

THE LAW REFORM COMMISSION OF HONG KONG

Report

Contracts for the Supply of Goods

Executive Summary

1. Background

1.1 In day to day life, goods can be supplied under a number of different types of contract:

- (a) sale;
- (b) hire – for a specific occasion in return for a single payment (such as the hiring of videotapes, cars and clothing), or over longer periods in return for the payment of a rental payable daily, weekly, monthly or yearly (such as the hiring of televisions, photocopying machines, and plant and machinery);
- (c) hire purchase – in respect not only of consumer goods such as electrical appliances, motor vehicles, etc, but also of commercial goods such as plant and machinery;
- (d) contracts for work and materials (the "materials" part) – in respect of custom-made furniture, decoration work for residential properties, etc.

1.2 The Sale of Goods Ordinance (Cap 26) governs contracts for the sale of goods. Under Cap 26, a supplier of goods under a contract for the sale of goods (ie a seller) makes the following statutory undertakings:

- (a) that he has the right to sell the goods, and that the buyer can enjoy quiet possession of the goods;
- (b) where the contract is a sale by description, that the goods correspond with the description;
- (c) that the goods are of merchantable quality, and fit for the particular purpose for acquiring the goods which the buyer has made known to the seller;
- (d) where the contract is a sale by sample, that the bulk corresponds with the sample in quality.

1.3 However, these implied undertakings under Cap 26 apply to contracts of sale only, but not to other contracts for the supply of goods. Case law instead of legislation governs these kinds of supply of goods. The case law is, however, unclear and uncertain as to whether there are such implied undertakings, and, if there are, what is their exact scope. Although academics and the courts have argued that similar undertakings should be implied in other kinds of contracts for the supply of goods, there remain significant gaps in the law.

2. Preface

2.1 The preface sets out the background, the terms of reference, the consultation process, the layout of the report and acknowledgements.

3. Chapter 1

3.1 This chapter examines the existing statutory provisions in Cap 26 and the Control of Exemption Clauses Ordinance (Cap 71). The following arguments are discussed in favour of new legislation to make provision for the undertakings to be implied in respect of suppliers of goods in contracts other than sale:

- (a) as a pre-requisite for applying the existing protection under Cap 71

Cap 71 regulates exemption clauses not only in contracts of sale, but also in other types of contract for the supply of goods. Section 12 limits the ability of the supplier to exclude or restrict his liability for breach of obligations "arising by implication of law" from the nature of the contract. It is obviously a pre-requisite for such protection that obligations which arise by implication of law can be clearly identified. There is therefore a need to set out the supplier's obligations in clear statutory form

- (b) for certainty and clarity of the law

The existing case law is far from clear as to the precise nature and effect of the supplier's obligations under contracts for supply of goods. There is a need to clarify the position through new legislation.

- (c) for consistency of the law

Lord Upjohn once stated that if the law treated implied obligations differently in contracts of sale from those in contracts for work and materials, it would be "*most unsatisfactory, illogical, and indeed a severe blow to any idea of a coherent system of common law....*" The implied obligations of suppliers should be consistent for all types of contract for the supply of goods.

- (d) to reflect reasonable expectations as to the nature of the implied obligations

It is reasonable that persons supplied with goods under contracts other than sale should expect to be protected by implied obligations similar to those in contracts of sale. By the same token, as the implied obligations in contracts of sale are provided in Cap 26, persons acquiring goods through other types of contracts for the supply of goods would also expect to find the relevant implied obligations set out in a statute. The fact that goods are now commonly supplied to

consumers through transactions other than sale adds to the desirability of clear legislative provisions.

- (e) experience in other jurisdictions

Other jurisdictions have already made legislative provision for the implied obligations of suppliers. A table comparing the statutory implied obligations of suppliers in contracts for the sale and supply of goods in a number of different jurisdictions is at Annex 3 of the report.

Recommendation 1

Suppliers' implied obligations in contracts for the supply of goods (other than sale) should be put into a statute (to be referred to as the "Recommended Legislation").

4. Chapter 2

4.1 This chapter explains the expression "contracts for the supply of goods". The expression covers three types of contracts: contracts for the transfer of property in goods, contracts of hire and hire purchase agreements. The elements involved in each type of contract are discussed.

Recommendation 2

A contract for the transfer of property in goods should be defined to mean a contract under which a person transfers or agrees to transfer to another the property in goods, excluding contracts of sale, hire purchase, etc.

Recommendation 3

A contract of hire should be defined to mean a contract under which a person hires out or agrees to hire out goods to another.

Recommendation 4

A hire purchase agreement should be defined to mean an agreement by which goods are supplied on hire and the hirer has the right, but not an obligation, to buy the goods.

Recommendation 5

The definition of "goods" should follow that in Cap 26.

5. Chapters 3 to 6

5.1 These chapters discuss four types of implied undertakings which should be imposed on suppliers in respect of each of the three kinds of contracts for the supply of goods described in chapter 2. The Commission recommends that a supplier under a contract for the supply of goods should be subject to the same implied undertakings as apply to a supplier under a contract of sale. These are:

(a) chapter 3 - implied terms about title

- an implied condition that a supplier (i) in the case of a contract for the transfer of property in goods, has a right to transfer the property of the goods; (ii) in the case of a contract of hire, has a right to hire out the goods; (iii) in the case of a hire purchase agreement, will have a right to sell the goods when the property is to pass;
- implied warranties that the goods are free from undisclosed encumbrances and the customer can enjoy quiet possession;

(See Recommendation 6 in respect of contracts for the transfer of property in goods; Recommendation 7 in respect of contracts of hire; and Recommendation 8 in respect of hire purchase agreements.)

(b) chapter 4 - correspondence with description

- an implied condition that the goods correspond with the description if the supply is by description;
- if the supply is both by description and by sample, an implied condition that the bulk of the goods correspond with both the description and the sample;

(See Recommendation 9 in respect of contracts for the transfer of property in goods; Recommendation 10 in respect of contracts of hire; and Recommendation 11 in respect of hire purchase agreements.)

(c) chapter 5 – implied terms about quality or fitness

- an implied condition that the goods are of satisfactory quality;
- where a customer has made known to the supplier any particular purpose for acquiring the goods, an implied condition that the goods are reasonably fit for that purpose;

(See Recommendation 12 in respect of contracts for the transfer of property in goods; Recommendation 13 in respect of contracts of hire; and Recommendation 14 in respect of hire purchase agreements.)

(d) chapter 6 – supply by sample

- an implied condition that the bulk shall correspond with the sample in quality;
- an implied condition that a buyer shall have a reasonable opportunity of comparing the bulk with the sample;
- an implied condition that the goods shall be free from any defect rendering them unsatisfactory which is not apparent on a reasonable examination of the sample;

(See Recommendation 15 in respect of contracts for the transfer of property in goods; Recommendation 16 in respect of contracts of hire; and Recommendation 17 in respect of hire purchase agreements.)

6. Chapter 7

6.1 This chapter discusses the remedies for breaches of the implied terms recommended in chapters 3 to 6. It first examines the existing remedies for breaches of the implied obligations classified as “conditions” and “warranties” under Cap 26. A breach of a “condition” entitles the innocent party, if he so chooses, to treat himself as discharged from any obligation to fulfil the contract, and in any event to claim damages for loss caused by the breach. A breach of a “warranty” does not entitle the innocent party to treat himself as discharged, but he may claim damages.

6.2 This chapter also discusses case law developments in relation to intermediate/innominate terms. The law must have regard to the nature and gravity of the breach before determining whether the innocent party is entitled to repudiate the contract for a breach of a term of this character.

6.3 The report notes that the classification of contract terms into “conditions” and “warranties” has long been considered too inflexible. The strictness of the classification causes injustice in cases where, for instance, a contract is repudiated because of slight defects in the goods. Having considered a number of options, the Commission concluded that to do away with the classification altogether would be too drastic a step.

Recommendation 18

In the Recommended Legislation, the implied terms recommended in chapters 3 to 6 should be classified as “conditions” and “warranties” according to the approach adopted in Cap 26.

6.4 The report draws a distinction between the interests of consumers and non-consumers, and proposes that the right of non-consumers to repudiate a contract should be more limited than that of consumers. The report also points out that consumers acquire goods for their own use and not for profit. A reduction in price or compensation for defective goods will not necessarily satisfy the needs of a consumer since he acquires the goods because of his wish to have goods in working

condition for his own consumption. In addition, it is usually difficult for a consumer to dispose of defective goods, or to quantify his loss. Last but not least, sellers or suppliers usually have much stronger bargaining power than consumers.

6.5 In contrast, non-consumers acquire goods for commercial purposes and it is therefore easier to quantify their losses. Monetary compensation can usually compensate non-consumers for defective goods and non-consumers can more readily dispose of defective goods. Furthermore, the respective motives of consumers and non-consumers for repudiation of a contract can be different. Consumers normally repudiate contracts because the defective goods cannot satisfy their needs. Non-consumers, on the other hand, may choose to repudiate contracts for trivial defects because of market fluctuations.

6.6 The Commission therefore recommends restricting non-consumers' rights to repudiate a contract to non-trivial breaches only. Consumers' rights to repudiate should, on the other hand, remain unfettered.

Recommendation 19

In the case of a non-consumer, if the breach by a supplier is so slight that it would be unreasonable for the non-consumer to repudiate the contract of supply, the breach will only be treated as a breach of a “warranty” but not of a “condition”.

Recommendation 20

The definition of “dealing as consumer” should follow that in section 2A of Cap 26.

7. Chapter 8

7.1 This chapter discusses exclusion of liability for breaches of the implied terms recommended in chapters 3 to 6. Under the existing law, exclusion of liability in contracts for the sale of goods is allowed, subject to the control of Cap 71. Similarly, exclusion of liability in respect of the terms implied by the existing case law in other kinds of contracts for the supply of goods is also subject to the control of this Ordinance. Unless there is a good reason to deviate from the present control in Cap 71, the status quo should be maintained.

Recommendation 21

The Recommended Legislation should include a provision to allow contracting out of any right, duty or liability arising from the suppliers' implied obligations, subject to the control of Cap 71.

8. Chapter 9

8.1 In the course of reviewing the law on contracts for the supply of goods, the Commission also discussed various issues concerning contracts for the sale of goods. These issues are also included in the report:

(a) sale of goods forming part of a bulk

The practice of purchasing a specified quantity of goods forming part of an identified bulk (such as 300 tons of wheat out of a cargo of 500 tons on board a certain ship) is more commonly adopted by business buyers.

Section 18 of Cap 26 provides that property in the goods cannot pass to the buyer unless and until the goods are ascertained. The effect of section 18 is that a buyer of goods forming part of a bulk cargo does not obtain property in the goods until the goods are ascertained, irrespective of whether or not payment has been made. If the seller becomes insolvent, the buyer will become an unsecured creditor while the goods and the price paid by the buyer will pass to the office-holder in insolvency. In other words, section 18 prevents property from passing. It does not, however, prevent risk from passing to the buyer. This means that a buyer of goods out of a bulk may still have to bear the loss if the goods are damaged or lost during transit. This is unsatisfactory and unfair.

Recommendation 24

To rectify this unsatisfactory position, the Commission recommends that where there is a sale of a specified quantity of unascertained goods forming part of an identified bulk and the buyer has paid for the goods or some of them, property in an undivided share in the bulk should pass to the buyer, unless otherwise agreed.

(b) right of partial rejection

Under section 13(3) of Cap 26, where a contract of sale is not severable, a buyer who has accepted some of the contract goods will be treated as having accepted all the contract goods. The effect is that he will lose his right of rejection. The buyer's options are to accept or reject all of the goods, though he still has the right to claim damages in either case. He cannot reject the non-conforming goods and keep the conforming ones.

The general rule in section 13(3) is too stringent. First, it would be reasonable to allow buyers to reject only the non-conforming goods and to accept the rest. Secondly, the all-or-nothing approach in section 13(3) not only deprives the buyer of choices, but also may not necessarily be in the sellers' interests. For example, if a buyer is

forced to reject all the contract goods, the seller will then have to refund the entire contract price.

Recommendation 25

Where a buyer has a right to reject the goods supplied because of a breach of the contract by the seller which affects some or all of the goods, the buyer should be able to accept part of the goods and reject the remainder. In the case of a consumer, the application of this provision should not be capable of exclusion or restriction by reference to any contract term;

- (c) repealing section 24 of Cap 26

Under the existing law, a seller cannot give the buyer any better property rights than he himself has. Section 24 provides for an exception to this rule. Where a buyer buys goods from a shop or market without notice of any defect or lack of property rights on the part of the seller, he will obtain good title, even though the seller did not have such title (as, for instance, where the goods are stolen). The theory underlying this exception is that the true owner is expected to be able to find his lost goods in the market place. While this may have been a realistic possibility in the Middle Ages when the exception originated, it is inappropriate to modern conditions.

All major jurisdictions in the common law world have either abolished or rejected at the outset this exception.

It is necessary to strike a balance between the interests of innocent buyers and of innocent owners. The Commission believes that as between an innocent buyer and an equally innocent owner, an owner is more vulnerable. A buyer can protect himself by inquiring as to the source of the goods, going to more reputable shops, etc. An owner is in a more passive position than a buyer, who can take a more active role to protect himself.

Recommendation 26

The exception in section 24 of Cap 26 to the basic principle that the seller cannot give the buyer a better title than he has himself should be repealed.

- (d) restricting non-consumers' rights of rejection on delivery of a wrong quantity

Under section 32(1) of Cap 26, where a seller delivers less than the contract quantity to a buyer, the buyer may reject the goods. Similarly, under section 32(2), a buyer may also reject the whole of the goods if the quantity delivered is more than that contracted for. The courts have, however, made this right of rejection subject to certain

restrictions. Where a long or short delivery is "microscopic" and is not capable of influencing a buyer's mind, he cannot reject the goods. The court will decline the right of rejection if the difference in quantity is merely trivial, such as an excess of 55 lbs of wheat over the contract quantity of 4,950 tons. However, this restriction only applies to microscopic but not minor deviations from the contract quantity. This means that its application is very limited.

In line with chapter 7's recommendation to restrict non-consumers' rights of rejection for slight breaches of the statutory implied terms, the Commission recommends a similar restriction on non-consumer buyers' rights of rejection on delivery of a wrong quantity.

Recommendation 27

Section 32 of Cap 26 should be amended to restrict a non-consumer's rights of rejection on delivery of a wrong quantity if the shortfall or excess is so slight that it would be unreasonable for him to do so.

- (e) acceptance of goods

According to section 37 of Cap 26, a buyer will be deemed to have accepted the goods if he intimates this to the seller or acts in a way inconsistent with the seller's ownership. He will also be deemed to have accepted the goods if a reasonable time has lapsed after his retention of the goods without advising the seller that he has rejected them. However, it remains unclear whether a buyer's attempt to remedy the defective goods or to have them remedied by the seller would amount to an inconsistent act or intimation of acceptance under section 37(1).

Recommendation 28

Section 37 of Cap 26 should make it clear that a buyer shall not be deemed to have accepted the goods merely because he asks for, or agrees to, their repair by or under an arrangement with the seller.

9. Concluding observations

9.1 The law relating to consumer protection in Hong Kong is currently to be found in a number of different ordinances. The Commission recommends that consideration should be given to consolidating the consumer protection provisions within a single statute. A consolidated statute could significantly enhance the law's accessibility and make it easier for the public (especially consumers) to determine their rights and liabilities.