PASSING OF RISK IN THE SALE OF GOODS ORDINANCE NO 11 OF 1896 IN SRI LANKA; AN ANTIQUATED THEORY: A COMPARATIVE STUDY

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Applicable Law in Sri Lanka

Sale of Goods law in Sri Lanka is governed by Sale of Goods Ordinance No 11 of 1896. The risk of accidental loss of the goods sold passes prima facie when the property passes as per section 21(1) of the Sale of Goods Ordinance No 11 of 1896 in Sri Lanka. Section 21(1) – "Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer the goods are at the buyer's risk, whether delivery has been made or not".

This is an antiquated rule found in the Sale of Goods Ordinance No 11 of 1896 derived from its predecessor the UK Sale of Goods Act of 1893. More modern texts, such as the Uniform Commercial Code, the Uniform Laws on International Sales and the Vienna Convention on Contracts for the International Sale of Goods, provided that, as a rule, the risk shall pass on delivery of the goods.

Sri Lankan and foreign sales law

The first issue which has to be examined when a dispute arises between the parties about the delivery of the goods, the passing of the property or the risk, is whether the dispute is to be considered under Sri Lankan law or the foreign law prevailing in the country of the buyer or some other law chosen by the parties.

The adoption and implementation of the UN Convention on Contracts for the International Sale of Goods (CISG) can be resolved these problems much easier, and bring about greater certainty into the law. The answer which the rules on the conflict of laws may provide is that the issue is decide by Sri Lankan law, in which case provisions of the Sale of goods Ordinance will apply[1].

If, however, the contract is governed by foreign law, the SriLankan courts may still have jurisdiction to hear the case. The only inference which has to be drawn from the application of foreign law to a particular contract is that the rules of the relevant foreign law displace the provisions of the Sale of Goods Ordinance, and that foreign law can be relied upon in the Sri Lankan courts if its rules can be proved by expert witnesses or in another admissible manner.

In *Blue Diamond* case[2], about sale of diamonds to a foreign buyer and as to the place where contract was made and cause of action arose, Sri Lankan Supreme Court held that the District court of Colombo had jurisdiction to determine the case. If the Sri Lankan exporter has avoided the application of foreign law by the means of including in his contract an express stipulation that the contract shall be governed, in all respects, by Sri Lankan law, the Sale of Goods Ordinance would then apply to the sale contract.

Sri Lankan court decision on *Usman v Rahim*[3]

Sri Lankan Court of appeal in *Usman v Rahim* case held that "section 58(2) of the Sale of Goods Ordinance No 11 of 1896, applies only to the English law in force at the time the section was enacted, and not to any subsequent change in the English law". This rule still valid in Sri Lanka.

Passing of property and the importance of time of passing of property

It is important to know the precise moment of time at which the property in the goods passes from the seller to the buyer, because-

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[1] *Blue Diamonds Ltd v. Amsterdam Bank*, 2 Sri Lankan Law Reports 249.
[2] *Id.*
[3] 32 NLR (New Law Reports), 259.

(1) As a general rule, as provided in section 21 of the Sale of Goods Ordinance, the party entitled to property in the goods has to bear the risk of destruction of the goods by fire or other accidental cause; and
(2) In case of the bankruptcy of either seller or buyer, it is necessary to know whether the goods belong to the trustee of the bankrupt or not.

In the law of international trade, contrary to the presumption contained in section 21(1) of the Sale of Goods Ordinance, the two concepts of the passing of the risk and the transfer of property are regularly separated and the statutory presumption may be displaced by agreement of parties. Special arrangements may be agreed between themselves. In the absence of such arrangements the risk will generally pass in a contract for the sale of goods abroad when the goods leave the custody of the seller. In an Ex Works contract the risk normally passes when the goods are delivered to the buyer or his agent. In FAS contracts it passes when the goods are placed alongside the ship and in FOB and CIF contracts normally when they are delivered over the ship's rail.

If the contract provides for Delivered Duty Paid (DDU) of the buyer, the intention of the parties as regards the passing of the risk can often be gathered from the terms of payment and the insurance arrangement[4]. If the price is prepaid and the buyer is responsible for insurance, there is hardly a doubt that the goods travel at his risk. The result would be reversed if the price was collected on delivery and the seller had to cover the insurance risk. In container delivery terms the risk passes normally when the goods are delivered into the custody of the carrier[5].

The risk, unlike the property, may pass to the buyer although the goods are unascertained goods that have not been appropriated, but traditionally only if some "special facts" could be

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[4] Saleem Marsoof PC, *Introduction to International Sale of Goods*, 33,(2006).
[5] *Id.*

established. Such facts included situations where the buyer accepted the delivery order of the seller which instructs a warehouse man, for example, in *Sterns Ltd V Vickers Ltd*[6] court held that to deliver a certain quantity from a bulk held at the warehouse, particularly if the buyer by the acceptance of the order undertakes the appropriate charges in respect of the goods comprised in the order.

Passing of risk according to the Civil and Commercial Code in Thailand

According to section 458 of the Civil and Commercial Code of Thailand (Hereinafter referred to in this thesis as "CCC") ownership of the property is transferred to the buyer from the moment when the contract of sale is entered into. If a contract of sale is subject to a condition or a time clause then the ownership is transferred after the said condition is fulfilled or the said time has arrived. Section 458 of the CCC sets the rule that ownership passes to the buyer at the time of sale.

Section 460 states that, in case of unascertained property, the ownership is not transferred until the property has been numbered, counted, weighed, measured or selected or its identity has been otherwise rendered certain.

The rule as to "risk" is not laid down in the sale part of the CCC but is specified as a general rule, applicable to all contracts, in section 370 and 371 of the code. Under section 370, in a reciprocal contract intended to transfer any real right, right in rem, in specific property, if the property is lost or damaged without fault of the debtor, such loss or damage is borne by the creditor.

The application of section 370, in the context of a contract of sale, leads to a legal consequence that the buyer has to bear, immediately at the time the contract is entered into, the loss of or damage to the goods sold. In other words, risk pass to the buyer at the time of sale. But, if the goods are not yet ascertained and the property

[6] [1923] 1 KB 78.

is not yet “specific property” accordingly, the risk of loss or damage does not yet fall on the creditor, under section 371 of the CCC.

Passing of risk under Sale of Goods Act 1979 in UK

According to section 20(1) of the Sale of Goods Act 1979, the risk passes at the time agreed upon by the parties., unless the parties have a contrary intention, the risk passes with title.

Common ownership rule

Section 20A, under the caption of “undivided shares in goods forming part of a bulk’, applicable to contracts for the sale of a specified quantity of unascertained goods if the conditions in 20 A (1) are met. Those conditions are:

(a) The goods or some of them form part of a bulk which is identified either in the contract or by subsequent agreement between the parties; and

(b) The buyer has paid the price for some or all of the goods which are the subject of the contract and which form part of the bulk.

Section 20A further states that in subsection (2), “where this section applies, then (unless the parties agreed otherwise) as soon as the conditions specified in paragraphs (a) and (b) of subsection (1) above are met or at such later time as the parties may agree-

(a) Property in an undivided share in the bulk is transferred to the buyer, and

(b) The buyer becomes an owner in common of the bulk.

Section 20A(3) states that “the undivided share of a buyer in a bulk at any time shall be such share as the quantity of goods paid for and due to the buyer out of the bulk bears to the quantity of goods in the bulk at that time”. If a buyer has paid the price for only some of the goods due to him out of a bulk, any delivery to the buyer out of the bulk shall be ascribed in the first place to the goods in respect of which payment has been made. This section further explains that ‘a payment of part of the price for any goods shall be treated as payment for a corresponding part of the goods'.

UK legislators added another subsection to section 20 recently under the caption, 'Deemed consent by co-owner to dealings in bulk goods'. Section 20 (B) (1) says that,

A person who has become an owner in common of a bulk by virtue of section 20A shall be deemed to have consented to-

(a) Any delivery of goods out of the bulk to any other owner in common of the bulk, being goods which are due to him under his contract;

(b) Any dealing with or removal, delivery or disposal of goods in the bulk by any other person who is an owner in common of the bulk in so far as the goods fall within that co-owner's undivided share in the bulk at the time of the dealing, removal, delivery or disposal

Passing of risk-chapter IV of CISG

The Convention's provisions on the passing of risk will apply only when the parties had not made any previous express or implied arrangement on the issue, since the CISG forms positive law, which means that the parties can exclude the application of its provisions completely or vary the effect of specific articles[7].

The Vienna Convention regulates the passing of risk from the seller to the buyer in Chapter IV of Part III, in articles 66-70 CISG. Those articles deal with the allocation of "price risk" and give answers to the following questions;

i) is the buyer in a case of accidental loss or damage of the goods still obliged to pay for their price notwithstanding their loss or damage?
ii) And does the seller still have the right to claim payment of the price?

[7] CISG article 6.

‘Loss or Damage’ to the goods after the risk has passed to the buyer- Article 66

The consequence of passing of risk according to the first sentence of article 66, is that the buyer will still be obliged to pay the price of the goods, which have been accidentally lost or damaged, as if he had received goods conforming to the contract of sale. The factors leading to that choice are various: the buyer will be the one who will receive the goods at the end of the day and he will be in a better position to check them and handle their possible loss or damage.

The meaning of risk in Chapter IV encompasses any loss or damage to the goods due to any incident for which neither of the parties is responsible. Since the loss was accidental, the buyer cannot accuse the seller for non-performance and deny fulfilling his obligations. Article 66 CISG clearly states that the buyer is obliged to pay for the price of the goods after the risk has passed to him.

Nevertheless, the last phrase of article 66 introduces an exception to the previous rule of the first sentence of article 66. Thus, if the loss or damage is caused by an act or omission of the seller, then the seller will be the party that will bear the risk and the buyer will not be obliged to pay the price.

Risk when contract involves carriage- Article 67

The passing of risk in sales involving carriage of goods is regulated in the Convention in a separate article, in article 67, and since sales involving carriage of the goods is the most common situation in international sale contracts, article 67 forms the basic provision for the passing of risk under the Convention. Paragraph one of article 67 establishes two rules:

a) If the seller and buyer did not agree for the goods to be handed over at a particular place, then the risk passes to the buyer when the goods are handed over to the first carrier in accordance with the contract of sale.

b) If the parties agreed on the handing over of the goods to the carrier in a particular place, the risk passes when the goods are handed over to the carrier at that particular place.

This rule is very practical and efficient, since the splitting of transit risk is avoided and the buyer bears the risk during the whole transport in land and water. Generally the splitting of transit risk is undesirable, as it presents serious problems of proof. Hence, it is not easy to prove when the damage occurred -- if it happened before or after the point of passing of risk to the buyer -- especially when it was caused by a non obvious event (overheating, seawater damaging the cargo), which is normally revealed at the end of the journey[8].

The first sentence of article 67(1) eliminates that possibility by charging the buyer with the burden of bearing the transit risk. On one hand, that is fair, since the goods are not under the seller's control anymore and he should not bear the risk of goods that are no longer in his hands. But on the other hand, the goods are not under the physical control of the buyer either -- they are under the control of the carrier[9].

The rule in the second sentence of article 67(1) does not present any special difficulties. It applies in situations where the parties have agreed on the handing over of the goods in a specific place[10]. In these situations the risk will not pass when the goods are handed over to the first carrier, but when they are handed over to the carrier in the agreed place, and if the place is generally described, the seller will have the right to specify it.

The third sentence of article 67(1) stresses that even if the seller has retained any documents, with which he is able to control the disposition of the goods, this does not prevent the risk from passing. This phrase is an indicative declaration that the Convention does not connect the passing of risk with ownership. "The purpose of

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8 Zoi Valioti, "*Passing of Risk in International Sale Contracts*", **Nordic Journal of Commercial Law**, 14, (2002).

9 *Id.*

10 *Id.*

the third sentence of Article 67(1) is to ensure that the rules as to risk in the first two sentences are not subverted by the common practice of sellers of retaining the shipping documents as a form of security for the payment of the price. It guards against misunderstanding which might arise, particularly in the minds of those accustomed to legal systems in which risk and property are linked"[11].

The second paragraph of article 67 clearly requires that the goods should be "clearly identified to the contract" for the risk to pass to the buyer. By this prerequisite there is an attempt to protect the unsuspicious buyer from the seller's false claims in a partial loss or damage, that the lost or damaged goods were those that the buyer bought [12]. This provision especially refers to bulk goods and collective consignments, like wheat or oil and generally to liquid cargos. It is necessary, therefore, that the goods are identified and this happens, according to the article's wording, when the seller puts markings on the goods, when the goods are expressly indicated in the shipping documents, when the seller gives notice to the buyer, or in any other way, since the enumeration in article 67(2) is not exhaustive[13].

Sale of goods during transit -Article 68

The Convention has a separate article on the passing of risk of goods that are sold during transit. Goods afloat are a quite special category that needs a separate regulation, since they are several times exposed to unusual circumstances, like perils of the sea, risks of war, piratery and more. This is frequently the case where the seller has bought in advance large cargos of oil, wheat, natural gas, and metals and generally goods that are carried in bulk and starts the journey

[11] S. Bollee, *'The Theory Risks in the 1980 Vienna Sale of Goods Convention"* , 256, available at http://cisgw3.law.pace.edu/cisg/biblio/bolle.html, (last accessed April.30, 2016).
[12] *Id.*
[13] Zoi Valioti, *supra* note 8.

towards a destination without having previously sold the goods and without knowing the recipients[14].

The contracts of sale will then be concluded while the goods are in transit and in most cases the goods will be sold several times until their final destination. The CISG deals with this situation in article 68, which provides that the risk passes to the buyer from the moment that the contract is concluded [15] and only in special circumstances does the risk pass retroactively from the moment of handing over of the goods to the carrier who issued the documents embodying the contract of carriage.[16]

The third sentence of article 68 "introduces a proviso"[17]; it provides that when the seller knew or was supposed to know at the moment when the contract was concluded, that the goods had suffered damage or loss and did not inform the buyer, then he bears the risk of the loss or damage.

General residual rules on risk-Article 69

Article 69 is called the ‘residual rule’ on the passing of the risk in the CISG. Contracts of international sale of goods that do not fall within the scope of article 67, involving carriage, and article 68, sale of goods in transit, will be governed by article 69:

(1) In cases not within articles 67 and 68, the risk passes to the buyer when he takes over the goods, or if he does not do so in due time, from when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery.

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[14] K.Pantelidou, "*Issues from the allocation of risk under the Vienna Convention for the International Sale of Goods*" 97, **Private Law Chronicle,** (2002).

[15] Article 68 first sentence.

[16] Artcle 68 second sentence-exception.

[17] B.Nicholas in C.M.Bianca and M.J.Bonell (eds), *Commentary on the International Sales Law. The 1980 Vienna Sales Convention* (Milan: Giuffrè, 1987) art 68, para 2.3.

(2) However, if the buyer is bound to take over the goods at a place other than a place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place.

Risk when the seller is in breach- Article 70

Article 70 of the Vienna Convention handles the relationship between the rules on passing of the risk and the rules concerning breach of contract by the seller. It answers the question whether the risk can be transferred back from the buyer to the seller when that seller is in breach of the contract.

Passing of risk according to the Incoterms 2010-

The meaning of risk under INCOTERMS 2010 is the same as in the Vienna Convention and covers any physical loss or damage to the goods that is "accidental" and for which neither of the parties is responsible, i.e. caused by "acts of God" or acts or omissions of third parties.

The transfer of risk in Incoterms is linked to the delivery obligation of the seller. The main rule expressed in Incoterms is that the seller bears all risks of loss of or damage to the goods until they have been delivered in accordance with the Incoterm, and that the buyer bears all risks of loss of or damage to the goods from the time they have been delivered as envisaged in the Incoterm.

Concept of Risk

The concept of risk and which will be the party who bears it, is an issue of extreme importance, which preoccupies both parties in a contract of sale. The reason of its importance is its peculiar nature, which might lead to certain harsh and unfair effects and result in the buyer being obliged to pay the price for the goods, even if they have been lost or damaged by a cause irrelevant to the party's act or omission. Therefore, because of its nature and especially because of its consequences, normally the parties will make specific arrangements in their contract regulating the passing of risk, or make express or implied agreements on the application of standard trade terms. In the most rare case of no previous arrangement, then national laws or international conventions regulating the matter will apply[18].

Time and consequence of passing of risk

It is true that the goods might suffer loss or damage in various points in time from the formation of the contract of sale till the actual handing over to the buyer, since these two actions might either coincide and take place at the same time, or a long period of time might elapse between them .During that time there is always the possibility that the goods might suffer loss or damage due to a sudden and unexpected accidental event, for which neither the seller nor the buyer share any responsibility. The question that is of importance in all these situations is a question of time: when did the risk pass? The answer is decisive since by answering this question it is determined which of the parties; the seller or the buyer will bear the risk and its consequences . The rules on the passing of risk, therefore, are dealing with the issue of whether the buyer will still have to pay for the price of the lost or damaged goods even if he never received them or he received them in a poor state, and whether the seller will still be entitled to receive the price for the goods.

Theories on the passing of risk

Depending on the legal structures, social circumstances and background, three main theories have developed and been adopted regarding the time of passing of risk :

The first theory links the time of the passing of risk with the time of conclusion of the contract of sale . This theory is not very practical, since most of the times, especially in international sales, at the moment when the contract is concluded the goods are still in the hands of the seller and thus, under his control. A situation where the seller has the control of the goods and the buyer has to bear the risk is hardly desirable, since the buyer will always claim that the seller did

[18] Zoi Valioti, *supra* note 8, at 2-3.

not exercise due diligence, creating serious disputes and litigation. The first theory is adopted by Switzerland, Spain, Netherlands, and CISG article 68 on sale of goods during transit.

The second theory connects the passing of risk to the passing of ownership . This theory is quite impractical as well, since the ownership is not at all connected or related to the notion of risk. Moreover, this theory does not correspond to the latest practices of sale of goods with retention of ownership, given that in these cases the seller maintains the ownership while the buyer possesses the goods. That means that the seller will have to bear the risk of goods that are under the control of the buyer; this result is undesirable as well, since it will certainly lead to litigation. The second theory is adopted by Sale of Goods Act 1979 in UK, Sri Lanka, Hong Kong, Singapore, France, Italy, India and Thailand

The third theory that has developed connects the passing of risk with the time of delivery of the goods . That means that the party, which has physical control over the goods will be the one bearing the risk. This theory seems the most fair and reasonable since the party that possesses the goods is in a better position to guard them, take the necessary precautions for their safety, or the appropriate actions to save them after the damaging event had occurred, collect the remaining goods that escaped the damage or loss, assess the damage and turn to the insurer for indemnification where and when the goods are insured . The third theory is adopted by CISG in articles 67 and 69, Germany, Greece, Sweden, USA, China, Japan and Singapore.

Analysis

Having examined the pertinent provisions and case law, we can conclude that the CISG, as a general law, would follow the approach that links the transfer of risk and the delivery of the cargo. On the other hand, the SGA 1979 connects transfer of property and transfer of risk.

In relation to the basic situation where the seller must deliver a particular cargo to the purchaser at his own location of business, the Vienna Convention 1980 follows the same method because it considers that risk will pass on delivery as soon as the purchaser takes control over the cargo. On the other hand, in English law risk passes prima facie once the contract is concluded by parties, and this is the decisive point for transferring the property. It has been suggested that the Convention is fair and useful because the seller has control over the cargo and it is easier for the seller to provide insurance for the goods as well as protecting them while they are under his control. Moreover, it is likely that the cargo can be covered by standing policies, which are held by the seller with regard to his location and their contents, while the purchaser will most likely need a particular policy in order to cover certain risks.

In respect of the sale of unascertained commodities, it appears that both the SGA 1979 and the CISG rely upon previous ascertainment by the seller. In a sale in which the dispatch of the commodities is not involved, the Vienna Convention 1980 first requires the seller to identify the commodities and after doing so, he should put them under the control of the purchaser[19], who is in default when not accepting delivery. In addition, both the SGA 1979 and the Convention use the same methods with regard to the purchaser's default in accepting the commodities delivery. In this situation, the risk under the CISG transfers to the buyer at the moment that the cargo is put at his disposal; or if the delay by him is enough to be a breach of contract. Similarly, under the SGA 1979 the purchaser is responsible for the risk if he causes the delay to the delivery and this delay contributes to the loss of the cargo, as was the case in *Demby Hamilton and Co Ltd v Barden*[20].

We have seen that the passing of risk provisions in the Sales of Goods Ordinance No 11 of 1896 in Sri Lanka are antiquated. Fundamental reason for this situation is that Sri Lankan courts are not allowed to follow SGA 1979 provisions on passing of risk by the Court of Appeal decision in *Usman v. Rahim*. Since we have not adopted CISG into our domestic legal system Sri Lanka courts have no jurisdiction to interpret risk provisions in CISG.

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[19] Article 69.3 of the Convention.
[20] *Demby Hamilton and Co Ltd v Barden*, [1949] 2 All ER 435.

Sale of Goods Ordinance No 11 of 1896 is not a complete and comprehensive piece of legislation for modern business world. It is most unfortunate and indeed inexplicable as to why the Sale of Goods Ordinance has been allowed to remain almost unchanged for nearly 120 years. This is especially so when the areas requiring radical change have been highlighted through the numerous reforms that have transformed the original English Act in to quite a different entity[21].

Recommendations

Sri Lanka should adopt CISG to rectify the present antiquted legal theory in Sale of Goods law in Sri Lanka. Sri Lankan Parliament has the power to adopt and regulate CISG into domestic legal system in Sri Lanka. This is similar to Singapore's formation of CISG into its domestic legal system.At the same time Sri Lankan Parliament could pass a legislature to overrule the decision in *Usmain v. Rahim* and allow the Sale of Goods Act 1979 in UK to be applicable in Sri Lanka as its domestic law. Finally, Sri Lankan Parliament could pass a new legislature to adopt Sale of Goods Act 1979 in UK and its subsequent amendments.

[21] Dynalex, "*The Sale of Goods Ordinance No 11 of 1896-A Long way to go?*", available at https://dynalex.wordpress.com/2012/10/25/the-sale-of-goods-ordinance-no-11-of-1896-a-long-way-to-go. (last accesed on April. 30, 2016)