Scottish Law Commission

DISCUSSION PAPER NO. 81

Passing of Risk in Contracts for the Sale of Land

MARCH 1989

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The Commission would be grateful if comments on this Discussion Paper were submitted by 12 May 1989. All correspondence should be addressed to:-

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NOTES

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SCOTTISH LAW COMMISSION

DISCUSSION PAPER NO 81

PASSING OF RISK IN CONTRACTS FOR THE SALE OF LAND

PART I

INTRODUCTION

Purpose of discussion paper

1.1 In this discussion paper we examine the law regulating the passing of risk under contracts for the sale of land. It has come to our attention that the present rule, whereby the risk of damage to or destruction of land passes from the seller to the purchaser once there is a binding contract for sale, is unsatisfactory in many respects. The purpose of this discussion paper is to seek comments on possible reform of that rule.

Scope of discussion paper

1.2 We use the terms "land" and "property" rather than "heritable property" or "heritage" for convenience in this discussion paper. No difference in meaning is intended. The comments and provisional proposals which follow apply equally to contracts for the sale of a building or buildings as they do to contracts for the sale of vacant sites.

Arrangement of discussion paper

1.3 In Part II of this discussion paper we outline the present law in relation to the passing of risk under contracts for the sale of land. Part III contains criticisms of the present law and practice. We discuss in Part IV the options for reform and set out our provisional proposals. Finally, Part V contains a summary of the proposals and questions on which we invite comment.

PART II

PASSING OF RISK - THE PRESENT LAW

2.1 Under the present law, the risk of damage to or destruction of land passes from the seller to the purchaser once the contract for sale is "perfect" - on conclusion of missives which are not subject to any suspensive condition such as the granting of planning permission or the transfer of a licence.[1] In cases such as these, the contract will fall if the planning permission or transfer of licence, as the case may be, is not granted. In most cases, there is an interval of time between conclusion of missives and the purchaser's date of entry. The property being sold could be destroyed or damaged in many ways during this period (as it could be at any time) - fire, storm, burst pipes, vandalism. The effect of the present law is that, subject to certain exceptions[2], the purchaser bears the loss of such damage or destruction as soon as there is a binding contract for sale, even though the property will not really be "his" for some time. In cases where the common law rule applies, it is essential therefore that the purchaser takes out adequate insurance cover for the property - otherwise he could face severe financial hardship. He has to go ahead with the purchase, paying the price agreed in the contract in full. He is not entitled to any reduction in the price to take account of the damage sustained.[3] It is generally thought that, because the risk has been allocated, the doctrine of frustration of contract on the ground of destruction of the subject-matter cannot be founded upon by the purchaser in order to bring the contract to an end and release him from his obligations under it.[4]

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[1] Sloans Dairies Ltd v Glasgow Corporation 1976 SLT 147; 1977 SC 223; 1979 SLT 17.

[2] See para 2.2 below.

[3] Sloans Dairies Ltd v Glasgow Corporation supra; Bell's Princs, 10th edn s 87; Erskine Inst III, iii, 7.

[4] Stephen Woolman: An Introduction to the Scots Law of Contract 169.

2.2 In certain cases, the risk does not pass to the purchaser on conclusion of a binding contract for sale; the loss resulting from damage or destruction which occurs before the date of entry has to be borne by the seller. This is the case, first, where the contract so provides;[1] and, secondly, where the damage or destruction is attributable to the seller's fault. The onus is on the purchaser, however, to establish fault on the part of the seller by showing that he failed to take reasonable care of the property, and that the damage or destruction was attributable to that fault.[2] A third situation in which it appears that the seller must bear the loss is where the damage or destruction occurs at a time when he has wrongfully prevented the purchaser from taking entry.[3]

2.3 The legal basis of the common law rule as to the passing of risk was fully set out in the judgments delivered on appeal in the case of Sloans Dairies Ltd v Glasgow Corporation:[4]

> "the concluded contract of sale gives to the buyer the legal right to the specific article on tendering the price ... if the seller has not been at fault or in mora, he is merely a debtor for the property."[5]

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[1] The type of clause generally adopted in practice at present is mentioned at para 3.7 below.

[2] Meehan v Silver 1972 SLT (Sh Ct) 70; Bell's Princs, 10th edn s 232; Erskine Inst, III, iii, 7.

[3] Erskine Inst, III, iii, 7, treats this as an example of fault on the part of the seller and says that the seller is not liable if the reason for the delay is the purchaser's failure to pay the price. The institutional writers deal with this point in relation to the common law rules relating to sale of goods. There is no case directly in point, but there are dicta of interest in Meehan v Silver, supra.

[4] 1979 SLT 17.

[5] Lord Dunpark at 22.

The underlying principle appears to be that once there is a binding contract for the sale of land, the purchaser has a right to insist on completion of the sale. Because he is entitled to any benefit arising from any increase in the value of the land in the interim, he ought also to run the risk of the land's deterioration. The passing of risk therefore has nothing to do with a right of possession, but has to do rather with the acquisition by the purchaser of an unconditional right to become owner at some future date, on payment of the price. In the words of Lord Dunpark, the purchaser's right is to

> "acquire the subject-matter of the sale as it exists at the due date, with all accretions and improvements on the one hand, and deteriorations on the other.[1]

The seller's duty at common law is merely to take reasonable care of the subjects of sale until the purchaser takes them over.[2] Hence the exception to the common law rule based on the seller's fault.[3]

2.4 The rule on the passing of risk in contracts for the sale of land contrasts with the rule for the sale of goods where, unless otherwise agreed, the risk remains with the seller until the purchaser becomes owner. Section 21 of the Sale of Goods Act 1979 provides -

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[1] Sloans Dairies Ltd v Glasgow Corporation 1977 SC 223 at 241; 1979 SLT 17 at 24.

[2] Erskine Inst, III, iii, 7; Meehan v Silver 1972 SLT (Sh Ct) 70; Sloans Dairies Ltd v Glasgow Corporation 1976 SLT 147; 1977 SC 223; 1979 SLT 17.

[3] See para 2.2 above.

"Risk prima facie passes with property

20.-(1) Unless otherwise agreed, the goods remain at the seller's risk until the property in them is transferred to the buyer, but when the property in them is transferred to the buyer the goods are at the buyer's risk whether delivery has been made or not.

(2) But where delivery has been delayed through the fault of either buyer or seller the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

(3) Nothing in this section affects the duties or liabilities of either seller or buyer as a bailee or custodier of the goods of the other party."

PART III

CRITICISMS OF THE PRESENT LAW AND PRACTICE

3.1 **General.** The ordinary person is unlikely to be aware of the common law rule as to the passing of risk. When considering purchasing a property, he is unlikely to give much thought to the matter of who is to bear the consequences of damage to the property which might occur before he acquires title to it. If he does, he is likely to be surprised to learn what the law is. It would seem perfectly reasonable for the layman to expect the position to be the opposite. He is not yet the owner of the property. He does not even possess it and he has no control over it. He has no physical means of protecting it until he enters into possession. In our view, it is unsatisfactory that the law as to the passing of risk in the sale of land does not accord with the reasonable expectations of the ordinary person. It seems reasonable for such a person to expect that the seller should not simply be obliged to sell him a particular property, but rather a property in a particular condition. It is also unsatisfactory that, because the law is as it is, no mention of the position need be made in the contract. A purchaser who has no legal advice therefore can fall into a trap. Without insurance, he can face severe financial loss.

3.2 **The purchaser who is not legally represented.** We are aware that in practice a number of prospective purchasers attempt to deal with the contract stage themselves, so as to avoid the need to consult a solicitor and incur legal expense if they are unsuccessful in purchasing a property. One such situation which has been drawn to our attention is where a body issued an offer of sale of a property to an individual [B]. The body intended the risk of damage or destruction to pass to B, in accordance with the common law, at conclusion of missives. The offer was silent

therefore about the passing of risk. There was nothing in it to alert B to the position. Although in a covering letter the body stressed that B should consult a solicitor on the terms of the offer, B decided not to do so and wrote out and signed an acceptance which he sent to the body. In such a situation, the purchaser has no warning of the risk he bears. Because of that, he is unlikely to take out insurance for the property, believing that to be necessary only once he pays the price and is entitled to take entry. Even if he then goes to a solicitor who advises him of the position, he has for a period borne the risk of severe financial loss.

3.3 **The purchaser who is legally represented.** Even where purchasers consult a solicitor at the contract stage, they are often not fully protected. Failure by a solicitor to advise a purchaser of his risk, and of the need for adequate insurance cover, would constitute professional negligence, rendering the solicitor liable in damages. Professional negligence cases take time to be resolved, however, and in the meantime an uninsured purchaser can bear a heavy loss. In practice, many solicitors have block insurance policy arrangements with insurance companies and arrange cover for their clients under such schemes. It seems, however, that some properties may only be insured for the price to be paid for them, rather than for their reinstatement value. A further question is the adequacy of the extent of the cover provided. Is the cover for "all risks" and what types of damage are excluded?

3.4 **Acceptance effective when posted.** Under the present law, missives for the sale of a property are concluded when an unconditional acceptance is posted.[1] There is always a period, therefore, when a purchaser is at risk without insurance cover.

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[1] Gloag on Contract (2nd edn) 33.

The period between posting and receipt of an acceptance is usually short, but there is a risk, albeit a small one, that a property might be destroyed by fire during that period. Similarly, where land is sold at auction, the successful bidder signs what is the equivalent of an acceptance of the terms of the articles of roup at the time.[1] He is unlikely to have arranged insurance cover in advance, because he does not know whether or not his bid will be successful.

3.5 **Double insurance.** While some sellers agree to contract out of the common law rule and accept a provision in the missives to the effect that the risk of damage or destruction will remain with them until the purchaser's date of entry, many do not. The seller is often in a stronger bargaining position - particularly in a buoyant market where closing dates for receipt of offers are common. In cases where the parties do not contract out of the common law rule, it is essential that the purchaser be adequately insured from the date of conclusion of missives. Otherwise he runs the risk of severe financial loss. The result of the common law rule prevailing is "double insurance". While "double insurance" is not technically the correct term, as the seller and the purchaser are each insuring a different interest in the property, two policies are in existence, with two premiums being paid for the one property. It is extremely unlikely that the seller will cancel his own insurance. He is usually obliged, either by the terms of his standard security or his title, to keep it in force until settlement of the sale. In any event, he should keep up his existing policy, as the sale might not go ahead for some reason. The purchaser might be sequestrated, for example, in which case the property would have to be marketed all over again. In the

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[1] Halliday, Conveyancing Law and Practice Vol II 79-80.

event of the property being damaged or destroyed, only one insurance company will have to pay out. Accordingly, the other company gets the premiums for nothing. Since the seller in many cases has to keep up his own insurance until settlement, and in all cases should do so, it seems unnecessary that the buyer should also have to insure.

3.6 **Not enough to give purchaser benefit of seller's policy.** Many insurance policies nowadays contain a provision to the effect that, if the seller contracts to sell the property insured, the purchaser will have the benefit of the policy between conclusion of missives and his becoming entitled to take entry. A typical clause is as follows -

> "If at the time of destruction or damage to any building hereby insured the Insured shall have contracted to sell his interest in such building and the purchase shall not have been but shall be thereafter completed, the purchaser on the completion of the purchase, if and so far as the property is not otherwise insured by or on behalf of the purchaser against such destruction or damage, shall be entitled to the benefit of this Policy so far as it relates to such destruction or damage without prejudice to the rights and liabilities of the Insured or the Insurer under this Policy up to the date of completion".[1]

This arrangement, however, will not necessarily give the purchaser adequate protection. The purchaser's right can be only as effective as the seller's cover, which the purchaser has no foolproof way of checking. The seller may be under-insured or have inadequate cover - surprisingly common, particularly where the property concerned is not subject to any heritable security.

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[1] Form of wording recommended by the Association of British Insurers for inclusion in insurance policies. This form may not automatically be included in all buildings insurance policies available from insurance companies.

The seller may have been responsible for a material non-disclosure or misrepresentation to the insurance company, thereby enabling the company to deny liability. An imprudent purchaser might place undue reliance on a flawed policy. A prudent purchaser should still take out his own insurance.

3.7 **Not enough simply to allow contracting out of the common law rule.** The seller and purchaser can contract out of the common law rule and agree that the risk of damage or destruction will not pass to the purchaser on conclusion of missives. A typical clause adopted in practice is as follows -

> "The subjects including the whole garden ground will be maintained in their present condition, fair wear and tear excepted, and will remain at the seller's risk until the said date of entry. In the event of the subjects, or any part thereof, being substantially damaged or destroyed by fire or other cause prior to the said date of entry the purchaser will be entitled to resile from the bargain without any claim or penalty being due to or by either side."[1]

A purchaser who is not legally advised, however, may not appreciate the need to contract out.

3.8 **Conclusion.** In the absence of insurance, no solution can protect all parties. Someone must bear the loss resulting from physical damage to property which is the subject of a contract of sale. In our view, there are sounder reasons for protecting the purchaser, particularly where he is uninsured. The common law rule as to passing of risk in contracts for the sale of land puts the buyer in a risky, and often an unfair, position. We think it is unsatisfactory that the law does not accord with the reasonable expectations of the ordinary person. We therefore **propose** -

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[1] J H Sinclair, Handbook of Conveyancing Practice in Scotland (1986) 210.

1. **The present rule of the common law, whereby the risk of damage to or destruction of land passes to the purchaser on conclusion of a binding contract for sale, should be altered.**

In the next part of the paper, we go on to consider various options for reform.

PART IV
OPTIONS FOR REFORM

4.1 **Insurance based approach.** Some jurisdictions, rather than generally altering the rule as to the passing of risk, have preferred to give the purchaser a statutory right to the benefit of the seller's insurance cover.[1] While the risk of damage or destruction continues to pass to the purchaser on conclusion of missives, he has a right to the insurance proceeds payable to the seller, the intention being that he need not take out his own policy. At the time the damage or destruction occurs, however, the risk has already passed to the purchaser, and so no money is strictly "payable" to the seller. The purchaser therefore is entitled to nothing. An insurance contract is a contract of indemnity. The insured is entitled to be paid insurance money only for the loss he sustains. Since the seller is entitled to receive the full contract price from the purchaser, he suffers no loss. If the seller has already been paid the purchase price, nothing will be payable under his insurance policy. This was what happened in an Australian case,[2] and the result would be likely to be the same here. So too, if the seller has not yet been paid the price, the insurance company, if it pays up under the policy, is subrogated to the seller's rights. It can demand payment of the full contract price from the purchaser.

4.2 In many cases, insurance policies contain a clause specifically dealing with this point, ensuring that the purchaser will be entitled to claim under the seller's policy.[3] The purchaser's right

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[1] eg Queensland - Property Law Act 1974 s 63 (right to rescind in s 64 is confined to dwelling-houses); Victoria - Sale of Land (Amendment) Act 1982, s 35 (right to rescind in s 34 is confined again to dwelling-houses); Northern Territory - Real Property (Insurance Money Application) Ordinance 1975 s 4;

[2] Ziel Nominees Pty Ltd v VACC Insurance Company Ltd (1975) 7 ALR 667.

[3] See para 3.6 above for a recommended form of wording.

to do so has been put on a statutory basis in Victoria, s 35(2) of the Sale of Land (Amendment) Act 1982 providing that it shall be no defence or answer to any claim by or against the insurer that the seller has suffered either no loss or a diminished loss by reason of the fact that he is entitled to be paid the price or balance of the price by the purchaser.

4.3 Even where the purchaser is entitled to claim under the seller's policy, however, he may still face problems. The seller may have acted in a way which enables the insurance company to avoid liability. He may have made a material misrepresentation or non-disclosure to the company, eg by not notifying the company that the house insured was left unoccupied for longer than the period permitted under the policy. The Victoria legislation again protects the purchaser in such circumstances by providing that the insurer cannot deny liability to him because of a fault on the part of the seller which would bar the latter from claiming under the policy.[1]

4.4 This is still not sufficient, however, to protect the purchaser, whose right can be only as effective as the seller's cover. He can claim only what is payable to the seller. The seller may not be insured at the relevant time. His policy may have lapsed through non-payment of premiums. Even where he is insured, his cover may not be adequate.[2] A clause in the policy entitling the purchaser to claim under the seller's policy is of no help in such circumstances. Nor, in our view, would it be right to provide by statute that insurance companies must pay out for the full loss sustained in such circumstances. In any event, it could be difficult for the purchaser to ascertain what, if any, insurance

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[1] s 35(9).

[2] See para 3.6 above.

cover the seller has and the adequacy of that cover. This would be time-consuming and might delay missives being concluded. Double insurance would be unlikely to be avoided, as a prudent purchaser would still take out his own cover. In our view, reform based on giving a purchaser a statutory right to claim under a seller's insurance policy would be unsatisfactory and, in many cases, of little help to a purchaser. We therefore reject such an approach. The real issue is who should bear the risk of damage to or destruction of land occurring between conclusion of missives and the purchaser's date of entry. We are firmly of the view that any reform should deal directly with this issue.

4.5 **Risk to remain with the seller.** We discussed above how, in general, a seller has to continue with his own insurance until the sale settles.[1] If a seller is already uninsured, it is this failure to insure, rather than his entering into a contract for sale, which causes his loss. The same applies where he is insured, but not adequately. The real problem is his failure to take out adequate cover. The seller is in a position to protect the property from damage so long as he has possession of it. The purchaser has no such control. A major defect of the present law is that the risk of damage or destruction can be transferred to the purchaser without his knowledge.[2] If the law were changed so that the risk remained with the seller, express provision in the missives would be needed to alter that rule. The purchaser would be alerted. In our view, a change in the law would remove a serious potential hardship for the purchaser, without significantly prejudicing the seller. The seller could claim on his insurance in respect of the loss he suffered. An incidental benefit of a change in the law to the effect that the risk would remain with the seller would be a reduction in conveyancing costs by significantly reducing double insurance.

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[1] See para 3.5.

[2] See paras 3.1-3.2 above.

At what point should the risk pass?

4.6 **The purchaser takes/becomes entitled to take possession.** A major criticism of the present common law rule is that it makes the purchaser bear the risk of damage or destruction in circumstances outwith his control; he is usually neither occupying the property nor in a position to protect it. It would seem logical, therefore, that if the law were changed so that the risk of damage or destruction did not pass to the purchaser on conclusion of missives, but remained with the seller, it should nevertheless pass to the purchaser once he is in possession of the property and so is in a position to protect it. It would seem unreasonable to expect the seller to bear the risk at that stage.

4.7 In many cases, the date of entry specified in the missives, settlement of the sale and the taking of possession by the purchaser will all coincide. In some cases the purchaser may be prevented, through no fault of his own, from taking possession at the date of entry originally agreed. The seller may still have to resolve a defect in his title. The date of entry may be expressly or impliedly postponed by agreement. In such a case, it would not seem right to make the purchaser bear the risk until he takes possession, or at least becomes entitled to take possession. In other cases, the purchaser, either with or without the seller's agreement, may take possession at a date which is earlier than either the contractual date of entry originally agreed or the date of settlement. It is true that, in such cases, the sale may still not go ahead for some reason - for example there may be a major defect in the seller's title. It is also true that the seller is likely to, and should, continue his own insurance until the sale does settle. It would seem illogical, however, to expect the seller

to bear liability for damage or destruction to property once the buyer is in possession. In our view, it would also be unfair.

4.8 In many cases, the buyer will become entitled to take possession on a particular date but may decide not to take actual possession for some time. Entitlement to take possession will coincide with the contractual date of entry, whether that is the original date of entry stipulated in the missives or a different date expressly or impliedly agreed by the parties. In some cases, entitlement to take possession will coincide with settlement of the sale. In others, it may arise at an earlier date. The parties may have agreed, for example, that the purchaser is to be entitled to take possession on conclusion of missives. The sale will settle at a later date once the conveyancing is completed. In all of such cases, it may be that the purchaser will decide in fact not to take possession for some time, but that would be his decision. In such circumstances, the risk of damage or destruction should pass as soon as the purchaser is entitled to take possession. He should not be able to delay the passing of risk by delaying taking actual possession. We therefore **propose** -

2. **It should be provided by statute that the risk of damage to or destruction of land which is the subject of a contract for sale should remain with the seller until the purchaser takes possession, or is entitled to take possession, whichever is the earlier.**

4.9 We do not think that legislation should define what constitutes possession. This would be a question of fact in each case. In most cases, there should be no problem, eg a mere right of access for taking measurements would not constitute possession.

In cases where the property is occupied by a tenant, "possession" means civil possession or entitlement to the rents. In a sale to a sitting tenant, it would be irrelevant that he in fact already occupied the property. Risk would pass only once he took, or became entitled to take, possession as owner in terms of the missives of sale. Where the sale was of the landlord's interest in a tenanted property, the new landlord would become entitled to take possession in the sense that he would become entitled to be paid the rent. This could be made clear without the need for a rigid rule.

Alternative dates for the passing of risk

4.10 **The date of settlement of the sale.** In general, a sale settles by the purchaser paying the price in return for a validly executed conveyance, the prior title deeds, the keys and a letter of obligation to deliver a clear search. We considered whether the date of settlement in itself should have any relevance in relation to the passing of risk. As we have already said, the date of settlement may coincide with the purchaser taking possession or becoming entitled to take possession of the property. In such cases, it is the taking of possession or entitlement to take possession that is and should be relevant. The date of settlement is the latest date at which entitlement to take possession will arise. If such entitlement arises at an earlier date, the risk should pass then. So too if actual possession is taken before settlement. Accordingly, we see no point in referring to the date of settlement in any statutory provision governing the passing of risk. Such reference would serve no purpose and might be confusing.

4.11 **The date of transfer of legal title.** We do not think that the date of recording of the conveyance in favour of the purchaser in the Sasine Register, or the date of application to have his interest registered in the Land Register should have any relevance in relation to the passing of risk. There is often in practice a time delay between settlement of a sale and recording or registration. The timing of recording or registration is really in the hands of the solicitors and not the parties themselves. In the case of the Sasine Register, we think that arguments would arise as to whether the effective date was the date of presentment, or the date of recording, of the conveyance. There could be quite a time gap between the two, particularly if the conveyance or accompanying forms required to be amended.[1] It is also quite common for sales to settle and purchasers to take possession on an obligation to deliver a validly executed conveyance within a specified time. In such circumstances, there is an even longer time gap between settlement and transfer of legal title. In our view, just as settlement in itself is not the relevant fact, so too transfer of legal title is not relevant for the purposes of passing of risk. It is unlikely to coincide with the purchaser taking possession or becoming entitled to take possession. If it does coincide, it is the fact of possession which is relevant.

4.12 **The date when the price is paid.** The price is often paid at settlement of the sale so that the purchaser becomes entitled to

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[1] This problem would not arise in relation to the Land Register. Provided the deed which induces registration and the application for registration are both validly signed, return of either for adjustment does not alter the date of registration. That remains the date of the application for registration.

take possession of the property. Similarly it may be paid at an earlier date to enable the purchaser to take possession, or because it is discovered that he has already taken possession. Again therefore, we see no convincing role for payment of the price in relation to the passing of risk.

4.13 **Is there a need to spell out the legal consequences of the proposed new rule?** It has to be considered whether the problems which arise under the present law would be dealt with adequately by the change we have proposed in relation to the rule on the passing of risk. Is it enough to provide that the risk of damage or destruction will remain with the seller, or should legislation go further and also provide for what the legal consequences of the proposed new rule should be? The answer to this question would seem to depend on how clear the general law would be as to where the parties would stand in the event of the property being damaged or destroyed while at the seller's risk.

4.14 It could be argued that, as a matter of general law, for a seller to be able to insist on payment of the purchase price, he would have to be able to implement his side of the bargain, namely by conveying the property in the condition it was in before it was damaged.[1] On that basis, the purchaser would be entitled to insist on the seller repairing or reinstating the property, or paying damages in respect of the damage it suffered. In our view, in many cases, that would be unfair on the seller and unduly favourable to the purchaser. The damage might be substantial, in which case reinstatement would be likely to be a major task. The seller might not be adequately insured. As a matter of policy, we think that where property is destroyed or substantially damaged, both the seller and the purchaser should be

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[1] There is no clear authority on this point, but arguably such a conclusion can be drawn from the case of Hoey v Butler 1975 SC 87.

released from the contract. The purchaser could then go and find another property. The seller would still be left with a substantially damaged property, but would be able to assess repairs without being under pressure from the purchaser.[1] We think that result would achieve a fairer balance between the interests of the parties. It is, of course, the result that would be achieved if the contract could be regarded as frustrated.

4.15 Under Scots law, leases of property have been held to be frustrated on the ground that the property has been destroyed.[2] It has been accepted for some time in Canada that a contract for the sale of land can be frustrated by destruction of the subject matter of the contract.[3] There is strong argument, however, that under Scots law frustration of contract cannot operate in circumstances where the risk of damage or destruction has been allocated to one of the parties.[4] If that argument is sound, however attractive and fair a result it might seem in the case of destruction or substantial damage, as a matter of law frustration of contract could not operate alongside a rule (statutory or otherwise) allocating the risk of damage or destruction to a party. Further, if legislation were simply to set out the proposed new rule on the passing of risk without more, it could be argued that, regardless of the extent of damage, the parties would be tied to the contract. The purchaser would be able to insist on the seller either restoring the property or paying him damages. As we have said, we think that this would be an unsatisfactory result where the damage was substantial.

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[1] We discuss at paras 4.24 and 4.25 below what additional rights the parties should have where either is at fault.

[2] Cantors Properties (Scotland) Ltd v Swears and Wells Ltd 1978 SC 310.

[3] Cahan v Fraser [1951] 4 DLR 112; see also Capital Quality Homes Ltd v Colwyn Construction Ltd (1975) 61 DLR (3d) 385 (constructive destruction).

[4] Stephen Woolman: An Introduction to the Scots Law of Contract 169. It is of interest to note that frustration was not pleaded in the case of Sloans Dairies Ltd v Glasgow Corporation 1976 SLT 147; 1977 SC 223; 1979 SLT 17.

4.16 If the desired legal consequences of the proposed new rule on the passing of risk could be spelled out in a short, attractive way, then such spelling out might be useful. It would assist the parties in determining where they stood in the event of the property being damaged or destroyed while the risk remained with the seller. It would reduce the scope for uncertainty and dispute. An additional benefit would be that it might help to reduce the number of provisions which otherwise would be included in contracts for the sale of land. If matters were left to be governed by the general law, we think it would be likely that clauses would continue to be inserted in missives with a view to regulating the position of the parties in the event of the property being destroyed or damaged. It may be that it would be more helpful for sellers, purchasers and their agents if there were clear legislative provision on this matter. Accordingly, we invite views on the following question -

3. **Should legislation provide for the respective rights of the seller and purchaser in the event of property which is the subject of a contract for sale between them being destroyed or damaged while the risk remains with the seller?**

4.17 **How best to provide for the respective rights of the parties.** As we have said, as a matter of policy, we think that where property is destroyed or substantially damaged, both the seller and the purchaser should be released from the contract. In effect, the contract should be regarded as frustrated. We think that this could be achieved by simple and clear legislative provision which would be understandable to the layman. Using the doctrine of

frustration of contract would also be a direct approach which would avoid the use of artificial concepts. Frustration would result in the contract being dissolved automatically at the date when the destruction or substantial damage occurred.[1] Termination of the contract would not depend, therefore, on the choice or election of either party. Nor would it depend on the knowledge of either party as to the event which caused frustration. Frustration depends on what actually has happened and the effect of that on the possibility of performing the contract.[2] As we have said, strictly speaking, for frustration to operate, neither the law nor the parties themselves should have allocated the risk of the event, which should be unforeseen, but it has been held that -

> "Although the words of the stipulation may be such that the mere letter would describe what has occurred, the occurrence itself may yet be of a character and extent so sweeping that the foundation of what the parties are deemed to have had in contemplation has disappeared, and the contract itself has vanished with the foundation."[3]

4.18 In addition, neither party should have been at fault in relation to the event which caused frustration.[4] We do not think, however, that any of the foregoing rules of law need prevent the adoption of an approach under which a contract would be regarded as frustrated in the event of the property covered by it being destroyed or substantially damaged. In our view, it would seem logical to extend the doctrine of frustration of contract to this area. The essential basis of the doctrine is that there has been

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[1] Gloag on Contract (2nd edn) 345; Fraser & Co v Denny, Mott and Dickson, Ltd 1944 SC (HL) 35.

[2] Bell's Princs, 10th edn s 29.

[3] Tamplin SS Co Ltd v Anglo-Mexican Petroleum Products Co Ltd [1916] 1AC 397 per Lord Haldane at 406.

[4] Bell's Princs, 10th edn s 29; we discuss at paras 4.24 and 4.25 below the question of the seller or purchaser being at fault.

an alteration in circumstances material to the contract which would render performance of it impossible, or so different from what the parties as reasonable men originally contemplated that, if rendered, it would amount in substance to the fulfilment of a different contract.[1] One of the principal grounds of frustration of contract is destruction of the subject matter - rei interitus. Leases have been held to have been frustrated, and so terminated, by destruction of the property leased.[2] Considerable inconvenience as a result of damage has not been enough to found a plea of frustration - the property must be destroyed or materially damaged.[3] As we have said, we think that a contract for the sale of land should be regarded as frustrated where the property concerned is either destroyed or substantially damaged. We discuss later what we mean by "substantial" damage.[4]

4.19 The law on frustration of contract is well developed and the consequences clear. 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.[5] 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

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[1] Gloag on Contract (2nd edn) 343. See also National Carriers Ltd v Panalpina (Northern) Ltd [1981] AC 675.

[2] Cantors Properties (Scotland) Ltd v Swears & Wells Ltd 1978 SC 310.

[3] Allan v Markland (1882) 10 R 383; Duff v Fleming (1870) 8 M 769.

[4] At para 4.23 below we suggest that property should be regarded as substantially damaged if it is damaged to such an extent that it is rendered materially different from that which the purchaser contracted to buy.

[5] Cantiere San Rocco v Clyde Shipbuilding Co 1923 SC (HL) 105.

contract is under any obligation to give the other notice that he holds the contract at an end.[1] On this approach, therefore, there would be no question of the buyer having to elect to end the contract so as to avoid being tied to it. Both the seller and purchaser would know where they stood - it would be a matter of fact. There would be nothing to stop the parties renegotiating and entering into a new contract to go ahead with the purchase at a reduced price. The seller would not be able to insist, however, on the purchaser paying the full price originally agreed. Nor would the purchaser be able to insist on the seller reinstating a destroyed or substantially damaged property.

4.20 It is for consideration whether, under a "frustration of contract" approach, the contract should still be terminated where the seller or the purchaser had caused the destruction or damage by his fault. We think it should be. As we discuss later, we propose that this would be without prejudice to any claim for damages that either party might have against the other.[2]

4.21 All of this would be achieved without the need for lengthy detailed statutory provision. There would be a simple provision that, in the event of destruction or substantial damage, the contract would be treated as frustrated. The legal consequences of frustration would then apply. Express provision would be made to deal with the case where the property was damaged, but not substantially. In such a case, frustration would not operate. Both parties would be bound by the contract, but the purchaser would be entitled to have the property restored by the seller to the condition it was in before it was damaged. The seller would be

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[1] Bank Line Co v Capel [1919] AC 435.
[2] Paras 4.24 and 4.25 below.

able to claim against his insurance company for the cost of repair if, as would normally be the case, he was insured against the risk in question. If the seller failed to restore the property, the purchaser would have to go through with the purchase, but would have a claim for damages against the seller in respect of this failure. In practice, the purchaser would probably retain a portion of the price to cover any such eventual claim for damages. There would be nothing to stop the parties agreeing instead to go ahead with the transaction at a reduced price, if that was what they preferred to do. This should, however, be a matter of choice for the parties. Statute should not intervene to impose on them what would in effect be a different contract.

4.22 A question would arise as to what the measure of damages would be where the seller failed to restore the damaged property. Should it be the difference in market value of the property as at the date of entry which had been agreed by the parties, or should it be the reasonable cost of repair? We are dealing here with damage which is not substantial. In many cases the damage might result in no, or at most only a slight, reduction in the market value of the property, yet it will cost money to put it right. One example would be storm damage to windows. We think the measure of damages should be the reasonable cost of repair. That would be fairer to the purchaser, without unduly prejudicing the seller. We think that this should be provided for expressly in any proposed new legislation so as to avoid doubt and possibly unjust decisions. Accordingly we **propose** -

4. If consultees would prefer the proposed new statutory rule on the passing of risk to be accompanied by a statement of the legal consequences which would flow from it, then legislation should provide as follows -

(a) **In the event of property which was the subject of a contract of sale being destroyed or substantially damaged while the risk remained with the seller, the contract would be treated as frustrated. Accordingly, both parties would be released from it at the date when the destruction or substantial damage occurred.**

(b) **In the event of such property being damaged, but not substantially, while the risk remained with the seller, the contract would not be treated as frustrated. The seller would be under an obligation to repair the property to the condition it was in before the damage occurred. The purchaser would be entitled to insist on the seller performing his obligations. If the seller failed to do so, the purchaser would be entitled to claim damages from him. The measure of damages should be the reasonable cost of repair of the property as a result of the damage.**

4.23 **"Substantial" damage.** The above proposal would involve a test based on whether or not the damage was substantial. We think such a test would be workable. As we have seen, in many cases such a test is already incorporated into contracts for sale,[1] and we are not aware of it causing any problems. The question of who would determine whether property was substantially damaged or not would not be a new one. Guidance could be given in the proposed new legislation as to what would constitute substantial damage. Given that our preferred approach is based on the idea of frustration of the contract, we suggest that, for damage to be substantial, the property would have to be rendered materially different from that which the purchaser contracted to buy. If part only of the property were damaged, the purchaser's

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[1] The wording of a typical clause is set out at para 3.7 above.

rights would depend on whether or not that resulted in the property as a whole being substantially damaged. The test would be an objective one. We therefore **propose** -

> 5. **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.**

4.24 **The destruction or damage was attributable to fault on the part of the seller or purchaser.** Circumstances might arise where the seller or the purchaser caused or at least contributed to the destruction or damage. Nothing in our proposals would be intended to alter the duty a seller has at present to take reasonable care of the property until the risk passes to the purchaser. Accordingly, he would be liable if either by negligence or deliberate act he failed to do so and, as a result, the property was damaged. It should also be noted that, when a contract is frustrated, it is terminated for the future. The seller would remain liable for any breach of contract which occurred before the date of termination. In our view, it should be made clear in legislation that any new statutory provisions dealing with rules on the passing of risk and their legal consequences would be without prejudice to the purchaser's right to claim damages from the seller for negligence or breach of contract which occurred before the contract was terminated. That would apply equally to negligence or breach of contract which caused or contributed to the event which led to the contract being terminated. In some circumstances, damages might include the difference in the price

of an equivalent house between the date of the contract and the date of the destruction or damage. They might also include the purchaser's conveyancing and other costs reasonably incurred pursuant to the contract. The seller would also, of course, remain liable for such negligence or breach of contract in cases where the damage to the property was not substantial and so the contract was not terminated. In those circumstances, damages might inlcude costs reasonably and necessarily incurred by the purchaser while the property was being restored by the seller.

4.25 It could equally be the case that the damage or destruction was caused by the negligence or deliberate act of the purchaser. While gaining access for measuring purposes, for example, he might cause a fire by dropping a lit cigarette. It would be unfair to take no account of the purchaser's fault. So too, there might have been an earlier breach of contract by the purchaser. Accordingly, we think it should also be made clear in legislation that the proposed new rules on the passing of risk and their legal consequences should be without prejudice to the seller's right to claim damages from the purchaser for negligence or breach of contract occurring before the contract was terminated. That would apply equally to negligence or breach of contract which caused or contributed to the event which led to the contract being terminated. Again, the purchaser would also remain liable for his negligence or breach of contract in cases where the damage was not substantial and so the contract was not terminated. Accordingly, we **propose** -

> **6. It should be made clear in legislation that any new statutory provisions dealing with rules as to the passing of risk under contracts for the sale of land**

and the legal consequences of such rules would be without prejudice

(i) to the purchaser's right to claim damages from the seller, and

(ii) to the seller's right to claim damages from the purchaser

for negligence or breach of contract which occurred before the contract was terminated. That would apply also to negligence or breach of contract which caused or contributed to the damage or destruction which led to the contract being terminated. The seller and purchaser would also remain liable for their negligence or breach of contract in cases where the property was damaged, but not substantially, and so the contract was not terminated.

4.26 **No retrospectivity.** We do not think that the proposed new rules should be retrospective. It would be contrary to principle to alter the legal effects of contracts entered into on the basis of the present law. We therefore **propose** -

7. Nothing in the above proposals should affect contracts entered into before any implementing legislation comes into force.

4.27 **Scope of reform.** We have noted that some jurisdictions have confined their recommendations and legislation to the effect

that risk should not pass to the purchaser on conclusion of missives to dwelling-houses.[1] Some might argue that the legally unrepresented purchaser, who is the person most at risk under the present law, would be more likely to purchase a house than other property, and that purchasers of commercial property are more knowledgeable. We do not think, however, that this is necessarily the case. We think it would be unsatisfactory to have different rules for different types of heritable property. Accordingly we **propose** -

> **8. There should be no exceptions for particular types of heritable property from the scope of the above proposals.**

4.28 **Contracting out.** It has to be considered whether the parties should be able, by an express term of a contract, to contract out of the proposed new rules as to the passing of risk, eg by reallocating the risk of damage to the purchaser, or modifying his rights in the event of damage occurring while risk remained with the seller. In general, the approach under Scots law is to permit contracting out of statutory rules unless there are strong reasons for prohibiting it. Again, some jurisdictions have a different rule on contracting out for dwelling-houses than for other types of heritable property. In the case of houses, some expressly prohibit contracting out of the rule that risk is to remain with the seller.[2] The justification seems to be that a purchaser of a house is in more need of protection, particularly where the seller is a large body, eg, a firm of builders. We do not think it wise, however, to have different rules on contracting out for different types of property. While an individual purchasing

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[1] Victoria - Sale of Land (Amendment) Act 1982; Queensland - The Property Law Act 1974.

[2] New South Wales - Conveyancing (Passing of Risk) Amendment Act 1986.

a house from a large body might be in a weak position, it is not necessarily the case that this would be so with all purchasers of houses. An inequality in bargaining positions could arise in relation to the purchase of all types of property.

4.29 A major mischief of the present law is that the risk of damage to or destruction of property can pass to the purchaser without his being aware of that fact. Nothing needs to be said in the missives for the common law rule to apply. If the law were changed so that the risk of damage or destruction remained with the seller, then express provision in the missives would be necessary to alter that rule. The purchaser would be alerted. We think this would be adequate protection for a purchaser. Accordingly, we **propose** -

> 9. **There should be no prohibition against contracting out of the proposed new rules as to the passing of risk under contracts for the sale of land.**

4.30 **Moveables included in the contract.** In many contracts for the sale of land, moveable items are included in the contract price, eg carpets, plant. A question might arise as to whether or not money already paid for such items should be recoverable by the purchaser on frustration. Similarly, should the part of the full purchase price which arguably relates to such moveables, if not already paid, be due to be paid by the purchaser despite frustration? We do not think that any legislative provision would be necessary on this point. Situations such as these arise already in cases of frustration. A contract has to be looked at as a whole to see if it is severable so that some parts survive.

4.31 **Approaches rejected.** We considered other ways of spelling out what the respective rights of the parties should be in the event of property being destroyed or substantially damaged while at the seller's risk.[1] One approach would treat the seller as being in breach of contract if he failed to convey the property to the purchaser in the same condition as it was in at the date of conclusion of missives. Another approach would give the purchaser the right to terminate the contract in certain circumstances, but without treating the seller as being in breach of contract. We have rejected both approaches as unsatisfactory. They seem to us to be both artificial and unavoidably complicated. For the information of consultees we outline here what each approach would involve, and why we have rejected it.

4.32 **Treat the seller as being in breach of contract.** This approach would put the seller under a general obligation to convey the property to the purchaser in the physical condition it was in at the date of conclusion of missives, fair wear and tear excepted. Failure to do so would constitute breach of contract by the seller. It would be up to the purchaser therefore as to what would happen next - it would not simply be a matter of fact. In the event of the property being substantially damaged, the breach of contract would be material, and the purchaser would have the right to terminate the contract. In general, however, on material breach of contract, the party not in breach would be entitled also to claim damages. To be consistent with the general law, a purchaser who chose to terminate the contract in the event of

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[1] There is not the same range of choices in relation to non-substantial damage. In all cases, the contract would go ahead, but the seller would be liable for repair or reinstatement.

destruction or substantial damage should also have a right to claim damages for incidental expenses and outlays and consequential loss, such as the increase in price of an equivalent property, and rent for alternative accommodation in the interim. If the property were damaged, but not substantially, the breach would not be material. The purchaser would not be able to terminate the contract, but would have the right to claim damages to cover the cost of repairs and any consequential loss, such as the rent of temporary alternative accommodation if the damaged property could not be occupied until repaired.

4.33 We think that it would be artificial and unsatisfactory to imply terms into a contract and then use the law on breach of contract to regulate a situation where performance of the contract in accordance with those terms has become impossible through no fault of either party.[1] That is not the approach taken in the law of contract generally. Nor is it the approach taken in relation to the sale of goods. The Sale of Goods Act 1979 provides in section 7 that

> "Where there is an agreement to sell specific goods and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is avoided."

4.34 Using the law on breach of contract seems inappropriate in this situation. It would give the purchaser all the options, even although neither party was at fault. That seems unfair. It is in particular difficult to see why, in the absence of fault, a seller who was left with destroyed or substantially damaged property should have to pay any damages at all to a purchaser who chose to terminate the contract. The purchaser should no doubt be

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[1] Remedies for fault should be a separate issue - see paras 4.24 and 4.25 above.

entitled to such a claim where the destruction or damage was attributable to the seller's fault, but, as we have said, that is a different matter. Moreover, this approach could lead to considerable uncertainty if the purchaser delayed exercising his options. The seller would be in breach of contract, and unless the missives expressly provided otherwise, the purchaser would have the upper hand. The seller would not know whether or not the contract was at an end. On the other hand, however, the approach would be complicated if restrictions were to be placed by the law on the purchaser's freedom to keep his options open indefinitely. Yet it would seem only right that some time limit should be placed on the purchaser's right to choose to terminate the contract. Otherwise that right would last forever, subject only to the common law of personal bar. We are strongly of the view that an approach based on breach of contract would be unsatisfactory. Using the doctrine of frustration of contract seems more logical, and would result in a simpler, less complicated and more direct approach, promoting certainty.

4.35 **Give the purchaser the right to rescind.** The other approach which we considered and have rejected would give the purchaser a statutory right to rescind the contract in the event of the property being destroyed or substantially damaged, but no right to claim damages for incidental or consequential losses.[1] The contract would come to an end at the date of rescission. The purchaser would be entitled to recover any sums, eg a deposit, already paid under it. Both parties would be relieved of all liability under the contract for the future, but would still be liable for any breach of contract which occurred before the purchaser rescinded. This approach would have some advantages

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[1] This approach has been adopted in New South Wales - the Conveyancing (Passing of Risk) Amendment Act 1986.

over a "full" breach of contract approach. It would be more direct. It would also be fairer to the seller while still giving adequate protection to the purchaser. The seller would not be faced with having to keep a destroyed or substantially damaged property and also having to compensate the purchaser for consequential losses.[1] Nevertheless, this approach would be open to some of the same criticisms as a "full" breach of contract approach. It would give the purchaser all the options even where neither party was at fault. In particular, he could opt not to rescind, but rather to insist on the seller reinstating the property and performing the contract, even in a case where a building had been reduced to rubble. That could be very hard on the seller in certain circumstances. Fairly complex and detailed provisions would be required to achieve a different result. In any event, this approach would also require quite detailed statutory provisions to enable the policy to be achieved fully, and to avoid uncertainty.

4.36 Giving the purchaser a statutory right of rescission for destruction or substantial damage would not be enough in itself. The seller would not be in a position to perform his obligations under the contract. He could not therefore insist on the purchaser exercising his option by the contractual date of entry or within a certain period after it. Unless the missives expressly imposed such a deadline, the purchaser could take his time deciding what to do. Legislation would therefore have to impose some time limit in relation to the exercise of the purchaser's right to rescind. It would have to be relatively short. It would not be fair on the seller if the purchaser were given a long-term right: the seller would have to be able to know where he stood. The purchaser would have to be given enough time, however, to enable him to make a considered decision.

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[1] See para 4.32 above.

4.37 As under a "full" breach of contract approach, again the seller might claim that the purchaser, despite intimating his intention to rescind within the required time limit, was barred by his actings from rescinding. The certainty of the proposed new rules could be reduced considerably if the common law of personal bar were to apply. It would not seem right, however, to ignore actings by the purchaser which would otherwise constitute personal bar. A degree of uncertainty would be unavoidable under any approach which would give the purchaser an option to terminate a contract.

4.38. In our view, an approach based on giving one party a right to rescind in a situation where the property is destroyed or substantially damaged, even though neither party might be at fault, is fundamentally unsound and would require quite detailed regulation to make it work. Accordingly, we have rejected it.

PART V

SUMMARY OF PROVISIONAL PROPOSALS AND QUESTIONS FOR CONSIDERATION

Note. Attention is drawn to the notice at the front of the discussion paper concerning confidentiality of comments. If no request for confidentiality is made, we shall assume that comments submitted in response to this discussion paper may be referred to or attributed in our subsequent report.

1. The present rule of the common law, whereby the risk of damage to or destruction of land passes to the purchaser on conclusion of a binding contract for sale, should be altered. (Paras 3.1 to 3.8)

2. It should be provided by statute that the risk of damage to or destruction of land which is the subject of a contract for sale should remain with the seller until the purchaser takes possession, or is entitled to take possession, whichever is the earlier.

   (Paras 4.5 to 4.8)

3. Should legislation provide for the respective rights of the seller and purchaser in the event of property which is the subject of a contract for sale between them being destroyed or damaged while the risk remains with the seller?

   (Paras 4.13 to 4.16)

4. If consultees would prefer the proposed new statutory rule on the passing of risk to be accompanied by a statement of the legal consequences which would flow from it, then legislation should provide as follows -

(a) In the event of property which was the subject of a contract of sale being destroyed or substantially damaged while the risk remained with the seller, the contract would be treated as frustrated. Accordingly, both parties would be released from it at the date when the destruction or substantial damage occurred.

(b) In the event of such property being damaged, but not substantially, while the risk remained with the seller, the contract would not be treated as frustrated. The seller would be under an obligation to repair the property to the condition it was in before the damage occurred. The purchaser would be entitled to insist on the seller performing his obligations. If the seller failed to do so, the purchaser would be entitled to claim damages from him. The measure of damages should be the reasonable cost of repair of the property as a result of the damage.

(Paras 4.17 to 4.22)

5. 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.

(Para 4.23)

6. It should be made clear in legislation that any new statutory provisions dealing with rules as to the passing of risk under contracts for the sale of land and the legal consequences of such rules would be without prejudice

(i) to the purchaser's right to claim damages from the seller, and

(ii) to the seller's right to claim damages from the purchaser

for negligence or breach of contract which occurred before the contract was terminated. That would apply also to negligence or breach of contract which caused or contributed to the damage or destruction which led to the contract being terminated. The seller and purchaser would also remain liable for their negligence or breach of contract in cases where the property was damaged, but not substantially, and so the contract was not terminated.

(Paras 4.24 and 4.25)

7. Nothing in the above proposals should affect contracts entered into before any implementing legislation comes into force.

(Paras 4.26)

8. There should be no exceptions for particular types of heritable property from the scope of the above proposals.

(Para 4.27)

9. There should be no prohibition against contracting out of the proposed new rules as to the passing of risk under contracts for the sale of land.

(Paras 4.28 and 4.29)

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