THE LAW REFORM COMMISSION

AN COIMISIÚN UM ATHCHÓIRIÚ AN DLÍ

(LRC 39-1991)

REPORT

ON

LAND LAW AND CONVEYANCING LAW:

(3) THE PASSING OF RISK FROM VENDOR TO PURCHASER

IRELAND
The Law Reform Commission
Ardilaun Centre, 111 St Stephen's Green, Dublin 2

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THE LAW REFORM COMMISSION

The Law Reform Commission was established by section 3 of the *Law Reform Commission Act, 1975* on 20th October, 1975. It is an independent body consisting of a President and four other members appointed by the Government.

The Commissioners at present are:

The Hon Mr. Justice Ronan Keane, Judge of the High Court, President;
John F. Buckley, Esq., B.A., LL.B., Solicitor;
William R. Duncan, Esq., M.A., F.T.C.D., Barrister-at-Law, Associate Professor of Law, University of Dublin;
Ms. Maureen Gaffney. B.A., M.A., (Univ. of Chicago), Senior Psychologist, Eastern Health Board; Research Associate, University of Dublin;
Simon P. O'Leary, Esq., B.A., Barrister-at-Law.

The Commission's programme of law reform, prepared in consultation with the Attorney General, was approved by the Government and copies were laid before both House of the Oireachtas on 4th January, 1977. The Commission has formulated and submitted to the Taoiseach or the Attorney General thirty-eight Reports containing proposals for the reform of the law. It has also published eleven Working Papers, five Consultation Papers and Annual Reports. Details will be found on pp 28-31.

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NOTE

This Report was submitted on 20th December 1991 to the Attorney General, Mr. Harold A. Whelehan, S.C., under section 4(2)(c) of the Law Reform Commission Act, 1975. It embodies the results of an examination of and research in relation to the law relating to The Passing of Risk from Vendor to Purchaser which was carried out by the Commission at the request of the former Attorney General, Mr John Rogers, S.C., together with the proposals for reform which the Commission were requested to formulate.

While these proposals are being considered in the relevant Government Departments the Attorney General has requested the Commission to make them available to the public, in the form of this Report, at this stage so as to enable informed comments or suggestions to be made by persons or bodies with special knowledge of the subject.

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CHAPTER 1

Introduction

1. On the 6th March, 1987, the then Attorney General, in pursuance of section 4(2)(c) of the *Law Reform Commission Act, 1975*, requested the Commission to formulate proposals for the reform of the law in a number of areas. Among the topics was:

> "Conveyancing law and practice in areas where this could lead to savings for house purchasers".

2. The Commission recognised that a comprehensive review of land law and conveyancing law was not feasible within the limited resources available to them at the time, and accordingly established a Working Group which was asked to identify a number of areas in which reform of land law or conveyancing law could be brought about more easily. The Working Group was asked to concentrate on areas where it could recommend changes in the law which would remove anomalies or redundant provisions.

3. The members of the Working Group appointed were Mr John F. Buckley, Commissioner (Convener), Miss Justice Mella Carroll, Professor J.C. Brady, Mr George Brady, SC, Ms Mary Laffoy, SC, Mr Ernest B. Farrell, Mr Rory McEntee, Solicitors. Miss Justice Carroll resigned from the Working Group in November 1988 following her appointment as a judge of the Court of the International Labour Organisation.

4. The Commission has already published two reports in the areas of the land law and conveyancing law. The first contained General Proposals - LRC 30-1989, and second dealt with Enduring Powers of Attorney - LRC 31-1989.

5. Ms Mary Laffoy, SC and Mr Rory McEntee resigned from the Working Group following the publication of the first two Reports and Ms Mary Geraldine Miller and Ms Deborah Wheeler, Barristers-at-Law, and Mr Patrick Fagan and Mr Tom O'Connor, Solicitors, joined the Working Group.

The Working Group has continued to concentrate on matters which occur in a significant number of conveyancing transactions which give

rise to unreasonable delays in the completion of those transactions and it has also identified a number of aspects of statute law which are in need of reform.

6. The Commission would like to record its deep appreciation of the contribution which the members of the Working Group have made to the Commission's examination of this difficult and technical area of the law. Their knowledge and experience were invaluable in enabling the Commission to formulate practical proposals for alterations in the law. As usual, however, the Commission emphasises that it alone is responsible for the contents of this Report.

7. The position of parties in the intermediate stage in the conveyancing process between contract and completion has given rise to considerable controversy in Ireland. This controversy not only manifests itself in the area of the passing of risk between contract and completion, but also, for example, in that of the registration of judgment mortgages against the vendor's estate during this period.

8. In view of the considerable complexities in this area, together with the comparative materials which need to be referred to, the Commission decided to publish a separate Report on the area of the Passing of Risk from Vendor to Purchaser.

CHAPTER 2: THE PRESENT LAW

2.1 There is a general equitable principle that where there is a contract for the sale of land, the vendor is usually regarded as holding the property on trust for the purchaser.[1] The trust has sometimes been called a constructive trust, as it arises without any intention on the part of the parties.[2] The exact nature of the trust is, however, as yet unclear - both in this jurisdiction and in Britain.[3] The issue which causes the greatest disagreement would appear to be the question of when the beneficial interest in the land is to be regarded as passing to the purchaser and from the vendor. One view is that the vendor becomes a trustee of the legal estate and the purchaser becomes the owner of the beneficial interest as soon as the contract for sale is entered into.[4] This view is subject to the qualification that the contract must be one of which a court would grant specific performance.[5] There is, however, also authority for the opinion that the crucial fact is not the signing of the contract, but rather the payment of the purchase money by the purchaser.[6] Under the latter theory, the purchaser does not acquire the entire beneficial interest in the land until he has paid the whole of the purchase money to the vendor, and accordingly, the vendor is a trustee for him only to the extent to which he has paid part.

The Passing of Risk

2.2 The general rule is that the purchaser is entitled to any gains which accrue in relation to the property between contract and completion.[7] If for example, the value of the property increases during this period, it is the

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1 *Daire v Beversham* (1661) Nels 76; *Green v Smith* (1738) 1 Ark 572; *Lysaght v Edwards* (1876) 2 Ch D 449. See also Wellings, "*Vendor as Trustee*" (1959) 23 Conv 173.

2 Waters, "*Constructive Trust: Vendor and Purchaser*" (1961) 14 CLP 76; Wellings, *loc.cit.*; Keane, *Equity and the Law of Trusts in the Republic of Ireland*, paras 13.08-09.

3 For a civil law view of the trust see A D M Forte, "*Must a Purchaser Buy Charred Remains? An Analysis of the Passing of Risk on Civilian Principles*" (1984) Ir Jur 1.

4 *Shaw v Foster* (1872) LR 5 HL 321 at 388 (*per* Lord Cairns); *Lysaght v Edwards* (1876) 2 Ch D 449 at 506 (*per* Jessel MR); *Allen v IRC* (1914) 1 KB 327.

5 *Harnett v Yielding* (1805) 2 Sch & Lef 549; *Holroyd v Marshall* (1862) 10 HLC 191 at 209-10 (*per* Lord Westbury LC); *Howard v Miller* [1915] AC 318. See also *Williams on Title* (4th ed) ed. Battersby, at p712.

6 *Rose v Watson* (1864) 10 HLC 672 at 683-684 (*per* Lord Cranworth); *Tempany v Hynes* [1976] IR 101 at 114 (*per* Kenny J; O'Higgins CJ concurring).

7 *Vesey v Elwood* (1843) 3 Dr & War 74 (*per* Sugden LC); *Enraght v Fitzgerald* (1842) 2 Er & War 43; *Ex parte Manning* (1727) 2 P Wms 410.

purchaser who benefits. The corollary of this rule is that he also suffers the losses,[8] subject to the vendor's duty to maintain the property so long as he retains possession.[9] It is the purchaser, therefore, who bears the loss or damage caused to the property by such things as fire, flood or storm and other elements which are beyond his control.

Standard Conditions of Sale attempt to ameliorate the purchaser's position. Condition 43 of the Incorporated Law Society's General Conditions of Sale (1988 Ed.) provides that the vendor shall be liable for any loss or damage howsoever occasioned to the subject property between the date of sale and the actual completion of the sale. The condition limits the amount of such liability to the sale price. Condition 44 introduces qualifications to the general principle, namely that the liability shall not apply to inconsequential damage from reasonable wear and tear in the course of normal occupation and use or to damage occasioned by operations reasonably undertaken by the vendor in vacating the property (provided the same are undertaken with reasonable care).[10]

Condition 45 provides that nothing in Conditions 43 and 44 shall affect, *inter alia*, the purchaser's right to specific performance, the operation of the doctrine of conversion, the rights and liabilities of parties other than the vendor and the purchaser, the rights and liabilities of the purchaser on foot of any lease subsisting at the date of sale, the purchaser's right to effect, on or after the date of sale, his own insurance in respect of the property, or the purchaser's right to gains accruing to the subject property after the date of sale.[11]

While we applaud the general thrust of these provisions and the principle behind them, we realise that not all sales of land are governed by the Law Society's Contract and we would in any event question the efficacy of dealing with this problem by contractual provisions alone.

2.3 It is beyond doubt, therefore, that at common law the purchaser bears the loss or damage caused to the property from the date of the contract by such things as fire, flood, storm and tempest. Various commentators have suggested ways of getting around this doctrine[12] and a recent English decision suggests that the doctrine of frustration may apply to contracts for the sale of land, albeit in very limited circumstances.[13] Frustration is where an act occurs which is the fault of neither party to a contract and the effect of that act is to deprive one of the parties of substantially the whole benefit which it was the intention of the parties that he should derive from the contract.

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8 Eg. earthquake - *Cass v Rudele* (1693) 2 Vern 280. See also *White v Nutts* (1702) 1 P Wms 61; *Vincent v Going* (1841) 3 Dr & War 75. If the value of the land decreases during this period, it is the purchaser who suffers the loss - *Poole v Shergold* (1786) 1 Cox 273.

9 *Tempany v Hynes* [1976] IR 101; *Re Dwyer* [1901] 1 IR 165; JE Adams, "*Property Damage Between Contract and Completion*" 68 (1971) L Soc Gaz. 224. See also note at (1978) Conv 183-5 suggesting that the onus should be on the vendor to show that for example a fire was not his fault.

10 General Conditions 44(a) and 44(b).

11 General Conditions 45(a) to (f).

12 M S Thompson, "*Must a Purchaser Buy a Charred Ruin?*" (1984) Conv 43; Aldridge, "Shifting the Insurance Burden" (1979) 124 NLJ 966.

13 By analogy with a lease - *National Carriers Ltd v Panalpina (Northern) Ltd.*, [1981] AC 675 and in Scotland, *Cantors Properties (Scotland) Ltd v Swears and Wells Ltd* 1978 SC 310. The Ontario Court of Appeal has held that the doctrine does apply to contracts for the sale of land; *Cahan v Frazer* (1951) 4 DLR 112. See also *Capital Quality Homes Ltd v Colwyn Construction Ltd* (1975) DLR (3d) 385.

It would appear, however, that the principle that the purchaser bears the loss or damage still applies with undiluted force in Ireland.[14] The result of this principle is that a purchaser must take out insurance to cover the property from the date of the contract,[15] and must be advised to do so by his solicitor.[16] Even when the purchaser does take out his own policy this is not free from problems; generally a purchaser can succeed in obtaining fire cover only for the premises.[17]

2.4 It is clear that it is inadvisable to rely on the existing insurance policy of the vendor, for a number of reasons:

(a) The vendor is under no duty to keep up his insurance[18] with the result that the cover may have lapsed between contract and completion. A wise vendor would, of course, maintain his insurance lest the sale should not be completed. It is clear that as long as the vendor has not been paid he has an insurable interest.[19]

(b) Even if the vendor does keep up his insurance, the trust which arises[20] is confined to the land itself and does not extend to anything which may be substituted for it, such as the proceeds of an insurance policy.[21] In the event of damage to the property therefore, the purchaser is still bound to pay the full purchase price for the property even in its damaged state. The vendor may claim the insurance money but the purchaser may not recover the insurance money from the vendor. However, since an insurance contract is merely one of indemnity[22] and is personal to the insured[23] and as the vendor will have suffered no loss (having received the full purchase price) the insurance company can reclaim the insurance money from the vendor once he has been paid by the purchaser.[24] The company may also claim to be subrogated to the vendor on completion and recover from the purchase money.[25]

(c) Again, even if the vendor does keep up his insurance, the purchaser cannot be certain that the premises have been adequately insured by the vendor. If there has been a rapid rise in the price of houses, it may well be that a house which was reasonably adequately insured at the commencement of the premium year could be significantly under-insured at the time of the damage and there would be a danger of "average" being applied.

It appears that in most cases a purchaser takes out his own insurance cover

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14 Wylie, *Irish Conveyancing Law*, paras 11.32-11.35.
15 *Ibid*, paras 3.111 & 11.33; Aldridge "*Insurance of Buildings Under a Contract for Sale*" (1974) 124 NLJ 966; Peverett, "*Shifting the Insurance Burden: Another View*" (1975) 125 NLJ 217.
16 It has been suggested that failure to so advise may constitute negligence on the part of the solicitor - Wylie, *op cit*, para 11.35 and Scottish Law Commission Discussion Paper No 81 (1989) at para 3.3. See also *Carly v Farrelly* [1975] NZLR 356.
17 Wylie, *op cit*, at para 11.35.
18 *Paine v Meller* (1801) 6 Ves 349.
19 *Collingridge v Royal Exchange Assurance Corp.* (1877) 3 QBD 173.
20 As outlined above para 3.
21 *Raynor v Preston* (1881) 18 Ch D 1.
22 *Gaggin v Upton* (1859) Dru Temp Nap 427.
23 See generally Peverett, *loc cit.*
24 *Raynor v Preston* (1881) 18 Ch D 1; *Castellain v Preston* (1883) 11 QBD 380.
25 *Raynor v Preston (1881) 18 Ch D 1; Castellain v Preston (1883) 11 QBD 380; Collinridge v Royal Exchange* (1877) 3 QBD 173, *West of England Fire Insurance Co v Isaacs* (1896) 2 QBD 377.

from the date of the contract regardless of what existing cover the vendor has.[26] It has been pointed out above that the type of cover available is, however, extremely limited and usually extends to fire cover only.

2.5 Arranging for the vendor's policy to be endorsed in favour of the purchaser is also possible, but this causes obvious practical problems among which would be, for example, establishing the type of policy the vendor has,[27] with which company, together with the need for the consent of the company, etc. in most instances. There is also the question of the amount of premium that the purchaser would be required to pay upon such endorsement. We believe that endorsement is, in any event, rather unusual. Many insurance policies for buildings of a private dwelling house contain a clause along the following lines:

> "In the event of the insured having contracted to sell his interest in the buildings the contracting purchaser who completes the purchase shall have the benefit of the insurance .... up to the date of completion if and so far as the buildings are not otherwise insured and without prejudice to the rights and liabilities of the insured or the insurers."[28]

The Irish Insurance Federation says that a similar clause appears in some, but not all policies of insurance on commercial property. It is also clear that if the purchaser insures his interest himself (which, as has been mentioned, is usually the case) the extension of the vendor's policy will not operate to indemnify him. There is also the possibility that the vendor may allow the policy to lapse anyway, not to mention the difficulty of establishing if the policy contains such a clause at all.[29]

2.6 As regards the purchaser taking out his own insurance, this does take time: if only from the point of view of valuations. If, for example, a purchaser brought a house at an auction at 2pm (the knocking down of a bid being the acceptance for contractual purposes[30]) and the house was burnt down at 5pm before he had arranged appropriate cover, he would have to purchase the charred ruin and would receive no insurance money. We are aware that some firms of solicitors have a general policy which would cover this situation - i.e. where due to inadvertence the premises had not been insured immediately after the purchase.

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26 Communication from the Irish Insurance Federation of 23rd November 1988. See also Keane, *op cit*, paras 13.08.-09.

27 Also if it contains a clause which permits endorsement - see generally Peverett, *loc cit*, (1975) 125 NLJ 217.

28 From the correspondence referred to above fn 26. A similar clause is also typical in Scotland - see the Scottish Law Commission Discussion Paper No 81 (1989) at para 3.6.

29 See Peverett *op cit*, at p218. There is also the probability that a purchaser would be unable to sue the company on such a clause as he is not party to a contract - *Drimmie v Davies*, [1899] 1 IR 176.

30 *Tully v Irish Land Commission* (1963) 97 ILTR 94.

CHAPTER 3: THE PROBLEM/THE CASE FOR REFORM

3.1 Many commentators regard the present law as highly unsatisfactory,[31] as do several Law Reform Commissions and other Committees that have examined the area.[32] A number of areas of difficulty have been identified:

(i) As the trust created between vendor and purchaser upon the signing of the contract is an unusual one, it is difficult to derive from normal trust principles what the exact obligations of the vendor and purchaser actually are - particularly in the area of the passing of risk.[33] The existence of uncertainty is in itself a good reason why the law should be put on a statutory footing to ensure that these important matters are made clear.

(ii) It is clear that the purchaser is exposed to serious risk when he enters into a contract to buy a property. The existence of this risk may be quite unknown to an unadvised purchaser who might (reasonably) take the view that his responsibility for the property will start when he becomes the legal owner of it or at least when he gets possession of it. In our opinion it is unsatisfactory that the law as to the passing of risk does not accord with the reasonable expectations of the ordinary person.

(iii) As outlined above,[34] there may be practical difficulties for a purchaser

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31 D I Cassidy, "*The Insurance of Land and Buildings the Subject of a Contract of Sale*", (1971) 45 ALJ 30; Trevor M Aldridge, *loc cit*; J E Adams and T M Aldridge, "*Insurance of Domestic Property between Contract and Completion*", (1980) 77 L S Gaz 376; Gordon Walker, "*Insurance and the Sale of Land*", [1981] Aust Bus L Rev 148; Thompson, *op cit*, at pp50-52. See also Conveyancer's Notebook (1978) Conv 183. Cf Peverett, *op cit*, at p217.

32 Survey of Land Law of Northern Ireland (1971) p60; New South Wales Law Reform Commission, Passing of Risk Between Vendor and Purchaser of Land, LRC 40 (1984); The Tasmania Law Reform Commission Report No 36 (1984), para 2.14 and New Zealand Contract and Commercial Law Reform Committee; Aspects of Insurance Law; The Second Report of the Conveyancing Committee (UK) (1985) para 7.14; The Law Commission (UK) Working Paper No 119, Transfer of Land - Passing of Risk from Vendor to Purchaser (1988); The Scottish Law Commission, Discussion Paper No 81 (1989): Passing of Risk in Contracts for the Sale of Land.

33 See generally the discussion in the Law Commission's Working Paper No 109 paras 1.7-1.70.

34 At paras 5 and 6 above.

in ensuring that the property is insured from the date of the contract. The likelihood in the case of an auction, for example, is that insurance will not have been arranged prior to the auction (it being difficult to predict in advance who the successful bidder will be) and the purchaser is therefore at risk until insurance is arranged.[35]

(iv) The vendor's position on the other hand is far safer. Because he is the legal owner of the property, he will almost inevitably have insured the property and is unlikely to have cancelled his policy simply because he has entered into a contract to sell the house. Under the present law we have an ironic situation whereby the vendor is in a much safer position after he signs the contract if for some reason he has neglected to insure the property, or if it is under-insured, as the risk passes to the purchaser.

(v) Under the present law, it is important that the purchaser takes out insurance from the date of the signing of the contract. This will be irrespective of any policy that the vendor may already have.[36] In the majority of cases, therefore, the two parties are insuring for the same perils for the period of time between contract and completion.[37] This appears to us to be an unnecessary duplication of expenditure.[38]

(vi) It would be a mistake for a vendor to allow his policy to lapse, however, because of the possibility of the sale falling through with the result that the risk passes back to the vendor. In any event, the vendor's mortgagees will not allow the insurance to be cancelled until their debt is repaid.[39]

(vii) The risk to which the purchaser will be exposed will usually be caused by events outside his control as it will usually be the vendor who remains in possession up to completion.[40] The property will be controlled by the vendor, while the risk is transferred to the purchaser. This appears to us to be unjust and even unreasonable.

(viii) The type of damage to property which commonly arises (other than fire) is burst water pipes as a result of frost, for example, which causes flooding and damage to carpets and floorboards. This is a risk which a purchaser certainly cannot get cover against and would be a typical example of an instance where he is utterly dependent on the vendor's goodwill in seeking any remedy against the insurers.

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35 Adams, *loc cit*; The Law Commission Working Paper No 109 para 1.73.

36 See the position as outlined on paras 5 and 6 above.

37 As confirmed by the Irish Insurance Federation in correspondence dated 23rd November 1988. See also Scottish Law Commission Discussion Paper No 81 (1989) at para 3.5.

38 Some commentators would disagree with this - Peverett (1975) 125 NLJ 217 argues that both policies cover different rights and interests and so are not a dual insurance. He also says that the cost of insurance during the period leading up to completion is "relatively small". Mr Peverett is an insurance broker.

39 Aldridge, *loc cit*.

40 As indeed he is entitled to do. See Keane, *op cit*, at paras 13.08-09.

CHAPTER 4: OTHER JURISDICTIONS AND THEIR PROPOSALS FOR REFORM

(i) Northern Ireland

A. The Law

4.1 The law in Northern Ireland is the same as that in the Republic.[41]

B. Proposals for Reform

4.2 The Survey of the Land Law of Northern Ireland recommended that where a vendor recovers money under an insurance policy maintained by him he should on completion of the contract account for it to the purchaser.[42] Since insurers might argue that they are not liable because the risk had passed to the purchaser, they recommended that provision should be made that the money does not cease to become payable to the vendor merely because the risk has passed to the purchaser, so that if the purchaser had paid the vendor, and the vendor had not claimed from the insurers, the purchaser would be entitled by subrogation to sue the insurers. The vendor, if unwilling to sue, would be joined as defendant. This would be subject to any stipulation to the contrary in the contract of sale or policy of insurance.[43]

(ii) England and Wales

A. The Law

4.3 The Common law rule that immediately the contract is binding the property is at the risk of the purchaser also applies in England and Wales. There are, however, two statutes which modify the rule.

1. Section 83 of *the Fire Prevention (Metropolis) Act 1774*[44] provides that

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41 Wylie, *op cit*, at paras 11.32-11.35; Wylie, *Irish Land Law*, (2nd ed) 1986, at para 9.061. See also summary of the law in Survey of the Land Law of Northern Ireland (1971) at para 167.

42 *Ibid.*

43 *Ibid* at para 167.

44 See Foote, "*Liability for Fire before 1800*" (1969) 20 NILA 141. It is clear that section 83 never applied in this jurisdiction - *Andrews v Patriotic Assurance Co.* (1886) 18 LR Ir 335, but does apply in England and Wales and not merely in London. *Ex parte Gorely* (1864) 4 De GJ & Sm 477. See also Magillivray and Parkington on Insurance Law, 7th Ed, (1981) para 1686.

if a vendor has insured a building which is damaged or destroyed by fire before completion, the purchaser, as a person interested, can require the insurance company to lay out the insurance money towards reinstating the building in question. This possibility is generally considered to be "under a cloud"[45] by conveyancers and it has been suggested that reliance should not be placed on it.[46]

2. Section 47 of the *Law of Property Act 1925* enables the purchaser to take the benefit of the vendor's insurance even if there is no express assignment of it.

Section 47 states:

> "(1) Where after the date of any contract for sale or exchange of property, money becomes payable under any policy of insurance maintained by the vendor in respect of any damage to or destruction of property included in the contract, the money shall, on completion of the contract, be held or receivable by the vendor on behalf of the purchaser and paid by the vendor to the purchaser on completion of the sale or exchange, or so soon thereafter as the same shall be received by the vendor.
>
> (2) This section applies only to contracts made after the commencement of this Act, and has effect subject to:
>
> (a) any stipulation to the contrary contained in the contract,[47]
> (b) any requisite consents of the insurers, and
> (c) the payment by the purchaser of the proportionate part of the premium from the date of the contract."

Some commentators have argued that under (c) payment by the purchaser is a condition precedent to taking the benefit of section 47.[48] In practice this would involve difficulties of calculation and would raise the unclear question of whether it is the vendor or his insurers who should receive payment. In addition, to obtain the benefit of section 47, the consent of the insurers is required, but most policies contain terms indicating the consent of the company. The same difficulties about ascertaining the requisite information about a vendor's policy would apply here.

4.4 It has been recommended practice in England for a purchaser to insure immediately on entering the contract.[49] Emmet on Title[50] states that most companies include in policies of fire insurance a term that if at the time of the damage the insured has contracted to sell his interest, the purchaser on completion shall be entitled to the benefit of the policy. This type of term could also be seen as a consent of the insurers for the purposes of section

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45 Farrand, *Contract and Conveyance* (4th Ed) at p168.
46 *Ibid*, at p169; *Gibson's Conveyancing* (20th Ed) at p150, *Emmet on Title* (19th Ed), ed Farrand, at para 1.081. See generally the Law Commission Working Paper No 109 at paras 2.5-2.8.
47 It is presumed that this is the contract of sale rather than that of insurance - Farrand, *op cit*, at p168 and the Law Commission Working Paper No 109 at para 2.22.
48 *Emmet on Title*, *op cit*, at para 1.081.
49 *Ibid*, para 1.081; *Williams on Title*, *op cit*, at p554; Farrand, *op cit*, at p169, The Law Commission Working Paper No.109, 1988, at para 2.30.
50 At para 1.081.

47 above, and so the purchaser would obtain the benefit of any sums payable.

4.5 The publication of Standard Conditions of Sale in March 1990 has introduced a significant change in conveyancing practice regarding the passing of risk. This single set of conditions replaces the two pre-existing sets of conditions-the Law Society's General Conditions of Sale and the National Conditions of Sale. The general consensus is that in respect of these latter two sets of conditions the situation was not entirely satisfactory[51] and the purchaser was always advised to arrange his own insurance.

On the issue of the passing of risk, the Standard Conditions of Sale provide:

> "**5.1. Responsibility for Property**
>
> 5.1.1 The seller will transfer the property in the same physical state as it was at the date of the contract (except for fair wear and tear), which means that the seller retains the risk until completion.
>
> 5.1.2 If at any time before completion the physical state of the property makes it unusable for its purpose at the date of the contract:
>
> (a) The buyer may rescind the contract,
> (b) The seller may rescind the contract where the property has become unusable for its purpose as a result of damage against which the seller could not reasonably have insured, or which it is not legally possible for the seller to make good.
>
> 5.1.3 The seller is under no obligation to the buyer to insure the property.
>
> 5.1.4 Section 47 of the *Law of Property Act 1925* does not apply".

The impact of this change should prove to be very significant, although clearly the situation at law remains in an unsatisfactory state. The Law Commission has expressed the following prediction:

> "If, as we envisage, the use of the Standard Conditions of Sale is widespread or near universal, there will in practice have been a radical change in the provisions affecting the passing of risk. In relation to most physical damage, parties using the Standard Conditions who make no special provision will accept the passing of risk on completion. Others, who agree alternative arrangements, will have to make specific provision in the contract excluding or varying the relevant general condition. It will only be in a small minority of cases that the parties

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51 Condition 21 of the National Conditions of Sale (20th Ed 1981) states that the vendor is not bound to keep on foot any insurance nor to give notice to the purchaser of any premium being or becoming due. The purchaser can insist on having his name endorsed on the policy, as a person interested, in which event he must pay a proportion of the premium from the date of the contract. This is compared to Condition 11 of the Law Society's General Conditions of Sale (1984 Revision) which is to similar effect and expressly excludes the provisions of section 47 of the 1925 Act. The only difference is that it has been drawn to deal with the position where both parties insure. Condition 18(4)(c) provides for insurance by a purchaser allowed into possession before completion. Insurance problems arising are fully considered but no entirely satisfactory solutions found by Adams, *loc.cit.* See also The Law Commission Working Paper No.109, 1988, at para 2.39.

are not alerted to the question of the passing of risk".[52]

B. Proposals for Reform

1. Second Report of the Conveyancing Committee[53]

4.6 The Committee suggests that the solution to the problem lies in the alteration of the general rule so that the risk of damage to the property should not pass from the vendor to the purchaser until actual completion. The rule could be made subject to any contrary agreement between the parties for example when the purchaser is permitted to take possession before completion. This solution, the Committee argues, would certainly reduce the expenses arising out of domestic conveyancing.

2. *The Law Commission*

4.7 In August 1988, the Law Commission published a Working Paper[54] in which the rule regarding the passing of risk was examined and a provisional conclusion reached that the present state of the law is unsatisfactory. One solution that the Commission envisaged would be to allow the purchaser to benefit automatically from the vendor's insurance policy. The Working Paper acknowledges, however, that that would not be a comprehensive solution and considers four possible reforms:

(a) Abolition of trust. The point at which the risk passes could be altered by changing the time at which the trust arises.

(b) Making the risk pass on completion, thereby bringing the sale of land in line with the sale of goods.

(c) Obliging the vendor to pass on the property in the physical condition it was in at the date of the contract. This was the approach favoured by the Commission in the Working Paper.

(d) Giving the purchaser the right to rescind should the property be seriously damaged before completion.

4.8 In its Report on the subject, published in April 1990, the Law Commission reached the following conclusion:

> "We consider that there is a clear case for a change in the present rule. On the other hand, where the matter has been drawn to the parties attention, there can be no objection to their agreeing individual arrangements by contract. Accordingly, what is needed in our view is a new rule that, subject to agreement to the contrary, the risk of physical damage should pass to the purchaser on completion of the contract, rather than when the contract is made".[55]

In light of the recent publication of the Standard Conditions of Sale, the Commission is of the view that the practical effect of any legislation altering

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52 *Transfer of Land - Risk of Damage After Contract for Sale*, Report No.191, April 1990, at para 3.4.

53 *Conveyancing Simplifications*, chaired by Professor J T Farrand, presented to the Lord Chancellor January 1985, at paras 7.14 and 7.15.

54 "Transfer of Land - Passing of Risk from Vendor to Purchaser" Working Paper No.109.

55 *Ibid* at para 2.25.

the existing rule would be extremely limited and therefore does not consider it appropriate to recommend any legislative change at the present time.[56] Any such change would merely duplicate the Standard Conditions, use of which, the Commission anticipates, will be widespread. The continued application of the present rule and its defects will therefore be limited to a small minority of cases.

(iii) Scotland

A. The Law

4.9 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'.[57] In certain cases, the risk does not pass to the purchaser on conclusion of a binding contract. These are (1) where the contract so provides and (2) where the damage or destruction is attributable to the seller's fault.[58] It also appears that the risk does not pass where the damage or destruction occurs at a time when the seller has wrongfully prevented the purchaser from taking entry.[59]

B. Proposals for Reform

4.10 Following the publication of a Discussion Paper in March 1989,[60] the Scottish Law Commission issued a Report on the *Passing of Risk in Contracts for the Sale of Heritable Property* in October 1990.[61] The basic recommendation of the Commission is to the effect that:

> "In a contract for the sale of heritable property with vacant possession, where the purchaser is not already in occupation, the risk of destruction of, or damage to, that property should pass to the purchaser when he is entitled to take possession (whether or not he takes actual possession at that time) or if and when he takes possession without the seller's consent".[62]

The Commission further recommends that risk should pass to the purchaser on the date of entry agreed under the contract in two special cases: **(a)** Where the purchaser is already in occupation of the property and **(b)** where the puchaser does not actually take possession (i.e. where the purchaser is without vacant possession).[63] Where there is no agreement as to such date, the risk should pass on the date of settlement of the transaction, unless it has

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56 *Ibid* at para 3.10.
57 *Sloans Dairies Ltd v Glasgow Corporation* 1979 SLT 17.
58 *Meehan v Silver* 1972 SLT 70.
59 Scottish Law Commission Discussion Paper No.81 (1989) at para 2.2.
60 Discussion Paper No 81 (March 1989). The Law Commission's tentative proposal (pending consultation with interested bodies) was that the risk to the subject of a contract for sale should remain with the vendor until the purchaser takes possession, or is entitled to take possession, whichever is the earlier. It was recommended that (if consultees would prefer a statement of the legal consequences flowing from the new rule) legislation should provide that if the property is destroyed or substantially damaged while the risk remains with the vendor the contract should be treated as frustrated. If, however, the property is not *substantially* damaged, the vendor should be under an obligation to repair the property to the condition it was in before the damage occurred. The Law Commission recommended that there should be no prohibition against contracting out of the proposed new rules as to the passing of risk.
61 Report No.127, 17th October 1990.
62 *Ibid* at para 4.12. It is envisaged that the new rule on the passing of risk will apply to all kinds of heritable property: para 4.28.
63 *Ibid* at para 4.18.

already passed to the purchaser by virtue of his taking possession without the seller's consent.[64] Finally, where the purchaser becomes owner of the property before the date when risk would pass under these recommended rules, the risk of damage to or destruction of that property should pass to the purchaser when he becomes owner of the property.[65]

(iv) Australia[66] - Reforms Effected and Proposed

- *Queensland*

4.11 *The Property Law Act 1974* was enacted as a result of recommendations of the Queensland Law Reform Commission.[67] The legislation[68] in effect adopts section 47 of the English Act subject to providing specifically that the vendor's insurer will still be liable even though the risk has passed to the purchaser,[69] and further, that the consent of the vendor's insurer is not required. Section 64 of the Act gives the purchaser a right of rescission where a dwelling house is so destroyed or damaged between contract and completion or possession (which ever earlier occurs) as to be unfit for occupation as a dwelling house.

The Tasmanian Law Reform Commission recommends that a section similar to section 63 of the *Queensland Act 1974* should be adopted there.[70]

- *Victoria*

4.12 Following two slightly conflicting Reports[71] the *Sale of Land (Amendment) Act 1982* was passed. That Act introduces a right to rescind similar to that contained in the Queensland legislation. It also provides that where the vendor has an insurance policy the benefit of it shall enure for the benefit of the purchaser between contract and possession, and any money that becomes payable under the insurance policy shall on completion be held or recoverable by the vendor on behalf of the purchaser and paid by the vendor to the purchaser on completion or as soon as the money is received by the vendor (whichever is later). The legislation also gives the vendor the option of restoring the premises in which case the purchaser may not rely on the above provisions.

- *New South Wales*

4.13 *The Conveyancing (Passing of Risk) Amendment Act 1986* was enacted

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64 *Ibid* at para 4.22.

65 *Ibid* at para 4.26.

66 Most Australian states (except New South Wales, *Reid v Fitzgerald* (1926) 48 WN (NSW) 25) adopted section 90E of *Conveyancing and Law of Property Act 1884* which is derived from the *Fire Prevention (Metropolis) Act 1774*, section 83, and section 47 of the *Law of Property Act 1925*.

67 Queensland Law Reform Commission, Report on a Bill to Consolidate, Amend, and Reform the Law Relating to Conveyancing, Property, and Contract and to Terminate the Application of Certain Imperial Statutes, QLRC 16 (1973).

68 Sections 63 and 64 of the 1974 Act.

69 Even this provision may not be sufficient to achieve the desired effect because the reason that the money is not payable to the vendor is not because the risk has passed to the purchaser but because he suffered no loss - see the NSW Law Reform Commission, *op cit.* paras 3.9-3.10.

70 Law Reform Commission of Tasmania, Report No. 36, Report and Recommendations for Reform on Fifteen Conveyancing Matters (1984), para 2.14.

71 The Chief Justice's Law Reform Committee's Report on Insurance of Real Property (1979) and the Dawson Committee of Inquiry into Conveyancing, Further and Final Report (1980).

following the recommendations of the New South Wales Law Reform Commission.[72] This Act is intended to ensure that the purchaser need not insure the property at the date of contract. It does so by preventing the passing of risk until completion or, if the parties agree, the time that possession is taken. Where the land is substantially damaged after contract and before the risk has passed to the purchaser, he may by notice rescind the contract and recover money already paid. Where the property is damaged, but not substantially damaged, the purchase money is to be reduced "by such amount as is just and equitable in the circumstances". The Act cannot be excluded or limited by contract in the case of dwelling houses but can be in the case of other properties.

(v) United States of America

4.14 The courts in the majority of States have adopted the rule that the risk passes to the purchaser upon entry into a binding contract,[73] although the purchaser is usually able to claim the benefit of the vendor's insurance.

A number of States have adopted the *Uniform Vendor and Purchaser Risk Act.* Liability for loss under the Act is governed by the passing of title or possession. So long as legal title and possession remain with the vendor, the vendor cannot enforce the contract if all or a material part of the property is destroyed. Once legal title or possession has been transferred to the purchaser, the purchaser must pay the full price regardless of the extent of the damage. In practical terms, the Act reverses the common law rule about the passing of risk, though the presumption may be reversed by express agreement between the parties. The Act does not purport to interfere with or regulate the liability of insurers.

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72 Community Law Reform Program - Fifth Report, Passing of Risk Between Vendor and Purchaser of Land, LRC 40 (1984).

73 Those States which adopt the rule that the risk does not pass until completion or earlier possession by the purchaser include Connecticut, Maine, Montana, New Hampshire, Massachusetts, Oregon, Rhode Island and Washington. They do, however, differ in approach.

CHAPTER 5: THE COMMISSION'S PROPOSALS FOR REFORM

5.1 It can be seen that under the present law the person most likely to suffer is the purchaser of land. For the reasons outlined above,[74] the Commission has considered a number of possible reforms, the major ones being:

1. Granting the purchaser a right to claim upon the vendor's insurance policy where the property is damaged or destroyed after the date of the contract but before the transaction is completed or the purchaser enters into possession.

2. Granting the purchaser the right to rescind the contract for sale in the event of substantial damage to, or destruction of, the property during the same period.

3. Providing that the risk of damage to, or destruction of, the property shall not pass to the purchaser until the transaction is completed or the purchaser enters into possession.

4. Obliging the vendor to pass on the property in the physical condition it was in at the date of the contract.

5. Releasing the vendor and the purchaser from the contract where property is destroyed or substantially damaged, i.e. providing that the contract would in effect be regarded as frustrated.[75]

5.2 We are of the opinion that it is not sufficient to deal with this issue solely in the standard conditions of sale, as this gives rise to uncertainty and also allows parties to contract out of these provisions, particularly a vendor in auction or tender conditions.

We are conscious of the danger of tinkering with one aspect of the extremely complex relationship of vendor and purchaser between contract and completion as this may unwittingly cause undesirable consequences on other

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74 At pp6-8.
75 See para 5 above for a discussion of the law of frustration.

aspects of the relationship.

We are not convinced that an insurance-linked solution will provide a solution that would be generally satisfactory. We are, however, encouraged by the fact that a number of common law Law Reform Commissions have thought it necessary to reform the law in this area.[76]

5.3 Our principal conclusion is that the risk of damage should remain with the vendor until completion unless the purchaser has gone into possession of the property prior to completion.

5.4 Where damage occurs before the risk has passed to the purchaser, then if the damage is substantial, a purchaser should have the right either to rescind the contract or to require completion of the contract on the basis of an abatement of the purchase price to cover the reduction in value resulting from such damage.

When damage has occurred prior to the risk passing to the purchaser, the vendor should be obliged to serve a notice on the purchaser specifying the damage which has occurred and indicating that the vendor believes it to be substantial and requiring the purchaser to say whether the purchaser proposes to rescind the contract or to complete with abatement of the purchase price. The purchaser should be given 10 days to respond to this notice and if he does not respond the purchaser should be deemed to have lost his right to rescind.

If there is a dispute as to whether the damage is substantial or non-substantial this issue should be decided by arbitration which would be binding on both parties.

If the transaction proceeds to completion, the vendor should be entitled on completion to receive interest from the purchaser to cover the period from the completion date fixed by the contract or the date on which the damage has occurred (whichever should be the later) to the date of actual closing at a rate to be equivalent to the last long-dated Government security.

If the damage is not substantial, whether this is agreed by the purchaser or determined on arbitration, the vendor is entitled to enforce completion of the purchase, subject to the purchaser receiving damages to compensate for the reduction in value of the premises consequential on damage. An obligation should be placed on the purchaser to pay interest for the same period as stated above. The rate of interest to be paid by the purchaser should depend on whether the purchaser admits the damage to be non-substantial or contended that the damage was substantial. In the event that the purchaser contended that the damage was substantial and it was subsequently either agreed by the purchaser or determined on arbitration that it was not substantial, the interest to be paid by him shall be at a rate which shall be 4% per annum over the lower rate.

If there is disagreement on the level of compensation which the purchaser should receive, whether the damage is substantial or non-substantial, the amount of compensation should be determined by arbitration.

We do not anticipate any difficulties about the recommended procedure in

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76 See footnote 31.

respect of substantial damage because of the purchasers entitlement to rescind which would significantly strengthen his negotiating position. But there does exist a problem which we have not been able to solve in relation to non-substantial damage. Ideally, the contract should proceed to completion in the case of non-substantial damage, but it may be unreasonable to require the parties to complete in the absence of agreement between them on the level of compensation for the damage. If the amount of the damages cannot be readily calculated, so that it could be deducted from the purchase money on completion, and has to be determined by arbitration, it would be unfair to one or other of the parties to make completion compulsory. If the purchaser were to be required to pay all of the purchase money on the basis that repayment would be made by the vendor the vendor might not be able to offer the purchaser any security for the repayment. Equally, even if a retention is agreed and the purchaser only pays the balance of the purchase money, the vendor may not have any satisfactory security for the payment of the balance. The vendor will, of course, have a lien for unpaid purchase money but in the great majority of cases purchasers will be borrowing money from a lending institution to complete the purchase and that lending institution will require a first legal mortgage over the property, thereby postponing any lien for unpaid purchase money to being at best a second charge. Accordingly, we are unable to do more than express the view that the parties should endeavour to arrange to complete the purchase on the basis of an estimate of the likely amount of the damage.

There is one special situation which we believe requires separate treatment and that is where a purchaser is in delay in completing and the vendor has already served a valid notice requiring the purchaser to complete before the damage occurred. In such circumstances where the damage is non substantial, we recommend that the vendor should be entitled to interest on the entire of the purchase money, 7 days from a date after the service of the completion notice to the date of actual completion, the purchaser continuing to be entitled to an abatement of the purchase money in respect of the damage. We do not make any special recommendation in respect of the situation where the damage caused is substantial and occurs after a valid completion notice has been served because the purchaser should still have a right to rescind and completion by the purchaser is likely to be based on terms negotiated between the parties.

5.5 The vendor should not be liable for nor the purchaser entitled to abatement for damages for inconsequential damage or insubstantial deterioration from reasonable wear and tear in the course of normal occupation and use of the premises or from operation to vacate the premises undertaken with reasonable care and not materially affecting value.

It is suggested that arbitrations should be conducted by an arbitrator, who, in default of agreement, would be appointed by the President of the Incorporated Law Society.

5.6 The parties should not be permitted to contract out of the proposed legislation in transactions concerning residential accommodation of which vacant possession is to be given.

Recommendation

5.7 We have considered all of the various possibilities for reform and recommended the following:

A. *A statutory provision should be enacted to provide that:*

(i) *The risk will pass to the purchaser in all situations where the purchaser goes into possession of the premises, or on completion of the purchase, whichever is the earlier.*

(ii) *Where the purchaser does not go into possession prior to completion, the risk will remain with the vendor.*

(a) *In the case of substantial damage to the property, the vendor must give notice of the damage to the purchaser whereupon the purchaser will have the right to rescind the contract within ten days of the receipt of such notice. If the purchaser elects not to rescind, or fails to do so, he will be entitled to an abatement of the purchase price to be assessed on the basis of the reduction in the value of the property. If the purchaser elects not to rescind or fails to do so, the vendor will be entitled to seek specific performance of the contract with an abatement of the purchase price.*

(b) *Where the purchaser accepts that the damage is substantial, or it is found on arbitration to be such, and agrees to complete or where the purchaser accepts that the damage is non-substantial the purchaser shall pay interest to the vendor on the balance of the abated purchase price from the date of the damage or the agreed completion date, whichever is the later up to the date of actual completion at a rate equivalent to the yield (at issue and before deduction of tax if any) on the long-dated security of the Government last issued before the date on which the transaction shall actually be closed (allowance having been made in the calculation of the said yield for any profit or loss which might occur on the redemption of the security). ("The lower rate").*

(c) *In the case of non-substantial damage to the property, the purchaser will be required to complete but shall be entitled to damages only, again on the basis of the reduction in value.*

(d) *Where the purchaser claims that the damage is substantial and it is subsequently agreed or found on arbitration to be non-substantial, the purchaser shall pay interest on the full balance of the purchase price for the same period as in the previous paragraph at a rate which shall be 4 per centum per annum above "the lower rate".*

(iii) *Where a vendor has served a valid completion notice and damage for which the vendor was not responsible has subsequently occurred to the property, the vendor should, on completion, be entitled to interest on the balance of the purchase money from a date seven days after the service of the completion notice, the purchaser continuing to be entitled to an abatement of the purchase money in respect of the damage. The interest should be calculated on the basis of the full rather than the abated purchase price.*

(iv) *The vendor shall not be liable for inconsequential damage or insubstantial deterioration from reasonable wear and tear in the course of normal occupation and use or from operations to vacate the premises undertaken with reasonable care, and not materially affecting value.*

(v) *Any disputes as to whether the damage is substantial or as to the amount of any abatement in the purchase price or damages shall be determined by an arbitrator, who in default of agreement shall be appointed by the President of the Incorporated Law Society of Ireland.*

(vi) *Persons should not be entitled to contract out of the legislation in the case of any sale of residential property of which vacant possession is to be given.*