Consumer Sales Contracts: Transfer of Ownership

Summary of Report

Law Commission
Reforming the law

Introduction

Consumers often pay for goods in advance of receiving them. This happens whenever consumers buy goods online. It can also happen when consumers pay for goods in a physical store, but the goods have to be made to the consumer's order, are not available to be taken away there and then or are left with the retailer to be altered. If the retailer goes insolvent before the goods are delivered to the consumer, who owns the goods?

Currently, this is determined by complex and technical rules which have remained largely unchanged since the late 19th century. Some of the terminology is old-fashioned and unclear. These transfer of ownership rules were not designed with consumer transactions in mind, let alone internet shopping. As a result, the rules can be a source of confusion for consumers. On retailer insolvency, consumers can have difficulty understanding why they cannot claim goods they have paid for.

In July 2020, we published a draft Bill that would seek to reform the transfer of ownership rules as they apply to consumers, and an accompanying consultation paper. We asked consultees for their views on the drafting of the proposed rules and their potential impacts on consumers, businesses and insolvency practitioners. We also discussed a related issue concerning the practice among retailers of delaying the formation of the sales contract, and asked questions about this practice and its impact.

Following the consultation, we have produced a final draft Bill and report. This document is a summary of that report. This summary:

- explains the key aspects of the final draft Bill and how the draft Bill would operate in its wider context;
- sets out our findings about the practice of delayed contract formation and the impact of the final draft Bill; and
- sets out our conclusion about whether, on balance, the draft Bill should be implemented at the present time.

The final draft Bill

The final draft Bill would introduce new rules into the Consumer Rights Act 2015 about the transfer of ownership under contracts for the sale of goods between a trader and a consumer. Below we summarise the key aspects of the final draft Bill.

Modernised language

The final draft Bill uses the more modern, consumer-focused language of the Consumer Rights Act 2015, in contrast to the more old-fashioned language of the Sale of Goods Act 1979.

The proposed new rules refer to "trader" and "consumer" (rather than "buyer" and "seller") and "transfer of ownership" (rather than "passing of property"). The terms "deliverable state", "ascertainment" and "unconditional appropriation", which have not always been interpreted consistently, do not feature in the proposed rules.

Scope of the proposed rules

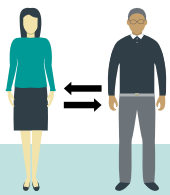
The proposed rules in the final draft Bill would apply only to sales contracts. These are contracts where the trader transfers or agrees to transfer ownership of the goods to the consumer in exchange for a price.

The final draft Bill would not apply to:

- Conditional sales contracts, under which the price of the goods is payable by instalments and the trader retains ownership of the goods until conditions specified in the contract are met.
- Hire-purchase agreements, under which possession is transferred to the consumer in return for periodical payments. Ownership only transfers to the consumer if the consumer exercises an option to buy the goods.
- Contracts for the transfer of goods, under which the trader transfers ownership of goods in exchange for consideration other than the payment of a monetary price.

How would ownership transfer under the proposed rules?

The final draft Bill sets out different rules for the transfer of ownership, depending on the type of goods which are the subject of the sales contract. The infographics below set out how the rules in the final draft Bill would operate.



Actual goods are selected at the time the contract of sale is made

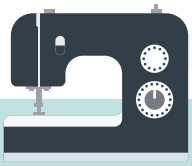
For example, items selected in a physical store, or where there is only one (like an antique bought online)

Ownership transfers to the consumer when…

The contract is made, even where the goods are left with the retailer (for example, for alteration)

Goods are physically labelled with the consumer's name in a way that is intended by the trader to be permanent

Goods are physically set aside for the consumer in a way that is intended by the trader to be permanent



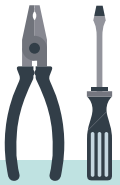
Alteration of the goods to a specification agreed between the trader and the consumer is completed

Consumer is told by the trader that goods bearing a unique identifier will be used to fulfil the contract

Actual goods are not selected at the time the contract of sale is made

For example, items bought online according to a generic description

Ownership transfers to the consumer when…



Manufacture is completed, if the goods are to be manufactured for the consumer to a specification agreed between the trader and the consumer

Goods that are to be used to fulfil the contract are selected by the trader in some other way, and the trader intends the selection to be permanent

Goods are delivered to the consumer

Goods identified as being those for delivery to the consumer are delivered to a carrier

On examining the goods the consumer agrees that they are to be used to fulfil the contract

Contracts for an undivided share of goods and goods forming part of a bulk

The rules in the final draft Bill apply to sales contracts for goods as well as sales contracts for an undivided share of goods (specified as a fraction or percentage). Where the contract is for the sale of an undivided share of goods (specified otherwise than as a fraction or percentage), or for the sale of an undivided share of goods forming part of a bulk, the transfer of ownership rules in the Sale of Goods Act 1979 will continue to apply.

Rules to be mandatory

The transfer of ownership rules in the final draft Bill would be mandatory. Contract terms that would result in ownership transferring to the consumer at a later time than under the final draft Bill would be, to that extent, of no effect. This would include a contract term that delays the transfer of ownership until the consumer has paid the full price of the goods. However, a trader who has not been paid would continue to have the right under the Sale of Goods Act 1979 to retain possession of the goods until the whole price has been paid.

The final draft Bill in context

In the report, we consider how the proposed new rules would operate in their wider context. Specifically, we consider:

- how the proposed new rules would operate alongside the existing protections for consumers who have paid for goods by credit or debit card.
- how the proposed new rules would interact with the claims of other creditors in an insolvency situation.
- the impact of the proposed rules on businesses, insolvency practitioners and consumers.

Section 75 and chargeback

When a consumer pays with their credit or debit card for goods, they may claim a refund if those goods are not delivered or if they are otherwise left out of pocket. This is a major source of protection for prepaying consumers.

The consumer may obtain a refund in two ways:

- For credit card transactions where the goods cost between £100 and £30,000, the consumer may bring a claim under section 75 of the Consumer Credit Act 1974. Section 75 makes the card issuer jointly and severally liable for the retailer's breach of contract. The consumer can recover the total loss caused by the breach, irrespective of the amount paid by credit card.
- For all card transactions (debit or credit cards), card schemes provide a system of "chargeback", which allows the consumer to claim the amount they paid on their card. Unlike the protection under section 75, chargeback is not a statutory right for consumers, and it only permits recovery of the amount paid by card.

The operation of section 75 and chargeback will not be significantly affected by the proposed rules. In online sales, the consumer has a right to cancel the sales contract and claim a reimbursement from the retailer of their prepayments, under the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 (CCRs 2013). The right to reimbursement is itself a term of the contract between the consumer and retailer. Accordingly, the failure of an insolvent retailer to reimburse the consumer would be an actionable breach of contract against the card issuer under section 75 – whether or not ownership of the goods has transferred to the consumer.

Where the consumer does not have a right to cancel and claim reimbursement under the CCRs 2013, and ownership of the goods has transferred to them, the consumer's section 75 rights may be more limited. The consumer may be limited to claiming the additional costs incurred in recovering their goods from the insolvent retailer (for example, storage and delivery costs). However, in these situations, it is likely that the consumer would be able to raise a chargeback to obtain a full refund. This is because a chargeback is available in all cases where the goods paid for have not been provided, regardless of whether ownership has transferred to the consumer.

Interaction with claims of other creditors

Retention of title

Suppliers often supply goods to retailers subject to a retention of title clause. These clauses typically state that ownership of the goods does not transfer to the retailer until the retailer pays for the goods in full.

The rules in the final draft Bill would not complicate the law that applies to retention of title clauses in contracts between retailers and suppliers. If a retailer sells goods to a consumer, the consumer will generally take free of a supplier's rights under a retention of title clause. This is because retention of title clauses typically empower the retailer to resell the goods in the ordinary course of business. The rules in the final draft Bill would only change the time at which a transfer of ownership of goods from the retailer to the consumer could occur. In practice, this may diminish the security afforded to suppliers by retention of title clauses.

Liens

Retailers often enter into contracts with warehouses and delivery companies to provide storage and logistics services. These contracts typically provide the warehouse or delivery company with a lien as security for their unpaid fees. The lien is typically drafted broadly so that it applies to all the goods in the possession of the warehouse or delivery company.

Where the lien is in existence before ownership of the goods transfers to the consumer, the consumer will acquire ownership of the goods subject to the lien. This is because the retailer cannot transfer a better title than it has. In contrast, where the lien arises after the transfer of ownership, the consumer would only be bound by the lien if they gave their express or implied consent to the lien. The final draft Bill does not complicate the application of these legal principles.

The impact of the proposed rules

The final draft Bill aims to simplify and modernise the transfer of ownership rules so that they provide clarity for consumers about when they will own goods, including in an insolvency situation. In the consultation paper, we asked consultees for their evidence and views about the costs and benefits of the proposed rules.

The responses from consultees suggest that changing the law in this area may impose substantial additional costs on business. These include familiarisation and legal costs, such as the cost of training staff to apply the new rules and the cost of obtaining legal advice to update businesses models and documentation. The proposed rules may also result in a significant increase in the time spent and costs incurred by insolvency practitioners in determining ownership of goods in a retailer insolvency.

The responses also suggested that our proposals may provide only limited benefits to consumers. Many prepaying consumers are already sufficiently protected on retailer insolvency by section 75 and chargeback, meaning that the consumer group that stands to benefit from the proposed rules is small. The practice of delayed contract formation (discussed below) may also significantly reduce the number of consumers who could benefit from the rules.

Overall, it appears that the proposed new rules may impose substantial costs on businesses without providing corresponding benefits to consumers. The potential impacts of the proposed new rules therefore require careful consideration.

The timing of contract formation

The transfer of ownership of goods, and several key consumer rights, depend on the existence of a sales contract between the retailer and the consumer. However, retailers often state in their terms and conditions that the contract does not form until the goods are "dispatched" to the consumer. In the report, we discuss this practice and its potential impact on consumers.

The practice of delayed contract formation

The formation of a sales contract, like any other contract, requires an agreement containing an offer and acceptance. When a consumer selects an item in a physical shop and presents the item at the checkout, or when the consumers submits an order online, the consumer makes an offer to the retailer to purchase goods. The next question is: when does the retailer accept the offer?

Leaving aside retailer terms and conditions, we think that, at the latest, the consumer's offer is accepted, and the sales contract forms, when the retailer takes payment from the consumer. However, at least in the case of online sales, retailers often to seek to delay the formation of the sales contract until the "dispatch" of the goods to the consumer. Some retailers do this even where payment is taken immediately upon the consumer placing their order, which may be days, weeks or even months before the goods are dispatched.

Why do retailers seek to delay contract formation?

When a sales contract forms, the retailer comes under an obligation to deliver the goods to the consumer. We have been told that retailers would face practical problems if the sales contract were to form prior to dispatch of the goods. The retailer may be bound to deliver goods which it does not have in stock, which have been mispriced, or which are age-restricted. Delaying the formation of the contract until dispatch helps to avoid these problems.

An alternative way of dealing with these problems may be the use of conditional contracts. For example, the sales contract may provide that the retailer is not under an obligation to deliver the goods if the goods are not in stock or the goods have been mispriced. However, consultees suggested that conditional contracts may be unnecessarily complex and difficult for consumers to understand.

Are consumers suffering detriment as a result of delayed contract formation?

A range of consumer rights and protections depend on the existence of a contract between the consumer and retailer. Accordingly, delayed contract formation could weaken these rights and protections and potentially cause detriment to consumers.

For example:

- Under the Consumer Rights Act 2015 it is an implied term of a sales contract that the retailer must deliver the goods to the consumer, unless the parties agree otherwise. If the contract does not form until dispatch, the retailer's obligation to deliver the goods will not arise until the retailer has, in effect, sent the goods out for delivery.
- A claim under section 75 of the Consumer Credit Act 1974 requires that the retailer be in breach of contract. Terms and conditions delaying formation mean that there may be no contract between the retailer and consumer where goods have not been delivered. This may undermine the consumer's ability to claim a refund from their card issuer under section 75.
- The current transfer of ownership rules and the rules in the final draft Bill depend on the existence of a contract between the consumer and the retailer. If the contract does not come into existence until dispatch, then there can be no transfer of ownership until dispatch.

Despite the potential detriment posed to consumers by the practice of delayed contract formation, we did not receive any evidence that consumers are suffering actual detriment at the present time as a result of the practice.

The fairness of delayed contract formation

There may be an argument that terms and conditions delaying formation are unfair contract terms or consumer notices under the Consumer Rights Act 2015. This is because:

- *they potentially create an imbalance between retailer and consumer:* the consumer (at least in some cases) is obliged to pay money to the retailer without the retailer being under a contractual obligation to deliver the goods.
- *they potentially cause detriment to the consumer:* as noted above, if contract formation is delayed until the goods are dispatched, the transfer of ownership rules do not apply and the consumer's right to delivery and possibly their section 75 rights may be compromised.
- *they potentially offend the principle of good faith:* terms which are disadvantageous to the consumer should be given appropriate prominence, but it appears that these terms and conditions are not brought specifically to consumers' attention by retailers.

Is action necessary?

The evidence and comments we have received do not suggest that the practice of delaying contract formation is causing significant consumer detriment at the moment. On the other hand, the responses to the consultation suggest that retailers have legitimate reasons for delaying formation in this way, and that alternative means of achieving these aims may not amount to an improvement for consumers. We suggest that the impact on consumers of this practice is kept under review so that the Competition and Markets Authority or government (as appropriate) can take action in future if necessary.

Implementation of the final draft Bill

It is for government to decide whether to implement the Bill. In the report, we set out the Law Commission's observations given our recent work in this area.

Any decision as to whether to implement the final draft Bill would need to balance a number of relevant considerations. These include the benefits and costs of the proposed rules, the impact of the practice of delayed contract formation on the proposed rules, and other options for protecting consumers in the event of a retailer insolvency.

The final draft Bill has the potential to make the law on transfer of ownership more accessible to consumers. We are still of the opinion that this may be reason enough for reform. However, we have reached the conclusion that there may not be sufficient justification for implementation of the final draft Bill at the present time. We have reached this conclusion based on evidence that implementing the proposed rules at this time would deliver only a limited benefit for consumers while resulting in potentially substantial costs.

Certain issues have also come to light during our work, particularly the practice by retailers of delaying the point at which the sales contract is formed. This common practice limits the potential benefits that our recommended rules could have for consumers. At the same time, the evidence we have received about the practice does not suggest significant consumer detriment or a need for urgent law reform in this area at present. We do, however, consider that our work has been beneficial in raising awareness of this practice.

We do not rule out the possibility that our proposed reforms might be more effective in future, should conditions change. For example, the argument for reform may strengthen if contract formation is not routinely delayed either as a result of retailers changing their practices or of direct action by the Competition and Markets Authority or government. The potential impact on consumers could also increase if there is an increase in the number of consumer transactions which fall outside the protections currently afforded by section 75 and chargeback.