CHAPTER 2

TYPES OF TRANSACTION

This chapter considers the different ways in which the act of supplying goods may take place. It is largely descriptive, but some legal consequences flow from the choice of transaction, and these are pointed out.

NON-CONTRACTUAL SUPPLY

2–01 Usually, where goods are supplied, there will be a contract between the supplier and the receiver of the goods. Most of this chapter is taken up with considering the various kinds of contract which can be involved, but it should be noted first that a contract is not essential.

The most obvious case where there is no contract is where there is a gift. In English law, promises to make gifts in the future are not binding unless they are made under seal (for example, covenants in favour of charities) but a gift, once executed, will be effective to transfer ownership from donor to donee provided that the appropriate form has been used. So, in principle, effective gifts of goods require physical handing over though, no doubt, in the case of a bulky object like a car, it would be sufficient to hand over the keys as the effective means of control. A major difference between gifts and other forms of supply is that the legal responsibility of the donor for the condition of the goods is relatively slight. It will be pointed out in Chapter 8 that most suppliers of goods make implied undertakings about the quality of the goods but, in the case of a gift, the donor's liability is probably limited to warning of known dangerous defects in the goods. So, if I give away my car, I ought to warn the donee if I know that the brakes do not work, but I shall not be liable if the engine seizes up after 200 miles.

In some cases, a donee may have an action against the manufacturers. So, if I give my wife a hair dryer for her birthday and it burns her hair because it has been badly wired, she will not have an action against me except in the unlikely case that I knew of the defect. In most cases, the retail shop which supplies the goods would be in breach of their contract with me but I would not have suffered the loss, whereas my wife, who has suffered the loss, has no contract with them. However, she could sue the manufacturer if she could prove that the

hair dryer had been negligently manufactured. It is a curious feature of the present law that my wife would legally be much better off if I had given her the money to buy the hair dryer for herself.

It can be surprisingly difficult to decide whether or not a transaction is a gift. Many promotional schemes make use of so called gifts; can customers complain if they do not receive the gift? Often, the answer seems to be yes. The question was examined by the House of Lords in *Esso Petroleum v Customs and Excise* (1976).[1]

2–02 In this case, Esso devised a marketing scheme which was linked to the England football squad for the 1970 World Cup in Mexico. Coins were provided, each of which bore the head and shoulders of a member of the squad. Prominent signs were placed in Esso filling stations stating that those who bought four gallons of petrol would receive a coin, and books were given away in which sets of coins could be collected. The legal analysis of this scheme arose in an unexpected way. Customs and Excise claimed that the coins were subject to purchase tax. This tax (effectively the predecessor of VAT) was due if the coins were produced for the purpose of being sold. The scheme had been so successful that, although each coin was of minimal value, over £100,000 would have been due if Customs and Excise had won the case. Esso argued that because the coins were being *given away*, the customer who bought four gallons would have no legal right to a coin. In the House of Lords, this argument failed, though only by three votes to two. The majority view was that the customer would have a legitimate expectation of receiving a coin, but in practice it was very unlikely that a disappointed customer would go to court and pursue a claim. However, Esso succeeded with a second line of argument. Of the three judges who held that the coins were supplied under contract, two were persuaded that the transaction involved was more than one contract. According to this analysis, the customer bought the petrol under a conventional contract of sale, and there was a separate contract under which the filling station owner undertook to transfer a coin for every four gallons bought. The legal point of this was that this second contract was not a contract of sale since the coin was not being bought for money and purchase tax was only due if the coins were being produced for the purpose of being sold.

Even where it is clear that money will change hands, the transaction is not necessarily contractual. An important example is the supply of prescribed drugs under the National Health Service. Although for many patients there is now a substantial charge, the House of Lords held in *Pfizer Corp v Minister of Health* (1965)[2] that there is no contract between patient and pharmacist. The basic reason for this is that a

1 [1976] 1 All ER 117; [1976] 1 WLR 1.
2 [1965] AC 512.

contract depends on agreement, even though the element of agreement is often somewhat attenuated in practice. The patient's right to the drugs and the pharmacist's duty to dispense do not depend on agreement but on statute. Similar reasoning applies to public utilities, such as suppliers of water (*Read v Croydon Corporation* (1938)).[3]

SALE OF GOODS/SALE OF LAND

2–03 Section 2 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'. It follows that this is essentially a transaction in which one side promises to transfer the ownership of goods and the other pays the price in money. Therefore, cases where there is no money price and situations where the object of the sale is not goods but land or intangible property, that is, property interests which cannot be physically possessed, such as shares, patents and copyrights (discussed further in Chapter 3), are not contracts for the sale of goods.

It is one of the features of English law that quite different regimes apply to contracts for the sale of land and the sale of goods. So, for instance, while sellers of goods are under extensive implied liability as to the quality of these goods, sellers of land are liable only for their express undertakings as to quality. Usually, of course, there is no difficulty in deciding whether the contract is one for the sale of land or for the sale of goods, but there are some borderline problems in relation to growing crops or minerals under the land. Under s 61(1) of the Sale of Goods Act 1979, a contract for crops or minerals is a contract for the sale of goods if they are to be severed from the land either 'before the sale or under the contract of sale'.[4] On the other hand, a contract for the sale of a farm would normally be treated as a contract for the sale of land even though there were growing crops.

In some cases, however, the court might treat the transaction as two contracts, one for the sale of the farm and the other for the sale of the crops. In *English Hop Growers v Dering* (1928),[5] the defendant (the owner of a hop farm) had agreed to sell hops only to the plaintiff. The defendant sold the farm when the hop crop was nearing maturity and the court analysed this transaction as being two contracts, one for the

3 [1938] 4 All ER 632.
4 For fuller discussion, see Bridge, *Sale of Goods,* paperback edn, 1998, Oxford: OUP, pp 22–24.
5 [1928] 2 KB 174.

sale of the farm and the other for the sale of the hops. The practical result was that the defendant was in breach of the contract with the plaintiff. If the transaction had been treated as a single contract, the result would have been different for the defendant had not promised not to sell the farm.

EXCHANGE

2–04 The requirement in s 2 of the 1979 Act that there must be a money price in a sale means that an exchange of a cow for a horse is not a sale. For most purposes, this makes no great practical difference because the courts are likely to apply rules similar to the Sale of Goods Act by analogy. Between 1677 and 1954, contracts for the sale of goods worth £10 or more were required to be evidenced in writing. This requirement was never applied to *exchanges,* so many of the older cases arose in this context. Straightforward exchange or barter does not appear to be very common in domestic trade, though it is increasingly common in international trade where one of the parties is short of hard currency. On the other hand, *part exchange* is very common, particularly in relation to motor cars. This raises the question of the correct classification of, for example, an agreement to exchange a new car for an old one plus a payment of £2,000. In practice, this is often solved by the way that the parties write up the contract. In many cases they will price each car so that the natural analysis is that there are two sales with an agreement to pay the balance in cash. This was how the transaction was approached in *Aldridge v Johnson* (1857),[6] where 32 bullocks valued at £192 were to be transferred by one party and 100 quarters of barley valued at £215 were to be transferred by the other.

Many 'new for old' car trades would be susceptible to this two contract approach. An alternative approach would be to say that the new car was being sold but that the customer was given the option of tendering the old car in part payment rather than paying the whole price in cash. Customary practices as to part exchange prices would usually make this a more attractive option to the buyer. Sales where the buyer has the option to do or deliver something in partial substitution for the price are by no means unusual. Such an option does not convert the transaction from a sale to an exchange.

Where the component elements of the deal are not separately priced, it is obviously difficult to adopt this analysis. So, if, in *Aldridge v Johnson,* the agreement had simply been one for 32 bullocks and £23 to be

6 (1857) 7 E & B 855.

transferred by one party and 100 quarters of barley by the other, the transaction would have been properly classified as an exchange. It is possible that if the money element in the exchange was predominant and the goods element a makeweight, the transaction should be regarded as a sale, but this situation seems never to have been litigated in England.

Exchange is usually discussed in relation to transfer of goods by each party, but the same principles would seem to apply where goods are transferred in exchange for services.

CONTRACTS FOR WORK AND MATERIALS

2–05 Many contracts which are undoubtedly contracts of sale include an element of service. So, if I go to a tailor and buy a suit off the peg, the tailor may agree to raise one of the shoulders since one of my shoulders is higher than the other. The contract would still be one of sale. Conversely, if I take my car to the garage for a service, the garage may fit some new parts, but such a transaction would not normally be regarded as a sale. Of course, in both these cases, the parties could, if they wished, divide the transaction up into two contracts, one of which would be a contract of sale and the other a contract of services, but in practice this is not usually done.

It is clear that there are many contracts in which goods are supplied as part of a package which also includes the provision of services. Some are treated as contracts of sale; others are treated as a separate category called contracts for work and materials. Again, this distinction was important between 1677 and 1954 because contracts of sale over £10 were required to be evidenced in writing, whereas contracts for work and materials did not. Since 1954, the distinction is less important because, although the Sale of Goods Act does not apply to contracts for work and materials, similar rules are usually applied by analogy. This is perhaps as well, since it is far from clear where the line between sale and work and materials is to be drawn.

In some cases, it is possible to say that the property transfer element is so predominant that the contract is clearly one of sale; in others, the work element is so large that it is obviously one of work and materials. This approach seems to work with the off the peg suit (sale) and car 5service (work and materials) examples above, but what is the position where there is a substantial element of both property transfer and work?

Unfortunately, in the two leading cases, the courts adopted different tests. In *Lee v Griffin* (1861),[7] a contract by a dentist to make and fit

7 (1861) 1 B & S 272.

dentures for a patient was said to be a contract of sale on the ground that at the end of the day there was a discernible article which was to be transferred from the dentist to the patient. On the other hand, in *Robinson v Graves* (1935),[8] it was said that a contract to paint a portrait was one for work and materials because 'the substance of the contract is the skill and experience of the artist in producing a picture'. These tests appear to be irreconcilable.

2–06 The way in which the parties have set up the transaction may sometimes solve the problem of classification. If I select a length of cloth from my tailor, pay for it and then ask for a suit to be made up from it, a court is very likely to say that there are two contracts, one to buy the cloth and the other to make the suit. In commercial life, it is quite common for the customer to provide the materials from which goods are produced. The free issue of materials is discussed below.

Where the contract is classified as one for work and materials, the supplier's obligations as to the quality of the goods will be virtually identical to those of the seller, since the terms to be implied under the Supply of Goods and Services Act 1982 are the same as those to be implied under the Sale of Goods Act 1979. It is worth explaining, however, that the supplier's obligation as to the quality of the work will often be substantially different from that concerning the quality of the materials. This can be simply illustrated with the everyday case of taking a car to a garage for a service. Let us suppose that, during the service, the garage supplies and fits a new tyre to the car. As far as fitting is concerned, the garage's obligation is to ensure that the tyre is fitted with reasonable care and skill. However, it may be that the tyre, though fitted carefully, contains a defect of manufacture not apparent to visual inspection which leads to a blow-out when the car is being driven at speed on the motorway. The garage will be liable for this defect because the tyre was not satisfactory or reasonably fit for its purpose, and this liability is quite independent of any fault on the part of the garage owner.

In other situations, contracts for work and materials may be treated differently from contracts of sale. In *Hyundai Heavy Industries Co Ltd v Papadopoulos* (1980)[9] and *Stoczia Gdanska SA v Latvian Shipping Co* (1998),[10] the House of Lords held that, in a shipbuilding contract which was terminated after work had started but before delivery, there was no total failure of consideration. The result would certainly have been different if the transaction had been treated as a sale.

8 [1935] 1 KB 579.
9 [1980] 2 All ER 29.
10 [1998] 1 All ER 483.

CONSTRUCTION CONTRACTS

2–07 In most respects, a contract with a builder to build a house is very like a contract with a tailor to make a suit. In both cases, property in the raw materials will pass but the skills deployed in converting the raw materials into the finished product appear to make up the greater part of the transaction. There is one obvious difference, however. A contract to buy a ready made suit is clearly a contract for the sale of goods, but a contract for a house already built is a contract for the sale of land. This has meant that the seller of a house does not normally undertake the implied obligations as to the quality of the product which are undertaken by the seller of goods. It is perhaps doubtful whether this distinction is sensible, since it seems to be based on historical factors rather than on any underlying policy reasons. In modern practice, the purchaser of a new house will often be offered an express guarantee as, for instance, under the National Housebuilders Council (NHBC) scheme, and the prudent purchaser of a second hand house will have it surveyed, although this will not protect against defects which the reasonably competent surveyor could not be expected to discover.

However, although English law treats sales of 'off the peg' suits and houses quite differently, it treats the contract to make suits and build houses very similarly since it will imply into a contract to build a house terms as to the quality of the materials and workmanship. So, in *Young and Marten Ltd v McManus Childs Ltd* (1969),[11] a contract for the erection of a building required the builders to use 'Somerset 13' tiles on the roof. They obtained a supply of these tiles (which were only made by one manufacturer) and fixed them with reasonable skill. Unfortunately, the batch of tiles proved to be faulty and let in the rain. The House of Lords held that the builders were in breach of their implied obligations as to fitness for purpose.

FREE ISSUE OF MATERIALS

2–08 Tailors who make suits to measure tend to have lengths of suitable cloth in stock. However, not everyone who is in the business of making up something will find it convenient to hold stocks of materials. It may be commercially more satisfactory for the customer to provide the material. This leads to the phenomenon often called free issue of materials. For example, a customer may collect supplies of steel from a stockholder and deliver them to a fabricator for making up according to a specification.

11 [1969] 1 AC 454.

On the face of it, this transaction does not involve any changes in ownership since the steel already belongs to the customer when it is handed to the fabricator. Such a contract would, therefore, be one for the fabricator's services.

The position might be different where the raw materials were invoiced to the supplier and the finished product then invoiced back to the customer. This will often support an inference that the customer had sold the raw materials and was buying the finished product.

The most difficult case is perhaps when the finished product is made up partly from materials supplied by the maker and partly from those supplied by the customer. The solution appears to lie in deciding which are the principal materials.

HIRE PURCHASE

2–09 It seems likely that buyers have always been keener to get the goods than to pay for them, but undoubtedly one of the features of the modern consumer society is the extent of the credit explosion fuelled by a deliberate decision by suppliers to encourage consumers to acquire goods on credit rather than for cash. This leads to all sorts of problems which are outside the scope of this book, but it is necessary to notice the effect on the range of possible transactions.

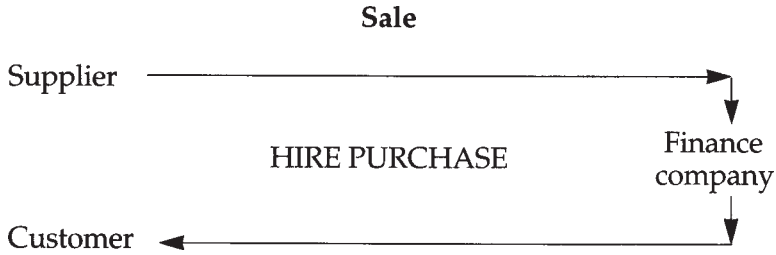
One of the risks that a seller who supplies on credit runs is that the customer will fail to pay. A natural response to this is to provide that, if the buyer does not keep up the payments, the seller can repossess the goods. It is not necessarily sufficient, however, to rely on a contractual right to repossess, since a customer who is a bad payer may have other financial problems and could become insolvent leading to any asset being divided up amongst all the creditors. In order to guard against this possibility, a seller may provide that the goods are to remain his or her property until the buyer has paid for them in full and to a large extent this will protect against the buyer's insolvency. (This is discussed more fully in Chapter 6.)

A buyer who is hard up may not simply fail to keep up the payments but may sell the goods in order to raise some cash. Although a buyer who has not yet become the owner should not do this, such a sale will often be effective to transfer ownership to the sub-buyer (Chapter 6). In the 1890s, ingenious lawyers were seeking a way to prevent the seller's rights being defeated in this way and invented the contract of hire purchase.

Under this contract, the customer agrees to hire the goods for a period (usually two or three years) and has an option to buy them at

the end of this period, usually for a nominal additional sum. The economic expectation of the parties is that the customer will exercise this option and, indeed, the rate charged for hire will be calculated on the basis of the cash price of the goods plus a handsome rate of interest and not on the market rate for hiring them. Nevertheless, the customer does not actually contract to buy the goods, and the House of Lords held in *Helby v Matthews* (1895)[12] that the contract was not one of sale, and that a sale by the hirer before all the instalments had been paid did not operate to transfer ownership to the sub-buyer. The effect of this decision was that, although economically and commercially a contract of hire purchase had the same objectives as a credit sale, its legal effect was fundamentally different.

A further oddity of hire purchase is that, particularly in the case of motor cars, the finance does not actually come from the supplier but from a finance company, that is, a body whose commercial purpose is to lend money, not to supply goods. The position may be represented diagrammatically in the following way:



2–10 The customer may often think that the goods are being bought on credit from the supplier, whereas, in fact, they are being acquired on hire purchase from the finance company. Typically, the supplier will have the finance company's standard forms which will be completed for the customer to sign. These will usually amount to an offer to sell the car to the finance company and an offer by the customer to take the car on hire purchase terms. Both contracts will come into existence when the finance company decides to adopt the transaction. In the standard situation, there is indeed no contract between the supplier and the customer, though courts have been willing to discover such a contract with relative ease. For instance, in *Andrews v Hopkinson* (1957),[13] a car dealer said to a customer: 'It is a good little bus; I would stake my life

12 [1895] AC 471. For a modern example of a case which was treated as a conditional sale although labelled as a hire-purchase, see *Forthright Finance Ltd v Carlyle Finance Ltd* [1997] 4 All ER 90, where the contract required the customer to pay all the instalments making up the price of the car.

13 [1957] 1 QB 229.

on it.' This was held to be a contractually binding warranty. In that case, the contract between dealer and customer was what lawyers call a 'collateral' contract, that is, one dependent on the main contract between the finance company and customer. Implicitly, the dealer is treated as saying: 'If you take this car on hire purchase terms from the finance company, I will guarantee it.'

Instead of taking the car on hire purchase terms, the customer might go to a bank for a personal loan in order to buy the car for cash. In substance, this would be a very similar transaction; the interest charged would be comparable and, indeed, many of the finance companies are owned by banks. It will be seen, however, that the legal form is very different. This artificiality has been the source of many difficulties, some of which will be considered later.

From the 1890s onwards, hire purchase became a very popular technique for supplying goods on credit. It has been widely used in consumer transactions but is by no means unknown in commercial ones. It has always co-existed with conditional sales, that is, transactions where the supplier delivers goods but on condition that the ownership shall remain in the seller until all instalments have been paid. The modern tendency embodied in the comprehensive and complex Consumer Credit Act 1974 is to treat all forms of instalment credit in the same way.

HIRE

2–11 In practice, whether the contract is one for sale, exchange, work and materials or hire purchase, the customer will end up as the owner of the goods. However, the customer may be more concerned with the use than the ownership of the goods. One reason for this could be that only short term use is intended, for example, a car which is hired for a week's holiday. But, there may be other reasons. Many British families choose to rent rather than buy a television, despite countless articles demonstrating that, if the television lasts for more than three years, it is cheaper to buy it than to rent it. Perhaps the most plausible reason for this is the belief that rental companies offer better service than sellers or independent repairers.

A contract in which goods are transferred from the owner to a user for a time with the intention that they will be returned later is a contract of hire. It is an essential part of such a contract that the possession of the goods is transferred. So, a number of transactions which would colloquially be described as 'hire' are not accurately so called. For instance, one might well talk of hiring a bus for a school outing but this

would not strictly be correct if, as would usually be the case, the bus came with a driver. In that case, the owner would remain in possession through the driver and the contract would be simply one for use of the bus. The position is the same in a commercial context, where a piece of plant, such as a bulldozer or a crane, is supplied with an operator (except where, as is often the case, the operator is transferred with the equipment and becomes for the time being the employee of the hirer). In this latter case, it would be accurate to describe the transaction as hire.

LEASES

2–12 In recent years, it has been common for contracts for the use of goods to be made and described as 'leases'. So, a car may be 'leased' rather than bought as may major items of office equipment or computers. There can be a number of advantages in this from the customer's point of view. One is that such transactions appear to be of an income rather than a capital nature, so they will not show up in the company's balance sheet as a capital purchase. This can be attractive as it may make the company's financial position look better. Nor is this necessarily a cosmetic benefit since there can be perfectly good business reasons for wishing to avoid tying up capital in equipment, particularly where it has to be borrowed at high rates of interest. Apart from these financial advantages, there may also be tax benefits for a business in leasing equipment rather than buying it.

Although the term 'lease' is very commonly used to describe such transactions, there is at present no separate legal category of leases of goods, unlike leases of land which have been recognised from the 12th century. Therefore, in law, most leases will simply be contracts of hire. In some cases, however, there may be an understanding that at the end of the period of the lease the customer may or will buy the goods. This may amount to no more than a non-binding arrangement, in which case it will have no effect on the legal nature of the transaction. If, however, the customer has an option to buy the goods at the end of the lease, the transaction will in substance be one of hire purchase. If the customer has agreed to buy the goods at the end of the lease, then it would seem that the contract is actually one of sale.

It is worth noting that, in many 'leases', the 'lessor' is not the supplier but a bank or finance house. In such cases, the supplier sells the goods to a bank which then leases them to the customer. This produces a triangular relationship similar to that in a hire purchase contract, shown diagrammatically at para 2–09. This rather artificial arrangement can