PCLL Conversion Examination
June 2018
Examiner's Comments
Commercial Law

General comments

The standards were mixed but generally leaning on the side of poorer quality answers. Some students showed that they knew the law well or knew it to the level of gaining a pass in the examination, but many of the students had poor answering technique and particularly were poor in applying the law to the facts and the application to answer the issues. There were also some students who were not able to identify all the key legal issues within the question and therefore did not discuss them at all and lost valuable marks. A portion of the students were not able to complete the answers and this may be partly due to mis-management of time during the examination and a failure to be prepared for the examination.

Part A (Sale and Acquisition of Goods)

Part A consisted of two problem type questions. Question one required a detailed examination of the implied terms under the Sale of Goods Ordinance (SOGO) in particular under sections 15, 16 and 2(5) and the remedies available. Question two required students to examine on the passing of risk and passing of property and an application of the *nemo dat* rule and its exceptions.

Question 1

The main focus of the question is based on the quality of the cotton fabric provided by Moon to Sun and whether the cotton in question breached the implied terms in the SOGO and if so, what are the remedies available.

A good answer should first have considered section 15 of the SOGO and consider whether there is a breach of conduction of the description on the 'pure cotton' fabric. The answer should discuss whether having 2% spandex is considered 'pure cotton' in the clothing trade (*Peter Darlington* v *Gosho* case). If the clothing trade determine that having 2% spandex is considered 'pure cotton' there may be no breach of section 15, if not , there would be a breach of the implied term. The answer should note that the quality, i.e. having spandex in the cotton makes the shirt more comfortable to wear and easier to wash and iron are not relevant, as quality is not at concern with section 15 but identity/description.

If it is established the 98% is a mis-identity, the answer should discuss whether the 2% spandex could be considered a minor deviation that could be ignored under the *de minimis* rule. The application of the *de minimis* rule is unlikely as case law seems to confine the application of the rule to slight difference in quantity. Sun will have to prove that the description is a substantial ingredient of the identity of the cotton fabric and not a minor mis-description and that Sun relied on it as one of the reason in making the contract.

A discussion of a breach under section 16(2) of the SOGO on merchantable quality is

also required. The answer should discuss whether the shrinking of the fabric is breach of the merchantable quality and would depend on (s.2(5)) whether the fabric fit all the purposes as it is reasonably expected. An argument may be put forward that as fabric of this kind is not usually washed with high temperature, therefore it was not reasonable expected of the fabric to not shrink when washed in high temperature. A counter-argument can be put forward that the court will take into account whether any instructions or the lack thereof in accompanying the goods (*Wormell* v *RHM Agriculture*) and a failure by Moon to given such instruction regarding the temperature issue could make the goods unmerchantable. In relation to the strength of the fabric, again the fabric need to fit all purposes commonly purchased for, therefore, if strength is a requirement in the higher brand shirt, the lack of it may be breach of section.16(2). In arguing the luxury brand requirement, section 16(3) could also be discussed, but the answer need to identify that Moon may not have actual knowledge of the use and a discussion of whether the use was implied.

The remedies available are the second main part of the question. A good answer should explain whether is the normal remedy available for a breach of an implied condition, being that the seller can end the contract and obtain a refund of the price unless there was acceptance. The answer should state there is acceptance as the fabric had been made into shirts and resold (section 37(1)). It must be noted that under section 37(2), the buyer already had a reasonable opportunity to examine the fabric but decided not to. The remedies available therefore against Moon by Sun will therefore be for damages for a breach of warranty as to quality, damages *prima facie* will be the difference between the value the goods should have had (normally the contract price) and their actual value at the time of delivery.

Question 2

The main focus of the question is on the passing of property and the passing of risk with a discussion on the *Nemo dat quod non habet* exception.

Qu. 2(a)

A good answer should state that usually (section 22 of SOGO) risk of accidental loss lies with the party who has property in the goods. In determining who has property, the answer will need to discuss the difference and whether the goods in question are specific or unascertained goods. The answer should note the absolute rule of section 18 of SOGO that property cannot pass if the goods are unascertained and determine that the goods being unascertained apply s.20 rule 5 of SOGO to determine whether the property had passed. Using the case of *Carlos Federspeil* v *Charles Twigg* the components required to apply s.20 r5 would require the goods to be put in a deliverable state, placed in boxes with GP's names on them and either GP is informed that the goods are ready for collection or delivery is actually made to GP's premises, the facts do not details information of delivery.

Qu. 2(b)

The goods are unascertained goods and the answer needs to discuss the issue of the passing of the risk. The issue would be whether property had passed under S20 R5 and whether the act of placing the goods in boxes with GP's name on it would amount

to unconditional appropriation. In particular UA normally requires some act of irrevocability by the seller and here KP could change its mind and use other goods. If property had not passed again GP would not have to bear the risk under section 22. However if property and risk had passed and the fire was caused by KP's negligence KP would be liable for breach of their bailment obligations to take reasonable care of the goods under the proviso of section 22.

Qu. 2(c)

Identification that the exception in section 22 would apply, if delivery delayed risk is with the party at fault. This proviso is not dependent on whether the goods are specific unascertained or ascertained (*Demby Hamilton* v *Barden*).

Qu. 2 (d)

Explain *Nemo dat quod non habet* and identify the relevant exception – i.e. section 27(1) of SOGO. The answer would need to apply the facts to the exception in section 27(1). First- title must have passed to B. Clearly this has occurred on the facts as A has paid for the goods and is requesting GP to keep goods as a bailee. Therefore GP is clearly a seller in possession that would apply section 27(1) and further required that GP must stay in possession (as the seller) throughout even though there is a change in status from owner (as a seller) to a bailee (*Pacific Motor Auctions* v *Motor Credits*). The answer should discuss whether delivery was in good faith and whether there is constructive delivery by argument that the receipt (even not a document of title) is an acknowledge that GP is holding the goods on behalf of B.

Qu. 2(e)

Pacific Motor Auctions v *Motor Credits* makes it clear that for section 27(1) to work the seller (GP) must be in continuous possession of the goods even though his status may change. Thus if, as here, there was break in the continuity of physical possession then B cannot rely on S27(1) and has no title to the goods.

Part B (Personal Property)

Question 1

The main focus of the question is on the bailment relationship and the duty and rights of between the parties of the relationship and of a lien.

A good answer should define what is a bailment relationship and the nature and elements of a bailment relationship. In discussing the issues, the answer needs to discuss the loss of the handbag, the loss of the ring the damage to the chassis and also the lien that was placed over the car.

<u>Handbag</u>
Whether Ace Repairer is a bailee of the handbag? Ace Repairer is a bailee of the handbag as there was transfer of possession of the bag while the ownership remained with the owner. Further there was consent on both parties in the creation of the

bailment relationship via the conversation Brian and Johnny had regarding the safekeeping of the handbag. The answer should explain Ace Repairer was in the position of a gratuitous bailee and explain the traditional view and modern view of the standard of care (*Coggs* v *Bernard; Houghland* v *RR Low*). The modern view can be further developed in the discussion of the reversal of burden of proof that Ace Repairer will need to show it was not negligence in the care of the handbag – but he forgot to lock his office and therefore is negligent.

Ring

Ace Repairer was not a bailee of the diamond ring as there was not transfer of possession of the ring as it was locked in the glove compartment of the car and Brian was the person who had the key. Further no information was given to Johnny or Ace Repairer regarding the ring being in the car therefore there was no consent in being a bailee by Ace Repairer. As Ace Repairer is not a bail CarKlean cannot be a sub-bailee of the ring and therefore both Ace Repairer and CarKlean are both not liable for the loss of the ring.

Chassis

Whether CarKlean is a sub-bailee of the car? CarKlean took possession of the car with sufficient notice that the car belonged to another and due to long working relationship between AceRepairer and CarKlean and what Johnny might have told CarKlean when engaging them to tow Brian's car, therefore more likely a sub-bailee. Although there is no privity of contract between CarKlean and Brian, CarKlean as sub-bailee owes a duty of care directly to Brian. CarKlean had been negligent while the car was in their possession causing damage to the chassis, however, CarKlean can rely on the exclusion clause in his contract with AceRepairer as against Brian only if Brian consented to it or if AceRepairer had ostensible authority to include the exclusion clause in the sub-bailment (*Pioneer Container, and Morris* v *CW Martin & Sons Ltd*)

Lien

By refusing to release the car until the repair servicing bill is paid, AceRepairer was claiming a lien on the car for payment of repair and service charges as no document was executed, AceRepairer can only claim a common law lien which arises by operation of law. Ace Repairs is entitled to a special lien (as opposed to a general lien) for only the work done on it and therefore is entitled not to release the car until payment for repair and service charges is made. However, as Brian had entrusted the car to Ace Repairs for work to be done on it, Ace Repairs does not have a lien for the additional storage charges.

Question 2

The main focus of the question is fix and floating charges with a discussion of priority of the charges. A good answer need to discuss the bank's fixed charge over book debts, the floating charge, Fong's shareholder's loan and the priority of the charge and securities of the securities.

Bank's fixed charge over book debts

For the fixed charge over the book debts to be effective, there must be sufficient restriction on the chargor dealing with the book debts, i.e. not to further encumber the

book debts; not to dispose of the book debts; pay the collected book debts into a specified bank account; the specified bank account must be a "blocked" account (Re Spectrum Plus)

The answer should note that the Debenture contain a negative pledge clause; a non-alienation clause; a covenant to pay the collected book debts into a specified bank account. However, the fact is that there is no restriction on the chargor's freedom to use the collected book debts, i.e., no "blocked" account therefore the fixed charge over book debts therefore failed to take effect as such and takes effect only as a floating charge over book debts, Re Brightlife

Bank's floating charge
As the charge over book debts can only take effect as a floating charge, in effect, the Bank has only a floating charge over all the assets of the Company and as the floating charge has been timely registered at the Companies Registry, it is valid against the Company's creditors

Peter Fong's security for the Shareholder's Loan
Peter has a valid fixed charge over the office equipment of the Company as the fixed charge has been timely registered at the Companies Registry, it is valid against the Company's creditors

Priority of the charges
The answer should state that a fixed charge has priority over a floating charge, therefore, Fong's fixed charge should have priority over the Bank's floating charge although the former was created later in time however, a subsequent fixed charge is postponed to a prior floating charge if the fixed charge is created with notice of a breach of a negative pledge clause in the prior floating charge (*Wilson v Kelland*). From the facts, Fong knew of the negative pledge clause in the Debenture as he was the director who executed the Debenture and therefore knew the fixed charge created in his favour was in breach of the negative pledge clause in the Debenture, as such Fong's fixed charge is therefore postponed to the Bank's floating charge over all the assets of the company including its office equipment depending on the provisions of the Debenture and the circumstances (the Company ceasing business or goes into a winding-up), the Bank's floating charge may be crystallised and a receiver appointed to enforce the charge against all of the Company's assets

Part C (Consumer Credit and Protection)

The overall answers from the students on the application of the concept of undue influence were better applied and explained.

Question 1

A good answer would include the discussion of Annie's liability to the Bank, in particular the nature and validity of the guarantee together with Benson's liability towards the moneylender and undue influence towards Annie.

Nature and validity of guarantee

A guarantee needs to be supported by consideration but the consideration needs not appear in the document, s14 LARCO as the consideration can be found in the advance by the Bank of the loan amount to the Company. The liability of Annie is that as she has given a guarantee which means that she could be called upon to repay the loan.

Annie's loan

This is an issue to discuss whether Annie is liable for HK$1.5 million or just the original HK$1 million loan under her guarantee. Students should discuss it is more likely that her guarantee was only limited to just HK$1 million and the increase in the loan amount to HK$1.5 million was without Annie's consent which would discharge the guarantee (Holme v Brunskill) as the extension of the repayment period as well as the increase in the loan amount are each a material variation which is prejudicial to Annie and as this was done without Annie's knowledge, her guarantee would highly likely be discharged.

Undue influence

The answer should explain the concept of undue influence and apply the Etridge case. As Benson and Annie were husband and wife, the answer should state that they are not a class 2A relationship (i.e. where there is a presumption of undue influence) and that husband and wife is under class 2B where a relationship of trust and confidence needs be proven.

The answer need to apply the facts that if a trust and confidence relationship is proven by Annie by Benson and that this is a transaction which calls for explanation, then there is a presumption of undue influence the Bank has constructive notice of the undue influence because it is put on inquiry; and it failed to take reasonable steps to ensure Annie fully understands what she is doing a bank is put on inquiry whenever a wife stands as surety for her husband's company's debts having been put on inquiry, the Bank should take the following reasonable steps: informs Annie it requires written confirmation from a solicitor acting for her that she understands what she is doing; provides Annie's solicitor with sufficient financial information; and not to proceed until it receives the written confirmation from Annie's solicitor in these circumstances, if Annie can prove undue influence, she will be able to rescind the guarantee.

Benson's liability towards the moneylender

The answer should discuss whether Golden Opportunity is a money lender within the meaning of that term under the Money Lender's Ordnance and whether Golden Opportunity run the business of lending money? It is arguably not as its main business is import and export and if the lending transactions are far and few between.

If Golden Opportunity is a money lender a license under s7 MLO is required. And if Golden Opportunity is an unlicensed money lender, the loan to Benson and interest cannot be recovered unless the court is satisfied that in all the circumstances, it would be inequitable that Golden Opportunity would not be entitled to recover the loan and interest, s23 Money Lenders' Ordinance. If Golden Opportunity is a money lender, the loan agreement cannot be enforced unless a copy of a note or memorandum is given to the borrower within 7 days of the loan agreement. Under s18 MLO the note or memorandum must contain the particulars set out in s18(2) MLO and given to the borrower and as the fact is clear that a copy of the note was not given to Benson, there

is breach of s.18 MLO. However, the loan is still enforceable if the court is satisfied that in all the circumstances, it would be inequitable that the loan would be held not to be enforceable under s18(3) MLO, e.g., documentary deficiencies does not prejudice the borrower (Strong Offer Investment Ltd v Nyeu Ting Chuang). It should be noted that regardless of whether one is a money lender, an interest rate of over 60% per annum is prohibited under s24 MLO. Here, the interest rate works out to be only 54% per annum.

An interest rate of 54% per annum will however presume the transaction to be extortionate but the court may declare the agreement not to be extortionate if, having regard to all the circumstances, the court is satisfied that such rate is not unreasonable or unfair, s25(3) MLO. If the court does not so declare, the transaction will be considered to be extortionate and liable to reopened so as to do justice to all the parties having regard to all the circumstances, s25(1) MLO.

Question 2

A good answer require a brief discussion of the Bank's liability and more in-depth discussion the Unconscionable Contract Ordinance, the Control of Exemption Clauses Ordinance, the Misrepresentation Ordinance and the Supply of Service (Implied) Terms Ordinance.

Qu. 2(a)

Whether the terms incorporated? Normal rule is that when a document is signed the terms are incorporated (L'Estrange v Graucob). There is authority in Hong Kong, however, that if particular terms are unduly onerous they must be highlighted before the contract is made irrespective of whether the terms are in a signed contract or not (Wing On Properties v Wave Front Enterprises).

<u>Unconscionable Contracts Ordinance</u>
The answer need to explain due to the business-consumer relationship of the service contract, the UCO applies. The answer need to also explain that the onus is on the consumer to prove unconscionability and understand the powers of court if the terms are unconscionable. The answer will need to discuss the criteria court will take into account in considering unconscionability, especially those listed in section 6 of the UCO, which are not exhaustive (*Chang Pui Yin* v *Bank of Singapore*) and the discussion of the doctrine of unconscionabiltiy, which is that the consumer need to should need to prove knowledge of weakness and knowingly taking advantage of the weakness (*Shum Kit Ching* v *Caesar Beauty Centre Ltd, Ming Shiu Chung* v *Ming Shiu Sum*) (doctrine of unconscionability)

<u>Control of Exemption Clauses Ordinance and the Misrepresentation Ordinance</u>
In the discussion of the terms in the question (i) – (iv): the answer will need to answer whether these are exclusion clauses? A good answer can discuss that as Sam is a consumer and that even the clauses are written in a way that does not exclude liability, the substance of the clauses are to 'rewrite history' and in reality exclude liability for negligence and/or misrepresentation. The court would focus on the substance and not the form, as such more likely an exemption clause. The answer should discuss in particular Term (v) that as it attempt to exclude liability for negligence; it is subject to

the reasonableness test under section 7 of CECO.

The discussion of section 4 of the Misrepresentation Ordinance is similar to the above points as referred to for the CECO.

Supply Of Services (Implied Terms) Ordinance

The answer should state that one cannot contract out of section 5 Supply of Services (Implied Terms) Ordinance implied term of care and skill if Sam is a consumer and that section 5 is therefore Sam's best remedy.

Qu. 2(b)

The answer need to state that there would a difference and that the Unconscionable Contracts Ordinance does not apply as Sam's company is not a consumer. As Sam's company is not acting as a consumer this would mean section 8 does not apply and thus any attempt to exclude the implied term of care and skill would now be subject to the section 7 reasonableness test.