbally).

Candidates will then need to discuss the rules governing priority, in particular, that legal assignments have priority over equitable assignments and as between equitable assignments, the rule in Dearle v Hall applies, which states that generally, the first assignee to give notice to the obligor will have priority, provided that the assignee does not have knowledge of a prior assignment. Applying to the question's facts, Express' legal assignment will have priority over Newcomer's equitable assignment, notwithstanding Newcomer's assignment was agreed earlier. Furthermore, Express also notified Excellent first (6th December vs. 10th December), but this is not a critical point since Express has a legal assignment.

Part C

Question 1

(i) Most answers correctly identified that undue influence was the most likely ground on which the agreement could be rescinded. The better answers identified the fact that as Alan was not a party to the Bert –Mega Bank contract and not acting as Mega Bank's agent, Mega Bank would only be liable for Alan's undue influence under the constructive notice principle established in ROYAL BANK OF SCOTLAND v ETRIDGE (No.2); LI SAU YING v BANK of CHINA. Answers were generally poor in discussing whether the presumption of undue influence existed. It was not enough simply to mention the two requirements –a relationship of trust and confidence and a suspicious transaction. While it was impossible to give a definitive answer on the facts that was no excuse for not making any real attempt to apply the law to the facts

(ii) Most answers correctly identified that there was likely to be a misrepresentation. Alan had misrepresented a fact –the state of his mind as to his intention as to what to do with the money Edgington v Fitzmaurice.The better answers then referred to the need for reliance and the remedies, making the point again that as Alan was not a party to the Bert - Mega Bank contract, Mega Bank would only be liable for Alan's misrepresentation under the constructive notice principle (see above)

(iii) Most answers correctly identified that the increase in the loan without the consent of the guarantor was potentially a material variation of the guarantee agreement and would allow Bert to terminate the guarantee agreement if he did not consent to it HOLME v BRUNSKILL. It was also possibly even a new agreement TRIODAS v DOBBS. However, again the application to the facts was often poor with few considering whether the fact the guarantee agreement had a very wide scope, covering "any loan agreement" meant that the change was simply within the scope of the original agreement. In addition, did the fact that the agreement made the guarantor a principal debtor exclude the material variation rule-did it convert the agreement into an indemnity?

(iv) There were three points to be made. Bert could recover the amount paid to Mega under the indemnity principle – the guarantor can recover from the debtor any sum paid to the creditor by the guarantor as the debtor should be the one ultimately liable to repay the loan. Subrogation - if the entire loan is paid off, Bert can take over any securities Mega Bank obtained from Cedar Ltd and realise them. Finally, as Bert and Alan are co –guarantors then the general rule is that they should contribute equally –Bert had therefore a right to contribution from Alan for half the sum that he had paid to Mega Bank. Most answers identified one or two of the above but few all three.

(v) This was a suspense account clause. It should have been explained that such an account was a way in which Mega Bank could exclude Bert's rights of indemnity , subrogation and prevent Bert proving as a creditor on Cedar's winding up as the money that Bert pays is not going to pay off the loan but is instead being placed in a 'neutral' account at the bank.

Question 2

(i) The first point to be considered was whether the clauses were incorporated? –even though the contract was signed as clause 8 was excluding all loss it would seem unduly harsh, and it would fail the incorporation test unless reasonable steps have been taken to highlight the clause to customers before the contract is made. It should then have been identified that Jill was clearly a consumer S3 UCO, a cruise is the type of service normally supplied to consumers and Jill is not making the contract in the course of a business

As Cl 7 was not an exclusion clause UCO applied. UnderS5 (2) UCO the onus would be on Jill to prove the clause was unconscionable. If found unconscionable the court has wide powers including deleting the clause.

The S6 UCO non-exhaustive list of factors to be taken into account in deciding if there has been unconscionability should have been considered and applied to the facts. Too many answers were rather inflexible, for example, many answers said the facts were identical to Tung Wo Wah v Star Cruises (HK) Ltd where a similar clause was held not to be unconscionable because it was within the legitimate interest of the cruise ship owners to confine claims to one jurisdiction, given that there were passengers on the ship from many different countries. However, few answers made the obvious point that this case was pre-covid. The question concerned 'a cruise to nowhere' so it was highly likely the all the passengers were from Hong Kong so what justification was there to have jurisdiction clause in favour of Singapore! There were also many erroneous references to S7 UCO. Answers failing to appreciate that S7 is concerned with choice of law clauses and not choice of jurisdiction clauses!

Re clause 8, this was clearly an exclusion clause –excluding the remedy of damages S5 (1) (b) CECO. CECO therefore needed to be applied. As the main focus was the food, answers should first of all have made the point that regarding a claim for breach of contract concerning unmerchantable goods (the food) clause 8 would be void as Jill is a consumer S11 (2) or S12 ((2)CECO (if the contract comprised accommodation, entertainment and food it would not be classified as a sale of goods contract but a similar term concerning merchantable quality would be implied at common law and the same rules concerning exclusion clauses would apply under S12 (2) CECO)

Regarding a claim concerning negligence – in the case of a consumer any attempt to exclude liability for any loss would be void if a claim is brought for breach of the implied term of care and skill under S5 SOS (IT) O and Jill is a consumer S8)(1)SOS(IT) O ; re a claim in tort; S7(1) CECO any attempt to exclude liability for negligence concerning personal injury is void S7(1), any other loss being subject to the reasonableness test S 7(2)

(ii) The better answers correctly identified that the main way in which the advice would differ would be that Jack is not a consumer – clearly making the contract in the course of a business (profession) .Therefore UCO does not apply and neither does the SOS (IT) O (this provision does not apply to a contract of service S3 (2)) However re clause 8, regarding a claim in negligence, S7 CECO would still apply and the clause excluding liability for personal injury would still be void. Regarding a claim under SOGO re the food this would be subject to the reasonableness test S11 (3) or S12 (3) CECO.

(iii) Answers should have identified s23 Pawnbroker Ordinance applied, as the loan was not above HK$100,000 and it is an unlawful pledge. There should have been an explanation of s23 -court has wide powers to return the goods to Jill with or without any payment to Fung or to allow Fung to retain ownership. Relevant case law such as Legrand Jewellery v Wo Fung Pawnshop that established the courts are more sympathetic to owners –they have to take reasonable not obsessive care -should have been applied to the facts.