**LAW OF SECURITIES AND CREDIT 2014 – SOLUTIONS MAY 2014**

**QUESTION 1**

(a) Compare and contrast

(i) Real and personal security **(5 marks)**

(ii) **ANSWER:** *(i) real security means a security in an asset, whether of the debtor or of a third party. While personal security is the form of a personal undertaking which reinforces the debtor’s primary undertaking to give payment or other performance.*

*(ii) Under fixed charge, the asset is appropriated to satisfaction of the debt immediately or upon the debtor acquiring an interest in it. While under a floating charge, the appropriation is deferred.*

(b) Mention **five** characteristics of consensual security interest? **(10 marks)**

**ANSWER:**  *these are:*

*(i) It is a right given by a debtor to a creditor in an asset*

*(ii) The asset is given for the purposes of securing an obligation*

*(iii) The right is by way of grant of an interest in the debtor’s asset, not by way of reservation of title to the creditor*

*(iv) The asset is given in security only, not by way of outright transfer*

*(v) The agreement restricts the debtor’s right to dispose of the asset free from the security interest.*

**QUESTION 2:**

(a) Under what **five** conditions will a security interest be deemed to be equitable? **(10 marks)**

**ANSWER:**  *under the following:*

*(i)if it relates to future property*

*(ii) If there is no transfer or agreement for transfer at all, merely a charge*

*(iii) If there is no present transfer, merely an agreement for transfer or a declaration of trust by the debtor*

*(iv) If the transfer is not made in accordance with the formal requirements for the transfer of legal title*

*(v) If the transfer is* made *not to the creditor but a third party as trustee for the creditor.*

(b) Why is a ‘received for shipment’ bill not be accepted under a CIF Contract by a buyer? **(5 marks)**

**ANSWER:** *a ‘received for shipment bill is not to be accepted by a buyer since such a bill furnishes no proof of the date of shipment, no proof of the loading on any ship, it transfers risk before the goods have in fact been loaded and it affects payment where payment is against documents.*

**QUESTION 3:**

Write brief notes on the following forms of security:

i. Nature of pledge.  **(5 marks)**

*The pledge is the actual or constructive delivery of possession of the asset to the creditor by way of security. As possessor, the pledgee enjoys a ‘special property’ or limited legal interest in the asset, but ownership remains with the pledgor. The pledgee’s interest goes beyond a mere right to detain the asset. It encompasses :*

1. Nature of a charge. **(5 marks)**

*Atkin L.J in National Provincial and Union Bank of England v Charnely; said*

*‘ … where in a transaction for value both parties evidence an intention that property existing or future, shall be made available as security for the payment of a debt, and that the creditor shall have a present right to have it made available, there is a charge, even though the present legal right which is contemplated can only be enforced at some future date, and though the creditor gets no legal right of property, either absolute or special , or any legal right to possession, but only gets a right to have the security made available by an order of the Court. If those conditions exist I think there is a charge.’.*

*Thus a charge does not depend on either the delivery of possession or the transfer of ownership, but represents an agreement between creditor and debtor by which a particular asset or class of assets is appropriated to the satisfaction of the debt, so that the creditor is entitled to look to the asset and its proceeds to discharge the indebtedness.*

1. Contractual lien.  **(5 marks)**

*Whilst a possessory lien is generally described as a right conferred by law to detain goods until money owed to the detainee has been paid, a possessory lien may also be created by contract. It differs from a pledge in that the goods are deposited not for the purpose of security but for some other purpose e.g. custody or repair.*

**QUESTION 4:**

(a) Mention **three** documents that a banker’s documentary credit will call for, similar to those used in CIF and FOB International sales contracts? **(3 marks)**

**ANSWER:** *These are:*

*(i) Clean bill of lading*

*(ii) Policy of insurance*

*(iii) Invoice*

(b) Discuss any **four** terms of a valid guarantee? **(12 marks)**

**ANSWER:**

*Any of the following: (pg 127)*

*(i) consideration clause: Like any other contract, a guarantee requires consideration if it to be deemed valid. This is in form of some benefit or promise given by the lender to the guarantor in return for the guarantee. Usually the consideration for guarantee is the agreement of the lender to make the loan to the borrower if the guarantor agrees to give his guarantee.*

*(ii) Guaranteed sums: The guarantee should clarify what is guaranteed e.g all liabilities or those under a particular agreement.*

*(iii) Limited amount of guarantees: The liability of a guarantor may be limited to a specific sum. This may be because the guarantor is* prevented *by law or its constitution from issuing unlimited guarantees or the guarantee is not of the whole sum of the loan.*

*(vi) Demand: The guarantee should be payable on demand so as to establish clearly that the statute of limitations runs from the demand, not the date of the giving of the guarantee. Multiple demands should expressly be allowed, for example, to cover future liabilities not caught by the initial demand.*

**SECTION B (60 MARKS)**

**QUESTION 5:**

(a) Under letters of credit, outline the autonomous contracts that exist between or among the parties of the letters of credit? **(16 marks)**

**ANSWER:**

*There are four autonomous contracts that are formed. The underlying contract for the sale of goods to which the only parties are the buyer and seller. Secondly, there is a contract between the buyer and the issuing bank under which the latter agrees to issue the credit and either itself or through a confirming bank notify the credit to the seller and to make payments to or to the order of the seller against presentation of stipulated documents. The buyer agrees to reimburse the stipulated the issuing bank for payments made under the credit. For such reimbursement, the stipulated documents, if they include a document of title such as a bill of lading, constitute security available to the issuing bank. Thirdly, if payment is to be made through a confirming bank, the contract between issuing bank, the contract between issuing bank and the confirming bank authorising and requiring the latter to make such payments and to remit the stipulated documents to the issuing bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank for payments made under the credit. Fourthly, the contract between confirming bank and the seller under which the confirming bank undertakes to pay to the or seller, accept, or negotiate without recourse to drawer of bills of exchange drawn by him, up to the amount of the credit against presentation of the stipulated documents.*

(b) What is the importance of the clean-shipped bill of lading as regards the bank and the buyer? **(4 marks)**

**ANSWER:**

*The clean-shipped bill of lading provides best evidence that the seller has performed his contractual obligations. Under CIF or FOB contract, the seller is required to ship the goods , and not merely to deliver them into the charge if the carrier as opposed to received for shipment bill of lading. The reason for the requirement that the bill of lading be clean is to provide evidence that the goods have been shipped in apparent good order and condition. Further, the clean shipped bill of lading, transfers contractual rights. Under the contract of carriage to the holder for the time being of the bill of lading. Only the shipped bill of lading can perform this function.*

**QUESTION 6:**

(a) B Banking Limited has provided a loan to Dzuwa Investments. The security for the loan has been provided by a floating charge over the assets of Dzuwa Investment. Last year, Dzuwa Investment also obtained a loan from Tidziwe Bank Limited that was secured by a fixed charge over the assets of Dzuwa Investment. Dzuwa Investment is now under the liquidation.

(i) Differentiate between a floating and a *fixed* charge? **(4 marks)**

**ANSWER:** *A fixed charge is a kind of security where the asset is appropriated to satisfaction of the debt immediately or upon the debtor acquiring an interest in it. While under a floating charge, the appropriation is deferred, and the charge rights are not attached to specific assets but to shifting fund of assets.*

(ii) Assuming both B Banking Limited and Tidziwe Bank Limited wants to enforce their respective securities after liquidation, which one will have priority and why?

**(4 marks)**

**ANSWER:** *In this particular case, Tidziwe Bank Limited will have priority over B Banking Limited since their loan was secured by a fixed charge over Dzuwa Investment’s assets. It is a legal principle that fixed charges rank higher than floating charges.*

(iii) Before liquidation, B Banking Limited had written Dzuwa Investment directing them on what to do with the assets so that they realise more profits as to enable them settle the loan. Dzuwa Investment is arguing that as per rules governing floating charges, they are at liberty to deal with their assets, as the company is a going concern. Advise both parties. **(6 marks)**

**ANSWER:** *The essence of a floating charge is the liberty given to the debtor company, in this present case, Dzuwa Investment, to manage and deal with the assets compromising the security in the ordinary course of business. In taking a floating charge, the creditor, in this case, B Banking Limited binds himself not to intervene in the handling of the assets so long as the company runs under its own steam as a going concern. Therefore, the actions of B Banking Limited in directing the company on what to do with its assets is not in tanderm with the rules governing floating charges. B Banking Limited must not interfere in the operations of Dzuwa Investment until something happens that will crystallise the floating charge.*

(iv) From the facts, under what circumstances will the floating charge crystallise?

**(2 marks)**

**ANSWER:** *Since the company is now under liquidation, this means that the floating charge will now crystallise. B Banking Limited can now enforce the security since now there has been an intervention in the business of Dzuwa Investment.*

(iv) Mention **two** actions that are to be taken by a debenture holder in order to effectively crystallise a floating charge? **(4 marks)**

**ANSWER:** *These are: (i) intervention of a debenture holder be done with the intention of converting the charge into a fixed charge.*

*(ii) the intervention must be authorised by the express or implied terms of the debenture*

*(iii) or the intervention must divest the company of de jure control of the assets.*

**QUESTION 7:**

Joseph has bought a Nissan X-Trail from Local Automotives Company in Tokyo, Japan. The company has emailed Joseph the contract and an invoice for $2000. Joseph has paid the amount through his bank in Malawi. The company has now emailed Joseph a bill of lading, indicating that the carrier of the vehicle is Casa Blanca Vessel scheduled to dock at Dar es Salam port in Tanzania on 2nd March. The vehicle arrived on 28th March.

(a) Define bill of lading and its importance to Joseph in the above commercial transaction ? **(6 marks)**

**ANSWER:** *A bill of lading is a document issued by or on behalf of a carrier of goods by sea to person usually known as the shipper with whom he has contracted for the carriage of the goods. The advantage of this document to Joseph is that it is a document of title to the vehicle that he has bought. It is also evidence of a contract of carriage and that it is evidence that the vehicle has been received by the carrier, Casa Blanca Vessel. Finally, the bill of lading is evidence that the vehicle was shipped in apparent good order and condition.*

(b) While in transit, the vehicle got damaged. Joseph intends to sue the carrier for breach of contract. Advise Joseph. **(4 marks)**

**ANSWER:** *In these circumstances, Joseph can not sue the carrier since he is not a party to the contract between the carrier and the seller of the vehicle. Joseph can only sue in negligence on the basis that he had possessory rights in the goods.*

(c) What are the remedies available to Joseph for the late arrival of the vehicle in Tanzania? **(3 marks)**

**ANSWER:** *Joseph is at liberty to sue for damages or deny the delivery of the vehicle if no explanation was given. However, suits are very rare in these circumstances due to international barriers.*

(d) Joseph sent Tadala to collect the vehicle from Dar es salam. Tadala forgot to carry with him the bill of lading. The carrier has refused to deliver the vehicle to Tadala in the absence of the bill of lading despite him taking all the details of the car and its pictures. Advise Tadala? **(3 marks)**

**ANSWER:** *The carrier was very correct in denying Tadala delivery of the vehicle since a bill of lading is evidence of ownership. In the absence of the same, if the carrier delivers, he will be liable in conversion and breach of contract. So the carrier was correct. Tadala was to take with him the bill of lading.*

(e) State two reasons why a bill of lading does not qualify to be a negotiable instrument? **(4 marks)**

**ANSWER:** *These are:*

*(i) The transferee of a bill of lading only acquires limited interest.*

*(ii) The principles applicable to the transfer of a bill of exchange are not applicable to a bill of lading. A bill of lading is merely transferable not negotiab*le.

**QUESTION 8**

(a) The Agricultural Credits Act lists four categories of events causing a floating charge to become fixed. Mention **four** of those categories? **(4 marks)**

**ANSWER:** *These are:*

*(i) The making of a bankruptcy order against the farmer*

*(ii) The death of the farmer*

*(iii) The dissolution of the partnership whether the property charged is partnership property*

*(iv) Notice in writing to that effect by the bank on the happening of any event that by virtue of the charge confers on the bank a right to give such notice.*

(b) Under Companies Act, mention **five** particulars that are to be filed in order to constitute notice to third parties who intend to make a search? **(5 marks)**

**ANSWER:** *These are:*

*(i) The date and description of the instrument creating the charge*

*(ii) The name of the company and particulars of the persons entitled to the charge*

*(iii) The amount secured by it*

*(iv) Short particulars of the property charged*

*(v) Particulars if any commission paid in connection with the transaction.*

(c**) Explain the following*: (please provide the answers)***

(i) The autonomy of the credit **(5 marks)**

(ii) The doctrine of strict performance**(6 marks)**

**-THE END-**