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Report on the Passing of Risk in Contracts for the Sale of Heritable Property

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Scottish Law Commission

Item 2 of our First Programme of Law Reform

Report on the Passing of Risk in Contracts for the Sale of Heritable Property

To: The Right Honourable the Lord Fraser of Carmyllie, QC,
Her Majesty's Advocate

We have the honour to submit our Report on the Passing of Risk in Contracts for the Sale of Heritable Property.

(*Signed*) C K DAVIDSON, *Chairman*
E M CLIVE
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KENNETH F BARCLAY, *Secretary*
4th June 1990

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Part I Introduction

1.1 In this Report we are primarily concerned with changing the common law rule which identifies when the risk of damage to, or destruction of, heritable property passes from the seller to the purchaser under a contract of sale, where the damage or destruction occurs through no fault of either party. Consideration is also given to certain consequential issues arising from this change.

1.2 Parts II and III of this Report examine the common law rule on the passing of risk and the need for reform. Part IV recommends the introduction of a new rule on the passing of risk. Part V is concerned with the introduction of statutory rules which identify the legal consequences of the proposed new rule and Part VI focuses on the right to contract out of the statutory rules proposed. Part VII provides a summary of our recommendations for reform.

1.3 The Report follows on a Discussion Paper on *the Passing of Risk in Contracts for the Sale of Land* which was published in March 1989. We are very grateful to all those who responded to this Paper, and provide in Appendix B of this Report a full list of the consultees who submitted comments on our proposals. These comments have been of considerable assistance to us in the preparation of this Report.

Part II The Common Law Rule on the Passing of Risk

2.1 The risk of heritable property being damaged or destroyed normally rests with the owner of that property.[1] However, as we point out in our Discussion Paper,[2] within the context of the sale of heritable property the common law provides that, subject to the exceptions referred to in paragraph 2.3 below, such risk passes to the purchaser at the date when there is a binding contract for sale and not when he acquires ownership of the property which might take place at a much later date.

2.2 The effect of this rule is that once risk passes to the purchaser he must proceed with the transaction and remit the full purchase price to the seller notwithstanding that before he takes entry to the property it is destroyed or damaged through no fault on his part.

2.3 This common law rule, however, does not apply where the destruction or damage is attributable to the seller's fault; where the parties contract out of the consequences of this rule by providing in the missives, for example, that risk will remain with the seller until settlement of the transaction; or where the destruction or damage occurs at a time when the seller has wrongfully prevented the purchaser from taking entry.[3] In these circumstances the loss resulting from the damage or destruction rests with the seller.

1. Known as the *res perit domino* rule.
2. Para 2.1.
3. See para 2.2 of the Discussion Paper.

Part III The Need for Reform

3.1 Our reason for undertaking this exercise on the passing of risk arises out of our dissatisfaction with this common law rule—a rule which, in our view, does not accord with the reasonable expectations of the ordinary person.

3.2 Without the benefit of legal advice, a purchaser, whose offer has been accepted, is unlikely to realise that the risk of destruction or damage has passed to him at that time notwithstanding that he is not the owner of the property and has no physical means of protecting it. He is more likely to assume that the risk will not pass to him until he takes possession of the property, the seller being under an obligation until then to ensure that the property is maintained in the same condition which it was in at the time missives were concluded (fair wear and tear excepted).

3.3 The purchaser may not be alerted to this incorrect assumption. As we indicate in our Discussion Paper[1] it is unsatisfactory that where the missives make no reference to the allocation of risk the common law rule will prevail. This could be a trap for the unsuspecting purchaser who may face severe financial loss if he fails to insure against destruction or damage of the property as soon as a binding contract is concluded.

3.4 Not every prospective purchaser seeks legal advice at the missives stage. Some may decide not to do so until after missives are concluded in an attempt to minimise legal expense. This situation may arise, for example, where the purchaser intends to acquire a house in a new residential development and the seller has prepared a standard printed offer of sale. A written acceptance of such an offer concludes the bargain, and notwithstanding that the seller may advise the prospective purchaser to consult a solicitor before submitting his acceptance, such advice may be disregarded. Even where a purchaser submits an offer to purchase he may do so before consulting a solicitor, although we envisage that this is most likely to arise when neither party is legally represented at that stage of the transaction.

3.5 Not only does the common law rule not accord with the reasonable expectations of the purchaser but it encourages double insurance arrangements. Although the purchaser or his solicitor may secure appropriate insurance cover from the date of conclusion of the binding contract it is unlikely that the seller will cancel his existing cover until the transaction is settled. He may be obliged in terms of a heritable security or his title to insure the property until settlement. Furthermore, even if he is not subject to any obligations of this nature, he may consider that it would be prudent to continue with his insurance in case the purchaser, for any reason, is unable to proceed with the purchase.

1. See para 3.1.

Part IV The New Rule on the Passing Risk

Introduction

4.1 In the light of our dissatisfaction with the common law rule on the passing of risk we provisionally proposed in our Discussion Paper[1] that this rule should be altered. The majority of consultees supported our proposal. Accordingly we consider in this Part of our Report the introduction of a new rule for identifying when risk should pass from the seller to the purchaser.

4.2 In identifying when risk should pass we are concerned with three categories of sale transaction. The first, and most common category, is the sale of heritable property with vacant possession to a purchaser who is not already in occupation. The second concerns the sale with vacant possession to a person who is already in occupation of the property—the sale by a landlord to his tenant, for example, or a sale to a licensee, or invitee, or to a wife who is in possession by virtue of her occupancy rights under the Matrimonial Homes (Family Protection) (Scotland) Act 1981. The third category involves the sale of property without vacant possession—the sale, for example, by a landlord to a third party subject to the rights of the occupying tenant.

The normal case

4.3 Our examination in the Discussion Paper as to when risk should pass to the purchaser focused primarily on the first category of sale transaction—the sale with vacant possession to a purchaser who is not already in occupation of that property. We made the point that a major criticism of the existing common law rule in this context is that the purchaser is forced to bear the risk of destruction or damage in circumstances where he is neither occupying the property nor in a position to protect it.[2]

4.4 Accordingly we provisionally proposed that a statutory rule should be introduced which provides that the risk will not pass to the purchaser until he takes possession or is entitled to take possession of the property, whichever is the earlier.[3] In framing this formula we recognised that a purchaser may not necessarily take actual possession at the time he becomes entitled to do so under the contract, or he may take possession before he becomes so entitled by taking occupation without the seller's consent. We expressed the view in the Discussion Paper,[4] with regard to the first situation referred to above, that as a purchaser "should not be able to delay the passing of risk by delaying to take actual possession" risk should pass to him when he becomes entitled to take possession (whether or not he takes actual possession at that time). In relation to the second situation we considered that risk should pass when the purchaser takes possession without the seller's consent. The majority of consultees supported this approach. There were, however, two criticisms of our proposed formula which we should like to mention at this stage.

4.5 The first criticism was reflected in the suggestion of some consultees that any legislation enacted to implement this proposal should define what is meant by the reference to "possession" within the context of our formula so as to avoid any doubt as to the date when risk passes to the purchaser. One consultee expressed concern, for example, about the degree of control of the property which would be necessary

1. See provisional proposal 1.
2. Para 4.6.
3. Provisional proposal 2.
4. See para 4.8

to qualify as "possession" of the subjects citing as an area of doubt the purchaser who prior to the agreed date of entry is allowed access for the purpose of taking measurements, checking services etc. Another consultee, making the same point, indicated that in their experience it is fairly common, where the property has been vacated by the seller, for the purchaser to be given access for the purpose of redecorating before furniture is moved into the property, or even unlimited access prior to the date of entry. The question asked is whether such access could arguably constitute "possession" for the purpose of our proposal.

4.6 In our view what constitutes "possession" is a matter of fact in each case. In the majority of transactions possession will take place when the purchaser pays over the price to the seller and receives delivery of an executed disposition in his favour and the keys to the property. This may take place on the date of entry originally specified in the missives, or on a later or earlier date subsequently agreed between the parties.

4.7 On the other hand, the contracting parties may negotiate other arrangements. The purchaser may be offered possession on the date of conclusion of the missives—settlement taking place sometime later when the conveyancing is completed. Possession may be acquired on payment to account of the purchase price or on consignation of the price on deposit receipt in joint names of the seller and purchaser pending finalisation of the conveyancing. It could take place, as indicated above, without the seller's knowledge or consent, where, for example, the purchaser borrows the keys and then subsequently moves into the property without notifying the seller.

4.8 We consider that to define "possession" would reduce the flexibility required to cover the various circumstances referred to above. We are reasonably confident that, in identifying the degree of control necessary to constitute possession, a court would not consider that the limited rights of access referred to above by some consultees would be regarded as "possession" for the purposes of passing of risk.

4.9 The second criticism suggested that the formula put forward would not protect the seller against the dilatory purchaser who takes possession sometime after the agreed date of entry and thus delays the passing of risk.

4.10 To some extent our Discussion Paper anticipated the possibility that a purchaser might not choose to take possession on the agreed date, and to protect the seller's position in this situation we proposed that risk would pass when the purchaser takes possession or is entitled to take possession, whichever is the earlier.

4.11 Such a formula, although going some way towards protecting the seller from the dilatory purchaser, does not completely achieve this objective. It does not resolve the problem of the purchaser who so delays the progress of the transaction that he prevents the seller from being in a position to deliver a validly executed disposition on the date of entry initially agreed between the parties, effectively forcing the seller to accept a later date of entry upon which the purchaser obtains possession. We take the view that the seller can protect himself contractually against the dilatory purchaser in such a situation by ensuring that the missives include—in addition to any standard clause for payment of interest—a provision to the effect that where settlement is delayed by the purchaser he will reimburse the seller for the additional cost incurred by the seller in continuing to provide insurance cover for the property until the risk finally passes to the purchaser.

4.12 We **recommend** that:

1. **In a contract for the sale of heritable property with vacant possession, where the purchaser is not already in occupation, the risk of destruction of, or damage to, that property should pass to the purchaser when he is entitled to take possession (whether or not he takes actual possession at that time) or if and when he takes possession without the seller's consent.**

(Clause 1 (1), (2)(a) and (3)).

Special cases

4.13 As indicated above[1] we justified the application of the formula "entitlement to take possession or possession without the seller's consent" for identifying when risk should pass to the purchaser on the basis that the purchaser should not have to bear the risk until he is either in actual occupation of the property, or is in a position to protect it.

4.14 Arguably this justification for altering the common law rule on the passing of risk in this manner does not apply with such force when we consider the second category of sale transaction, where the purchaser is already in occupation of the property, or the third category, where the purchaser does not take occupation. Scottish Homes recognised this point in their rejection of our proposal to alter the common law rule on the passing of risk in relation to "sales to public sector tenants under Part III of the Housing (Scotland) Act 1987 (and under any voluntary arrangements following the lines of this Act)".

4.15 We expressed the view in the Discussion Paper, however, that in principle the same rule on the passing of risk should apply to all sale transactions. We envisaged, for example, transactions which involve the sale by a landlord either to his existing tenant,[2] or to a third party subject to tenant's rights.[3] In the first situation we proposed that risk should pass to the purchasing tenant when he takes "possession" as owner in terms of the missives of sale, and in the second situation, when he takes "possession" in the sense that he becomes entitled to collect the rent.[4] The majority of consultees supported our approach. We considered very carefully the reasons given by Scottish Homes for not giving support to our proposal in relation to sales to public sector tenants but came to the conclusion that the new rule on the passing of risk should apply, without exception, to all categories of sale transaction.[5]

4.16 Taking "possession" of property is likely to be thought of as taking physical occupation. Accordingly we propose, in identifying the date when risk passes under our new rule, to confine the concept of possession to the first category of sale transaction because it is that category where possession will mean occupation.

4.17 In identifying the date for the passing of risk in relation to the second and third categories of sale transaction we propose to achieve the same objective by adopting as the criterion "the date of entry agreed under the contract". This criterion is selected on the assumption that most contracts provide for a date of entry. The provision may take the form of a specific date incorporated in the original contract, which may be subsequently brought forward or delayed by agreement between the parties. Some missives, on the other hand, may incorporate a clause to the effect that the date of entry will be not later than a specified date;[6] or will take place on the occurrence of an identified event— such as the granting of planning permission; or will be a date to be agreed between the parties.[7]

4.18 Accordingly we **recommend** that:

2. Where there is a contract for the sale of heritable property

(i) with vacant possession, to a person already in occupation of the property; or

(ii) to a person without vacant possession;

the risk of damage to or destruction of that property should pass to the purchaser on the date of entry agreed under the contract.

(Clause 1(2)(b)(i) and (ii)).

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1. See para 4.3.
2. This transaction would fall within the second category of sale transaction.
3. This transaction would fall within the third category of sale transaction.
4. See para 4.9 of the Discussion Paper.
5. The observations made by Scottish Homes, however, alerted us to one of the consequences of the application of our intended new rule to which we refer in para 5.31 below.
6. See *Gordon District Council* v *Wimpey Homes Holidays Limited* 1988 SLT p 481.
7. See *Sloans Dairies Ltd* v *Glasgow Corporation* 1977 SC 223 ("the Sloans Dairies case").

4.19 It is conceivable that in the exceptional case the contract may omit to make any reference to a date of entry upon which the purchaser will become entitled to take possession of the property.[1]

4.20 Section 28 of the Conveyancing (Scotland) Act 1874 provides that—"Where no term of entry is stated in a conveyance[2] of lands, the entry shall be at the first term of Whitsunday or Martinmas after the date or last date of the conveyance, unless it shall appear from the terms of the conveyance that another term of entry was intended". Accordingly, if neither the missives of sale nor the subsequent conveyance of the property incorporates a date of entry then one may be supplied by section 28.

4.21 However, to delay the passing of risk until the first term of Whitsunday or Martinmas after the date of the conveyance would be, in our view, unfair to the seller. Consequently where there is no agreement as to the date on which the purchaser is to become entitled to take possession of the property or (as the case may be) as to the date of entry, we propose that the risk should pass to the purchaser on the date of settlement of the transaction, unless of course it has already passed to him by virtue of his taking possession without the seller's consent.

4.22 Accordingly we **recommend** that:

3. **Where there is no agreement as to the date on which the purchaser is to become entitled to take possession of the property or (as the case may be) as to the date of entry the risk of damage to or destruction of that property should pass to the purchaser on the date of settlement of the transaction, unless it has already passed to him by virtue of his taking possession without the seller's consent.**
(Clause 1(4)).

4.23 We are anxious to ensure that our recommended formula does not result in risk passing to the purchaser after he has acquired ownership of the property.

4.24 We envisage that this possibility might arise in the following circumstances. A firm may enter into negotiations to purchase an adjoining building for the purpose of extending its existing office premises. It may be, however, that the prospective purchaser does not anticipate carrying out the redevelopment for at least one year after the purchase is completed, and accordingly is prepared to allow the present owners to remain in occupation during that time. This arrangement could be reflected in the missives on the basis that the purchaser pays over to the seller two months after the contract is concluded the full purchase price in exchange for an executed disposition, entry, however, being postponed for 12 months.[3] If after property has passed to the purchaser but before the date of entry, the building is destroyed, through no fault of either contracting party, the risk of such destruction in our view should lie with the purchaser as owner of the building. Our recommended formula would not, however, achieve this objective.

4.25 Problems of this nature are unlikely to arise very often in practice, but, for the avoidance of doubt, we wish to ensure that risk passes at latest when property passes notwithstanding that the property may pass before the purchaser becomes entitled to take possession of the property or before the date of entry agreed under the contract.

4.26 Accordingly we **recommend** that:

1. Such a situation arose in *the Secretary of State for Scotland* v *Ravenstone Securities Limited* 1976 SC 171, where the court ruled that in the particular circumstances of that case entry was the date of settlement.
2. This situation could arise where the date of entry is inadvertently omitted from the conveyance, or, as in the Sloans Dairies case, where the subjects are being compulsorily acquired, and the conveyance is in the form provided in Schedule A to the Lands Clauses Consolidation (Scotland) Act 1845 which makes no provision for a date of entry.
3. There would be other ways, perhaps more usual, of achieving this type of result. A postponed date of entry would, however, be one possible way of doing so and the possibility must therefore be provided for.

4. **Where the purchaser becomes owner of the property before the date when risk would pass to him under the rules recommended above, the risk of damage to or destruction of that property should pass to the purchaser when he becomes owner of the property.**

(Clause 1(5)).

Scope of new rule

4.27 We examined in our Discussion Paper[1] whether the introduction of the new rule on the passing of risk should apply in relation to the sale of all kinds of heritable property, such as unbuilt upon land, dwellinghouses, offices, factories etc, or only to the sale of dwellinghouses. Notwithstanding that some jurisdictions have adopted the latter approach[2] we are of the view that to introduce different rules for different types of property is unsatisfactory. The majority of consultees agreed with us.

4.28 Accordingly we **recommend** that:

5. **The new rule on the passing of risk should apply to all kinds of heritable property.**

(Clause 1(1)).

1. See para 4.27 and provisional proposal 8.
2. Victoria—Sale of Land (Amendment) Act 1982; Queensland—The Property Law Act 1974.

Part V The Introduction of Statutory Rules which Identify the Legal Consequences of the Proposed New Rule on the Passing of Risk

Introduction

5.1 We proposed in our Discussion Paper that where, after a binding contract for the sale of heritable property is concluded, and before the risk has passed to the purchaser, the property is destroyed or damaged through no fault of either contracting party, statutory rules should be introduced for the purpose of identifying the legal consequences arising from such destruction or damage. The majority of consultees agreed with our proposal.

5.2 In our view one possible benefit of introducing such rules would be to assist parties in determining more clearly their rights and liabilities in such circumstances, thus reducing the scope for uncertainty and dispute. Furthermore we are hopeful that the adoption of such rules would result in a reduction in the number of clauses which are currently included in standard missives, and thus simplify the contractual arrangements entered into between the parties.

5.3 We envisage that statutory rules would be needed to regulate the rights and liabilities of the purchaser and seller in two situations. First, where the property is totally destroyed or substantially damaged, and second, where the property is damaged but not substantially. We examine below what should be the legal consequences arising from each of these situations, and how "substantial damage" can be adequately defined.

Destruction or substantial damage

5.4 In the Discussion Paper we suggested as a matter of principle that where property is destroyed or substantially damaged through no fault of either contracting party while the risk lies with the seller the contract should be regarded as frustrated.[1]

5.5 We applied the doctrine of frustration of contract in this context because we considered that the legal consequences of frustration provide the most appropriate and fairest remedy where property is totally destroyed or substantially damaged. We identify these consequences in the Discussion Paper[2] as follows:–

> "It brings a contract to an end and discharges the parties from further obligations under it. The parties' subsequent relations are governed by the principles of unjust enrichment—neither party should be enriched at the expense of the other.[3] Payments already made under the contract, therefore, can be recovered, and money due for things done prior to the event which caused frustration is still due. Neither party to the contract is under any obligation to give the other notice that he holds the contract at an end".[4]

5.6 Another benefit of adopting frustration is that it ensures enforceability of an arbitration clause even after the contract has come to an end. As Professor W W

1. See para 4.14.
2. Para 4.19.
3. *Cantiere San Rocco* v *Clyde Shipbuilding and Engineering Co* 1923 SC (HL) 105.
4. *Bank Line Co* v *Capel & Co* [1919] AC 435.

McBryde points out in his textbook on "Contract"[1], strictly speaking it is not the contract which is frustrated but it is the future performance of the adventure which is frustrated. Consequently he makes the point that even after frustration arbitration clauses may be enforceable,[2] and also clauses which might have survived full performance of the contract may survive frustration.[3]

5.7 The majority of consultees gave support to our proposal. However, a few put forward criticisms to which we think a reference should be made at this juncture.

5.8 The first criticism questioned whether frustration of contract should be the only remedy available to the parties in the event of the property being destroyed or substantially damaged. One consultee suggested that it is not the current practice to incorporate in the missives of sale a condition to the effect that on destruction or substantial damage of the property the contract will come to an end. In his experience the standard clause used offers the purchaser the option either to proceed with the purchase or to resile. He made the point (which was also put forward by another consultee), that there will be occasions when a purchaser would prefer to proceed with the transaction, subject to a reduction in the agreed price. The solution proposed by this consultee is to make the remedy of the *actio quanti minoris* available to the purchaser in the event that the purchaser does not wish to resile from the contract. This remedy, within the context of the sale of heritable property, would operate so as to confer upon the purchaser the right to proceed with the purchase and claim from the seller the difference between the value of the property before and after the destruction or damage.

5.9 Another consultee appeared to accept our proposal that the contract should terminate where the property is destroyed but suggested, in the case of substantial damage, that both parties should be given the option to resile, failing which the contract would proceed.

5.10 We are still of the view, however, that it is right in principle and fairer that where the subject matter of the contract is totally destroyed before the risk has passed to the purchaser the contract should come to an end. We are also of the opinion, particularly as land is rarely totally destroyed, that the same result should take place where the property is substantially damaged.

5.11 The second criticism suggested that frustration of the contract (or a rule terminating the contract) should not be the recommended solution where the risk of loss arising from destruction or substantial damage lies with one of the contracting parties. This criticism was based on the view that frustration (or termination) does not normally operate where risk has been allocated. It was argued that it would create an anomaly to bring the contract to an end in this situation. It was suggested that once risk is allocated the contract should simply proceed and that it was up to the party at risk to insure if so advised.

5.12 We agree that the doctrine of frustration (or a rule of termination) should not apply where the risk has passed to the buyer. In that event the only reasonable interpretation of the contract is that the buyer must pay the price in exchange for whatever performance (eg. conveyance of a burnt-out shell) is possible by the seller. It is up to the buyer to insure against the destruction of, or damage to, the property which is at his risk. We also agree that the doctrine of frustration (or a rule of termination) should not apply if the parties have expressly provided that the contract is to proceed, or that damages for non-performance are to be payable, notwithstanding the destruction of, or substantial damage to, the property. This is

1. pp 354-355.
2. *Heyman* v *Darwins Ltd* [1942] AC 356; *Kruse* v *Questier and Co Ltd* [1953] 1 QB 669; *Government of Gibraltar* v *Kenney and Another* [1956] 2 QB 410; *Scott & Sons Ltd* v *Del Sel* 1923 SC (HL) 37.
3. The examples given by Professor McBryde of clauses which survive full performance of the contract—indemnities against liability for taxes, accidents or infringement of patents, clauses protecting confidential information or provisions restraining trade or employment—do not appear to be relevant within the context of a contract for the sale of heritable property. However it is conceivable that some clauses under such a contract would survive frustration.

provided for in the draft Bill, which allows the parties to contract out of its provisions.[1] Where, however, the position is simply that the risk remains with the seller, without any provision being made in the contract as to the effects on the contract of the destruction of, or damage to, the property before risk passes to the buyer, then we think that the doctrine of frustration (or a rule of termination) can quite properly be applied.

5.13 The question is simply "What is to happen to the contract if the property is destroyed or substantially damaged, without fault by either party, while at the seller's risk?". In our view, as we have already indicated, the fairest and most principled solution is to say that the contract comes to an end without liability for damages. The fact that the seller, if uninsured, must bear the loss, or diminution in value, of the property does not necessarily mean that he should be liable in damages for non-performance of a contract relating to the property.

5.14 We do not accept that it creates an anomaly if the doctrine of frustration (or a rule of termination) is applied by statute in this situation. The rule we are proposing is in line with the rule which applies in a sale of goods where the goods are destroyed, without fault of either party, while at the seller's risk.[2] It is also in line with the rule applying, at common law, in the case of a lease of heritable property. Here it is accepted that if the subjects are accidentally destroyed, or so substantially damaged as to be unfit for the purpose for which they were intended under the lease, then the lease is at an end.[3] It would, we think, be anomalous if the doctrine of frustration, or a similar rule of termination, could *not* apply to a sale of heritable property.

5.15 Accordingly we **recommend** that:

6. Where heritable property which is the subject of a contract of sale is destroyed or substantially damaged, through no fault of either contracting party, while the risk of such destruction or damage lies with the seller, the contract should be regarded as frustrated as from the date of the destruction or damage.

(Clause 1(6)(a)).

Non substantial damage

5.16 We expressed the view in the Discussion Paper that where property is damaged, through no fault of either party, but not substantially, while the risk lies with the seller, frustration of contract should not operate.[4]

5.17 Instead we proposed that the seller should be under a contractual obligation imposed by statute to restore the property to the condition it was in before it was damaged. We considered that certain statutory remedies should be made available to the purchaser in the event of the seller being in breach of this obligation. The remedies suggested were entitlement to insist upon the seller performing his obligation to restore the property, and if he failed to do so, to claim damages from him, the measure of such damages being the reasonable cost of repairing the property.[5] The majority of consultees supported this provisional proposal.

5.18 On reflection, however, we have decided that our approach places too much emphasis on the nature of the remedies available to the purchaser rather than upon the seller's duty to reinstate the damaged property. We have come to the conclusion that the statutory rule should not identify the purchaser's remedies. Instead the remedies available under the common law for breach of contract should be left to apply.

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1. Clause 2.
2. Sale of Goods Act 1979, s 7.
3. *Walker* v *Bayne* (1813) 3 Dow 233, 6 Paton 217; *Duff* v *Fleming* (1870) 8 M 769; *Mackeson* v *Boyd* 1942 SC 56; *Cantors Properties (Scotland) Ltd* v *Swears and Wells Ltd* 1978 SC 310. English law used to be different on this point. See now, however, *National Carriers Ltd* v *Panalpina (Northern) Ltd* [1981] AC 675 where the House of Lords accepted that, in principle, a lease could be frustrated.
4. See para 4.21.
5. Provisional proposal 4(b) in the Discussion Paper.

5.19 With regard to the measure of damages which should apply if the purchaser elects to pursue this remedy we did give consideration to the suggestion put forward by one consultee that the purchaser's claim should be the difference between the value of the property before and after the damage has been sustained.[1] On the basis that the diminution in value of the property could be less than the cost of repairing the damage we concluded that it would be fairer to the purchaser if the measure selected was the reasonable cost of repairing the property.

5.20 Accordingly we **recommend**:

7. **Where heritable property, which is the subject of a contract of sale, is damaged, but not substantially, through no fault of either contracting party, while the risk of such damage lies with the seller, the legal consequences of such damage will be as follows:**

   (i) The seller will be under an obligation to convey the property to the purchaser in the same condition as it was in when the contract was concluded (fair wear and tear excepted).

   (ii) If the seller fails to perform his obligation under (i) above he will be deemed to be in breach of contract, and the purchaser will be entitled to exercise any of the common law remedies available to him for such a breach.

   (iii) In the event of the purchaser electing to claim damages against the seller, the measure of such damages will be the reasonable cost of repair of the property.

   (Clause 1(6)(b) and (8)).

Definition of substantial damage

5.21 Identification of what constitutes "substantial" damage is of considerable importance in ascertaining which of the proposed new statutory rules would apply when property is damaged. It provides the criterion for deciding whether the contract for the sale of heritable property comes to an end or continues to operate. Consequently it is important to devise some formula for defining this concept which can be operated by the parties involved with a degree of certainty—possibly with the assistance of their legal advisers, but without the need to refer the issue to the courts.

5.22 In the Discussion Paper we put forward for consideration the formula that "property would be regarded as substantially damaged if it were damaged to such an extent that it was rendered materially different from that which the purchaser contracted to buy".[2] The majority of consultees who responded to the Discussion Paper supported our proposed formula.

5.23 Some of these consultees, however, who initially indicated agreement, went on to qualify that agreement with comments on the possible problems which might arise in interpreting this formula. Difficulties were envisaged in ascertaining what degree of damage would be necessary to qualify as "substantial". It was anticipated that the degree of materiality of difference could cause initial problems until sufficient judicial authority was available to clarify how much damage will be necessary to render a property "materially different".

5.24 Other consultees suggested that the criterion for deciding whether damage is substantial or not should rest on whether the property is or is not in a habitable state after the damage has been sustained. Unfortunately the concept of habitability as the sole criterion for judging whether property is substantially damaged could also give rise to problems of interpretation. It would be difficult, for example, to apply this concept to property which is not residential.Two consultees rejected the need for a statutory definition, indicating that it should be left to the courts to provide a ruling where doubt arises.

1. The *actio quanti minoris*. See para 5.8 above.
2. See para 4.23 and provisional proposal 5.

5.25 Notwithstanding that the majority of consultees gave support for our formula we recognise that the use of the words "materially different" in that formula gives rise to possible problems of interpretation. Accordingly we have given further consideration to the possibility of achieving a clearer definition of "substantial" damage.

5.26 We now propose, in relation to a contract for the sale of heritable property, that damage should be regarded as "substantial" if the property could no longer be used for the purpose which was, or ought reasonably to have been, in the contemplation of the parties at the time the contract was concluded.[1] In relation to residential property this test would be very similar to the habitability test suggested by some consultees. It would, however, be capable of applying generally, to any kind of property.[2]

5.27 The test introduced for ascertaining what purpose was in the contemplation of the parties at the time the contract for sale was concluded is based on the contracting parties' actual or imputed knowledge. In imputing knowledge to each party the test to be applied would be the objective test of the reasonable man—what knowledge each party can reasonably assume to have possessed at that time, whether or not he actually posesses it.

5.28 Accordingly we **recommend**:

8. Damage to property should be regarded as "substantial" if as a result of it the property is no longer capable of being used

(a) for any purpose which might reasonably be supposed to have been in the contemplation of the purchaser and seller at the time when they entered into the contract; or

(b) for any purpose expressly made known by the purchaser to the seller at that time.

(Clause 1(7)).

Indirect loss

5.29 Our proposed new rule on the passing of risk is only concerned with allocating the loss directly arising from the property being destroyed or damaged. It is not concerned with indirect losses which may be sustained by either the purchaser or the seller as a result of the damage or destruction. Such losses, as under the present law, would remain with the party who has sustained them.

5.30 For example, a purchaser may have contracted to sell his house, and to vacate the property on the same day as he anticipates taking possession of his new house. If, shortly before that day, his new house is accidentally destroyed, then under our proposals, the contract to purchase will come to an end at that time. Nevertheless the purchaser will still be under an obligation to give entry to the new owner of his property. Accordingly as a consequence of the accidental destruction of his new home he may find it necessary to store his furniture and find rented or hotel accommodation for himself and his family until he has had an opportunity to purchase another property. These indirect losses, against which he may wish to insure, will require to be met by him.

5.31 Scottish Homes in rejecting the adoption of our proposed new rule on the passing of risk to the sale of property to a public sector tenant alerted us to another indirect loss which would require to be met by the prospective purchaser. In terms of section 62 of the Housing (Scotland) Act 1987 the public sector tenant is entitled to purchase his property at a discount. In the event of the property being destroyed

1. Cf *Hadley* v *Baxendale* (1854) 9 Exch 341. A similar test can be found in s 24 of the Unfair Contract Terms Act 1977, for ascertaining whether the terms in a contract are fair and reasonable for the purposes of that Act.
2. Cf *Duff* v *Fleming* (1870) 8 M 769 at p 771 where the lease of a shop was held to be terminated when, as a result of a fire, "the premises were rendered unfit for the purposes for which they were let".

before the purchasing tenant acquires ownership one of his indirect losses will be the loss of the right to purchase the dwellinghouse at substantially less than its market value. As Scottish Homes point out, the selling landlord cannot be expected to insure against the purchasing tenant's potential loss of his discount. Accordingly the tenant should bear in mind the advisability of insuring against this indirect loss notwithstanding that the risk of damage or destruction lies with the landlord.[1]

5.32 The example of purchase at a discount is no different from any situation in which the purchaser has made a good bargain and has managed to contract to buy a house at less than its full market value. In such a case the termination of the contract means the loss of the profit element. Conversely, if the purchaser has made a bad bargain and has offered an excessive amount for the house then the termination of the contract will be to his financial benefit. We do not regard these possible incidental effects as constituting any objection to the solution proposed.

1. If the tenant is rehoused in another public sector house then his loss may be affected by his right to buy his new house at a discount.

Part VI Contracting out of the Statutory Rules

6.1 We considered in the Discussion Paper[1] whether the purchaser and seller should be entitled to contract out of the proposed new statutory rules.

6.2 It is generally recognised under Scots law that contracting out of statutory obligations should be permitted unless there are strong reasons for restricting the parties' freedom in this respect. Such a restriction might be justified if one of the parties to the contract is invariably in a weaker bargaining position than the other party. Insofar as the sale of heritable property is concerned the bargaining position of either party will fluctuate from time to time depending upon whether there is a buyer's or a seller's market when the sale is being negotiated. We are not inclined to think that this fluctuation in the position of the parties would justify a prohibition against contracting out.

6.3 Although we hope that our proposed new rules on the passing of risk and the legal consequences arising therefrom will be acceptable to the majority of parties who enter into a contract for the sale of heritable property we recognise that in relation to some contracts, particularly those which involve complicated commercial transactions, as distinguished from the sale of a single dwellinghouse, parties may wish to negotiate different rules. In the case of buildings being bought for demolition and redevelopment, for example, the parties might not wish the contract to be regarded as frustrated even if the buildings were destroyed or substantially damaged through no fault of either party.

6.4 We have no doubt that parties should be able to contract out of the statutory rules and accordingly we **recommend**:

9. There should be no prohibition against contracting out of the proposed new rules on the passing of risk under contracts for the sale of heritable property and the legal consequences arising therefrom.

(Clause 2).

1. See paras 4.28—4.29.

Part VII Summary of Recommendations

1. In a contract for the sale of heritable property with vacant possession, where the purchaser is not already in occupation, the risk of destruction of, or damage to, that property should pass to the purchaser when he is entitled to take possession (whether or not he takes actual possession at that time) or if and when he takes possession without the seller's consent.

(Paragraphs 4.3—4.11; Clause 1 (1), (2)(a) and (3)).

2. Where there is a contract for the sale of heritable property

(i) with vacant possession, to a person already in occupation of the property; or

(ii) to a person without vacant possession;

the risk of damage to or destruction of that property should pass to the purchaser on the date of entry agreed under the contract.

(Paragraphs 4.13—4.17; Clause 1(2)(b)(i) and (ii)).

3. Where there is no agreement as to the date on which the purchaser is to become entitled to take possession of the property or (as the case may be) as to the date of entry the risk of damage to or destruction of that property should pass to the purchaser on the date of settlement of the transaction, unless it has already passed to him by virtue of his taking possession without the seller's consent.

(Paragraphs 4.19—4.21; Clause 1(4)).

4. Where the purchaser becomes owner of the property before the date when risk would pass to him under the rules recommended above, the risk of damage to or destruction of that property should pass to the purchaser when he becomes owner of the property.

(Paragraphs 4.23—4.25; Clause 1(5)).

5. The new rule on the passing of risk should apply to all kinds of heritable property.

(Paragraph 4.27; Clause 1(1)).

6. Where heritable property which is the subject of a contract of sale is destroyed or substantially damaged, through no fault of either contracting party, while the risk of such destruction or damage lies with the seller, the contract should be regarded as frustrated as from the date of the destruction or damage.

(Paragraphs 5.4—5.14; Clause 1(6)(a)).

7. Where heritable property, which is the subject of a contract of sale, is damaged, but not substantially, through no fault of either contracting party, while the risk of such damage lies with the seller, the legal consequences of such damage will be as follows:–

(i) The seller will be under an obligation to convey the property to the purchaser in the same condition as it was in when the contract was concluded (fair wear and tear excepted).

(ii) If the seller fails to perform his obligation under (i) above he will be deemed to be in breach of contract, and the purchaser will be entitled to exercise any of the common law remedies available to him for such a breach.

(iii) In the event of the purchaser electing to claim damages against the seller, the measure of such damages will be the reasonable cost of repair of the property.

(Paragraphs 5.16—5.19; Clause 1(6)(b) and (8)).

8. Damage to property should be regarded as "substantial" if as a result of it the property is no longer capable of being used

(a) for any purpose which might reasonably be supposed to have been in the contemplation of the purchaser and seller at the time when they entered into the contract; or

(b) for any purpose expressly made known by the purchaser to the seller at that time.

(Paragraphs 5.21—5.27; Clause 1(7)).

9. There should be no prohibition against contracting out of the proposed new rules on the passing of risk under contracts for the sale of heritable property and the legal consequences arising therefrom.

(Paragraphs 6.1—6.4; Clause 2).

Appendix A

CONTRACTS FOR SALE OF HERITABLE PROPERTY (SCOTLAND) BILL

ARRANGEMENT OF CLAUSES

Clause

1. Position of contracting parties if property destroyed or damaged without their fault.
2. Contracting out.
3. Transitional provision.
4. Short title, commencement and extent.

DRAFT

OF A

BILL

TO

A.D. 1990.

Amend the law of Scotland relating to the legal position of the parties to a contract for the sale of heritable property in the event of the property being destroyed or damaged without their fault.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

Position of contracting parties if property destroyed or damaged without their fault.

1.—(1) In a contract for the sale of heritable property, the risk of destruction of, or damage to, the property (in either case through no fault on the part of the purchaser or seller) shall pass to the purchaser on the relevant date; and any rule of law whereby such risk passes to the purchaser before the relevant date is hereby abolished.

(2) Subject to subsections (3) to (5) below, in this section "the relevant date" means in the case of—

(*a*) a sale with vacant possession of the property to a person not already in actual possession of it, the date on which the purchaser becomes entitled to take possession of it (whether or not he takes actual possession of it); or

(*b*) a sale—

(i) with vacant possession of the property to a person already in actual possession of it; or

(ii) without vacant possession of the property;

the date of entry for the purchaser agreed under the contract.

(3) For the purposes of subsection (2)(a) above, if the purchaser takes occupation of the property without the consent of the seller, the relevant date means the date on which he commences so to occupy it.

(4) Without prejudice to subsection (3) above, for the purposes of subsection (2)(a) or (b) above, if there is no agreement as to the date on which the purchaser is to become entitled to take possession of the property or (as the case may be) as to the date of entry, the relevant date means the date of settlement under the contract.

(5) If the purchaser becomes the owner of the property before the date when, but for this subsection, risk would pass to him under this section, the relevant date means the date on which the purchaser becomes the owner thereof.

Clause 1

General

This Clause implements Recommendations 1, 2, 3, 4, 5, 6, 7 and 8. It introduces a new statutory rule—as to when the risk of damage to, or destruction of, heritable property will pass from the seller to the purchaser under a contract of sale where the damage or destruction has occurred through no fault of either party; abolishes any existing rule of law on the passing of risk which conflicts with this rule; and provides for the introduction of further rules which regulate the rights and liabilities of the purchaser and seller in the event of the property being destroyed or damaged before such risk passes to the purchaser.

The new rule on the passing of risk applies in relation to all kinds of heritable property, such as unbuilt upon land, dwellinghouses, offices, factories etc.

The rule is concerned with damage or destruction caused accidentally or through the fault of a third party, who might be "a man of straw" and against whom a claim for damages might be impracticable.

Subsection (1)

This subsection introduces the new rule on the passing of risk and provides that such risk will pass to the purchaser under a contract for the sale of heritable property on "the relevant date" as defined by subsections (2)–(5). It abolishes any existing rule of law whereby risk passes to the purchaser before "the relevant date".

Subsections (2)–(5)

Subsection (2) places contracts for the sale of heritable property into three categories. The first, and most common category, covers the sale to a purchaser who is not already in occupation of the property, but who intends to take occupation. The second category concerns the sale to a person who is already in occupation of the property, such as a tenant, a licensee, invitee, or a wife by virtue of her occupancy rights under the Matrimonial Homes (Family Protection) (Scotland) Act 1981. The third category involves the sale of property where the purchaser is not entitled to occupation, such as the sale by a landlord to a third party subject to the rights of the occupying tenant.

Subsections (2)–(5) define "the relevant date"—the date upon which risk passes to the purchaser—in respect of each of the three categories of sale.

Paragraph (a) of subsection (2) and subsection (3)

These provisions implement Recommendation 1.

Paragraphs (b)(i) and (ii) of subsection (2)

These provisions implement Recommmendation 2.

Subsection (4)

This subsection implements Recommendation 3.

Subsection (5)

This subsection implements Recommendation 4. It is an avoidance of doubt provision which is incorporated to ensure that the risk of damage or destruction will pass, if it has not already done so under our earlier recommendations, when the purchaser becomes owner of the property.

(6) Where after the date when a contract for the sale of heritable property is concluded and before the relevant date the property (through no fault on the part of the purchaser or seller)—

(*a*) is destroyed or substantially damaged, the contract shall be regarded as frustrated as from the date of the destruction or damage;

(*b*) is damaged, but not substantially damaged, the seller shall be under an obligation to convey the property to the purchaser in the same condition as it was in when the contract was concluded (fair wear and tear excepted).

(7) For the purposes of subsection (6) above, damage to property shall be regarded as substantial if, as a result of it, the property is no longer capable of being used—

(*a*) for any purpose which might reasonably be supposed to have been in the contemplation of the purchaser and seller at the time when they entered into the contract; or

(*b*) for any purpose expressly made known by the purchaser to the seller at that time.

(8) If the seller fails to comply with the obligation imposed on him by subsection (6)(b) above, he shall be deemed to be in breach of contract; and, where the purchaser claims damages for the deemed breach, the measure of damages will be the reasonable cost of repair of the property.

(9) For the purposes of subsection (6) above and section 3 of this Act, the fact that the obligation to proceed with the contract is subject to a suspensive condition shall not prevent the contract from being regarded as concluded.

Contracting out.

2. The provisions of section 1 of this Act are without prejudice to any agreement between the purchaser and the seller which is inconsistent with any of those provisions.

Transitional provision.

3. This Act shall not apply to any contract which has been concluded before the commencement of this Act.

Short title, commencement and extent.

4.—(1) This Act may be cited as the Contracts for Sale of Heritable Property (Scotland) Act 1990.

(2) This Act shall come into force on the expiry of the period of 2 months beginning with the date on which it is passed.

(3) This Act extends to Scotland only.

Subsections (6), (7), (8) and (9)

General

These subsections introduce two further new rules in relation to a contract for the sale of heritable property. These rules regulate the rights and liabilities of the purchaser and the seller in the event of the property being destroyed or damaged, through no fault of either party, after the contract is concluded but before risk passes to the purchaser on "the relevant date" (as above defined). The first rule is concerned with the situation where the property is totally destroyed or substantially damaged. The second rule applies where the property is destroyed, but not substantially.

Subsection (6)(a)

Paragraph (a) of subsection (6) introduces the first new rule and implements Recommendation 6.

Subsections (6)(b) and (8)

Paragraph (b) of subsection (6) and subsection (8) introduce the second new rule and implement Recommendation 7.

Subsection (7)

This subsection defines what is meant by 'substantial' damage within the context of the two new rules and implements Recommendation 8.

Subsection (9)

This is an avoidance of doubt provision introduced so as to clarify what is meant by "the conclusion of a contract" within the context of Clauses 1(6) and 3. It provides in effect that where a contract for the sale of heritable property is subject to one or more suspensive conditions the contract will be regarded as concluded, not when the suspensive conditions have been purified, but when the offer to purchase or sell, as the case may be, which is made subject to such conditions, is accepted by the other party. For example, an offer to purchase may be submitted subject to the purchaser obtaining planning permission and building warrant for carrying out certain alterations to the property. The contract is concluded when the offer is accepted, not at the later date when planning permission and building warrant are granted.

Clause 2

This Clause implements Recommendation 9.

Clause 3

This Clause provides that the provisions of the Bill will not apply to contracts for the sale of heritable property which have been concluded before the date of the coming into force of legislation introduced to implement the recommendations in the Report.

Appendix B

List of those who submitted comments on the Discussion Paper

Association of British Insurers
British Insurance and Investment Brokers' Association
Derek J Buchanan, Solicitor
Building Societies Association
Carruthers & Co, Solicitors, Shetland
Convention of Scottish Local Authorities
Kenneth Donnelly
Faculty of Advocates
Faculty of Law, University of Aberdeen
Professor W M Gordon, University of Glasgow
Highlands and Islands Development Board
Ewan G Kennedy, Solicitor, Glasgow
Allen Kerr WS, Edinburgh
Law Society of Scotland
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Professor Emeritus A J McDonald WS, Dundee
Scottish Consumer Council
Scottish Homes
Scottish Law Agents Society
Scottish Landowners' Federation
Snell & Co WS, Edinburgh

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