COMMERCIAL AND BUSINESS LAW

The following areas are covered:

- The Law of Sale of Goods;
- Money lent (loans);
- The Law of Partnership;
- The Law of Guarantees, Sureties and Indemnities;
- The Law of Hire Purchase;
- The Consumer Credit Act;
- Commission Agents;
- The Law of Factoring;
- The Law of Liens;
- The Law of Set-off;
- The Law of Bailment;

SALE OF GOODS

The sale of goods is part of the law of contract, but is governed by its own statutory code, set out in the Sale of Goods Act 1979. The common law applicable to contracts applies in so far as it is not inconsistent with the Act and legislation of general application to contracts is also applicable to the sale of goods. In particular, a great deal of consumer protection legislation, much of which is derived from the European Union, has been enacted which is applicable to sales of goods.

The Sale of Goods Act 1979

Sale of goods is an area where the law has been codified for over a century. The present statute is the Sale of Goods Act 1979 and, unless stated to the contrary, references to section numbers are to sections of this Act. The Act was brought up to date in the 1990s.

The Sale and Supply of Goods Act 1994 modernised the conditions implied by s.14 of the 1979 Act, replacing the much loved but somewhat tautologous concept of “merchantable quality” with that of “satisfactory quality” (also widening its scope) and changed the rules relating to acceptance of goods and the right to reject.
Radical changes were made by the Sale and Supply of goods to Consumers Regulations 2002 (SI 2002/3045) which implemented Directive 1999/44 (the 2002 Regulations). The 2002 Regulations add substantially to the provisions of the 1979 Act and also to the provisions of the Supply of Goods (Implied Terms) Act 1973, the Unfair Contract terms Act 1977 (UCTA) and the Supply of Goods and Services Act 1982. There are really now two parallel sets of rules for sale of goods, one where the buyer is a consumer and the other where he is not. Both the substantive law and the available remedies for breach differ markedly between the two situations. The 2002 Regulations came into force on March 31, 2003. There are no transitional provisions and the assumption made in this section is that the 2002 Regulations will only apply to contracts made after that date.

The rules relating to exemption clauses in consumer contracts contained in the Unfair Contract Terms Act 1977 are now supplemented by a detailed code in the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083).

*Consumer, producers and guarantors*

A “consumer” for the purposes of the Act has to be a natural person (reg.2). Such a person is treated as a consumer if “in the contracts covered by these Regulations, [he] is acting for purposes which are outside his trade, business or profession”.

Contracts of sale by auction or competitive tender are no longer excluded from the definition by s.12(2) unless the buyer is an individual and the goods are second hand goods sold by a public auction which the individual has the opportunity to attend. Similar amendments are made to the term “consumer contract” by two new subsections added after s.24(1).

The Regulations introduce a new concept of “the producer” defined as the manufacturer of the goods, their importer into the European Union or any person who purports to be the producer by placing his name or trade mark on the goods. The term “guarantor” is used by the 2002 Regulations to connote any person who issues a consumer guarantee, itself defined as an undertaking given without extra charge to reimburse the price, or to replace, repair or handle goods which do not meet the specifications in the guarantee or in relevant advertising.

For the purposes of all legislation, apart from the Unfair Contract Terms Act 1977, a “consumer” must be a natural person. In a somewhat bizarre decision of the Court of Appeal, however, the court
held that a limited company (indeed a public limited company) can be a “consumer” under s.12 of the 1977 Act: Feldarol Foundry Plc v Hermes Leasing (London) Ltd [2004] EWCA Civ 747. That case involved the acquisition of hire-purchase of a car for the use of the company’s chairman and the court took the view that as acquiring cars was not the “business” of a steel foundry, the company had contracted as consumer. This remains, therefore, a pitfall for the unwary.

Sale of goods defined

A contract of sale is defined by s.2(1) as:

“a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price.”

The essential elements are thus the transfer of property and the payment of a monetary price. Where property passes to the buyer on agreement, there is a “sale” (s.2(4)) and where property is to pass at some future time, there is an “agreement to sell” (s.2(5)).

“Goods” are defined by s.61 as including:

“all personal chattels other than things in action and money ... and in particular ‘goods’ includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.”

“Things of action” includes shares, bills and cheques but although “money” is excluded, this does not affect the sale of coins and bank notes as collector’s items. In certain circumstances computer software may be treated as “goods” for the purposes of the Act (St Albans DC v ICL [1996] 4 All E.R. 481). The goods may be in existence at the time of the agreement or may come into existence at some future time (“future goods”): s.5.

Principal obligations

The principal obligations of the seller are to transfer property in the goods to the buyer and to deliver the goods. Those of the buyer are to accept the goods and to pay the price: s.27. Those obligations are concurrent and:
“the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of the goods” (s.28).

The price

The parties may agree upon a price at the outset or may agree a manner of fixing the price or the price may be determined by the parties’ course of dealing but, if the price is not fixed in any of these ways, the buyer must pay a reasonable price (s.8). If the price is to be fixed by third party valuation and the valuation is not made, the agreement is avoided unless goods have been delivered to and appropriated by the buyer, in which case he must pay a reasonable price for them (s.9).

Passing of property as between buyer and seller

In general, property in the goods passes when the parties intend it to pass (s.17) but, if the goods are unascertained at the time of the agreement, property does not pass until they are ascertained (s.16). There is now an exception to s.16 where the goods form part of an identified “bulk” and the buyer has paid for some or all of the goods. In that case the buyer becomes an owner in common of the bulk and owner of an undivided share (s.20A, added by the Sale and Supply of Goods Act 1979, above).

Section 18 lays down rules for the passing of property in default of agreement to the contrary. The most important of these is Rule 1 whereby an unconditional contract for the sale of specific goods in a deliverable state passes the property to the buyer when the contract is made, even if delivery or payment are postponed. Rules 2 and 3 provide that where work has to be done to make the goods deliverable or where they have to be weighed, measured or tested to ascertain the price, property passes when this has been done and the buyer notified. Rule 4 makes provision for goods on approval or sale or return and Rule 5 provides that the property in unascertained or future goods passes when goods of that description are appropriated to the contract – delivery to the buyer or to a carrier for delivery to the buyer being, in most cases, an unconditional appropriation.

Risk is an area where a major change has been made by the 2002 Regulations. For non-consumer sales the old rule is retained whereby the risk in the goods remains with the seller until property
passes to the buyer when the risk also passes to the buyer, whether or not delivery has been, made (s.20). If either party is at fault in relaying delivery, the risk of loss that would not have occurred but for that fault is on the party at fault (s.20(2)). For consumers, however, the new s.20(4) of the Act provides that the risk remains with the seller until the goods are delivered.

**Passing of title**

The general rule is that a seller who is not the owner or is not selling with the owner’s consent or authority, confers no better title on the buyer than he had himself (unless the owner is estopped by his conduct from denying the seller’s authority to sell: s.21). This rule, sometimes called the rule that *nemo dat qui (or quod) non habet*, is subject to several exceptions. With the disappearance of the rule relating to market overt, the principal remaining exceptions are:

(a) a seller who has a voidable title to the goods (e.g. because he has obtained them from the true owner by fraud) will pass a good title to a bona fide purchaser provided he sells them before the true owner avoids his title (s.23); and see, for example *Lewis v Averay* [1972] 1 Q.B. 198: note that a seller whose title is void ab initio (e.g. under a contract that is illegal or ultra vires the seller) cannot pass title under this section;

(b) a seller who remains in possession of the goods after a sale and delivers or transfers the goods under a sale, pledge or other disposition to a bona fide recipient, will pass title to that recipient (although the original buyer will have an action in damages against the seller for non-delivery: s.24). He must, however, remain in possession of the goods in his capacity as seller; a seller who sells to a finance company on a sale and leaseback arrangement while remaining in possession of the goods throughout is treated as notionally having delivered the goods to the finance company as seller will not pass title: *Michael Gerson (Leasing) Ltd v Wilkinson* [2001] Q.B. 514; [2001] 1 All E.R. 148;

(c) a buyer who is let into possession of the goods with the consent of the seller and delivers or transfers the goods under a sale, pledge or other disposition to a bona fide recipient will pass title to that recipient (s.25(1)); and see *National Employers’ Mutual General Insurance Association Ltd v Jones* [1990] A.C. 24; it should be noted that this section does not apply where the buyer is a buyer under a conditional sale agreement regulated by the Consumer Credit Act 1974 s.25(2);
(d) a mercantile agent who is in possession of the goods with the consent of the owner and delivers or transfers them in the ordinary course of his business as a mercantile agent under a sale, pledge or other disposition to a bona fide recipient, will pass title to that recipient (Factors Act 1889 s.2(1)); the mercantile agent must be in or let on hire-purchase to him in his private capacity: Belvoir Finance Co Ltd v Harold G Cole & Co Ltd [1969] 1 W.L.R. 1877;

(e) where the goods consist of a vehicle, a hirer under a hire-purchase agreement and a buyer under a conditional sale agreement can pass title (directly or indirectly through a dealer) to a private purchaser acting in good faith without notice of the hire-purchase or conditional sale agreement, under Pt 111 of the Hire-Purchase Act 1964.

Delivery

As with the passing of title, the Act contains rules for delivery of the goods, subject to the overriding consideration that what the parties have actually agreed about delivery will prevail (s.29(1)). In default of agreement:

(a) the place of delivery is the seller’s place of business or residence or, if specific goods are to the knowledge of the parties in some other place, that place is the place of delivery (s.29(2));

(b) if the goods are to be sent by the seller, they must be sent within a reasonable time (s.29(3));

(c) if the goods are in the hands of a third party, delivery is when the third party acknowledges that he holds them on behalf of the buyer (s.29(4));

(d) demand for and tender of delivery must be at a reasonable hour (s.29(5));

(e) the expenses of putting the goods into a deliverable state must be borne by the seller (s.29(6)).

If the seller delivers more or less goods than contracted for, or mixes the contract goods with others, the buyer has the choice of rejecting the whole consignment, of accepting those goods which are in
accordance with the contract and paying the contract rate for them or (in the case of over-deliveries) of accepting the whole delivery and paying for the excess at the contract rate (s.30). In non-consumer sales, the buyer may not be entitled to reject if the difference is “so slight that it would be unreasonable for him to do so” (s.30(2A)).

A buyer is only obliged to take delivery by instalments if he agrees to this (s.31(1)). Where instalments have been agreed and each instalment is to be paid for separately, it will be a question of fact in each case whether failure by the seller to make proper delivery of one or more instalments or failure by the buyer to pay for one or more instalments entitles the other party to treat the whole contract as repudiated or simply to treat the breach as severable and giving rise to a claim for what the Act calls “compensation” (s.31(2)). “The main tests to be considered in applying for sub-section ... are, first, the ratio quantitatively which the breach bears to the contract as a whole, and secondly the degree of probability or improbability that such a breach will be repeated” (Maple Flock Co Ltd v Universal Furniture Products (Wembley) Ltd [1934] 1 K.B. 149 at 157, per Lord Hewart C.J.).

Where the goods are to be sent to the buyer, the rules now diverge. In non-consumer sales, delivery to a carrier is deemed to be delivery to the buyer and the seller may make any reasonable contract with the carrier for the carriage. If he fails to do so and the goods are lost or damaged in transit, the buyer may refuse to accept delivery or sue the seller in damages (s.32). For consumers, none of these rules apply: under the new s.32(4), delivery of the goods to a carrier is not delivery of goods to the buyer: only actual delivery will suffice.

Acceptance

A buyer has the right to reject goods tendered or delivered otherwise in accordance with the contract but, once he has accepted them, the right of rejection is lost. The buyer is entitled to examine the goods before deciding whether to accept or reject them and must usually be given a reasonable opportunity for examination by the seller (s.35(2)). Until he has had a reasonable opportunity for examination, the buyer will not be taken to have accepted the goods (s.35(1)). Acceptance occurs when the buyer notifies the seller he has accepted the goods, when (after an opportunity for examination) he does an act inconsistent with the rights of the seller or when he retains them after a reasonable time has elapsed without telling the seller he has rejected them (s.35). If the buyer rejects the goods he is not obliged to re-deliver them to the seller (s.36).
The rules for acceptance and rejection have been clarified by the case of *J&H Ritchie Ltd v Lloyd Ltd* [2007] UKHL 9; [2007] 2 All E.R. 353 which decided that the buyer’s right to reject was a right which the buyer could not be expected to exercise until he had the information that he needed to make an informed choice. The seller could not refuse to give him the information that he needed to exercise it. If the information were refused (in *Ritchie* by the seller refusing to tell the buyer of the nature of the faults the seller had found in the goods and remedied), the buyer would not be taken as having accepted the goods and thus having lost the right to reject them.

In consumer sales, the practical effect of the rules relating to acceptance and rejection has been considerably eroded by the rules introduced by the new Pt 5A of the Act.

The “all or nothing” rule for rejection often operated harshly so the Sale and Supply of Goods Act 1994 added s.35A, whereby a buyer who has the right to reject goods by reason of a breach by the seller affecting only part of the goods but accepts some or all of the unaffected goods, does not lose the right to reject the affected goods.

**Claims by the seller**

*Action for the price*

Clearly the most important action open to a seller is to sue the buyer for the sale price.

Where the property in the goods has passed to the buyer or where a date for payment has been agreed (irrespective of delivery) and the price is not paid on that date, then the seller may maintain an action for the price (s.49). Provided that he is prepared to deliver the goods against payment of the price, the seller is not obliged to attempt to resell the goods to mitigate his loss nor is he restricted to a claim for damages for his actual loss.

*Damages for non-acceptance*

Instead of suing for the price, the seller can choose to sue the buyer for non-acceptance and prima facie the measure of damages will be the difference between the contract price and the market or current price at the time for acceptance or the time of refusal to accept (s.50).
Other remedies

The unpaid seller has available various other remedies such as a lien over the goods and a right of stoppage in transit. These rights will almost always be exercised by way of a defence to a claim by the buyer.

Claims by the buyer

Claims by the buyer fall into two main categories: claims based on the failure of the seller to make proper delivery of the goods; and claims based on the delivery of goods which do not conform to the terms of the contract. Claims in the latter category will, in turn, depend on whether the term broken is a condition or a warranty.

Non-delivery

The most common remedy sought for non-delivery of goods is an action for damages for non-delivery and, as with damages for non-acceptance, the measure of damages will prima facie be the difference between the contract price and the market or current price of the goods at the time for delivery or of the refusal to deliver (s.51). If delivery is simply delayed then the measure of damages will be the fall in the market or current value between the contractual time for delivery and the actual time for delivery: see for example Koufos v C Czarnikow Ltd [1969] 1 A.C. 350.

If the buyer has already paid all or part of the purchase price, the payment is recoverable either as damages for non-delivery or as money paid on a consideration which has wholly failed.

The actual resale price of the goods by the buyer (as where the buyer has sub-sold in advance of delivery) may be irrelevant to the assessment of damages based on the market price on the delivery date (see Williams Brothers v Ed T Agius Ltd [1914] A.C. 510) but if the seller has actual or imputed knowledge of the fact that the buyer has sub-sold or intends to sub-sell the goods, the actual loss sustained by the buyer on resale by way of lost profit or liability to the sub-buyer in damages may be recoverable as additional damages (see Hall v Pim [1927] 2 K.B. 535; Bence Graphics International Ltd v Fasson UK Ltd [1998] Q.B. 87; Total Liban SA v Vital Energy SA [2001] Q.B. 643).
In exceptional cases involving a failure to delivery specific and ascertained goods, the court may grant the buyer specific performance of the sale contract and compel the seller to delivery without giving him the option to retain the goods and pay damages (s.52).

Action for breach of condition or warranty

The law in this area has been revolutionised by the 2002 Regulations. These Regulations substantially amend the provisions of ss.13 to 15 of the Act and add a wholly new part, Pt 5A, which contains new and drastic remedies for the consumer.

Conditions and warranties

In general whether an express or implied term of a sale contract is a condition or a warranty is, as with all contracts, a matter of construction of the contract (s.11(3)) and where the Act implies terms into a sale contract, it is careful to specify which are conditions and which warranties, although the mechanism whereby the Act does this was refined somewhat by the 1994 update. Where there is a breach of condition, the buyer may treat the contract as repudiated or he may elect to treat the breach of condition as a breach of warranty and sue for damages (s.11(2)). In a non-severable contract, once the buyer accepts all or part of the goods (in the absence of an express or implied term in the contract to the contrary), the buyer can no longer reject the goods but must treat the breach of condition as a breach of warranty (s.11(4)). This is, however, subject to the rule concerning partial rejection in s.35A, and to the right of the buyer to proper information before deciding whether to accept or reject.

In consumer sales, however, the range of new remedies available to the buyer has somewhat overtaken the often mechanistic application of the rules relating to conditions and warranties. The law in this area remains the same for both categories of sale but the practical effect for consumers is greatly diminished.

Title and quiet possession

The basic rule is that there is an implied condition on the part of the seller that, in the case of a sale, he has the right to sell the goods and, in the case of an agreement to sell, that he will have that right at the time when property is to pass (s.12(1)). There are warranties that the goods are free from all
charges and encumbrances unless disclosed by the seller or otherwise known to the buyer and that the buyer will enjoy quiet possession of the goods (s.12(2)). There are similar warranties applying to sales where the seller is transferring only such title as he or a third party may have (s.12(3), (4) and (5)).

The condition in s.12(1) is regarded as fundamental by the courts. If it turns out, long after the goods have been delivered, that the seller had no right to sell, the buyer may treat the contract as repudiated and recover back the price and he need give no allowance for the value of any use of the goods he may have enjoyed in the meantime: Rowland v Divall [1923] 2 K.B. 500; Karflex Ltd v Poole [1933] 2 K.B. 251; Barber v NWS Bank Plc [1996] 1 W.L.R. 641.

If between the sale and the buyer’s decision to avoid the contract under s.12(1), a seller who had no title at the time of sale acquires title, this will “feed title” to the buyer and preclude him from treating the contract as repudiated by the seller: Butterworth v Kingsway Motors Ltd [1954] 1 W.L.R. 1286.

**Non-conformity with the contract**

Sections 13, 14 and 15 of the Act contain provisions as to the quality and condition of the goods sold. Traditionally, breach of any of the conditions implied into the contract of sale by those sections afforded the buyer the right to reject the goods or, where appropriate, to sue for damages for breach. This remains the law but in consumer sales, breach of the conditions implied by the three sections give rise to additional and alternative remedies. Part 5A of the Act creates the concept of non-conformity with the contract of sale (s48A(1)(a)) which is defined by s.48F as arising if “there is in relation to the goods a breach of an express term of the contract or a term implied by s.13, 14 or 15 [of the Act].”

**Correspondence with description**

Section 13 implies into a contract for the sale of goods by description a condition that the goods will correspond with the description. In practice, most sales are sales by description. There can also be difficulties where the seller has made statements about the goods prior to purchase, in determining what statements form part of the contractual description and what are pre-contractual representations not subsequently incorporated into the contract: see for example Oscar Chess Ltd v
Williams [1957] 1 W.L.R. 370. It is worth noting that selling a work of art as by a named artist is not necessarily a sale by description: Harlingdon and Leinster Enterprises Ltd v Christopher Hull Fine Art Ltd [1991] 1 Q.B. 564.

A sale is not precluded, however, from being a sale by description by the fact that the goods are exposed for sale or hire and are selected by the buyer (s.13(3)).

The condition of the goods

Section 14 starts by providing that there are no implied terms about the quality or fitness for purpose of goods beyond those set out in the Act (or in other enactments: s.14(1)). Such a term may be annexed to a contract by usage under s.14(4) but the most important conditions are those of satisfactory quality and reasonable fitness and contained in s.14(2) and (3). These conditions will be implied only where the seller is selling in the course of a business. If the seller is agent for another, the conditions will only be excluded if the agent’s principal is not selling in the course of a business and this is known by the buyer or reasonable steps are taken to bring it to his attention (s.14(5)). It should be noted that for a sale to be “in the course of a business”, it is not necessary to show that the seller’s business is that of selling goods of the description in question. A sale by a business enterprise of its old or surplus equipment can attract s.14: Stevenson v Rogers [1999] 1 All E.R. 613.

Satisfactory quality. Under s.14(2) there is an implied condition that the goods are of “satisfactory quality”. This term is widely defined by s.14(2A):

“... goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.”

The aspects of quality include s.14(2B):

“(a) fitness for all the purposes for which goods of the kind in question are commonly supplied;

(b) appearance and finish;
(c) freedom from minor defects;

(d) safety; and

(e) durability.”

To this is added, in, consumer sales, new provisions contained in s.14(2D) and (2E). Section 14(2D) and includes within the “relevant circumstances” determining satisfactory quality “any public statements on the specific characteristics of the goods made about them by the seller, the producer or his representative, particularly in advertising or on labelling”. The seller can avoid this provision if he can show that he was unaware of the public statement, or that it had been publicly withdrawn or corrected before the sale or that it could not have influenced the decision to buy the goods. Note that this is “could not” and not “did not”. The existing rules relating to representations about the goods are expressly preserved for all categories of sale by s.14(2F).

Satisfactory quality is thus a great deal wider than its predecessor merchantable but the revamp is s.14(2) has preserved the exception for defects specifically drawn to the attention of the buyer or, if the buyer examines the goods before the contract is made, defects which that examination ought to reveal or defects in a sale by sample which an examination of the sample would reveal.

Reasonable fitness. Under s.14(3), where the buyer expressly or by implication makes known to the seller or, where the price is to be paid by instalments, to the credit-broker, the purpose for which the goods are being bought there is an implied condition that the goods:

“are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller or credit-broker.”

Comparison between the provisions. As both subsections employ the concept of “reasonable fitness”, there is an obvious overlap between them. Satisfactory quality, however, relates to the ordinary purposes for which goods of that type are bought, whereas reasonable fitness imposes on the seller a duty to see that the goods are fit for the particular purposes of the actual buyer, which may be a higher duty. The purpose for which the buyer requires the goods may be impliedly
represented, which will usually be the case if they are being bought for their normal purpose (e.g. a hot-water bottle: *Preist v Last* [1903] 2 K.B. 148). If a special purpose is communicated to the seller and the goods are not fit for that purpose, it is no defence to say that the goods would have been fit for the normal purposes to which buyers might put them: *Bristol Tramways Carriage Co Ltd v Fiat Motors Ltd* [1910] 2 K.B. 831. Reliance on the skill and judgment of the seller or credit-broker will be presumed and it is for the seller or credit-broker to rebut it.

The subsections are not confined to manufactured goods: *Frost v Aylesbury Dairy Co Ltd* [1905] 1 K.B. 608 (milk); and also cover foods made up for the buyer: *Ashington Piggeries Ltd v Christopher Hill Ltd* [1972] A.C. 411; and second hand goods: *Bartlett v Sidney Marcus Ltd* [1965] 1 W.L.R. 1013; *Stevenson v Rogers* [1999] 1 All E.R. 613.

**Correspondence with sample**

Where goods are sold by sample, s.15 creates what are, in effect, two separate conditions:

(a) a condition that the bulk will correspond with the sample in quality (s.15(2)(a));

(b) a condition that the goods will be free from any defect, rendering them unmerchantable which would not be apparent on reasonable examination of the sample (s.15(2)(c)).

The second condition brings in the concept of satisfactory quality as defined by s.14(2A) above. As with correspondence with description, this condition is not confined to sales made in the course of a business.

**Trivial defects**

A new provision, s.15A, was added in 1994 for non-consumer sales. Where a buyer would otherwise have the right to reject goods for breaches of ss.13, 14 or 15, the breach will be treated as a breach of warranty and not as a breach of condition if “the breach is so slight that it would be unreasonable for him to reject them”.

**New remedies for consumers**
The objective of the new Pt 5A is to provide “additional rights of buyer in consumer cases”. Sections 48A to 48F apply where the buyer is a consumer and the goods do not conform to the contract of sale at the time of delivery. Goods which do not confirm to the contract at any time within six months of delivery to the buyer are presumed not to have conformed at the date of delivery subject to the right of the seller to prove that they did conform on delivery or that the six-month rule is incompatible with the nature of the goods or of the breach (e.g. perishable goods). This will have obvious practical effects on arguments about acceptance of defective goods.

The primary right of the buyer is to require the seller to repair or replace the goods – s.48B(1) – and if he does, the seller must repair or replace the goods within a reasonable time “but without causing significant inconvenience to the buyer” and bear any necessary costs of doing so (including postage) – s.48B(2). This right is not absolute. It cannot be exercised if the remedy is impossible or if the remedy chosen is disproportionate to the other (e.g. it is cheaper to repair than to replace) or if the remedy is disproportionate to having a reduction in the purchase price or to rescission of the contract – s.48B(3). Disproportionality is assessed by taking into account the value of the goods if they had conformed to the contract, the significance of the breach and whether the other remedy could be effected without significant inconvenience to the buyer – s.48B(4). Questions both of reasonable time and significant inconvenience are to be judged by reference to the nature of the goods and the purpose for which they were acquired – s.48B(5).

The buyer may require the seller to reduce the price or may rescind the contract, if he is precluded by s.48B(3) from demanding repair or replacement or if he is required repair or replacement and the seller has failed to do so within a reasonable time and without significant inconvenience to the buyer – s.48C(1) and (2). If the buyer rescinds, an allowance may be made against reimbursement of the price to reflect any use the buyer has had of the goods before rescinding – s.48C(3). If the buyer has required the seller to repair or replace the goods, he must give him a reasonable time to do so and cannot reject the goods or terminate the contract (or go for the other remedy) until that time has elapsed – s.48D.

The courts are given powers to implement these remedies under s.48E. The court may grant specific performance of the obligation to repair or to replace but has wide powers in any case involving repair, replacement, abatement of the purchase price or rescission to award one remedy in place of another and to make orders subject to any conditions it thinks fit (including ordering the buyer to make an allowance for use of the goods).
**Consumer guarantees**

Regulation 15 of the 2002 Regulations introduces the concept of the enforceability of consumer guarantees defined as “any undertaking to a consumer by a person acting in the course of his business, given without extra charge to reimburse the price or to replace, repair or handle goods which do not meet the specifications in the guarantee or in relevant advertising” (reg.2).

Where the goods are offered for sale with the consumer guarantee, this operates as a contractual obligation owed by the guarantor to the buyer under the conditions set out in the guarantee and its “associated advertising”. There are strict rules for the drafting of consumer guarantees and guarantees made in transitory form (e.g. television advertisements) must, on request, be supplied in writing or other “durable medium”. The terms of reg.15 apply not only to the guarantor himself but to “any other person who offers to consumers the goods which are the subject of the guarantee for sale or supply”. Thus a manufacturer’s guarantee is enforceable by the buyer against both the manufacturer and the seller.

**Exclusion of the statutorily implied conditions**

The right to exclude the conditions implied by ss.12 to 15 although in general preserved by s.55(1), has been greatly curtailed by the Unfair Contract Terms Act 1977 (UCTA). UCTA created the two categories of contracting party, those who “deal as consumer” and those who do not. In respect of sale of goods a person “deals as consumer” if:

(a) he neither makes the contract in the course of a business nor holds himself out as doing so; and

(b) the other party does make the contract in the course of a business; and

(c) the goods are of a type ordinarily supplied for private use or consumption (s.12(1) of UCTA).

Under reg.14 of the 2002 Regulations, however, the condition in (c) is to be disregarded if the buyer is an individual. Thus there are three categories of buyer for the purpose of s.12 of UCTA: non-
consumers; individual consumers where (a) and (b) only apply and corporate consumers where (a), (b) and (c) all apply.

A corporate buyer at a sale by auction or competitive tender is never a consumer (s.12(2) of UCTA). Under the substituted version s.12(2), however, an individual buyer may be a consumer unless the goods are second hand goods sold by a public auction which he has the opportunity to attend. UCTA is excluded from application to most international supply contracts (s.26). A limited company can be a “consumer” for the purposes of UCTA: *R & B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 W.L.R. 321; *Feldarol Foundry Plc v Hermes Leasing (London) Ltd* [2004] EWCA Civ 747.

How far the restrictions in the rules in UCTA relating to auction sales and international supply contracts are relevant to individual consumers may be doubted because the provisions of the Unfair Terms in Consumer Contracts Regulations 1999 have a wider application than UCTA. In these Regulations, there is no exclusion for auction sales or international supply contracts.

The rules governing the exclusion of implied conditions laid down by s.6 of the 1977 Act are:

(a) s.12: in no contract can these obligations be excluded or restricted;

(b) ss.13-15: where the buyer deals as consumer, these obligations cannot be excluded or restricted; where the buyer does not deal as consumer, these obligations can be excluded or restricted but only to the extent that relevant term satisfies the requirement of reasonableness.

The onus both of proving that the buyer did not deal as consumer and of proving that the exclusion or restriction clause was reasonable rests on the seller. The criteria for determining reasonableness are set out in s.11 of and Sch.2 to UCTA.

*Damages for breach of condition or warranty*

Where there has been a breach of condition and the buyer has accepted the seller’s repudiation of the contract, the measure of damages will normally be the amount of the price paid together with any consequential loss assessed in accordance with the normal principles of ascertainment of contractual damages (e.g. loss of profit on sub-sale). Where there has been a breach of warranty,
the buyer may either sue for damages or set up the damages as a set-off against the price (to the extent that it remains unpaid: s.53(1): it can thus found a cause of action or a defence. Prima facie, the measure of damages for breach of warranty will be the difference between the value of the goods at the time of their delivery to the buyer and the value they would have had if they had fulfilled the warranty (s.53(3)). Here again consequential loss can be recovered, for example loss of profit: Richard Holden Ltd v Bostock & Co Ltd (1902) 18 T.L.R. 317; liability to a sub-buyer: Hammond v Bussey (1887) 20 Q.B.D. 79; Total Liban SA v Vitol Energy SA [2001] Q.B. 643; or physical injury to the buyer or to any other person or property: Godley v Perry [1960] 1 W.L.R. 9.

Auction sales of goods

Auctions are within the code of the Sale of Goods Act 1979. The auctioneer sells as agent for the vendor and his authority will be limited by his instructions from the vendor.

Subject to those special rules which arise from the nature of auction sales, a sale of goods at auction is subject to all the rules governing other sales of goods, including the implication of the terms in ss.12 to 15.

Under s.57(1), where goods are sold in lots, each lot is prima facie the subject of a separate contract of sale. The analysis of an auction is that each bid is an offer which will be accepted when the auctioneer announces the completion of the sale “by the fall of the hammer or in any other customary manner” but until that occurs the bid can be withdrawn (s.57(2)). Similarly, the vendor may withdraw goods in advance from an advertised auction without exposing himself to an action from potential bidders and can withdraw them during the auction itself at any time up to the fall of the hammer.

Reserve prices. Under s.57(3) “a sale by auction may be notified to be subject to a reserve or upset price”. Where a seller gives authority to an auctioneer to sell subject to a reserve price, the auctioneer has no authority to accept a lower price: McManus v Fortescue [1907] 2 K.B. 1. If no reserve has been set, the auctioneer must knock the goods down to the highest bidder, however low the bid. If he fails to do so, the auctioneer will be personally liable in damages to the highest bidder on an analogy with s.57(4) (see para.25-37): Barry c Heathcote Ball & Co (Commercial Auctions) Ltd [2001] 1 A.E.R. 944.
Bids by the seller. Patently, if the seller himself can bid, he can push the price up and, if he (or his nominee) does it in secret, it is, in effect, a fraud on genuine bidders. The Act provides that the seller can reserve the right to bid (s.57(3)) but this must be announced before the sale and, if the right is reserved and notified, the seller or “any one person on his behalf” may bid at the auction (s.57(6)). If the seller’s right to bid is not notified to the other bidders, it is unlawful for the seller or his nominee to bid or for the auctioneer to accept such a bid (s.57(4)) and if it happens, the sale “may be treated as fraudulent by the buyer” (s.57(5)).

Defences

Section 18 of the Act provides:

“Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of the goods.”

The basic rule is, therefore, that, before one party can enforce his rights under a sale contract, he must be willing to perform his own obligations under the contract. If the seller is ready and willing to deliver against payment of the purchase price, it is not necessary for him to prove actual tender of the goods before he can sue for the price: Boyd v Lett (1845) 1 C.B. 222. In many cases the agreement will provide for payment and delivery not to be concurrent, as where the seller agrees to deliver on a certain date on terms that payment of the price will be made a given number of days after delivery or after invoice. Conversely, the buyer may agree to make payment in advance before the seller commences work on the manufacture of the goods. In these cases once the due date for the delivery or payment has passed, an action can be maintained even though at that time the other party is not required to be ready or willing to perform his obligation.

Defences of the seller

Claims by the buyer will normally fall into one or both of two categories, claims for non-delivery or late delivery of goods and claims based on breaches of conditions or warranties in the sale contract (the latter being frequently coupled with allegations of misrepresentation).
Claims for non-delivery or late delivery. Apart from denial of the facts relied on by the buyer, defences to claims for non-delivery or late delivery will normally be based on an express or implied term which would permit non-delivery or later delivery in the circumstances which have occurred (e.g. failure by or inability of the buyer to pay the purchase price) or on some external event preventing delivery but not involving fault on the part of the seller (e.g. loss or destruction of the goods at a time when the goods were at the risk of the buyer).

An unpaid seller is given certain rights by the Act, a seller being “unpaid” for these purposes if either the whole price has not been paid or tendered or a bill of exchange or other negotiable instrument has been received as conditional payment and the condition has not been met (either by dishonour or otherwise) (s.38).

An unpaid seller may exercise a lien over the goods until payment or tender of the price, where the goods have been sold without any agreement as to credit or where the agreed term of credit has expired or where the buyer becomes insolvent (s.41) and a seller who has made part-delivery can, unless he has waived his lien, retain the undelivered balance against payment (s.42). The lien is lost by delivery to a carrier for transmission to the buyer, by the buyer or his agent lawfully obtaining possession of the goods and by waiver (s.43).

An unpaid seller who delivers goods to a carrier or other bailee for transmission to the buyer can stop them in transit if the buyer becomes insolvent and resume his lien (s.44) by retaking possession of the goods or by notifying the carrier or other bailee in possession of them (or if he is an agent, by notifying his principal) (s.46).

Exercise of the lien or the right of stoppage in transit does not of itself rescind the contract of sale (a.48(1)) but, if the goods are perishable or if the seller gives notice of his intention to resell and the buyer does not pay or tender the price within a reasonable time, the seller can resell the goods and claim damages for breach of contract from the original buyer (s.48(3)).

Defences of the buyer

Where there has been an outright sale, the seller’s action will generally be for all or part of the purchase price or for damages for non-acceptance.
In a high proportion of cases, however, the buyer will want to set up as a defence the breach of some obligation of the seller, particularly the obligations created by ss.12 to 15. In these circumstances, the buyer must decide whether:

(a) he is alleging a breach of condition (with or without a pre-contract misrepresentation) which entitles him either to rescind the contract or to treat it as having been repudiated by the seller;

(b) whether he is alleging a breach of warranty which entitles him to damages alone; or

(c) in consumer cases, he is seeking to assert one of the remedies afforded by Pt 5A.

In (a), in addition to any damages which may be payable, the buyer is normally entitled to repayment of any part of the purchase price which has already been paid. In that what the buyer is alleging would be a complete defence to the seller’s claim, any claim for damages or the repayment of money must be included in a counterclaim.

In (b), any damages for breach of warranty can be set off “in diminution or extinction of the price” (s.53(1)) and the measure of damages is the “estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty” (s.53(2)). In the case of the breach of obligations under ss.13 to 15, the measure of damages is “prima facie the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty” (s.53(3)). This prima facie presumption can be displaced (e.g. if the goods are sold to a buyer known to the seller to be intending to use them in manufacturing other goods which would be sold on: Bence Graphics International Ltd v Fasson UK Ltd [1998] Q.B. 87; see also Total Liban SA v Vitol Energy SA [2001] Q.B. 643).

If, therefore, the damages for breach of warranty are unlikely to exceed the balance of the price due, the alleging of breach of warranty can, technically, be relied on as a defence alone, without the need for a counterclaim. It is usually wiser, however, in cases of breach of warranty to include a counterclaim, for the damages alleged.

Section 21(1) of the Sale of Goods Act 1979 defines a contract of sale of goods as "a contract by which the seller transfers, or agrees to transfer, the property in goods to the buyer for a
money consideration, called the price". As a consequence the analysis in this article is of the contracts which amount to a "sale" within the Sale of Goods Act 1979, and what for the purposes of the Act amounts to "goods".

The Law Governing Sale of Goods: The sale of goods is part of the law of contract, but is governed by its own statutory code, set out in the Sale of Goods Act 1979. The Act is retrospective in effect, applying to all contracts on or after 1 January 1894 (the date when its predecessor, the Sale of Goods Act 1893 came into force) - see s.1(1). It applies to the whole of the United Kingdom, although some provisions apply only to specific parts of it.


The rules of common law apply where the Act is not inconsistent with them. Section 62(2) of the Act provides:

"The rules of the common law, including the law merchant, except in so far as they are inconsistent with the provisions of this Act, and in particular the rules relating to the law of principal and agent and the effect of fraud, misrepresentation, duress or coercion, mistake, or other invalidating cause, apply to contracts for the sale of goods."

The reference to the common law in the section is generally regarded as also preserving the principles of equity (see Benjamin's Sale of Goods, 8th Ed, paras 1-008 to 1-009).

As part of the law of contract, other contract legislation is also applicable to the sale of goods, for example the Unfair Contract Terms Act 1977. In particular, this includes consumer protection legislation, much of which is derived from the European Union, for example the Unfair Terms in Consumer Contracts Regulations 1999/2083, the Consumer Protection (Distance Selling) Regulations 2000/2334, the Sale and Supply of Goods to Consumers Regulations 2002/3045, the Electronic Commerce (EC Directive) Regulations 2002/2013 and the Cancellation of Contracts made in a Consumer's Home or Place of Work etc. Regulations 2008/1816. Criminal and regulatory sanctions apply to sellers of goods to consumers through the Consumer Protection from Unfair Trading Regulations 2008/1277.
Savings from some earlier legislation is also made by the Sale of Goods Act 1979, in particular the Bills of Sales Acts of 1878 and 1882 (see s.62(3): "Nothing in this Act or the Sale of Goods Act 1893 affects the enactments relating to bills of sale, or any enactment relating to the sale of goods which is not expressly repealed or amended by this Act or that"). The effects of the Factors Act 1889, replacing and extending earlier Factors Acts, is also expressly preserved by s.21(2)(a): "Nothing in this Act affects... the provisions of the Factors Acts or any enactment enabling the apparent owner of goods to dispose of them as if he were their true owner". However, the Sale of Goods Act also substantially reproduces parts of the Factors Act 1889, but with slight changes of wording.

Certain goods also have specific legislation applying to them, for example ss.27-29 of the Hire Purchase Act 1964 (covering the transfer of title for motor vehicles), ss.68 and 72 of the Agriculture Act 1970 (creating a warranty for certain feedstuffs), and for goods covered by regulations made under the Consumer Protection Act 1987, an actionable statutory duty is imposed by that Act in relation to the supply of non-compliant goods.

The Definition of the Sale of Goods: Section 2(1) of the Sale of Goods Act 1979 defines a contract of sale of goods as "a contract by which the seller transfers, or agrees to transfer, the property in goods to the buyer for a money consideration, called the price." The definition requires an analysis of what is a sale for money consideration and what are goods.

"Sale": Under s.2(4) of the Sales of Goods Act 1979, a contract of sale under which the property in the goods is transferred from the buyer to the seller is called a sale. Under s.2(5) an agreement under which property in the goods is to be transferred at a future time or subject to a condition later to be fulfilled is called an agreement to sell. It becomes a sale when the time elapses or the conditions are fulfilled (s.2(6)). The sale is therefore more than just a contract; it invests the buyer with rights in the goods themselves.

Before there is a sale, there is a right to damages; once the sale has taken place, the seller can sue for the price and the buyer may claim for wrongful interference with the goods.

Sale does not cover transfers of property such as gifts or transfers which are not by way of consensual agreement. Nor does it cover exchange or barter, where the consideration is not a money consideration. "Money" is not the same as "money's worth". It does not even extend to
the extinguishment of a money debt: Simpson v Connolly [1953] 1 W.L.R. 911 (a transfer of land in consideration of a debt being excused was not a contract to pay money for the land).

A payment by credit or debit card, or a cheque, is the means by which the money consideration is paid to the seller. A sale paid for by such means is a payment for a money consideration.

A contract for an option to buy is not a contract of sale and there is no agreement to buy until the option is exercised. Similarly, the Sale of Goods Act 1979 does not cover hire-purchase. Until the option to purchase is exercised, this is not a contract of sale, but of hire. However, a conditional sale is a sale of goods, since both parties are bound by their agreement to sell and buy respectively (s.2(3) provides that a contract of sale may be absolute or conditional).

A delivery of goods on sale or return is not a sale of goods, as the recipient by definition has the option to return them. However, the Act does make specific provision in relation to such transactions, providing for the passing of property where no notice of rejection is given in accordance with the contract or in a reasonable time (s.18(r.4)).

An apparent sale of goods intended to operate by way of security (for example where there an option to repurchase in reality intended to act as a security, or the goods apparently sold to the buyer outright are bailed to the seller) will not be a sale of goods; rather it will be caught by the Bills of Sale Act 1882. Section 62(4) of the 1979 Act provides:

"The provisions of this Act about contracts of sale do not apply to a transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge, or other security."

"Goods": The sale must be one of goods. It will therefore not cover a contract for performance of services. A contract for performance of services where incidental materials are supplied is not a sale of goods under the Act; it will fall under Pt II of the Supply of Goods and Services Act 1982. It may be a difficult question whether a particular contract is one which is in substance a sale of goods (see the discussion in Benjamin's Sale of Goods 8th Ed, paras 1-041 to 1-047).

The word "goods" is defined in s.61(1):
"'goods' includes all personal chattels other than things in action and money, and in Scotland all corporeal moveables except money; and in particular "goods" includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale and includes an undivided share in goods."

"Goods" will include solid and liquid minerals (including water), vapours and gases (even air, as in bottled air), but probably not formless forms of energy such as heat or electricity. Personal chattels include large items, such as ships or aircraft (to the extent that they are not governed by other legislation). It includes living animals (unless still wild).

Section 61(1) expressly allows a sale of a part share in goods (and see also s.2(2), which provides "There may be a contract of sale between one part owner and another").

Things in action are not "goods": therefore shares, negotiable instruments, bills of lading and insurance policies, for example, are not "goods". Computer software per se is not considered goods, although the disc on which it is stored is (see St Albans City and DC v International Computers Ltd [1996] 4 All E.R. 481). However, in Southwark LBC v IBM UK Ltd [2011] EWHC 549 (TCC); 135 Con. L.R. 136 the view was expressed that a disc and the software on it was "goods".

While money is excluded from the definition, currency and banknotes which are merely collector's items and treated as a commodity in themselves rather than a means of exchange will be "goods". If a current note or coin can be exchanged as such, even if sold as a collectible item, it may be that it is not within the Act (see the discussion in Benjamin's Sale of Goods, 8th Ed, at para.1-084).

There is a distinction between a sale of land and a sale of goods, but the distinction can cause difficulties. The definition of "goods" in the Sale of Goods Act 1979 as including "emblements and industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale" means that the sale of things such as crops to be severed from the land may be both "goods" within that Act and a sale of an "interest in land" covered by the Law of Property (Miscellaneous Provisions) Act 1989, and therefore subject to greater formality. The reference to "emblements" and "industrial growing crops" is apparently a reference to "fructus industriales", which at common law meant crops
produced by labour and therefore in any event treated as chattels (in contrast to fructus naturales, or plants naturally growing on the soil, such as timber).

A contract can be for future goods, which either do not exist at all or which exist but are not in the sellers possession. Section 5(1) of the Act provides that:

"The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or goods to be manufactured or acquired by him after the making of the contract of sale, in this Act called future goods."

A speculative contract for future goods can be a contract for the sale of goods, but this is to be distinguished from a contract for differences where delivery is in fact not contemplated by either party (whatever the contract may say).

A contract for future goods is an agreement to sell, not a sale, so that the buyer does not own the goods until property passes. Even though goods of the type described in the contract are subsequently acquired, if not appropriated to the buyer's contract by the seller so that there is a sale, they do not become the buyer's property (see Goldcorp Exchange Ltd (In Receivership), Re [1995] 1 A.C. 74).

As a contract of sale may be conditional (see s.2(3) of the Act), there will be no breach by the seller if the sale is conditional on the goods coming into existence or being acquired. This is matter of construction.

The Act also distinguishes between specific goods and unascertained goods. "Specific goods" are defined by s.61(1) and means "goods identified and agreed on at the time a contract of sale is made and includes an undivided share, specified as a fraction or percentage, of goods identified and agreed on as aforesaid". Specific goods are therefore goods whose individual identity is so identified that only their supply is a performance of the contract. Future goods sufficiently identified would appear to be capable of being specific goods.

Although not a defined term, "unascertained goods" are goods which are not specific. Such goods can be the subject of a contract for the sale of goods. However, if the goods are unascertained goods, whether generic goods, or part of a bulk, or goods not yet in existence, property cannot pass until they are ascertained. Section 16 of the Act provides "Subject to section 20A below, where there is a contract for the sale of unascertained goods no property
in the goods is transferred to the buyer unless and until the goods are ascertained.” (Section 20 applies to contracts of specified quantities of unascertained goods, where the goods form part of an identified bulk). The effect of the contract being one for unascertained goods on the passing of property are dealt with in the chapter dealing with passing of property.

**MONEY LENT / LOANS**

A contract of loan of money is a contract whereby one person lends to agrees to lend a sum of money to another in consideration of an express or implied promise to repay that sum on demand, or at a fixed or determinable time, or conditionally upon an event which is a certainty. (Chitty on Contracts, 30th edn (2008), para. 38-223). A claim for money lent is a claim on a debt. (For the distinction between a claim for money lent and money paid see In re HPC Productions Ltd [1962] Ch. 466 at 487.) Where it can be shown (by proof or admission) that A has paid money to B then in the absence of any presumption of advancement, there is prima facie an obligation to repay upon B; the onus is upon B to establish that the money was intended as a gift. (Seldon v Davidson [1968] 1 W.L.R. 1083).

Where money is lent without any stipulation as to the time of repayment, a present debt is created which is generally repayable at once without prior demand. (Norton v Ellam (1937) 2 M.&W. 461; Atterbury v Jarvie (1857) 2 H.&N. 114 at 120; Re George (1890) 44 Ch. D. 627.) Commonly, however the parties will expressly agree a time for repayment, or that repayment should be made on demand. In certain circumstances, for example in respect of money in a bank account, (Joachimson v Swiss Bank Corp [1921] 3 K.B. 110) there will be an implied term that the loan is only repayable on demand. In order to constitute a valid demand:

“there must be a clear intimation that payment is required; nothing more is necessary, and the word 'demand ' need not be used, neither is the validity of a demand lessened by it being clothed in the language of politeness; it must be of a peremptory character and unconditional, but the nature of the language is immaterial provided it has this effect.” (Re Colonial Finance, Mortgage, Investment and Guarantee Corp Ltd (1905) 6 S.R.N.S.W. 6 at 9, cited with approval in Re a Company [1985] B.C.L.C. 37 and Bank of Credit and Commerce International SA v Blattner Unreported November 20, 1986).

A term loan contract may specify certain “events of default”, the occurrence of one or more of which will give the lender the right to “accelerate” repayment. Typical events of default include: the
insolvency or winding-up of the borrower, execution of any legal process on the borrower's property, and (if the borrower is a partnership) the dissolution of the partnership. (*Chitty on Contracts*, 30th edn (2008), para. 38-253). Unless otherwise stipulated there is no obligation to notify the borrower and the lender's right to immediate repayment may arise automatically upon the occurrence of an event of default. (*Chitty on Contracts*, 30th edn (2008), para. 38-247).

Where a loan is secured, the lender may nevertheless sue upon the borrower's personal obligation to repay, which is unaffected by the security. (*National Westminster Bank Plc v Kitch* [1996] 1 W.L.R. 1316, *Re Bank of Credit and Commerce International SA (No. 8)* [1998] A.C. 214). Alternatively, the lender may realise the security, and, if it proves insufficient, sue for the balance. (*Chitty on Contracts*, 30th edn (2008), para. 38-257). Where, however, the promise to repay is contained in a covenant in a deed, the action must be brought on the covenant. (*Courtney v Taylor* (1843) 6 M.&G. 851).

**Interest.** Interest may be claimed in accordance with the applicable contractual term. Where there is no express agreement, there may be an implied obligation to pay interest if, for example, there has been a course of dealing between the parties (such as where interest has been charged and paid on other accounts without objection) (*Great Western Insurance Co v Cunliffe* (1874) L.R. 9 Ch. 525. See also *Lloyds Bank Plc v Voller* [2000] 2 All E.R. (Comm) 978; [2001] Lloyd’s Rep. Bank 67 (interest on bank overdraft). However, in the absence of an express or implied agreement to pay interest, there is no obligation at common law to pay interest, although the practical effect of that rule has now diminished as statutory interest can in all cases be claimed under s.35A of the Senior Courts Act 1981 s.69 of the County Courts Act 1984 or other relevant provisions. (*Chitty on Contracts*, 30th edn (2008), para. 38-275. Note that the Late Payment of Commercial Debts (Interest) Act 1998 does not apply to pending contracts, but only to certain contracts for the supply of goods and services).

Compound interest is recoverable pursuant to an agreement or by virtue of an established custom binding on the parties, but not otherwise. (*Ferguson v Fyffe* (1841) 8 Cl.&F. 121 at 140. As an exception to this rule, a trustee or fiduciary may be charged compound interest where has wrongly profited from the use of trust money: see *Chitty* op cit., para. 38-267. It is now possible to recover compound interest at common law, provided that it can be shown that this represents the loss suffered by the lender: *Sempra Metals Ltd v. Commissioners of Inland Revenue* [2007] 3 W.L.R. 354). A bank has a right implied by usage to charge compound interest on an overdrawn account, and that

The rule that there was no general common law obligation upon a borrower to pay interest for late payment was heavily criticised and has now been departed from by the House of Lords in Sempra Metals Ltd v Commissioners of Inland Revenue [2007] 3 W.L.R. 354 which held that a creditor receiving late payment may, in accordance with general principles of damages, recover lost interest (including compound interest) provided that such a loss is pleaded and proven.

Challenges to interest rates. In general, the contractual terms of a loan will provide for interest to be payable, and the provision determining that rate of interest will not be susceptible to attack as a penalty since the obligation to pay interest does not arise as a result of any breach of contact. However, it is possible that a default rate of interest, i.e. a higher rate of interest arising as a result of the borrower defaulting in his contractual obligations, may be regarded as being penal. The law on this topic was set out by Coleman J. in Lordsvale Finance Plc v Bank of Zambia ([1996] Q.B. 752. In summary: (a) a default rate of interest which applies retrospectively is susceptible to attack as a penalty; and (b) in general, a prospective rate of interest will not be a penalty unless the rate is exceptionally high. (For an example of an exceptionally high rate of interest see Jeancharm Ltd v Barnet Football Club Ltd [2003] EWCA Civ 58 (a rate of 5% per week, equivalent to 260% pa). Cf Frost v James Finlay Bank Ltd [2002] Lloyd’s Rep. I.R. 429 (where the rate increased by 2% on default) and its dominant function is in terrorem the borrower. In general, a defaulting borrower is regarded as being a greater credit risk than the non-defaulting borrower, justifying the application of a higher rate of interest.

A loan agreement containing an exceptionally high rate of interest from the outset would also have been susceptible to attack as an extortionate credit bargain under s.138 of the Consumer Credit Act 1974. However, that provision has now been replaced by ss.l40A-l40D of the Act, which set a lower threshold: s.l40A enables a court to make an order under s.l40B if it finds that the relationship between the creditor and the debtor arising out of a credit agreement or that agreement taken with any "related agreement", is unfair to the debtor as a result of one or more of three factors. Those factors are: (a) any of the terms of the agreement (or related agreement); (b) the way in which the creditor has exercised or enforced any of his rights under the agreement (or any related agreement); or (c) "any other thing done (or not done) by, or on behalf of, the creditor (whether occurring before or after the making of the agreement or any related agreement)". In determining whether one or
more of the three factors in s.l40A(l) give rise to an “unfair” credit relationship, s.l40A(2) requires
the court to "have regard to all matters it thinks relevant", including matters relating to the debtor
as well as the creditor. It has been suggested that, notwithstanding the width of this provision, the
courts are unlikely to regard standard rates of interest (including default interest) as giving rise to an
unfair relationship provided that the rates are set for genuine commercial reasons, i.e. the
legislation is designed to protect consumers, but not to force creditors to act uncommercially.
(Brown, “The unfair relationship test, consumer credit transactions and the long arm of the law”
(2009) L.M.C.L.Q. 90.) This is in line with the Court of Appeal’s approach under the former
legislation. (Paragon Finance v Nash & Staunton [2002] 1 W.L.R. 685; Broadwick Financial Services

Novation. Novation of a debt requires the consent of both contracting parties, as well as the third
party. (Chitty on Contracts, op. cit., para. 19-086). Such a novation will arise, for example, where
the composition of partnership changes, (Chitty on Contracts, op. cit., para. 3-175) or upon the
amalgamation of companies. The effect of a novation is not to assign or transfer rights or liabilities
but rather to extinguish the original contract and to replace it by another. It is therefore necessary
for there to be consideration for the new contract. (Tatlock v Harris (1789) 3 T.R. 174 at 180).

THE LAW OF PARTNERSHIP

THE ESSENTIAL FEATURES OF PARTNERSHIP LAW

Introduction

The Partnership Act 1890 forms the basis of partnership law in the United Kingdom. This was a
codifying statute designed to “declare and amend the law of partnership” (the words used in the
long title). The Act provides that the common law rules remain in force except in so far as they are
inconsistent with the express provisions of the Act (Section 46).

A contractual relationship

A partnership depends upon an existing relationship which results from a contract. The contract is,
as Jessel MR explained in Pooley v Driver ((1877) 5 Ch D 458, 471)).
A contract for the purpose of carrying on a commercial business – that is a business bringing profit in some shape or another between the partners.

A partnership relationship can arise only by mutual consent, which may be express or inferred from parties’ conduct. No new partner can be introduced without the consent of all the partners (The personal nature of a partnership means that a partner has agreed to associate with his co-partners and no-one else).

**Partnership and legal personality**

**English Law**

English law does not recognise the partnership (or firm) as an entity separate and distinct from the partners who at any time may compose it. The firm cannot acquire rights nor can it incur obligations. A firm cannot hold property. The rights and liabilities of a partnership are the collection of the individual rights and liabilities of each of the partners. The firm name is a mere expression, not a legal entity (*Sadler v Whiteman* [1910] 1 KB 868, 889, *per* Farwell LJ).

A change in a membership of a firm “destroys the identity of the firm” (Lord Lindley quoted in *Lindley & Banks*, para 3-04; and see *De Tastet v Shaw* (1818) 1 B & A 664; 106 ER 244; *Richardson v The Bank of England* (1838) 4 My & Cr 165; 41 ER 65; *Lee v Neuchatel Asphalte Co* (1889) 41 CH D 1; *Green v Hertzog* [1954] 1 WLR 1309). The “old” firm is dissolved, and if the surviving members continue in partnership (with or without additional partners) a “new” firm is created. The new firm can take over the assets of the old one and assume its obligations (Transfer of obligations will normally require the consent of the creditor). This involves a contractual arrangement between the members of the old firm and the new firm, to continue the old firm’s business. But even an agreement in advance that partners will continue to practice in partnership on the retirement of one of their number does not prevent the partnership which practices the day after the retirement from being a different partnership from that in business on the previous day (Eichelbaum CJ in *Hadlee v Commissioners of Inland Revenue* [1989] 2 NZLR 447).

This legal analysis can be contrasted with the commercial view of the partnership. Lord Lindley summarised this approach in the following way:
The partners are the agents and sureties of the firm: its agents for the transaction of its business; its sureties for the liquidation of its liabilities so far as the assets of the firm are insufficient to meet them. The liabilities of the firm are regarded as the liabilities of the partners only in case they cannot be met by the firm and discharged out of its assets (Quoted in Lindley & Banks, para 3-02).

It has been suggested on a number of occasions that it would be appropriate to reform the English law of partnership to reflect more closely this commercial perception by introducing separate legal personality (Mercantile Law Amendment Commission, 2nd Report, 1855, p 18 and Lindley & Banks, para 1-09). By contrast the Scots law of partnership conforms substantially to Lord Lindley’s summary of the commercial view.

These contrasting views can be characterised on a conceptual level as partnership as an “aggregate” – that is, a relationship among the partners – or as an “entity” – that is, a personality existing separately from its partners (see particularly the academic debate in the United States of America, eg Gary S Roslin, “The Entity-Aggregate Dispute; Conceptualism and Functionalism in Partnership Law” (1989) 42 Arkansas Law Review 395-466).

To date English law has maintained the “aggregate” approach. There are, however, some exceptions to this approach. These are mainly for administrative convenience. For example the firm name is recognised for the purposes of court proceedings (CPR, Sched 1, RSC, O 81 r 1; CPR, Sched 2, CCR, O 5, r 9(1)). Also the firm name may be recognised for VAT purposes and, where it is, no account is taken of changes in a membership of a firm (Value Added Tax Act 1994, s45). Apart from such exceptions, the name of the firm is, in English law, no more than convenient shorthand for referring to a group of persons who conduct a business together.

Agency

In England and Wales a partner cannot be an agent of the firm as an entity because it lacks legal personality.

The critical concept in the English law of partnership is the concept of mutual agency (See 1890 Act, s 5). Whenever a partner makes a contract, it is on behalf of that partner and the other partners. If they breach the contract, they will be liable for any consequential loss. There is no limit to this liability. This is a facet of the law of agency: a partner is both an agent and a principal and, as a
principal, has unlimited liability for the acts of the agent. This extends to any debt or obligation contracted by the agent (1890 Act, s 9. In English law the liability of the partners is joint) any wrongful act done by an agent – that is, a partner – within the limits of his authority (1890 Act, s 10. Liability under s 10 now includes (as a matter of statutory construction) accessory liability in equity: see Dubai Aluminium Co Ltd v Salaam, The Times 21 April 2000. Partners’ liability under section 10 is joint and several: see 1890 Act, s 12) and any misuse of any property which has been received by an agent in the ordinary course of his principal’s business (1890 Act, s 11. Partners’ liability is joint and several under this section: see 1890 Act, s 12).

The liability of a partner (in English law as principal) lasts for as long as other partners (as agents) have authority to bind that partner. The partner is not liable for obligations incurred before this agency relationship is created (1890 Act, s. 17(1) (in absence of agreement to the contrary)), and he is not liable for obligations incurred by his former partners after the agency relationship has ended (See paras 10.49 – 10.53 below and 1890 Act, s 36).

**Fiduciary duties**

As partners place mutual trust and confidence in each other, they stand in a fiduciary relationship. A partner must display the utmost good faith towards his fellow partners in all partnership dealings. A partner owes his co-partners a duty to be honest in his dealings with third parties, even if the transactions are not of a partnership nature (See Carmichael v Evans [1904] 1 Ch 486. Honest in this context means abstaining from fraud. For a discussion of the content of the duty of good faith see para 14.9 et seq).

It is worth noting briefly some of the aspects of the partners’ fiduciary relationship. One partner cannot make a profit at the expense of his co-partners without their full knowledge and consent (1890 Act, ss 29 and 30). A partner should not make a secret profit in the course of a sale to or purchase from his firm and must account for such profit (Gordon v Holland (1913) 108 LT 385). To avoid this duty to account a partner must make full disclosure of his interest to his fellow partners.

A partner will be liable to account if he secures (or tries to secure) a personal benefit which should, as a consequence of his duties to his fellow partners, be obtained for the benefit of the firm (Powell and Thomas v Evan Jones & Co [1905] 1 KB 11). This obligation applies equally where the benefits are the result of the use of partnership property (1890 Act, s 29). A partner’s use of information received in the course of the partnership business to secure a personal benefit which will give rise to
a similar obligation (*Boardman v Phipps* [1967] 2 AC 46). A partner must not, without his co-partners’ consent, carry on any business in competition with the firm, although he may carry on a non-competing business.

In English law a partner’s fiduciary duties are owed to his fellow partners.

**Management and financial rights**

Section 24 of the 1890 Act sets out partners’ management and financial rights which apply in the absence of contrary agreement (Section 19 of the 1890 Act provides: “the mutual rights and duties of the partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing”. A person cannot agree to a contractual term of which he is unaware. Consequently, a new partner would be bound by an implied variation only if his assent could be inferred either from a further course of dealing or if the existing partners had informed him of the variation). These default rules provide, for example, that partners are entitled to share equally in the capital and profits of the firm, (1890 Act, s 24(1)) are entitled to take part in the management of the business (1890 Act, s 24(5)) and can agree ordinary matters connected with the partnership business by a majority (1890 Act, s 24(8)) so long as all partners are present and able to express a view (*Const v Harris* (1824) Turn & R 496, 525; 37 ER 1191, 1202; *Lindley & Banks* para 15-08, Clark, Vol I p 189). To reflect the contractual nature of partnership unanimity is required for the introduction of a new partner (1890 Act, s 24(7)).

**Partnership property**

In England and Wales the firm does not have separate legal personality and, unlike a company, cannot own property. It is necessary therefore to distinguish between property held for the partnership and the property of its individual members. This is done in the 1890 Act by the concept of partnership property (1890 Act, s 20(1)). It is of fundamental importance in distinguishing between the assets available to meet claims of the creditors of individual partners and the creditors of the firm and in attributing the benefit of any increase in the value of the property.

The question of what is partnership property is not always straightforward. Property can be used for the purposes of the partnership and yet not be part of the partnership’s property: its status depends on the agreement, express or implied, between the partners. In practice the preparation of
accounts may well disclose whether an asset is partnership property. If every partner has assented to the inclusion of an asset in the balance sheet, this will normally be sufficient agreement. If there is no express agreement sections 20 and 21 of the 1890 Act set out the factors which will generally be relevant. The circumstances behind and the purpose of the acquisition of the asset, the source from which it is financed and how it is subsequently dealt with, will normally determine the status of property.

In English law a legal estate in land can only be held by a maximum of four partners (Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2)). For larger firms four partners will hold the legal estate on trust for themselves and their co-partners according to their beneficial interests. An alternative option is for partnerships to vest land either in a company controlled by the partnership and set up for that purpose or in a nominee which holds the land on a bare trust for the partnership. This avoids the need to transfer the estate on the death or retirement of one of the trustees.

Partners, express or implied, determines the status of the property (Bell, Comm II, 501-502. The title of a bona fide third party may however prevail over a latent trust: see Redfern v Somervail (1813) 1 Dow 50; 3 ER 618).

**Duration of partnership**

A partner has no right to retire from a partnership otherwise than by agreement. A partnership falls into one of two categories namely a partnership at will or a partnership for a fixed term. A partnership at will exists where the partnership agreement is silent as to the duration of the partnership (Moss v Elphick [1910] 1 KB 465 and 846; Walters v Bingham [1988] 1 FTLR 260; Abbott v Abbott [1936] 3 All ER 823). A partner in a partnership at will can, however, dissolve the partnership immediately by notice (1890 Act, ss 26 and 32). Transactions begun but unfinished may then be completed (1890 Act, s 38) and the partnership’s assets distributed (1890 Act, ss 39 and 44).

In a partnership for a fixed term, a partner who wants to retire can only do so with the consent of his fellow partners. Alternatively, he can apply to the court to wind up the firm under section 35 of the 1890 Act.

If a partnership for a fixed term is continued after the expiry of that term, without any express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term, so far as is consistent with the incidents of a partnership at will (1890 Act, s 27(1). It may
be difficult to determine which clauses are consistent with a partnership at will. See for example *Lindley & Banks* paras 10-20 – 10-21). In English law, where a new partner is admitted to a fixed term partnership, that partnership is determined and a new one is created, which may also be a fixed term partnership or may be at will, depending upon the terms of the original agreement (*Firth v Amslake* (1964) 108 SJ 198).

Unless the partners agree otherwise, the death or bankruptcy of a partner means that the partnership is dissolved as regards all partners and that it should be wound up (1890 Act, s 33). This is so even if the partnership was entered into for a fixed term which has not expired (*Crawford v Hamilton* (1818) 3 Madd 251; 56 ER 501; *Downs v Collins* (1848) 6 Hare 418; 67 ER 1228; *Lancaster v Allsup* (1887) 57 LT (NS) 53).

All the partners can agree to dissolve the partnership. Parties to a contract can agree to terminate the relationship; and this applies to the relation of partnership as much as to any other contract. The partnership agreement may, of course, vary these requirements, so that unanimity is not needed.

A temporary cessation of the partnership business may not cause a dissolution (*Millar v Strathclyde Regional Council* 1988 SLT (Lands Tribunal) 9). But, as the very existence of a partnership is intrinsically linked to the carrying on of a business, an agreement of the partners permanently to cease all forms of business must be taken as an agreement to dissolve the partnership.

A partnership is dissolved where an event occurs which makes it unlawful to carry on the business of the firm or for the members to carry it on in partnership (1890 Act, s 34). Repudiation of the partnership contract, which is accepted by the partner or partners not in breach, may also bring a partnership to an end. The 1890 Act does not regulate withdrawals from a firm, expulsions or the effect of the assumption of a new partner but does provide that a partner may apply to the court to dissolve a partnership on a number of specified grounds, including the general ground that it is just and equitable that the partnership be dissolved (1890 Act, s 35).

Where a partnership agreement provides that the partnership is not to be dissolved on the death of a partner, the 1890 Act envisages that there will be no dissolution (1890 Act, s 33(1)). Many partnership agreements provide for the partnership to continue notwithstanding the death, retirement or expulsion of a partner or the assumption of a new partner. In such circumstances, case law suggests that the partnership as a contractual relationship does not come to an end so long
as two or more partners remain in business together (Jardine-Paterson v Fraser 1974 SLT 93 and William S Gordon & Co Ltd v Mrs Mary Thomson Partnership 1985 SLT 122. See also Knapdale (Nominees) Ltd v Donald (unreported) 25 May 2000, Lord Kingarth, in which doubts were expressed as to the correctness of the decision in William S Gordon & Co Ltd).

Relations with third parties

Effect of change in membership of firm

The basic contractual position is that a party to a contract cannot transfer his obligations under that contract without the other party's consent (Humble v Hunter (1848) 12 QB 310, 317; 116 ER 885, 887; Don King Productions Inc v Warren and Others [1999] 3 WLR 276, 201; Gloag, Contract (3nd ed 1929) p 416, but cf Cole v CH Handasyde & Co 1910 SC 68). But there is an objection to a third person's performance of a contracting party's obligations where the contract is not connected with the skill, character or other personal qualifications or attributes of that party (See Halsbury's Laws of England, Vol 9 (4th ed 1974) para 337; Don King Productions Inc v Warren and Others [1993] 3 WLR 276, 201; McBryde, Contract, para 17-36 et seq). This does not mean that the original party is released (Tolhurst v Associated Portland Cement Manufacturers Ltd [1903] AC 414, 423-424, per Lord Lindley), unless express agreement between all of the parties or their conduct is sufficient to effect a novation. Whether a contract has a nexus with the skill, character or other personal attributes of a party is a question of construction of the true intention of the parties to the contract.

In English law a contract with a partnership is a contract with the members of that firm. It is a matter of construction whether a contract can be performed “vicariously” by another set of persons, for example, a “new” partnership.

Whether a change in the identity of the party determines the contract and whether or not it amounts to a breach of contract also depends on the nature of the change and the proper construction of the contract (Tasker v Shepherd (1861) 6 H & N 575; 158 ER 237; Brace v Calder [1895] 2 QBD 253; Sheppard & Cooper Ltd v TSB Bank plc [1997] 2 BCLC 222, 227). In general, it is more likely that dissolution of the firm on a change in its membership terminates a contract where the firm is small, for example a two-man partnership, than where the contract is with a larger firm (Briggs v Oates [1990] ICR 473, 482).
**Loans and the rule in Clayton’s case** (In this section the discussion of *Clayton’s Case* is relevant not only generally in England and Wales but also in Scotland in circumstances where a change in the membership of a firm terminates the legal personality of the “old” firm and gives rise to a “new” firm).

Lenders to a firm that has changed its membership may, under the terms of the loan, change a “rearrangement” fee for the substitution of the “new” firm as “new” borrowers in place of the old. Even if this is done, they may refuse to release the outgoing partner from his contractual liability.

If a single running account is maintained with the bank, on a change of membership of the firm, the well-known rule in *Clayton’s Case* ([1816] 1 Mer 572; 35 ER 781) will apply. Withdrawals from the account will operate to reduce or cancel deposits in the order in which they were made – the “first in, first out” rule. Deposits will be applied in reduction of indebtedness in the same order. For partnerships this means that money paid into a current account by the “new” firm will reduce the debts of the “old”. Therefore, if deposits of the “new” firm exceed the debts of the “old”, a debit balance on the account will be a liability of the “new” firm alone (If a new partner has joined, he will only be liable if he has expressly or impliedly consented to treating debts before and after his admission as forming one continuous account. See 1890 Act, s 17(1)). If the “new” firm becomes insolvent, the creditor has no recourse against the “old” firm whose indebtedness has been discharged.

The rule in *Clayton’s Case* applies even if the bank is unaware of a change in composition, (See *Lindley & Banks*, para 13-88. The rule is based on the parties’ presumed intentions. It can be modified by express or implied agreement: see *Barlow Clowes International v Vaughan* [1992] 4 All ER 22, 28 – 29), provided that both firms have been treated on the basis of one running account. In practice the rule in *Clayton’s Case* does not present problems for banks. A bank may keep accounts of the “old” and “new” firms separate. To prevent the operation of the rule when a partner leaves the firm, banks will frequently “freeze” the current account, unless:

1. on a debit balance, the bank is content to accept the “new” firm’s assumption of the indebtedness of the “old”, and thereby discharge the outgoing partner; or

2. on a credit balance, the outgoing partner confirms that he has no claim to the deposit.

**Partner’s liability and a third party’s access to information**
A partner’s liability (In England and Wales as a principal and in Scotland through his subsidiary liability for the firm’s debts) for new debts incurred on the firm’s behalf lasts for as long as other partners (as agents) have authority to bind that partner. Nonetheless, third parties are entitled to assume that other partners remain agents until they are notified to the contrary (1890 Act, s 36). This means that partners should notify any future clients by advertising their withdrawal from partnership in the London Gazette (if the firm is English or Welsh) (1890 Act, s 36(2)). An outgoing partner who wishes complete freedom from post-withdrawal partnership debts may require to notify clients who had dealings with the firm before his withdrawal as the Gazette advertisement under section 36 of the 1890 Act is notice only to persons who had no such dealings.

It is often difficult for a third party to ascertain who was a partner at a particular time. The Business Names Act 1985 (This Act is discussed in more detail in Part 21 below) requires the disclosure of the names of current partners where a firm has a place of business and carries on business in Great Britain under a business name which does not consist exclusively of the surnames of all of the partners (with certain permitted additions) (These permitted additions include the forenames and initials of the partners and the letter “s” if there is more than one partner sharing the same surname).

There is no obligation under the Business Names Act 1985 to record when a person becomes a partner. There is no requirement to keep a record of “old” partners. Consequently the Business Names Act 1985 does not help a third party establish at a later date who were the partners at the time a liability was incurred.

Insolvency

In English law the Insolvency Act 1986, as applied by the Insolvent Partnerships Order 1994 (SI 1994/2421), tries to assimilate partnerships into the framework that governs corporate insolvency.

Under English law, a partnership may be wound up as an unregistered company and be subject to the legislation governing corporate insolvencies. Under this procedure a partner will be regarded as an office of the firm and also as a contributory. As an office the partner may be subject to the provisions of the Company Directors (Disqualification) Act 1986 (As modified by Schedule 8 to the 1994 Order). To bring it into line with corporate rescue options a partnership can now be subject to an administration order (1994 Order, art 6 and Sched 2) and to voluntary arrangements (1994 order, art 4 and Sched 1) but these procedures do not protect the personal estates of the partners.
Existing law on dissolution of partnership as regards all the partners

The following are the grounds on which a partnership comes to an end as regards all the partners:

(a) Reduction of the number of partners to below two (This is the result of the definition of a partnership);

(b) Expiry of fixed term, subject to any agreement between the partners (1890 Act, s 32(a). Although this is said to be “subject to any agreement between the partners” an advance agreement to the contrary would normally convert the partnership into something other than one for the original fixed term and an agreement to the contrary after the termination of the partnership would, logically, be an agreement for a new partnership. See also s 27 which regulates the position where the business in fact is continued after the fixed term without any express new agreement. Section 27 implies a new agreement on the same terms as the old so far as is consistent with the incidents of a partnership at will. In Scotland, the effect of s 27 is that the partnership contract is one to which the doctrine of tacit relocation applies (although with the modification that the contract is continued indefinitely rather than for the same length of time as the original term or on a year to year basis). It should be noted that tacit relocation does not apply where the partnership continues after any other event which should terminate the partnership (eg, a partner’s death or bankruptcy));

(c) Termination of the single adventure or undertaking for which the partnership was entered into, subject to any agreement between the partners (Section 32(b). Again, it may be observed that if the partners have agreed to the contrary in advance then the partnership could no longer be regarded as one entered into for that undertaking or adventure. If they agree later to continue the partnership then that comes too late and they are really agreeing to a new partnership);

(d) Notice by one partner of intention to dissolve the partnership (A right to give such notice, in any case where no fixed term has been agreed for the duration of the partnership, is conferred by s 26, Section 32(c) regulates the effect, on the partnership as a whole, of giving notice) where the partnership was entered into for an undefined time (A partnership entered into “until dissolved by mutual agreement” is not entered into for an undefined time: Moss v Elphick [1910] 1 KB 465 and 846. Neither is a partnership entered into until a
new partnership deed is executed: *Walters v Bingham* [1988] 1 FTLR 260), subject to any agreement between the partners; (Section 32(c). The Act provides that: “The partnership is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is so mentioned, as from the date of the communication of the notice”. The effect of an agreement between the partners would depend on its terms. If it provides that the partnership is to be dissolved only as regards the partner giving notice then the effect would be to confer a right to retire rather than a right to dissolve the partnership as regards all the partners. See, eg, *Abbott v Abbott* [1936] 3 All ER 823. Here the partnership agreement between a man and his five sons provided that the death or retirement of any partner was not to terminate the partnership. It made provision for buying out the share of a retiring partner at book value. One son gave notice of dissolution under s 32 and asked for the affairs of the partnership to be wound up by the court. It was held that the effect of this notice was not to determine the partnership as regards all the partners but only to determine the partnership relationship between the son giving the notice and the other partners);

(e) Death or bankruptcy of a partner, subject to any agreement between the partners (Section 33(1));

(f) At the option of the other partners, a partnership may be dissolved if any partner “suffers his share of the partnership property to be charged under this Act for his separate debt” (Section 33(2). This is of no application in Scotland where s 23 (on charging the partner’s share of the partnership property) does not apply);

(g) Occurrence of an event which makes it illegal for the partnership business to be carried on or for the partners to carry it on in partnership (Section 34);

(h) Dissolution by a court on one of several statutory grounds; (Section 35. See para 6.37 below);

(i) Dissolution by the unanimous agreement of the partners for the time being (This is a consequence of the fact that a partnership is a voluntary association which depends on there being a continuing contractual relationship between the partners. We understand that it is common practice to provide in the partnership agreement that a majority of the
partners can dissolve the partnership by agreement. However, we are dealing here with default rules which apply when there is no agreement to the contrary).

Prior to the House of Lords decision in Hurst v Bryk, ([2002] 2 WLR 740) it was assumed that a recession or setting aside of an underlying partnership agreement led to an automatic dissolution of the partnership (See for example, the Court of Appeal decision of Hurst v Bryk [1999] Ch 1). Doubts were expressed by Lord Millett in the House of Lords as to whether this assumption was correct.

It will be noted that some of the terminating events apply “subject to any agreement between the partners”. Any such agreement has to be unanimous. Normally it would be contained in the partnership agreement but in any event it must, if it is to prevent termination, be made before the terminating event takes place. An agreement after that event would come too late to prevent termination (The partners could of course agree to enter into a new partnership but that is a different matter).

It will also be noted that the Act does not provide for the whole partnership to come to an end on the retirement or expulsion of a partner in the terms of the partnership agreement. There is, however, nothing to stop the partners providing for this result in their partnership agreement. They may well do so if, for example, the skills of the partner in question are essential to the success of the partnership business.

Effect of death or bankruptcy of a partner

The 1890 Act provides that:

Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner (Section 33(1)).

Effect of illegality affecting only one partner

Section 34 of the 1890 Act provides that:

A partnership is in every case dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership (Section 34).
It can quite easily happen that an illegality affects only one partner. For example, in a professional partnership where each partner must have a licence or certificate to practice, one partner may lose the licence or certificate and may be unable to practice lawfully as a partner (See *Hudgell Yeates & Co v Watson* [1978] QB 451. It is possible for a partnership agreement to provide that a disqualified partner is deemed to have retired immediately prior to the disqualification).

**Effect of challenge to partnership agreement on common law ground**

In *Hurst v Bryk*, at first instance and in the Court of Appeal it was assumed that ordinary principles of contract law applied to partnership contracts (*Hurst v Bryk* [1999] Ch 1). According to that view, the partnership contract may be terminated by a partner if there has been a reputation of it or a material or fundamental breach (these are the Scottish and English terms respectively) of it by the other partner or partners. The effect would be to bring the contract to an end, subject to certain qualifications (for example, clauses like arbitration clauses may survive. Section 38 of the 1890 Act will apply. See *Hurst v Bryk* [1999] Ch 1). However, in *Hurst v Bryk* in the House of Lords, Lord Millett has expressed the obiter view that an accepted repudiatory breach terminates the partnership contract, but that it does not bring about an automatic dissolution of the partnership (*Hurst v Bryk* [2000] 2 WLR 740, 746-750). He reserved for future consideration whether this was the case. His main reason was that such a dissolution would circumvent the court’s discretion under section 35(d) as to whether or not to order a dissolution. In his opinion in entering a partnership relationship parties submit to the equitable jurisdiction and give up their right to bring about a dissolution by repudiatory breach. He was of the view that there should not be another ground for dissolution outside the provisions of the 1890 Act.

We respectfully question Lord Millett’s view. If it is correct, the termination of the contract will bring about a partnership at will which the accepting parties may then terminate immediately, rendering section 35(d) otiose. It seems strange that the accepting partners, having terminated the partnership agreement, should have to take any further step to terminate the partnership at will. In the circumstances of a repudiatory breach and an acceptance putting an end to the formal contract the conduct of the accepting partners is likely of itself to put an end to the partnership at will at the same time as it would commence under Lord Millett’s analysis.

**Fraud and misrepresentation**
There is a common law right of rescission where a partner makes a fraudulent, negligent or innocent misrepresentation to a prospective partner, inducing him to enter into partnership (Adam v Newbigging (1888) 13 App Cas 308; Redgrave v Hurd (1881) 20 ChD 1. See generally, Chitty on Contracts (28th ed 1999) paras 6-101 et seq). Section 41 of the 1890 Act provides for the situation where a partnership contract is rescinded on the ground of fraud or misrepresentation, by conferring certain rights on the partner entitled to rescind the partnership contract. Although it need not be, the rescission would normally be effected by court order. Consistent with our provisional view in relation to repudiatory breach we suggest that rescission in cases of fraud and misrepresentation should only be effected by court order.

Dissolution by court

At present section 35 of the 1890 Act provides as follows:

On application by a partner the Court may decree a dissolution of the partnership in any of the following cases:

(a) [mental incapacity of a partner] (The provisions vary for different parts of the United Kingdom. In Scotland the original s 35 still applies. It provides for dissolution by the court “When a partner is found lunatic by inquisition, or in Scotland by cognition, or is shown to the satisfaction of the Court to be of permanently unsound mind, in either of which cases the application may be made as well on behalf of that partner by his committee or next friend or person having title to intervene as by any other partner”. This archaic language clearly needs to be updated. In England and Wales the original wording has been repealed and the current provisions are now found in the Mental Health Act 1983 s96(1)(g) which provides that “the judge shall have power to make such orders and give such directions and authorities as he thinks fit for the purposes of [section 95] and in particular may for those purposes make orders or give directions or authorities for ... the dissolution of a partnership of which the patient [ie, a person who the judge is satisfied, after considering medical evidence, is incapable, by reason of mental disorder, of managing and administering his property and affairs – section 94(2)’] is a member”;

(b) When a partner, other than the partner suing, becomes in any other way permanently incapable of performing his part of the partnership contract;
(c) When a partner, other than the partner suing, has been guilty of such conduct as, in the opinion of the court regard being had to the nature of the business, is calculated to prejudicially affect the carrying on of the business;

(d) When a partner, other than the partner suing, wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the other partner or partners to carry on the business in partnership with him;

(e) When the business of the partnership can only be carried on at a loss;

(f) Whenever in any case circumstances have arisen which, in the opinion of the court, render it just and equitable that the partnership be dissolved.

The court only has power to dissolve the partnership as a whole. It cannot expel the partner who is causing the difficulty, while allowing the partnership to continue as between the other partners.

Other possible reforms

Frustration of the partnership contract

It is unclear whether a frustrating event automatically dissolves the partnership contract. It is submitted in Lindley & Banks that the doctrine of frustration cannot be applied to partnership agreements (Lindley & Banks, para 24-05). This view is formed on the basis that “a number of potentially frustrating events are specifically catered for by the Partnership Act 1890, so that, by necessary implication, the application of the doctrine to those and other events must be excluded”. Sections 33(1) (death or bankruptcy), 34 (illegality) and 34(b) (permanent incapacity) are given as examples by Lindley & Banks of potentially frustrating events specifically covered by the 1890 Act. The doubts expressed in Hurst v Bryk ([2000] 2 WLR 740) as to whether normal rules of contract apply to partnership contracts add to the uncertainty regarding frustration.

POSITION OF OUTGOING PARTNER

There will be an outgoing partner, where one partner ceases to be a partner but the partnership continues as a relation or voluntary association between at least two remaining partners. It may
continue either because the partnership agreement provides for this or because new default rules are introduced to provide for continuity.

**General**

The 1890 Act deals with the main effects of dissolution of a partnership in sections 36 to 44 (it also has rules, in sections 14, 17 and 36 on the liability of an outgoing partner for partnership debts. We deal with these rules later). The Act does not contain separate parts dealing respectively with the position where the partnership comes to an end as regards all the partners.

**An outgoing partner’s right to enforce a sale**

Section 39 of the 1890 Act provides that:

> On the dissolution of a partnership every partner is entitled, as against the other partners in the firm, and all persons claiming through them in respect of their interests as partners, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus assets after such payment applied in payment of what may be due to the partners respectively after deducting what may be due from them as partners to the firm; and for that purpose any partner or his representatives may on the termination of the partnership apply to the court to wind up the business and affairs of the firm.

Although this appears to give an absolute right to an outgoing partner to demand a winding up, with the sanction of applying to the court if the other partners do not agree, its effects have been qualified by the courts. First, it may be held that the outgoing partner has expressly or by implication waived the right to demand a winding up, particularly if all the partners had agreed in advance that the partnership and its business would continue (See, e.g., Sobell v Boston [1975] 1 WLR 1587, 1591, *per* Goff J). Secondly, a ‘salaried partner’, even though held to be a true partner, might not have a right to demand a winding up, depending on the circumstances of the case (See Stekel v Ellice [1973] 1 WLR 191, where the salaried partner was held to lack any proprietary interest in the firm’s capital, goodwill or clients). Thirdly, the English courts have retained a discretion to order that the share of the outgoing partner in the partnership should simply be valued and paid in lieu of having a winding up. This is known as a *Syers v Syers* ((1876) 1 App Cas 174) order after the decision of the House of Lords in that case (This discretion is unaffected by the 1890 Act: see *Hugh
Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie [1917] 1 KB 842, 857, per Lawrence J (CA); [1918] AC 239, 254 – 255, per Lord Atkinson (HL)).

A Syers v Syers order should not be part of a ruling on the entitlement to partnership assets, but should only be made when the Court is giving directions on the method of winding up a partnership and the ascertainment and distribution of assets (Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie [1918] AC 239, 255). The precise extent of the availability of a Syers v Syers order is unclear. It may be available when the outgoing partner’s share is small as in Syers v Syers itself (Partners holding a seven-eighths interest in the firm were allowed to buy the remaining one-eighth interest of the other partners). It may also be available where a sale of the assets is impracticable.

In the unreported Court of Appeal case of Hammond v Brearley and Burnett (10 December 1992) Hoffman LJ noted that a Syers v Syers order is available in ‘exceptional’ cases (In Hammond v Brearley and Burnett (unreported) 10th December 1992, Hoffman LJ also observed that it is ‘notorious’ in the Chancery Division that Syers v Syers is more frequently cited than applied). In Hammond, one partner had a share in minor assets, but no interest in the firm’s goodwill. At an interlocutory hearing an order for the sale of partnership assets was made. Hoffman LJ considered the facts of the case to be highly unusual and possibly appropriate for a Syers v Syers order. He held that this possibility should have been left to the discretion of the trial judge (Similarly in Toker v Akgul [1996] 6 CL 466 Evans LJ, giving the leading judgment of the Court of Appeal, held that the court’s ability to make the appropriate order in a partnership dispute “should reign supreme”).

The courts, by modifying the apparently unqualified right conferred by section 39, have recognised that it is not always appropriate for an outgoing partner to have an absolute right to demand a winding up of the partnership. However the above cases demonstrate the limited availability of a Syers v Syers order. The usual position will be that, in the absence of an express or implied waiver, an outgoing partner has the right to enforce a winding up of this business.

The right of the outgoing partner to have the partnership affairs wound up and the assets applied to meet the liabilities is arguably too strong. It places the outgoing partner in a powerful position and may lead to the break-up of businesses which could otherwise have continued. On the other hand it is necessary for the default rules in the Act to recognise, and provide proper protection for, the legitimate interests of the outgoing partner who might have serious and well-founded doubts about
the ability of the remaining partners to pay the value of the outgoing partner’s share in the partnership.

**Interest on the value of the outgoing partner’s share**

**Section 42**

Section 42 deals with the situation where the continuing partners carry on the partnership business with its capital or assets without any final settlement of accounts with the outgoing partner. It applies not only where the partnership continues but also where the partnership assets are used in the way indicated – even if by a new partnership or even by a sole remaining partner (See, for example, *Barclays Bank Trust Co Ltd v Bluff* [1982] Ch 172). It is a sort of special statutory rule on restitution or unjustified enrichment designed to prevent the persons using the assets from profiting from that use at the expense of the outgoing partner.

Section 42 provides that:

1. Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the Court may find to be attributable to the use of his share of the partnership assets (The section refers to partners carrying on the business of the firm “with its capital or assets”. Interestingly earlier drafts of the Partnership Bill referred throughout to capital or assets. However, a partnership’s assets would include its capital, so nothing turns on this), or to interest at the rate of five per cent, per annum on the amount of his share of the partnership assets.

2. Provided that where by the partnership contract an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of the profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.
Section 24(1) provides that, subject to agreement to the contrary, partners are entitled to share equally in the capital and profits of the business. That those rights continue following dissolution is apparent from Section 38 (See para 8.5 et seq). In *Popat v Shonchhatra* ([1997] 1 WLR 1367) the Court of Appeal held that section 42(1) is an exception to the general application of section 24(1) post-dissolution, but that post-dissolution capital profits are covered by section 24(1), not being profits within the meaning of section 42(1) (It is our view that an increase in value of a capital asset cannot be regarded as being attributable to the *use* of a share of the partnership assets).

There are considerable practical problems in determining what profits (if any at all) are attributable to a partner’s share of partnership assets (These difficulties were considered in *Willet v Blanford* (1842) 1 Hare 253, 269; 66 ER 1027, 1033; per Wigram V-C and in *Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie* [1917] 1 KB 842, 849 (affirmed [1918] AC 240 (HL)) by Swinfen-Eady LJ, where it was pointed out that; “subsequent profits may be wholly attributable to the diligence, business aptitude, credit, and personal qualities of the remaining partners”. Wigram V-C’s guidelines amount to this: an outgoing partner may be entitled to an account of post-dissolution profits but this can only be satisfactorily determined when all the facts are put before the court; there are a number of conceivable outcomes).

In many situations the partners have control over the duration of the partnership. In such situations there is nothing to stop partners from winding up the affairs of the partnership, so far as possible, before it is dissolved. They may be able to sell all the assets, pay all the debts, distribute all the surplus and then dissolve the partnership by unanimous agreement. There are advantages in proceeding in this way where it is possible; it gives rise to no legal problems requiring reform and we do not deal with it further. We are concerned in this Part with the more usual situation where the partnership is dissolved first and its affairs are wound up afterwards.

Winding up the affairs of a dissolved partnership can take different forms. In some cases it may be possible to dispose of the whole business as a going concern. In some such cases the acquirers may be a new partnership consistent of some of the partners of the dissolved partnership. In other cases the business may have to be broken up and the assets sold. In all cases the legal problem is that someone has to have all the powers and responsibilities necessary to complete the winding up.

Winding up is currently carried out in one of two ways: either by the former partners under the powers given to them for this purpose by section 38 of the 1890 Act or by a court under section 39, with the assistance of a receiver in England and Wales or a judicial factor in Scotland.
Winding up by the former partners

Existing law: section 38

Section 38 of the Partnership Act 1890 provides that:

After the dissolution of a partnership the authority of each partner to bind the firm, and the other rights and obligations of the partners, continue notwithstanding the dissolution so far as may be necessary to wind up the affairs of the partnership, and to complete transactions.

Winding up by court

Existing law

On the termination of a partnership any partner is entitled under section 39 to apply to the court to have the partnership wound up. The mechanisms differ as between England and Wales on the one hand and Scotland on the other.

In England and Wales the winding up will proceed under the supervision of the court in any case where a partner is represented by a personal representative or trustee in bankruptcy, or if any dispute arises between the partners. Such a partnership action normally has two stages. First, the judge decides at trial matters such as the existence of the partnership and its terms. A dissolution is normally ordered. This requires one party to bring in an account which may include a profit and loss account to the date of dissolution, a balance sheet at dissolution, and a post dissolution account (for the difficulties with this, see Part 7). The other party then serves notice of any objection he has. In theory this should identify the issues and enable the court to give directions for their speedy resolution. This is rarely so in practice.

A receiver may be appointed but:

the receiver’s function is not to wind up the partnership, as a liquidator winds up a company, but merely to get in and preserve the assets and pay the partnership debts, while the Court takes the usual partnership accounts and enquiries and supervises the dissolution. If assets are not in danger, there is generally no purpose in appointing a receiver, who (except by consent) has no power to determine the rights of the partners inter se (Supreme
The receiver has no power to carry on the business. Only a manager, under the direction of the court, may do this (see the comment of Lord Lindley quoted at para 23-149 in *Lindley & Banks*). A receiver may, however, be appointed as a manager as well (The appointment of a receiver (or a receiver and manager) should normally be regarded as a remedy of last resort: see *Lindley & Banks*, para 23-149 and the approach taken by the Court of Appeal in *Toker v Akgul* [1996] 6 CL 466). Although an insolvent partnership may be wound up as an unregistered company (Under the Insolvency Act 1986 as amended by the Insolvent Partnerships Order 1994, SI 1994/2421), and an administrator or liquidator appointed with powers equivalent to their registered company counterpart (namely administrators under Insolvency Act 1986 s 14(1), Sched 1 (modified by the Insolvent Partnerships Order 1994, SI 1994/2421, art 6, Sched 2, paras 1, 8 and 10, as amended by SI 1996/1308); and liquidators in compulsory winding up under Insolvency Act 1986, s 167 (1), Sched 4 (modified by the Insolvent Partnerships Order 1994, SI 1994/2421, art 7, Sched 3, paras 1 and 10, as amended by SI 1996/1308)) there is no equivalent for the winding up of a solvent partnership (An unregistered company cannot be wound up under Insolvency Act 1986 voluntarily (see s 221 (4))).

The procedure for winding up a partnership is similar to the old procedure for winding up an estate under a full administration order. The court assumed full control of the administration. This had three main consequences:

1. none of the trustees’ powers could be exercised without the authority of the court;
2. the court could only act on a party’s application; and
3. the court required many matters to be formally proved even if they were undisputed.

The effect of these characteristics was that the court could not act as an initiator. It was constrained by the system. The delay and expense were notorious. These features were behind the passing of the Judicial Trustees Act 1896. Full administration orders of this kind are now almost completely obsolete, except for partnerships. It is not difficult to understand why. Whatever the merits of an adversarial system in deciding disputes between parties, it is ill-suited to a largely administrative process, like winding up a partnership.
The inherent problems with the procedure as applied to partnerships remain. Thus to give just one example (This case was quoted by the Chief Chancery Master, J M Dyson, in a letter to Mr Justice Rattee on 16 March 1995 and subsequently included as an attachment to a letter from Mr Justice Rattee to the Law Commission on 10 May 1995): in 1984 a receiver and manager was appointed over a partnership business. This was bitterly resented by the defendants. The partnership business was eventually sold by the receiver. However, it had been impossible to wind up the receivership. The defendants had constantly brought applications challenging the receiver’s conduct, his accounts, and his remuneration. Nearly every order was appealed. The taking of accounts was ordered in 1984, but did not proceed far. The defendants did not recognise that it was a separate proceeding from the receivership, one of their complaints was that the receiver had not ascertained the balances due to them. While the defendants attacked the receiver, the plaintiff lost interest in the action. Eleven years after the appointment of the receiver and manager the defendants were still challenging the conduct of the receivership, it seemed likely that there would be no funds left for the partners and that the receiver would make a loss.

A practical consequence of this sort of experience is that many partnership actions are avoided or settled at an early stage. Parties are warned of the likely procedural difficulties and costs (Settling or avoiding disputes is, of course, desirable, but it is a perverse logic which welcomes the inaccessibility of the judicial system in encouraging this). Actions to wind up a solvent partnership are relatively rare, so comparatively few practitioners are familiar with the procedure. In time this becomes self-perpetuating. Even when they do take place, the receiver’s legal costs and remuneration sometimes exceed the partnership’s assets.

Substantive rights of former partners

Existing law

Section 44 of the 1890 Act provides that:

In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

(a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits;
(b) The assets of the firm including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order;

1. In paying the debts and liabilities of the firm to persons who are not partners therein;

2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital;

3. In paying to each partner rateably what is due from the firm to him in respect of capital;

4. The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible.

Example

Suppose that X, Y and Z enter into a partnership sharing profits equally but contributing £9,000, £6,000 and £3,000 respectively to the firm’s capital of £18,000. In addition, Y advances £2,000 by way of a loan to the partnership. On dissolution of the partnership, the total assets of the firm are £10,000. £2,000 is owed to creditors.

The payment of outside creditors and Y’s advance leaves surplus assets of £6,000. There has, therefore, been an overall loss of £12,000 capital (the difference between the surplus assets and the firm’s capital). This must be made up by the partners in the same proportion in which they share profits.

Profits are divisible equally, so X, Y and Z must each contribute £4,000. In the final analysis, X receives £5,000 (£9,000 capital less £4,000 contribution to loss), Y receives £4,000 (£6,000 capital contribution plus £2,000 advance (As discussed above, the advance is returned in priority to the capital contributions) less £4,000 contribution to loss), and Z has to contribute £1,000 (the difference between the £4,000 contribution and the £3,000 capital due).

The rule in Garner v Murray
Where there has been an overall trading loss and one of the partners is insolvent, the process becomes more complicated (see generally Lindley & Banks, para 25-45 et seq; Higgins & Fletcher, The Law of Partnership in Australia and New Zealand (7th ed 1996) 260 et seq). If the required contribution of the insolvent partner exceeds the balance on that partner’s capital account, there will be a deficit in the assets available for distribution. In Garner v Murray ([1904] 1 Ch 57) Joyce J held:

Section 44 is plain. I do not find anything in that section to make a solvent partner liable to contribute for any insolvent partner who fails to pay his share. Subsection (b) of s 44 proceeds on the supposition that contributions have been paid or levied. Here the effect of levying is that two partners can pay and one cannot. It is suggested on behalf of the plaintiff that each partner is to bear an equal loss. But when the Act says losses are to be borne equally it means losses sustained by the firm. It cannot mean that the individual loss sustained by each partner is to be of an equal amount. There is no rule that the ultimate personal loss of each partner, after he has performed his obligations to the firm, shall be the same as or in any given proportion to that of any other partner. I have to follow the Act, and I see no difficulty in doing so in this case. The assets must be applied in paying to each partner rateably what is due from the firm to him in respect of capital, account being taken of the equal contribution to be made by him towards the deficiency of capital ([1904] 1 Ch 57, 60).

This has become known as the rule in Garner v Murray. The deficiency, caused by the inability of the insolvent partner to contribute the full share due, is borne by the solvent partners in proportion to their capital entitlements. It appears to have been based on the premise that it would be unjust to require partners to contribute to a shortfall not relating to sums they have withdrawn (See Lindley & Banks, para 25-48).

Taking the above example, with Z insolvent, the total assets available for distribution after the payment of debts and advances would be £14,000. This is made up of surplus assets of £6,000 plus the notional contributions of £4,000 from each of X and Y. This is divided in the ratio 3:2, reflecting their capital entitlements. X receives £4,400 (£8,400 less £4,000 contribution) and Y receives £3,600 (£5,600 plus the advance of £2,000 less £4,000).

The application of the rule is less clear where the capital account of the insolvent partner is overdrawn at the date of dissolution or after debiting that partner’s contribution to the lost capital
(as in *Garner v Murray* itself). There appear to be two schools of thought on the treatment of overdrawings (see *Lindley & Banks*, para 25-47). The first is simply to ignore them for the purpose of the rule; the other is to treat them as a loss, which must be shared between all the partners.

Although the question arose on the facts in *Garner v Murray* itself, the solution is not expressly set out in the reported judgments. The preferred view, which appears to be based on the actual terms of the order, is that the overdrawing is treated as an uncollectable debt of the firm. This is counted with trading losses as part of the firm’s overall loss (see Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand, op cit*, at p 261). One report of the judgment referred to the insolvent partner as being “indebted to the firm” with the overdrawings “treated as irrecoverable”. In calculating the shortfall, the report referred to “[t]he assets (treating [the insolvent partner’s] debt as irrecoverable)...” (1904) 52 WR 208.

**PARTNERSHIP AND AGENCY**

Partnerships, being either groups of persons have to act through agents. They may appoint agents who are not partners, in which case the normal law on agency applies. They may use the partners as agents.

The basic rule on partners as agents

**Section 5**

**Section 5 of the 1890 Act provides that:**

Every partner is an agent of the firm and his other partners (Previous versions of the Partnership Bill referred only to a partner being an agent of his other partners for the purpose of the business of the partnership, while the side-note referred to this as the ‘power of a partner to bind the firm’. It was only when the Bill was extended to apply to Scotland where the firm had separate personality that the clause was amended so that a partner was also an agent of the firm) for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member, bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular
matter, and the person with whom he is dealing either knows that he has no authority, or does not know or believe him to be a partner.

The main part of section 5 of the 1890 Act provides for the normal rules of agency to apply to partnerships. An act of a partner on behalf of the firm within the scope of the partner’s actual authority binds the firm (This is the case irrespective of whether the act was done in the course of carrying on the partnership business in the usual way). An act of a partner on behalf of the firm in the course of carrying on the partnership business in the usual way also binds the firm: the partner acts with implied or apparent authority. An act of a partner done without actual or apparent authority, and not binding on the firm, may become binding on the firm if it is subsequently ratified.

The limit of a partner’s implied authority is set by the usual course of the particular business carried on. It is this and not the nature of the individual’s involvement which is normally decisive in establishing whether the partner acted with authority.

THE LAW OF GUARANTEES

Nature of Guarantee. A guarantee is an accessory contract by which the promisor undertakes to be an answerable to the promisee for the debt or default of another person (the principal debtor) whose primary liability to the promisee must exist or be contemplated. (See Halsbury’s Laws, 5th edn, (2008) Vol. 49, para. 1013). The promisor is the guarantor or surety. The principal debtor is primarily liable to the creditor for the obligation guaranteed. Although sometimes bound by the same instrument as the guarantor, the principal debtor is not a party to the guarantor’s contract to be liable to the creditor.

Contract of Guarantee. As in the case of any other contract, a valid guarantee requires an agreement, made between parties intending to create legal relations and having the capacity to contract, supported by actual or implied consideration. In addition the statutory requirements of the Statute of Frauds are that the contract must either be in writing or be evidenced by a written note or memorandum signed by or on behalf of the party to be charged. Although contracts of guarantee and contracts of indemnity may perform similar commercial functions in that they both provide compensation to the creditor for the failure of a third party to perform his obligation, there is a conceptual distinction between the two.
In a contract of indemnity, the indemnifier undertakes an independent obligation which does not depend upon the existence of any other obligation of any other party. A contract of indemnity is a contract by one party to keep the other harmless against loss. In contrast, there can be no contract of guarantee unless there exists or is contemplated some other principal obligation of the principal debtor, to which the guarantor assumes a secondary liability to the creditor for the default of another, the principle debtor (who remains primarily liable to the creditor). (See Yeoman Credit Ltd v Latter [1961] 1 W.L.R. 828 at 831, CA; Goulston Discount Co Ltd v Clark [1967] 2 Q.B. 493; Argo Caribbean Group Ltd v Lewis [1976] 2 Lloyd’s Rep. 289 at 296 CA).

A contract of guarantee must also be distinguished from the once common “letter of comfort” given by a party (e.g. a parent company) indicating in general terms that it would financially support a third party (such as its subsidiary company). A letter of comfort has been held not to be intended to have legal effect. It created no legally enforceable obligation to anyone who dealt with the third party on the strength of it. (Kleinwort Benson Ltd v Malaysian Mining Corp Berhad [1989] 1 W.L.R. 379).

A contract of guarantee is to be construed according to the same principles that govern all contracts. The task is to ascertain the meaning that the guarantee would convey to a reasonable person having all the background knowledge which was reasonably available to the parties. (For recent examples, see Gastronome (UK) Ltd v Anglo Dutch Meats(UK) Ltd [2006] EWCA Civ 1233 and Egan v Static Control Components (Europe Ltd) [2004] EWCA Civ 392, applying Lord Hoffmann’s well-known principles in Investors Compensation Scheme Ltd v West Bromwich Building Society [1989] 1 W.L.R. 896. See also Aerospace Ltd [2008] EWCH 1207 and Kookmin Bank v Rainy Sky SA [2011] UKSC 50; November 2, 2011, which apply the principles established in Investors Compensation Scheme Ltd v West Bromwich Building Society (No. 1) [1998] 1 W.L.R. 896, Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38; [2009] 1 A.C. 1101 and Att Gen of Belize v Belize Telecom Ltd [2009] UKPC 10; [2009] 2 All E.R. (Comm) 1)).

Consideration. Every guarantee which is not made in the form of a deed must (like any other contract) be supported by consideration. The mere existence of the debt or default of another person is not sufficient to support he guarantor’s promise to the creditor. Total failure of consideration entitles the guarantor to have his guarantee delivered up to be cancelled. (See Cooper v Joel (1859) 1 De GF. & J. 240; Rolt v Cozens (1856) 18 C.B. 673). The consideration for the guarantor’s promise must move from the creditor, not from the principal debtor. It may consist
wholly of some advantage given to the principal debtor by the creditor at the guarantor’s request. It need not therefore directly benefit the guarantor.

The guarantor’s promise (which is often found in the standard terms and conditions of the guarantee itself) often stipulates for a supply of goods or an advance of money to the principal debtor. An illegal consideration will not support a guarantee. If a guaranteed debt is itself illegal, it cannot be recovered from the guarantor under his guarantee.

**Statutes of Frauds.** The Statute of Frauds 1677 provides that no action can be brought on a guarantee unless the guarantee agreement or some memorandum or note thereof is in writing and signed by the guarantor or his authorised agent. (For a recent case on the requirement of a signature, see *J Pereira Fernandes SA v Mehta* [2006] 1 W.L.R. 1543 in which it was held that automatic inclusion of an email address in an email did not constitute a signature for the purposes of s.4 of the Statute of Frauds). This is an enactment as to evidence, which although very old, is still in force. (See, e.g. *Elpis Maritime Co Ltd v Marti Chartering Co Inc* [1991] 3 All E.R. 758 and *Deutsche Bank AG v Ibrahim* [1992] 1 Bank L.R. 267. In *Actionstrength Ltd v International Glass Engineering INGLEN SpA* [2001] EWCA Civ 1477; [2002] 1 W.L.R. 566, the Court of Appeal upheld a defence that an agreement was a promise to answer for the debt of another (there being no requirement that the promise must impose liability on the promisor’s assets generally, rather than on a particular asset), and, not being in writing, was unenforceable by virtue of s.4. *Actionstrength* was unsuccessfully appealed to the House of Lords: see [2003] UKHL 17; [2003] 2 A.C. 541. The speeches of Lords Bingham and Hoffmann provide useful summaries of the application of s.4).

Further, a guarantee must comply with the requirements for the execution of deeds contained in the Law of Property (Miscellaneous Provisions) Act 1989, if it is to take effect as a deed rather than a simple contract.

If a *material* alteration is made to the guarantee document without the consent of the guarantor, when the guarantee document is in the custody of the promisee, such alteration discharges the promisor/guarantor from all liability on the guarantee. (Rule in *Pigot’s Case* (1614) 11 Co. Rep. Per Potter L.J. in *Raiffeisen Zentralbank Osterreich AV v Crosseas Shipping Ltd* [2000] 1 W.L.R. 1135; [2000] 3 All E.R. 274, material alterations include those which affect the very nature and character of the instrument, or those which are “potentially prejudicial” to the obligor’s rights or obligations).
When does the guarantor’s liability arise? The guarantor’s liability arises when the principal debtor has made a default, but not until that time. On the default of the principal debtor the guarantor is immediately liable to the full extent of his obligation and he is not (unless the contract expressly provides for this) entitled to require notice of the default or that the creditor should have recourse first against the principal debtor.

Unless a demand upon the principal debtor is necessary in order to establish the principal debtor’s own liability to the creditor, (This is essentially a question of construction of the contract in each case: see Joachimson v Swiss Bank Corp [1921] 3 K.B. 110 at 129. See GMAC Commercial Credit Development v Sandie [2001] EWCA Civ 1209; [2001] 2 All E.R. (Comm.) 782, where the Court of Appeal held that no valid notice was given in accordance with the agreement between the creditor and principal debtor, and thus there was no default on the part of the principal debtor at the time of the demand made on the guarantee, which was therefore ineffective. See also Frans Maas (UK) Ltd v Habib Bank AG Zurich [2001] C.L.C. 89; [2001] Lloyd’s Rep. Bank. 14, where Sir Christopher Bellamy (sitting in the Q.B.D.) held that the demand did not comply with the wording of the guarantee, and therefore did not trigger liability under the guarantee) it is not necessary for the creditor to make a demand of the principal debtor to pay before proceeding against the guarantor. However, modern guarantee forms usually require the guarantor to pay on demand. If this is stipulated in the guarantee, a valid demand is a necessary ingredient of the creditor’s cause of action against the guarantor. In this case, the demand must comply with any requirements imposed by the contract of guarantee as to the form and manner of the demand.

However this principle may not apply where the guarantee contains a clause which makes the guarantor liable as if he were a principal debtor: see Esso Petroleum Co Ltd v Alstonbridge Properties Ltd [1975] 1 W.L.R. 1274. Further, any express or implied conditions precedent to the guarantor’s liability must be fulfilled before recourse can be had to him: see Associated Japanese Bank (International) Ltd v Credit Du Nord SA [1989] 1 W.L.R. 255.

The creditor generally owes no duty to the guarantor to realise any other security before enforcing the guarantee. However, if the creditor chooses to realise a security, the creditor must do so with reasonable care so as to obtain a proper price. Subject to any contractual modification, this duty is owed to the guarantor in addition to the principal debtor. (See Barclays Bank v Kingston [2006] EWHC 533 (QB); [2006] 2 Lloyd’s Rep. 59. See also Newcastle Building Society v Mill [2009] EWCH 740).
Set-off and counterclaim. On being sued by the creditor for payment of the debt guaranteed, a guarantor may rely on any right of set-off or counterclaim which the principal debtor could set up against the creditor in reduction of the guaranteed debt in order to reduce the claim against him under the guarantee. However if on its true construction the guarantee requires the guarantor to pay a particular amount due irrespective of the accounting position between the principal debtor and the creditor, then the guarantor will not be entitled to rely on the principal debtor’s rights of set-off or counterclaim. (The standard terms of the guarantee may exclude the right of the guarantor to rely on a set-off or counterclaim – such a term was held to be enforceable in Coca-Cola Corp v Finsat International Ltd [1998] Q.B. 43 as applied in Axa Sun Life Services v Campbell Martin [2011] EWCA Civ 133. Axa Sun also held, first, that there should be no stay pending cross claims as this is inconsistent with the “no-set off” clause, and second that such clauses have to meet the test of reasonableness under the Unfair Contract Terms Act 1977, and on the facts of the case the clause was held not to have met the test and was therefore unenforceable).

Further, where the guarantee takes the form of a legal mortgage, the mortgagor guarantor cannot usually resist the creditor mortgagee’s claim for possession of the mortgaged property by relying on the fact that the principal debtor has a claim for unliquidated damages by way of set-off against the creditor for an amount which exceeds the amount secured. (See National Westminster Bank Plc v Skelton [1993] 1 W.L.R. 72 and Ashley Guarantee Plc v Zacaria [1993] 1 W.L.R. 62 CA).

Subrogation. As soon as the guarantor has paid to the creditor what is due under the guarantee, he is entitled to be subrogated to all the rights possessed by the creditor against the principal debtor in respect of the debt or fault to which the guarantee relates. The guarantor claiming to be subrogated to the rights of the creditor can have no greater rights than the rights possessed by that creditor. The right of subrogation arises on payment but not before. At that time the guarantor has a right to the benefit of all the securities which the creditor has received from the principal debtor before, at the same time as or after the creation of the guarantee. The right of subrogation arises from the obligation imposed on the principal debtor to indemnify the surety. It is clear that a party subrogated to a security is treated in equality as if he had that security, and in a case of competing equal equities, the earlier in time prevails: Halifax Plc v Omar [2002] EWCA Civ 121; [2002] 16 E.G. 180. (Rights of subrogation may be excluded or varied by the guarantee contract, but clear words are required: Liberty Mutual Insce Co (UK) Ltd v HSBC Bank Plc [2002] EWCA Civ 691).
Limitation. The creditor’s claim against the guarantor under a guarantee is a claim in contract, and an action to enforce the guarantee may therefore not be brought after the expiration of six years from the date on which the cause of action accrued.

When the guarantee is made by deed, the period is 12 years from the accrual of the cause of action. (The deed is a “speciality” under the Limitation Act 1980 s.8). The creditor’s cause of action accrues when the guarantor becomes liable to make payment under the guarantee. This depends on the terms of the guarantee, but will generally not be before or unless the principal debtor is liable. If a valid demand is a necessary ingredient of the creditor’s cause of action against the guarantor, time will not begin to run until such a demand has been made. It is no defence for the guarantor to show that the creditor’s claim against the principal debtor is time-barred, unless the claim under the guarantee is also thereby time-barred.

Misrepresentation. A contract of guarantee like any other contract is liable to be avoided if it is induced by a material misrepresentation of an existing fact, even if made innocently. See National Westminster Bank Plc v Philip Bowles [2005] EWHC 182 (QB) where a judgment in default of a defence entered against a guarantor by a bank was set aside. The basis for this was that the guarantor had an arguable case that the bank might not be entitled to enforce the guarantee either (1) because of the terms of an express agreement, or (2) on the principle that a surety was discharged if the creditor acted in bad faith towards him or was guilty of concealment amounting to misrepresentation or caused or connived at the default by the principal debtor in respect of which the guarantee was given. Although the primary remedy for misrepresentation is rescission of the guarantee, damages may be awarded in stead if it is equitable to do so, under the Misrepresentation Act 1967 s.2.

As to inducement, in the case of a false statement which is likely to be relied on by a reasonable person, there is presumption of fact that the misrepresentation acted as an inducement to the representee to enter into the contact of guarantee. The effect of this presumption is to reverse the burden of proof so that the representor must rebut the presumption. (See County NatWest Ltd v Barton [2002] 4 All E.R. 494 (Note) CA which was applied in Dadourian v Simms [2009] EWCA Civ 169, per Arden L.J., see [99] and [101]).

Non-disclosure. An ordinary contract of guarantee, unlike a contract of insurance, is not a contract which requires full disclosure of all material facts by the contracting parties or a duty of good faith.
A creditor who is not specifically asked is generally under no duty to disclose to an intending guarantor all the facts about the transaction, such as the extent of the overdraft or the fact that the creditor intends to lend a further substantial sum on the faith of the guarantee.

There are however certain circumstances in which the creditor must make disclosure to an intending guarantor, for example where the creditor is asked a specific question by the intending guarantor or where there is anything that might not usually be expected to take place between the principal debtor and the creditor and the fact is within the creditor’s knowledge. Any omission by the creditor to mention such a special fact in the transaction may be an implied representation to the intending guarantor that it does not exist, which again may entitle the guarantor upon discovering the true position to avoid the guarantee.

It is also the duty of a creditor to give a true, honest and accurate answer to any specific question directed to him by an intending guarantor if the answer is in any way material to the giving of the guarantee. If the creditor does not answer a specific question, or if the creditor’s answer is misleading, this may amount to a misrepresentation entitling the guarantor to avoid the guarantee. However, these duties may be excluded by an appropriately worded exclusion clause. For an example of a clause where this was held to be the case see North Shore Ventures Ltd v Anstead Holdings Inc [2010] EWHC 1485 (Ch): [2011] 1 All E.R. (Comm) 81; [2010] Lloyd’s Rep. 265 at [177] et seq. (overturned on other grounds in [2011] EWCA Civ 230).

**Discharge of guarantee by giving time.** A guarantor is discharged if the creditor without his consent and without expressly reserving his rights against the guarantor enters into a binding arrangement with the principal debtor to give him time to perform the principal obligation. Under this principle the guarantor is released whether or not he is prejudiced by the giving of time, and the release extends not only to the guarantor’s personal liability but also to any security he has given. If there is a reservation of remedies by the creditor against the guarantor, this is usually expected to appear on the face of the agreement giving time to the principal debtor, and this term will usually appear in the standard provisions of the guarantee.

Discharge of guarantor by release of the principal debtor or by variation of the principal contract. A guarantor is discharged if the creditor without his consent unconditionally releases the principal debtor or varies the principal contract in a material way. The release or variation extinguishes the principal obligation. For recent examples, see Lloyds TSB Bank Plc v Norman Hayward [2005] EWCA
Civ 466; St Microelectronics NV v Condor Insurance Ltd [2006] EWHC 977 (comm.); Beck Interiors Ltd v Russo [2009] EWHC 3861 (QB); and Associated British Ports v Ferryways NV [2009] EWCA Civ 189; [2009] 1 Lloyd’s Rep. 595. It is true to say though that the guarantee will often contain standard form provisions designed to preserve the liability of the guarantor in these circumstances, and if appropriately worded, such provisions are effective to preserve the guarantor’s liability. A creditor may also expressly reserve his rights against the guarantor in these circumstances. (In Greene King Plc v Stanley [2001] EWCA Civ 1966, the Court of Appeal held that the court must look at all the circumstances to establish whether or not there has been an effective reservation of rights by the creditor against the guarantor. See also Lloyds TSB Bank Plc v Shorney [2001] EWCA Civ 1161; [2002] 1 F.L.R. 81; The Times, October 25, 2001, where the Court of Appeal, relying on the general principle that equity intervenes to protect a guarantor, held that the Bank could not rely on a standard term permitting it, without the consent of the guarantor, to act in a way which materially affected the surety’s position. However where clear consent is given, discharge will not be reasonably arguable (see Beck Interiors v Russo [2009] EWHC 3861 (QB)). In Skipton BS v Stott [2001] Q.B. 261 the Court of Appeal held that a creditor’s failure to obtain the proper price value of a security on realisation did not discharge the guarantor’s liability, but reduced it pro tanto (based on the security’s market value). However, it has been held that sums due from a company under a loan agreement are not covered by a guarantee of the sums due “under or pursuant to” an earlier loan agreement where the subsequent loan agreement is on substantially different terms and can not be regarded as a n amendment or variation within the general purview of the original agreement: see Triodos Bank NV v Ashley Dobbs [2005] EWCA Civ 630, applying Trade Indemnity Co Ltd v Workington Harbour and Dock Board [1937] A.C. 1.

SURETY

Surety is a form of contract whereby one person assumes responsibility for the obligations of another. The responsibility may be collateral to the liability of the principal debtor, as with a guarantee, or may involve primary liability to the creditor, as with an indemnity.

Guarantee

A contract of guarantee is a contract whereby the guarantor agrees that, upon default by the principal debtor of his obligations under the contract between the principal debtor and the creditor, the guarantor will perform those obligations for the creditor. A guarantee is therefore a secondary obligation and is dependent for its efficacy on the existence and enforceability of the primary
obligation. Although the right to an indemnity can be implied or can arise by operation of law, a guarantee can be created only by means of a contract between the creditor and the guarantor.

The right of action against a guarantor is dependent on a default by the principal debtor. The principal debtor’s liability may or may not depend on a demand being made by the creditor but, in practice, a demand is virtually always necessary to activate the obligation of the guarantor to make good that default.

**Indemnity**

An indemnity can arise either by contract or by operation of law.

Contract of indemnity. A contract of indemnity is a contract whereby the indemnitor binds himself as a principal debtor to the creditor. An indemnitor’s obligations are thus primary obligations and do not necessarily depend for their efficacy on the enforceability of the obligations as between debtor and creditor.

As the liability of the indemnitor is primary and not secondary, the creditor does not need to establish a default by the principal debtor to proceed against the indemnitor and, unless the contract provides otherwise, notice to the indemnitor is not required to activate the indemnity (Cutler v Southern (1667) 1 Wms. Saund. 1871 Ed. 133).

Indemnity by operation of law (implied indemnity). An indemnity arises by way of operation of law (sometimes expressed as by way of implied contract) in a number of disparate cases, the common factor of which is nearly always the payment by the “indemnitor” to the “creditor” of money due from the principal debtor, or the payment to the “creditor” of monetary compensation for breach of the principal debtor’s obligations to the creditor. Thus, an agent acting within the scope of his authority is entitled to be indemnified by his principal (Thacker v Hardy (1878) 4 Q.B.D. 685; Re Famatina Development Corp [1914] 2 Ch. 271). The corollary is that an employer or principal rendered, vicariously liable for the negligence or other tort of his employee or agent is entitled to be indemnified against that liability (Lister v Romford Ice and Cold Storage Co Ltd [1957] A.C. 553).

When A requests B to perform what is prima facie a lawful act on his behalf which B would otherwise be under no legal obligation to perform, B will normally be entitled to an indemnity
against the consequences of performance but that indemnity will arise only where the law feels it proper to imply an obligation to indemnify.

“It is quite clear from the authorities establishing or supporting the general principle of indemnity upon which the appellants rely that indemnity is not the automatic consequence of a request to do an act. Such a right of indemnity arises only where the circumstances justify the implication of a contract to indemnify” (JH Rayner (Mincing Lane) Ltd v Department of Trade (the “Tin Council Case”) [1990] 2 A.C. 418 at 520, per Lord Oliver).

Thus, where a company in good faith registered, at the request of an innocent transferee, a transfer which turned out to be forged, a contract was implied whereby the transferee was obliged to indemnity the company (Sheffield Corp v Barclay [1905] A.C. 392). A minor is liable to indemnify his next friend (litigation friend) for costs properly incurred in litigation (Steeden v Walden [1910] 2 Ch. 393).

No contract to indemnify will be implied if the act is criminal or obviously tortious (Askey v Golden Wine Co [1948] 2 All E.R. 35) and, outside the context of liability insurance, even an express contract of indemnity will be unenforceable if it provides for an indemnity against the consequences of crime or tort (Weld-Blundell v Stephens [1920] A.C. 956).

Construction and formalities

The Statute of Frauds 1677. The distinction between a guarantee and an indemnity is vital. Under the Statute of Frauds 1677 s.4, a guarantee must be made in writing or evidenced by a note or memorandum in writing, in either case signed by or on behalf of the guarantor. Unlike other requirements of the Statute of Frauds, equity did not mitigate this rule and it remains in full vigour.

If the document signed by the guarantor refers to some other document or transaction, external evidence is admissible to explain the reference or to identify the document, and the document signed by the guarantor can be read together with another document to constitute an enforceable guarantee (Elias v George Sahely & Co (Barbados) Ltd [1983] 1 A.C. 646.

The consideration for a guarantee need not, however, be in writing (Mercantile Law Amendment Act 1856 s.3). On the other hand no formalities are required by law for an indemnity.
The requirements of the Statute of Frauds make it imperative to ascertain into which category of surety an agreement falls and, indeed, whether an agreement is truly a surety agreement. As with all areas of contract where categorisation is relevant, a court will have regard to the substance of the contract and not necessarily to its wording. The acid test is principal debtor, in which case it is a guarantee and the statute applies or whether the surety’s obligations are primary obligations, in which case it is an indemnity and the formalities are unnecessary (Harburg India Rubber Comb Co v Martin [1902] 1 K.B. 778).

It is thus a commonplace of litigation where there has been an informal assumption by one person of another person’s obligations, for the beneficiary (the creditor) to argue that the assumption constituted an enforceable indemnity and for the apparent surety to argue that it constituted a guarantee rendered unenforceable for want of the essential formalities.

A second area of dispute arises when a creditor seeks to rely on an undertaking by the apparent surety which does not, on analysis, amount to a contract of surety. Thus a promise made only to the debtor to put him in funds to meet his liabilities to the creditor creates no obligation to the creditor to guarantee those liabilities (Eastwood v Kenyon (1840) 11 A. & E. 438). Similarly the “letter of comfort” once so fashionable in commercial circles whereby a person indicated in general terms that he would give financial support to a third party was held not to be intended to have legal effect and to create an obligation to anyone who dealt with the third party on the strength of it (Kleinwort Benson Ltd v Malaysian Mining Corp Berhad [1989] 1 W.L.R. 379).

Defences of the guarantor

In general, a guarantor can raise against the creditor any defence which would have been available to the principal debtor including a set-off of damages for breach of the contract guaranteed. A discharge of the principal debtor’s obligations either by agreement or by operation of law will relieve the guarantor (though it may not relieve an indemnitor in the same situation).

A surety who has been induced to execute a guarantee or indemnity by the undue influence or misrepresentation of the principal debtor may be entitled to set it aside if the creditor had actual or constructive notice of the undue influence or misrepresentation (Royal Bank of Scotland v Etridge (No. 2) [2001] UKHL 44; [2002] 2 A.C. 773).
As a matter of general law, a variation of the principal contract will operate to discharge the guarantor unless it is so insubstantial that it could not prejudice the guarantor but, where the variation involves the giving of time to the debtor, then it is a very old rule, that such variation (whether prejudicial or not) automatically discharges a surety who has not assented to it (Rees v Berrington (1795) 2 Ves. 540). It is open to the parties to contract out of this rule and most contracts of guarantee (especially guarantees of liabilities to institutional lenders) will provide that a variation of the principal contract or the giving of time to the debtor does not release the guarantor from his obligations.

It should be noted that the cancellation by the consumer of an agreement under the Cancellation of Contracts made in a Consumer’s Home or Place of Work etc Regulations 2008 (SI 2008/1816) not only operates automatically to cancel any credit agreement linked to the agreement but also cancels any real or personal security.

Right of sureties

A surety who discharges the liabilities of the principal debtor is entitled to an indemnity from the principal debtor (Re a debtor (No. 627 of 1936) [1937] Ch. 156). In those circumstances a surety is also entitled to be subrogated to all the rights of the creditor against the principal debtor, including assignment of real securities (Mercantile Law Amendment Act 1856 s.5; Wilkinson v London and County Banking Co (1884) 1 T.L.R. 63).

One of the co-sureties who discharges the entire debt or more than his share of it can, in the absence of agreement to the contrary, recover a contribution from the other co-sureties in respect of any excess paid by him over his share of the liability.

Where the creditor has enforced the debt against a property security but has negligently sold that property at an undervalue, this does not automatically discharge the guarantor from liability but the guarantor is entitled to treat the element of the debt satisfied from the sale as being equivalent to the full market value and remains liable under the guarantee only for the balance, if any, of the debt: Skipton Building Society v Stott [2001] Q.B. 261.

THE LAW OF HIRE PURCHASE
A hire-purchase agreement is an agreement whereby the owner of a chattel lets it on hire to a hirer for a fixed period and agrees that upon the happening of a stated event (usually, but not necessarily, the exercise by the hirer of an option to purchase) property in the chattel will pass to the hirer. The acquirer is a hirer until the option is exercised and then becomes a buyer. The essential point to note is that hire-purchase is not a contract of sale and although people (even, regrettably practitioners and judges) sometimes speak of “buying on hire-purchase”, this is not only incorrect but misleading, creating the false belief that the hirer, like a purchase, has title to the goods which he can dispose of by sale or otherwise.

The key elements of hire-purchase are:

1. the creditor owns the goods and remains owner until the option to purchase is exercised;
2. the hirer obtains physical possession of the goods and accepts the obligations of a hirer of goods;
3. the hirer is not obliged to exercise the option or acquire title;
4. if the hirer defaults, (subject to statutory controls) the owner can terminate the agreement, repossess the goods and sell or re-let them.

As with any area where it is necessary to assign a contract to a particular category, courts will have regard to the substance of a contract rather than its appearance. If a contract has these essential elements, it will be a hire-purchase contract whatever terms the parties may care to have used (Staffs Motor Guarantee Ltd v British Wagon Co [1934] 2 K.B. 305). The wide range of controls over virtually all forms of chattel acquisition other than outright sale have removed most of the point from trying to disguise hire-purchase as something else, but parties sometimes do mistake the category into which an agreement comes and this can lead to problems of enforcement if the wrong prescribed wording is used in the written contract.

Analysis of a hire-purchase situation is essential. Virtually all hire-purchase involves three parties: a supplier of the goods, a creditor and a hirer. There will be a contract whereby the supplier sells the goods to the creditor and a second (and separate) contract whereby the creditor lets them on hire-purchase to the hirer. The mistake is often made (and not only by lay people) of believing that the
hirer has “bought” the goods from the supplier with a loan from the creditor. This may be the financial reality of the transaction but it is not the legal reality. There may be no contract (or, at best, only a collateral contract) between the hirer and the supplier and, at common law, the creditor was only in very rare cases made liable for the supplier’s representations or warranties to the hirer.

THE CONSUMER CREDIT ACT 1974

Conditional sale

Conditional sale is an agreement whereby a seller sells goods to a buyer on terms that the purchase price is paid (normally with interest) and property in the goods does not pass until the final instalment is paid. Though very similar in concept to hire-purchase, there are two main differences:

1. There is no option to purchase: the sale is concluded at the outset and title passes automatically on payment of the last instalment. This enables the creditor to provide for acceleration of the balance of the purchase price on default with concomitant passing of title on the buyer’s default (Wadham Stringer Finance Ltd v Meaney [1981] I W.L.R. 39).

2. Being a contract of sale, the Sale of Goods Act 1979 applies: in particular, the buyer, being in possession of the goods with the consent of the owner, can pass a good title to a sub-buyer under s.25(1) of that Act, though this provision is now confined to conditional sale agreements not regulated by the Consumer Credit Act.

Loans

A loan is an agreement whereby the lender pays a sum of money to the borrower or to his order on terms requiring the borrower to repay it to the lender with or without interest.

To constitute a loan, the money must be repayable on the happening of some ascertainable event (including a demand by the lender) although this may be implied (Joachimson Swiss Bank Corp [1921] 3 K.B. 110).
Categories of loan. Except where the loan was charged on property, common law did not concern itself with either the nature of the loan or its purpose. The CCA, though not defining “loan” (preferring the generic “credit”) does both. Credit is divided into defined categories:

1. “fixed-sum credit” and “running account credit” (the latter including both overdrafts and credit tokens);

2. “restricted-use credit” (where the use to which the debtor is to put the credit is a term of the agreement) and “unrestricted-use credit” (where the debtor may use the money how he pleases)

Lease and hire of chattels

Although “lease” is a more up-market word which tends to be employed when the chattels are expensive, there is no juridical difference between lease and hire of a chattel and the word “hire” will be employed as shorthand for this type of contract.

Hire is a bailment of a chattel by the owner to the hirer in return for the making of one or more payments of rent. The hirer obtains possession of the goods but not title. Although hire does not technically involve an element of credit as that concept is normally understood, from time to time fiscal advantages have made hire a preferable method of acquiring the benefit of chattels to purchase on credit or hire-purchase. Thus hire is now treated as analogous to credit, and hire contracts are regulated by the CCA (though the CC contains no definition of “hire”). Hire contracts will be “consumer hire agreements” if they are made with an “individual” and are not expressly exempted from regulation by the CCA and its statutory instruments: s.15.

It is important to note that if the agreement contains any term which entitles either party to pass title to the hirer, it is not a hire agreement but a hire-purchase agreement. This has important consequences as to whether and as to how the agreement is regulated by the CCA.

Security

Real security falls into three categories:
1. Mortgage or charge, whereby land or other property is charged with the payment of a sum of money on terms which entitle the creditor on default to take possession of the security but otherwise the debtor remains in possession (not covered in this section);

2. Mortgage of a chattel, whereby the owner of a chattel executes a document transferring title to the creditor to secure payment of a sum of money, the debtor remaining in possession of the chattel (normally described as a “[security] bill of sale”);

3. Pledge or pawn of a chattel, whereby the debtor deposits the chattel with the creditor to secure payment of a sum of money, the debtor retaining title but the creditor obtaining possession with a right of sale on default.

The CCA regulates the provision of security (real or personal) where the agreement secured is a regulated agreement.

**Distance selling**

“Distance selling” includes any contract negotiated at a distance and includes letter, telephone call, mail order, fax, video text, teleshopping and all forms of “e-commerce”. Credit and leasing agreements are affected by the Consumer Protection (Distance Selling) Regulations (S1 2000/2334) and the Financial Services (Distance Marketing) Regulations 2004 (S1 2004/2095). These Regulations define “consumer” as a natural person who contracts for purposes which are outside his business. The 2000 Regulations apply to most types of sale of goods or services and require the supplier to provide the consumer with a lot of information (including notice of the right to cancel) both before and after the conclusion of the contract.

Regulation 10 of the 2000 Regulations gives the consumer a right of cancellation (subject to limited exceptions under reg.13) and if notice of cancellation is given, it is as if the contract had never been made. If the supplier has given all the requisite information, the consumer has seven days from the contract being concluded (or if the information is given post-contract) from the date the information was given. In all other cases the consumer has three months plus seven working days from delivery of the goods (supply of goods) or the conclusion of the contract (supply of services).
On cancellation, all sums paid by or on behalf of the consumer must be reimbursed and all security returned (reg.14) and any related credit agreement is automatically cancelled by the same notice (reg.15), again with sums reimbursed and security returned. Any credit paid to the consumer must be repaid (reg.16). Pending return of goods, the consumer must retain possession and take reasonable care of them (reg.17).

It should also be noticed that a consumer has the right to cancel payment where fraudulent use has been made of his payment card and has the right to be re-credited with the amount of the payment by the credit provider (reg.21).

The 2004 Regulations provide an analogous right of cancellation of credit agreements concluded at a distance.

“Doorstep selling”

The Cancellation of Contracts made in a Consumer’s Home or Place of Work etc. Regulations 2008 (S1 2008/1816: note the “etc” forms part of the official title) which came into force on October 1, 2008 makes a whole range of contracts concluded away from business premises cancellable by the consumer. There are exceptions (listed in Sch 3 to the Regulations). These contracts must contain prescribed formulae and a cancellation notice and are unenforceable by the seller if they do not, though they remain enforceable by the consumer. The consumer may cancel the contract by serving a written notice of cancellation on the trader, or on any other person specified in the notice of cancellation rights as a person to whom notice of cancellation may be given, within the period of seven days following the making of the contract. Except as otherwise provided, a cancelled contract is to be treated as if it had never been entered into by the consumer. Any sum paid under or in contemplation of the contract is repayable and if the consumer or any other person on his behalf is in possession of any goods he is given a lien on them to secure repayment. Security provided in relation to the contract is to be treated as never having had effect, and any property lodged with the trader solely for the purposes of that security is to be returned by him forthwith. Notwithstanding the cancellation of a contract under which credit is provided, the contract remains in force so far as it relates to repayment of credit and payment of interest. Cancellation of any contract for goods or services has the effect of automatically cancelling any related credit agreement and where the credit agreement is a regulated agreement, it is treated as if it had been cancelled under the cancellation
provisions of the CCA 1974 and those provisions will apply (notwithstanding that the agreement may not itself have been cancellable under the CCA).

The Consumer Credit Act 1974

This Act, with its substantial body of subordinate legislation, represents a major statutory intervention in the law of contract. Its provisions are detailed, lengthy and extremely complex.

Scheme of the CCA. The purpose of the CCA is protection of debtors and hirers by:

1. licensing all branches of the credit and hire business;
2. controlling advertising and canvassing;
3. requiring full information to be given by creditors;
4. regulating the form and content of documents;
5. restricting rights of termination and enforcement;
6. giving debtors and hirers rights of early termination;
7. making the creditor liable for faulty goods and services;
8. giving relief from various types of extortionate and unfair agreements.

The CCA regulates agreements, within the financial limits current at the date of the agreement – the upper limits being:

1. agreements made up to April 30, 1998: £15,000;
2. agreements made on and after May 1, 1998 and up to April 5, 2008: £25,000.
(The lower limit is £50. Below that limit the agreement is a “small agreement”: s.17).

One of the major changes brought by the 2006 Act was the abolition of financial limits. All financial limits for regulation were abolished in relation to all agreements made on or after April 6, 2008. Thus all “consumer credit agreements” and “consumer hire agreements” (i.e. credit and hire agreements made with individuals) will be regulated by the CCA unless the subject of an express exemption under the Act or its subordinate legislation. Prior to 2008 the principal exemptions were contained in s.16 and the Consumer Credit (Exempt Agreements) Order 1989, which was and is constantly updated and amended.

High net worth debtors and hirers. For agreements made after April 6, 2008, CCA s.16A exempts agreements made by “high net worth” debtors and hirers. In summary, the really affluent can obtain a certificate showing that their income or net assets exceed a limit established by regulations and can use this to bargain better credit or hire terms against voluntary exemption from regulation. The agreement had to be certified as free from exemption using a statutory formula. This exemption was seriously weakened by the implementation of the Consumer Credit Directive and now only applies where the total amount of the credit exceeds £60,260 (the ceiling for regulation under the Directive, being the 2008 equivalent of €75,000).

Business agreements. When the financial limits of control were removed on April 6, 2008, for the first time since it was passed, the CCA distinguished between agreements by criteria related to the purpose of the agreement. CCA s.16B creates an exemption for an agreement that is “entered into by the debtor or hirer wholly or predominantly for the purposes of a business carried on, or intended to be carried on by him”. This is not, however, a blanket exemption. It only applies to agreements above the £25,000 limit which is retained for this purpose. Thus business agreements below the limit will be regulated as if they were non-business agreements. Regulations prescribe a rubric which will must be included in agreements, in effect to certify that they are business agreements and there are anti-avoidance provisions to prevent creditors trying to evade regulation by expressing all agreements as business agreements. Note that business agreements of all kinds are outside the scope of the EU Directive so that business agreements that are still regulated by the CCA (i.e. under £25,000) will be governed by the provisions of the Act and the Regulations existing before February 1, 2011, unless the creditor chooses to ‘contract into’ the new version of the rules.
Investment finance. (Sometimes referred to as “buy-to-let finance”). CCA s.16C (in force from October 31, 2008) exempts a category of investment agreements, essentially loans secured on residential property where the borrower or his family are not occupying more than 40 per cent of the property. Although quite widely drafted, this exemption is intended to exempt buy-to-let finance. Unlike “high net worth” and business agreements, buy-to-let credit agreement documents do not have to carry a statutory declaration of exemption.

Licensing. Any person carrying on the business of providing credit or letting goods under contracts regulated by the CCA must obtain a licence as must most credit-brokers, debt-adjusters, debt-counsellors, debt-collectors and credit reference agencies. The 2006 Act has added two new categories of ancillary credit business to the existing list and there are now nine categories of business which require a licence:

(a) consumer credit;
(b) consumer hire;
(c) credit brokerage;
(d) debt adjusting;
(e) debt counselling;
(f) debt collecting;
(g) debt administration;
(h) provision of credit information services;
(i) operation of a credit reference agency.

The significance of licencing is that agreements made by unlicenced traders (s.40) or introduced by unlicenced credit-brokers (s.149) are unenforceable without an order from the Office of Fair Trading.

The formalities of the agreement. The form and contents of regulated agreements are rigidly controlled by the CCA and its attendant regulations. Until 1 February 2011, the regulations were the Consumer Credit (Agreements) Regulations 1983 but these were amended from time to time, sometimes drastically.

The rules for the form and content of agreements were made much more complicated but the Consumer Credit (Agreements) (Amendment) Regulations 2004 (S1 2004/1482) which came into force on May 31, 2005 and apply to agreements made after that date. These regulations drastically
amended the 1983 Regulations, thus providing two regimes, one for agreements before May 31, 2005 and one for agreements after that date. The major changes were:

- the prescribed information has now to be given in a fixed and immutable order;
- there are changes to the warning boxes and additional warning and consent boxes introduced;
- additional information has to be given;
- the legibility and prominence provisions have been greatly tightened;
- changes have been made to the calculation and statement of the APR.

This level of complication did not appeal to the EU legislators and the Directive imposed a lengthier but much less rigid form of agreement, in line with its policy that the relevant information should be provided to the customer in advance by the SECCI and explained to the customer by the creditor before the agreement was signed. This necessitated a new set of Regulations, the Consumer Credit (Agreements) Regulations 2010 (SI 2010/1014). These provide that, in all cases where the 2010 Disclosure Regulations apply, the creditor must ensure that the contract is in the form prescribed by the 2010 Agreements Regulations. This means the 2010 Agreements Regulations apply in all cases where the 2020 Disclosure regulations apply compulsorily (i.e. all credit agreements other than those secured on land, those for business purposes and those for credit over £60,260) and in those further cases where the creditor has voluntarily chosen to comply with the 2010 Disclosure Regulations for agreements otherwise exempt from them.

Enforcement. Before any right can be exercised by the creditor or owner, save the right to recover instalments due under the agreement, notice must be given, even if that right is not dependent upon the debtor or hirer being in breach of contract. Notice of the exercise of rights other than the right to terminate must be given under s.76, notice of the exercise of a right exercisable on default under s.87 and notice of the right of termination for reasons other than default (e.g. death or bankruptcy) under s.98. With notices of default, if the breach is capable of remedy, the debtor or hirer must be given the opportunity to remedy it and, if not, he must be notified of the sum required
to be paid in compensation with, in each case, a date for compliances: s.88. If the debtor or hirer complies then the breach is wiped out: s.89. All notices must be in the form prescribed by the Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983. Copies of all notices must be served on sureties: s.111. Compliance with these rules is a condition precedent to exercising the rights relied on.

Where more than one-third of the total sum payable has been paid under a hire-purchase or conditional sale agreement, even after the proper notices have been served, the creditor cannot repossess the goods without a court order (s.90), and if he does, the debtor will be released from all liability under the agreement and can recover all money previously paid to the creditor: s.91.

The 2006 Act made significant changes to the enforcement provisions. The CCA s.88 lays down the rules for default notices served under s.87. Under s.88(1) a default notice must specify:

(a) the nature of the alleged breach;

(b) if the breach is remediable, what is to be done to remedy it and the date before which it is to be done;

(c) if the breach is not remediable, the sum to be paid by way of compensation and the date before which it is to be paid.

Under s.88(2) and (3) the relevant date under s.88(1) must be not less than seven days after the date of service of the notice and the creditor or owner may not take any enforcement action under s.87(1) until that period has elapsed. Section 14(1) of the 2006 Act makes an important change to these provisions by substituting 14 days for seven days in s.88(2) and (3). This provision came into force on October 1, 2006. Hence from October 1, 2006 all default notices must give the debtor or hirer 14 days, not seven, in which to comply and this applies to any default notice served on or after October 1, 2006 regardless of the date of the agreement or the date of the breach to which the default notice relates: Sch.3 para.10.

The 2006 Act made other changes to default notices. Changes to ss.87 and 88 of the CCA together with the Consumer Credit (Information Requirements and Duration of Licences and Charges) Regulations 2007 (SI 2007/1167) considerably increased the amount of information and statements
of rights to be included in default and termination notices and there is an obligation to accompany such a notice with a copy of the current edition of the OFT’s “Default Information Sheet”. The sanction of non-compliance is that the agreement is unenforceable during any period of non-compliance. These changes came into force on October 1, 2008 and apply not only to new agreements but to any agreement still current at the time.

Note that it is now obligatory for those serving default or termination notices to inform the debtor or hirer (in statutorily prescribed wording) of the existence of these rights.

Termination by the debtor or hirer. Sections 94 to 97 and ss.99 and 100 give various rights to the debtor to terminate credit agreements ahead of time and provide for the outstanding charges to be rebated in consequence. Section 101 gives a hirer the right to terminate a hire agreement after the agreement has run at least 18 months.

It should also be noted that the previously existing right of the debtor to repay the credit early under CCA s.94 has been expanded by the Directive as from February 1, 2011 to a right to pay off part of the credit and not solely the whole credit. There is a new right for a creditor who suffers loss as a result of early repayment to recover a limited “compensation”.

Pawn. Contracts of pledge are strictly regulated, except for non-commercial agreements and pledges of documents of title or bearer bonds: s.114(3). The pawnor must be given a pawn-receipt (s.114(1)) in the form specified by the Consumer Credit (Pawn-Receipts) Regulations 1983. Pawning by minors is forbidden: s.114(2). The pawn is redeemable for at least six months (longer, if so agreed) (s.116) and must be delivered up to the person tendering the pawn-receipt and the sum due: s.117. If the pawn is unredeemed within the period, then, if the pawn is for less than £25 and the redemption period is six months, property in the pawned goods passes automatically to the pawnee: otherwise the pawn becomes realisable by the sale on notice to the pawnor, the pawnee giving notice of the result of the sale to the pawnor and paying to him any surplus over the amount due: ss.120-121.

Extortionate credit bargains. The CCA introduced the concept of extortionate credit bargains by ss.137-140. If the court finds a credit bargain to be extortionate by requiring the making of “grossly exorbitant” payments or by “otherwise contravening the principles of fair dealing”, the court, can reopen the agreement and largely rewrite it: ss.137-140. These provisions apply to all credit
agreements where the debtor is an individual and are not confined to agreements regulated by the CCA. Further this part of the CCA applies fully retrospectively and applies to an agreement whenever it was made (even, theoretically, before 1974). Although the court has the widest possible powers, in practice, few agreements have yet been held to be extortionate. The provisions do not apply to agreements made on or after April 6, 2007 for the reasons set out in the following paragraphs.

Unfair relationships. Extortionate credit bargains have been replaced by a concept of “unfair relationships between creditors and debtors” which is intended to be far wider in its ambit and to give judges much more discretion to intervene in the operation of agreements which, in some way or other, offend against ordinary canons of fair dealing. The mechanism is by inserting four new sections into the CCA – ss.140A-140D will apply to all credit agreements (including otherwise exempt agreements) except for agreements exempt under s.16(6C) (mortgages regulated by the 2000 Act) but the new provisions (like ss.137-140) do not apply to hire agreements. These provisions came into force on April 6, 2007 with elaborate transitional provisions for existing agreements over the following year.

Section 140A confers on the court the power to make an order under s.140B:

“if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following –

(a) any of the terms of the agreement or of any related agreement;

(b) the way in which the creditor has exercised or enforced any of his rights under [0] 11 the agreement or any related agreement;

(c) any other thing done (or not done) by, or on behalf of, the creditor (either [0]11 before or after the making of the agreement or any related agreement).”

Section 140A(2) enables the court to have regard to “all matters it thinks relevant” which means that the court can have regard to the acts or omissions of any associate or former associate of the creditor and to treat them as the acts or omissions of the creditor himself.
The court may do any or all of the following:

(a) require payment of any payment made to anyone by the debtor or by a surety by virtue of the agreement or any related agreement;

(b) require the creditor to do or cease doing anything in connection with the agreement or any related agreement;

(c) reduce or discharge any sum payable by the debtor or a surety;

(d) direct the return to a surety of any property provided by way of security;

(e) set aside any obligation of the debtor or surety;

(f) alter the terms of the agreement or any related agreement;

(g) order accounts to be taken between any persons.

Note that, under s.140B(9), if, in any relevant proceedings, the debtor or a surety alleges that the relationship between the creditor and the debtor is unfair to the debtor, the onus is on the creditor to prove the contrary.

The powers can only be invoked by the debtor or a surety. There seems to be no mechanism for the court to act of its own motion. The definition of “the court” in s.189(1) is replaced by special provisions whereby in the case of England and Wales the application must be made to the County Courts: s.140B(4)(a).

Where goods are purchased with the aid of credit covered by ss.75 and 75A of the Consumer Credit Act, the buyer will have identical rights against both the seller and the creditor.

In general, the Acts of 1973, 1979 and 1982 imply into the relevant contracts terms providing that:

1. the seller or owner has title to the goods and can pass it to the buyer or hirer;

2. the goods are reasonably fit for the purpose for which the buyer or hirer requires them, are of satisfactory quality and conform to description and sample.

As will be seen under “Sale of Goods”, the scope of the provisions as to fitness and quality have been considerably enhanced by the Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002.3045). In this context the term “consumer” differs from that employed by the Consumer Credit Act and will apply to contracts outside the financial limits of regulation by that Act. It includes any individual (natural person) who makes the contract when “acting for purposes which are outside his trade, business or profession”.

The concept of “satisfactory quality” has been expanded for consumer transactions and now includes, in effect, conformity with “public statements” made about the goods by the manufacturer or (if the goods are imported into the EU from outside) the importer on packaging and in advertisements.

Under reg.15 of the 2002 Regulations, where the goods are offered for sale with a “consumer guarantee”, this operates as a contractual obligation owed by the guarantor to the buyer under the conditions set out in the guarantee and its “associated advertising”. The terms of reg.15 apply not only the guarantor himself but to “any other person who offers to consumers the goods which are the subject of the guarantee for sale or supply”. Thus a manufacturer’s guarantee is enforceable by the buyer against both the manufacturer and the seller.

In cases covered by the Sale of Goods Act 1979, the 2002 Regulations have created a new Pt 5A which affords the consumer a series of new remedies for breach of ss.13, 14 and 15 of the 1979 Act including the right to demand repair or replacement of the goods and a right to abatement or return of the price.
Liability of the creditor or owner under the CCA for faulty goods and services. At common law where there is the tripartite relationship involving the creditor, the hirer and the supplied, it is often difficult to make the creditor liable for the misrepresentations and breaches of warranty of the supplier (Branwhite v Worcester Works Finance Ltd [1969] A A.C. 552).

The CCA, however, gives the debtor or hirer considerable rights against the creditor. Section 56 applies to “debtor-creditor-supplier agreements”. Although the definition of these agreements in s.12 is elaborate, in essence these are credit agreements where the immediate supplier is the creditor himself (e.g. hire-purchase or conditional sale) or is someone with whom the creditor has or intends to have an arrangement (either in respect of the individual transaction or a class of transactions). Section 56 provides that where, prior to the making of an agreement in this category, these are “antecedent negotiations” conducted by a creditor, credit-broker or supplier, then any person conducting the negotiations is deemed to act as the agent of the creditor or owner as well as on his own behalf. “Negotiations” is defined sufficiently widely as to encompass collateral agreements between the supplier and the debtor or hirer. It is important to note that s.56 does not apply to hire agreements ad there is no equivalent provision for them in the CCA. The hirer is thus thrown back on the common law.

Sections 75 and 75A (the latter added by the Directive as from February 1, 2011 and essentially providing a like remedy to s.75 but for transactions above £30,000, the cap for s.75 and £60,260, the cap for the Directive) apply to debtor-creditor-supplier agreements where the supplier is not the creditor himself (mainly restricted use loans or agreements such as credit-token agreements where the debtor can only use the token with suppliers who have a prior arrangement with the creditor). Thus it does not apply to hire-purchase.

**Defences**

In most cases the contractual defences will relate to misrepresentations made before the contract was entered into or breaches of express or implied conditions or warranties as to the condition, fitness or description of the goods or services which are the subject-matter of the credit agreement. See the paragraphs “Claims relating to fault goods and services” above. The provisions relating to “distance selling” afford new defences based on cancellation or deemed cancellation as do the rules contained in the “Doorstep Selling” Regulations.
The Consumer Credit Act 1974

The formalities required or the formation and enforcement of a regulated agreement are so complex that there is a high risk of the creditor or owner infringing the rules and opening the way for the debtor or hirer to claim that the agreement is unenforceable. The fact that there are now three different sets of rules governing the form and content of regulated agreements has only added to the problem.

It must be emphasised, however, that the CCA has not done away with the need to consider contractual defences in cases involving agreements regulated by the CCA, and such defences will frequently be more important than the technical defences. Even where the debtor or hirer may have a defence arising from a breach of the CCA, if there is a defence on the real merits of the Action, it is always wise to give such a defence prominence because there is a natural reluctance on the part of judges to accede to strictly technical defences when the defendant is otherwise wholly unmeritorious.

Defences under the CCA fall into five main areas:

1. Defences arising out of events before the contract is made (e.g. that the creditor or credit-broker was not the holder of the proper licence) or that the creditor failed to provide the requisite pre-contract information).

2. Defences arising out of the making of the agreement, in particular defences arising out of non-compliance with the regulations concerning the form and content of regulated agreements, failure to give notices such as cancellation notices and failure to provide the correct copies.

3. Defences arising out of events after the making of the contract such as those based on failure by the creditor to provide statutory statements (much strengthened by the 2006 Act and by the implementation of the Directive) and default notices (prior to enforcement notices) introduced by the 2006 Act.
4. Defences arising from breaches of the rules governing enforcement by the creditor such as those prescribing the form and content of default notices and statement of the time given to the debtor to comply.

5. Extortionate credit bargains and unfair relationships

Time orders. Even where the defendant has no defence to the claim either on its merits or on technical grounds under the CCA, he may be able to seek a time order under the CCA 1974 s.129. Whether or not the creditor’s claim is admitted, it would seem good practice for the debtor to include the application for such an order in a counterclaim. This is subject to procedural rules whether made as a free-standing claim by the debtor or hirer, or in proceedings brought against him by the creditor or owner (see above, under Category 5).

Time orders were enlarged by the 2006 Act. The new requirements for the creditor or owner to serve a notice of default once the debtor or hirer reaches specified levels of default (even if he does not intend to enforce the agreement at that stage) mean that a debtor or hirer who is served with such a notice may pre-empt enforcement by making his own application for a time order under s.129A of the CCA (introduced by s.16 of the 2006 Act).

Interest. In cases governed by the CCA, interest can be claimed under contractual provisions for interest or as discretionary interest under s.69 of the County Courts Act 1984. In other cases, however, it may be possible to claim interest and the statutory penalty under the Late Payment of Commercial Debts (Interest) Act 1998. This Act now covers all commercial transactions for the supply of goods or services, including contracts of hire and hire-purchase, provided that they are not consumer credit agreements (as defined by the CCA – these are excluded by s.2(5) of the 1998 Act) or security contracts (mortgage, pledge, etc.). Note that interest on default sums (i.e. charges imposed on default in addition to any arrears or outstanding balance) will have to be charged at simple interest rates when s.13 of the 2006 Act comes into force in April 2008.

THE LAW OF COMMISSION AGENTS

As a result of the obligation to implement EU Council Directive 86/653m the Commercial Agents (Council Directive) Regulations 1992 (SI 1993/3053) were made by the Secretary of State for Trade and Industry. The 1993 Regulations came into force on January 1, 1994 and apply to all contracts...
entered into under the agency agreement after that date, and whether or not the agency agreement itself pre-dates the commencement date. The Regulations define a commercial agent as a self-employed intermediary with continuing authority to negotiate the sale or purchase of goods on behalf of his principal or to negotiate and conclude the sale or purchase of goods on behalf of and in the name of that principal. There must be a contractual relationship of principal and agent between the parties so, for example, a sub-agent who had not directly contracted with the principal cannot invoke the Regulations (Light v Ty Europe Ltd [2004] 1 Lloyd’s Rep.693). The regulations are concerned with the sale and purchase of goods and not of services. Officers of a company or association (or partners in the case of a partnership) are excluded from the definition but there are few other exceptions. The primary ones are where the commercial agent’s activities are secondary to his principal commercial agency activities (Crane v Sky In-Home Service Ltd [2007] EWHC 66 (Ch); [2007] 2 All E.R. (Comm) 599) or are unpaid or where he is operating on a commodity exchange or in the commodity market.

In performing his activities a commercial agent must look after the interests of his principal and act dutifully and in good faith (reg.3). He has three specific obligations: (a) the duty to make proper efforts to negotiate and where appropriate conclude the transactions he is instructed to take care of; (b) the duty to communicate to his principal all necessary information available to him; and (c) the duty to comply with his principal’s reasonable instructions.

The principal has a similar duty to act dutifully and in good faith (reg.4). This duty includes the obligation to provide all necessary documentation relating to the goods concerned as well as information necessary for the performance of the agency contract. In particular, where the principal knows that the volume of commercial transactions are likely to decrease to less than normally expected, he must tell his agent.

The parties are not free to contract out of these duties. Furthermore, the 1992 Regulations apply where an agent’s operations take effect within the European Union on behalf of a principal situated outside the European Union. This cannot be overridden by a choice of law purporting to choose the law of a non-EU jurisdiction: Ingmar GB Ltd v Eaton Leonard Technologies Ltd [2001] I All E.R. (Comm) 329; [2001] 2 All E.R. (EC) 57.

Part III of the regulations deals with remuneration. In the absence of agreed term remuneration, the agent is entitled to remuneration with commercial agents applied for the goods forming the subject
of the agency are customarily allowed, in the place where the agent carries on his activities. In the absence of such a custom, it is then that he is entitled to reasonable remuneration taking into account all the aspects of the transaction.

Part IV of the 1993 regulations deals with the conclusion and termination of the agency contract including a statutory right to compensation contained in reg.17. There is also a specific limitation on the right to impose restraint of trade clauses. For the purpose reg.17 the “agency contract” is to be widely construed as meaning the agency itself rather than the particular contract in force at the date of termination: Moore v Piretta PTA Ltd [1999] I All E.R. 174.

THE LAW OF FACTORING

Under a conventional factoring agreement, the finance company agrees to provide a factoring service under which a dealer assigns his commercial debts to the finance company in return for the immediate payment of a percentage of their value. The dealer agrees to serve notices of assignment upon his customers, (the debtors). It is then for the finance house to collect the debts. As the legal assignee of the debt, the finance company is able to sue the debtors in its own name to recover the amount owing, thanks to the terms of s.126 of the Law of Property Act 1925. When a customer pays the full value of the debt, the finance house either keeps the balance as payment, or accounts to the dealer for the balance but keeps a percentage as a commission.

The customer is permitted to raise by way of a defence those matters which he could have raised as a defence if the claim had been brought by the dealer from whom he purchased the goods or services. In such cases, the agreement may permit the finance company to call for a re-assignment of the debt and the repayment of sums that it has already paid the dealer. The dealer is then left to proceed against his customer. In some cases, the dealer agrees to indemnify the finance company where the customer fails to pay by reason of the dealer’s default in the contract of supply.

The finance company’s direct right of action against the debtor depends upon the service of a notice of assignment. Failure to serve a notice of assignment amounts to a defence for the customer but should render the dealer liable under the terms of the factoring agreement.

The recent changes to the Consumer Credit Act 1974 (CCA) and to its attendant statutory instruments have been of considerable relevance to factors who factor agreements regulated by the
Act. The position has always been that the definition of “creditor” and “owner” in s.189(1) of the CCA has been wide enough to encompass assignees of the original creditor or owner. The amendments made to the CCA by the Consumer Credit Act 2006 (CCA 2006) have imposed on both original creditors and on assignees much greater burdens to provide information during the currency of the agreement and on termination with the drastic sanction of the agreement being unenforceable during any period of non-compliance. The fact that many creditors carried out block assignments of sub-prime agreements to factors or other debt-purchasers without supplying the assignees with adequate records or copies of documents has led to a multiplicity of defences being available to the debtor sued by an assignee.

The removal of the financial limits for CCA regulation on April 6, 2009 has greatly increased the number (as well as the value) of regulated agreements. This step obliges those who factor agreements which are (or may be) regulated to consider the technical niceties at all times.

THE LAW OF LIENS & SET-OFF

At common law, a lien refers to the right of one person, rightfully and continuously in possession of property belonging to another, to retain that property so long as an existing claim against the owner remains unsatisfied or to retain specific goods in relation to which charges have been incurred until the charges have been paid. General liens are not favoured by the courts because of the priority they afford as against other creditors and can exist only upon proof of a general usage or by express agreement.

On the other hand, an equitable lien is not dependent upon possession and is in the nature of a charge, giving rise to a right of sale albeit only by order of the court. As such, it falls within the definition of a mortgage for the purpose of s.205 of the Law of Property Act 1925 and, in order to rank ahead of a purchaser, should be registered as a land charge.

A legal lien affords a defence to an action by the owner for possession of the goods. It does not itself confer a right of action. A person exercising a lien has sufficient interest in retaining possession of the property that is the subject of the lien to maintain a cause of action in conversion or trespass. Being dependent on possession, a legal lien is not required to be registered under statutory rules relating to bills of sale or under the Companies Act 1985. Unlike an equitable lien, a lien at common law does not confer a power of sale. In notable examples, however, statute has intervened to
provide an express power of sale, such as in ss.12 and 13 of the Torts (Interference with Goods) Act 1977 and ss.39, 41-42 of the Sale of Goods Act 1979.

The term “lien” may also be applied to a right held by a person who does not possess the relevant property but nevertheless enjoys a right against the owner. For example, a solicitor, in addition to his legal lien over a client’s documents within his possession, has a statutory right to ask the Court to direct that property recovered is to stand as security for his costs (Re Fuld (No.4) [1968] P.727).

**Liens at common law**

The person claiming to exercise a lien must be lawfully in possession of the property. Thus if a buyer rejects goods for which he has paid, he loses his right to possession of them and, therefore, a lien over them for the return of the price (JL Lyons & Co v May & Baker Ltd [1923] 1 K.B. 685). Possession must be continuous so that if the owner has the right to call for the return of the goods, the lien is lost (Scarfe v Morgan (1838) M. & W. 270 where the livery stable owner who was required to permit the owner to remove the horse as and when the owner required its use did not thereby obtain a lien).

General Liens – examples. A banker, in the absence of an agreement to the contrary, has a general lien upon the securities of his customers, which are in his hands as a banker (Brando v Barnett (1846) 12 C1. & F.787) but this lien may be subject to a trust in favour of a third party where the banker has knowledge of circumstances giving rise to such a trust (Barclays Bank Ltd v Quist-close Investments Ltd [1970] A.C. 567).

Solicitors have a general lien for their taxable costs, charges and expenses on the deeds and papers of their clients which have come into their hands in the course of their professional employment (Stevenson v Blakelock (1813) 1 M. & S. 535 cited in Re Taylor, Stileman and Underwood [1891] 1 Ch.590 at 600).

Hotel proprietors, as innkeepers, enjoy a lien upon any property (subject to certain statutory exceptions) brought by a guest in respect of the guest’s unpaid bill.
A factor has a general lien upon all goods consigned to him as factor for the balance due to him (*Dixon v Stansfield* (1850) 10 C.B. 398). He does not lose his lien because he has instructions to sell the goods at a particular price and in the principal’s name (*Stevens v Biller* (1883) 25 Ch. D. 31).

A packer has a general lien upon the goods of his customer which are in his hands (*Re Witt* (1876) 2 Ch. D. 489). Wharfingers and warehousemen have similar liens (*Holderness v Collinson* (1827) 7 B. & C. 212) but not where the transaction shows an intention on the part of both parties inconsistent with such a general lien (*Hill & Sons v London Central Markets Cold Storage Co* (1910) 102 L.T. 715). A warehouseman cannot assert a general lien against all goods deposited by a factor in his own name whether his goods or not (*Leuckhart v Cooper* (1836) 3 Bing. N.C. 99).

Stockbrokers have a general lien upon the securities of their customers (*Re London and Globe* [1902] 2 Ch.416 and *Hope v Glendinning* [1911] A.C. 419). A similar lien is available to insurance brokers (*Hewison v Guthrie* (1836) 2 Bing. N.C. 755).

Particular Liens. Where a party is obliged by law to receive goods, the common law imposes the concomitant obligation to pay for the services rendered and a lien upon the goods until payment is effected. Thus, a common carrier, being bound to carry the goods, has a particular lien on the goods carried until payment is made. Where there is no obligation to receive goods, there is lien for monies spent on improving the goods but the lien does not extend to labour expended on mere maintenance (*Re Southern Livestock Producers Ltd* [1964] 1 W.L.R. 24). To train a horse gives rise to a lien but to stable one does not (*Bevan v Waters* (1828) Mood & M. 235).

Particular liens have arisen in the following cases, amongst many others: an accountant upon the books of account of his client; an architect upon plans drawn by him; an auctioneer for his commission; a conveyancer upon documents prepared by him; a garage proprietor for a car repaired by him; a printer upon copies of a book printed by him; and a tailor for the price of the suit.

Equitable liens. An equitable lien arises by operation of law and is not dependent upon possession. It is not possible to state, by reference to a general rule, the circumstances in which the law imposes an equitable lien. A vendor of land has a legal lien on the land sold and on documents of title within his or her possession until completion of the transaction. The vendor also has an equitable lien for the unpaid purchase price of any part of it. It ranks as an overriding interest for the purposes of the Land Registration Act 2002 in a claim for specific performance, the vendor may also expressly plead
that he or she is entitled to a lien (Tacon v National Standard Mortgage and Investment Co (1887( 45 L.J. Ch. 529).

Conversely, a purchaser of land who has paid part of the purchase price not only has a lien on the title deeds in his or her possession but also has an equitable lien on the vendor’s land. The effect is the same as if the vendor had executed a charge upon the property.

Other examples of equitable liens are found as between partners in relation to the partnership estate and in the case of a remainderman who has a lien upon profits receivable in the tenant’s hands against the tenant who has committed acts of waste (Briggs v Earl of Oxford (1855) 1 Jur. M.S. 817 and Re Spurlings Wills Trusts [1966] 1 W.L.R. 920).

A lien or charge in favour of a person who expends money for the benefit of or on the property of another may arise if the payer is under an obligation to spend or is entitled to be indemnified for such expenditure (Chalmers v Pardoe [1963] 1 W.L.R. 677).

A person entitled to trace proprietary right into trust moneys or their proceeds may in appropriate circumstances be entitled to an equitable lien over those moneys or proceeds: Foskett v McKeown [2001] 1 A.C. 102

SET-OFF

Set-off is a method of adjusting cross claims to monetary relief. In the absence of lien or some form of real security, an entitlement to set-off does not give one party the right to detain the property or assets of the other as a “set-off” against the other’s monetary claims: Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend CBC [2002] 1 A.C. 336.

Where a claimant claims a sum of money against a defendant who has a monetary cross-claim, such that the defendant is entitled to the extent of his cross-claim to be relieved from payment of the claim and to set it up as a defence in the claimant’s action, the defendant is exercising a right of set-off to the extent of his cross-claim.

With contracts for the sale of goods and for work done, the Sale of Goods Act 1979 permits a defendant to raise a breach of warranty as a defence to a claim for the price. In this case the
defendant is not strictly setting off his claim at all but exercising a right to an abatement of the price provided that he establishes that the seller’s breach has caused him damage.

In practice a defence of set-off will nearly always be accompanied by a counterclaim.

Set-off at law


Equitable set-off

Where either the claim or cross-claim is equitable only, a set-off will be allowed in equity if the case is analogous to one where a set-off would be permitted at common law. An equitable set-off may also arise by agreement, express or implied such as by a course of dealing (Jeffs v Woods (1723) 2 P.Wms. 128), provided it is supported by consideration (Birkbeck Building Society v Birkbeck (1913) 29 T.L.R. 218). There is also a general equitable right to set-off where a cross-claim for a money sum is so closely connected with the claim as to raise an equity in favour of the defendant such as it would be unfair to disregard it. Such a cross-claim is said to impeach the claimant’s title or, put another way, an equitable set-off may arise if there is a cross-claim flowing out of and inseparably connected with the dealings and transactions which arise in the claim (Bank of Boston Connecticut v European Grain & Shipping Ltd [1989] A.C. 1056). The cross-claim must be for a sum of money, liquidated or not.

In order for a defendant to be able to rely on a counterclaim as an equitable set-off, his counterclaim has to be closely connected with the same transaction as that giving rise to the claimant’s claim and the relationship between the respective claims has to be such that it would be manifestly unjust to allow one to be enforce without regard to the other (Esso Petroleum Co Ltd v Milton [1997] 1 W.L.R. 938 CA, per Simon Brown L.J.). In that case, claim for unpaid direct debits for fuel supplied by the claimant was answered by a cross-claim for damages for future losses under a licence agreement. Although claim and cross-claim arose out of a single trading relationship, it was not sufficient to amount to an equitable set-off.
Exceptions


Rent. A tenant may set up a cross-claim based on the landlord’s breach of covenant as defence to a claim for rent provided the cross-claim is sufficiently closely connected (British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd [1980] Q.B. 137). Even where a lease provided for rent to be paid without any deductions, it was held that this would not ordinarily exclude a right of equitable set-off arising from the landlord’s own breach (Connaught Restaurants Ltd v Indoor Leisure Ltd [1994] 1 W.L.R. 501).

Contracting-out. Parties may contract out of the obligation to permit a set-off but this can only be done by clear and unequivocal words or a clear implication: Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd [1974] A.C. 689 at 724, per Lord Salmon; Coca-Cola Financial Corp v Finsat International Ltd [1998] Q.B. 43. Save in the most exceptional circumstances, the Court will usually enforce a “no set-off” clause Credit Suisse International v Ramot Plana OOD [2010] EWHC 2759 (Comm).

Capacity

In general, the cross-claim must involve the claimant and the defendant acting in their same capacities as for the claim. Thus if the action is for a debt due from the defendant to the claimant separately, the defendant cannot set off a debt due from the plaintiff jointly with others (Arnold v Bainbridge (1859) 9 Ex. 153) although if the plaintiff is jointly and severally liable with others to the defendant there may be a set-off (Owen v Wilkinson (1859) F C.B. (N.S.) 526). The debts of an individual partner cannot be set off against debts due to the firm (Piercy v Fynney (1871) L.R. 12 Eq. 69) and debts of the firm cannot be set off against the claim of a partner in his personal capacity (Re Pennington & Owen Ltd [1925] 1 Ch. 825).
If the claimant claims as an executor or trustee, his personal debts to the defendant cannot be set off (Rees v Watts (1855) 11 Ex. 410) and, if he claims against the defendant personally, the defendant cannot set off claims he may have qua executor or trustee against the claimant (Phillips v Howell [1901] 2 Ch. 773).

In equity, however, regard is paid to the beneficial ownership of property and rights. A defendant is entitled to set off against the claim of a trustee a debt due from the cestui que trust (Cochrane v Green (1860) 9 C.B. (N.S.) 448) or a debt of the real plaintiff for whom the nominal claimant is acting trustee (Agra Bank v Leighton (1866) L.R. 2 Ex. 56).

Date of set-off

The sum claimed to be set off must have accrued due before the action was commenced (Richards v James (1848) 2 Ex. 471). A cross-claim arising after the date of the proceedings must be raised in a separate action. For limitation purposes a claim by way of set-off or counterclaim is deemed to be a separate action and to have been commenced on the same day as the original action (Limitation Act 1980 s.35).

THE LAW OF BAILMENT

Bailment

The essence of bailment is the possession of goods by a person, a bailee, without his simultaneous holding of the immediate reversionary interest in the goods. It does not follow, however, that all possessors are bailees, or at least bailees in any real sense of the term. Nor indeed does it follow that all bailees owe duties in bailment to each and every party with a superior interest in the chattel bailed so that each and every such party is regarded as a bailor to him.

The law of bailment embraces a number of legal concepts and is not easily capable of any neat subdivision or categorisation. A bailment confers possession on the bailee and possession, along with ownership, is an interest in personal property. The relationship of bailment also confers mutual rights and obligations on bailor and bailee and is, as such, also an aspect of the law of obligations.

Bailment is sometimes now spoken of as an independent cause of action. There is probably, however, no claim for breach of bailment that cannot also be pleaded in tort so if bailment is an
independent cause of action it is effectively a redundant one. Nevertheless a plea of a bailment relationship by a claimant may often be necessary to give rise to a remedy in tort (or indeed contract) that would otherwise not be available to him absent any such plea or to facilitate proof of the case.

Conversely a plea by a defendant of a relationship of bailment (e.g. as to some form of bailment on terms) may be an essential element in any defence he may wish to raise to any claim brought against him in any cause of action and whether pleaded in bailment or otherwise.

The primary remedy for breach of the terms of a bailment, contractual or otherwise, lies in the tort of conversion (including the tort formerly known as detinue) where the common law has notably fashioned particular remedies adapted to the bailment relationship so that conversion may be occasioned by a bailee against his bailor in numerous cases where otherwise outside a relationship of bailment there would be no conversion at all.

Defining a Bailment? Though the language of bailment often talks, especially in the older cases, of the bailor entrusting the goods to the bailee the relationship of beneficiary and trustee is not that of bailor and bailee. Nor can it any longer be said that all bailments, including even those of a gratuitous nature, give rise without more to a supposed implied contract. The fiction of an implied contract has now long gone.

A commercial bailment will usually be incepted through a delivery by the bailor to the bailee and terminate with a redelivery by the latter but in cases of bailment by taking and finding there is no delivery at all and in other cases, as where an owner sells goods but remains in possession as bailee of the buyer, only a constructive delivery. Where goods are sold with a subsisting third party bailment a deemed delivery may arise by any attornment between the buyer and the existing bailee.

During the period of the bailment, the bailee's interest in the property is prima facie superior to that of all others, including the bailor, unless the bailee violates some term of the agreement so as to bring his right to continue in possession to an end.

The bailee assumes a positive obligation to his bailor(s) to care for the goods and once the purpose for which the property has been delivered has been accomplished, the goods must be returned by the bailee to the bailor or otherwise alienated or disposed of pursuant to the bailor's directions.
At least so far as modern commercial bailments are concerned the absence of reward is likely to be largely, if not wholly, immaterial to the standard of care expected of the bailee (Port Swettenham Authority v TW Wu & Co Sdn Bhd [1979] A.C. 580).

In practice a more relevant distinction may often lie between those bailments which are truly consensual, or at least originated in that fashion, and those "bailments" where the possessor is either an unwilling or unwitting "bailee" (and especially where he was always so from the very outset) or a mere finder with the liability of an ordinary convertor and between those bailments which are bare bailments and those which are on terms.

Identifying the Bailor: A bailee is never just a bailee but always a bailee to somebody and the real difficulty in the law of bailment is often not in identifying a party as a bailee but rather in identifying whose bailee he is. A bailor need not be the owner of the goods but, as possession is the essence of a bailment, the bailor must, it seems, have the ability to confer such possession by transfer of the same directly or through others who hold possession for him. Possession is a relative concept and it is immaterial for the purposes of creation of a bailment how the bailor came into possession of the goods (Armory v Delamirie 93 E.R. 664).

Nevertheless it does not follow that all or any persons with some possessory or proprietary interest in the goods superior to that of the ultimate possessor automatically and without more stand in a relationship of bailment to the actual possessor so that all are in law each his bailor. This will only be so to the extent that the latter can properly be said to have consented to have assumed possession on behalf of each respective party. Nor does it follow (and again this is an illustration of the consensual aspect of bailment) that a disposition by a bailor of whatever interest he has in the goods, whether possessory or proprietary, will automatically import a relationship of bailment between his transferee and the bailee.

Where the party transferring possession is himself a bailee it will be a matter of fact in each case, to be determined by reference to the general contractual matrix, as to whether it is intended that the transferor should retain an interest in the goods and a continuing relationship with his own bailor (so as to effect a sub-bailment) or whether it is intended that on transfer of possession to the new bailee the transferor’s bailment relationship should thereupon cease altogether so that the transferee becomes the direct bailee of the latter.

Identifying the Bailee: Voluntary assumption of possession by delivery, taking or finding is the keynote to identifying the bailee (Scottish & Newcastle International Ltd v Othon Ghalanos Ltd [2008] UKHL 11; [2008] 2 All E.R. 768) and in most commercial cases some form of delivery is the
foundation of the bailment unless the bailee is already in possession of the goods in some other previous capacity, e.g. as owner or as bailee for another in which case there may be a deemed delivery on acknowledgement or attornment by the bailee of the relationship of bailment.

The bailee must truly consent to the possession of the goods. So where a person is entirely unconscious of his possession of the goods or though conscious of same, is an unwilling possessor through events over which he had no effective control, or perhaps where in some circumstances he has been fundamentally misled as to the nature of the goods, he has given no effective consent to the taking of possession and there is no true bailment at all. The obligations of the bailee may be very circumscribed in such case and in many or most cases the liability of the possessor lies if anything in conversion rather than in any special rules applicable to a bailee proper.

Unintended and Mistaken Deliveries: Unintended and mistaken deliveries to the wrong contractor are problematic examples in the commercial context of the difficulties created by this type of case, as are bailments of goods in sealed containers. In the later context, the bailor will have been deemed to have consented to such goods that might reasonably have been expected to have been found in the container (Moukataff v British Overseas Airways Corp [1967] 1 Lloyd's Rep. 396) so that where the goods are particularly valuable or unusual or dangerous, the bailee might not be taken to have consented to their possession. If the bailor on delivery of the container to the bailee informs the bailor of the contents and the bailee makes no objection, consent will usually be inferred (Metaalhandel JA Magnus BV v Ardfields Transport [1988] 1 Lloyd's Rep. 197).

Quasi-bailment: So-called quasi-bailment arises where an intermediate party promises an owner of goods that services will be performed in relation to the goods, but delegates the task to a third party without getting possession personally. If such intermediate party had a duty to take possession, he will owe duties determined by the express or implied terms of his contract similar to those of a bailee but, the absence of any possession on his part, restricts the cause of action against him to one in contract on the basis of his agreement to take possession rather than in bailment or tort and the only delivery of possession, and hence the only bailment, is between the bailee proper and the owner (China-Pacific SA v Food Corp of India (The Winson) [1982] A.C. 939 and Pioneer Container, The [1994] 2 A.C. 324).

Obligations of the Bailor: The duties of the bailor have received remarkably little attention by the courts and indeed the bailor’s duties appear to be very few. There is authority, albeit rather sparse, to the effect that the bailor warrants he has the right to bail the goods (Cheesman v Exall 155 E.R.
and Biddle v Bond 122 E.R. 1179) and to do so on the terms agreed with the bailee (Pioneer Container, The [1994] 2 A.C. 324).

Section 7(1) of the Supply of Goods and Services Act 1982 implies a condition that in the case of a contract for the hire of goods (as in a demise charter or other from of "dry" chattel lease where the bailee pays the bailor for the use of the bailor's goods) the bailor has a right to transfer possession of the goods by way of hire for the period of the bailment and, in the case of an agreement to bail, he will have such a right at the time of the bailment.

Section 7(2) of the Act implies a right on the part of the bailee in a contract for hire to quiet possession. By s.8 of the Act there is also an implied term of correspondence with the description where the hire is by description, by s.9 an implied term as to quality and fitness for purpose where the hire is made by the bailor in the course of a business and by s.10 an implied term of correspondence with any sample.

In the case of a bailment for carriage, storage or other work and labour (where the bailee is usually paid by the bailor), however, it appears that the bailor gives no warranty at common law or by statute qua bailor as to fitness or suitability of the goods for the proposed bailment; save as to that which arises in respect of carriage of dangerous goods.

A bailor must give instructions to his bailee where these are required and indemnify his bailee against extraordinary expenses properly incurred by him in preserving and protecting the goods. This is so quite irrespective of any contractual right on part of the bailee to remuneration; unless that is the goods are retained by the bailee for his own benefit as in the case of exercise of a lien (ENE 1 Kos Ltd v Petroleo Brasileiro SA Petrobras (The Kos) [2012] UKSC 17; [2012] 2 A.C. 164).

The bailor must also discharge any obligation to take re-delivery of the goods from his bailee at the appointed place (whether his own premises or those of the bailee as the case may be) upon the termination of the bailment.

Obligations of the Bailee: A bailee has a non-delegable (British Road Services Ltd v Arthur V Crutchley & Co Ltd (No.1) [1968] 1 All E.R. 811) duty of care (East West Corp v DKBS 1912 [2002] EWHC 83 (Comm); [2002] 1 All E.R. (Comm) 676) to perform such positive acts in the course of the bailment as are reasonably necessary to safeguard the goods (Coldman v Hill [1919] 1 K.B. 443). These duties may of course be subject in appropriate cases to the express or implied terms of any contract of bailment or any other protective terms upon which the bailee or sub-bailee has assumed possession of the goods with the consent, actual or ostensible, of the bailor.
Upon the termination of the bailment the bailed property must be returned to the bailor, or applied in accordance with his instructions (British Crane Hire Corp Ltd v Ipswich Plant Hire Ltd [1975] Q.B. 303), either in its original form, or where it is agreed that it should be altered, in its altered form (Mercer v Craven Grain Storage Ltd [1994] C.L.C. 328), but in those cases of mutuum where consumables are concerned the duty may be to return an equivalent (Wincanton Ltd v P&O Trans European Ltd [2001] EWCA Civ 227; [2001] C.L.C. 962).

The bailee is strictly liable in the tort of conversion, irrespective of any want of care, for, e.g. misdelivery, material unauthorised use of the goods, wrongful refusal to deliver up the goods or any other dealing in the goods inconsistent with the rights of the bailor including any other wrongful parting with possession of the goods as in the case of an unauthorised sub-bailment (Garnham, Harris & Elton v Ellis (Alfred W) (Transport) [1967] 1 W.L.R. 940).

Where such acts are committed by a sub-bailee in breach of the terms of the sub-bailment they will serve to terminate his right to possession against his immediate bailor and, if the same also amount to a breach of the terms of the head bailment, to additionally terminate the intermediate bailee’s right to possession against the head bailor so as to expose both bailees (the duty of the intermediate bailee being non-delegable) to a claim in conversion from the head bailor.

A bailee is also vicariously answerable for any and all wrongs, including theft (i.e. conversion) or complicity in theft, arson and malicious damage committed by any employee, sub-contractor or other person to whom he has entrusted the goods, altogether absent any want of care or other personal wrong on his part (Port Swettenham and China-Pacific SA v Food Corp of India (The Winson) [1982] A.C. 939).

A bailee is not vicariously liable for unauthorised acts amounting to wrongs by a servant or other party, including a stranger, who was not engaged to do anything in relation to the goods bailed, (Morris v CW Martin & Sons Ltd [1966] 1 Q.B. 716) but he may nevertheless be liable all the same for such acts where negligence can be shown in relation to his non-delegable duty to care for the goods and observe the terms of the bailment by, for example, neglect to appoint, retain and supervise competent and suitable employees of good character, or appoint suitable sub-contractors or neglect to implement proper security measures.

Other acts in breach of the terms of any contract of bailment, such as delay in delivery of goods carried causing pure economic loss, claims for damages for loss of promise or other defaults of the bailee’s covenants, including lesser infringements of the terms of use, may be actionable only as breaches of contract.
The standard of care will depend upon the circumstances in which the goods are given to the bailee; the value of the goods and their attractiveness to thieves; the likelihood of any avoidable hazard affecting the goods; the probability of theft (Date & Cocke v GW Sheldon & Co (London) Ltd (1921) 7 L. L. Rep. 53) or arson; and the expense of security measures in relation to the value of the goods. It may also vary over the years and depend upon issues of local custom and practice in the vicinity where the goods are kept by the bailee. The practice of other bailees in a similar way of business and having possession of similar goods may be relevant but is by no means determinative (British Road Services Ltd v Arthur V Crutchley & Co Ltd (No.1) [1968] 1 All E.R. 811).

The fact that the detrimental act takes the form of a deliberate injury to or wrongful taking of the goods or other malicious act inflicted by an independent third party with whom the bailee has no pre-existing relationship does not of itself relieve the bailee of the obligation to guard against such an act or its consequences. Nor do such facts necessarily render the resultant injury too remote.

However, with the exception of the special rules applicable to a common carrier, robbery (i.e. theft with violence or the threat of violence) will generally be sufficient excuse on the part of the bailee but a loss by a mere private or secret theft is, and never has been, deemed to be irresistible; and whether it excuses the party, or not, depends upon the nature of the bailment, and the particular circumstances of the case.

Even if an uncommon or unexpected danger arises, the bailee, certainly a bailee for reward, must use efforts in proportion to the emergency to ward it off. The rigorous nature of the bailee’s obligations extend to an obligation to preserve or secure goods even in circumstances where they has been a negligent, or even malicious act, of a third party (Coldman v Hill [1919] 1 K.B. 443).

The basic rule of causation in bailment (which is often confusingly referred to a rule relating to the burden of proof in the course of trial but it is in fact more than that) is akin to that in tort as one would expect given that the primary remedy for a breach of bailment lies in conversion. This is to be contrasted with the much stricter test for causation in ordinary contract actions where a cause has to be of at least equal co-efficacy as any other. Indeed in deviation cases it seems that the "but for" test suffices without more.

In demonstrating causation the burden of proof rests on the bailor to show that the goods came into the possession of the bailee in circumstances giving rise to a bailment and that there was loss, damage or delay in delivery to the goods but once these matters are proved the onus is on the bailee to show that he took the proper degree of care of the goods that any failure to take such care
was entirely unconnected with the damage or (Joseph Travers & Sons Ltd v Cooper [1915] 1 K.B. 73 and British Road Services Ltd v Arthur V Crutchley & Co Ltd (No.1) [1968] 1 All E.R. 811).

It is not merely sufficient for the bailee to show that he had a proper system of, for example, security, to avoid theft. He must also show by evidence that any system was properly implemented (Port Swettenham Authority v TW Wu & Co Sdn Bhd [1979] A.C. 580).

Given this approach to the burden of proof in bailment in reality may be no discernible distinction between the apparently stricter "but for" (or "occasion of the loss") test possibly applicable in cases of deviation and the more usual "contributory cause" test in other cases. Contributory negligence on the part of the bailor has no application in relation to conversion (s.11(1) of the Torts (Interference with Goods) Act 1977).

However, where the bailee can point to a *contractual exception* in his contract with his bailor, or possibly even a bailment on terms, as the prima facie cause of the loss then it seems that in a bailment for carriage at least (but perhaps not other forms of bailment) the evidential burden of proof of showing that the exception is not applicable (e.g. by reason of the negligence of the bailee) in this respect, but no other, reverts back to the bailor (Imperial Smelting Corp Ltd v Joseph Constantine Steamship Line Ltd [1942] A.C. 154, Levison v Patent Steam Carpet Cleaning Co [1978] Q.B. 69 and Aktieselskabet de Danske Sukkerfabrikker v Bajamar Compania Naviera SA (The Torenia) [1983] 2 Lloyd’s Rep. 210; cf Exportadora Valle de Colina SA (t/a Exportadora Santa Elena) v AP Moller-Maersk A/S (t/a Maersk Line) [2010] EWHC 3224 (Comm)). Nevertheless, the basic causation test still remains the same as in any bailment; namely that an operative excepted cause will not defeat the claim (as it would do in contract) simply because it is of greater or even equal efficacy.

At common law a bailee was estopped from denying his bailor’s title as it stood at the time of the bailment and thereafter throughout the duration of the bailment and also from denying his bailor's right to substantial damages based on the full value of the goods; notwithstanding any lesser, or indeed even non-existent, interest on the part of the bailor in the goods at the relevant time. The bailee could not as such avoid liability to his bailor on the grounds that the latter had no interest to bail (e.g., he obtained the goods illegally or contrary to the rights of a third party) or even on the grounds they were disposed of to a third party before the end of the bailment (Stonard v Dunkin 170 E.R. 1178; Cheesman v Exall 155 E.R. 574; Biddle v Bond 122 E.R. 1179; Rogers Sons & Co v Lambert & Co [1891] 1 Q.B. 318 and China-Pacific SA v Food Corp of India (The Winson) [1982] A.C. 939).
The estoppel does not create a title in goods in favour of a person who would otherwise have none or otherwise operate in any to deprive the actual owner of his rights (Simm v Anglo-American Telegraph Co (1879) 5 Q.B.D. 188).

The common law, however, permitted three specific exceptions to this rule which might enable the bailee to set up a complete or partial defence to the bailor's claim where the title of another (including that of the bailee himself) justified the action. Firstly, eviction by title paramount where the true owner appears to demand the goods from the bailee (in which case the bailee's compliance with such a demand is an absolute defence to any proceedings by the bailor). Secondly, a defence by authority of the proper owner. Thirdly, a defence based upon the acquisition of property by the bailee himself prior to the occurrence of the wrong complained of. The estoppel operating in favour of the bailee at common law would appear to have has now been abrogated as a consequence of the statutory abolition of the (somewhat wider) Jus Tertii rule by s.8 of the Torts (Interference with Goods) Act 1977; at all events in relation to any claim for "wrongful interference"; which term doubtless extends to any claim pleaded in contract or bailment which could also be brought in tort and just as much to such claims as between bailor and bailee a well as between the bailee and third parties.

The old cases may, it is suggested, nevertheless still offer useful guidance as to the basis on which the statutory scheme is likely to be operated. In particular, it is likely that the three well-established common law exceptions to the rule will continue to be by far the most important circumstances in which the title of another can be set up to defeat a claim by a bailor against his bailee. It is manifest, however, that the mere fact that the bailor does not have the full title in the sense of complete ownership should not of itself affect his entitlement to bring suit and recover full damages by reference to the value of the goods bailed. Certainly where the bailee neglects to assert any other title as a defence to the claim, or having done so is unable to establish same to the satisfaction of the court as a sufficient defence, it would seem unlikely that the Act would usually result in the bailor receiving anything less than full damages, unless other relevant interested parties are before the court.

The Bailee as a Fiduciary: Bailees may also occasionally incur fiduciary obligations by reason of their taking into their possession the goods. There is little law in this regard. It has been held that bailees of goods under retention of title clauses do not necessarily, merely by being bailees, hold the proceeds of sale of the bailed goods as fiduciaries for the seller.
A bailee of goods can insure them in his own name and recover their full value in the event of loss or destruction regardless of whether the bailor himself has requested or consented to the insurance. The right to insure arises out of the bailee's possession rather than any liability he has to others in respect of the goods (William Waters Waters and Barnabas Steel v The Monarch Fire and Life Assurance Company 119 E.R. 705 and Hepburn v A Tomlinson (Hauliers) Ltd [1966] A.C. 451).

Where a bailee has insured on his own account and recovers the proceeds of the policy he must pay the residue (after deducting his costs and the value of any personal interest) to the owner, but the bailee is not in a true trust relationship unless he had insured goods at the bailors' request and also possibly has received the premium from them. Even in this latter case the proceeds and the policy may not strictly speaking constitute a trust fund, but merely items of property from which the bailee is obliged to pay out those bailors who have requested insurance (E Dibbens & Sons (In Liquidation), Re [1990] B.C.L.C. 577).

The Bailee as a Contractor: Although bailment, like agency, is essentially a matter of duties assumed through voluntary assumption of a certain status and bailment, like agency, can exist quite independently of contract, the contractual matrix will usually be the lodestar for determining the identity of the original parties to the bailment and for ascertaining whether any subsequent bailee is a substitutational bailee sub-bailee of the bailor (China-Pacific SA v Food Corp of India (The Winson) [1982] A.C. 939 and MB Pyramid Sound NV v Briese Schiffahrts GmbH & Co KG MS Sina (The Ines) (No.1) [1993] 2 Lloyd's Rep. 492); just as indeed the contractual matrix very much determines the identity of the original parties to any relationship of agency and whether any subsequent agent is a substitute agent, co-agent or sub-agent of the principal and/or some further principal.

The rights and obligations arising as a matter of law from the existence of duty-creating relationships, such as bailment and agency, are not in principle displaced by contractual rights and obligations unless the contract provides that such rights and obligations are to be excluded or includes terms which are inconsistent with the duties attributable as a matter of law to the relationship (Yasuda Fire & Marine Insurance Co of Europe Ltd v Orion Marine Insurance Underwriting Agency Ltd [1995] Q.B. 174 and Union Transport Finance v British Car Auctions [1978] 2 All E.R. 385).

The Bailee as an Agent: A bailee will not ordinarily acquire any agency authority, whether in relation to his dealings with third parties or other bailees, on behalf of the bailor qua bailee (Marine Blast Ltd v Targe Towing Ltd [2004] EWCA Civ 346; [2004] 1 Lloyd's Rep. 721 and Tappenden (t/a English & American Autos) v Artus [1964] 2 Q.B. 185).
In particular, authority to a bailee from his bailor to bind him to the protective terms of any sub-
bailment is not without more authority for the bailee to contract on his behalf, and as agent for him,
so as to make a contract between bailor and sub-bailee and thereby impose positive contractual
obligations on the his bailor vis a vis the sub-bailee. Nor does it appear that generally that a bailee is
agent for his sub-bailee in making any contract with the bailor.

Bailment on Terms: In appropriate circumstances the law recognises that a bailee may be able (quite
irrespective of any contractual relationship with his bailor, including also any head bailor, upon the protective terms, if any, of the bailment to him so that the terms upon which he may be taken to have assumed possession of the goods and assumed the duties of a bailee to his bailor(s) are to be so qualified and modified accordingly; provided only that the bailor, including any head bailor where relevant, must be said to have expressly or impliedly, or even ostensibly, consented to such bailment on terms (Pioneer Container, The [1994] 2 A.C. 324).

Effect of the Disposition of the Bailor of His Interest: Whereas possession itself is transferred by
actual or constructive delivery attornment is the means by which a transfer of constructive
possession is effected.

Bailment is essentially consensual so where a bailor sells or pledges to a third party the whole or
part of his interest in goods previously bailed the third party (whether e.g. seller or pledgee as the
case may be) does not automatically assume the rights and duties of bailor to the existing bailee or
otherwise get constructive possession of the bailed goods until such time as the bailee attorns to the
him (Dublin City Distillery Ltd v Doherty [1914] A.C. 823). A novation would generally speaking
include an attornment but an attornment would not necessarily amount to a novation.

An attornment occurs when a bailee of goods acknowledges that he holds the goods on behalf of a
person other than the original bailor without of itself necessarily entering into contractual relations
with the new owner by novation of the original contract of bailment or otherwise.

An attornment of itself does not create a contractual relationship between attornees and attornors or
operate as an assignment or novation of an existing contract of bailment. It operates as a deemed
delivery back to the original bailor and fresh delivery by the new bailor and may consist of any overt
or positive acknowledgement by a possessor that he now holds goods as bailee for someone other
than the party who originally bailed them to him (Official Assignee of Madras v Mercantile Bank of
An attornment is rather different from a transfer of a document of title in that an attornment confers constructive possession on the attornee whereas transfer of a document of title confers symbolic possession on the transferee but nevertheless both an attornment and a transfer of a document of title will have the effect of creating a valid pledge where the pledgee is not himself in possession of the goods pledged.

The attornment by the bailee may be a bare one or on express terms or certain terms may be implied through an attornment on terms.

It is suggested that no attornment is necessary by a sub-bailee to a new head bailor but the sub-bailee will need to attorn to a new intermediate bailee where the previous intermediate bailee disposes of his interest in the goods and if the intermediate bailee does not attorn to the new head owner neither intermediate bailee nor sub-bailee will, it is suggested, be in a bailment relationship with the new owner.

Once the bailee has attorned he assumes the same obligation to the attornee as the new bailor, as he had towards the original bailor, at least in bailment, if not in contract, and is thereby, inter alia, estopped at common law from denying his attornee's title (Laurie & Morewood v Dudin & Sons [1926] 1 K.B. 223).

The attornment operates so as to transfer constructive possession to the attornee (i.e. the incoming bailor) so as to give him a property interest in the goods bailed; as where the original bailor pledged goods in the possession of his bailee so that the pledgee stands as bailee to the pledgor and the original bailee as sub-bailee to the pledgee.

The act of attornment therefore not only operates as the means of ascertaining the date upon which the bailee's obligations to his original bailor cease (in bailment but not necessarily in contract without novation) but also as a means of identifying the date from when the bailee's obligations to his new bailor begin. Where the attornment is on the basis of a delivery order, warehouse receipt or other similar document describing the condition of the goods the attornment coupled with such document, may also give rise to an estoppel on the part of the bailee as to the condition of the goods as described in the document. In attorning without notice of a lien or contingent lien the bailee may waive his lien (John Pearson and Henry Hampton v John Dawson 120 E.R. 576 and Hawes v Watson 107 E.R. 484).

A bailee is only liable to his bailor to exercise reasonable care in the custody of the goods whilst they are in his possession for that bailor and he is not therefore liable for pre-attornment damage or loss
unless an estoppel arises. Accordingly a bailee who attorns with suitable reservations as to damage occurring to the goods, even by his own want of care, whilst the goods were held by him for a previous bailor is not to be held liable for such damage to the incoming bailor but rather to such previous bailor.

If the bailee does not attorn to the new owner the latter has no cause of action in bailment against the bailee (or indeed in tort based upon the higher duty of care assumed in a bailment) but he will have rights of suit in the usual way in negligence and conversion against the bailee and third parties dependent upon his proof of the immediate right to possession or damage to his reversionary interest as the case may be (Franklin v Neate 153 E.R. 200). The original bailor will retain a right of action in bailment but he may have difficulty in establishing any right to substantive damages if his title is put in issue by the bailee.

No bailor can alienate a property interest which he does not have, so where the ownership of the goods changes at a time when they are in the possession of another (i.e. the bailee) the bailor cannot of course effect an actual delivery of the goods and where the general property in the goods is divorced from the special property at the time of the sale, the seller is as at best able to pass only an immediate right to possession. The issue inevitably then arises as to the protective and other terms upon which the possessor continues in possession.

The subsisting bailment may be a bailment of the goods to a carrier or warehouser in which case it will usually be a bailment at will, a bailment by pledge or a bailment of the means of carriage (as in the case of a demise charter of a ship) and the cases involve consideration of these three very different situations.

In the first situation the issue is usually whether the new owner is bound by the terms of the previous owner's bailment, in the second whether the bailee is bound by the terms of the bailment to him from the previous owner to redeliver the goods to the new owner on the same terms as to redemption of the pledge and in the third case the issue is rather whether the new owner is bound to permit continuance of the bailment for the remainder of the term of the contract where there is no bailment at will but say a demise charter.

It is clear that in the first type of case the new owner is bound by the protective terms of any bailment or sub-bailment in favour of the bailee to which the previous owner consented, at least whilst the bailment is not validly revoked and this is so even absent any attornment or novation (Britain & Overseas Trading (Bristles) Ltd v Brooks Wharf & Bull Wharf Ltd [1967] 2 Lloyd's Rep. 51).
In the context of the second situation, which may well have much wider general application than simply cases of pledge, it is evident that where there has been a pledge of goods by the previous owner the pledgor's (i.e. bailor's) right to redeem the pledge is vested in the new owner and again this appears to be irrespective of notice or whether the transferee was not a volunteer (Franklin v Neate 153 E.R. 200).

In the third situation the rights of the bailee are much less precarious. In the ordinary way his rights would be restricted, it is suggested, to the rights of the bailee arising directly out of actual possession, such as any right of lien, together perhaps with any rights arising out of the protective terms of the bailment, rather than purely contractual rights exercisable under a contract with the previous owner to, say, payment for services rendered or to continue in possession under that contract pursuant to rights conferred therein (Lord Strathcona Steamship Co Ltd v Dominion Coal Co Ltd [1926] A.C. 108).

The position might be considered rather analogous to that in the law of real property (where the recognised property rights, such as they are, of a person in actual occupation are overriding interests binding the purchaser of the land of which the purchaser is deemed to have notice) in that the transferee can be considered to be on notice of the possible existence of certain rights of another in actual possession. In accordance with these principles a new owner is bound by an existing right of lien validly taken against the previous owner even if the transferee has no actual notice of same and has taken the goods for good consideration not reflecting the lien.

In other cases where the goods of various bailees are intermingled or blended by the bailee so as to create a new title to which the bailees accede as tenants in common. it would appear that the bailee would on the same general approach continue to hold the goods comprised within the new title albeit for each of the bailees according to the various, perhaps differing, terms he had previously agreed with each bailee.

Effect of the Disposition of the Bailee of his Interest: Where a bailee divest himself of possession of the bail goods the effect may variously, depending upon the circumstances, have the effect of a substutional bailment to a third-party, a sub-bailment to a third-party or a redelivery to the bailor.

In a substitutional bailment the incoming bailee displaces the original bailee and assumes a direct bailment relationship with the existing bailor. The original bailee owes no further responsibility to the bailor for the goods (China-Pacific SA v Food Corp of India (The Winson) [1982] A.C. 939 and Wincanton Ltd v P&O Trans European Ltd [2001] EWCA Civ 227; [2001] C.L.C. 962) and has no right of action in bailment against the incoming bailee for any later loss or damage to the goods as he is in
no bailment relationship with him. The critical question is always whether the parties agreed or intended (expressly or impliedly) that the obligations of the intermediate bailee should continue after he has parted with possession to a third party.

Where the bailee transfers possession of the goods to a third party and retains some possessory rights in the goods, a sub-bailment arises which creates a relationship of bailment between the head bailor and the sub-bailee. The sub-bailee therefore owes duties both to his immediate bailor and the head bailor (Pioneer Container, The [1994] 2 A.C. 324). The bailee's obligations are not displaced by the sub-bailment, as bailment is a non-delegable duty.

A sub-bailee whose consideration is received directly from his bailor rather than the head bailor owes the head bailor the duties of a bailee for reward but absent any contract between the head bailor and sub-bailee (whether made directly between the parties or through the agency of the bailee) the head bailor is not as such bound to perform the terms of his own intermediate bailee's contract with the sub-bailee just as the sub-bailee cannot without more enforce against the head bailor the terms of his contract with his own bailor.

There probably is no need for a direct attornment between sub-bailee to any head bailor. However, the intermediate bailee will need to attorn on a change of head bailor (his attornment will also it seems take effect also as that of his sub-bailee) and if the identity of the intermediate bailee changes there would still be a necessity for the sub-bailee to attorn.

The bailee's authority to sub-bail the goods depends in each case upon the purpose of the bailment and terms of the contract (if any) under which the goods are bailed to him.

Generally speaking redelivery to the bailor results in termination of the bailment but there may be sub-bailment to the owner for a special purpose; if the first bailee re-delivers the thing to the owner merely for a special purpose, the owner becomes the sub-bailee of his own bailee. Deemed redelivery will also occur on an attornment and upon delivery to a third party on the bailor's instructions.

Competing Claims etc.: Section 4 of the Torts (Interference with Goods) Act 1977 contains important powers for making of orders in interpleader situations and indeed in other cases where the bailee wishes not to interplead at all but rather to set up a positive case of his own to withhold delivery (e.g. assert his own right of lien).
Where a claimant is faced with competing, or potentially competing, claims for damages in respect of the same loss or he wishes to set up a defence to the claim of one claimant based on the right of another, it will be necessary for him to invoke ss.7-9, of the Torts (Interference with Goods) Act 1977 which provide that in any action for wrongful interference the defendant shall be entitled to show, in accordance with rules of court, that a third party has a better right than the claimant as respects all or any part of the interest claimed by the claimant, or in right of which he sues. The Act also makes provision for avoidance of double liability to different parties with different interests in the same goods and joinder of related concurrent actions.

A bailee may have a right to charge storage and/or a right to redirect the goods under express terms of contract or under the general law of bailment (ENE 1 Kos Ltd v Petroleo Brasileiro SA Petrobras (The Kos) [2012] UKSC 17; [2012] 2 A.C. 164). Rights of disposal may also subsist by the express terms of contract of bailment or under the common law of abandonment but otherwise only under the Torts (Interference with Goods) Act 1977 by which there are two procedures; namely self-help without involving court and under court order with only the latter capable of bestowing an inalienable title on any third party.

Civil Procedure Rules r.19.5A requires a claimant in a claim for wrongful interference to state in his particulars of claim the name and address of every person who, to his knowledge, has or claims an interest in the goods and who is not a party to the claim. The same rule enables a defendant to a claim for wrongful interference to apply for a direction that another person be made a party to the claim to establish whether the other person:

a. has a better right to the goods than the claimant; or

b. has a claim which might render the defendant doubly liable under s.7 of the 1977 Act.

In the common law in the ordinary way in the chattel torts where compensation is paid to a person in or without possession but with sufficient interest (i.e. at least an immediate right to possession) to sue for the whole value of the goods payment to one party bars any claim on the part of another with an interest in the goods. Furthermore now by statute payment of assessed damages or by a compromise in a claim for wrongful interference (s.5 1977 Act) results in the extinguishment of the whole of the claimant's interest in the goods and an "overpaid party" is obliged to account over to any other person with an interest in the goods (s.7 1977 Act).
Liens: Possessory liens may exist by contract or by implication of law, including general or local custom, in anything which is capable of being possessed, i.e. documents as well as goods.

A bailee who does nothing to improve, or at least alter the position of the chattel, does not have any right of lien (Southern Livestock Producers, Re [1964] 1 W.L.R. 24) absent special agreement or some general or local custom.

In the absence of a special agreement, or general or local custom, a lien does not give a right to sell the goods or otherwise realise the security (Societa Anonima Angelo Castelletti v Transmaritime Ltd (H Woodward & Sons (Watford)Ltd, Third Parties) [1953] 2 Lloyd's Rep. 440). The legal effect of a contractual lien differs from that of a pledge in that the latter carries with it an implied power of sale upon the debtor's default, whereas a lien is in principle a right of detention only, so that a power of sale would have to be expressly agreed.

Where the right is to retain possession in respect of a general balance of account, or until there is satisfaction of debts or obligations incurred independently of the goods or chattels subject to the right, it is called a general lien. Where the right is confined to debts and obligations incurred in respect of the goods and chattels subject to the right, it is called a particular lien.

The remedy can be excluded, as well as enlarged, by the terms of the contract between lienor and lienee either expressly or by necessary implication from other terms which are inconsistent with the exercise of a possessory lien (Tappenden (t/a English & American Autos) v Artus [1964] 2 Q.B. 185) or may be otherwise limited by law (T Comedy (UK) Ltd v Easy Managed Transport Ltd [2007] EWHC 611 (Comm); [2007] 2 All E.R. (Comm) 242). A particular lien arising out of an agreement may override a general lien arising by custom or usage (Langley, Beldon & Gaunt Ltd v Morley [1965] 1 Lloyd's Rep. 297).

Since a common law lien is a right to continue an existing actual possession of goods (that is to say, to refuse to put an end to a bailment) it can only be exercised if possession was lawfully held at the time at which the lien first attached. A party asserting a lien must either claim it for a definite amount, or give the owner particulars...
from which he himself can calculate the amount for which a lien is due and there can be no lien at common law for any claim which lies only in general damages whether liquidated or unliquidated (Phillips, Assignees of White, a Bankrupt v Rodie 104 E.R. 950).

The owner must then, in the absence of express agreement, tender an amount covering the lien really existing. If he does not, unless excused, he has no answer to a claim of lien. He may be excused from tendering: (1) if he has no knowledge or means of knowledge of the right amount; or (2) if the person claiming the lien for a wrong cause or amount makes it clear that he will not release the goods unless his full claim is satisfied, and that claim is wrongful. The fact that the claim is made for more than the right amount does not matter unless the claimant gives no particulars from which the right amount can be calculated, or makes it clear that he insists on the full amount claimed (Albemarle Supply Co Ltd v Hind & Co [1928] 1 K.B. 307).

A lien will be effective against a third party if the principles of bailment on terms as discussed above are satisfied; in other words where the owner of the goods may be taken to have expressly, impliedly or ostensibly authorised any bailment, and in particular any sub-bailment, on terms conferring a lien on the lienee the owner will be bound by such a lien entirely irrespective of whether he has any contractual liability on the debt in respect of which the lien arises. (Tappenden (t/a English & American Autos) v Artus [1964] 2 Q.B. 185).

Pledge (Pawn): A pledge (in a consumer transaction more commonly referred to as a pawn) is a form of bailment in that the bailed goods comprise the security for the debt of the pledgee. A pledge, unlike a lien, carries with it at common law an implied power of sale.

If the pledgee sells he does so by virtue and to the extent of the pledgor's ownership, and not with a new title of his own. He must appropriate the proceeds of the sale to the payment of the pledgor's debt, for the money resulting from the sale is the pledgor's money to be so applied. The pledgee must account to the pledgor for any surplus after paying the debt. He must take care that the sale is a provident sale, and if the goods are in bulk he must not sell more than is reasonably sufficient to pay off the debt, for he only holds possession as security for his advance. He cannot use the goods as his own.
An effective pledge cannot generally be created by a mere agreement to pledge (Dublin City Distillery Ltd v Doherty [1914] A.C. 823 and Official Assignee of Madras v Mercantile Bank of India Ltd [1935] A.C. 53) and as a general rule pledge (being no more and no less than a form of bailment) requires possession either by actual or constructive delivery of the goods to the pledgee or an attornment to the pledgee by a third-party bailee where the pledged goods are not in the possession of such third party rather than the pledge or himself.

A document of title (by statute or at common law) enables a pledgee to take an effective pledge by transfer of the document notwithstanding the fact that the goods may remain at all times in the hands of a third party (i.e. the bailee and issuer of the document title) and notwithstanding the absence of any attornment to the pledgee by such bailee as would be necessary so as to give the pledgee constructive possession.

The Consumer Credit Act 1974 regulates pawns.

Hire Purchase and Conditional Sale Agreements: Hire-purchase and conditional sale agreements are also a form of bailment and also regulated by the Consumer Credit Act 1974.

Hotels and Inns etc.: The Hotel Proprietors Act 1956 contains special rules as to the liability of hotels (and inns etc.) for the luggage of their guests and the hotel's right of lien thereon.

Carriage of Goods and Warehousing: The law as to common carriers, private carriers and warehousing is essentially an aspect of the law of bailment and the various convention carriage regimes for air, rail road and sea carriage as forming part of UK law are also very heavily influenced by the law of bailment.