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# Why not Hire-Purchase: A Critical Examination of the Consumer Credit Act No. 29 of 1982

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## ABSTRACT

*Hire-Purchase agreements have become a common method for individuals seeking to purchase movable properties in Sri Lanka due to some of the conveniences it provides in comparison to some of the other modes which are available. However, often individuals get into trouble by not knowing the full implications of the rights and duties of the respective parties to such a contract and hirers find themselves at a distinct disadvantage due to the existing law and the lack of knowledge. This paper aims to bring some insights into this issue and to clarify matters for the parties concerning their respective rights under a hire-purchase agreement pursuant to the Consumer Credit Act No 29 of 1982 in Sri Lanka.*

## I. INTRODUCTION

‘Hire-purchase’ is a very common term in everyday life, which is sometimes synonymously used with the term leasing, which is incorrect as a leasing agreement is different from that of a hire purchase one<sup>3</sup>. The law governing hire-purchase agreements is contained in the 1982 Consumer Credit Act, which has the pertinent purpose of regulating the duties of the parties to a hire-purchase agreement. But one must remember that hire-purchase is only one type of consumer credit; other types include Credit sales, Conditional sales, Personal loans, and Overdrafts<sup>4</sup>. The terminology used, therefore, may be a little confusing when one considers the Hire-Purchase Act 1972 of India, which strikingly has 31 sections and is identical to the Sri Lankan one, though the Indian Act is not called a consumer credit Act but a hire-purchase Act. Under section 31 of the Consumer Credit Act No 29 of 1982, a hire-purchase agreement is defined as an agreement under which goods are let on hire, where the possession of goods is delivered by the owner thereof to a person on condition that such person pays an agreed amount in periodical installments and either the hirer has an option to purchase the goods in accordance

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<sup>3</sup> Leasing Agreements are governed by Financial Leasing Act No 56 of 2000.

<sup>4</sup> David Kelly, Ruth Hayward and Ann Holmes, *Business Law* (5th edn, Taylor and Francis 2005).

with the terms of the agreement or the property in the goods is to pass to the hirer on the payment of the last of such installments.

One must remember that by entering into a hire-purchase agreement, the hirer does not become the owner of the goods but becomes a mere possessor of the goods, whereby the hirer is always under an obligation towards the owner of the goods to make the payments in due time and to exercise due diligence in using and protecting the goods that the hirer has hired.

## II. PROCEDURE FOR ENTERING INTO A HIRE-PURCHASE AGREEMENT

The Act under section 3 stipulates that when parties are planning to enter into a hire-purchase agreement, there is an obligation on the part of the owner to specify both the hire-purchase price and the cash price of the good/s which forms the subject matter of the contract. Further, the Act requires the owner to send the final agreement between the parties within two weeks from making the agreement.

Section 3(2) declares that an owner is disentitled from exercising the rights granted to him under the Act if he fails to comply with the requirements as laid down in section 3 of the Act. However, Section 3(4) declares that if the owner's failure is not prejudicing the hirer and if it is just and equitable to do so, the court can disregard the requirements that oblige the owner. The term *just and equitable* can give a wider sense of discretion to the court and is however used to serve the interest of the owner and not the hirer. The court is not authorized to take a *just and equitable* method in giving a final judgment.

The rate charged for hire [-purchase goods] will be calculated based on the cash price of the goods plus a handsome rate of interest and not on the market rate for hiring them<sup>5</sup>. Depending on the period of the hire-purchase agreement, the difference between the hire-purchase price and the cash price of the goods will vary significantly as the interest rate charged on hire purchase agreements vary from 24 per annum.

This is a higher rate when compared to bank loans. For example if a person takes a vehicle worth 1 million rupees (Cash Price) on a higher purchase basis for five years (or to be paid in 60 months), the hire-purchase amount would be 2.2 million rupees when the total payment is made. One must remember that even the cash price is deeded with a profit margin and when one takes the same vehicle on the hire-purchase basis, the amount that must be repaid is disproportionately expensive. This is due to the amount of interest charged on a transaction. In addition to this, there will normally be an initial deposit that will have to be deposited by the

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<sup>5</sup> M. P. Furmston, *Principles of Commercial Law* (2nd edn, Cavendish 2001).

hirer.

### III. WHY NOT HIRE-PURCHASE

One risk with credit is that consumers will take on more than they can afford, whether through impulsiveness, bad planning, or not fully understanding the extent of the commitment<sup>6</sup>. The number of hire-purchase litigation, or the HP cases as they are commonly known, is a result of this exact reason. The person taking the credit is not only to blame but also the institutions that give credit have to take some of the responsibility for this high number of litigations adding burdens to an already overwhelmed judicial system where cases are staking up faster than manhattans.

The draconian provisions of the Consumer Credit Act No 29 of 1982, if understood in their proper context, will for sure deter a person from going into a hire-purchase agreement. But information with clarity is hard to find, and in this article an attempt is made to make people easily understand the predicaments they will put themselves in when they enter into hire-purchase agreements.

The rights granted to an owner under the Consumer Credit Act No 29 of 1982 are so unequal in the context to those enjoyed by a hirer that the law is in effect strengthening a stronger party than the opposite, which should be the aim of the law as the bargaining powers of the parties are so unequal that the law ought to compensate for this inequality by safeguarding the disadvantaged hirer.

Section 6 of the Act is very clear about the *passing of property in the goods* in a hire purchase price. According to which until all the payments have been made in accordance with the agreement, the ownership of the goods does not pass to the hirer. However, the risk passes to the hirer once he is in possession of the goods and is therefore fully responsible for any loss or damage to the goods so hired to the actual owner of the goods. Therefore, a hirer is in a peculiar position where not being an owner of a chattel is still liable for its protection from loss or damage.

Hire purchase is popular with creditors as they can recover goods easily when the hirer fails to pay because ownership of the goods does not pass until the option to purchase has been exercised<sup>7</sup>. This is the most favourable reason for owners to provide goods on the hire-purchase basis as they can cease the goods upon failure of payment. According to section 18 of the Act, where the hirer fails to pay two consecutive installments, the owner has the option of

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<sup>6</sup> M. P Furmston and Jason Chuah, *Commercial Law* (2nd edn, Pearson 2013).

<sup>7</sup> Judith Tillson, *Consumer and Commercial Law* (1st edn, Pearson Longman 2011).

terminating the agreement by giving one week's notice where installments fall on a daily or weekly basis or two weeks' notice where installments fall due at latter times (i.e., monthly, quarterly). The Act is unfair as it allows the owner to wait for any period of time which he/she wishes to and thereby accumulate the sums due on the agreement. This allows the owner to exercise *economic duress* on the part of the hirer, as the owner is given the power to terminate the agreement when it is most favourable to him/her. However, if the law provided a definite time for an agreement to be terminated, the hirer would be inclined either to pay before the termination or incur lesser liability by the termination itself as the time period would be definite. As to the current law, an owner can terminate the agreement after any time where two consecutive installments have not been paid. This must be done by giving two weeks prior notice of the fact. In *L.B Finance V Weligamage and Others*<sup>8</sup> the Supreme Court held that this two weeks notice is imperative and that failure to do so would be detrimental to the owner. However, this requirement can be easily met by a hire-purchasing as they would have both personal and mechanical resources available to keep track of its transactions.

The fact that the right of termination arises after two defaults in payments and that it continues till the day when the right to termination is evoked is unfair on the part of the hirer as an owner can decide on the best moment to terminate and to get the maximum benefits of termination to himself.

Under section 19(a) the owner of the goods has the right to repossess the goods. This can be done in two ways. First, where the hirer has failed to pay 75% of the hire-purchase price, and owner can repossess the goods without seeking the permission of the Court. Second, where the hirer has paid 75% or more of the hire-purchase price, then the owner can repossess the goods through seeking the permission of the court. One must remember that the percentages are calculated from the hire-purchase prices and not the cash prices of the goods. However, one must not forget that even the cash prices are determined with a huge margin of profit and at least to make the playing field a bit more equal the threshold should have been the cash price of the goods and not the hire-purchase price.

When one reads the right of repossessing given to an owner, it is only subjected to section 16 and 21. The latter only acts as a restriction only when 75% or more of the hire-purchase price has been paid. Section 16 stipulates that; a hirer can reclaim for the excess of money he/she has paid when the market value of the repossessed goods and the amounts already paid exceeds the hire purchase price. But this will only be a hypothetical situation as much of the power and

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<sup>8</sup> *L.B Finance V Weligamage and Others* [2011] 2 Sri L R 182 (SC).

authority of deciding on the market value of the thing repossessed lies with the owner of the goods the combined figures of the market value and the amounts already paid will never exceed the hire-purchase value.

Another serious issue is that the Act is silent about the methods used in repossessing the goods. Even if illegal methods are used in repossessing the goods given under a hire-purchase agreement that will not come under consideration in the final analysis in deciding on the respective duties and liabilities of the parties. Therefore, a person who has defaulted on his payments under a hire-purchase agreement has to stay in constant fear of his hired goods being repossessed by the owner.

Once the hire-purchase agreement is terminated in accordance with the Act, the owner of the goods is given a further set of rights to enjoy. The owner is given the right of retaining the initial deposit. Owner is also entitled to recover the sums that were spent on repossessing the goods, garaging, repairing, towing, or any other incidental expense incurred on that regard. Further, an owner has the right to recover the unpaid installments with interest and the remaining uncovered hire-purchase price from the hirer with interest.

A common occurrence that prevails with most hire-purchase agreements are that they are prepared in English. The terms are so manipulatively drafted let alone the layman even lawman would find it very difficult to figure things exactly. Therefore, the need of informed consent taken to the agreement may not be available in an instance where the whole agreement is drafted in an alien language to a party signing the contract. However as stated in the case of *Mercantile Credit v Thilakarathne*<sup>9</sup> "Where a person who is neither illiterate nor blind signs a deed without examining the contents he would not as a general rule be permitted under the Roman Dutch Law to set up the plea that the document is not his." Going by this decision it would be somewhat impossible to argue that the contents of the agreement is something that one did not understand unless that person was either blind or illiterate.

Further one must think of the litigation process that follows a hire-purchase agreement which may take somewhere around 5-8 years. If one calculates the interest rate at 12% per annum and if the litigation takes 8 years to finish the defendant hirer may be at risk of requiring to twice the amount that was pleaded for in the plaint.

One must also remember that once you enter into litigation the likelihood of a hirer losing the case is far greater than him winning against a hire-purchase company as the respective bargaining powers are so unequally poised in favour of the hire purchase company. Another worry would

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<sup>9</sup> *Mercantile Credit v Thilakarathne* [2002] 3 Sri L R 206 (SC).

be the place of jurisdiction for determining the issue and in most of the times it will be in Colombo where the hire-purchase contracts are concluded thus requiring people from the outer-Colombo areas to take the cumbersome journey from their residence to Colombo.

#### **IV. CONCLUSION**

Consumer credit or in this instance hire-purchase may be a convenient and less cumbersome way to get what a consumer need but at the peril of the person so taking as well. Though, the legislation itself was brought to equal out the unequal bargaining powers of the owners and hirers, the Act has not been a sufficient tool for achieving this goal. The Act is heavily in favour of the person who is letting or hiring the goods and the person who is taking the hire is at a distinct disadvantage.

Hire-purchase agreements gives the owner of easy repossessions, deducting initial payments, demanding for unpaid installments, and remaining hire-purchase money. The procedure used for terminating hire-purchase agreements are less favourable for the hirers. Even at litigation due to the cost and the expertise of the hire-purchasing entities winning a lawsuit is almost impossible.

Therefore, it is suggested that before one enters into and hire-purchase agreement one must be very careful to read and understand the predicaments that he/she is going to put him/herself by signing such agreements.

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#### **V. REFERENCE**

1. Furmston M, *Principles of Commercial Law* (2nd edn, Cavendish 2001)
2. Furmston MJ Chuah, *Commercial Law* (2nd edn, Pearson 2013)
3. Kelly D, R Hayward, A Holmes, *Business Law* (5th edn, Taylor and Francis 2005)
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