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The Compatibility of a CIF Contract with the Provisions of Sale of Goods Ordinance No. 11 of 1896: A Critical Analysis

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ABSTRACT

A CIF contract denotes that the seller is responsible for the delivery of the documents that accompanies the goods. It implies that the buyer is responsible to make the payments concerning the cost, insurance, and freight and whereas the seller is required to plan in organizing them. This article explores the compatibility of a CIF arrangement against the provisions of the Sale of Goods Ordinance No. 11 of 1896.

I. INTRODUCTION

The Sale of Goods Ordinance No. 11 of 1896 that was introduced to the Sri Lanka is almost a carbon copy of the same enactment introduced in United Kingdom in 1893, some three years prior. This enactment was a consolidation of the existing common law rules relating to a contract concerning a contract for the sale of goods and it was introduced by Sir MacKenzie Chalmers who pioneered in its production[3]. It was introduced with bringing some parity between the unequal bargaining powers of a seller and a buyer, where the sellers would hold an upper hand in the transaction. While many of its provisions acknowledged and accepted the party autonomy in making a contract as the parties wished under the notion of 'freedom of contract', among other things, it introduced implied conditions and warranties, which even if not directly stipulated in the contract would becoming binding on the parties as per the provisions of the Act, albeit in an implied manner. The Sale of Goods Ordinance (hereafter SOGO) was introduced as a means of regulating contractual arrangements between the parties regarding a sale of goods transaction and it has given impetus for the development of the law relating to such transactions in the mercantile world.

In looking at the historical origins of the CIF contract, it was initially developed through the practices of the merchants, whereby through their customs and practices, they developed the

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3 M, Bridge, *Sale of Goods* (3rd edn Oxford 2014)

trade term CIF, denoting Cost, Insurance and Freight, almost as a global phenomenon where its usage and prominence has attained global status.[4] A CIF contract is favoured due to the distinct advantages it offers for both the seller and the buyer. For example, a seller in undertaking to arrange for insurance and carriage of the goods, would be in a better position to arrange for a carrier and to obtain an insurance policy at a lesser price than a buyer who would normally have to employ an agent on behalf of him to do the same, and would have to have a separate contract of agency to get the same thing done under a one single CIF contract. Further, a buyer would be in a much better position to transfer his goods which are evidenced by a bill of lading and covered by an insurance policy, whereby he would be able to pledge the bill of lading for credit prior to arrival of the goods.

II. WHAT IS A SALE OF GOODS?

From the outset, it must be mentioned that a contract for a sale of goods is a contract *per se.* However, every contract is not a contract for the sale of goods *per se*. This is because, in order to be considered as a contract for the sale of goods, it must come under the interpretation of a sale of goods under the SOGO. Section 2 of SOGO defines a sale of goods contract as a 'contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price'. Therefore, the contract must be concerning goods, and goods are interpreted under section 59 of SOGO as 'all movables except moneys. The term includes growing crops and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale'. The definition makes it clear that immovables will not be covered under SOGO and the part concerning growing crops has become somewhat obsolete since the language adopted in the late 19th century has not changed according to the new advancements in trade and technology.[5]

A seller or buyer hoping to get the benefits of the SOGO concerning their agreement must therefore would be required to initially prove that, their contract is in fact a contract concerning a sale of goods as provided in the SOGO. While there is a plethora of decided cases spelling out the goods which may come under the sale of goods ordinance, there are not many cases decided in a Sri Lankan context. In the case of ***Perera v. Zainudeen***[6] the Court held that, sale of the sweep tickets in this case was the sale of a chose in action, namely, the sale of a right on the part of the buyer to receive a prize from the seller on the happening of a certain event, the sweep ticket merely providing evidence of that contract of sale and that it did not come under

4 C, Murray, *Schmitthoff's the Law and Practice of International Trade* (12th edn, Sweet and Maxell 2012)
5 M. Bridge, *Benjamin's Sale of Goods* (10th edn, Sweet and Maxell 2010)
6 [1962] 65 NLR 261

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the ambit of 'goods' as defined in the SOGO. While the Sri Lankan law has not been blessed with decisions interpreting as to what amounts to 'goods' under the SOGO, a comparative analysis with the law in United Kingdom suggests that the term 'goods' is not included to cover blood transfusions[7], sale of software when such is delivered without accompanying tangible property[8]. On the other hand, there are decisions, in which electricity has been held to come under sale of goods if such can be stored and delivered[9]. Therefore, what would be included under the definition of 'goods' may still be of mystery for many.

III. What is a c.i.f. Contract?

C.I.F. was a creation of mercantile practices and customs which later came to be judicially recognized as being a form of a contract associated with international trade. C.I.F. stands for cost, insurance, and freight. It is in form a contract for the sale of goods where the amount to be paid by the buyer for the goods covers not only the invoice figure of the goods, but also the items of insurance and freight for the transportation of the goods by sea to a named port of destination as indicated by the buyer[10]. In the case of ***Biddell Bros. v. Horst***[11] the Court held that, under a C.I.F. contract, a seller under a contract of sale containing such terms has firstly to ship at the port of shipment goods of the description contained in the contract; secondly to procure a contract of affreightment, under which the goods will be delivered at the destination contemplated by the contract; thirdly to arrange for an insurance upon the terms current in the trade which will be available for the benefit of the buyer; fourthly to make out an invoice. In the case of ***Smyth and Co Ltd v. Bailey Son and Co Ltd***[12] Lord Wright summarized a C.I.F. contract as 'a type of contract which is more widely and more frequently in use than any other contract used for purposes of sea-borne commerce. An enormous number of transactions, in value amounting to untold sums, are carried out every year under c.i.f. contracts. The essential characteristics of this contract have often been described. The seller must ship or acquire after that shipment the contract goods, as to which, if unascertained, he is generally required to give a notice of appropriation. On or after shipment, he must obtain proper bills of lading and proper policies of insurance. He fulfils his contract by transferring the bills of lading and the policies to the buyer. As a rule, he does so only against payment of the price, less the freight which the buyer must pay. In the invoice which accompanies the tender of the documents on the 'prompt'

7 C. Twigg-Flesner and R. Canavan, *Atiyah and Adams' Sale of Goods* (13th edn, Pearson 2016)
8 *St Albans City and DC v. International Computers Ltd,* [1996] EWCA Civ 1296
9 *Ibid*
10 P. Thayer, 'C. I. F. Contracts in International Commerce', [1940] Harvard Law Review, Vol. 53, No. 5, 792.
11 [1912] A.C. 18
12 [1940] 3 All ER 60

that is, the date fixed for payment – the freight is deducted, for this reason. In this course of business, the general property remains in the seller until he transfers the bill of lading'.

Under a C.I.F. contract, a seller would be required to, ship or procure goods of the description contained in the contract under a contract of affreightment which will ensure the delivery of the goods at the destination contemplated in the contract, arrange for insurance which will be available to the buyer, make out an invoice for the goods and tender the documents to the buyer in exchange for the price, so that the buyer will know the amount of the freight he must pay, and so that he can obtain delivery of the goods if they arrive, or recover for their loss if they are lost on the voyage[13]. It is also worth mentioning that, the seller is required to supply the goods according to the description as initially agreed by the parties and to make sure that such is also recorded in the bill of lading, and to send the bill of lading endorsed in the name of the buyer or according to his instructions, and to tender the policy of insurance which covers the goods that are in transit. If the seller only fulfils one of the two conditions, he will be held to have breached the contract and as a result the buyer will get the opportunity of repudiating the contract as a result.

A buyer under a C.I.F. contract also has the duties of, paying the price as provided in the contract of sale, accepting delivery of the goods when they have been delivered and receive them from the carrier at the named port of destination, accepting the transport documents and paying all costs and charges incurred in obtaining the documents or equivalent electronic messages and reimburse the seller in rendering his assistance. A buyer who enters in to a C.I.F. contract has the distinctive advantage of getting the option of pledging the documents which he receives from the seller before the goods arrive at the port of destination and to obtain a loan facility against such documents.

IV. Compatibility of C.I.F. Contracts with SOGO

As explained above, a C.I.F. contract is a contract for the sale of goods. However, a C.I.F. contract would normally be formulated between a seller and a buyer when they are from different jurisdictions, to facilitate their transaction. When one considers the provisions of the SOGO, it is primarily designed to deal with local transactions relating to sale of goods, where ample reference is made to transactions involving sale of goods where the seller and the buyer are from different jurisdictions. In this backdrop, it becomes pertinent to examine the compatibility of a C.I.F. contract with the respective provisions of the SOGO.

13 C, Murray, *Schmitthoff's the Law and Practice of International Trade* (12th edn, Sweet and Maxell 2012)

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(A) Nature of the Contract

As mentioned above, a C.I.F. contract would fall under the definition of a sale of goods transaction as provided in section 02 of the SOGO. While a C.I.F. contract may relate to a transaction which may take place between a seller and a buyer from two different jurisdictions, the Courts in Sri Lanka would get the jurisdiction to determine the matter if such is brought before them under the applicable law governing the sale of goods agreement. Since much of the provisions in the SOGO leaves the parties to determine the specific terms of their contract regarding a sale of goods, one must look at such provisions which do not allow for any deviation from what is sated in the SOGO and to evaluate its compliance with the accepted practices and customs of concluding a C.I.F. contract.

(B) Passing of the Risk and Property of Goods

Under section 21 of the SOGO, if the parties do not agree otherwise, both the risk and the property in the goods will pass simultaneously from the seller to the buyer. Therefore, ascertaining the exact moment where the property in the goods is transferred from the seller to the buyer would also help to determine as to who would have to bear the loss or damage to the goods. Section 18 (1) provides that, 'where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred'. This makes it clear that, while the risk and the property may pass from the seller to the buyer simultaneously, if there is no contrary arrangement, when the parties intend to pass the property under section 18(1), all that would matter is to figure out their intention.

In considering the normal customs and practices associated with a C.I.F. contract, it provides an exception to the general rule where the risk and property in the goods passes together. A C.I.F. would therefore, fall under the pretext 'unless otherwise agreed', where the seller and the buyer agree that, risk and property in the goods shall pass at different occasions. According to the Incoterms of 2020[14] under a C.I.F. contract, the risk pertaining to the goods will pass from the seller to the buyer once the goods cross over the rail of the ship or once they are loaded onboard the ship[15]. The difficulty in ascertaining the exact moment when the goods cross the rail of the ship was highlighted in the case of ***Pyrene Co Ltd v. Scindia Steam Navigation Co Ltd***[16] where Lord Delvin opined that, 'only the most enthusiastic lawyer could watch with

14 These Incoterms are designed and developed by the International Chamber of Commerce, and are accepted as representing the general practices of the merchants carrying on international trade.
15 M, Bridge, *Sale of Goods* (3rd edn Oxford 2014) Para 3-56.
16 [1954] 2 QB 402

satisfaction the spectacle of liabilities shifting uneasily as the cargo sways at the end of a derrick across a notional perpendicular projecting from the ship's rail. Due to this difficulty, even in earlier cases[17], accepting the ship's rail as determining the liability concerning a loss or damage to goods has been rejected. Hence, now it is normally accepted that, the risk pertaining to the goods will pass from the seller to the buyer when the goods are loaded on board the ship.[18] On the other-hand when it comes to the passing of the property in the goods, it is usually accepted that such will only take place much later in the transaction, or at least that, passing of the risk and property will not occur simultaneously under a C.I.F. contract. According to Prof. Chuah[19], the passing of the property under a C.I.F. contract is somewhat problematic since section 18 (1) of the SOGO which states that, property in the goods will pass when the parties intend it to pass. However, when one looks at the rules that are provided under section 19 of the SOGO in ascertaining the intention of the parties, it fails to provide any guideline as to how the intention of the parties may be gathered concerning the passing of the property in the goods under a C.I.F. contract.

As mentioned above, the seller in a C.I.F. contract has the dual responsibility of providing the goods as agreed in the initial contract of sale and to furnish the buyer with a bill of lading by arraigning for shipment of the goods and a policy of insurance adequately covering the goods. A buyer would have a remedy for the failure of the seller to provide the agreed goods and the documents, as two different causes of actions. However, when looking at the question as to when does the property in the goods passes to the buyer, Prof. Chuah opines that, the accepted practice is to assume that property in the goods will pass with the tendering of the documents against the payment of the money. This is because, even where the goods have not been delivered and the documents have arrived, as the buyer would have the option of claiming insurance against the lost or damages goods, he would be required to pay in advance, and before the arrival of the goods at the port of destination, where the documents have been correctly tendered. It is also worth mentioning, since the buyer would be in possession of the bill of lading covering the goods described therein, he would have a documentary title to the goods, which he could transfer to another party upon indorsement, this giving the buyer a right to dispose of his goods to a third party without having to transfer the goods physically. This stance was taken in the case of ***Mitsui and Co Ltd v. Flota Mercante Granco-lubiana SA***[20] the Court

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17 *Glengarnock Iron and Steel Co., Ltd v. Cooper and Co.* [1895] SLR 32
18 J. Chuah, *Law of International Trade: Cross-Border Commercial Transaction* (4th edn, Sweet and Maxwell 2009)
19 *Ibid,* para 4-33 and 4-34
20 [1988] 2 Lloyd's Rep. 208

indicated that, where international sales contract (whether C.I.F. or F.O.B.) is characterized by the transfer of documents, property is to pass on tender of documents and payment of price.

The dilemma does not end there, since there is a possibility where the documents mat be correctly tendered where the goods may still become incompatible with what the parties have initially agreed. The question is an acute one as the buyer at the time of receiving the documents will not be in a possession to inspect the goods to check their conformity with the initial agreement concerning the goods. Section 16 (2) (b) of the SOGO ordinance provides that, there is an implied condition in the contract giving the buyer a reasonable time to compare the goods with the bulk, when the sale is made by a sample. In such a situation, even if the documents have been tendered and the payment is made, the property in the goods will only pass to the buyer in a defeasible manner[21], where if the goods fail to correspond with the initial agreement between the parties concerning the goods, the property in the goods vested with the buyer would become defeasible and be revested in the seller, who would have to bear the risk of the goods as well.

In the case of ***Hardy and Company v. Hillerns and Fowler***[22] Lord Blackburn opined that, 'if the goods are not in accordance with the contract the property does not pass to the purchaser upon his taking up the documents if he has not had at that time an opportunity of ascertaining whether the goods are in conformity with the contract. Though it may be that the property passes subject to its being revested when the buyer exercises his right of rejection'.

A similar incompatibility can also be found under section 20 (3) of the SOGO. According to section 20(3), 'where the seller of goods draws on the buyer for the price, and transmits the bill of exchange and bill of lading to the buyer together, to secure acceptance or payment of the bill of exchange, *the buyer is bound to return the bill of lading if he does not honour the bill of exchange, and if he wrongfully retains the bill of lading the property in the goods does not pass to him.*'[23] According to this provision, where the buyer fails to honour the bill of exchange as the payment for the goods evidenced by the bill of lading, the property in the goods will not pass to him. However, this is generally contradictory to the accepted practice concerning C.I.F. contracts, where it is generally assumed that property in the goods is transferred by the tendering of the documents covering the agreement. In this kind of a situation, one would have to conclude that, this would be an exception to the general practice concerning C.I.F. contracts, where honouring the bill of exchange would become a condition precedent for transfer of the

21 M, Bridge, *Sale of Goods* (3rd edn Oxford 2014)
22 [1923] 2 KB 490
23 Emphasis added

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property in the goods from the seller to the buyer. Another question which may arise would concern the risk of loss or damage concerning the goods. In such a situation, it would be safe to assume that the goods will be at the risk of the buyer since the risk would pass upon shipment under a C.I.F. contract.

(C) Payment for the Goods

According to section 28 of the SOGO, the payment and the delivery of the goods are considered as concurrent obligation unless the parties have agreed otherwise. The C.I.F. contracts provides an exception to this rule, where the payment would in most of the occasion would be made prior to the actual delivery of the goods, since a buyer would become liable to pay upon the receipt of the documents which includes the bill of lading and a policy of insurance. Beside this, in a C.I.F. contract, the seller does not actually guarantee the actual delivery of the goods. This was clearly stated in the case of ***Arnold Karberg v. Blythe, Green Jourdain and Co.***[24] where Lord Scrutton stated that, '[C.I.F.] is not a contract that goods shall arrive, but a contract to ship goods complying with the contract of sale, to obtain, unless the contract otherwise provides, the ordinary contract of carriage to the place of destination, and the ordinary contract of insurance of the goods on that voyage, and to tender these documents against the payment of the contract price.' Therefore, it becomes clear that, under a C.I.F. contract payment even if made prior to the arrival of the goods, is not made against their actual arrival, but upon the receipt of the corresponding documents accompanying the sales contract.

(D) Delivery of the Goods

According to section 32(1), delivery *prima facie* occurs where goods are handed over by the seller to an independent carrier for the purpose of transmission to the buyer. The reason for this is that the carrier is presumptively the buyer's agent. The prima facie rule in section 32(1) applies even if the carrier is not nominated by the buyer. Since the rule in section 32(1) is something that is *prima facie*, it should be displaced where goods are deliverable under a non-negotiable waybill to a named consignee but the seller consigning the goods has reserved, under the contract of carriage, the right to alter delivery instructions. Section 32(1) is also ousted in those cases where delivery to the carrier is not intended by the seller to be delivery to the buyer. This will be so where the seller retains the right of disposal under section 19, where delivery will take place constructively on the exchange of documents between seller and buyer. The rule in section 32(1) will therefore be displaced for C.I.F. sales. It is because goods may already be afloat before the contract of sale is concluded or before a particular cargo is appropriated to the

24 [1915] 2 K.B. 379

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contract, so that it is impossible to treat the carrier retrospectively as the agent for the buyer. In C.I.F. contracts, the seller's delivery obligation is commuted into an obligation to transfer shipping documents[25] and the buyer obtains the benefit of the contract of affreightment on the documentary exchange.

When one considers the situation stipulated under section 32(2), where 'unless otherwise authorized by the buyer, the seller must make such contract with the carrier on behalf of the buyer as may be reasonable, having regard to the nature of the goods and the other circumstances of the case'. So far as C.I.F. contracts are concerned, one of the most important requirements of a 'reasonable' shipping contract is that it should give the buyer a right of action against the shipping company for loss or damage to the goods throughout the whole period of the voyage.[26] However, in the event where the goods are damages, the buyer would not always be in a possession to make the seller responsible for the damages, since under the policy of insurance tendered along with the bill of lading would help to recover the cost of damages from the insurer himself.

Like section 32(2) in drawing on the seller's default is section 32(3), which establishes the presumptive rule that, where goods are 'sent' by sea by seller to buyer, in circumstances where insurance is usually carried, a failure by the seller to give such 'notice' as to enable the buyer to insure the goods in transit means that the goods will be at the seller's risk. This provision does not sit comfortably with English practice in the area of international documentary sales on C.I.F. terms. In such contracts, the risk is on the buyer from shipment, which is the case dealt with by section 32(3). That provision is ousted by contrary implication in the case of C.I.F. contracts, since insurance is the responsibility of the seller. Another contrary provision is the shifting of the risk to the seller during transit in the failure for obtaining the required insurance. Under a C.I.F. contract the risk pertaining to the goods will be with the buyer from the time of shipment and it will not be reverted to the seller under any condition, even where both the goods and documents do not comply with the contract since the seller would have a remedy where there is a default in providing agreed goods or the required documents for a failure of consideration.[27]

(E) Acceptance of the Goods

It can be generally shown that the rules relating to acceptance of the goods may also sit uncomfortably with the governing principles underlining a C.I.F. contract as section 35 of the

25 *Manbre Saccharine Co. Ltd v. Corn Products Co. Ltd* [1919] 1 K.B. 198
26 *Hansson v Hamel & Horley* Ltd [1922] 2 AC 36
27 C. Twigg-Flesner and R. Canavan, *Atiyah and Adams' Sale of Goods* (13th edn, Pearson 2016)

SOGO stipulates that, where a buyer does something which is inconsistent with the ownership of the seller, then the buyer would be deemed to have accepted the goods. In a C.I.F. contract this would also happen in a defeasible manner since, where a buyer under a C.I.F. contract may pledge the documents for obtaining a loan and may later find that the goods do not correspond with the initial agreement, whereas in such a situation the ownership of the goods will be reverted to the seller as what the buyer has done which is inconsistent with the ownership of the seller would not be capable of granting the ownership of the goods which does not comply with the initial agreement concerning the sale of goods.

V. Conclusion

The SOGO being a creature of the common law principles pertaining to contracts covering sale of goods and C.I.F. contracts predating the enactment was a creature of the customs and practices of traders who went beyond their home territories in search of trade. In discussing the compatibility of the provisions of the SOGO with the general practices accommodating C.I.F. contracts, it would be safe to say that much of it is not inconsistent *per se* with the provisions of SOGO, since it allows party autonomy by giving the parties to stipulate their terms which may be not according to the general rule as provided under SOGO, but as an exception to it. For example, the transfer of risk and property while being stipulated that, generally it should be passed simultaneously, C.I.F. contracts provides and exception to that rule yet it is not violative of the provisions of the SOGO as it is a valid exception for the general rule. On the other instances, such as where the risk is reverted to a seller who fails to obtain insurance for a sale of goods concerning chattel where it is usual to obtain insurance would sit uncomfortably as it is mandatory for the seller to obtain a policy of insurance under a C.I.F. contract.

Therefore, while there are some provisions in the SOGO which provides a general rule that is an exception to the basic principles of a C.I.F. contract, and some relatively small section of provisions being incompatible with the C.I.F. contracts *per se,* much of other provisions envisaged by the SOGO does not contradict with the basic principles of C.I.F. contracts if it is covered by the phrase ‘unless otherwise agreed’.

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