Supply of Goods | A Litigation Guide

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Part A - INTRODUCTION

Although for many years it was perhaps unfashionable to say so, products and goods will always form the lifeblood of the economy. Ultimately they secure our wealth and standard of living.

In a practical sense businesses depend on products in making other products and in generating wealth themselves. What remedies do they have if the products turn out to be defective or cease to work ? That is the aim of this "litigation guide".

My focus is to-day is on business to business sales, although it could equally cover private sales. To some extent it is applicable to consumer sales but the practical differences are such that another talk, or conference on consumer law would be required.

For the purposes of the talk, assume that you have a client who has purchased, hire purchased, or let a machine or machines which have stopped working properly. If you

are acting for a supplier, simply look at matters the other way around. What remedy can you provide your client?

First and foremost you must obtain the contractual documents and find out when they were signed or agreed to. This will identify the parties and the type of contract in question. Any time limits will also become apparent.

Part B – JURISDICTION

The supplier may be domiciled outwith Scotland. Can he be sued in Scotland ? Without it the client will have to go elsewhere. Indeed even if there is question mark over the Scottish court's jurisdiction and another country clearly has jurisdiction it may be better to advise the client to go elsewhere. However interesting it may be to the lawyers, in my experience clients tend not to wish to spend time and money on jurisdictional arguments. Nevertheless there may be other tactical reasons why a Scottish court would be preferable for the client and make the argument worthwhile.

Start with the Council Regulation (EC) No. 44/2001 (re EU domiciliary), and schedules 4 (re UK domiciliary) and 8 (all others) of the Civil Jurisdiction and Judgments Act 1982, to see if any of the alternative grounds of jurisdiction apply.

(A) *Place of performance jurisdiction*

> "in matters relating to a contract, in the courts for the place of performance of the obligation in question"

This is the most common alternative ground. The "obligation" is the obligation the breach of which gives rise to the claim.

It must be an obligation which must be performed in Scotland – it's not enough that it could be performed in Scotland or elsewhere.

Where the obligation relates to the quality of a machine, the obligation has been understood as being the obligation <u>to deliver</u> a machine which is of satisfactory quality, fit for its purpose, or other contracted-for requirement (**Viskase Ltd v. Paul Kiefel Gmbh** [1999] 1 W.L.R. 1305, 1317)

In short for a Scottish court to have jurisdiction under place of performance under schedules 4 and 8, <u>the obligation</u> (under whichever law applies to the contract) <u>must require delivery of the goods to a place in Scotland</u>

In the Regulation (but not in schedules 4 and 8), article 5 (1) (b) goes on to provide that unless otherwise agreed "place of performance of the obligation in question" shall be in the case of the sale of goods, the place in a member state where under the contract the goods were delivered, or should have been delivered".

This appears to give a wider scope for jurisdiction than schedules 4 and 8 in tying jurisdiction not merely to the contractual obligation to deliver the goods but also the place where in actual fact the goods were delivered, regardless of obligation.

(B) *Exclusive jurisdiction* –
Watch out for a prorogation of jurisdiction clause which would have the effect of ousting the jurisdiction of the Scottish courts (sched. 4 rule 12 and sched. 8 rule 6) Yes, such a clause can oust and not merely prorogate (i.e. extend) jurisdiction : (**McGowan v. Summit at Lloyds** 2002 S.C. 638)

Often jurisdiction is an afterthought to the drafters who hoped no dispute would arise. It follows that often these clauses are not well drafted. For example:

"This document shall be governed by the laws of England whose courts shall have jurisdiction in any dispute arising hereunder"

Do English courts have exclusive jurisdiction?
Answer: "No" (**McGowan** (above)) - a case which repays close study.

(C) Arbitration & Expert Determination
Finally, and not least look out for an arbitration or expert determination clause. These will not oust the jurisdiction of the court but if not waived will prevent the court from deciding the merits (with any court action being sisted to allow this happen). For more detail see section 10 of the Arbitration (Scotland) Act 2010 and for the distinction between the arbitration and expert determination see **Macdonald Estates plc v. National Car Parks** 2010 S.C. 250.

For jurisdiction between Scottish courts the usual choice applies. Again, given clients' reluctance to be involved in jurisdictional disputes, if there is doubt, the Court of Session should generally be preferred and in particular the commercial court there.

PART C – GOVERNING LAW

Even a contract with an English supplier is international. This means that the applicable law is governed by the Regulation (EC) No. 593/2008 ("the Rome I Regulation") even in relation to intra UK matters (S.I. 2009/3064, reg. 4). Broadly speaking a contract is governed by :

- The law chosen expressly by the parties or clearly impliedly by virtue of the terms of the contract or the circumstances of the case, failing which
- The habitual residence of the seller (in a sale of goods) or of the service provider (in a provision of services), or the person who has to perform the characteristic of the contract

So one needs to look for not merely an express choice but also to be aware of an implied choice or the habitual residence test

Habitual residence = for legal persons the place of central administration, and for natural persons the principal place of business activity.

Having said all that, if a Scots court has jurisdiction it will assume that the terms of the foreign law are the same as Scots law unless a party avers otherwise. So you may wish to check out the foreign law from a foreign expert to see if it is more favourable than Scots law.

The foreign law might well have adopted the CISG (UN Convention on Contracts for the International Sale of Goods), otherwise known as the Vienna Convention. You can get it on www.uncitral.org. It has implied implies terms into contracts similar to those in UK legislation.

Having established jurisdiction and that Scots law should be applied in form or substance what next?

PART D – CONTRACTS OF SUPPLY

Next, you'll need to decide the type of supply contract that the customer has, if you haven't already done this for the purpose of jurisdiction. There are 4 main types of contract involving the supply of goods:

- Sale of goods contracts
- Transfer agreements
- Hire purchase agreements
- Hire (or leasing) agreements

Sale of goods = agreement whereby a seller obliges himself to transfer of property in goods in exchange for which the purchaser obliges himself to pay money (Sale of Goods Act 1979, s. 2(1)) = governed by the Sale of Goods Act 1979

> The goods may or may not be in existence at the time of the contract and if they are not, they are called future goods.

Goods = corporeal (tangible) moveables except money e.g a disk with a computer program on it

However, the following are not sale of goods agreements :

- If the agreement merely gives the recipient an option to acquire the property in the goods – e.g. a hire purchase contract (**Helby v. Matthews** [1895] A.C. 471)
- If the agreement is essentially a contract for labour (*locatio operis*) with the delivery and transfer of goods ancillary to that – e.g. a contract to paint a painting (**Robinson v. Graves** [1935] 1 K.B. 579), or all building contracts
- (arguably) the downloading of computer software or other incorporeal material from the internet

Non-sale contracts for the transfer of goods ("transfer agreements")

These are governed by Parts IA and III of the Supply of Goods and Services Act 1982

They include building contracts and contracts for labour (i.e. the contract to paint a painting), missives for the sale of heritable property

Hire-purchase agreements

These are governed by the Supply of Goods (Implied Terms) Act 1973

Hire agreements

These are also governed by Parts IA and III of the Supply of Goods and Services Act 1982, and the common law in so far as not superseded by the 1982 Act.

PART E - QUALITY TERMS

Each type of supply contract has terms relating to quality implied under the general law, either common law or statute. But these are implied and can, subject to the common law and statute be contracted out of. Andy Bowen has covered exclusion clauses in his talk.

Exclusions are common, so check to see what implied terms are excluded, or covered by a general indemnity, or superseded by express terms, or a combination of all of these.

Usually there will be some form of exclusion or indemnity clause and, possibly some other clause dealing with what quality is warranted by the seller.

If such a clause is valid, then you will need to show breach of the warranty that is given.

Here the focus on the implied terms relating to quality (apart from samples) which will still apply except in so far as excluded and which will form the backdrop to the interpretation of any wording used in the contract, and so possibly aid interpretation of it.

In either event you will need to precognose the client on the circumstances of the purchase and obtain an expert's report on the nature of the defect in order to establish breach of any contractual term of quality (of which more later). Before doing so you should be clear on the term the breach of which the evidence has to satisfy.

There are 3 main implied terms on quality for commercial transactions:

- Unfitness for specified purpose
- Unsatisfactory quality
- Not matching description

(i) Implied term that where buyer expressly or by implication makes known to seller[1] any particular purpose for which the goods are being bought –the goods are reasonably fit for that purpose, whether or not that is a purpose for which goods are commonly supplied

(except where circumstances show that the buyer did not rely or it was unreasonable for him to rely on the skill or judgment of the seller – onus being on the seller to establish this)

This applies to all of types of supply contract[2] (for buyer, read transferee, hire-purchaser or hirer) e.t.c..

"Makes known any particular purpose" – old case law on a purpose being a "particular" rather than a "general" purpose is now out of date (**Slater v. Finning** 1997 S.C. (H.L.) 8, 17).

No great level of specification is needed for the making known of a purpose. Thus e.g. I'm looking for electric boilers for use in a flat conversion at York House, sufficed to make known the particular purpose for which the boilers were required (**Jewson Ltd v. Boyhan** [2004] 1 Lloyd's Rep. 505)

[1] (or credit-broker – i.e. the "seller" where the purchase is a conditional sale by a finance company to whom the "seller" has introduced the buyer)
[2] SGA 1979, s. 14 (3); 1982 Act, s. 11D(5) and (6), s. 11J(5) and (6); and 1973 Act, s. 10

The purpose can be made know impliedly. Thus

e.g. while carrying out investigation of crankshaft of boat engine, seller of camshaft says to buyer, "You should also get the camshaft changed" and buyer agreed was implication of particular purpose (**Slater** (above))

"Circumstances show that the buyer did not rely on it or it was unreasonable for him to rely on the skill or judgment of the seller" –

the more expertise that the buyer has and the less that the seller has, the more likely it is that the seller can establish either that the buyer did not rely on the seller's skill and judgment in ensuring that the goods met the stated purpose or that it was unreasonable for him to rely on that skill and judgment. Equally the vaguer the purpose the easier it will be for the seller to show that the buyer was not relying on his skill or judgment.

Implied term not breached if the failure of the goods to meet the specified purpose arises from an abnormal feature or idiosyncracy in the circumstances of use by the buyer which the buyer does not inform the seller (**Slater** (above)).

(ii) Implied term that the goods are of satisfactory quality[3], namely that 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.

(except where any defect making the goods of unsatisfactory quality (a) was specifically drawn to the buyer's attention before the contract was made, (b) the buyer examined the goods before the contract was made and the examination ought to have revealed it, or (c) if the buyer bought on the basis of a sample a reasonable examination of the sample would have made it apparent)

The standard or quality of the goods involves their state and condition and can include :

- fitness for all purposes for which goods of the kind are commonly supplied
- appearance and finish
- freedom from minor defects
- safety

[3] SGA, s. 14(2A); 1982 Act, s. 11D(2), s. 11J(2); 1973 Act, s. 10(2)

- durability

Relevant circumstances can include public statements made on the specific characteristics of goods in advertising or on labelling. Each case must depend on its own facts

(ii) Where goods are sold by description (given by or on behalf of a seller) – there is an implied term that the goods will correspond with their description[4]

Goods are sold "by description" where both parties contemplate that the buyer is relying on a description of an essential ingredient of the goods so it covers –

- goods which the buyer has not seen at the time of the agreement but of which the essential ingredient had been described to him
- goods which he had seen before the agreement but where his examination or the circumstances of the examination did not exclude a reliance on the seller's description.

e.g. purchase of a reaping machine, described as new the year before without seeing it : machine turned out to be much older – implied term applied and was breached (Varley v. Whipp [1900] 1 QB 513)

e.g. purchase of a car described as Herald Convertible 1200: upon buyer's examination nothing would have questioned that : car turned out to be parts of 2 cars put together. – implied term applied and was breached (Beale v. Taylor [1967] 1 W.L.R. 1193)

e.g. purchase of 2 paintings described as by Gabrielle Munter, upon buyer's examination seller's representative said he knew nothing about the painter or her paintings – implied term did not apply as buyer not relying on initial description (Harlingdon & Leinster Enterprises v. Christopher Hull Fine Art [1991] 1 QB 564

Expert's examination – this is crucial and the sooner it is carried out the better, for a number of reasons e.g.

- post-delivery events may make the goods worse (e.g. deterioration, modification)
- there are fairly strict time limits for the remedy of rejection

Hopefully this will provide material for the court to infer that the defect was present at the time of delivery and therefore prove the breach.

[4] SGA, s. 13(1), 1982 Act, s. 11C(2), s. 11I(2), 1973 Act, s. 9(1)

Sometimes it will be obvious whether the defect was present at the time of delivery, but sometimes more investigation will be needed.

The expert should be invited to give a view on the cause of the defect and whether the defect is one that would have been present at delivery (whether or not it would have been identifiable).

Armed with information about the defect you can then consider whether breach of any of the 3 implied terms (or other express terms) can be proved

PART F - BUYER'S REMEDIES ON QUALITY

Again, check the contract to see if any statutory or common law remedy has been negatived or varied by an express term which is inconsistent with the remedy.

The remedies are :

- rejection, repetition (repayment) and damages
- damages
- retention or set-off
- specific implement

Generally the express term will have to clearly exclude the remedy for a court to hold it to have been excluded. But some remedies are varied in contracts, for example terms which require goods to be returned to the seller for repair e.t.c..

Issues can then arise whether those terms are ineffective under the Unfair Contract Terms Act or at common law.

As before I will assume that the remedies have not been negatived or varied

(A). Rejection, Repetition (Repayment of consideration) and Damages

Requirements:

(1) Breach Must be Material

Breach must go to the heart of the contract. If the breach is of a term relating to quality, it must materially prejudice the effectiveness of the goods. Unless appearance is a critical part of the goods, then it might not be material.

(2) Intimation of Rejection Must be Timeous

Timeousness depends on the nature of the contract. General rule is, as with all contracts, that:

Rejection of goods must be within a reasonable time of the breach (where goods have been delivered, within a reasonable time of the delivery of the goods).

The provisions on timeousness vary depending on the type of contract.

Sale of Goods - Rejection is barred by "acceptance" of the goods
What is "acceptance"? Three possibilities:

1. retention of goods for a reasonable time without intimation of rejection
   retention includes the situation where goods have been re-delivered back to the seller for repair,
   what is "reasonable time" will vary with the goods in each case but it may expire even if the buyer is still unaware of the lack of conformity
   e.g. if the defect is discovered and repair is agreed, it might expire by the time the repair agreement is entered into[5]

   e.g. if the defect is unclear (latent) the court may be more generous in fixing a time[6] and if repair is agreed, it may be extended until the goods are re-delivered, but there are limits even for latent defects

   For a survey of times for rejection of vehicles see **Douglas v. Glenvarigill Co Ltd** 2010 S.L.T. 634

2. Intimation of acceptance
   e.g. delivering a certificate that the goods accord with the specification
   e.g. payment of price post-delivery without reserving right to reject

3. Conduct with the goods by the buyer inconsistent with the ownership of the seller
   e.g. fitting tanks into the buyer's vessels, re-selling the goods

But note that for type 2 and 3 acceptances, if the buyer did not examine the goods before delivery, there will not be acceptance until the buyer has had a reasonable opportunity to examine the goods to see if they conform to contract.

Transfer Agreement - here the transferee has a duty to allow a reasonable time for repair or replacement before having a right to reject the goods (presumably

[5] J & H Ritchie Ltd v. Lloyd Ltd 2007 S.C. (H.L.) 89, § 15
[6] Mechans Ltd v. Highland Marine Charters Ltd 1964 S.C. 48, 63

because the rejection and rescission would also involve the repayment of the price for non-goods related work already done)

Hire and hire purchase Agreements - here the general law rule applies, although the English cases suggest that the time only begins to run after the buyer becomes aware of the breach (e.g. **Farnworth Finance Facilities Ltd v. Attryde** [1970] 1 W.L.R. 1053, 1059)

With rejection there is a claim for repayment (repetition) of the purchase price plus possible damages for any consequential loss

e.g. lost sugar mixed with defective purchased sulphuric acid, liability to sub-purchaser[7]

(B) Damages

Here it is considered as an alternative to rejection. Quantification is crucial and will vary with the type of contract.

Sale of Goods – As with all damages claims –

(1) a comparison must be done between the situation with the breach and the situation which would have existed without the breach and a quantification of that made starting at the time of the breach

And

(2) The rules of remoteness must then be applied – in ss. 53A and 54 of SGA).

There is a difference depending on whether the goods have been delivered.

If the goods have been delivered, the claim is for:

(a) The estimated loss directly and naturally arising in the ordinary course of events from the breach (SGA, s. 53A - first rule in Hadley v. Baxendale – see in general **Transfield Shipping Inc. v. Mercator Shipping Inc.** [2009] 1 A.C. 61, 76-77 for the quote from Hadley)

Where the breach is in the quality of the goods required by the contract, loss is *prima facie* difference between the value of the goods at the time of delivery and their value had there been no such breach

(SGA, s. 53A(2) - effectively this is an *actio quanti minoris*)

plus

[7] Bostock v. Nicholson & Son Ltd [1904] 1 K.B. 725

(b) the loss which both parties would have anticipated at the time of the conclusion of the contract as a type of loss that would be caused by the breach in question (s. 54; the second rule in Hadley v. Baxendale)

If the goods have not been delivered, the claim is for :

The estimated loss calculated under (a) and (b) above but

If there was an available market in the goods in question, loss is *prima facie* the difference between the contract price and the market price at the time of delivery.

Transfer, hire and hire purchase Agreements - here the general law rules on quantification and remoteness apply. For the SGA provisions on remoteness apply the principles in **Transfield** and other cases.

So the cost of obtaining substitute goods and consequential costs may be recoverable (if not too remote under the Hadley rules).

(C) Retention and Set-off

Where a supplier sues for payment of the consideration due to it under the contract, the common law remedy of retention of the consideration (pending performance by the supplier of its duties) applies.

If the goods have been accepted and the price unpaid, the retention can be pending payment by the supplier of damages as already discussed. The claim for damages can be made in a counterclaim and possibly by way of defence, if it is less than the price being retained. In effect this is a form of extra-statutory set-off.

In any event the court has a discretion to order the buyer to consign the price under s. 58 (**George Cohen & Sons Co. Ltd v. Jamieson & Paterson** 1963 S.C. 289; and **Lithgow Factoring Ltd** 1999 S.L.T. 106).

(D) Specific Implement

This is also a possible remedy for the buyer, transferee, hire purchaser, hirer.