

## READING SUITABILITY AGAINST FITNESS FOR PURPOSE—THE EVOLUTION OF A RULE\*

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For some time, and more urgently since the global financial crisis, there has been an interest in suitability as a method for protecting consumers. In broad terms, suitability means that consumers should receive the thing which best suits or fits their requirements or purposes. In the context of making loans to consumers, this means that consumer credit products should be suitable to the circumstances and requirements of the borrower. Suppliers in the market for goods have long been required to provide goods that are fit for the purpose of the buyer. Nevertheless, the idea that credit providers must supply loans that are not unsuitable is seen as startlingly new. This article examines the long and international history of the statutory obligation of fitness for purpose. It argues that this history shows that the objectives of the implied term are not dissimilar to the objectives for responsible lending and now, the imposition of a suitability requirement. In this way, the article explores a convergence between what is required of product providers in the market for goods and services and those in the market for financial services, with a particular examination of the Australian model in the *National Consumer Credit Protection Act 2009* (Cth).

### I. INTRODUCTION

There is a resurgent interest in suitability as a way to protect consumers. Broadly speaking, suitability means that consumers should receive that thing which suits or fits their requirements or purposes. The context of this revival is making loans to consumers. This has been given urgency by the market failure of sub-prime lending in the US and the consequent global financial crisis. The idea now is that consumer credit products should be suitable to the circumstances and requirements of the borrower. The Australian proposal is the *National Consumer Credit Protection Act 2009* (Cth) with responsible lending provisions.

Suitability obligations, imposed on lenders, engage the notion that there is a convergence of what is required of product providers in the market for goods and services and the market for financial services. Suppliers in the market for goods have long been required to provide goods that are fit for the purpose of the buyer. That credit providers must supply loans that are not unsuitable is seen as startlingly new.

There is a long and fairly uncontroversial history to the statutory obligation of fitness for purpose. This history suggests that the objectives of the implied term are

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not dissimilar to the objectives for responsible lending—prevention of a race to the bottom via products of an inferior quality, maintenance of the market, protection of acquirers and the imposition of responsibility on those providing products.

In 1829, in a decision on whether copper sheathing was fit for the purpose of using for a ship, Best CJ and Park J said:

[G]ood policy requires that the seller should be responsible where he sells an article for a specific use. ...[I]t will teach manufacturers that they must not aim at underselling each other by producing goods of inferior quality, and that the law will protect purchasers who are necessarily ignorant of the commodity sold.<sup>1</sup>

[I]t is important for the interests of commerce that it should be so.<sup>2</sup>

Yet, as recently as 2008, the question of the difference in the market for goods and the market for financial services was posed this way—and then answered:

Why are consumers protected from dangerous products and sharp business practices when they purchase tangible consumer products, but left at the mercy of their creditors when they sign up for routine financial products like mortgages and credit cards? ... The difference between the two markets is regulation.<sup>3</sup>

The difference may not be only regulation, that is, the intentional means to promote change in behaviour. It also relates to the evolution of private law and the statutory expression of terms in contracts. If we follow the rule that goods must be ‘fit for the purpose’ we move from commercial sales to consumer sales and services and, in the Australian context, to a requirement that financial services be fit for the purpose or of a quality able to achieve the desired result. Most recently, a new conduct norm has been legislated to regulate consumer lending. The *National Consumer Credit Protection Act 2009* (Cth) provides that both the broker and the lender must suggest and provide only loan products that are ‘not unsuitable’ for the particular individual acquirer.

Rules to safeguard the interests of consumers and retail clients or small investors have evolved differently in the market for goods or tangibles and in the market for financial services or intangible financial promises. With goods, the emphasis in Anglo-Australian law has been on the contract and the contractual obligations of the supplier to ensure that buyers receive what they have contracted for, being something that should serve the buyer’s purpose and be generally saleable, thus linking individual purpose to the market. Product liability or regulation for safety builds on this. In American law, there has been a greater emphasis on the doctrine of product liability. The Americans evolved a doctrine of suitability for investments.<sup>4</sup>

In the market for credit, however, the emphasis in Australia, the US and the UK has been on the disclosure of information to assist the choice of the borrower—so-called ‘truth in lending’. Information disclosure has played a role in the regulation of the market for goods, as in product labelling, but the provision of information has never displaced the obligations of the seller with respect to the actual product.

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<sup>1</sup> *Jones v Bright* (1829) 5 Bing 533, 535, 546; 130 ER 1167, 1169, 1173 (Best CJ).

<sup>2</sup> *Ibid* 548; 1173 (Park J).

<sup>3</sup> Oren Bar-Gill and Elizabeth Warren, ‘Making Credit Safer’ (2008) 157 *University of Pennsylvania Law Review* 1, 3–4.

<sup>4</sup> See below Part III.

These different emphases in the market for goods and the market for credit suggest a different allocation of risk. In the market for goods, sellers, once they are taken to know of the purpose, are liable for the goods not being suitable for the buyer and the market, unless the seller specifically disavows this responsibility. In consumer sales, the seller must accept this responsibility and risk. In the market for credit, providers calculate their risk in the decision to lend, protect that risk through taking security, and as yet (and until the new legislation came into effect on 1 July 2010 had no explicit obligations), have no explicit obligations to provide a product that is suitable for the acquirer.

The authors of the work on safety in credit argue that innovation in physical products has resulted in greater safety while innovation in financial products has led to incomprehensibility.<sup>5</sup> Their overall thesis, supported by extensive analysis, is that credit products are designed deliberately in response to imperfect consumer information and rationality and designed to be exploitative. That is credit products have been designed so that the risk is with the acquirer.<sup>6</sup> Of course the risk that the borrower will not repay remains with the lender, but the lender has a sophisticated set of tools to assess this and can disperse this risk in a variety of ways. The borrower bears the risk of the nature of the product.

If we accept that one of the purposes of the implied terms regime in contracts for the sale of goods and its reallocation of risk is directed at a fair and efficient market that promotes the confident circulation of goods, we might argue that the rediscovery of suitability for the credit market, while not concerned with the circulation of credit products, is concerned with constituting a fair and efficient market.

The Australian solution in the *National Consumer Credit Protection Act 2009* (Cth) is for responsible lending that will impose an obligation on intermediaries and lenders to ensure that borrowers enter into credit contracts that are not unsuitable and that the borrower has the capacity to repay. This will limit the risk of the product to the borrower. The suitability provisions impose a statutory obligation to assess the requirements of the potential borrower, gather information and verify the financial circumstances of the potential borrower and make an assessment.<sup>7</sup> There is a prohibition on assisting with or providing an unsuitable credit contract.<sup>8</sup> If the borrower is provided with an unsuitable credit contract, the borrower has a right to apply for an injunction, seek compensation, seek a declaration that the contract is void or seek a variation of the contract.<sup>9</sup> Lack of suitability must be judged against the ability of the consumer to comply with their obligations under the contract, that is, to repay without substantial hardship, and on whether the contract will meet the consumer's requirements.<sup>10</sup> The Australian Securities and Investments Commission described the latter as 'fitness for purpose: [d]etermining the consumer's requirements and objectives in relation to the credit contract'.<sup>11</sup> The Australian standard for

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<sup>5</sup> Bar-Gill and Warren, above n 3, 5.

<sup>6</sup> Ibid 6.

<sup>7</sup> *National Consumer Credit Protection Act 2009* (Cth) ss 115–17, 128–30.

<sup>8</sup> This has civil and criminal consequences: see ibid ss 123, 124, 133.

<sup>9</sup> Ibid ss 177–9.

<sup>10</sup> Ibid ss 118(2), 119(2), 123(2), 124(2), 131(2), 133(2).

<sup>11</sup> Australian Securities and Investments Commission, *Responsible Lending*, Consultation Paper No 115 (2009) 29.

consumer lending will be ‘not unsuitable’, arguably a slightly lower standard than the affirmative ‘suitable’.

The fitness rule developed in tandem with industrial production of goods and new modes of transportation. These developments meant that goods could easily be transported beyond the place where they were made and beyond a place where buyers and sellers knew of each other. The suitability rule for credit has been developed as a response to an era where the relationship between lender and borrower has been sundered by mass production of credit products, products are distributed via intermediaries such as mortgage brokers, and borrowers are no longer sure who holds their debt.

In the 19<sup>th</sup> century, the fitness rule developed as part of the movement to categorise, systematise, assimilate, consolidate and codify the law. This was aimed at certainty, knowability, an efficient legal system with clear rules, and the promotion of trade. In the 21<sup>st</sup> century, the suitability rule for credit has been generated in Australia as part of an agenda to streamline national consumer protection and promote a more efficient national market and in response to global concerns that selling unsuitable credit may have generated the global financial crisis. Consolidating, codifying and streamlining have much in common. The 19<sup>th</sup> century process of commissions of enquiry, consultation, involvement of interested parties, and circulation of drafts echoes in contemporary 21<sup>st</sup> century law-making practices.

There is a paradox here: why was an obligation that goods be suitable for the buyer so readily accepted and why has an obligation that credit contracts be fit for the purpose of the borrower provoked debate? Some answers can be sought in the emphasis placed by credit regulators on consumer responsibility, information disclosure, and consumer choice.

## II. MAKING THE STATUTORY RULE THAT GOODS SHOULD BE FIT FOR THE PURPOSE

The genesis of the statutory rule that goods should be fit for the purpose usually is assumed to be the UK *Sale of Goods Act 1893*, drafted by Mackenzie Chalmers. This was the second codification of English commercial law rules. In fact, the long and global history of this rule, traversing through Scotland and India, indicates how relatively uncontroversial and widely accepted it already was. The following survey shows the evolution of the statutory rule of fitness for purpose. In Australian law, the rule moved from the market for goods, to consumer protection for goods and services, and to financial services.

### A. Assimilating Around Fit for Purpose

In mid-19<sup>th</sup> century Britain, a Royal Commission considered the disparate commercial laws of different countries within the United Kingdom—whether different laws were ‘inconvenient’ and might hinder transactions throughout the UK; whether different sets of laws were inconsistent with the idea of the nation; and whether different rules should be ‘assimilated’. Most discussion centred on differences between Scotland and England. There was a global dimension to this project as

commentators suggested the exercise should result in ‘one system of mercantile jurisprudence for the British Empire’.<sup>12</sup>

The Royal Commissioners considered sale of goods. Issues included the validity of oral contracts, ownership of stolen goods and warranties to protect buyers from defects in the goods. It is here that we take up the story of the implied term of fitness for purpose. This term now works alongside the term of merchantable, satisfactory or acceptable quality. Throughout the 19<sup>th</sup> century, the terms were entangled. That goods should be saleable or merchantable is clear from judicial decisions,<sup>13</sup> and the Royal Commission refers briefly to marketability.<sup>14</sup> These terms do not appear in early statutory expressions where the emphasis was on fit for ‘the’, ‘such’ or ‘that’ purpose.<sup>15</sup>

There were differences between the Scottish and English law of warranties on quality: ‘In England, the seller is not presumed to warrant the quality or soundness of the goods sold. In Scotland he is.’<sup>16</sup> The fitness term, linked to the warranty of the quality of the goods, developed from an exception to the situation in England where there was no general implied warranty of the quality of the goods.

There is some unresolved debate as to whether pre-1856 Scottish law included a warranty of fitness for purpose. The Commissioners stated that in Scottish law:

[t]here is an implied warranty on the part of the seller, that the thing sold will be fit for the purpose for which the seller knows that it was bought, even against defects unknown to the seller, and when the purchaser has had a full opportunity of inspecting the thing.<sup>17</sup>

This statement did not refer to the requirement that the full price be paid or to latent defects. The commissioners said there was no such implied warranty in English law.<sup>18</sup> Richard Brown, Professor of Mercantile Law, Glasgow, in the 1890s, said that the implied warranty of fitness for the intended purpose was not, as assumed, part of the old law of Scotland prior to the 1856 Act.<sup>19</sup> He emphasised the Scottish requirement of soundness or quality of the goods irrespective of the knowledge of the parties about the goods or the knowledge of the seller of the purpose of the buyer, and contrasted this with the 18<sup>th</sup> century English doctrine of caveat emptor. In Scotland, said Brown, ‘a sound price implied a sound article’.<sup>20</sup>

At any rate, the 1850s Royal Commissioners on Assimilation of Laws said that, in Scotland, a buyer was entitled to return the goods to the seller and obtain the price (if already paid) if there was a latent defect in the goods. This required the sale of ‘a specific article’, sold for full price, and the fault ‘so latent as not to be observable at

<sup>12</sup> United Kingdom, Mercantile Laws Commission, *Second Report* (1854) (‘Mercantile Laws Commission’) 110 (Appendix A) (copy on file with author).

<sup>13</sup> *Gardiner v Gray* (1815) 4 Camp 144; 171 ER 46.

<sup>14</sup> Mercantile Laws Commission, above n 12, 10.

<sup>15</sup> *Ibid* 130 (Appendix B); *Mercantile Law Amendment Act 1856* 19 & 20 Vict, c 97, s 5; *Indian Contract Act 1872* (Imp) s 114 (repealed).

<sup>16</sup> Mercantile Laws Commission, above n 12, 118 (The Chamber of Commerce of Edinburgh—General Replies to the Questions on Assimilation).

<sup>17</sup> *Ibid*, 49 (Appendix A).

<sup>18</sup> *Ibid*.

<sup>19</sup> Richard Brown, ‘The Contract of Sale: Origin and Development in Scotland of the Implied Warranty of Fitness’, extracted in Note, ‘Notes on Current Law’ [1896] *Scottish Accountant* 1, 4, 5.

<sup>20</sup> *Ibid* 3. The exception was if the parties had expressly agreed otherwise.

the time of the sale'.<sup>21</sup> Scottish law also implied that the seller warranted that 'the article is of marketable quality, even against latent defects unknown to himself'.<sup>22</sup>

In England, there was no implied obligation that the seller warrant the quality of goods against unobservable latent defects in specific goods or against marketability. There were two exceptions in England. The first was if there was an implied obligation to warrant against latent defects or to warrant the quality of the goods by custom in a particular trade. The second exception was if the article was 'bought expressly for a particular purpose, in which case there is an implied warranty that it shall be reasonably fit for that purpose'.<sup>23</sup>

On pragmatic grounds, the commission preferred the English rule on quality and fitness to the Scottish rule. The report said that there was not much to choose between the rules because the price of the goods can accommodate the risk of latent faults:

Perhaps the one rule cannot be said to be more or less just than the other; because the risk of latent faults is one of the elements which enter into the amount of the price, and that price may be expected to be adjusted, so as to be of greater or less amount, according as the party liable to this risk is the seller or the buyer.<sup>24</sup>

Their reason for preferring the English rule was that the Scottish rule tended to create litigation while the English rule would reduce litigation 'without doing any injustice'. Litigation arose because it was difficult to establish if, at the time of sale, the defects were latent or patent and it was difficult to say if the faults meant that the goods were of 'unmarketable quality' since these were generally just matters of 'conflicting opinion'.<sup>25</sup>

We have to turn to the respondents' comments on the commissioners' statements of the law for a closer reading of differences in these implied terms.<sup>26</sup> The commentators were more or less equally divided on the preference for one set of rules over the other. One said that, as a warranty of quality is applied to a horse in England, why not to other goods?<sup>27</sup> A number said there was no inconvenience due to differences in the rules; and some said that there should be differences in the rules depending on whether goods were bought in open market or from a retailer. Only two commentators referred to litigation, one saying that, although the Scottish principle might be sound, exclusion of litigation required 'that the loss arising from latent defect, unknown to either party, should fall on the one who is the owner of the article at the time of the discovery of the defect'.<sup>28</sup> Another said that the implied warranties encouraged litigation.<sup>29</sup>

Some commentators discussed the balance in responsibility between the seller and buyer, as in the following thoughtful comment from MD Hill, who would have

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<sup>21</sup> Mercantile Laws Commission, above n 12, 10.

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

<sup>26</sup> Mercantile Laws Commission, above n 12, Appendix A to Second Report: 'Points of Difference in the Mercantile Laws, With the Observations Thereon of Respondents', 49, 116, 118, 120.

<sup>27</sup> *Ibid.* 50.

<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

preferred goods be fit for their ordinary purpose as opposed to the buyer's purpose, thus prefiguring 20<sup>th</sup> century tests of quality:

In these cases two sound principles of legislation come into conflict, and require adjustment. The first is, that implied warranties ought to be discouraged as tending to lay vigilance asleep, and to give rise to litigation. The other principle is, the advantage of uniting responsibility with power. There should, I think, be no implied warranty against defects obvious to a vendee acting according to the usual course of trade. But with regard to all other defects, unless the vendee is put on inquiry by lowness of price, I think there should be an implied warranty that the article is reasonably fit for its ordinary purpose. The effect of such a warranty would be that the ultimate buyer (namely, the user of the article,) would have a remedy against the shopkeeper, who would fall back on the merchant or factor, who again would have recourse to the manufacturer, and he in some cases would have his remedy against the producer or importer of the raw material. Thus a chain of responsibility would be established which in the majority of cases would make the loss fall on the party really to blame in the transaction. From this answer it will be perceived that though I prefer the Scotch rule to the English, I think each is open to amendment.<sup>30</sup>

Another commentator equivocally rejected the warranty of 'fit for the purpose':

[I]t would appear to be not absolutely unjust nor utterly inconvenient that there should be an implied warranty [sic] on the part of the vendor that the article sold should be fit for the purpose for which it is bought, if the seller knew or may be fairly inferred to know that purpose. But the law has always been otherwise in England and America, and in the latter country has been much discussed, and on the whole it appears to be most convenient, for the sake of preventing litigation and preventing questions being unsettled between buyer and seller, and to make buyers cautious, that a contract of sale of an article not expressly made for the buyer should not be supposed to have any implied warranty [sic]. If there be any wilful concealment on the part of the seller it may be fraud.<sup>31</sup>

This commentator referred to cultural differences between Scotland and England suggesting that, in England, a person who does not fulfil a contract is not regarded as a wrongdoer and the buyer gets less than an indemnity. In Scotland, that person will be treated as a wilful wrongdoer even if prevented from fulfilling the contract by unavoidable causes, with the result that the buyer gets more than an indemnity.<sup>32</sup>

What was the result of this enquiry into mercantile laws? Through statute, in 1856, there was a limited attempt at assimilating some of the commercial laws of England and Scotland. Subsequent commentators, including Chalmers, did not believe the section in question achieved the desired purpose of assimilation.<sup>33</sup>

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<sup>30</sup> Ibid.

<sup>31</sup> Ibid 122. The commentator was 'Germain Lavie, 8 Frederick's Place, Old Jewry, London, Solicitor. (One of the three persons to whom the queries issued by the Commission were referred by the INCORPORATED LAW SOCIETY)': at 120.

<sup>32</sup> Ibid 122.

<sup>33</sup> Judge Chalmers, *The Sale of Goods Including the Factors Act 1889* (1890) viii. Chalmers referred to the *Scotch Mercantile Law Amendment Act*, which had done such a bad job of assimilating English and Scottish law, and to the rule that in the absence of express warranty or knowledge of the seller, goods with

Nevertheless, the legislation which set out when there should be a warranty implied that goods should be fit for purpose.<sup>34</sup> This provision was explicit in addressing the risk as between the purchaser and the seller. Risk was with the purchaser unless there was an express warranty of quality or sufficiency or unless the goods were expressly sold for a specified and particular purpose.

At the same time as the Royal Commission into Mercantile Laws of 1854, there was a Royal Commission into Consolidating the Statute Law. This Royal Commission was set up by Lord Chancellor Romilly.<sup>35</sup> This followed on from interest in the New York Code and earlier attempts at digesting and consolidating the common law, in particular, the work of the Board for the Consolidation of the Statute Laws, headed by Mr Bellenden Ker of Lincoln's Inn.<sup>36</sup> This Royal Commission had grand plans to consolidate nine areas of law and employed sub-commissioners to draft legislation that was eventually supposed to include mercantile contracts.<sup>37</sup>

### B. *Making Law for India, and then the UK*

Plans to recast vast swathes of English law did not get very far before events intervened and there was a wider field for legislative experimentation in India. Prior to 1857, India and the UK had been in tandem in moves to systematise and modernise the law. After 1858, India pulled ahead and the work of the Indian Law Commissions and their codes of law bore fruit. The task of the Third Indian Law Commission, also headed by Lord Romilly, was to prepare a body of substantive law for India. It

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all faults are at the risk of the buyer unless they have been expressly sold for a specified and particular purpose. Chalmers said that this rule seemed to negative the ordinary warranty of 'merchantableness' and established a different standard from that in English law: Judge Chalmers, 'The Codification of the Law of Sale' (1891) 12 *Journal of the Institute of Bankers* 11, 17.

<sup>34</sup> The *Mercantile Law Amendment Act Scotland 1856* 19 & 20 Vict, c 60, s 5:

Where goods shall, after the passing of this Act, be sold, the seller, if at the time of the sale he was without knowledge that the same were defective or of bad quality, shall not be held to have warranted their quality or sufficiency, but the goods, with all faults, shall be at the risk of the purchaser, unless the seller shall have given an express warranty of the quality or sufficiency of such goods, or unless the goods have been expressly sold for a specified and particular purpose in which case the seller shall be considered, without such warranty, to warrant that the same are fit for such purpose.

See also Chalmers, *The Sale of Goods Including The Factors Act 1889*, above n 33, 129; Brown, above n 19, 3.

<sup>35</sup> United Kingdom, Royal Commission for Consolidating Statute Law, *First Report* (1854–1855) [1963] (Proceedings Appendix Report from Her Majesties Commissioners for Consolidating the Statute Law 1855). The members of the Royal Commission included Baron Cranworth, Baron Brougham, Sir Frederick Jonathan Pollock and Bellenden Ker.

<sup>36</sup> See Report of Bellenden Ker to Lord Chancellor on Proceedings of Board for Revision of Statute Law (1854); Third Report of Bellenden Ker to the Lord Chancellor on the Proceedings of the Board for the Revision of the Statute Law (13 June 1854) 5; Copy of a Letter from the Lord Chancellor (Cranworth) to the Chancellor of the Exchequer, 28 February 1853, in Statute Law Commission, Copy of Papers relating to the construction of the Board for the Consolidation of the Statute Laws, and of the Written Instructions given to them by the Lord Chancellor.

<sup>37</sup> Royal Commission for Consolidating Statute Law, above n 35; United Kingdom, Royal Commission for Consolidating Statute Law, *Third Report* (1857) [2219], [2219-1].



issued seven reports.<sup>38</sup> Henry Maine described the draft Indian Contract Bill as ‘the second chapter of the proposed Civil Code’.<sup>39</sup> This eventually became the *Indian Contract Act 1872*, which in turn influenced the UK *Sale of Goods Act 1893*. Sale of goods was part of the *Indian Contract Act 1872* until enacted in separate legislation modelled on the UK Act that it had originally influenced.<sup>40</sup>

The Third Indian Law Commission sent the Indian Contract Bill to India in 1866. There was no change between the Bill and the Act in the ‘Warranties’ Part, including the implied warranty of ‘fit for that purpose’. The two controversies over the *Indian Contract Act 1872*—the deletion by Henry Maine of provisions on specific performance and the resignation of the English Indian Law Commissioners over a difference of opinion as to who had the right to make laws for India—did not impact on the implied warranties. Neither did the later rearrangement and redrafting of parts of the Bill by James Fitzjames Stephen. While there were extensive submissions in the consultation process on ownership rules, there was hardly any discussion on the warranties.<sup>41</sup> The rule that a seller might be liable for ensuring that goods were fit or suitable for their purpose went unremarked. This indicates that it was uncontroversial.

There were two relevant sections in the *Indian Contract Act 1872* on fitness for purpose.<sup>42</sup> First, the seller warrants that the goods are fit for the purpose. This applies if the buyer specifies the purpose of the goods ordered, and that purpose is a purpose for which goods of that ‘denomination’ are usually sold. If this is the case, then there is an implied warranty by the seller that the goods are ‘fit for that purpose’. Second, there is no such implied warranty of ‘fitness for any particular purpose’ on the sale of goods that are ‘an article of a well-known ascertained kind’. In a further provision, the seller is not responsible for a ‘latent defect’ if the article ‘answers the description under which it was sold’ unless there is fraud or an express warranty of quality.<sup>43</sup> Two earlier warranties dealt with establishing goodness or quality by custom and the soundness of provisions.<sup>44</sup>

When Chalmers came to digest and draft sales law, there was hardly any guidance from English statutes. Chalmers characterised them as ‘fragmentary in character’

<sup>38</sup> These were: *Succession and Inheritance* (1863); *Contracts* (1866); *Negotiable Instruments* (1867); *Specific Performance* (1867); *Evidence* (1868); *Real Property* (1870); *Revision of the Criminal Procedure Code* (1870). IOR v/26/100/11 Indian Law Commission 1861–70 (Substantive Law Reports).

<sup>39</sup> ‘Note by the Honourable Mr Maine Dated 15<sup>th</sup> July 1867’ 518 *National Archives of India Legislative Dept A*, May 1872 Nos 513–615.

<sup>40</sup> See Law Commission of India, *Sale of Goods Act, 1930* No 8 (1930).

<sup>41</sup> Maine, above n 39.

<sup>42</sup> *Indian Contract Act 1872* s 114:

Warranty where goods ordered for a specified purpose: Where goods have been ordered for a specified purpose, for which goods of the denomination employed in the order are usually sold, there is an implied warranty by the seller that the goods supplied are fit for the purpose.

s 115: ‘Warranty on sale of article of a well-known ascertained kind: Upon the sale of an article of a well-known ascertained kind, there is no implied warranty of its fitness for any particular purpose.’

<sup>43</sup> *Ibid* s 116: ‘Seller when not responsible for latent defects: In the absence of fraud and of any express warranty of quality, the seller of an article, which answers the description under which it was sold, is not responsible for a latent defect in it.’

<sup>44</sup> *Ibid* s 110: ‘Standard of implied warranty of goodness or quality: An implied warranty of goodness or quality may be established by the custom of any particular trade’; s 111: ‘Warranty of soundness on sale of provisions: On the sale of provisions, there is an implied warranty that they are sound.’

and dealing only with ‘isolated points’.<sup>45</sup> These included two 16<sup>th</sup> century statutes on the sale of horses, the *Statute of Frauds*, a section of the *Larceny Act* dealing with the restitution of stolen goods, two sections of the *Mercantile Law Amendment Act 1856*, and three sections of the *Factors Act 1889*.<sup>46</sup>

That there was little by way of an existing English legislation strengthens the claims of the *Indian Contract Act 1872* as the legislative model. Chalmers acknowledged explicitly the advantages and influence of the Indian Codes as a model for codification and followed the lead of the *Indian Contract Act 1872* in drafting propositions of law as a statement of principle.<sup>47</sup> He was also influenced by Blackburn and Benjamin, who had drafted treatises on the English law of sale, and by Pothier.<sup>48</sup> Both the Indian Act and the Chalmers Act drew on English case law.

There is a clear connection between Chalmers’ draft legislation and the *Indian Contract Act 1872* so far as the warranties are concerned. We can see this in the warranties of title, description (denomination) and correspondence of sample with the bulk.<sup>49</sup> This is also the case for goodness or quality, and fitness.

Chalmers first dealt with the implied terms of ‘reasonable’ fitness for a purpose and ‘merchantable quality and condition’ as exceptions to a general principle of caveat emptor.<sup>50</sup> The first exception to the caveat emptor rule in s 17(1) of the Sale of Goods Bill 1889 is virtually identical to s 110 of the *Indian Contract Act 1872*. The second exception on fitness for purpose encompasses ss 114 and 115 of the *Indian Contract Act 1872*. The provision in the *Indian Contract Act 1872* on sound provisions (food) was not replicated. Foodstuffs could be dealt with under the fitness and quality provision. The notion in the *Indian Contract Act 1872* provision on latent defects was incorporated into Chalmers’ clause on merchantable quality. Chalmers’ extensive provisions on sale by sample<sup>51</sup> also build on the *Indian Contract Act 1872* provision.

Between Chalmers’ initial draft and the final form of the UK *Sale of Goods Act 1893*, there were changes in the language of the section concerned with fitness for purpose and merchantable quality that subtly altered meaning.<sup>52</sup> One of these shifts concerns communication of a particular purpose. The initial draft required the buyer, relying on the seller’s skill and judgment, to order goods for a particular purpose known to the seller.<sup>53</sup> The April 1893 Bill required the buyer expressly or impliedly to make known to the seller the particular purpose so as to show the buyer relies on

<sup>45</sup> Chalmers, ‘The Codification of the Law of Sale’, above n 33, 13.

<sup>46</sup> Ibid. Chalmers says that Courtenay Ilbert, then Assistant Parliamentary Counsel and drafter of the *Factors Act*, deliberately kept its language ‘uniform’ with the Sale of Goods Bill 1889: at 12. See also Chalmers, *The Sale of Goods Including the Factors Act 1889*, above n 33, v–vi.

<sup>47</sup> MD Chalmers, ‘On the Codification of Mercantile Law’ (1881) 2 *Journal of the Institute of Bankers* 123; MD Chalmers, ‘Codification of Mercantile Law’ (Speech delivered to the American Bar Association, Saratoga, August 1902) (1903) 19 *Law Quarterly Review* 10, 11–12.

<sup>48</sup> See Chalmers, ‘The Codification of the Law of Sale’, above n 33, 13; Chalmers, *The Sale of Goods Including the Factors Act 1889*, above n 33, vi–vii.

<sup>49</sup> See *Indian Contract Act 1872* ss 109, 113, 112.

<sup>50</sup> See Sale of Goods Bill 1889 cl 17 (drafted by MD Chalmers 1888) (‘Sale of Goods Bill 1889’); Sale of Goods Bill 1889 cl 15, House of Lords, April 1893; Sale of Goods Bill 1889 cl 14, House of Lords as Amended by the Select Committee, 15 August 1893.

<sup>51</sup> Sale of Goods Bill 1889 cl 18.

<sup>52</sup> The Select Committees and the account of amendments give results, but not details, of reasons.

<sup>53</sup> Sale of Goods Bill 1889 cl 17(2).

the seller.<sup>54</sup> It is also interesting to observe how the exception to the implied term of fitness for purpose, that is, goods ‘of a well known ascertained kind’, derived from the *Indian Contract Act 1872*, eventually transformed into ‘specified article under its patent or other trade name’. It should also be noted that the side note that said caveat emptor was dropped.

In a further development of the Scottish story, differences between English and Scottish law, and the desire of Scottish lawyers not to be left out, held up the enactment of the Sale of Goods Bill as it was amended to apply to Scotland.<sup>55</sup> Although Chalmers acknowledged the influence of the *Indian Contract Act 1872* both in his explanations in his book on sale of goods and in his lectures, it is curious that there has never been a more detailed acknowledgement of the debt the UK statute owes to this earlier Indian legislation in concept, substance and as an initial template from which to work.

In his commentary, Chalmers analysed *Jones v Bright*.<sup>56</sup> This is said to be the first case where implied warranties were distinguished from false representations. In this case the court explicitly stated that the purpose of the implied warranties was to prevent fraud, to protect persons and to ensure the supply of the best article. Chalmers referred to the judgment of Best CJ, who said:

It is the duty of the court in administering the law to lay down rules calculated to prevent fraud, to protect persons necessarily ignorant of the qualities of a commodity they purchase, and to make it the interest of manufacturers and those who sell, to furnish the best article that can be supplied. ... I wish to put the case on a broad principle. If a man sells an article he thereby warrants that it is merchantable—that is fit for some purpose. ... If he sells it for some particular purpose he thereby warrants it fit for that purpose.<sup>57</sup>

By citing Best CJ at length, Chalmers did more than give an account of the law. He endorsed the view that people should be provided with the best, and protected from the unscrupulous. This was particularly important when people were necessarily ignorant of the qualities of a product.

Until 1973, fitness for purpose remained a default rule that could be excluded by the parties to the contract. Following reports on consumer protection and exemption clauses, the *Supply of Goods (Implied Terms) Act 1973* (UK) provided that fitness for purpose could not be excluded in consumer transactions, thus conferring non-excludable rights in consumer sales.<sup>58</sup> The *Consumer Credit Act 1974* (UK) added to this protection by making the credit provider, with the supplier, jointly liable for the goods.<sup>59</sup> These provisions furthered seller responsibility and purchaser protection.

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<sup>54</sup> Sale of Goods Bill 1889 cl 15(2), House of Lords, April 1893.

<sup>55</sup> Allan Rodger, ‘The Codification of Commercial Law in Victorian Britain’ (1992) 80 *Proceedings of the British Academy* 149, 161–3.

<sup>56</sup> (1829) 5 Bing 533; 130 ER 1167.

<sup>57</sup> *Jones v Bright* (1829) 5 Bing 533, 542; 130 ER 1167, 1171–2, quoted in Chalmers, *The Sale of Goods Including the Factors Act 1889*, above n 33, 22.

<sup>58</sup> United Kingdom, *Final Report of the Committee on Consumer Protection*, Cmnd 1781 (1962); Law Commission No 24 and Scottish Law Commission No 12, *Exemption Clauses in Contracts: First Report: Amendments to the Sale of Goods Act 1893* (1969); *Sale of Goods (Implied Terms) Act 1973* (UK) ss 1–7, 55. Now see *Sale of Goods Act 1979* (UK).

<sup>59</sup> *Consumer Credit Act 1974* (UK) s 75.

### C. Fitness in Australia

The plea for an Imperial Code was not realised.<sup>60</sup> Yet, in common with other parts of the common law world and the old British Empire, the Australian states enacted Sale of Goods legislation based on the 1893 UK Act.<sup>61</sup> In 1974, a new focus on specific protection for consumers resulted in additional Australia-wide legislation that enacted a new version of implied terms in transactions concerning goods and also in the supply of services.<sup>62</sup> All depended on the recipient being a consumer.<sup>63</sup> In such a case, in contrast with sale of goods, the implied contractual terms could not be excluded—if they could be implied, they were mandatory. In association with the supply of goods, liability was imposed on linked credit providers if goods were not fit for the purpose.<sup>64</sup> Obligations were also imposed on manufacturers, based on the implied terms notions and later a regime for ‘safe’ goods.<sup>65</sup> State legislation echoed Commonwealth legislation.<sup>66</sup> The changes in language in the *Trade Practices Act 1974* (Cth) and the State Fair Trading Acts did little to alter the substance of the obligation to provide goods and services that were fit for the purpose.

Following the UK, which had previously followed India, in order to imply the contractual term that the goods are fit for the purpose, the buyer must communicate the purpose to the supplier, either expressly or impliedly. The buyer must rely on the supplier, or it must be not unreasonable for the buyer to rely on the supplier. In the case of goods, these must be goods of a kind which the seller deals in or supplied in the course of business. Services must be supplied in the course of business. Goods must not be sold under the patent or trade name.<sup>67</sup> In Australian law, fitness for purpose has been applied to products as diverse as shoes,<sup>68</sup> windows,<sup>69</sup> carpet,<sup>70</sup> heart pacemakers,<sup>71</sup> oysters,<sup>72</sup> prawns,<sup>73</sup> and the installation of burglar systems.<sup>74</sup> It is clear that many areas of human endeavour are missing from this list.

<sup>60</sup> See John Dove Wilson, ‘The Proposed Imperial Code of Commercial Law—A Plea For Progress’ (1896) 8 *Juridical Review* 329.

<sup>61</sup> See, eg, *Sale of Goods Act 1923* (NSW).

<sup>62</sup> *Trade Practices Act 1974* (Cth) pt V div 2; on services, see *Trade Practices Act 1974* (Cth) s 74. It should be noted that *Trade Practices Act 1974* (Cth) s 74(2) does not apply to architectural, engineering, transport or storage services.

<sup>63</sup> *Ibid* s 4B.

<sup>64</sup> *Ibid* ss 73, 73A, 73B. See, eg, *New Holland Credit Aust Pty Ltd v Vandeleur* [2006] SADC 57 (2 June 2006).

<sup>65</sup> Liability is imposed on manufacturers as if there had been a breach of an implied term in a contract between a supplier and a consumer: *Trade Practices Act 1974* (Cth) pt V div 2A; goods are defective if they are not as safe as persons generally are entitled to expect: *Trade Practices Act 1974* (Cth) pt VA.

<sup>66</sup> See, eg, *Fair Trading Act 1987* (NSW).

<sup>67</sup> *Sale of Goods Act 1923* (NSW) s 19(1); *Fair Trading Act 1987* (NSW) ss 40Q(2), 40S(2), 40(U); *Trade Practices Act 1974* (Cth) ss 71(2), 74(2), 74B.

<sup>68</sup> *David Jones Ltd v Willis* (1934) 52 CLR 110.

<sup>69</sup> *Expo Aluminium (NSW) Pty Ltd v WR Pateman Pty Ltd* (1990) ASC ¶55-978.

<sup>70</sup> *Cavalier Marketing (Australia) Pty Ltd v Rasell* [1991] 2 Qd R 323.

<sup>71</sup> *Medtel Pty Ltd v Courtney* (2003) 130 FCR 182.

<sup>72</sup> *Graham Barclay Oysters Pty Ltd v Ryan* (2000) 102 FCR 307.

<sup>73</sup> *Regal Pearl Pty Ltd v Stewart* (2003) ASAL ¶55-091.

<sup>74</sup> *Crawford v Mayne Nickless Ltd* (1992) ASC ¶56-144.

There is not an extensive jurisprudence around services being fit for the purpose. It was decided that the term could apply to lending money, though some early attempts to use the provision in a financial services context failed due to implication problems.<sup>75</sup> Successive courts have rejected attempts to argue that the term prescribed a norm of conduct distinct from the contract.<sup>76</sup>

When financial services, as opposed to services generally, were regulated in separate legislation, again there was a place for a non-excludable obligation of fitness for the purpose.<sup>77</sup> Previously, generic consumer laws had applied to services generally and to services provided in conjunction with materials.<sup>78</sup> This was in part designed to overcome the traditional distinction between goods and work and materials supplied. As Australia constructed overarching financial services regulation in place of an array of different financial product based laws, the Parliament simply re-enacted these provisions in new legislation specific to financial services.<sup>79</sup> If a person expressly or impliedly makes known the particular purpose for which the financial services are required, or the result that he or she desires the services to achieve, there is an implied warranty that the services and any materials will be reasonably fit for that purpose or are of such a nature and quality that they might reasonably be expected to achieve that result—unless the consumer does not rely or it is unreasonable for the consumer to rely on the supplier's skill or judgment.<sup>80</sup>

This shift in the implied term of fitness for the purpose from the market for goods, first to services generally, and then to financial services, has occurred with minimal debate. The financial services term does apply to a service in relation to a credit facility.<sup>81</sup> It would apply to rights, benefits, or interests provided in relation to the provision of credit and the provision of a mortgage. There is little litigation of the obligation to provide services that are fit for the purpose and no cases squarely on the financial services implied term. There is no judicial guidance on how far the obligation that the financial service be fit for the purpose, or of such nature and quality that it might achieve the desired result, reaches into the entirety of the product itself.

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<sup>75</sup> *Warnock v Australia and New Zealand Banking Group Ltd* (1989) 5 ANZ Insurance Cas ¶60-897; *Currabubula Holdings v State Bank of NSW* [1999] NSWSC 276 (30 March 1999); *Zoneff v Elcom Credit Union Ltd* (1990) 6 ANZ Insurance Cas ¶60-961.

<sup>76</sup> This was for two reasons: to establish that the statutory right to damages under the Act was distinct from contractual damages for breach of an implied contractual term, and to maintain a distinction between a contractual obligation and a duty of care in tort. See *Hjertum v Ahern* [1987] ATPR ¶40-823, 48, 909–10; *Port Kembla Coal Terminal Ltd v Braverus Maritime Inc* (2004) 140 FCR 445, 570; *Kuhne v Shastra Holdings Pty Ltd* [2009] QSC 91 (1 May 2009) [25].

<sup>77</sup> *Australian Securities and Investments Commission Act 2001* (Cth) ('ASIC Act 2001 (Cth)') ss 12EB, 12ED. See also *Australian Securities and Investments Commission v Online Investors Advantage Inc* (2005) 194 FLR 449. But see *ASIC Act 2001* (Cth) s 12ED(3): the term does not apply to contracts for insurance.

<sup>78</sup> *Trade Practices Act 1974* (Cth) s 74.

<sup>79</sup> Parts of pt V 'Consumer Protection' of the *Trade Practices Act 1974* (Cth) were re-enacted in the *Australian Securities and Investments Commission Act 1989* (Cth) (repealed). The 1989 Act in turn became the *ASIC Act 2001* (Cth).

<sup>80</sup> *ASIC Act 2001* (Cth) s 12ED(2).

<sup>81</sup> *Ibid* ss 5, 12BA, 12BAB(1)(a), 12BAB(1)(g), 12BAA(7)(k); *Australian Securities and Investments Commission Regulations 2001* (Cth) reg 2B.

### III. A DIFFERENT SUITABILITY TRACK

Arthur Leff's work on the contract itself as a thing has been enormously influential as a starting point in imposing quality or suitability obligations beyond goods. In 1970, intervening in the debate on contracts of adhesion, Leff suggested that we should re-think classification and asked what should fall within the notion of contract, whether consumer transactions should be classified as contracts, and whether a sale of consumer goods along with a consumer credit contract should be described as a thing.<sup>82</sup>

The idea of a contract as a thing opened up the question of whether, similarly to goods, there could be quality control of this contract/thing. Leff's concern was with the mass production of standard form contracts that consumers accepted, or not, on a take it or leave it basis. He saw the consumer-purchase transaction as 'a diagnosed disease seeking a nostrum'<sup>83</sup> and suggested that, if a particular contract is a mass-produced inalterable thing, then the words that make it up are just elements of the thing, 'like wheels and carburettors'.<sup>84</sup> His diagnosis suggested there were different ways of regulating consumer transactions depending on whether they were viewed as a process or a product. The focus could be on the parties, deal control or product control.<sup>85</sup>

Leff pushed the analysis of contract as a thing to discuss similarities between knowability of the product and the meaning of the contract, the role of examination and disclosure, and the importance of quality, safety and fairness. He stepped back from quality control as too interventionist for most product/things and opted for more disclosure. What is remarkable is that having suggested that there should be safety in consumer contracts—perhaps even warning labels<sup>86</sup>—he did not discuss suitability, a central tenet of goods law.

This blindness to the remedial potential of suitability was a feature of discussion of consumer credit through the 1970s. In an article on the pathology of credit breakdown, as attitudes to debt changed along with ever increasing amounts of outstanding consumer credit, Michael Trebilcock and Arthur Shulman canvassed many regulatory proposals, including disclosure and opportunities for comparison between products, but suitability was not one of them.<sup>87</sup>

Leff's insight into the nature of consumer contracts was developed by Henry Greely, who suggested that there was a parallel process occurring in the standardisation of goods and the standardisation of contracts. As goods were standardised, standards were applied to them, and even the process of making product standards was standardised through the standards setting groups.<sup>88</sup> Greely pointed to the reduced information costs to buyers of both goods and contracts when products are standardised and suggested this was particularly significant for secondary buyers.<sup>89</sup>

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<sup>82</sup> Arthur Allen Leff, 'Contract As Thing' (1970) 19 *American University Law Review* 131.

<sup>83</sup> *Ibid* 142.

<sup>84</sup> *Ibid* 153.

<sup>85</sup> *Ibid* 148.

<sup>86</sup> *Ibid* 155.

<sup>87</sup> Michael Trebilcock and Arthur Shulman, 'The Pathology of Credit Breakdown' (1976) 22 *McGill Law Journal* 415.

<sup>88</sup> Henry T Greely, 'Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts' (1989) 42 *Vanderbilt Law Review* 133, 144.

<sup>89</sup> *Ibid* 137.

He argued that, if there had been national mortgage standardisation, the standardisation process occurring in the residential mortgage market would have benefited secondary purchasers by reduced information costs. Despite the focus on sub-sales, there was no discussion of the concept of saleability or merchantability, a concept linked to suitability.

One explanation for the absence of suitability from this discussion of the consumer transaction in goods and credit may be the weight given to strict product liability in American law and its emphasis on safety.<sup>90</sup> This approach can be seen in AJ Duggan's reflections on Australian consumer law when he asked, 'how much safety, information or fairness do we want?'<sup>91</sup>

Yet suitability makes an appearance in a different context. This is suitability aimed at investor protection. The suitability doctrine in American securities law is primarily self-regulatory.<sup>92</sup> The idea is that a particular transaction should be suitable for the needs of the customer and there is a match between the requirements of the client and the nature of the product. In other words, those advising or transacting for clients should know the client and know the product.<sup>93</sup> The UK also requires attention to the suitability of advice and decisions for clients.<sup>94</sup> This is underpinned by the European Union Directive on Markets in Financial Instruments ('MiFID').<sup>95</sup> In Australia, there is something akin to a suitability requirement as personal financial services advice, which includes investment, must be appropriate to the client.<sup>96</sup>

Earlier, in 1999, the UK Parliamentary Joint Committee on Financial Services and Markets considered the link between suitability of goods and suitability of investment products and rejected financial product regulation.<sup>97</sup> The National Consumers' Council and the Financial Services Authority Consumer Panel suggested

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<sup>90</sup> On the evolution of the law of product liability, see William L Prosser, 'The Assault upon the Citadel' (1960) 69 *Yale Law Journal* 1099; William L Prosser, 'The Fall of the Citadel (Strict Liability to the Consumer)' (1965) 50 *Minnesota Law Review* 791.

<sup>91</sup> AJ Duggan, 'Some Reflections on Consumer Protection and the Law Reform Process' (1991) 17 *Monash University Law Review* 252, 253.

<sup>92</sup> See National Association of Securities Dealers, *NASD Rules*; New York Stock Exchange, *NYSE Rules*. See also Securities Exchange Commission, *Final Rules*.

<sup>93</sup> There is an extensive American literature on suitability. See, eg, Daniel R Fischel and Sanford J Grossman, 'Customer Protection in Futures and Securities Markets' (1984) 4 *Journal of Futures Markets* 273; Geoffrey B Goldman, 'Crafting a Suitability Requirement for the Sale of Over the Counter Derivatives—Should Regulators "Punish the Wall St Hounds of Greed"?' (1995) 95 *Columbia Law Review* 1112; Lewis D Lowenfels and Alan R Bromberg, 'Suitability in Securities Transactions' (1999) 54 *The Business Lawyer* 1557; Alessio M Paces, 'Financial Intermediation in the Securities Markets Law and Economics of Conduct of Business Regulation' (2000) 20 *International Review of Law and Economics* 479; Roger W Reinsch, J Bradley Reich and Nauzer Balsara, 'Trust Your Broker?: Suitability, Modern Portfolio Theory, and Expert Witnesses' (2004) 17 *St Thomas Law Review* 173; Lewis D Lowenfels and Alan R Bromberg, 'A Proposal to Refine the Suitability Standard by Quantifying Recommendation Risk and Client Appropriate Risk Levels' (2006) 1 *Brooklyn Journal of Corporate, Financial & Commercial Law* 231.

<sup>94</sup> Financial Services Authority, *FSA Handbook*, PRIN 2.1 principle 9, COBS 9 (see especially COBS 9.2 on assessing suitability), MCOB 4 (see especially MCOB 4.7).

<sup>95</sup> See generally Niamh Moloney, 'Large-Scale Reform of Investor Protection Regulation: The European Union Experience' (2007) 4 *Macquarie Journal of Business Law* 147.

<sup>96</sup> *Corporations Act 2001* (Cth) s 945A.

<sup>97</sup> Joint Committee on Financial Services and Markets, Parliament of United Kingdom, *First Report* (1999) [38]–[41]. See also, Colin Scott and Julia Black, *Cranston's Consumers and the Law* (Butterworths, 3<sup>rd</sup> ed, 2000) 210.

that any doctrine of caveat emptor applied in the financial services context should be modified by a 'fitness for purpose' concept imported from sale of goods law. Consumers, they said, can assess fitness for purpose of goods soon after purchase but fitness in investments may take years to assess; however, consumers should still know what they are getting and the product should be 'suitable for their needs'.<sup>98</sup> The Joint Committee said arguably the self-regulatory organisations which the Financial Services Authority was replacing incorporated an equivalent of a fitness for purpose rule in their rulebooks which required financial services to meet the circumstances and needs of clients.<sup>99</sup> However, the ultimate solution of the Joint Committee was to recommend more information about products, so consumers can be responsible for their decisions, and to reject product regulation.<sup>100</sup> Instead of products being fit, consumers should be 'fit ... for their caveat emptor responsibilities'.<sup>101</sup>

The turn of the century emphasis in the market for credit was on responsible lending. This balanced the responsibilities of the consumer/borrower and the lender. Responsible lending was contrasted with irresponsible lending and over-indebtedness, and the market cautioned not to exclude persons from access to credit.<sup>102</sup> Yet by 2008, the responsible lending article in the proposed EC Consumer Credit Directive had been watered down.<sup>103</sup> The directive imposes responsibility on the creditor to assess and check the creditworthiness of individual consumers by using information obtained from the consumer and databases, yet the consumer remains responsible for deciding which agreement is 'the most appropriate for his needs and financial situation'.<sup>104</sup> To this end creditors and credit intermediaries should assist consumers.<sup>105</sup> This falls short of a suitability standard as the obligation to assist with information so the consumer can decide which product is most appropriate is not an affirmative obligation to provide only a suitable product.

The UK Joint Committee had rejected product regulation in 1999 for three stated reasons. Product regulation might be viewed as product endorsement by the regulator and might lower consumers' standards of care. The suitability of a financial product would depend on the situation of the consumer as much as on the nature of the product. There was a risk that product regulation would reduce competition and

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<sup>98</sup> Joint Committee on Financial Services and Markets, above n 97, [38].

<sup>99</sup> Ibid [39].

<sup>100</sup> Ibid [40], [41].

<sup>101</sup> Ibid [55].

<sup>102</sup> See Thomas Wilhelmsson, '“Social Force Majeure”—A New Concept in Nordic Consumer Law' (1990) 13 *Journal of Consumer Policy* 1; Geraint Howells, 'Seeking Justice for Poor Consumers' in Iain Ramsay (ed), *Consumer Law in the Global Economy* (Ashgate Publishing, 1997); Iain Ramsay, 'From Truth in Lending to Responsible Lending' in Geraint Howells, Andre Janssen and Reiner Schulze (eds), *Information Rights and Obligations: A Challenge for Party Autonomy and Transactional Fairness* (Ashgate Publishing, 2005); Therese Wilson, 'Responsible Lending or Restrictive Lending Practices? Balancing Concerns Regarding Over-Indebtedness with Addressing Financial Exclusion' in Michelle Kelly-Louw, James P Nehf and Peter Rott (eds), *The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems* (Ashgate Publishing, 2008).

<sup>103</sup> Manfred Westphal, 'The EU Financial Services Policy and its Effect on Consumer Law' in Michelle Kelly-Louw, James P Nehf and Peter Rott (eds), *The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems* (Ashgate Publishing, 2008). See also *Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC* [2008] OJ L 133/66.

<sup>104</sup> Directive 2008/48/EC, above n 103, arts 26–8.

<sup>105</sup> Ibid art 27.



innovation to the detriment of consumers.<sup>106</sup> In the light of subsequent events this view lacked foresight.

The twinned notions of consumer responsibility and risk aversion by the regulator underpinned this rejection. At this point the distinction between retail and wholesale clients with their different levels of expertise was still being worked through<sup>107</sup> and embracing more disclosure of product characteristics emphasised the responsibilities of the acquirer. At the same time, the regulator was concerned that consumers would have unrealistic expectations of the regulator's capacity: the regulator could attempt to prevent 'mis-selling' but could not accept responsibility to prevent 'mis-buying'.<sup>108</sup> In hindsight, it is striking that, having recognised the link between the suitability of the product and the circumstances of the consumer, only the consumer, at risk of caveat emptor, was expected to assess these circumstances.

There has been a resurgence of interest in suitability linked to the sub-prime mortgage crisis in the US and the ensuing global crisis. Clearly sub-prime loans were marketable or merchantable but were they fit for the particular purpose of the acquirer? Since at least 2001, academic lawyers and others have advocated suitability as a solution to predatory lending<sup>109</sup> and since the crisis there have been various legislative enactments and proposals.<sup>110</sup> These include the *Mortgage Reform and Anti-Predatory Lending Act of 2007* directed at ability to pay, the *Consumer Financial Protection Agency Act of 2009* which would facilitate 'standard products' and the *Financial Product Safety Commission Act of 2009* for safety rules.<sup>111</sup> Not surprisingly, a suitability doctrine or standard for lending has not been greeted with universal acclaim.<sup>112</sup> Suitability was rejected by US mortgage bankers, who argued a suitability standard would restrict choice and innovation and undermine the democratisation of credit.<sup>113</sup> The key to fair lending, they said, echoing the UK regulator, was consumer responsibility through financial literacy and simplified disclosure for consumers to understand information.<sup>114</sup>

There is a global dimension to this rekindled interest in suitability. In 2008 the Basel Committee on Banking Supervision canvassed how the notion of suitability is reflected in regulatory requirements for financial products with an investment

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<sup>106</sup> Joint Committee on Financial Services and Markets, above n 97, [41].

<sup>107</sup> Ibid [27], [35].

<sup>108</sup> Ibid [36].

<sup>109</sup> Daniel S Ehrenberg, 'If the Loan Doesn't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending' (2001) 10 *Journal of Affordable Housing and Community Development Law* 117, 125; Kathleen C Engel and Patricia A McCoy, 'A Tale of Three Markets: The Law and Economics of Predatory Lending' (2002) 80 *Texas Law Review* 1255, 1337; Frank A Hirsh Jr, 'The Evolution of a Suitability Standard in the Mortgage Lending Industry: the Subprime Meltdown Fuels the Fire of Change' (2008) 12 *North Carolina Banking Institute* 21, 25.

<sup>110</sup> Hirsh Jr, above n 109, 21, 33.

<sup>111</sup> None of these is law: Mortgage Reform and Anti-Predatory Lending Act, HR 3915, 110<sup>th</sup> Congress (2007); Consumer Financial Protection Agency Act, HR 3126, 111<sup>th</sup> Congress (2009); Financial Product Safety Commission Act, HR 1705, 111<sup>th</sup> Congress (2009).

<sup>112</sup> In 2007, the US Mortgage Bankers' Association ('MBA') opposed a suitability standard for the mortgage lending industry: MBA, *Suitability—Don't Turn Back the Clock on Fair Lending and Homeownership Gains* (2007) MBA: <[http://www.mortgagebankers.org/files/Conferences/2007/2007LIRC/MBA\\_Suitability\\_Policy\\_Paper.pdf](http://www.mortgagebankers.org/files/Conferences/2007/2007LIRC/MBA_Suitability_Policy_Paper.pdf)>.

<sup>113</sup> Ibid 7, 20, 22, 24.

<sup>114</sup> Ibid 3, 7, 17.

component sold to retail clients. It did not examine credit products. The driver of the study was concern for mis-selling.<sup>115</sup>

When the US Department of Treasury issued its white paper on Financial Regulatory Reform in June 2009, it canvassed a number of consumer protection options for the proposed new regulatory agency—the Consumer Financial Protection Agency.<sup>116</sup> These included ‘plain vanilla mortgages’ that would be ‘suitable and affordable’ for the borrower<sup>117</sup> and the imposition of a duty of care on financial intermediaries of ‘best execution with respect to available mortgage loans’ and of determination of ‘affordability for borrowers’.<sup>118</sup>

In July 2009, the UK Office of Fair Trading (‘OFT’) issued a consultation paper on Irresponsible Lending.<sup>119</sup> This paper sets out General Principles of Lending. The first is that ‘creditors should employ the use of appropriate business practices and procedures’. To meet this requirement, the OFT expects creditors to ‘fully consider the suitability of credit products based on the borrower’s needs and taking account of his circumstances’ and to ‘assess a prospective borrower’s ability to meet repayments over the life of a loan in a sustainable manner, taking into account the impact of the loan on the borrower’s overall financial well-being’.<sup>120</sup> This obligation is further fleshed out in guidance on the assessment of affordability, which sets out what the OFT regards as meeting repayments in a sustainable manner and factors to be taken into account in assessing affordability.<sup>121</sup>

The notion of suitability is linked to the notion of safety. Building from Leff’s notion of a contract as a thing, Bar-Gill and Warren argue that consumer credit, like goods, should be safe. That is, there should be product liability for consumer credit contracts.<sup>122</sup>

#### IV. MAKING CREDIT CONTRACTS SAFE—SUITABILITY AS FITNESS

Australia has passed National Consumer Credit Protection legislation.<sup>123</sup> Like much law reform, and similarly to our earlier story of assimilation, consolidation and codification, the drive for this reform is the process of streamlining rules for an efficient national economy. Consumer protection is explicitly part and parcel of this. Credit reform is also about suitable and safe credit.

<sup>115</sup> Basel Committee on Banking Supervision, *The Joint Forum: Customer Suitability in the Retail Sale of Financial Products and Services* (April 2008) Bank for International Settlements: <<http://www.bis.org/publ/joint20.pdf?noframes=1>>.

<sup>116</sup> United States Department of the Treasury, *Financial Regulatory Reform. A New Foundation: Rebuilding Financial Supervision and Regulation* (2009).

<sup>117</sup> *Ibid* 66.

<sup>118</sup> *Ibid* 68.

<sup>119</sup> United Kingdom OFT, *Irresponsible Lending—OFT Guidance for Creditors (An OFT Consultation)* (July 2009). This paper is linked to s 25(2B) of the *Consumer Credit Act 1974* (UK), as introduced in 2006.

<sup>120</sup> *Ibid* 7.

<sup>121</sup> *Ibid* 25–30.

<sup>122</sup> Bar-Gill and Warren, above n 3, 99.

<sup>123</sup> *National Consumer Credit Protection Act 2009* (Cth). The Bill passed the House of Representatives on 20 August 2009, was referred by the Senate to the Economics Legislation Committee on 25 June 2009, and their Report was tabled 7 September 2009. Recommendations of the Committee were moved by the Government in the Senate on 26 October 2009, and the Bill passed in December 2009.

There have been various iterations of legislation in Australia to regulate the supply of consumer credit, to protect individuals from borrowing what they could not repay, and to protect lenders so that they would be repaid. The penultimate version of this is the *Uniform Consumer Credit Code* ('UCCC'), state-based legislation based on template legislation in one state and adopted by reference in other states.<sup>124</sup> It regulates the credit provider rather than the broker. It is 'truth in lending' legislation that adopts a disclosure paradigm and does not fully regulate the appropriateness of the credit transaction.

The *National Consumer Credit Protection Act 2009* (Cth) transfers responsibility for regulation of consumer credit from the states to the Commonwealth, licenses intermediaries and lenders, introduces mandatory membership of external dispute resolution schemes, gives greater powers to the regulator, replicates the UCCC as the National Credit Code and expands it to include residential investment properties, and introduces responsible lending obligations. The trigger for the responsible lending provisions is a prospective particular credit contract with a particular provider. Responsible lending is about the suitability of the product.

The following is not an outline of responsible lending as such, but an analysis of proposed provisions as a continuation of the history of fitness for purpose.

Regulation for responsible lending is not very different from the requirement that goods be fit for the purpose made known by the buyer to the seller. The *National Consumer Credit Protection Act 2009* (Cth) has provisions that expand the longstanding fitness for purpose requirement, though this is nowhere stated. In line with much modern drafting, the Act has veered back to detailed exposition rather than clear statement of a proposition. It is surprising that suitability, which is such an uncontroversial obligation in the market for goods, has proved controversial in the market for credit. The Australian Bankers' Association ('ABA') was not warm in welcoming this proposal, although it has supported responsible lending in principle.<sup>125</sup>

The effect of the responsible lending provisions is to transform the obligation of suitability. Suitability began in contract. From an implied contractual term dependent on the acquirer making known the purpose, there is now an affirmative conduct obligation. This obligation arises once the potential borrower may enter a contract. The obligation rests on the credit assistant (broker) and on the credit provider. The person who provides credit assistance (which includes advice) or credit has an obligation to do two things. The first is to discover the objectives and requirements—that is, the purpose—of the prospective acquirer. The second is to suggest or provide only suitable credit. This positive obligation is expressed in the negative. That is, the provider must assess whether the credit is unsuitable. It will be both a civil and criminal offence to provide or suggest an unsuitable credit contract.<sup>126</sup>

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<sup>124</sup> The *National Consumer Credit Protection Act 2009* (Cth) re-enacts the UCCC in an amended form as Commonwealth law via sch 1 of the Act. It is expected to be further amended in what is referred to as 'Phase 2'.

<sup>125</sup> ABA, 'Australian Bankers' Association comments on draft National Consumer Credit Protection Bill 2009' (Press Release, 27 April 2009) Australian Bankers' Association Inc: <<http://www.bankers.asn.au/Australian-Bankers-Association-comments-on-draft-National-Consumer-Credit-Protection-Bill-2009/default.aspx>>. See also Senate Economics Legislation Committee, Parliament of Australia, *Inquiry into the National Consumer Credit Protection Bill and Related Bills* (2009).

<sup>126</sup> *National Consumer Credit Protection Act 2009* (Cth) ss 123(1), 124(1), 133(1) (civil penalty); ss 123(6), 124(6), 133(6) (criminal penalty).

To discover the purpose, the assistant and provider must make reasonable enquiries as to the consumer's requirements and objectives in relation to the credit contract and about their financial situation.<sup>127</sup> They must also verify information that goes to the heart of suitability of credit; that is, the 'financial situation' of the consumer.<sup>128</sup> There is a constructive notice obligation imposed on the credit assistance provider and credit provider.<sup>129</sup> There are civil penalties for failure to make these enquiries.<sup>130</sup> Thus, the situation of the consumer, once judged an obstacle to importing fitness for purpose into financial services in the UK, is now a mandatory inquiry in Australia.

The credit assistance provider or credit provider must assess the credit contract as unsuitable if certain conditions are met.<sup>131</sup> These include the likelihood that the consumer will be unable to comply with financial obligations under the contract; will be able to comply only with substantial hardship (which includes being able to meet repayments only by selling the home); and that the contract will not meet 'the consumer's requirements and objectives'.<sup>132</sup> The obligation to make the suitability assessment falls at various points in the transaction cycle—from prior to receiving loan advice to increasing a credit limit. The time at which or for which ability to comply or ability to meet objectives is assessed differs according to the point in this transaction cycle. There is a civil penalty for failure to make the assessment and failure to assess as unsuitable if the contract is in fact unsuitable according to the criteria.<sup>133</sup>

In the credit market, unlike the goods market, these provisions mean there should be no transaction unless the provider knows the purpose. The only product that can be supplied must be a suitable product. This goes beyond non-excludability of a contractual term, for in the goods market, the question of whether the term can be implied remains.

The positive obligation to assess the consumer's position makes a process that a supplier in the market for goods would have to undertake explicit. In the market for goods, there is a nexus between the supplier's knowledge of the purpose and ensuring fitness for the purpose. The supplier must know something of the acquirer's circumstances and requirements in order to assess whether the thing will be suitable. The positive credit market obligation makes it clear that the provider has accepted the responsibility of suitability and that the consumer does rely on the provider.

If we attempt to assimilate the proposed new credit obligations with the old goods law then we could say that the sections that impose the obligation to make enquiries are simply about communicating the purpose of the product.<sup>134</sup> In the market for credit, the onus for exploring and understanding the purpose of the acquirer is to be shared between the provider and acquirer. The provider must take steps to know the purpose of the acquirer. It is assumed that the acquirer will provide information. This is actually not such a change from the market for goods since, there, the purpose

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<sup>127</sup> Ibid ss 117(1)(a), (b), 130(1)(a), (b).

<sup>128</sup> Ibid ss 117(1)(c), 130(1)(c).

<sup>129</sup> Ibid ss 118(4)(b)(ii), 119(4)(b)(ii), 123(4)(b)(ii), 124(4)(b)(ii).

<sup>130</sup> Ibid ss 117(2), 130.

<sup>131</sup> Ibid ss 115(1)(c), 116(1)(b), 118(1), 119(1) (credit assistance providers); ss 129, 131 (credit providers).

<sup>132</sup> Ibid ss 117(1), 118(2), 119(2), 124(2), 131(2).

<sup>133</sup> Ibid ss 115(2), 118(1), 119(1), 128(1), 131(1).

<sup>134</sup> Ibid ss 115, 116, 128, 129.

of goods can be communicated to the supplier by impliedly being made known. It does not take much to meet this requirement.<sup>135</sup>

It could be argued that while the positive obligation to make the enquiries may be somewhat onerous, it actually protects the provider from the uncertainty of implied communication of purpose or the expectation that the seller should know.<sup>136</sup> Yet it also provides additional protection to the acquirer. There is a line of cases where the general purpose was known but there was some abnormal or idiosyncratic feature that was not made known and therefore the term was not implied.<sup>137</sup> The obligation on the provider to enquire will circumvent this.

In the goods market, the suppliers are left to their own devices to assess suitability. There is no guidance to the seller as to how to meet the obligation to provide goods that are fit for the purpose. The seller uses his own judgment to assess whether the goods will meet the purpose communicated by the buyer. In this sense the market is self-regulating. In the national credit law, there is explicit direction as to how the credit contract must be assessed as unsuitable for the consumer. These directions for assessing unsuitability help the provider. They can protect the provider from liability for background or 'superadded' risk where a product might otherwise work for the acquirer.<sup>138</sup> The unsuitability factors realise the reasonable expectations of the community. In this, the mandatory assessment based on mandatory enquiries is another step in eliding the obligation of suitability and quality.

The *National Consumer Credit Protection Act 2009* (Cth) is another step in expanding the categories of person who may be liable for unsuitable products. In the market for goods, the obligation that the goods be fit for the purpose is imposed primarily on the seller but may also extend to the manufacturer and the linked credit provider. In the credit market, the obligation to assess the purpose of the prospective borrower and to assess whether the credit product is suitable likewise falls at a number of steps in the loan process. The Act introduces the concept of credit assistance.<sup>139</sup> The steps at which purpose must be ascertained and suitability assessed by the credit assistance provider are: prior to or 'preliminary' to offering credit assistance of different kinds,<sup>140</sup> suggesting or assisting with an application for a credit contract or an increase to a credit limit<sup>141</sup> and suggesting remaining in a credit contract.<sup>142</sup> The Act uses the existing concept of 'credit provider'.<sup>143</sup> The credit provider must assess purpose and suitability prior to entering a credit contract or increasing the credit limit in a credit contract.<sup>144</sup> There are also similar obligations regarding consumer leases.<sup>145</sup>

These proposed rules do introduce new obligations. Yet when we read them against the obligation of fitness for purpose we can see that they are not unlike. In

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<sup>135</sup> See, eg, *Expo Aluminium (NSW) Pty Ltd v WR Pateman Pty Ltd* (1990) ASC ¶55-978.

<sup>136</sup> See, eg, *Manchester Liners Ltd v Rea Ltd* [1922] 2 AC 74.

<sup>137</sup> See, eg, *Slater v Finning Ltd* [1997] AC 473.

<sup>138</sup> *Medtel Pty Ltd v Courtney* (2003) 130 FCR 182.

<sup>139</sup> *National Consumer Credit Protection Act 2009* (Cth) s 8.

<sup>140</sup> *Ibid* ss 115, 116, 118, 119.

<sup>141</sup> *Ibid* s 123.

<sup>142</sup> *Ibid* s 124.

<sup>143</sup> *Ibid* s 8.

<sup>144</sup> *Ibid* s 128.

<sup>145</sup> *Ibid* pt 3-3.

this sense there is a convergence in the regulation of the market for goods and the market for credit—acquirers should get that thing that will meet their needs, and, knowing of their needs, providers should supply the thing that meets those needs.

There is a further question of how this obligation of suitability may differ from the obligation to supply products that are fit for the purpose. Neither require ‘the best’ or ‘the most appropriate.’ Unlike the implied term, the obligation to lend responsibly through ‘not unsuitable’ products does impose a norm of conduct that may be closer to a tort-like obligation. The implied term does not take account of the individual’s personal circumstances unless specifically considered. The suitability obligation is emphatically directed towards the person’s individual circumstances. For this reason, a loan product may be fit for a purpose stated by an individual but may not be suitable for the circumstances of that individual. While a Ferrari may be fit for the purpose of driving, a loan product to purchase that car may be unsuitable for many borrowers.

## V. CONCLUSION

I have attempted to show that there is a long history to legislation expressing the policy that providers should provide products that are suitable for the requirements of acquirers. Most Australian borrowers would be surprised to know that a source of 21<sup>st</sup> century responsible lending is from mid-19<sup>th</sup> century India. We might wish for these latest rules to be expressed as elegantly as the late 19<sup>th</sup> century rules.

Nearly all sales transactions are unproblematic because of longstanding and well-understood expectations of suppliers and acquirers. I have not attempted to pose or answer the question of how the implied term of fitness for purpose has contributed to a competitive, efficient and fair market in goods. If the Bar-Gill and Warren thesis is correct that, to date, credit products have been manufactured to take advantage of lack of information and irrational decision-making by consumers, can the same be said of the market for goods? Has the fitness for purpose obligation, along with other provisions, limited such exploitative manufacture? Will the supplier’s obligation to know what is required and then recommend and lend only suitable credit products lead to shrinkage of the market or change credit product manufacturing practices? Just as we do not want ‘provisions’ (foodstuffs) that are not ‘sound’ because they are not fit for the purpose of eating,<sup>146</sup> we are saying, through legislation, that we do not want ‘unsuitable’ credit products that do not meet our circumstances and requirements and that we cannot repay without significant difficulty. ‘Good policy’ and the ‘interests of commerce’<sup>147</sup> demand it.

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<sup>146</sup> *Indian Contract Act 1872* s 111.

<sup>147</sup> *Jones v Bright* (1829) 5 Bing 533, 535, 548; 130 ER 1167, 1169, 1173.