Passing of Property in International Sale Contracts - A Conceptual Analysis

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Cite as : (2003) PL WebJour 13

Passing of property is of vital importance in a contract of sale of goods. This is so since it has important consequences in terms of risk, the right to sue, the ability to pass a good title and the security of payment of a party as against an insolvent other party. Further, in cases of international sales, problems with regard to passing of property arise most frequently in order to determine whether the goods can be treated as security for payment of the price1. Here the law appears to start with the assumption that a seller of goods in transit will not normally wish to part with the property in the goods so long as he needs it as a security for payment of the price. Therefore, what follows is a discussion on the rules relating to passing of property and their application to international contracts of sale, particularly f.o.b.2 and c.i.f.3 contracts. The paper also talks about how and when risk passes in such contracts.

Rules of passing of property

The general rules relating to the passing of property from the seller to the buyer are contained in Sections 18, 19 and 20 of the Sale of Goods Act, 1930 (the Act).

Section 18 provides the general rule that property in goods cannot pass unless and until the goods are ascertained. Goods initially unascertained become ascertained when they are earmarked or identified to the contract in such a way that the seller demonstrates an intention that these particular goods will be used for the fulfilment of the contract. This was established in the case of Wait, Re4 which has been the long-standing authority in this respect. Here the buyer had paid in advance for 500 tons of wheat out of a consignment of 1000 tons on board a particular ship. But before he could take delivery, the seller went bankrupt. The question before the court was whether the buyer could claim his 500 tons. The court answered this in the negative as it held that since the 500 tons still formed the part of the bulk at the time of the sellerâ€™s bankruptcy the property in them had not passed to the buyer despite him paying in advance. Therefore, all he could do was to prove as an unsecured creditor in the sellerâ€™s bankruptcy. Although, in India this is still the law5, in England, this position has changed with the recently introduced Section 20-A in the (English) Sale of Goods Act, 1979 which provides that the property in unascertained goods may pass where the price has been paid. In such a case the buyer obtains an undivided share in the bulk so as to become an owner-in-common of that bulk. Of course, the buyerâ€™s interest in the bulk is a proportional one, relative to that of other interested parties; and the buyer is deemed to consent to deliveries out of the bulk to the other owners-in-common.

Section 19(1) provides that property is to pass when the parties intend it to pass. Subject to the goods being ascertained, it is for the parties to decide when property is to pass. Clause (2) of this section further states that for the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case. The starting point of modern discussion in this regard is the decision of the English Court of Appeal in Aluminium Industrie Vaassen BV v. Romalpa Aluminium Ltd.6, where the plaintiff was a Dutch company which sold aluminium foil to the defendant, an English company. The plaintiff had elaborate standard conditions of sale which provided, inter alia, that the property would not pass to the buyer until they had paid all that was owing to the seller and till then the buyer would keep the articles manufactured with the foil as â€œfiduciary ownerâ€• of the seller. The buyer, if necessary, was to store the articles in such a way that it could be clearly recognized as the property of the seller till the time of payment. The buyer eventually became insolvent owing to the seller over Â£ 1,20,000. The Court of Appeal held that the property had not passed to the buyer and he resold the goods only as the agent of the original seller and hence the latter were entitled to the retail price in preference to the other creditors of the insolvent buyer.

Following this case, many firms, seeing the advantage they could obtain by retaining ownership in goods even though they had transferred possession of them to a buyer, adopted similar provisions in their contracts. Even in international sales this has been the standard practice.7

Section 20 gives the third rule which is the most important and lays down rules for passing of property where the parties have not expressed an intention as to when the property should pass. It states that where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer at the time the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods are both postponed. Thus, firstly, the contract should be an unconditional one i.e. a contract to which there are no conditions upon which the passing of property depends. Secondly, the sale must be of specific goods. Specific goods are goods that are identified and agreed upon at the time the contract of sale is made. Thirdly, the goods must be in a deliverable state i.e. the state in which they are to be delivered by the terms of the contract. In other words, it can be said that the goods are in such a state that the buyer would under the contract be bound to take delivery of them.

Passing of property in international sales

In international sales the seller and the buyer are situated in different countries and hence there is a fairly strong presumption that the seller does not intend to part with the property until he has been paid or has been given adequate assurance for the same.8 Section 23(2) of the Act states that a seller who delivers the goods to a carrier for transmission to the buyer is to be taken to have unconditionally appropriated them to the contract if he does not â€œreserve a right of disposalâ€•. Whether the seller has reserved a right of disposal is a question that depends, in the first place, on any relevant provisions in the contract itself. The right of disposal can also be reserved by the way in which shipping documents have been made.

However, difficulty arises in cases where the contract itself contains contradictory provisions. In Nippon Yusen Kaisha v. Ramjiban Serowgee9 the contract provided for payment by cash against the mateâ€™s receipts. Had this provision stood alone, it would have postponed the passing of property until such payment. The contract, however, further went on to provide that so long as the mateâ€™s receipts were in the possession of the seller, his lien was to subsist until payment in full. This clause led to the conclusion that the property had passed before payment for the seller could not have a lien over goods which were his own property.

By Section 25(2) of the Act, a seller is prima facie taken to have reserved the right of disposal if the bill of lading is made in the name of the seller or his agent. When this is the case, the property will not pass merely by virtue of shipment as here mere shipment will not mean an â€œunconditional appropriationâ€• of the goods by the seller. But it would be a different case if the bill of lading is made to the order of the buyer. If the bill of lading is endorsed in blank, or to the buyerâ€™s order, and sent directly to the buyer, the property will pass to the buyer unless contrary intention appears from the terms of the contract or from the circumstances in which the bill was sent (sending the bill through his agent with instructions to present it in exchange for payment).

The seller may, also, send to the buyer a bill of exchange together with a bill of lading. In such a case, the buyer is under a contractual obligation to honour the bill of exchange if the bill of lading is according to the terms of the contract. If the buyer does not honour the bill of exchange and wrongfully retains the bill of lading the property in goods does not pass to him.

F.O.B. contracts

The term f.o.b. signifies free on board i.e. the seller fulfils his obligation to deliver when the goods have passed over the shipâ€™s rail at the named port of shipment. An f.o.b. seller is not, in the absence of specific stipulations in the contract, bound to find shipping space for the goods or to insure them; and the cost of carriage or insurance, even if these terms are procured by the seller, is normally for the buyerâ€™s account.

The cardinal rule in cases of f.o.b. contracts is that the property and risk pass on shipment i.e. when the goods have passed over the shipâ€™s rail and the risk in each parcel of the cargo will pass when it crosses the same.10 Thus the sellerâ€™ obligation under an f.o.b. contract comes to an end when the goods are delivered for shipment to the carrier named by the buyer at the named port of shipment. When this is done the seller is deemed to have delivered the goods to the buyer.

However, this is true only where the seller has not reserved a right of disposal. As an f.o.b. seller quite commonly does reserve a right of disposal even after shipment, the abovementioned rule i.e. property passes on shipment seems to hold little water. Therefore, it becomes necessary to restate the general rule negatively i.e. property does not pass before shipment. This would be true even in the case where goods have been wholly paid before shipment. Additionally, where the sale is of specific goods in a deliverable state the property in them would not pass to the buyer, in an f.o.b. contract, at the time when the contract is made11 since shipment of the earmarked goods is an essential condition to be fulfilled by the seller in such cases. Support for this can be drawn from the words of Pearson, J. in Carlos Federspiel & Co. SA v. Charles Twigg & Co. Ltd.12 where he said:

â€œ[F]or the purpose of passing of property a mere setting apart or selection by the seller of the goods which he expects to use in the performance of the contract is not enough â€¦ usually, but not necessarily, the appropriation act is the last act to be performed by the seller. But, here the important and decisive act remained to be done by the seller who was to send the goods to the port of shipment and have them shipped. Accordingly property had not passed.â€•13 (emphasis supplied)

In the instant case, childrenâ€™s bicycles were sold through an f.o.b. contract; freight and insurance were to be arranged by the seller, on the buyerâ€™s account. The goods were paid for and packed in cases marked with the buyerâ€™s name. Althoug shipping instructions were given, the goods were never shipped, nor even dispatched from the works of the seller. On the sellerâ€™s insolvency, the question arose whether the property in goods had passed to the buyer. It was held that the property had not passed to the buyer since in international sale contracts, it is a specific obligation of the seller to ship the goods and till this is done, both risk and property remain with the seller.

C.I.F. contracts

A c.i.f. contract is an agreement to sell goods at an inclusive price covering the cost of goods, insurance14 and freight.

The seller in a c.i.f. contract fulfils his part of the bargain by tendering to the buyer proper shipping documents (which include the contract of affreightment, insurance policy and the bill of lading) after having shipped, or sold afloat, goods in accordance with the contract. If he does this, he is not in breach even though the goods have been lost before such tender. In the event of such loss the buyer must nevertheless pay the price on tender of documents, and his remedies, if any, will be against the carrier or the insurer but not against the seller.

The passing of property in c.i.f. contracts is of great significance as it carries serious consequences for the parties in cases of insolvency of any party or the loss or destruction of goods where such loss or destruction is not covered by insurance. Property in c.i.f. contracts passes to the buyer when the seller transfers the bill of lading and the insurance policy to him thereby giving him the right of action in respect of loss or damage to the goods. The goods are placed at the buyerâ€™s risk from that point onwards. However, the property in goods may not pass if the seller reserves a right of disposal. Lord Wright in Ross T. Smyth & Co. v. T.D. Bailey, Son & Co.15 observed that in c.i.f. contracts, property would not pass on shipment in cases where the seller reserves a right of disposal, which is to be inferred from retention of the shipping documents by the seller or his agent for presentation to obtain payment.

Additionally, the seller in modern conditions is usually not content to rely on his right of lien or stoppage in transit but wishes to reserve a right of disposal. This is so where the seller has taken a bill of lading to the order of the buyer but retained it in his possession. The situation is even clearer where the seller has taken the bill of lading to his own order or to the order of the bank which has financed the transaction.16

Similar to an f.o.b. contract, where a c.i.f. contract is for specific or ascertained goods the property in them does not pass before the goods are shipped. This is so, since, though the goods are ascertained or agreed upon, not only shipment is an essential condition to be performed by the seller, but both the bill of lading and the insurance policy cannot in the ordinary course be properly filled out and issued until the shipment agreements have been completed.

In cases of c.i.f. contracts the goods are generally appropriated to the contract when they are already sailing on the high seas. It is usual, therefore, for the seller to send to the buyer a notice of appropriation stating the precise quantity of goods appropriated, the name of the ship, the dates of the bills of lading etc. Where the contract requires the seller to furnish such a notice, the requirement is an essential condition of the contract to be performed by the seller. His failure to comply with it entitles the buyer to reject the documents and rescind the contract.

The buyer who has paid for and accepted documents which appear to be conforming prima facie could still reject the goods if they do not conform to the contract. If he rejects the goods and signifies his rejection to the seller, the property in goods returns to the seller.17 It is submitted, that this remedy is available only in the case where the seller has shipped non-conforming goods in the first place. Where the general character of goods has changed during the voyage, the seller cannot be held liable for it. The claim in such a case, as has been stated earlier, must lie against either the insurer or the carrier as it would be unjust to hold the seller responsible for the deterioration of goods that have long ceased to be under his control and supervision.

The issue of risk in international sale contracts

Generally, risk passes with property.18 Thus, the goods agreed to be sold remain at the sellerâ€™s risk until the property in goods passes to the buyer. However, this presumptive rule can be modified and passing of property and passing of risk may be separated by agreement between the parties. This may be done either by an explicit provision on risk in the contract, or in the absence of such a provision by referring to Incoterms (1990) and its definition of a specified trade term like ex works, f.o.b., c.i.f.19, c.i.p. etc. or by referring to the provisions of CISG20. Moreover, if delivery has been delayed by the fault of the seller or the buyer, then the goods are at the risk of the party in default, as regards any loss, which might not have arisen but for such default.

The passing of risk is a matter of intention. Like in the case of passing of property, the risk cannot pass until the goods have been delivered to the carrier for shipment. Once this is done, the parties intend that the sellerâ€™s responsibility ceases although he may still be obliged to tender the correct documents to the buyer. Support for this proposition can be garnered from Article 67(1) of CISG, 1980 which provides that the risk of loss passes to the buyer when the goods are handed to the first carrier for shipment to the buyer, unless the contract is specific about where the goods are to be handed over to a carrier, in which case, risk of loss passes when the goods are delivered to the carrier at that specific place.

If the goods are already in transit, Article 68 of CISG provides that the risk of loss passes to the buyer at the time of conclusion of the agreement, or, if the circumstances indicate, the risk is assumed by the buyer from the time the goods were handed over to the carrier. The latter part of the article means that the risk passes retrospectively to the buyer from the time of shipment since it is almost impossible to decipher the exact point at which the risk would pass when a sale occurs at a time when the goods are in transit.21

However, it must be noted that in both f.o.b. and c.i.f. contracts the sellerâ€™s undertakings as to quality refer to the time of

shipment and only subsequent deterioration of the shipped goods is governed by the rules of risk. Hence no question of risk arises in relation to non-conformity of goods at the time of shipment, the risk in which case must lie wholly on the seller. Also, where the seller ships the goods but asks for a higher price than agreed to under the contract, the risk lies on the seller even when the goods would have reached the buyer.

Further, Article 69 of CISG provides that if the buyer fails to take delivery of the goods, risk of loss is still deemed to have passed on to him when the goods are placed at his disposal.

However, the application of Article 67(2) of CISG creates some problems in cases of bulk shipments. Article 67(2) provides that risk will not pass to the buyer until the goods are identified to the contract. Now, if identification means ascertainment as understood under the Act, it has mischievous effects on cases of bulk shipment for the goods would not be identified in such cases until separation in a discharge port. If it means when the notice of appropriation is received or transmitted, this risk in many c.i.f. cases would be transferred at some point, perhaps unknowable on the high seas, which is itself a point of uncertainty. To calculate the precise time when risk would pass in such cases is, therefore, next to impossible. It is here, that Section 20-A of the (English) Sale of Goods Act, 1979, which provides that in cases of bulk shipments the buyer obtains an undivided share in the bulk to become an owner-in-common, comes to our aid. It becomes important at this point to state that Section 20-A, since it was incorporated in 1995, has become a standard clause in international contracts of sale and its importance in such transactions has long been accepted and appreciated. Now since Section 20-A allows for passing property rights in bulk shipment, the risk may similarly pass from the time the bill of lading is handed to the buyer as he is the legal owner of the goods from that point onwards thereby ending the ownership and hence the control of the seller over the goods. More so, it is an implied term in a c.i.f. contract that risk is to pass to the buyer from the time the goods are shipped since he at all times is covered by insurance, which would safely transfer the risk on him to the insurer. If this is not the case, then the seller might continue to feel apprehensive about loss or destruction of goods even when the goods are no longer his property. It is submitted that Article 67(2) of CISG may be amended to bring it in conformity with the present-day international practice.

Concluding remark

When property or risk is to pass is, therefore, a question that depends on the intention of the contracting parties. If a contract provides for a specific method, place or time of passing of property or risk or both, the courts would normally uphold it even though it differs from the provisions of the Sale of Goods Act or the standard commercial practice, except in cases where the contract is struck by illegality under the general principles of contract law and is void prima facie, or causes unnecessary prejudice to either of the contracting parties, or is against public policy. The reason for this â€œhands-offâ€ approach adopted by the courts is that it is for the parties to decide what is most suited to their business needs and interests on a minimum-risk-incurring basis. For the seller, the risk is of not getting his payment in return for the goods, while for the buyer, this risk takes the form of the goods getting lost or destroyed even before the buyer actually takes delivery of them in cases where the risk of loss was to be borne by the buyer. Both these risks get significantly increased in an international sale transaction where the parties are placed in different countries.

It is generally to minimize the risk of non-payment that the seller either puts various clauses in the contract that restricts the passing of property till he has been paid or instructs the buyer beforehand that the financing will take place through documentary credit. Under documentary credit, the buyer instructs his bank to release payment to the sellerâ€™s bank only when it is satisfied that the documents tendered by the seller (or his bank) are in conformity with the terms of the contract. This kind of an arrangement is most suited to the seller and provides him with maximum security against non-payment as the transaction is between two established commercial banks trading in normal course and not between two unknown entities situated in two different countries. On the other hand, the buyer avoids the risk of loss or destruction of goods by either contracting on a trade term which covers the goods with insurance from the time of shipment, or in the absence of such a term, to instruct the seller to do so on the buyerâ€™s account.

Statutes, conventions and important judicial precedents are, therefore, to be regarded as mere guiding tools for parties at the contract formulation stage; and for judges while interpreting a contract if a dispute arises subsequently. They are by no means comprehensive, and the law gives a free hand to contracting parties to make their own specific contracts for specific situations under its broadly defined parameters.

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1. A.G. Guest, et al, Benjaminâ€™s Sale of Goods, 5th Edn., Sweet and Maxwell, p. 1133. Return to Text

2. Free on board. Return to Text

3. Cost insurance freight. Return to Text

4. 1926 All ER Rep 433 Return to Text

5. The parties may nevertheless include a clause in their contract effecting that property may pass in unascertained

goods against the payment of price, in part or in full. Return to Text

6. (1976) 2 All ER 552 Return to Text

7. Such a clause is popularly known as a â€œRomalpa clauseâ€• deriving its name from the above case. Return to Text

8. Of course the presumption can be rebutted if the contract provides for the specific time and place for passing of property. Return to Text

9. 1938 AC 429 : (1938) 2 All ER 285 Return to Text

10. Colonial Insurance Co. of New Zealand v. Adelaide Marine Insurance, (1886) 12 AC 128. The risk would pass over to the insurance company in cases where the buyer is adequately covered by insurance. Return to Text

11. See Section 20 of the Act. Return to Text

12. (1957) 1 Lloydâ€™s Rep 240 Return to Text

13. Ibid., at p. 255 Return to Text

14. Under a c.i.f. contract the seller is only required to obtain insurance on minimum coverage. Return to Text

15. (1940) 3 All ER 60 Return to Text

16. Benjaminâ€™s Sale of Goods, 3rd Edn., Sweet and Maxwell, para 1687. Return to Text

17. Kwei Tek Chao v. British Traders and Shippers Ltd., (1954) 1 All ER 779. Return to Text

18. Section 26 of the Act. Return to Text

19. The risk is commonly separated from property in a c.i.f. contract by the fact that the seller is under an obligation to cover the buyer by insurance from shipment, which is enough evidence to the intention of the parties to exclude the general rule. Return to Text

20. Where the States to which the contracting parties belong have ratified the United Nations Convention on Contracts for the International Sale of Goods (CISG), 1980. Return to Text

21. See generally The Julia, 1949 AC 293, at p. 309 : (1949) 1 All ER 269. Return to Text