**LAW OF SECURITY: 2016 SOLUTIONS**

**SECTION A:**

**QUESTION ONE:**

1. Explain **three** forms of security known to law? **(6 marks)**
2. Describe in detail the **two** stage test used by the courts in determining whether a charge is fixed or floating? **(9 marks)**

**RESPONSES:**

1. These are:

* The Mortgage: which is a security transfer of ownership
* The Pledge which creates a limited legal interest by the delivery of possession
* Contractual lien where the creditor’s possession was acquired otherwise than for the purpose of security, as where goods are deposited for repair and the repairer then asserts a lien for unpaid repair charges.

1. At the first stage, it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. it is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument is to grant the company rightsin respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it. See the case of Agnew-V-Inland Revenue Commissioners as per Lord Millet.

**QUESTION TWO:**

1. In order for security interest to attach otherwise than by operation of law, conditions need to co-exist. Discuss the following **three** conditions
2. the asset to be given in security must be identifiable **(3 marks)**
3. the debtor must have an interest in the asset  **(3 marks)**
4. there must be an agreement for security conforming to statutory formalities **(3 marks)**
5. contractual conditions for attachment must have been fulfilled **(3 marks)**
6. Mention **three** categories of goods from where a pledge may be taken?

**RESPONSES:**

1. **(i)** The asset to be given in security must either be identified by the security agreement, or in the case of fungibles ascertained subsequently as the result of an unconditional act of appropriation of the asset to the agreement. Rules of identification are the same as those that apply in contract of sale of goods.

**(ii)** The debtor must have a present interest in the asset intended to comprise the security or altenatively has by virtue of some exception to the nemo dat rule, a present power to dispose of the asset or grant a charge over it. The debtor cannot normally give a valid security over someone’s asset, save for authorised agents and where the owner of the asset holds out the debtor as having a power of disposal.

**(iii)** mere action by the creditor against the asset does not suffice to give him a security interest. There must be an agreement to create a security interest. The agreement may be to create a pledge or a mortgage or an equitable charge where there is a mere incumbrance on the debtor’s continuing ownership.

**(iV)** attachment does not take place unless the conditions for attachment specified in the security agreement have been fulfilled. This does not however, imply that the parties may, consistently with the equitable rules for creation of a security interest by agreement, stipulate any event they choose as producing attachment. On the contrary, where the designated event is a mere contingency, then unless the contingency is simply the debtor’s acquisition of an interest in the asset, even on the occurence of the contingency.

1. These are:

* bills of lading and other documents of title to goods
* negotiable instruments
* negotiable securities

**QUESTION THREE:**

1. Discuss rights acquired by an assignee in assignment of security? **(9 marks)**
2. State **three** circumstances that will make a security interest legal? **(6 marks)**

**RESPONSES:**

1. The assignee of a receivable takes subject to equities ie to all defences available by the debtor against the assignor and all rights of set off open to the debtor against the assignor in respect of claims arising prior to the debtor’s receipt of notice of assignment.

Secondly, the assignor is trustee of sums received by him. Where the debtor, whether or not has notice of assignment, makes payment of a receivable to the assignor, the latter holds the sum received, whether in cash or in the form of a cheque or other instrument, on trust for the assignee. In the latter case, wrongful appropriation of the instrument constitutes a conversion with an an alternative liability to account for the proceeds of the instrument in action for money had and received.

Thirdly, tracing receivables into proceeds. A security interest in receivables automatically attaches to any proceeds received in exchange for them, except where the assignor has been given freedom to deal with the receivables and to mingle the proceeds with his own moneys. So if the receivables are disposed of by the assignor without the assignee’s authority, or if it is evident that the assignor is in any event required to keep collections and other proceeds as a separate fund for the assignee, the latter’s security interest will automatically attach to them, whether they result from collection or sale by the assignor and whether they take the form of cash, instruments, other receivables, goods, land or indeed anything given in exchange. This tracing right is available against the assignee’s trustee in bankruptcy or liquidator.

1. These are:

* must be a present transfer of an existing asset
* the transfer must be to the creditor himself and must be made in conformity with any statutory formalities
* the transferor’s title to the asset must be a legal title, not merely an equitable interest.

**QUESTION FOUR:**

1. What are the **two** technical differences between joint liability and several liability as applied in guarantees? **(6 marks)**
2. Write short notes on the following:
3. Delivery order **(3 marks)**
4. mates’s receipt **(3 marks)**
5. book debt **(3 marks)**

**RESPONSES:**

1. These are:
2. when an individual guarantor is jointly bound with a co-guarantor, the guarantor’s liability terminates with his death. The survivor becomes liable. But where his liability is joint and several, his liability passes to his estate.
3. where the liability is joint there is only one clause of action. this means that although each guarantor is liable for the full amount, the lender can only bring one suit. He can bring an action against all the joint guarantors or he can bring an action against one of them. But if he brings an action against one of them and the judgment is unsatisfied, he cannot afterwards bring an action against the others. On the other hand several liability results in there being as many causes of acations as there are obligors.
4. (i) Delivery Order: A delivery order is an order addressed to a person in possession of the goods ordering him to deliver them to the holder of the order. A delivery order is issued at the port of destination in exchange for an original indorsed bill of lading. In practice, they are a token of authority to receive in possession. It is prepared subject to the terms and conditions contained in the carrier’s bill of lading. It must not contain any reservations or clauses other than those in the bill.
5. Mate’s receipt: When the shipper delivers goods to the carrier and the goods are received by an agent of the shipowner for shipment the agent gives the shipper a receipt known as a mate’s receipt. when the goods are shipped the mate receipt is exchanged for signed bills of lading. The shipper delivers the signed bills of lading to the shipper.
6. Book Debt: A book debt is a debt arising in the course of a trader’s business which is of such a kind that it would ordinarily be entered in a trader’s books or the modern equivalent of books, whether in fact so entered or not. It is generally considered that money deposited by a trader with his bank does not give rise to a book debt, since although the banker is the trader’s debtor the debt does not arise in the way of trade but is merely a consequence of the deposit of surplus funds.

**SECTION B:**

**QUESTION FIVE:**

Mr Phiri has obtained a loan facility from Zao Bank pledging his assets in form of a floating charge. However, Mr Phiri does not know under what circumstances will the charge crystallise. Please advise him on effective interventions required to crystallise the charge? **(20 marks)**

**RESPONSE:**

One of the interventions is taking possession. If the debenture holder ( Zao Bank) lawfully takes possession of the charged assets ( of Mr Phiri as pledged) this crystallises the charge, for it ends the company’s control. It is not necessary that he should seize all the assets at once, which in most cases would be impracticable. The debenture holder may take possession of part in the name of the whole, whether the assets consist of land or goods.

Order of possession or sale in favour of the debenture holder, in this case, Zao Bank. Though there appears no decision directly on the point, it seems clear that an order requiring the company (Mr Phiri) to deliver up to the debenture holder (Zao Bank) possession of land or goods crystallises the charge, for the effectof such an order is to terminate the company’s right ( Mr Phiri’s right) to hold and deal with the land or goods in question. The same applies to an order for sale.

Appointment of receiver out of court. The apppintment of an administrative receiver by the debenture holder out of court has long been the most common method of crystallising a floating charge and is well established as effective for that purpose. Crystallisation does not depend on the receiver taking possession of the assets; the commencement of the receiver’s appointment is all that is required, for by executing a debenture which authorises the debenture holder to appoint a receiver in stated events the company implicitly recognises that its right to continuemanaging its business is terminated upon such appointment.

Appointment of administrator out of court by qualifying chargeholder. The power of a qualifying floating charge holder to appoint an administrator replaces the power to appoint an administrative receiver. It is therefore clear the exercise of this power will crystallise the floating charge.

Appointmnt of a receiver by the court. Where at the instance of the debenture holder a receiver is appointed by the court, the floating charge crystallises when such an appointment takes effect.

**QUESTION SIX:**

1. Define and illustrate how a bill of lading operates in commercial transactions? **(10 marks)**
2. Mention **five** duties a buyer under CIF Contract ? **(10 marks)**

**RESPONSE:**

1. A bill of lading is a document issued by or on behalf of a carrier of goods by sea to a person, usually known as the shipper, with whom he has contracted for the carriage of the goods. The bill will provide for the delivery of the goods at the agreed destination either to a named person or to such a person or his order or assigns or simply to order or assigns, in which case it is the shipper who is entitled to give the order or to bearer. Section 1 of the Bills of Lading Act 1855, defines the relationship between shipper, carrier and consignee. The Section stipulates that every consignee of goods, named in a bill of lading, and every endorsee of a bill of lading, to whom the property in the goods therein mentioned shall pass or by reason of such consignment or endorsement shall have transferred to and vested in him all rights of suit, and be subject to the same liabilities in respect of such goods as if the contract contained in the bill of lading had been made with himself.

The principal purpose of the bill of lading document i s to enable the owner of the goods, to which it relates, to dispose of them rapidly although the goods are not in his hands but are in the custody of a carrier. When goods are in transit in the oceans say from London to Dar es salam to Blantyre, and the bill of lading has been faxed to Candlex, the buyer in Blantyre Candlex becomes the owner of the goods. The bill of lading representing the goods enables Candlex to pledge the goods with its bank, say Natwest Bank. Candlex may resell the goods to any customer. In essence, bills of lading facilitate international commerce and provide a source of financing.

1. These are:

* accept documents when tendered by the seller, if they are in conformity with the contract of sale, and pay the price.
* receive the goods at the agreed port of destination and bear with the exception of the freight and marine insurance, the cost and charges incurred in respect of the goods in the course of their transit by sea until they arrive at the port of destination.
* bear all risks of the goods from time to time when they have effectively passed the ship’srail at the port of shipment.
* pay for all customs duties as well and any other costs connected with importation
* procure and provide at his own risk and expense any import licence or permit
* If he has the obligation to choose the port of destination, and he fails to give instructions in time, bear the additional costs thereby incurred and all risks of the goods from the date of the expiration of the period fixed for shipment.

**QUESTION SEVEN:**

1. Outline main features of combined transport and problems arising out of combined transport document? **(12 marks)**
2. State **four** legal problems associated with container transport? **( 8 marks)**

**RESPONSES:**

1. The main features of the combined transport are that goods are out into a container at an inland port. Secondly, the container is then sealed and carried by road or rail to sea port and put on a board ship. Thirdly, at the end of the sea transit the container is unloaded and carried by road or rail to an inland destination where the container is opened and the goods are delivered to or made available for collection by the consignee. Fourthly, under combined transport the carrier accepts through liability as a principal for the contracts that he makes with sub contractors.

Problems arising out of combined transport document are that the carriage may be governed at different stages by different legal reguirements under regional or international conventions on carriage. Carriage by sea is regulated by Hague Visby Rules, Carriage by air by the Warsaw Convention, Carriage by road by the CMR Convention and Carriage by rail by the CIM Convention. Secondly, combined transport document may lack the characteristics of a bill of lading as a document of title capable of transfering constructive possession. Thirdly, it may be incapable of transfering contractual rights and liabilities by indorsement.

1. These are:

* The point at which risk passes is difficult to determine. If the container transport is contemplated the critical point is the place at which the carrier of his agent takes charge of the goods. This may be container freight station inland.
* Documents used in container transport are different from those customary in system of carriage. No uniform practice has developed.
* Container bills of lading lack the characteristics of the bills of lading issued under the 1855 Act.
* the door to door container should properly be sealed by the owners of the collecting vehicle. The exporter should ensure this because if there is a claim for shortage or damage to the cargo carried in the container, the state of the seal may allow some conclusion of what may have happened. If this is broken it would indicate that the cargo was tampered with.

**QUESTION EIGHT:**

1. Explain in detail terms of a guarantee? **(10 marks)**
2. Describe the following legal checks as they apply in guarantees:
3. corporate powers and benefit? **(4 marks)**
4. contractual restrictions? **(3 marks)**
5. Financial assistance? **(3 marks)**

**RESPONSES:**

1. Like any other contract, a valid guarantee requires consideration. The consideration is the agreement of the lender to make the loan to the borrrower if the guarantor agrees to give his guarantee. It has to be mentioned that even in guarantees, past consideration is not good consideration at all. Hence if a gurantee expressed to be granted in consideration of the lender making the loan, is given after the loan has been made or after the lender is already committed, the consideration is past and the gurantee will lapse for failure of consideration.

Secondly, every guarantee should have aguaranteed sums. The guarantee should clarify what is guaranteed, for instance, all liabilities or those under a particular agreement.

Demand, which is, every guarantee should be payable on demand so as to establish clearly that the statute of limitations runs from demand, not the date of the giving of gurantee. Multiple demands should be expressly allowed.

Limited amount gurantees, where the liability of gurantor my be limited to a specific sum. This may be because the gurantor is prevented by law or its constitution from issuing unlimited guarantees or the guarantee is not of the whole sum of the loan.

First demand guarantees, where a provision that the guarantee is payable on firdt demand approximates the guarantee to a letter of credit. Under a letter of credit the beneficiary is in the absence of fraud, entitled to draw on the credit upon presenting the documents called for by the credit. The issuer of the credit must pay regardless of a dispute in relation to the underlying transaction.

(b)(i) Corporate powers and benefit: Like any other corporate transaction, a legal entity must have corporate power to give a guarantee. A perennial though dwindling problem in relation to corporate guarantees arises from the rule, historically applicable in most jurisdictions, whereby it is ultra vires a corporation and a fraud upon its shareholders and creditors if it gives away its assets without receiving some benefit in return. If the guarantee is called, the company is paying the debt of a third party It is said that charity has no place at board meetings. Where there are minority shareholders in a subsidiary which is called upon to guarantee the parent’s debt, a local corporate concept that the parent has a fiduciary duty to the minority not to operate the subsidiary solely in the selfish interests if the parent may come into play. But this rule has been eroded in commercial jurisdictions in keeping with the general tendency to limit the scope of the ultra vires doctrine, which has little to commend it.

(ii) Contractual Restrictions: There may be limits on guarantees in the loan agreements, of the guarantor or its parent. Financial ratios might be breached. A breach might trigger an acceleration by the lender where a credit agreement covenant is broken or expose the creditor taking the guarantee to the tort of inducing a breach of contract if the creditor knew the breach.

(iii)Financial Assistance: One should check whether the guarantee is prohibited financial assistance for the purpose of the company’s shares within the Companies Act, as where for example a company guarantees a loan made to another company to buy the guaranteeing company’s shares in a take-over.

-**THE END-**