# INCOTERMS as a form of standardisation in international sales law: an analysis of the interplay between mercantile custom and substantive sales law with specific reference to the passing of risk

by
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## DECLARATION

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By submitting this dissertation electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the authorship owner thereof (unless to the extent explicitly otherwise stated) and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

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**SUMMARY**

International sales contracts have very specific needs that stem from the multiplicity of legal systems which apply to such contracts. In addition to harmonised law, mercantile custom is able to address many of these needs. Mercantile custom represents usages which are clear, certain and efficient and are expected to be known and applied by merchants in a particular trade or region. To this extent mercantile custom fulfils an automatic harmonisation function.

However, where a custom does not enjoy uniform application across all branches of trade, the harmonisation function of mercantile custom is limited, as is the case with trade terms. Trade terms reflect mercantile customs and usages which developed over a long time in order to simplify the trade in goods that are transported from one place to the other. They regulate the delivery obligations of the seller and buyer as well as associated obligations such as the passing of risk. Trade terms negate the need for elaborate contract clauses and appear in abbreviated form in contracts of sale. Although they provide a uniform expression of mercantile custom in a particular location or trade, the understanding of trade terms tend to differ from country to country, region to region or from one branch of trade to the next. The ICC INCOTERMS is an effort to standardise trade term definitions at the hand of the most consistent mercantile customs and practices.

The aim of this study is to investigate the efficiency of INCOTERMS as a form of standardisation in international sales law. For purposes of the investigation the focus is limited to the passing of risk. Although national laws usually have a default risk regime in place, merchants still prefer to regulate risk by means of trade terms. This study will investigate the legal position in the case of FOB, CIF and DDU terms. An analysis of the risk regimes of a few selected national systems will show that each has their own understanding of these trade terms. The United Nations Convention on Contracts for the International Sale of Goods (CISG) does not refer to trade terms, but many commentators have concluded that the CISG risk rule is consistent with INCOTERMS. The study will discuss this in more detail. To determine the efficiency of INCOTERMS as a form of standardisation in international sales law, the study examines their characteristics, legal nature as well as their limited scope of

regulation. Specific emphasis is placed on the interplay between the CISG and INCOTERMS and the possibility of some form of interaction and collaboration between the two instruments. It is concluded that collaboration between INCOTERMS and the CISG adds value to the international law of sales by increasing the efficiency of an international business transaction and thereby facilitating international trade.

## OPSOMMING

Internasionale koopkontrakte het spesifieke behoeftes wat voortspruit uit die veelvoudigheid van regstelsels van toepassing op so 'n kontrak. Baie van hierdie behoeftes kan aangespreek word deur geharmoniseerde regsreëls in samehang met handelsgewoontes en –gebruike. Handelsgewoontes verteenwoordig duidelike, seker en effektiewe gebruike. Daar word dus van handelaars wat in 'n bepaalde bedryf of streek handel dryf, verwag om van hierdie gebruike kennis te neem en hulle toe te pas. In hierdie konteks vervul handelsgebruike 'n outomatiese harmoniseringsfunksie.

Waar 'n gebruik nie eenvormig toegepas word oor alle bedrywe heen nie, is die harmoniseringsfunksie van handelsgebruike egter beperk. Handelsterme bied 'n tipiese voorbeeld hiervan. Handelsterme verteenwoordig bepaalde handelsgewoontes en –gebruike wat oor 'n geruime tyd ontwikkel het ten einde handel in goedere wat van een plek na die ander vervoer word, te vergemaklik. Hulle reguleer die leweringsverpligtinge van die verkoper en koper asook ander verpligtinge wat met lewering verband hou, soos byvoorbeeld die oorgang van risiko. Handelsterme doen weg met lang en omslagtige kontraksbedinge aangesien hulle in die vorm van afkortings in die kontrak figureer. Alhoewel handelsterme 'n uniforme uitdrukking van gebruike in 'n bepaalde gebied of bedryf verteenwoordig, is dit egter so dat die inhoud van handelsterme van land tot land, streek tot streek of van een tipe bedryf tot die ander verskil. *INCOTERMS* is 'n poging om die inhoud van handelsterme te standaardiseer aan die hand van die mees eenvormige handelsgewoontes en –gebruike.

Die doel van hierdie studie is om die effektiwiteit van *INCOTERMS* as 'n vorm van standaardisering in die internasionale koopreg te ondersoek. Vir doeleindes van die ondersoek word die fokus beperk tot die oorgang van risiko. Al het nasionale regstelsels gewoonlik 'n verstek risiko-reël in plek, verkies handelaars steeds om risiko by wyse van handelsterme te reguleer. Die studie ondersoek die regsposisie in die geval van *FOB*-, *CIF*-, en *DDU*-terme. 'n Analise van risiko-regulering in 'n aantal nasionale sisteme toon dat elk hul eie betekenis heg aan die inhoud van hierdie terme. Alhoewel die Weense Koopkonvensie geensins na handelsterme verwys nie,

voer verskeie kommentatore aan dat die Konvensie se risiko-bestel verenigbaar is met dié van *INCOTERMS* en sal hierdie aspek gevolglik in meer besonderhede in die studie aangespreek word. Ten einde die effektiwiteit van *INCOTERMS* te bepaal, word daar ondersoek ingestel na hulle kenmerke, regsaard en beperkte aanwendingsgebied. Spesiale klem word gelê op die wisselwerking tussen die Weense Koopkonvensie en *INCOTERMS* asook die moontlikheid van interaksie en samewerking tussen die twee instrumente. Die gevolgtrekking is dat interaksie tussen die Koopkonvensie en *INCOTERMS* waarde toevoeg tot die internasionale koopreg deur die effektiwiteit van die internasionale besigheidstransaksie te verhoog en gevolglik internasionale handel te bevorder.

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## LIST OF ABBREVIATIONS

### JOURNALS

| | |
|---|---|
| Am J Comp L | *The American Journal of Comparative Law* |
| Am U Int'l L Rev | *American University International Law Review* |
| Can Bus Law J | *Canadian Business Law Journal* |
| Cardozo J Int'l & Comp L | *Cardozo Journal of International and Comparative Law* |
| Chi J Int'l L | *Chicago Journal of International Law* |
| CILSA | *Comparative and International Law Journal of South Africa* |
| Colum J Trans L | *Columbia Journal of Transnational Law* |
| Com L Ann | *Commercial Law Annual* |
| Del L Rev | *Delaware Law Review* |
| Cornell Int'l LJ | *Cornell International Law Journal* |
| Dick L Rev | *Dickenson Law Review* |
| Duke J Comp & Int'l L | *Duke Journal of Comparative and International Law* |
| Eur Trans L | *European Transport Law* |
| ELJ | *European Law Journal* |
| Ga J Int'l Comp L | *Georgia Journal of International and Comparative Law* |
| Harv Int'l LJ | *Harvard International Law Journal* |
| Harv L Rev | *Harvard Law Review* |
| Hong Kong LJ | *Hong Kong Law Journal* |
| ICLQ | *International and Comparative Law Quarterly* |
| ICCLR | *International Company and Commercial Law Review* |
| Ind J Global Legal Stud | *Indiana Journal of Global Legal Studies* |
| Int'l Law | *The International Lawyer* |
| Int'l Rev L & Econ | *International Review of Law and Economics* |
| Int'l Tax & Bus Law | *International Tax and Business Lawyer* |
| JBL | *Journal of Business Law* |
| JOC | *The Journal of Commerce Online* |
| JIBL | *Journal of International Business Law* |
| J Law & Econ | *Journal of Law and Economics* |
| J Legal Stud | *Journal of Legal Studies* |

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|---|---|
| Oxford U Comparative L Forum | *Oxford University Comparative Law Forum* |
| JL & Com | *Journal of Law and Commerce* |
| JL Econ & Org | *Journal of Law, Economics and Organization* |
| Loy LA Int'l & Comp LJ | *Loyola of Los Angeles International and Comparative Law Journal* |
| LMCLQ | *Lloyd's Maritime and Commercial Law Quarterly* |
| Mich L Rev | *Michigan Law Review* |
| N Ill U L Rev | *Northern Illinois University Law Review* |
| NJCL | *Nordic Journal of Commercial Law* |
| NYLJ | *New York Law Journal* |
| Nw J Int'l L & Bus | *Northwestern Journal of International Law and Business* |
| Nw UL Rev | *Northwestern University Law Review* |
| Ohio St LJ | *Ohio State Law Journal* |
| Oxford J Legal Stud | *Oxford Journal of Legal Studies* |
| Pace Int'l L Rev | *Pace International Law Review* |
| RabelsZ | *Rabels Zeitschrift für ausländische und Internationales Privatrecht* |
| RHDI | *Revue Hellénique De Droit International* |
| RIW | *Recht der internationalen Wirtschaft* |
| SA Merc LJ | *South African Mercantile Law Journal* |
| SALJ | *South African Law Journal* |
| THRHR | *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* |
| Tul L Rev | *Tulane Law Review* |
| Tul Mar LJ | *Tulane Maritime Law Journal* |
| U Miami Inter-Am L Rev | *The University of Miami Inter-American Law Review* |
| U Pa J Int'l Econ L | *University of Pennsylvania Journal of International Economic Law* |
| U Pa L Rev | *University of Pennsylvania Law Review* |
| Unif L Rev | *Uniform Law Review* |
| Va J Int'l L | *Virginia Journal of International Law* |
| Va L Rev | *Virginia Law Review* |
| VJ | *Vindobona Journal of International Commercial Law and Arbitration* |
| Wayne L Rev | *Wayne Law Review* |
| Yale LJ | *The Yale Law Journal* |

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|---|---|
| Yale J Int'l L | *Yale Journal of International Law* |

**MISCELLANEOUS**

| | |
|---|---|
| 3PLS | third party logistics providers |
| ABA | American Bar Association |
| AEC | African Economic Community |
| AEO | Authorised Economic Operator |
| ALI | American Law Institute |
| AGB | *Allgemeine Geschäftsbedingungen* |
| AGBG | *Gesetz zur Regelung des Rechts der Allgemeine Geschäftsbedingungen* |
| APPF | Asian Pacific Parliamentarian Forum |
| AU | African Union |
| BGB | *Bürgerliches Gesetzbuch (*German Civil Code) |
| BGH | *Bundesgerichtshof* (German Supreme Court) |
| BOLERO | Bill of Lading Electronic Registry Organisation |
| C&F | Costs and Freight |
| CIDIP | *Conferencias Especializades Interamericanas Sobre Derecho Internacional Provado* (Inter-American Specialised Conferences on Private International Law) |
| CIETAC | China International Economic and Trade Arbitration Commission |
| CFR | Common Frame of Reference |
| CFR | Cost and Freight |
| CFS | container freight station |
| CFS/CFS | container freight station-to-container freight station |
| CIF | Costs, Insurance and Freight |
| CIF & C | Costs, Insurance, Freight and Commission |
| CIF C & I | Costs, Insurance, Freight, Commission and Interest |
| CIF & E | Costs, Insurance, Freight and Exchange |
| CIP | Freight, carriage and insurance paid to |
| CISG | United Nations Convention on Contracts for the International Sale of Goods 1980 |
| CLP | ICC Commercial Law and Practice Committee |
| CMEA | Council of Mutual Economic Aid |

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| CMI | *Comité Maritime International* |
| CPT | Carriage Paid To |
| C-PTAT | Custom-Trade Partnership Against Terrorism |
| CY | container yard |
| CY-CY | container yard-to-container yard |
| DCFR | Draft Common Frame of Reference |
| DDU | Delivered Duty Unpaid |
| EC | European Community |
| ECE | Economic Commission for Europe |
| EEC | European Economic Community |
| EDI | Electronic Data Interchange |
| EDIFACT | Electronic Data Interchange for Administration, Commerce and Transport |
| FCA | Free Carrier |
| FCL | full container load |
| FCP | Freight or Carriage Paid to |
| FIATA | International Federation of Freight Forwarders Associations |
| FOB | Free on Board |
| FOBT | Free on Board Trimmed |
| FOBST | Free on Board Stowed and Trimmed |
| FOR | Free on Road |
| FOSFA | Federation of Oils, Seeds and Fats Association |
| FRC | Free carrier … named point |
| FTA | free trade agreement; free trade area |
| GAFTA | Grain and Feed Trade Association |
| GATT | General Agreement on Tariffs and Trade |
| GSF | Global Shippers' Forum |
| HGB | *Handelsgesetzbuch* (German Commercial Code) |
| ICC | International Chamber of Commerce |
| INCOTERMS | International Commercial Terms |
| INTRATERMS | International Trade Terms |
| LAWSA | *The Law of South Africa* |
| LCL | less than full container load |
| LO-LO | lift on-lift off |
| NCCUSL | National Conference of Commissioners on Uniform State Laws |

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|---|---|
| NEPAD | New Partnership for African Development |
| NGFA | National Grain and Feed Association |
| OAS | Organisation of American States |
| OHADA | Organisation for the Harmonisation of Business Law in Africa (*Organisation pour l'Harmonisation des Droit des Affaires en Afrique*) |
| REC | regional economic communities |
| RIA | regional integration agreement |
| RTA | regional trade agreement |
| SADC | Southern-African Development Community |
| SGA | English Sale of Goods Act 1979 |
| THC | transport handling costs |
| UCC | American Commercial Code |
| UCP | Uniform Commercial Practices |
| ULF | Uniform Law on the Formation of Contracts for the International Sale of Goods (1964) |
| ULIS | Uniform Law on the International Sale of Goods (1964) |
| UNCID | Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNCTAD | United Nations Conference on Trade and Development |
| UNIDROIT | International Institute for the Unification of Private Law |
| WTO | World Trade Organisation |

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# CHAPTER ONE
# INTRODUCTION

## 1 1 Legal impediments to international sales

During the last three decades international trade has increased remarkably. This is especially so in light of new emerging world markets.[1] Globalisation is one of the single most important factors contributing to this increase.[2] The formation of regional economic and political units as well as the abolition of regulatory constraints on trade between different countries has facilitated international trade to a large extent.[3] Developments in transportation and communication stimulate the growth of international commerce even further. Innovation in the field of information telecommunications and technology is another key driver in the globalisation process.[4] The possibility of concluding contracts electronically by telefax, email or over the Internet has eliminated the constraints of distance and time and opened up new world markets, which in turn has led to an increase in the volume of international trade.

Although a country may increase its economic wealth by exporting goods,[5] it is also true that international sales are subject to legal impediments which are directly connected to the international nature of the transaction.[6]

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[1] Horn "Uniformity and Diversity in the Law of International Commercial Contracts" in Horn & Schmitthoff (eds) *The Transnational Law of International Commercial Transactions II* (1982) 3 4-5.

[2] Zeller "The Development of Uniform laws – A Historical Perspective" 2002 (14) *Pace Int'l L Rev* 163 167.

[3] See Mörner "Financing Trade Within a Regional Framework – Legislative Options: Clive M Schmitthoff on the Unification of the Law of International Trade Revisited" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 419 n 9 on regional trade agreements (RTAs), also known as regional integration arrangements (RIAs), free trade areas (FTAs), customs unions and common markets as related phenomena facilitating international trade. Some 421 RTAs have been notified to the GATT/WTO up to December 2008. See http://www.wto.org/english/tratop_e/region_e.htm (accessed 30-10-2009). On economic unions, see in general, Ademuni-Odeki *The Law of International Trade* (1999) 6; Kronke "UNIDROIT 75th Anniversary Congress on Worldwide Harmonisation of Private Law and Regional Economic Integration: Hypotheses, Certainties and Open Questions" 2003 *Unif L Rev* 10.

[4] Walker "The Strategic Response to Globalisation" 1999 *JIBL* 245, 248-249.

[5] For an economic viewpoint on the historical development of international trade, see Ademuni-Odeki *International Trade* 3-5. Fox *International Commercial Agreements: A Primer on Drafting, Negotiating and Resolving Disputes* (1998) 1.

[6] Although impediments to international trade are not restricted to private law matters and extend to issues that fall within the domain of private and public international law, this study restricts its focus to that of the substantive private law.

Every contract is governed by an applicable legal system. When a dispute arises it is often uncertain which country's law governs the transaction, which court is to be approached for legal relief, or whether there will be access to a favourable court at all. The multiplicity of legal systems relevant to the transaction results not only in problems of forum shopping, but also in uncertainty as to the respective rights and obligations of the parties to the contract. Although the parties are in general free to choose the law applicable to their contract,[7] in practice, the choice of a legal system is often not provided for in the contract. If not chosen, it is left open to the relevant courts and arbitral tribunals to establish the applicable law by using conflict-of-law principles, also known as the principles of private international law. This entails an extremely complicated and possibly expensive enquiry, the results of which are often haphazard and unclear.[8] Contracting parties, therefore, could be faced with uncertainty as to which system governs their contractual dispute; and even if the choice of law is clear, they could still be confronted with problems because of differences in the substance of national laws. Moreover, different aspects of a contract could be governed by different legal systems,[9] which could complicate the situation even further.

Scholars furthermore argue that most domestic sales laws do not take into consideration the specific characteristics of international economic relations.[10] Domestic sales laws are simply not geared for international situations. Often they are too generalised and rely on historical concepts which do not address the needs of modern day trade. In addition they are designed to meet the economic and social needs of specific societies and, therefore, fail to address the needs of transnational

[7] In the absence of a common legal system, a contractual choice-of-law clause functions as a gap filler. The rationale for a choice of law lies in the fact that party autonomy can provide certainty and predictability, which are essential to commercial transactions. North & Fawcett *Cheshire and North's Private International Law* 13th ed (1999) 553. See also Farnsworth "Recent Trends in International Sales Law" in Peng Kee et al (eds) *Current Developments in International Transfers of Goods and Services* (1994) 3 10-12; the discussion on choice-of-law clauses 4 3 4 *infra*, but see Linarelli "The Economics of Uniform Laws and Uniform Lawmaking" 2003 (48) *Wayne L Rev* 1387 1404-1410, who submits that contractual choices-of-law can be costly.

[8] De Ly "Sources of International Sales Law: An Eclectic Model" 2005-2006 (1) *JL & Com* 1-2. See also 4 3 4 *infra*.

[9] The principle of *dépeçage* or scission provides the possibility for parties to choose different laws for different parts of the contract. The choice can be expressed by the parties or inferred by the courts. See North & Fawcett *Private International Law* 553; Viejobueno "Private international law rules relating to the validity of international sales contracts" 1993 (26) *CILSA* 172 178-180.

[10] Enderlein & Maskow *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods* Preface para 1 1; Juenger "The *lex mercatoria* and private international law" 2000 *Unif L Rev* 171 176-177; Eiselen "Adoption of the Vienna Convention for the International Sale of Goods (the CISG) in South Africa" 1999 (116) *SALJ* 323 329; De Vries "The Passing of Risk in International Sales under the Vienna Sales Convention 1980 as compared with Traditional Trade Terms" 1982 (17) *Eur Trans L* 495 497; Goode "Insularity or Leadership? The Role of the United Kingdom in the Harmonisation of Commercial Law" 2001 50(4) *ICLQ* 751 752.

relationships.[11] Adjustment of these laws to the needs of international trade can be impeded by the fact that domestic statutes are difficult to reform.[12] Moreover, because arbitration is often the preferred method of resolving international commercial disputes, national case law has contributed little to the development of domestic laws in line with commercial needs.[13] It should also be kept in mind that modern international business practice has developed complex and often mixed forms of contracts which cannot be easily classified under the standard types of contract governed by national law.[14] In spite of modern developments, municipal law remains pre-occupied with the traditional nominate contracts.[15]

Although the regulation of international sales transactions poses special problems, there is no *numerus clausus* of such problems. For purposes of this particular investigation, some issues are identified, which are subsequently discussed in more detail.

[11] Klotz & Barrett *International Sales Agreements: An Annotated Drafting and Negotiating Guide* (1998) xxvi. Some scholars, however, argue that there is no clear difference between domestic and international commercial contracts because of the interconnectedness of domestic and international economies. See Viejobueno 1993 (26) *CILSA* 174. Moreover, some consider the distinction artificial since international trade is not a distinct category of trade engaged by a distinct group of people. See Rosett "Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods 1984 (45) *Ohio St LJ* 265 269, 275 and "Unification, Harmonisation, Restatement, Codification, and Reform in International Commercial Law" 1992 (3) *Am J Comp L* 683 687; Calus "Modernisation and Harmonisation of Contract Law: Focus on Selected Issues" 2003 *Unif L Rev* 155 162; Rusch "The Relevance of Evolving Domestic and International Law on Contracts in the Classroom: Assumptions about Assent" 1998 (72) *Tul L Rev* 2043 2062.

[12] Goldštajn "Usages of Trade and other Autonomous Rules of International Trade According to the UN (1980) Sales Convention" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 56 66.

[13] Often arbitral awards are not reported, which limits the opportunity of referring to them when deciding a case. Maniruzzaman "The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration" 1999 (14) *Am U Int'l L Rev* 657 729; Goldštajn "Usages of Trade" in *International Sale of Goods* 60; Mistelis "Is Harmonisation a Necessary Evil? The Future of Harmonisation and New Sources of International Trade Law" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 13 para 1-005.

[14] Modern countertrade transactions, for example, may include elements such as barter or re-purchase ("buy-back"). Often they comprise complicated contractual exchanges of economic resources which give rise to hybrid forms of contract. See Astrup et al *Guide to Export-Import Basics* 2nd ed (2003) 31; Mirus & Yeung "Economic Incentives for Countertrade" 1986 (27) *JIBS* 27; Ademuni-Odeki *The Law of International Trade* 11-12.

[15] Goldštajn "Usages of Trade" in *International Sale of Goods* 60, 66.

## 1 2 The features of an effective international sales law regime

### 1 2 1 Default rules that entrench the principles of economic efficiency and party autonomy

According to the principle of freedom of contract, freely negotiated contracts form the core of all international economic relations.[16] Contract law fosters voluntary exchange by enforcing mutually understood agreements (*pacta sunt servanda*) and imposing sanctions on the party who fails to perform.[17]

Apart from regulating social behaviour, it is also said that the law promotes the efficient allocation of resources. Many of the doctrines and institutions of the law can be explained as efforts to promote such an allocation.[18] Economic efficiency requires a choice of "entitlements"[19] or interests "which would lead to an allocation of resources that could not be improved on in the sense that a further change would not so improve the condition of those who gained by it that they could compensate those who lost from it and still be better off than before."[20] Efficiency therefore entails the allocation of resources in such a way that value is maximised.[21]

In terms of the economic analysis of the law theory, contracting parties are considered to be "utility" or "value maximisers"; that is, they are assumed to act rationally with the view of advancing their economic interests.[22] Contracts which maximise value are efficient transactions. If transaction costs are low, the transaction is deemed to be economically efficient. By minimising transaction costs, efficient

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[16] Viejobueno 1993 (26) *CILSA* 172.
[17] Ruhl "The Battle of the Forms: Comparative and Economic Observations" 2003 (24) *U Pa J Int'l Econ L* 189 210-211; Kronman & Posner *The Economics of Contract Law* (1979) 4; Goode *Commercial Law* 3rd ed (2004) 65.
[18] This is the basis of the economic approach to the law. See Posner *Economic Analysis of the Law* 6th ed (2003) 25.
[19] "Entitlement" refers to the interest which should be upheld in the case of conflict. In other words, the concept is similar to that of a right. Calabresi & Melamed "Property Rules, Liability Rules and Inalienability: One View of the Cathedral" 1972 (85) *Harv L Rev* 1089 1090.
[20] This is the notion of Pareto optimality as formulated by Calabresi & Melamed 1972 (85) *Harv L Rev* 1094, which assumes that when exchange takes place voluntarily, no transaction costs exist. However, Posner *Economic Analysis* 13 points out that the Pareto criterion has little application in the real world because most transactions have effects on third parties. He prefers the Kaldor-Hicks concept of efficiency, also referred to as potential Pareto superiority, which takes the compensation of third parties into account in determining the efficiency of an exchange.
[21] Posner *Economic Analysis* 9-10. "Value" is defined as how much someone is willing to pay for something or how much money he demands for parting with it. In terms of economic analysis, "value" is also referred to as "utility", in the sense of an expected cost or benefit which enhances the wealth of society.
[22] Posner *Economic Analysis* 3-5, 10-12. "Utility" refers to man's self-interest. It also refers to willingness to pay and is therefore synonymous to the economist's concept of value. People respond to incentives, such as price increases, by changing their behaviour in order to maximise their self-interest or utility.

legal rules will maximise value and allocate resources efficiently. Low transaction costs will directly promote voluntary exchange.[23] The term "transaction costs" is a wide concept that in the context of international sales could include negotiation costs, legal costs, the costs of researching the effects and probability of a contingency, costs of drafting and printing the contract, costs of executing the transaction and enforcing its obligations, and also the costs of settling or adjudicating a legal dispute against the background of multiple legal systems and jurisdictions.[24]

According to Posner,[25] the law of contract has five economic functions. Firstly, to prevent opportunism;[26] secondly, to interpolate efficient terms;[27] thirdly, to prevent avoidable mistakes; fourthly, to allocate risk to the superior risk bearer;[28] and fifthly, to reduce the costs of resolving contract disputes.

When, as in the case of international sales, the exchange of goods for money does not take place simultaneously, risks increase and the contract's ability to maximise value decreases.[29] International sales law therefore has to be directed towards

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[23] Ruhl 2003 (24) *U Pa J Int'l Econ L* 212. The basis for transaction cost analysis is found in the Coase Theorem introduced by Ronald Coase "The Problem of Social Cost" 1960 (3) *J Law & Econ* 1. This theory states that in a world with no transaction costs, contractual negotiations will eliminate externalities and will drive the market to an efficient solution without central intervention from the state. One of the basic principles of economics is that resources tend to gravitate toward their most valuable uses if voluntary exchange is permitted. Voluntary exchange is therefore aimed at maximising value. Kronman & Posner *Economics of Contract Law* 2; Posner *Economic Analysis* 9.

[24] Ayres & Gertner "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" 1987 (99) *Yale LJ* 87 92-93. Where Coase 1960 (3) *J Law & Econ* 1 mainly focused on the costs of negotiation, Calabresi & Melamed 1972 (85) *Harv L Rev* 1089 1103 expanded the notion of transaction costs to include enforcement and adjudication costs. According to Elkin-Koren & Salzberger "Law and Economics in Cyberspace" 1999 (19) *Int'l Rev L & Econ* 553 554, 567-568 the current paradigm of transaction cost economics is much broader. This expansion is linked to the development of the law and economics movement, from the traditional Chicago School economic analysis of the law to a transaction cost analysis to the third generation neo-institutional law and economics movement. The latter movement broadens the concept of transaction costs to include institutional structures such as political, bureaucratic, legal, commercial or non-commercial variables.

[25] *Economic Analysis* 96-98.

[26] The law may impose costs for opportunistic behaviour where a party contemplates breach or monopolistic behaviour. Non-instantaneous or extended exchange increases the opportunity for so-called "strategic" breach of contract. See Kronman & Posner *Economics of Contract Law* 4; Linarelli 2003 (48) *Wayne L Rev* 1400.

[27] The law is able to fill gaps, especially in cases of long term relationships where it is not always possible to contemplate every contingency or where contingencies are so unlikely that the drafting costs to regulate such situations outweigh the benefits. The parties often elect to leave the gap when the cost of *ex ante* contracting is higher than that of *ex post* litigation. It is then left to the courts to interpret the contract to cover such a contingency when it occurs. See Schwartz & Watson "The Law and Economics of Costly Contracting" 2004 (20) *JL Econ & Org* 2 3.

[28] Posner *Economic Analysis* 97 uses the example where A buys goods from B, but before delivery of the goods, B's warehouse burns down due to circumstances beyond his control. The contract is silent on allocation of risk before delivery. Economic analysis reveals that because B can prevent (or insure against) a fire at his own warehouse at lower cost than A can, the parties, if they had thought about the matter, would probably have assigned the risk to B.

[29] Because non-instantaneous or extended transactions create uncertainty and the risk that the costs and benefits of the exchange will turn out to be different from what the parties expected. See Kronman & Posner *Economics of Contract Law* 4.

facilitating a contract that will maximise value and minimise transaction costs. The law should supply a set of default terms which the parties do not have to negotiate. At the same time, the default rules should provide information on contingencies that may arise from the transaction, which will enable parties to plan their transaction sensibly. Both functions will contribute to a reduction in transaction costs.[30]

Where the costs of contracting are prohibitive in the sense that they outweigh all benefits, or if the magnitude or probability of a contingency is sufficiently low, parties may conclude a contract without providing for the issue or issues in question, resulting in what is called "contract incompleteness".[31] In these instances, parties often rely on default rules provided by the governing law of the contract or on standard form contracts.[32] Default rules should address the basic issues common to all contracts of sale.[33] If the default rules[34] of a particular legal system are efficient and reflect the common intentions of both parties to the contract, it will limit bargaining costs and increase the overall efficiency of the transaction. The parties, therefore, would not have to negotiate and provide for all these aspects contractually. By providing default rules which reflect the most likely outcome had the parties negotiated on the issue,[35] contract law can keep transaction costs as low as possible.[36]

Normally default rules regulate issues of contract formation and validity, such as the influence of mistake, duress, misrepresentation and undue influence on the contract,

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[30] In the absence of such rules, parties will be uncertain as to which default rules will apply to the transaction due to the multiplicity of legal systems potentially applicable to such a contract. Default rules of the applicable domestic law could increase transaction costs due to legal costs incurred in establishing the content of the law as well as opportunity costs spent on wasted time and effort to familiarise oneself with the law. See Linarelli 2003 (48) *Wayne L Rev* 1401-1402.

[31] Posner *Economic Analysis* 96; Schwartz & Watson 2004 (20) *JL Econ & Org* 2-3; Linarelli 2003 (48) *Wayne L Rev* 1401-1402. "Incompleteness" may also result from the failure of a contractual party to disclose information which could affect his share of the gains. See Ayres & Gertner 1987 (99) *Yale LJ* 92-94.

[32] Kronman & Posner *Economics of Contract Law* 4. On standard form contracts, see also 4 2 1 & 4 3 1 *infra*.

[33] Typically, substantive law rules consist of default rules or a combination of mandatory rules and default rules.

[34] Ayers & Gertner 1987 (99) *Yale LJ* 91 distinguish between a "tailored default" which provides contracting parties with what they would have contracted for and an "untailored" or "off the rack" default which the majority of contracting parties would have wanted.

[35] Default rules mostly consist of the rule that the majority of the parties would have wanted. See Stocks "Risk of Loss under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods: A Comparative Analysis and Proposed Revision of UCC Sections 2-509 and 2-510" 1993 (87) *Nw UL Rev* 1415 1445-1446; Note "Unification and Certainty: The United Nations Convention on Contracts for the International Sale of Goods 1979 (65) *Harv L Rev* 557 558-559; Ayres & Gertner 1987 (99) *Yale LJ* 89-90.

[36] Unfortunately, it is not entirely clear how default rules should be set in order to be the most efficient. Although default rules are aimed at reducing transaction costs, it may happen that a particular default rule can actually be more costly, depending on the circumstances of the case, whilst a negotiated rule can present a more cost efficient alternative. See Ayres & Gertner 1987 (99) *Yale LJ* 93-95.

the capacity of the parties to contract, as well as possibility and legality of performance. A sales law regime should furthermore regulate the nature and quality of the subject matter of the contract and provide guidelines on the determination of the contract price. Moreover, legal rules should determine the rights and obligations of the parties, for instance the time and place of delivery and of payment. These rules should also regulate breach of contract and the remedies available for breach, govern the transfer of property in the goods, allocate risk and provide for impediments that are beyond the control of the parties. Where a sales law regime is incapable of regulating all these aspects at once, it will be supplemented by the general principles of contract law and even by other rules of the substantive law.

To increase the efficiency of a legal system, rules of the substantive law should be flexible and provide businesspeople with the opportunity to modify or exclude any default rule that does not address their specific needs. Because individuals are assumed to be rational maximisers of their own welfare and have specific knowledge about their needs and preferences, this proposition provides the opportunity to maximise value and thereby increase the overall efficiency of the transaction. Party autonomy furthermore provides the possibility of protecting trade practices that parties have developed during a longstanding business relationship or in a particular trade, which will also benefit the overall efficiency of the transaction.

### 1 2 2 Legal rules that are certain, clear and predictable

Because of the highly competitive nature of international trade and the high financial stakes involved, it is important that the legal implications and consequences of such transactions are clear and free from uncertainty. International trade is an economic endeavour which, with a view to being profitable, requires that transactions take place in the shortest possible time, at the least expense and with the elimination of misunderstanding, uncertainty and legal disputes to the greatest possible extent.

International sales law must therefore provide a high level of certainty and predictability to allow parties to structure their business transactions properly.[37] Parties should not only be certain that their agreement will be legally binding, but

[37] Horn "Uniformity and Diversity" in *Transnational Law II* 4; Eiselen 1999 (116) *SALJ* 339.

also that they understand how those agreements will be interpreted if challenged.[38] A legal rule should be able to generate clarity; not only for the parties to the contract but also as regards a judge or arbitrator who has to apply the rule to settle a dispute. If a legal rule can minimise the risks of misunderstanding and uncertainty and provide predictability on the outcome of a dispute, it lowers transaction costs and improves the overall efficiency of the transaction.

### 1 2 3 Rules that recognise the importance of mercantile custom and trade usage and are cognisant of commercial realities

Mercantile custom plays an important role in international commerce.[39] Trade usage often fills the gaps in default rules, which the parties fail to provide for contractually. In that sense, trade usage not only fulfils an interpretative function to establish the intent of the parties to the contract, but also functions as substantive law where the default rule fails to regulate all possible contingencies. The incorporation of trade usages into a contract can reduce transaction costs. In the international context, mercantile custom could sometimes be more cost effective than express contractual terms, since the latter might still have to be translated into foreign languages, which may result in mistakes and misunderstandings.[40] Custom also allows parties in a particular trade to settle on practices that initially might have been the subject of explicit bargaining, but have become regularised among members of the trade to the extent that negotiations are no longer necessary to settle the content of the custom.[41]

International commercial law is to a large extent shaped by the parties engaged in international trade.[42] Because contractual parties are rational maximisers of utility, distinct customary ways of doing business have developed internationally. As these practices are widely and regularly followed in international trade, they are presumed to be economically efficient as inefficient practices would not have stood the test of time.[43] At the same time, it is assumed that the content of such practices is certain

[38] Walt "Novelty and the Risks of Uniform Sales Law' 1999 (39) *Va J Int'l L* 671 671-672.
[39] See Berman & Kaufman "The Law of International Commercial Transactions (Lex Mercatoria)" 1978 (19) *Harv Int'l LJ* 221 272-273, who refer to "an international body of law, founded on the commercial understandings and contract practices of an international community composed principally of mercantile shipping, insurance, and banking enterprises of all countries."
[40] Gillette "Harmony and Stasis in Trade Usage for International Sales" 1999 (39) *Va J Int'l L* 707 724.
[41] Gillette 1999 (39) *Va J Int'l L* 707-708.
[42] Cutler *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* (2003) 185-186.
[43] Dalhuisen "Custom and Its Revival in Transnational Private Law" 2008 (18) *Duke J Comp & Int'l L* 339 370.

and clear, otherwise they would not have become established as widely used customs. To this extent mercantile custom fulfils a harmonisation function, as it constitutes practices and usages which exist beyond physical and legal borders. To prevent confusion and to ensure economic efficiency, rules of the positive law should not deviate from established customary practices, but should be accommodative of these practices.

This is especially so in the case of international trade where new practices are developing continually. It has already been indicated that domestic rules are often out of touch with the economic reality of international sales. The ideal would be that rules which regulate international sales should be free from the political, social and ideological constraints of domestic laws and be focused primarily on the commercial needs of the parties to the contract.[44]

On this basis, modern international business practices, modernised transport techniques and electronic methods of communication should be recognised and accommodated by the legal regime governing an international sales contract. Today, the bulk of goods sold internationally are transported by container. It is the practice to load export goods into shipping containers at the seller's place of business or at some other inland point and then to carry them to the buyer through a chain of different modes of transportation that may include trucks and trains followed by ships or aircraft.[45] Damage could therefore occur during any of the transport stages. In most instances it is difficult, if not impossible, to establish precisely when containerised goods were damaged during the course of their transportation, unless the container itself was damaged too. This gives rise to uncertainty as to who bears the risk for the damage.

The type of goods that is sold internationally today differs significantly from that sold a few decades ago. In the late twentieth century, as a result of globalisation, so-called "intermediate goods" have replaced raw materials or finished products as the primary focus of international trade. The container made international transportation

[44] Schmitthoff **"**The Law of International Trade*"* in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 220 holds that the law of international trade should be based on universally accepted general principles as the legal techniques of carrying on international trade are the same everywhere.

[45] The goods are first carried from the seller's inland warehouse or factory to an airport or seaport loading dock by truck or rail. From there a second carrier will be responsible for the transnational carriage to a designated port. From the port, another carrier will transport the goods to their final destination.

cheaper and more dependable[46] and enabled manufacturers to find the cheapest place to manufacture goods and to ship the components to a final point of assembly by means of a global supply chain.[47] A large part of international sales today deals with high-technology goods or perishables which can easily become damaged or deteriorated during transportation.

International sales law should therefore be cognisant of developments in modern international commerce and accommodate such by recognising international trade usages and adjusting the law to the needs of commercial reality.[48]

## 1 3 Trade terms as a reflection of mercantile custom

### 1 3 1 Standardised patterns of contracting

Although the parties to an international contract of sale are free to arrange their rights and obligations and the allocation of costs in any way they see fit, they usually follow recognised and established forms of contract. Such patterns of contracting allocate the duties and expenses of the buyer and seller to a great extent automatically with reference to mercantile custom.[49] In so doing, merchants supplement many of the deficiencies of national laws by means of mercantile practice.

These standardised forms of contract originated in the English common law but, over time, found their way into other legal systems as well. Two basic patterns are identified, namely dispatch (also known as shipment contracts) and arrival (destination) contracts. Under a shipment contract, the seller must ship the goods from his own country; alternatively deliver them to a carrier or other party at some inland delivery point prior to shipment. After the goods have been shipped, the seller no longer has any responsibility in regard to them, nor does he bear any costs and also no liability for loss of the goods during transit, due to the risk in the goods having passed at shipment. In the case of a destination contract, the seller's duty to deliver

[46] See the general discussion on containerisation 1 3 3 *infra*.
[47] Levinson *The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger* (2006) 265-267.
[48] To this end, judges and arbitrators may contribute by handing down decisions which are cognisant of commercial needs.
[49] Griffin *Day & Griffin The Law of International Trade* 3rd ed (2003) 4-7.

is only performed when the goods are delivered to an agreed destination in the buyer's country. Responsibility for costs and losses also extend to that point.[50]

Normally, the underlying nature of the contract finds expression in a trade term incorporated into the contract.[51] Trade terms amount to a form of "legal shorthand", expressing the parties' respective obligations relating to delivery, the passing of risk and other incidental obligations.[52] Since trade terms negate the need for elaborate contract clauses, they add to the efficiency of the contract by lowering transaction costs.[53]

Trade terms function both as price terms and delivery terms. As price terms they indicate that certain aspects of a contract of sale, such as the cost of transportation of the goods, are covered by the contract price and that it is an obligation which is for the seller's expense. In addition, they function as delivery terms, indicating where delivery takes place, and thus when costs and risks are transferred to the buyer.[54]

Traditionally, trade terms only indicated that the goods should be delivered in a particular way and that certain basic costs should be paid by either the seller or the buyer. Questions relating to who should clear the goods for export and/or import; who should pay the costs of loading and discharging the goods; how the risk of loss or damage to the goods should be divided between them; and who should take out insurance as protection against the risks, were left unanswered. A more detailed elaboration of the trade term, either by specific provisions in the contract of sale or by the applicable law or custom of the trade, was therefore required.[55] Because contracting parties normally do not elaborate these points specifically, there was an additional need for a more extensive standardisation of customs and practices in this regard.

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[50] Goode *Commercial Law* 867.
[51] Shipment contracts are represented by the so-called F- and C-terms such as FOB and CIF, whilst the destination terms are covered by the D-terms, such as DDU for instance.
[52] Such as obligations to clear the goods for export and import, to pack the goods, to take delivery and to provide proof that the respective obligations have been met.
[53] To negotiate and draft clauses relating to delivery and the passing of risk not only takes time and costs money, but can also delay the conclusion and execution of a contract.
[54] Goode *Commercial Law* 866-867. Murray et al *Schmitthoff's Export Trade: The Law and Practice of International Trade* 11th ed (2007) para 2-005 indicates that in the practice of the UK Customs and export licencing authorities, the export value of the goods is founded on an FOB calculation, irrespective of what the agreed terms of delivery may be.
[55] Ramberg *Guide to INCOTERMS 1990* (1991) 12.

### 1 3 2 History and development of trade terms

The history and development of trade terms reflect the history and development of international trade generally. Their evolution is not a purely legal matter, but has been shaped by economic, political and technological factors[56] as well as developments in transportation techniques, containerisation and the movement towards paperless trading.

The means and methods of overseas trade conducted in the late eighteenth and nineteenth centuries differed considerably from those prevailing today. In essence, international trade was conducted by a merchant using his own ship or by him chartering a vessel to call at different foreign ports to purchase whatever goods were available there. He or his agent would personally be on board to inspect merchandise delivered to the vessel. If the goods conformed to a sample he had previously seen, he would immediately tender the price or other consideration. Goods were loaded by hand over the ship's rail. The transfer of costs and risks followed the methods of cargo handling at that time. Hence, costs and risks transferred at the moment of shipment. Although the earliest reported decisions in which the FOB term is mentioned in English and German law date back to the early years of the nineteenth century,[57] it is believed that this term was prevalent in international sales contracts long before that time.[58]

The development of means of communication, such as the postal system, the telegraph and radio, considerably changed the conditions of international trade. Information was more readily available and the possibility of posting documents facilitated contact with overseas merchants on a more permanent basis. Legislation dealing with bills of lading was introduced for the first time, which made it possible for the buyer to sue on a contract of carriage concluded by a seller.[59] The introduction of

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[56] As trade terms originated from mercantile custom, the courts had very little to do with the development and evolution of trade terms apart from refining and defining them. See Sassoon "The Origin of FOB and CIF Terms and the Factors Influencing their Choice" 1967 *JBL* 32 32-33; Großmann-Doerth *Das Recht des Überseekaufs I* (1930) 45.

[57] Großman-Doerth *Überseekauf I* 44; Renck *Der Einfluß der INCOTERMS auf das UN-Kaufrecht: Eine Untersuchung zu den rechtlichen Wirkungen der INCOTERMS 1990 im Recht des internationalen Warenkaufts* LL M thesis Hamburg (1995) 5. The first English judicial pronouncement dealing with the FOB clause dates back to 1812. See *Wackerbarth v Masson* (1812) 3 Camp 270; *Craven v Ryder* (1816) 6 Taunt 433; *Ruck v Hatfield* (1822) 5B & Ald 632. The German High Court also dealt with the FOB term from early on. See RGZ 106 213.

[58] Sassoon 1967 *JBL* 33; Ramberg *INCOTERMS in the Era of Electronic Data Interchange* published public lecture at the *Forum Internationale* (November 1988) 5.

[59] In English law, the Bills of Lading Act was enacted in 1855. See Zeller "Is the Ship's Rail Really Significant?" 2005 (2) *NJCL* 1 4; De Vries 1982 (17) *Eur Trans L* 513-514.

regular shipping lines made the transport of merchandise much easier. New means of finance were also devised,[60] resulting in banks starting to participate in these transactions as a so-called "buyer of exchange". Because these methods were more suitable to the conditions of international trade, business could take place much easier, faster and more effectively than before. These developments introduced a parallel development in the use of the FOB term, which eventually culminated in the CIF term.[61]

The first cases decided on the CIF term[62] indicate that it evolved from the FOB term as a result of efforts by buyers to shift the risk of fluctuations in the cost of freight to the seller. The case law shows that the FOB term frequently acquired some of the attributes of what is today known as a CIF contract. For example, sellers often undertook to secure the shipping space on behalf of buyers and would then also procure the bill of lading and act as shipper.[63] The so-called “extended” FOB sale had certain distinctive disadvantages for the buyer. Because the seller had to arrange for carriage and insurance, the buyer was left at the mercy of the seller, who normally had no special interest in negotiating the best prices possible for the buyer. The second disadvantage was that the buyer could not at the outset know the overall cost of the goods. If the costs for carriage and insurance exceeded the quoted price, the buyer had to pay the difference on receipt of the goods. These were all factors that influenced the buyer’s ability to resell at a profit or determined whether raw materials could be processed at a profit. These uncertainties often made it impossible for traders to conclude import contracts.[64]

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[60] According to Hugo *The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks* LL D dissertation Stellenbosch (1996) 63-64, 72-75, letters of credit were used by Italian merchants as early as the 14th century. What is known today as the “open letter of credit” was used extensively in the 18th and 19th centuries in England. The modern documentary credit is believed to have developed from open credits during the first half of the 19th century. During the same time, the financing of international trade became an important part of the business of the large import and export merchants in England. The natural development from this point was that many of these merchants became merchant bankers. The contribution of the merchant bankers in the field of letters of credit later on played a major role in London’s dominance over the world economy. Letters of credit remained the field of activity of the English merchant bankers until the end of the First World War, after which it became part of the regular business of the commercial banks in London. The documentary credit as the most important instrument of payment attained its status during the course of the 20th century.

[61] Sassoon *CIF & FOB Contracts* 4th ed (1995) para 432; Sassoon 1967 *JBL* 33-34.

[62] *Tregelles v Sewell* (1862) 7 H&N 574; *Ireland v Livingston* (1872) LR 5 HL 395. In Germany they appeared 10 years later in a decision of the Hamburg *Handelsgericht* HansGZ Hptbl 1873 130, 132 (Nr 110).

[63] Sassoon 1967 *JBL* 35. See also the *dicta* of Devlin J (as he then was) in *Pyrene & Co Ltd v Scindia Navigation Co Ltd* [1954] 2 QB 402 424 and Bailhache J in *Bain v Field & Co Fruit Merchants* 1920 3 LILR 26 29. See also 2 2 1 1 (i) *infra* for a more elaborate discussion of the different FOB forms or variants, ranging from the so-called “simple” to the “classic” and “additional services” variants.

[64] Großmann-Doerth *Überseekauf I* 191-192.

Buyers started to pressurise sellers by requiring the lowest shipping costs possible.[65] An English case, in which a wheat dealer from Hampshire required the seller from Southampton to deliver 500-700 tons of black oats "at 11s. 9d. per barrel, free on board, and freight not to exceed 2s., if it does, Mr Bamford (seller) to pay the addition," reflects this development.[66] The formulation "at … s… d… per quarter, free on board at port of X, and including freight and insurance" was used for quite some time, as is evident from a long line of English cases heard between 1850 and 1860.[67]

A similar development took place in German law. The oldest reported German case dealt with a sale between an English buyer and a seller from Hamburg, who agreed on "*950 quarter Weizen nach Probe zu 54s. 6d. frei an bord incl. Fracht und Assecuranz*".[68] A later case[69] mentioned the words "inclusive *Kost, Dampferfracht und Assecuranz*".

The "improved" FOB contracts addressed the disadvantages of the traditional FOB sale and were often referred to as FOB-IF (free on board-insurance freight) contracts.[70] In time, the FOB characteristics were left out altogether. One such contract referred to a sale "at the price of 39s. 6d. per quarter of 492 lbs. delivered, including freight and insurance (the latter free of war risk) to Limerick."[71] *Tregelles v Sewell*[72] is considered to be the oldest reported case[73] to refer to the price in terms of what we today know as a CIF contract,[74] namely "at 5 £ 14s. 6d. per ton, delivered at Harburgh, cost, freight and insurance …".[75]

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[65] *Hutchinson v Bowker* (1839) 52 RR 821; *Wait v Baker* (1848) 76 RR 469. In *Loder v Kekulé* (1857) 111 RR 575, the seller was requested to obtain shipment "on the best terms".

[66] *Sparkes v Marshall* (1836) 42 RR 725. Another example is that of *Joyce v Swann* (1846) 142 RR 258, where a guano dealer in Londonerry wrote a seller he would buy 100 tons FOB "providing freight does not exceed 6s. 6 d.", to which the seller replied that he succeeded in obtaining a carrier "to carry about 115 tons, at your limit of 6s 6d." The contract in *Barber v Taylor* (1839) 52 RR 814 also stated that the agreement "is understood to include freight and all your (the seller's) charges."

[67] In *Couturier v Hastie* (1852) 96 RR 584, the sale was made at " 27s per quarter free on board and including freight and insurance to a safe port in the UK." See also *Covas v Bingham* (1853) 95 RR 842; *Pennel v Alexander* (1854) 97 RR 470; *Tamvaco v Herford* (1859) 121 RR 866.

[68] GZ 1861 102. Großmann-Doerth *Überseekauf I* 194 points out that standard contract forms such as those of the Nordic agricultural trade associations and CIF Contract No 26 of the IncOilSeed Ass contain similar wording.

[69] Decided in 1872.

[70] Großmann-Doerth *Überseekauf I* 194.

[71] *Russell v Nicolopulo* (1860) 125 RR 683.

[72] *Supra.*

[73] Sassoon 1967 *JBL* 34; Sassoon *CIF & FOB Contracts* para 432. However, Großmann-Doerth *Überseekauf I* 195 considers *Russell v Nicolopulo supra* to be the oldest CIF case heard in a court of law.

[74] Case law also illustrates that the abbreviation was originally written in a different manner, namely CF & I.

[75] It should be noted that, even though some contracts seem to be CIF contracts, it can be that they actually are FOB contracts. See the facts of *The Parchim* (1918) 87 LJP 18, [1918] AC 157. See also the discussion on CIF terms under English law 2 2 1 1 (ii) *infra.*

Where the buyer or his agent was not physically present at the point of delivery and payment was not effected immediately but deferred to a later date, the CIF term served the interests of the seller much better than the FOB term. He is the shipper and the person to whom the bill of lading is issued, whilst under the FOB sale the buyer is the shipper. Risk of loss and damage during transit is covered by insurance, which is included in the CIF price together with the cost of the goods as well as the freight to the port of destination. The seller was therefore less concerned about recovering the value of the goods in the event of loss or damage before payment than an FOB seller would be. The documentary nature of this term also served the interests of the seller better than the FOB term. Under a CIF term, the seller is ensured of payment, even before arrival of the goods at their final destination. At the same time, the CIF term also had clear advantages for the buyer in the sense that he was now relieved of the responsibility of securing the necessary shipping space and arranging for the insurance of the goods. Since the transport documents provide control over the goods, which can function as a form of security in the case of payment default, the buyer could obtain finance and credit facilities more readily. In addition, the buyer was also in the position to deal with the goods whilst afloat, even before their actual arrival, by transferring the documents representing the goods.[76]

The CIF contract soon gained ground and gradually replaced the FOB term as the most widely used form of contract in international maritime trading. By the beginning of the twentieth century, the volume of business transacted on CIF terms far exceeded those transacted on any other basis.[77] Notwithstanding, the FOB term still performed a useful function, for example in situations where, because of the size and nature of the cargo purchased, or for any other reason, the buyer chartered a vessel under hire.[78]

The First World War had a significant effect on the use of the CIF term. One of the problems experienced as a result of the war was a scarcity of shipping space. The volume of trade transacted on CIF terms started decreasing. Sellers were reluctant to undertake the onus and risk of securing tonnage because of the uncertainty

[76] Sassoon 1967 *JBL* 34-36; Sassoon *CIF & FOB Contracts* para 4. On the advantages for the buyer and seller, see *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola* 1976 4 SA 464 (A); *Thomas & Co Ltd v Whyte & Co Ltd* 1923 NPD 413 422; *Mee v McNider* 109 NY 500, 17 NE 424 (1888).

[77] As per Lord Wright in *Ross T Smyth & Co Ltd v TD Bailey, Son & Co* [1940] 3 All ER 60 68. Großmann-Doerth *Überseekauf I* 44.

[78] This practice still continues today, eg in the oil and other bulk trades where entire shiploads are bought. See Sassoon *CIF & FOB Contracts* para 432.

resulting from rapid fluctuations in the availability and price of freight.[79] A similar situation prevailed with respect to insurance premiums, in particular the cost of covering war risks.[80] Accordingly, trade on FOB terms once again started to increase. Once normal shipping conditions were re-established during the 1920s, the CIF contract regained its pre-eminence in a revival which lasted until the Second World War when FOB trade once again increased for the same reasons as at the time of World War One.[81]

Even when sufficient tonnage again became available, new factors, such as the development and establishment of many new national shipping and insurance industries as well as the scarcity of foreign exchange, sustained business on FOB terms. In order to preserve foreign currency or support domestic industries, governments restricted the allocation of foreign currency to the FOB value of the goods at the foreign port of embarkation.[82] This compelled importers to procure carriage and insurance in the local market and in the domestic currency. Pressure was also exerted to restrict imports to FOB terms in order to support and promote national shipping and insurance industries.[83]

### 1 3 3 The influence of technological change on international commerce and trade terms

As technology developed, it played an equally important role in the development of trade terms inasmuch as new terms had to be developed and others adapted to meet the needs of modern international trade.

Traditionally, the carriage of goods by sea has been conducted by one of two methods, which, in turn, are determined by the nature of the goods. For goods to be carried in bulk, such as grain, coal or oil, the shipper hired a whole vessel by means of a charterparty. Where individual packages of goods were to be loaded into the ship's hold or onto the deck by hand, loading took place through the traditional

[79] The situation is described in *Blythe & Co v Richards Turpin & Co* (1916) 114 LT 753.
[80] See observations in *The Kronprinsessan Margareta & other ships* [1921] 1 AC 486.
[81] Sassoon *CIF & FOB Contracts* para 433.
[82] Report of the United Nations Conference on Trade and Development *Invisibles: Insurance* TD/B/C3/107 April 30 1973 para 17.
[83] Sassoon 1967 *JBL* 32; Sassoon *CIF & FOB Contracts* para 433; Griffin *Law of International Trade* 65. Under FOB terms, the buyer is to arrange for carriage and he can save foreign currency for freight and insurance by appointing national carriers and insurers.

break-bulk method.[84] New means of transportation, the advent of the container and modern cargo unitisation methods brought significant changes to the traditional patterns of trade. In modern international transport, apart from bulk cargoes, goods are predominantly transported in containers.

Although the technology of the container had already been available for decades[85] and was used in the transportation of goods from train to truck and *vice versa*, containerised shipping on a formal level was for the first time introduced to the world on April 26, 1956 when an American shipper, Malcom McLean, loaded a converted tanker with containers and sent them from Newark, New Jersey, to Houston, Texas, by ship. The containers were sealed inland and were lifted by crane onto a specially modified deck of a ship and were off-loaded in the same manner.[86] A fraction of the traditional workforce was used to complete the loading of the ship and the task was completed in a much shorter time than was the case with the break-bulk method. This event marked the start of the container revolution.

The basic concept of the container is that cargo can move seamlessly among trains, trucks and ships. If, for example, the goods have to pass through different stages of transportation, such as land, sea and again land, they will travel in the same container from the place of loading to that of discharge. In the process, physical labour as well as the cost of conveying them from one vehicle to the next is saved.[87] The carriage of containers is mainly conducted by means of combined or multi-modal transport arrangements which involve a combination of several means or modes of transport and different carriers all under a single contract of carriage.

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[84] "Break bulk" means that the freight is handled one parcel at a time by hand from one mode of transport to the next. In the case of maritime transport, the goods are hoisted by a cargo net and crane onto the ship where they are again positioned by hand. See Gans "Inside the Black Box: A Look at the Container" 2006 *JEL* 3; Chadwin et al *Ocean Container Transportation: an Operational Perspective* (1990) 1.

[85] The container was first used by the US government during the Second World War. Instead of shipping commodities in bulk, army and navy specialists began to mix cargo by loading freight onto pallets and then load the pallets into specially constructed "boxes". This method proved to be ideal for unloading and distributing army supplies quickly and efficiently.

[86] Chadwin et al *Ocean Container Transportation* 1-2.

[87] In 1961, before the container was in use internationally, ocean freight costs alone accounted for 12% of the value of US exports and 10% of the value of US imports. The biggest expense in the transport chain was to shift the cargo from land transport to the ship at the port of departure and moving it back to a truck or train at the other end of the ocean voyage. Half of the freight costs were consumed by these two movements. In some instances the costs of freight were as much as 25% of the costs of the product, which in many cases made selling internationally not worthwhile. When container ships started operating, ocean freight rates plummeted, which meant that international trade became economically more viable. The standardisation of containers brought further advantages as they could now be directly transferred from one mode of transport to another. See Levinson *The Box* 8-10, 239; Griffin *Law of International Trade* 120.

There is no data available on precisely how much money is saved through containerisation. However, what is known is that it takes a fraction of the time and labour to load a container ship in comparison to the traditional manual way of loading a conventional ship.[88] Containerisation lowers the costs of transportation.[89] In addition, the danger of theft and pilferage is reduced because the container is sealed at an inland point. Less handling also means less frequent damage to cargo.[90] In the decade after the container first came into use, the volume of international trade grew more than twice as fast as the volume of global manufacturing production and two and a half times as fast as global economic output. In the last two decades, the volume of sea freight shipped in containers rose four times.[91] The sharp drop in freight costs[92] played a major contributory role in integrating the global economy. In time it also affected general trade patterns in regard to the type of goods that are traded internationally.[93]

However, the changes in cargo handling techniques had a significant impact on the use of the traditional shipment terms such as FOB or CIF.[94] Where sellers used to

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[88] It can take up to 3 weeks to load a ship by hand. Normally the task has to be completed by a gang of at least 20 longshoremen. Each gang can load about 20 tons per hour. With containerised transport it is possible to load one 20 ton container in 2-3 minutes. One crane and half as many men can load and stow 400-500 tons an hour. Unloading is also much faster. Break-bulk ships often take a week to be unloaded, whilst a container ship takes 4-6 hours. See Chadwin et al *Ocean Container Transportation* 3.

[89] Containerships are cheaper to operate than conventional break-bulk ships on a per-ton basis because they can carry more freight. Already in 1970, the United Nations Conference on Trade and Development (UNCTAD) concluded that the costs of transporting freight on containerships were less than half of those on conventional ships. In 1971, a bank study also found that the costs of shipping machinery from Germany to New York by containership were one-third less than the costs of transportation by break-bulk ship. Because the trade in some regions was too small to justify the capital outlay for buying containerships and building ports that are able to handle these types of ships, routes to developing countries, such as those in Africa and Latin America, were still serviced by break-bulk ships until well into the 1980s. In 1977, container shipping was for the first time introduced to the route between SA and Europe. See Levinson *The Box* 246-251.

[90] Murray et al *Schmitthoff's Export Trade* para 16-001. See also Chadwin et al *Ocean Container Transportation* 3.

[91] Levinson *The Box* 271.

[92] However, in some instances containerisation does not cut costs. Landlocked countries, inland places in countries with poor infrastructure and countries without enough economic activity to generate a high demand for container shipping may find containerised shipping more costly than break-bulk transportation. According to one study, being landlocked raises a country's average shipping costs by half. Another study found, that at that time it was conducted, it cost $2,500 to ship a container from Baltimore on the US Atlantic coast to Durban SA and then $7,500 more to take it from Durban to Maseru. In 2002, the World Bank reported that the cost of transporting a container from a central city in China to a Chinese port was three times as much as shipping the same container from China to the United States. See Levinson *The Box* 270.

[93] Containers mean secure, dry storage of cargo and controlled climates and added shelf life for perishables. This meant a shift from exporting and importing raw materials and commodities to trade in perishable goods. As the container made international transportation cheaper and more dependable, it also made it easier for manufacturers to find the cheapest place to manufacture and then ship all the components in a global supply chain, alternatively to buy from any supplier around the world to lower their production costs. See Levinson *The Box* 248, 265-267; Chadwin et al *Ocean Container Transportation* 3.

[94] Ramberg *INCOTERMS in the Era of Electronic Data Interchange* 5-7.

deliver their shipments to port locations, their obligation under the FOB term was discharged when their cargo was loaded aboard the vessel, often on the same day it was delivered to the port. In the case of containerised cargo, the goods are no longer delivered directly onto the ship but are stowed in container or shipping terminals before the arrival of the ship. At all but the smallest ports, shipping lines require sellers to deliver cargo at these terminals.[95] Delivery to the terminal is often required days before the vessel is loaded. The result is that the seller under the FOB and CIF terms remains responsible for the goods, even though he or she has physically relinquished control over the goods to the carrier.[96] It soon became clear that the traditional terms such as FOB and CIF could no longer be applied in their usual form, but that new terms were required to accommodate the changes in commercial practice and the resultant effects on the distribution of risks and costs.[97]

Moreover, the traditional "port-to-port" type of sea transport made way for a new "door-to-door" combined transport concept.[98] Although there is no explicit proof, it could be argued that the container revolution and the possibility of seamless transportation of goods brought a shift from shipment to destination contracts.[99]

The influence of the computer revolution on the practice of international commerce should also be recognised. The possibility of concluding contracts and delivering transport documents electronically facilitated international commerce but brought

[95] The exporter, having made arrangements with a forwarder or directly with the office of a shipping line, sends the goods to the nearest container loading depot of the forwarder or shipping line. These depots, called container freight stations (CFSs), are situated inland or at the ports of all major industrial centres. If the exporter intends to fill a full container load (FCL), the forwarder or shipping line will send an empty container to the exporter for loading. If the exporter has arranged for the delivery of the goods to the overseas buyer's place of business, the container would be a door-to-door container. If the cargo is less than a full container load (LCL), the exporter sends it to the container freight station where it will be consolidated with the goods of other exporters in a groupage container. On arrival at the place of destination, it will again be taken to a container freight station, where the parcels contained therein will be separated and delivered to the various consignees. See Murray et al *Schmitthoff's Export Trade* para 16-002.

[96] Reynolds *INCOTERMS for Americans* (1999) 67.

[97] Treitel "Other Special Terms and Provisions in Overseas Sales" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) paras 21-074, 21-094. See 5 4 1 and 5 6 *infra* for a discussion on the incorrect use of the traditional FOB and CIF terms in the context of modern transportation techniques.

[98] Sassoon *CIF & FOB Contracts* para 22.

[99] Sassoon *CIF and FOB Contracts* para 23 n 3. Note the difference between the 2nd and 3rd editions of Goode *Commercial Law*. In the 2nd edition (1995) 878, Goode holds that the change in transportation techniques, where goods are delivered to an inland terminal or collection point, resulted in "a movement from the dispatch to the arrival contract," whilst in the 3rd edition (2004) 864, he submits that the contract remains a shipment contract and that the only changes relate to the point of dispatch and the stages of the transit covered by the transport document.

their own unique legal challenges.[100] An increase in paperless trading necessitated further adaptations to the trade terms as well as to their interpretation.[101]

### 1 3 4 The effect of divergent commercial custom on the use of trade terms

The majority of commercial sales contracts, including standard contracts used by specific branches of trade, contain trade terms.[102] However, because such terms appear in abbreviated form they need to be defined or interpreted to be legally relevant. Differences and variations in the content and meaning of trade terms create problems, not only for their interpretation, but also for the harmonisation function of mercantile custom.

The meaning of a particular trade term may differ from one country to another or even from one region within a country to another region in the same country, depending on the practices that prevail in these geographical areas. The liabilities of the parties arising under a trade term are sometimes defined by usage prevailing in a particular trade or a particular port, which means that the understanding of a trade term in one trade or port may differ from the understanding of the same term in the next trade or port. For example, the meaning of FOB in the international oil trade differs from that in the Swedish lumber trade;[103] whilst in the port of Stockholm, a trade usage exists which determines that, if wood is sold “FOB Stockholm”, the buyer has to bear the loading costs of the goods into the vessel, which is not typical of a traditional FOB sale.[104]

Inconsistency in commercial practice is the main stumbling block when it comes to interpreting trade term content. However, it is also a fact that trade term meanings are not immutable. The problem of interpretation is often exacerbated by the fact that trade terms are by nature dynamic and susceptible to development in commercial practice. Moreover, the dynamic nature is not always self-initiated. Parties tend to

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[100] The validity of electronic contracts, as well as the authenticity and negotiability of electronic transport documents are a few of the issues that had to be addressed.
[101] See Ramberg *INCOTERMS in the Era of Electronic Data Interchange* 10-13 in regard to the use of electronic data interchange (EDI) in the context of trade terms. See 5 2 3 1 *infra* for a discussion on the development of trade terms in reaction to changed commercial needs.
[102] See 7 1 *infra.*
[103] Klotz & Barrett *International Sales Agreements* 72-73.
[104] Schmitthoff *International Trade Usages* report published by the Institute of International Business Law and Practice (1987) para 37; Klotz & Barrett *International Sales Agreements* 72-73. For more examples of divergent trade term meanings, see 5 1 *infra*.

adapt trade terms to suit their particular needs, for example by adding the stowing or trimming obligation to FOB. Such modifications are often attended with great uncertainty as people attribute different meanings to the terms so modified.[105] Once again this can be a hurdle to the harmonisation function of mercantile custom and the economic efficiency of the contract.

### 1 4 Rationale for and aim of the study

In the international context, diversity in the meaning and interpretation of trade terms can lead to misunderstandings between merchants who do not share the same commercial background. If there is no clarity or certainty on the content of a trade term, the harmonisation function of mercantile custom is lost. This can give rise to disputes as well as to expensive and time-consuming litigation. What is required, is a form of trade term standardisation whereby the meaning of trade terms is harmonised or standardised with reference to mercantile customs and practices which are known and applied internationally. The ICC INCOTERMS endeavour to fulfil such a standardisation function.

INCOTERMS represent a codification of international mercantile customs and usages, which have been formulated in an effort to provide a standardised interpretation for trade terms. However, it is very difficult to find consistent commercial practice in different countries and trades, for example practices in the loading of ships under the FOB term and the unloading from ships under CFR and CIF terms.[106] Because commercial practice is not the same everywhere, INCOTERMS can merely reflect the most common or dominant practice. In the absence of sufficient precision, INCOTERMS often have to be supplemented by the governing law of the contract or through customs and trade usages prevalent in a particular trade or port or even through a previous course of dealing between the parties to the contract.

The aim of this study is to investigate the efficacy and efficiency of INCOTERMS as a form of standardisation for mercantile custom. Since INCOTERMS regulate a number of issues related to the delivery obligations of the party, the focus of this

[105] See Klotz & Barrett *International Sales Agreements* 69-73 for a discussion on the modifications of the FOB term. See also 5 5 *infra* for an analysis of trade term variations.
[106] Ramberg *Guide to INCOTERMS 2000* 14.

investigation will be restricted to the allocation of risk, which is mostly regulated by mercantile usages and practices existing in a particular trade.[107] A question that immediately arises, is why do merchants still prefer to regulate the allocation of risk by means of trade terms whilst domestic sales law regimes all have a default risk rule? Could that perhaps be an indication that domestic laws do not accommodate mercantile custom on the passing of risk adequately?

Although INCOTERMS purport to standardise trade term definitions, they are still perceived as having particular shortcomings. INCOTERMS have a limited scope of regulation. They do not regulate all the aspects of a sales contract and apply only to the primary obligations of delivery and related issues, such as risk, insurance, documentation and matters incidental to the export and import of goods.[108] INCOTERMS, therefore, have to function in conjunction with other stipulations of the contract or the governing law to regulate the contractual rights and obligations of the parties to the contract in full. Is this a limitation for the efficiency of INCOTERMS, or is there perhaps scope for interaction with the governing law of the contract, which may supplement and even strengthen both INCOTERMS and the governing law?

It is generally accepted that INCOTERMS will only be applicable when incorporated into the contract of sale. Whether they are capable of enjoying a form of autonomous application independent of party agreement is not clear. This is an aspect that is central to the question whether INCOTERMS are efficient as a means of harmonising and standardising mercantile custom. The investigation, therefore, will have to consider the possibility of application in the absence of express or implied agreement.

INCOTERMS primarily deal with the delivery obligations of the parties. Hence, in a given situation it is possible that aspects concerning delivery and risk allocation could be regulated by both INCOTERMS and the governing law of the contract, such as the United Nations Convention on the International Sale of Goods (CISG) for example. In these instances, will INCOTERMS replace the default rules on passing of risk as would a contractual exclusion? And if that is the case, are the CISG provisions completely excluded or will it still be possible to invoke aspects of the CISG rule where the INCOTERMS rule falls short?

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[107] Honnold "Risk of Loss" in Galston & Smit (eds) *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (1984) para 8 01.
[108] ICC *INCOTERMS 2000* the official rules para1; Ramberg *ICC Guide to INCOTERMS 2000* 11-13.

## 1 5 Methodology

Chapter Two commences the investigation with an analysis of the passing of risk provisions in selected national legal systems. This chapter will reveal differences in policy underlying the risk regimes of national laws. Selected trade terms are simultaneously examined to determine how each of these systems allocates risk. This analysis will demonstrate the inconsistency in mercantile customs and practices of different countries.

When choosing the legal systems to be examined, it is possible to depart from the basis of the theoretical foundations of risk rules, alternatively to base the analysis on the traditional division between common law and civil law systems.[109] For purposes of this study the latter approach is adopted. The following legal systems have been selected for these reasons:

(i) Apart from being the root of the common law legal family, English law has had an important influence on the development of international trade law, especially where goods are transported by sea. Its influence is strongly felt even until this day and many international contracts of sale indicate English law as the parties' choice of law. A significant number of international commercial cases are litigated in London according to English law.[110] The importance of English law in international trade is buttressed by the persistence amongst former members of the British Empire to still make use of this system.[111] British sales law is mainly regulated by the Sales of Goods Act 1979. Trade terms are not covered by the Act and are defined in terms of mercantile customs and usages.

[109] According to Fox *International Commercial Agreements* 17-18, most comparative law scholars agree that there are at least 4 broad classifications or families of law, namely the civil law, the common law, socialist law and Islamic law. Other subcategories are also identified, such as Latin American law (which is generally derived from various versions of European civil law), so-called hybrids (eg Japanese law, which consists of a mixture of indigenous rules and customs, the German civil code and American law) and aboriginal systems (such as African tribal laws).

[110] Linarelli 2003 (48) *Wayne L Rev* 1438; Goode 2001 50(4) *ICLQ* 756-757; Sono "Japan's Accession to the CISG: the Asia Factor" 2008 (20) *Pace Int'l L Rev* 105 106; Bridge "Uniformity and Diversity in the Law of International Sale" 2003 (15) *Pace Int'l L Rev* 55 58, 61-62 explains that English law and the English Sale of Goods Act are sometimes considered as superior, to the extent that they function as an international standard.

[111] The legal systems of Australia, New Zealand and Singapore are a few examples of countries that are still steeped in the common law tradition. Great Britain is one of the so-called "G5 countries" of the world, a group which represents the world's leading economies.

(ii) The United States of America ranks as one of the key players in international trade.[112] Although American commercial law is derived from the British common law, the various states of the United States all have their own sales laws.[113] Sales laws in the United States ultimately moved in the direction of codification and increased uniformity when the Uniform Commercial Code (UCC) was introduced.[114] The law of sales is regulated by Article 2 UCC.[115] This article was extensively revised in 2003, which included some amendments to the risk rule. In recognition of the pace against which modern mercantile customs and trade usages develop, it was decided to repeal the standard trade term definitions which have been contained in the Code. During the revision process, extensive reference was made to the laws of other countries as well as to the CISG.

(iii) Germany has always been an important contributor to the world economy, especially as a country exporting manufactured goods.[116] The German Civil Code (BGB) provides an example of a codified civil law legal system.[117] In 2002, the German Law of Obligations was extensively revised and modernised to bring it in line with new developments internationally and specifically in the European Union. The CISG has been a major influence in the revision of the Code. The revisions included

[112] Although the USA has always been considered as the economic giant of the world, China's fast growing economy makes it an upcoming new force to reckon with. The USA is also one of the G5 countries.

[113] American law has developed separately from that of Britain for the last two hundred years and, in many respects, reflects its own unique character.

[114] In 1952.

[115] The individual states in the United States have jurisdiction to develop their own commercial law principles. However, differences among the laws of the various states tend to be relatively small and insubstantial. Over the last three decades, a great deal of uniformity has been created by state-by-state adoption of the Uniform Commercial Code (UCC). The UCC is now the law in 50 states as well as the District of Columbia, the Commonwealth of Puerto Rico and Guam and the US Virgin Islands. Louisiana, the one state that has not done so, follows a civil law approach as it entered the Union as a former French colony and derives some of its commercial principles from the Code Napoleon.

[116] Germany is also one of the G5 countries and has the largest economy in Europe and the third largest in the world. Germany is the world's largest exporter of manufactured merchandise. Exports account for one-third of its national output. See http://www.countryreports.org/economy/exports.aspx?Countryname=&countryId=91 (accessed 21-10-2009); American Library of Congress – Federal Research Division Country Profile: Germany April 2008 http://lcweb2.loc.gov/frd/csprofiles/Germany.pdf (accessed 30-10-2009). The country's strength lies in the fact that it is a centre of industry and an export nation. See Czuczka "German Exports Remain Key to Economic Power, Merkel Tells Union" http://www.bloomberg.com/apps/news?pid=20601100&sid=aXPcSBAdb9GQ (accessed 21-10-2009).

[117] The BGB grew out of scientific legal scholarship and resulted in a highly detailed set of provisions drafted with specific reference solely to Germany. The German Code had a substantial influence on the laws of a number of countries, including Greece, Switzerland, Brazil, and Japan. Apart from the code itself, a strong body of case law also influences the legal system. In addition to the BGB, the commercial law is regulated by the German Commercial Code (HGB).

amendments to the risk rule, which makes the discussion of this system not only relevant but also indicative of new international trends.

(iv) Because these systems are not completely representative of laws applicable to international sale contracts, the analysis also includes a mixed legal system. South African law displays a hybrid character derived from its Roman, Roman Dutch and English roots. The risk rule was mainly influenced by Roman and Roman Dutch law. Since the rule is applied by modern day courts of law in much the same way as it was by its civilian ancestors, the question arises whether this rule is still capable of coping with the needs of modern international trade. This question is especially relevant in light of the fact that after years of international isolation the country has emerged as the "economic powerhouse" and leading international trading nation in southern Africa, if not of the entire African continent.

(v) The study also includes an analysis of the risk regime of the United Nations Convention on Contracts for the International Sale of Goods (CISG). The CISG was created to unify international sales laws. Its main aim is to provide certainty and clarity and to address the problems associated with multiple legal systems. Since its inception in 1980, the number of countries that have adopted it has risen to over seventy countries.[118] The fact that many legal systems, such as the UCC and the BGB, referred to the CISG when they revised their laws on sale, shows the international relevance and influence of the Convention. Due to the dynamic nature of mercantile customs and practices, the CISG refrained from defining trade terms.[119]

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[118] As of 18 May 2009, the count is 74 States. See http://www.cisg.law.pace.edu/cisg/countries/cntries.html (accessed 18-07-2009).

[119] Von Hoffmann "Passing of Risk in International Sales of Goods" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 296 explains that trade term definitions in the Convention would have resulted in a "petrification" of trade terms. Commercial usage is in a permanent state of development and takes continual notice of new developments such as containerisation, multimodal transport documents or communications technology. Roth "The Passing of Risk" 1979 (27) *Am J Comp L* 291 309-310 ascribes the absence of trade term definitions from the CISG to the inability of uniform law to be amended on a frequent basis and to its general function, namely to prescribe a common global framework law that is to be supplemented by regional measures and commercial practices. See, however, Berman & Ladd "Risk of Loss or Damage in Documentary Transactions under the Convention on the International Sale of Goods" 1988 (21) *Cornell Int'l LJ* 423, who are of the opinion that the absence of specific trade term definitions in ULIS deprived the rules of risk of much value and rendered the law an incomplete regulation of international sales.

Because international sales are conducted mainly on shipment or delivery terms, this study approaches the investigation of trade terms along the same lines. The analysis is limited to a discussion of the FOB, CIF and DDU terms under the selected legal systems. The FOB and CIF[120] terms represent the traditional and the most commonly used shipment terms and still comprise in one form or another a large part of international trade. Developments in transportation methods and containerisation have had a huge influence on the use of these types of contract. Sellers of manufactured goods, whose products have to compete in the country of destination and who have to guarantee their obligations in regard to the quality of the goods, however, often find it more appropriate to control the carriage as well as the delivery at destination. International trade is consequently increasingly conducted on delivered terms. It is, therefore, important to include a D-term into the investigation. The choice falls on the DDU term which can be used regardless of the mode of transport and is suitable to modern multimodal and containerisation transportation methods.

It is also necessary to evaluate the viability and efficiency of the national risk regimes. Chapter Three contains a brief exposition of scholarly opinion on the requirements for an effective international risk rule and then proceeds to evaluate the rules analysed in Chapter Two at the hand of criteria deduced from such opinions.

The underlying differences in the national approaches to the passing of risk, as analysed and discussed in Chapters Two and Three, reveal the need for a harmonised approach towards international sales law. Harmonised or unified international sales law is capable of enhancing the efficiency of an international risk rule by providing greater certainty, clarity and predictability on the content of the rule and the outcome of a possible dispute. Harmonisation of law, at least in so far as commercial law is concerned, is not a novel concept. The classic *lex mercatoria* was an early attempt to harmonise mercantile custom.[121] Chapter Four presents a general overview on the concept of harmonisation and endeavours to analyse the

[120] Griffin *Law of International Trade* 65 states that the CIF contract is the most important in the context of carriage of goods by sea. However, the extent to which CIF contracts are preferred to FOB contracts is determined by various factors. One factor is the availability of shipping space and the rates of freight. An even more important factor is the extent to which governments control their economies. Any government concerned about its foreign exchange may bring pressure on its importers to buy FOB and thereby employ its national carriers and insurers, instead of spending foreign currency reserves in carriage and insurance by foreign firms in the seller's country.

[121] See Bainbridge "Trade Usage in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions" 1984 (24) *Va J Int'l L* 619 624-627; Ferrari "Uniform Interpretation of The 1980 Uniform Sales Law 1994-1995 (24) *Ga J Int'l Comp L* 183 185. See also the general discussion on the *lex mercatoria* 4 3 1 *infra.*

advantages and disadvantages of legal harmonisation as well as the different techniques that may be employed to realise the goal of greater uniformity in international sales. The role of mercantile custom in harmonising international commercial law will also be examined.

Chapter Five presents a closer look at the harmonisation function of mercantile custom. The focus of this chapter is on INCOTERMS and how they standardise mercantile custom in so far as the meanings of trade terms are concerned. The chapter also evaluates the effect of inconsistent commercial practices, trade term variations and INCOTERMS' limited scope of regulation on their ability to standardise mercantile custom effectively and efficiently.

Chapter Six focuses on the unified risk rule of the CISG and discusses its content. Despite the apparent advantages of a unified risk rule, the discussion shows that there are major problems with the interpretation of the CISG risk rule. Commercial reality furthermore indicates that, despite the existence of a unified default rule, in most cases the parties still elect to regulate the aspect of risk by means of trade terms. This point will be used to evaluate the practical and commercial efficiency of the CISG risk rule.

Chapter Seven focuses on the interplay between INCOTERMS and the CISG. Generally, INCOTERMS have to be incorporated by agreement to have any legal significance. If they are capable of operating independently of the contract, INCOTERMS can constitute an autonomous, binding system of usages of which a judge or arbitrator will take judicial notice without requiring proof of their content.[122] The discussion approaches this issue in the context of the CISG as the governing law of the contract and addresses scholarly opinion and case law which support a theory of autonomous operation. As regards the limited scope of INCOTERMS, supplementation by the governing law of the contract is needed. This chapter will analyse the ability of the CISG to supplement INCOTERMS in cases which fall outside their scope of regulation. At the same time, the discussion will show that INCOTERMS are also capable of supporting and enhancing the CISG risk rule.

[122] Schmitthoff *International Trade Usages* para 53.

Chapter Eight summarises the conclusions of the study and briefly looks at the role that INCOTERMS can play to stimulate cross-border trade amongst countries on the African continent and between them and the rest of the world.

## 1 6 The focus of this study: the legal regulation of risk

### 1 6 1 The relevance of rules on passing of risk

Sales that involve the carriage of goods from one point to another are attended by the risk of unexpected incidents that can result either in loss of or damage to the goods. Although in most instances the goods will be insured against such risks,[123] the allocation of risk is still of considerable practical importance. It holds financial implications for every transaction and it is, therefore, important that the default rules regulating the passing of risk should be effective. In instances where no provision was made for insurance, the risk rule determines who has to carry the loss or damage to the goods and, ultimately, whether the buyer has to pay for goods that he never received or only received in a damaged or deteriorated condition. However, the rules on risk not only determine who will carry the risk in the event of a disaster, but at the same time, albeit indirectly, determine the obligations of the parties in regard to insurance; such as who will take out the insurance, who will institute the claim against an insurer, who will bear the burden in the case of inadequate insurance cover and who will salvage the goods in case of damage.[124] The incidence of risk is sometimes said to depend on which party is best able to insure the goods or deal with the insurer.[125] Since loss of or damage to the goods is generally revealed only on receipt of the goods, the buyer is as a rule in a better position than the seller to establish the damage, initiate a claim against the insurance company and salvage

[123] See Valioti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000* LL M thesis Kent (2003) http://cisg3.law.pace.edu/cisg/biblio/valioti.html (accessed 01-04-2009) n 52 for a discussion of the various types of risk that can be covered by insurance. There are, however, some risks that cannot be covered by insurance. See Hager "Article 66" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) para 2. See also the Lloyd's Marine Policy Institute Clauses B and C which cover a particular list of risks, whilst the "all-risks-clause", Clause A, contains a series of non-insured exceptions.

[124] Roth 1979 (27) *Am J Comp L* 291; Goodfriend "After the Damage is Done: Risk of Loss Under the United Nations Convention on Contracts for the International Sale of Goods" 1984 (22) *Colum J Trans L* 575 577; Sevón "Passing of Risk" in *Schweizerisches Institut für Rechsvergleichung* (ed) *Wiener Übereinkommen von 1980, Lusanner Kolloquium 1984* (1985) http://cisgw3.law.pace.edu/cisg/biblio/sevon3.html (accessed 29-10-2008) 191 194; *Secretariat Commentary on Art 78 of the 1978 Draft CISG* http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-66.html (accessed 29-10-2008) para 2.

[125] Posner *Economic Analysis* 97 explains that efficient contract law assigns risk to the superior risk bearer. See 1 2 1 *supra.*

the remaining goods. This is especially the case with containerised goods where it is difficult to establish when the damage occurred if the container was not damaged.

Whether the seller or the buyer, or neither of them, bears the loss when the goods are damaged or destroyed after conclusion of the contract, is not only a problem of great practical importance but is also one that enjoys much academic interest. The passing of risk has remained a controversial issue in the law of sale since the time of Justinian[126] and continues to attract attention to this day.[127]

### 1 6 2 Defining the notion of "risk"

Goods may be lost or damaged at various points from the formation of the contract of sale until the actual handing over to the buyer. Damage to the goods may happen in several settings, for example they may be destroyed on the seller's premises before being handed over to a carrier, during loading or carriage[128] or upon arrival at the buyer's premises.[129] Loss or damage may also occur as a result of various kinds of incidents. However, not all incidents resulting in loss of or damage to the goods are regulated by the rules regarding the passing of risk. The operation of these rules will depend on the definition of risk.

"Risk" in the legal sense refers to events that cause accidental physical destruction of, damage to or deterioration of the goods. The loss or damage should therefore not be attributable to an act or omission of one of the parties to the contract. The notion covers those instances which traditionally are known as *vis maior* or *casus fortuitus* incidents. In addition, risk also covers events such as theft and those that affect the quality of the goods such as exposure to seawater or overheating, confusion of the goods (especially liquids) with other goods, contamination, spoilage, shrinkage or

[126] *Inst* 3 23 3: *periculum est emptoris.* Also see Sohm *Institutionen* 16th ed (1920) 543.
[127] Rabel *Das Recht des Warenkaufs* (1958) 291; Schmitthoff "The Risk of Loss in Transit in International Sales" in Cheng (ed) *Clive Schmitthoff's Select Essays on International Trade Law* (1988) 277; Erauw "Observations on passing of risk" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 292. The Special Commission, appointed in 1951 by the Hague Conference on the Sale of Goods, reported that this was "one of the most serious problems which were presented to the draftsmen." See *Diplomatic Conference on the Unification of Law Governing the International Sale of Goods: Report of the Special Commission 1965* The Hague April 1964 II Documents 43 (1966) para 6 (Doc/V/Prep/1 32 para 6).
[128] Accidents can also happen during pre-carriage whilst the goods are transported from the seller or the manufacturer to the carrier that is to perform the main transnational carriage; after the goods have been delivered to the carrier, but before being loaded onto the principal means of carriage whilst stored in a shipping or container yard of the carrier, or even when the goods are loaded from one means of carriage to the next in the case of multiple carriers.
[129] Honnold "Risk of Loss" in *International Sales* para 8 01 (2).

evaporation.[130] When goods are transported over long distances, for example at sea, these types of risk could easily affect the performance of the seller. The question of risk allocation determines whether these factual events should have any legal relevance for the parties to the contract.

Whether risk has passed to the buyer will depend on when the loss occurred. If the loss or damage occurred after the risk has passed, the buyer will be held responsible for payment of the purchase price; otherwise the loss will remain on the seller.

The risk rule is unique in the sense that it functions as an exception to the normal rules applicable to reciprocal contracts. As a point of departure, the law normally attributes loss of or damage to the goods to their owner. The risk rule, however, constitutes an exception to the maxim *res perit domino*. Normally, if the *res vendita* no longer exists, such as the case would be if the goods were destroyed as result of an accidental disaster outside the control of the parties, both the parties to a contract are released from their obligations due to the rules of supervening impossibility. If the goods no longer exist, there is nothing to sell and the contractual obligation is extinguished. However, in the case of a sale, once the risk has passed from the seller to the buyer, the loss will fall on the buyer despite the fact that performance became impossible. Although the seller is released from his obligation to deliver due to supervening impossibility of performance, the buyer still remains liable for paying the purchase price due to the risk having passed. Once the risk has passed, the buyer is to carry the loss even if the seller is still the owner of the goods.

### 1 6 3 Price risk and other ancillary concepts

Although risk can be defined in various ways, the principal aspect of risk in the context that it is used in this study is whether the buyer is bound to pay the price despite the fact that the goods are lost or damaged. This is known as the “price risk”. By virtue of this concept there is always a point in time during the transaction after which the buyer is bound to pay the purchase price, even if he does not receive the goods which are the subject of the sale.

[130] One important question is whether risk includes damage or loss caused by acts of state, such as confiscation, import or export customs’ formalities or embargos. The prevailing view is that these acts are left outside the notion of risk. See Hager “Article 66” in *Schlechtriem-Schwenzer Commentary* para 4.

However, risk is a concept that reaches further than mere price risk.[131] On occasion, it has been described as "an elusive concept".[132] It can embrace several notions that are not always easy to distinguish. If the goods are lost or damaged while they are at the seller's risk, not only is the buyer not liable for the price, but the seller may also be liable for damages for non-delivery (for example, for replacement at a higher price).[133] Also, if the risk has passed to the buyer, the seller may be able to recover damages for non-acceptance (such as storage charges) in addition to being entitled to payment of the price.[134] Here we have to distinguish between the passing of risk and the financial obligations incumbent upon the person on whom the risk falls. Schmitthoff[135] believes that "the true character of the legal concept of risk is not revealed if risk is solely treated as meaning price risk." It is his submission that risk should be understood as a concept wider than price risk, and therefore formulations of the risk rule should not refer to mere price risk but should rather treat the concept of risk in a general manner.[136]

In theory it is possible to "split" the concept of risk between price risk and the risk of non-performance. Price risk refers to the risk of having to pay the purchase price notwithstanding the fact that performance can no longer be rendered. Risk of non-performance refers to the risk of still having to perform or being liable in damages despite impossibility of performance. Schmitthoff argues that risk should include loss of or damage to the goods in its totality irrespective of whether it imports the payment of the price by the buyer (price risk) or compensatory payment (risk of non-performance). Treitel[137] explains the doctrine of the passing of risk in a similar way. He states that the passing of risk "unites" the two forms of risk in one party to the extent that one party to the contract is discharged from some of his obligations whilst the other is not. The doctrine of risk operates so as to displace any doctrine aimed at discharging the obligation. However, where the physical integrity of the subject-matter is affected before the risk has passed to the buyer to the extent that

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[131] See Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 293-298 for a discussion on the various forms that risk may take, such as economic risk, legal risk, contractual risk and price risk. See also Erauw "CISG Articles 66-70: The Risk of Loss and Passing It" 2005-2006 (25) *JL & Com* 203 204-208; Treitel *Frustration and Force Majeure* 2nd ed (2004) para 3-008.

[132] Roth 1979 (27) *Am J Comp L* 292. For a contrary opinion, see Von Hoffmann "Passing of Risk" in *International Sale of Goods* 265 n 2, who argues that this statement is only true when the different legal issues raised by the factual event giving rise to the damage or loss are not efficiently distinguished.

[133] Unless he can prove exemption from liability on grounds of *vis maior*, *casus fortuitus* or *force majeure*.

[134] Roth 1979 (27) *Am J Comp L* 291-292.

[135] "Risk of Loss in Transit" in *Schmitthoff's Select Essays* 279.

[136] 279-280.

[137] *Frustration and Force Majeure* paras 3-007-3-008.

performance becomes objectively impossible, both parties to the contract are discharged from all of their obligations.

More confusion is created by events which occur before risk passes but cause supervening loss, destruction or deterioration of the goods. The theory of risk, therefore, should be clearly distinguished from legal doctrines such as supervening impossibility of performance, frustration and *force majeure* which do not address the issue of the passing of risk but relate to the same circumstances associated with the passing of risk. These doctrines either discharge the obligation or represent forms of exemption from liability, either on the side of the seller or the buyer or sometimes even for both.[138]

[138] Frustration may discharge the contract completely, depending on the type of impossibility or frustration. For the legal position on frustration in English law, see Treitel *Frustration and Force Majeure*; Guest "Risk and Frustration" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006). On the American law of frustration and impracticability, see ss 261 & 265; Bridge "The 1973 Mississippi Floods: 'Force Majeure' and Export Prohibition" in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 287; Restatement (Second) of Contracts; Nehf "Impossibility" in Perillo (ed) *Corbin on Contracts IVX* (2001) 2-6, 29-30; Digwa-Singh "The Application of Commercial Impracticability under Article 2-615 of the Uniform Commercial Code" in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 305. For the German position regarding impossibility and the so-called *Wegfall der Geschäftsgrundlage*, see Markesinis et al *The German Law of Contract: A Comparative Treatise* 2nd ed (2006) 409-410; Ramsden "Supervening Impossibility of Performance and Changed Circumstances in German Law" 1976 *THRHR* 361, 1977 *THRHR* 68. Under German law, the judge is not only allowed to terminate the contract but can also change or adapt its terms on the basis of the notion of good faith. South African law applies the doctrines of impossibility and supervening impossibility of performance which discharge the obligation if performance becomes impossible. See Ramsden *Supervening Impossibility of Performance in the South African Law of Contract* (1985); De Wet & Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 5th ed (1992) 84-89; Van der Merwe et al *Kontraktereg: Algemene Beginsels* 3rd ed (2007) 199-204; Lubbe & Murray *Farlam & Hathaway Contract Cases, Materials and Commentary* 3rd ed (1988) 297-306. Whether South African law recognises commercial impracticability as a form of supervening impossibility is a controversial issue. See Floyd & Pretorius "Mistake and Supervening Impossibility of Performance" 1994 *THRHR* 325 328; Ramsden "Could Performance Have Been Impossible in Kok v Osborne & Another?" 1994 *SA Merc LJ* 340. On exemptions from liability, see in general, Hudson "Exemptions and Impossibility under the Vienna Convention in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 267; Diamond "Force Majeure and Frustration under International Sales Contracts" in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 257; Parker "Force Majeure in EU Law" in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 335; Rimke "Force majeure and hardship: Application in international trade practice with specific regard to the CISG and the UNIDROIT Principles of International Commercial Contracts" in Pace International Law Review (eds) *Pace Review of the Convention on Contracts for the International Sale of Goods* (1999-2000) 197.

# CHAPTER TWO
# NATIONAL RISK OF LOSS REGIMES

## 2 1 Introduction

A study of the rules of risk in different national legal systems shows that, despite broad similarities, the practical effect achieved display divergences in detail. And even where the substantive result is the same, the theoretical underpinning of these rules is often discrepant.[1]

The discussion on the regulation of risk under national legal systems will be limited to approaches followed by English law, American law, German law and South African law. Because the focus is on sales involving the carriage of goods, the discussion of each legal system is divided into an analysis of shipment and destination contracts, so-called residual cases, sales in transit and situations where either the seller or buyer is in breach. Moreover, because parties tend to regulate their legal position with reference to trade terms, the discussion of the default rules will be supplemented by a consideration of the risk rule under the FOB, CIF and DDU terms in the various systems.

## 2 2 National approaches to the passing of risk

### 2 2 1 English law

Under English law, the rules on the passing of risk deal with the notion of price risk.[2] Risk covers loss or damage caused by accidental disasters, the so-called *vis maior* situations. The risk of non-performance due to an accidental disaster is not covered by the provisions on risk but can be addressed by the doctrine of frustration.[3]

[1] Roth "The Passing of Risk" 1979 (27) *Am J Comp L* 291 292.
[2] See 1 6 3 *supra* for a general discussion on price risk.
[3] See 1 6 3 n 138 *supra* for general references on the English law of frustration.

As point of departure, English law follows the principle of *res perit domino.*[4] The general rule of section 20(1) of the Sale of Goods Act (SGA) 1979 provides that unless otherwise agreed, risk remains with the seller until property is transferred to the buyer.[5] Upon the transfer of property, the risk of loss is also transferred. Except for consumer sales,[6] this rule applies irrespective of whether delivery has been made or not,[7] unless the delay in delivery is the fault of either the seller or the buyer.[8]

Because the passing of risk is linked to the passing of property, it is necessary to understand when property passes under English law. Section 16 SGA 1979[9] requires that the goods have to be specified or easily ascertainable for ownership to pass. Section 17, furthermore, provides that in the event of a sale of specified or ascertained goods, the property can pass when the parties intend it to pass. Such intention is ascertained with reference to the terms of the contract, the conduct of the parties or the circumstances of the case.[10] Section 18 Rule 1 provides that in the case of an unconditional contract for the sale of specific goods[11] in a deliverable state,[12] property passes on conclusion of the contract, irrespective of whether payment or delivery is postponed.[13] In the case of conditional sales, such as where the seller is bound to do something to put the goods in a deliverable state, property does not pass until that thing is done and the buyer is notified.[14] Where the goods are to be weighed, measured, tested or some act has to take place to ascertain the price, the property does not pass until the act is done and the buyer notified.[15] Similarly, when goods are delivered to the buyer "on approval" or on "sale or return" terms, property passes when the goods are approved.[16]

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[4] Guest "Risk and Frustration" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) para 6-002; *Martineau v Kitching* (1872) LR 7 QB 436 454; *Hansen v Craig & Rose* (1859) 21 D 432 438.
[5] This rule is derived from the SGA's predecessor, the Sale of Goods Act of 1893.
[6] See s 20(4) SGA 1979, which gives effect to the Sale and Supply of Goods to Consumers Regulations 2002.
[7] S 20(1) SGA 1979.
[8] S 20(2) SGA 1979 provides that in such instances the goods are at risk of the party at fault in respect of loss that might not have occurred but for such fault. See 2 2 1 5 *infra*.
[9] Subject to s 20A SGA 1979.
[10] S 17(2) SGA 1979. S 18 provides 5 additional rules for ascertaining the intention of the parties.
[11] S 61(1) SGA 1979 defines specific goods as goods "identified and agreed upon at the time a contract of sale is made". S 61(1) SGA also provides that specific goods should include "an undivided share, specified as a fraction or percentage of goods identified and agreed on".
[12] S 61(5) SGA 1979 states that goods are in deliverable state "when they are in such a state that the buyer would under the contract be bound to take delivery of them".
[13] However, Atiyah et al *The Sale of Goods* 11th ed (2005) 326 indicates that postponement of payment or delivery can be construed as an intention to reserve the transfer of property. Other factors that may point to a contrary intention that property is not to pass, are agreements on the transfer of risk or placing an obligation on a party to insure the goods.
[14] S 18 Rule 2 SGA 1979.
[15] S 18 Rule 3 SGA 1979.
[16] S 18 Rule 4 SGA 1979. Also see the discussion of Atiyah et al *Sale of Goods* 329-332.

The requirement that goods have to be ascertained for ownership to pass has always presented difficulties, especially where the goods form part of a larger, but identified, bulk.[17] Under the terms of s 18 Rule 5, an "unconditional appropriation" is the usual method by which property will pass in the case of unidentified or unascertained goods. Generally speaking, this requirement means that "some ascertained and identified goods must be irrevocably attached or earmarked for the particular contract in question."[18] Rule 5(1) requires that appropriation should take place with the assent of the other party to the contract. The assent may be express or implied, made before or after appropriation.[19] The simplest and most common way in which appropriation happens is by delivery. Rule 5(2) provides that, if the seller delivers the goods to the buyer, a carrier or bailee and does not reserve the right of disposal,[20] they are considered to be unconditionally appropriated. However, this still does not provide a solution where the goods are delivered to a carrier mixed with other goods.[21] Even though the bulk itself may be identified or ascertained, the case law makes it clear that no property can pass until the part sold has been in some way physically severed or segregated from the remainder of the bulk or at least earmarked so that the parts appropriated can be readily identified.[22]

The Sale of Goods (Amendment) Act 1995[23] provides some clarity for contracts concluded after 19 September 1995. Section 18 Rules 5(3) and 5(4) now regulate the passing of property in goods sold as part of an identified bulk and in undivided shares in goods.[24] These amendments confirm the so-called "doctrine of ascertainment by

[17] Unascertained goods include future goods such as goods which are still to be manufactured or grown, goods which are simply identified by a generic description and goods which form part of a larger bulk but which have not yet been segregated. See *E Reynolds & Sons (Chingford) Ltd v Hendry Bros Ltd* [1955] 1 Lloyd's Rep 258 259; *Commercial Fibres (Ireland) Ltd v Zabaida* [1975] 1 Lloyd's Rep 27.
[18] Atiyah et al *Sale of Goods* 334-339. In the final instance, unconditional appropriation depends on the type of goods and the general circumstances of the case.
[19] Atiyah et al *Sale of Goods* 342-343; Guest "Passing of Property" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) para 5-047. Dispatch and receipt of invoices and delivery orders which clearly identify the goods have been considered enough to transfer property. See *Hendy Lennox Ltd v Grahame Puttick Ltd* [1984] 2 All ER 152.
[20] S 19 SGA 1979 regulates how the right of disposal can be reserved contractually, for example if the bill of lading is made out to the seller's order or if the seller keeps the transport documents.
[21] In *Healy v Howlett & Sons* [1917] 1 KB 337, the defendant ordered 20 boxes of mackerel from the plaintiff, an Irish fish exporter. The latter dispatched 190 boxes and instructed the railway officials to earmark 20 boxes for the defendant and the remaining boxes for two other consignees. The train was delayed before that could be done and the fish was spoilt. It was held that property had not pass before the goods were earmarked and therefore the deterioration was still at the seller's risk. In the absence of the identification of the goods, no appropriation to the contract could take place.
[22] *Healy v Howlett supra*; *Laurie & Morewood v John Dudin & Son* [1926] 1 KB 223; *In re London Wine Co (Shippers) Ltd* 1986 PCC 121. See also 2 2 1 4 *infra* for a discussion of the same problem in the context of sales *in transit.*
[23] *Cf* s 20A; s 18 Rule 5(3) & (4) SGA 1979.
[24] These amendments will be examined closer in the discussion on sales in transit. See 2 2 1 4 *infra.*

exhaustion".[25] Section 16 has also been amended by subjecting it to the provisions of section 20A, which provides for property to pass when there is a sale of a specified quantity forming part of a larger bulk which is identified, either in the contract or by subsequent agreement, and the buyer has paid for some or all of the goods.[26] The buyer now becomes an owner in common of the bulk.[27] It should be noted that section 20A only applies to the sale of "a specified quantity of unascertained goods" and does not apply to an undifferentiated part of a bulk cargo expressed as a fraction or percentage of the whole cargo. After the 1995 amendments, the latter example falls under the statutory definition of specified goods which has been broadened.[28] Therefore, where a contract provides for the sale of "half the cotton which has been shipped in bulk on the *Peerless*", it is a sale for specific goods, which is to be regulated by section 18 Rules 5(3) and 5(4). On the other hand, a contract for the sale of "500 out of the 1000 bales of cotton which have been shipped in bulk on the *Peerless*" is not a contract for specified goods but will be regulated by section 20A. Similarly, a contract which provides for the sale of "half the cotton to be shipped in bulk on the *Peerless* in October" if the quantity of the bulk is not yet identified, either in the contract or by subsequent agreement between the parties, will not be a contract for specified goods but will not be regulated by section 20A either.[29]

When goods are specified, risk passes on conclusion of the contract unless the parties by agreement separate the passing of risk from the passing of property.[30] In the context of international sales, this is a common phenomenon.[31] Deviation from the general rule often occurs through the incorporation of trade terms such as FOB and CIF.[32] It may also be inferred from a course of dealing or by usage.[33] The case

[25] This doctrine was judicially applied in *Karlshamns Oljefabriker v Eastport Navigation Corp* [1982] 1 All ER 208.
[26] See Atiyah et al *Sale of Goods* 346-352 for a discussion on the Sale of Goods (Amendment) Act 1995.
[27] See 3 3 2 1 *infra* for a discussion of this provision and the issues which are still not satisfactorily answered by the amendment.
[28] S 61(1) SGA 1979 as amended.
[29] The examples referred to are taken from Treitel "Overseas Sales in General" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) para 18-294. See also paras 18-285-18-307 for a general discussion on the regulation of bulk shipments under English law. In para 18-294 he notes that the fact that sales for a percentage or fraction of the cargo do not fall under the provisions of s 20A, might appear to be a gap in the 1995 amendment, but if that would be the case, it is not a serious gap. Sales of this kind are rare and no cases are reported where goods are sold on this basis. Moreover, such sales would involve considerable risk for the buyer, especially if he agrees to pay a lump sum for an unknown quantity.
[30] S 20 SGA 1979; Bassindale "The Passing of Ownership and Risk in International Commodity Contracts" 1993 4(2) *ICCLR* 51.
[31] Treitel "Overseas Sales" in *Benjamin's Sale* para 18-244.
[32] See 2 2 1 1 (i) and (ii) *infra.*
[33] Treitel "Risk and Frustration" in *Benjamin's Sale* paras 6-002-6-003; Grewal "Risk of Loss in Goods Sold in Transit: A Comparative Study of the UN Convention on Contracts for the International Sale of Goods, the UCC and the British Sale of Goods Act" 1991 (14) *Loy LA Int'l & Comp LJ* 93 113.

law also presents authority for exceptional cases where the risk passes before the property[34] and where the risk passes after the property.[35]

Special provisions apply where the goods are to be transported by carrier.[36] These are dealt with in connection with the distinction between shipment and destination contracts.

### 2 2 1 1 Shipment contracts

Because the general rule of section 20 SGA links risk to the transfer of property, the passing of risk depends on whether the goods are identified or ascertained. If so, risk will pass when the parties intend it to pass.[37] In the case of unascertained goods, the goods first have to be "unconditionally appropriated" to the contract.[38] Section 18, Rule 5(2) SGA 1979, determines that when goods are delivered[39] to a carrier, the goods are considered to be unconditionally appropriated to the contract, and therewith, property is transferred, unless the seller has reserved the right of disposal.[40] Risk will accordingly pass on delivery to the carrier. If the goods form part of an identified bulk, the provisions of sections 20A and 18 Rules 5(3) and (4) regulate the passing of property and therefore also the passing of risk.

Once again the default provisions on risk can be displaced by means of special contractual arrangements.[41] In the case of export sales, trade terms usually define

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[34] *Sterns Ltd v Vickers Ltd* [1923] 1 KB 78. See 3 3 2 1 *infra* for a discussion of the case.
[35] *Head v Tattersall* (1871) LR 7 Ex 7. This case illustrates that in the event of a right of rejection, the risk will remain on the seller even though the property has passed to the buyer. See also Atiyah et al *Sale of Goods* 356.
[36] According to a principle enunciated in *Beer v Walker* (1877) 46 LJQB 677 and *Mash & Murrell Ltd v Joseph I Emanuel Ltd* [1961] 1 WLR 862, when goods are sold under a contract which involves transportation of the goods, it is an implied term of the contract that the goods should be dispatched in a condition that they can endure a normal journey and on arrival at their destination be suitable for their ordinary purpose. The seller does not take the risk for extraordinary deterioration due to abnormal conditions but merely for necessary and inevitable deterioration which will render them unmerchantable on arrival. See also Treitel "Risk and Frustration" in *Benjamin's Sale* para 6-019.
[37] S 17 read with the 5 rules of s 18 for ascertaining intention and s 20 SGA 1979.
[38] S 18 Rule 5 SGA 1979.
[39] Where the seller is authorised or requested to send the goods to the buyer, s 32 SGA 1979 determines that delivery to the carrier is *prima facie* deemed to be delivery to the buyer. "Delivery" in terms of s 61 SGA 1979 means the "voluntary transfer of possession from one person to another, except that in relation to Ss 20A and 20B above it includes such appropriation of goods to the contract as results in property in the goods being transferred to the buyer." Goods are normally delivered to the buyer when he, or his agent, acquires custody of them or is enabled to exercise control over them.
[40] S 19(1) SGA 1979; Treitel "Risk and Frustration" in *Benjamin's Sale* para 6-010.
[41] S 20 SGA 1979 only operates as a default rule in cases where the parties have not agreed otherwise.

the place and time of delivery. The discussion of these deviations will be restricted to the traditional shipment terms, namely FOB and CIF.

### (i) FOB contracts

In English law, FOB ("free on board") is used in transactions of different character and the responsibilities which arise under the clause may differ according to the nature of the transaction. Definitions that apply to one type of FOB contract are therefore not necessarily applicable to another type; even if that contract might appear to be identical in nature.[42]

The FOB term did not originate from litigation but from the customs and usages of the merchants and commercial practice has always played a significant role in defining its content. FOB has served different interests in different periods of time. English courts have always been well aware of the evolution of the term and, therefore, always allowed for variations. Judicial attempts at defining the FOB term are accordingly couched in general terms.[43] When it comes to ascertaining the incidental obligations which the FOB term implies, English courts also maintain that these depend on the express or implied intention of the parties.[44] In the absence of express contractual stipulations, courts are bound to ascertain what the intention of the parties must have been; often by implication. In this regard, judicial interpretations of trade terms rely on mercantile usage or custom, such as usages at different ports or customs of the trade.[45]

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[42] Griffin *Day & Griffin The Law of International Trade* 3rd ed (2003) 52 holds that the FOB contract is not "susceptable to rigid definition".

[43] Sassoon *CIF and FOB Contracts* 4th ed (1995) paras 434, 437; Murray et al *Schmitthoff's Export Trade: The Law and Practice of International Trade* 11th ed (2007) para 2-007. Devlin J in *Pyrene Co Ltd v Scindia Navigation Co Ltd* [1954] 2 QB 402 424 described the FOB contract as a "flexible instrument".

[44] Murray et al *Schmitthoff's Export Trade* para 2-007; Sassoon *CIF and FOB Contracts* para 434. Thus in *NV Handel My J Smits Import-Export v English Exporters (London) Ltd* [1957] 1 Lloyd's Rep 517 521, it was said that the contract does not cease to be an FOB contract by virtue of the fact that the seller agreed to secure the shipping space. And in *Carlos Federspiel & Co SA v Charles Twigg & Co Ltd* [1957] 1 *Lloyd's Rep* 240, the seller, in addition, agreed to pay for the freight and insurance. Pearson J concluded that these CIF features are not necessarily inconsistent with the FOB term and that fundamentally the contract is to be regarded as an FOB contract. The House of Lords in *AV Pound & Co v MW Hardy Inc* [1956] AC 588 concluded that there could be no general rule to the effect that under FOB it was the buyer's duty to secure an export licence. Most authorities attribute this conclusion to *HO Brandt & Co v HN Morris & Co* [1917] 2 KB 784, decided by the Court of Appeal nearly 40 years earlier on the grounds that the FOB contract does not differ from the ordinary inland contract of sale except with respect to the place at which delivery was to be made.

[45] Sassoon *CIF and FOB Contracts* para 439; Griffin *Law of International Trade* 52. This is also the approach of private definitions such as the FOB definition of the British Export Institute and the FOB vessel definition published by the British Association of Chambers of Commerce in the United Kingdom.

Although there is no generally accepted system of subdividing the FOB term into different categories, it is possible to distinguish three types; viz the “classic” type, the "additional services" variant and the “strict” or "shipment to destination" variant.[46] This classification is mostly arbitrary and is based on an elaboration of the basic features of the term as to costs and responsibilities.[47]

The differences between the three types of FOB contracts indicate the flexible nature of this arrangement.[48] In practice, the classic FOB contract entails that the buyer nominates a ship and when it arrives in the port of shipment, the seller places the goods on board under a contract of carriage he has concluded with the carrier but for the account of the buyer.[49] The seller must see that the goods are loaded, the cost of which is chargeable to him; whilst further expenses such as the costs of shipment, insurance and unloading are chargeable to the buyer.[50] The seller receives a bill of lading that shows him as the consignor and which is made out to his order, which he then transfers to the buyer. However, it is also possible for the seller to take out the bill of lading in the buyer’s name.[51]

Under the so-called “additional services" or “extended” FOB variant, the seller makes shipping and insurance arrangements for the account of the buyer. The seller nominates the ship, contracts with the carrier, places the goods on board and transfers the bill of lading to the buyer. The buyer is not under an obligation to nominate a suitable ship.[52]

The third variant is called the "shipment to destination" variant or “simple” FOB, also commonly known as the “strict” variant. In terms of this variant, the buyer enters into

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[46] Griffin *Law of International Trade* 52; Murray et al *Schmitthoff’s Export Trade* para 2-007. Although Devlin J was the first to describe three broad categories of FOB terms in *Pyrene v Scindia Navigation supra*, Sassoon *CIF and FOB Contracts* para 435 is of the opinion that they could have been established much earlier. Note that Murray et al *Schmitthoff’s Export Trade* para 2-007 refer to the classic and strict variants as synonyms, which may give rise to misunderstandings. Other sources hold that the strict FOB term is a separate variant. See Sassoon *CIF and FOB Contracts* paras 442-443.

[47] Sassoon *CIF and FOB Contracts* para 441.

[48] Murray et al *Schmitthoff’s Export Trade* para 2-007; *Pyrene v Scindia Navigation supra* 424 as referred to with approval by the Court of Appeal in *The El Amria and El Minia* [1982] 2 Lloyd’s Rep 28 32.

[49] *Wimble Sons & Co v Rosenberg* [1913] 1 KB 279.

[50] *Wimble Sons v Rosenberg supra*; Tiplady *Introduction to the Law of International Trade* 68; Atiyah et al *Sale of Goods* 420. As there is no obligation on the seller to arrange for insurance, the buyer usually arranges for marine insurance himself. However, this is often inconvenient for him to do so. Because the seller is where the goods are to be dispatched, the buyer may ask the seller to do that for his, the buyer’s, account.

[51] *Pyrene v Scindia Navigation supra* 424; Treitel “FOB Contracts” in Guest (ed) *Benjamin’s Sale of Goods* 7th ed (2006) para 20-005.

[52] *The El Amria & The El Minia supra* presents an example of a sale concluded on the basis of this FOB variant.

a contract with the carrier directly, or through an agent, such as a forwarder. The buyer nominates the ship, the seller places the goods on board and a bill of lading is handed to the buyer through his agent in the port of shipment, the so-called freight forwarder, and, therefore, does not pass through the hands of the seller at all.[53] According to Sassoon,[54] the strict interpretation is the most satisfactory definition of the term FOB.[55] Because this interpretation has proved to be unsuitable in many cases other variants have developed as a result of the adjustment of the obligations of the respective parties.[56]

However, when it comes to the division of responsibilities connected to the notion of delivery, two definite features can be identified in regard to FOB sales, irrespective of the type or variant being used:[57]

(a) The seller undertakes to place the goods on board a ship at the agreed port of shipment at his own expense.
(b) Delivery takes place and the risk of loss of or damage to the goods is transferred to the buyer once the goods pass the ship's rail and are on board.

Although it is generally stated that costs and risks pass on shipment,[58] the precise moment of shipment is sometimes unclear. Moreover, its meaning has not been the subject of much judicial clarification.[59] Place and time of shipment refers to the place and moment of delivery. Under section 32(1) SGA, the seller is deemed to have delivered the goods once the goods are delivered to a carrier. What is relevant here, however, is that the FOB seller's duty to deliver the goods is generally described as a duty to place the goods on board the vessel. That also tends to be the defining point

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[53] Treitel "FOB Contracts" in *Benjamin's Sale* paras 20-003, 20-007; Atiyah et al *Sale of Goods* 421; Murray et al *Schmitthoff's Export Trade* para 2-007.
[54] *CIF and FOB Contracts* para 438.
[55] The FOB term of the Institute of Export 1951 14 *Export* 221 *et seq* para 4 also refers to the strict variant.
[56] Sassoon *CIF and FOB Contracts* para 439. The seller's capacity to secure the shipping space provides the key for differentiating between the FOB contract and other similar shipping contracts.
[57] *Stock v Inglis* (1884) 12 QBD 564 573 aff'd (1885) App Cas 263; *J Raymond Wilson & Co Ltd v N Scratchard Ltd* (1944) 77 Lloyd's Law Rep 373 374, *Carlos Federspiel v Charles Twigg supra*; Murray et al *Schmitthoff's Export Trade* para 2-005.
[58] *Stock v Inglis supra*; Treitel "FOB Contracts" in *Benjamin's Sale* paras 20-073, 20-078; Griffin *Law of International Trade* 62.
[59] Reynolds "Stowing, trimming and their effects on delivery, risk and property in sales 'fobs' 'fobt' and 'fobst' 1994 *LMCLQ* 119 125. Treitel "Overseas Sales" in *Benjamin's Sale* para 18-268 indicates that in English law, "shipment" *prima facie* means "placed on board ship", but it will not invariably be interpreted in this narrow sense, especially not in cases concerning multimodal and containerised transport. See also para 21-096, where it even is argued that the goods are shipped when they are placed into the containers.

for costs and risks to transfer from the seller to the buyer. A number of cases heard by the English courts have supported this view.[60]

Once again it is not clear what precisely is meant by "placing the goods on board". Traditionally it has been accepted that delivery is completed once the goods pass the ship's rail at the named port of shipment. The reference to "place on board" is therefore equated to "pass the ship's rail".[61] That implies that, in the absence of contractual provisions to the contrary, the seller does not have any further responsibilities beyond the point that the goods cross the ship's rail,[62] but bears full liability for the costs and safety of the goods up to that point.[63] The buyer, therefore, has to pay for all subsequent charges, such as the stowage of the goods in or on board the ship,[64] and has to carry all risks after the goods have crossed the rail.[65]

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[60] *Colley v Overseas Exporters* [1921] 3 KB 302 303, 307; *Cie Sucres et Denrées v C Czaparaikow Ltd; the Naxos* [1989] 2 Lloyd's Rep 462 474. In *Frebold and Sturznickel (t/a Panda OHG) v Circle Products Ltd* [1970] 1 Lloyd's Rep 499 (CA), goods were placed on board a ship FOB, but on arrival in the destination country they were temporarily misplaced by the railroad. The court of appeal held that any damage caused by the delay must be borne by the buyer, since the risk had already passed when the goods were placed on board the ship. In *M Golodetz & Co v Czaparaikow-Rionda Co (The Galatia)* [1980] 1 WLR 495 498 (CA), a fire broke out on board a ship carrying 2008 bags of sugar whilst it was en route. Water damage, caused by putting out the fire, together with the fire damage rendered the sugar worthless. The court of appeal held that the risk passed upon shipment, which took place on loading the sugar on board the ship.

[61] *Stock v Inglis supra; Colonial Insurance Co of New Zealand v Adelaide Marine Insurance Co* (1886) 12 App Cas 128; *Frebold and Sturznickel v Circle Products Ltd supra*; Atiyah et al *Sale of Goods* 423; Treitel "Overseas Sales" in *Benjamin's Sale* para 18-268; Murray et al *Schmitthoff's Export Trade* para 2-005.

[62] Sassoon *CIF and FOB Contracts* para 463; Treitel "Overseas Sales" in *Benjamin's Sale* paras 18-246–18-248; *Wimble Sons & Co v Rosenberg & Sons supra*. Unless there are incidental or so-called "marginal" responsibilities, which may be derived from legislation or from party agreement, that the seller still has to fulfil. These marginal responsibilities could relate to shipment or exportation. For example, s 32(3) of the SGA 1979 requires that, under certain circumstances, the FOB seller has to give the buyer due notice to enable him to insure the goods for sea transit. If the seller fails to do so, the goods shall be deemed to be at his risk during such transit.

[63] Sassoon *CIF and FOB Contracts* para 472 is of the opinion that shipping permits, dock and harbour dues and rates, export duties or licences and similar charges, fees and permits are usually the responsibility of the buyer as they do not relate to the delivery of the goods but to another phase of the transaction. The FOB term of the Institute of Export 1951 (14) *Export* 221 *et seq* para 4 also provides that the costs transfer when the goods cross the ship's rail. According to the Institute's definition, service charges for passing customs entries and port rates are not part of the delivery obligation and should be borne by the buyer even though these charges are due before loading can commence. The Association of British Chambers of Commerce, on the other hand, holds that the seller is responsible for all charges made against the goods until the point of passing the ship's rail. Under their FOB vessel term, the seller, therefore, is to bear these costs regardless of the customs and usages prevailing in practice in the different UK ports. See Sassoon *CIF and FOB Contracts* para 464. In regard to the duty of securing an export licence, Scrutton LJ in *HO Brandt & Co v HN Morris & Co supra* 798 held that it is the duty of the buyer. Also see the remark of Devlin J in *Pyrene v Scindia Navigation supra* 167 where he points out that in the port of London, it is the practice that all loading be done by the port authority and at the ship's expense, and that the whole charge for loading from alongside the ship is covered by the freight.

[64] Murray et al *Schmitthoff's Export Trade* para 2-005; Sassoon *CIF and FOB Contracts* para 463.

[65] *Frebold and Sturznickel v Circle Products Ltd supra.* In the event of bulk liquid cargoes, such as oil, the goods do not pass the ship's rail but are pumped directly into the ship's fittings, which means that property and risk pass when the cargo passes the flange connection between the delivery hose and the vessel's permanent cargo intake manifold.

There are two views as to when exactly the risk passes. One holds that the risk literally passes as the goods cross the ship's rail. Therefore, if the goods were to suffer damage after they have left the ground, but before they cross the ship's rail, the loss would normally be for account of the seller. But if the goods have crossed the rail and the damage occurred before they are safely on board, the damage would be for the buyer. The other view is that the risk passes only when the goods are safely loaded on board the ship.[66] When goods are placed on board a vessel, it entails lifting the goods across the ship's rail onto the deck. However, the obligation to place goods on board can entail various additional obligations, such as securing the goods on deck or in a hold.[67] Because the point of delivery is also the dividing point for costs and risks, the question arises as to who is responsible for the costs of these additional stages of the loading operation and who bears the risk for accidents that may occur during these stages of the loading process? The law does not clearly stipulate at which point of the loading process costs and risk pass from the seller to the buyer. When it comes to the transfer of risk, the practicability of the ship's rail as the dividing point for costs and risks is questionable,[68] especially in light of modern methods of containerisation[69] and trade usages at different ports. Usages or courses of dealing between parties can influence the division of loading and stevedoring costs.[70] Moreover, the parties can provide for these responsibilities either by agreement or by referring to a variant of the standard term, such as "FOB stowed" or "FOB stowed and trimmed".[71]

As regards the passing of property, the FOB term does not necessarily indicate when property is to pass.[72] Risk passes on shipment, but that does not necessarily coincide with the passing of property. When property passes depends on the intention of the parties. *Prima facie*, property passes on shipment since the loading of

[66] Atiyah et al *Sale of Goods* 423; Murray et al *Schmitthoff's Export Trade* para 2-013.
[67] These obligations are referred to as the stowing and trimming obligations.
[68] Devlin J in *Pyrene v Scindia Navigation supra* 419 mentioned that the division of the loading operation into two parts was outdated and "lost most of its nineteenth century significance." See also Murray et al *Schmitthoff's Export Trade* para 2-013 and the discussion 5 5 1 *infra.*
[69] In the case of containerised goods, the seller is no longer in control of the goods when they cross the ship's rail. Containerised goods are stowed in shipping or container terminals for long periods of time prior to departure of the ship. That renders it not only impracticable, but also unrealistic, to hold the seller responsible for the risk of the goods in circumstances where he has already relinquished his control over them to a third party. In these cases, the FCA term will be more appropriate. See 5 6 *infra*.
[70] Griffin *Law of International Trade* 58. In general, see 5 1 *infra* as well as the examples referred to by Sassoon *CIF and FOB Contracts* paras 468-473.
[71] It is not clear whether these additional obligations merely affect the seller's delivery obligation or whether it also means that he is to pay the costs for the stowage and trimmage. For a more detailed discussion on the uncertainties surrounding FOB variants, see 5 5 1 *infra.* The Institute of Export does not allow for any variation in the interpretation of FOB terms. In terms of their rules, variations are regarded as mere concessions. See Sassoon *CIF and FOB Contracts* para 473.
[72] Atiyah et al *Sale of Goods* 420 with reference to Staughton LJ in *Mitsui & Co Ltd v Flota Mercante Grancolumbiana SA* [1989] 1 All ER 951 956.

the goods is considered as an "unconditional appropriation" under section 18 Rule 5. However, if the goods are loaded together with other goods of the same description, unconditional appropriation of the goods sold takes place for purposes of delivery, but the goods are still unascertained for purposes of passing of property[73] unless section 20 A applies. Normally, property does not pass on shipment.[74] Moreover, the general presumption that property passes on shipment under an FOB contract no longer applies to modern international sales. It is nowadays common to treat the shipment as a conditional appropriation under section 19. The practice that payment is to be made against delivery of the shipping documents has become so established, that the seller must first be paid before property passes.[75] In these situations, the seller normally names himself as the consignee in the bill of lading, meaning that the goods will be deliverable under the bill of lading to him or to his order. Under section 19(2) SGA, that would mean that the right of disposal is reserved. The reservation of the right of disposal makes the appropriation conditional[76] so that property does not pass until the condition is satisfied, namely that the purchase price is paid.[77]

### (ii) CIF contracts

The CIF ("cost insurance freight") term also evolved in line with commercial developments.[78] This term is "more widely and frequently in use than any other

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[73] Murray et al *Schmitthoff's Export Trade* para 2-014; *Obestain Inc v National Mineral Development Corporation Ltd (The Sanex Ace)* [1987] 1 Lloyd's Rep 465 467; *Vitol SA v Esso Australia Ltd (The Wise)* [1989] 2 Lloyd's Rep 451 (CA). See also 2 2 1 4 *infra* for a discussion on s 20A.

[74] *Carlos Federspiel v Charles Twigg supra. Cf* Griffin *Law of International Trade* 59 who notes that the traditional point at which property passes under an FOB contract is when the goods cross the ship's rail. However, in certain circumstances, s 18 Rules 5(3) and (4) will determine how property is to be transferred. Property can only pass on shipment if the seller has not reserved the right of disposal. See Treitel "FOB Contracts" in *Benjamin's Sale* para 20-071.

[75] Atiyah et al *Sale of Goods* 424; Treitel "FOB Contracts" in *Benjamin's Sale* para 20-077.

[76] S 19(1) SGA 1979. That will be the case under the classic FOB contract and the FOB contract with additional services.

[77] Atiyah et al *Sale of Goods* 424-425; Griffin *Law of International Trade* 60; *Mitsui & Co Ltd v Flota Mercante Grancolumbiana supra.* In modern times, the seller only retains property as security or to obtain bridging finance. Once the goods are shipped, the buyer obtains an interest in the goods. As a result of the Sale of Goods (Amendment) Act 1995, S 20A SGA 1979 now determines that the buyer may acquire property in an undivided share of an identified bulk if he paid the full or a part of the purchase price. The property in the whole subject matter will pass when the goods are discharged from the ship and appropriated to the contract. See also Treitel "FOB Contracts" in *Benjamin's Sale* para 20-086.

[78] Oberman *Transfer of risk from seller to buyer in international commercial contracts: A comparative analysis of risk allocation under the CISG, UCC and INCOTERMS,* LL M thesis Laval (1997) http://www.cisg.law.pace.edu/cisg/thesis/Oberman.html (accessed 25-02-2009) text accompanying n 168.

contract used for the purposes of seaborne commerce."[79]

Under the CIF contract in its usual form, the seller is obliged to ship at the port of shipment goods of the description contained in the contract; procure a contract of affreightment; insure the contract goods; and invoice them to the purchaser. As soon as reasonably possible after shipment, the seller must tender to the buyer or his agent, in proper form, the so-called "shipping documents".[80] The buyer's obligation to pay or to assume liability to pay the invoice price arises upon such tender. The buyer is covered by the contract of insurance against the risk that at the time of tender or subsequently the goods have become lost or destroyed. It is also possible to purchase goods which are already in transit, by purchasing the shipping documents and tendering them together with the insurance and invoice to the buyer.[81]

The essential characteristic of a CIF contract of sale is that, while the seller undertakes to be responsible for transportation and insurance cover to a named destination, the buyer agrees to pay, not against delivery of the goods at that destination, but against tender of a set of documents comprising the invoice, bill of lading and insurance policy.[82] Because of this the CIF sale is sometimes considered to be not a sale of goods but one of documents relating to goods.[83] However, this does not mean that there is no duty to deliver goods.[84] If the goods are not delivered to the buyer, the seller will he held liable for breach of contract. Unless the contract so provides it is also not sufficient merely to prepare the goods for shipment, for instance by delivering them to the carrier ready for loading. The goods should in fact be loaded on board the ship. In *Hindley & Co v East Indian Produce*[85] the seller sold fifty tons of Siamese jute to the buyers C&F Bremen. The sellers bought the jute afloat. However, although the shipping documents seemed to be in order, the jute was never loaded on board the designated vessel. The sellers contended that they delivered apparently conforming documents and, therefore, had performed their obligation to deliver. Kerr J rejected this argument. Although the emphasis in CIF

[79] *Ross T Smyth & Co Ltd v TB Bailey, Son & Co* [1940] 3 All ER 60 68.
[80] *Ireland v Livingston* (1872) 5 LR HL 395; *Biddell Bros v E Clement Horst Company* [1911] 1 KB 214; *Ross T Smyth & Co Ltd v TB Bailey, Son & Co supra; Comptoir d'Achat et de Vente du Boerenbond Belge SA v Luis de Ridder Limitada (The Julia*) [1949] AC 293.
[81] Ademuni-Odeke *The Law of International Trade* (1999) 81-83. The documents represent the goods and enable the buyer and seller to deal with the goods afloat. This is one of the main economic functions of the CIF contract.
[82] Tiplady *Introduction to the Law of International Trade* 39; Ademuni-Odeke *International Trade* 72-73.
[83] See Scrutton J in *Arnold Karberg & Co v Blythe, Green, Jourdain & Co* [1915] 2 KB 388, aff'd [1916] 1 KB 495; Ademuni-Odeke *International Trade* 73-84. In modern times the CIF contract has probably become a sale in electronic messages instead of paper documents.
[84] Atiyah et al *Sale of Goods* 430.
[85] [1973] 2 Lloyd's Rep 515.

sales is on the tender of proper documentation,[86] such transactions remain sales of goods and the duty of the seller is either to ship contract goods, or if he is selling goods which he has himself bought afloat, the undertaking that such goods have actually been shipped is fundamental. The presentation of an apparently satisfactory bill of lading is insufficient if there is no actual shipment of goods behind it.[87]

However, not every contract which contains a CIF term is a CIF contract. Sassoon[88] remarks, "there is considerable laxity in the use of forms of contract for the sale of goods overseas, and the interpretation of any particular contract of sale expressed to be c.i.f. may present real difficulty." Sometimes terms are introduced into such contracts that contradict the understanding of CIF terms and prevent them from being CIF contracts.[89] Printed contract forms frequently contain terms that are inapplicable or unsuitable to a CIF contract. In some cases the meaning of CIF is vitiated, for example by determining that risk should remain on the seller until actual delivery to the buyer. This is contrary to the meaning of a CIF contract and is unacceptable.[90] Additional obligations reconcilable with the basic nature of a CIF contract amount to no more than variations of it.[91] An agreement in regard to passing of ownership;[92] a

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[86] The economic purpose is to provide the buyer as early as possible with the right of disposal, and to provide the seller with the price against delivery of the documents. Murray et al *Schmitthoff's Export Trade* para 2-020.

[87] Treitel "CIF Sales" in Guest *Benjamin's Sale of Goods* 7th ed (2006) para 19-008. The Court of Appeal in *Arnhold Karberg & Co v Blythe Green Jourdain & Co* [1916] 1 KB 495 dissented from the court *a quo* and stated that a CIF contact is a contract for the sale of goods to be performed by the delivery of documents. See also the discussion by Griffin *Law of International Trade* 70-72.

[88] *CIF and FOB Contracts* para 20.

[89] Griffin *Law of International Trade* 68-69. The facts of *The Parchim* [1918] AC 157 present an example. The contract in question was a cross between a CIF and an FOB contract. The price included costs and chartered freight to a European port but did not include the premium of an insurance policy. There were also provisions that, in the event of certain circumstances, the buyer was to find another ship to take the goods and was to pay for storage until loading and for any excess freight over the chartered freight. Although called a CIF contract, the contract contained more characteristics of an FOB contract. As a general rule, the designation of a contract as a CIF contract creates an inference in favour of it, unless the inference is to be rebutted by express provisions showing that the parties had a different intention. Roskell LJ's observation in *Concord Petroleum Corp v Gosford Marine Panama SA (The Albarezzo)* [1975] 2 Lloyd's Rep 295 (CA) should be noted in this regard:

> "It is a trite observation that what is sometimes called a true f.o.b. or a true c.i.f. contract is a comparative commercial rarity. Contracts vary infinitely according to the wishes of the parties to them. Though a contract may include the letters f.o.b. or c.i.f. amongst its terms, it may well be that other terms of the contract clearly show that the use of those letters is intended to do no more than show where the incidence of liability for freight or insurance will lie as between buyer and seller but is not to denote the mode of performance of the seller's obligations to the buyer or the buyer's obligations to the seller."

[90] *Law & Bonar Ltd v British American Tobacco Co Ltd* [1916] 2 Kb 605.

[91] Sassoon *CIF and FOB Contracts* paras 11-18; Murray et al *Schmitthof's Export Trade* para 2-037; Treitel "CIF Sales" in *Benjamin's Sale* para 19-006.

[92] *Redler Grain Silos Ltd v Bicc Ltd* [1982] 1 Lloyd's Rep 435 (CA).

stipulation that the contract is to be void for any portion shipped but not arriving[93] or that payment is to be on landing or landed weights[94] fall into this category.

The facts of *The Julia*[95] led the House of Lords to conclude that the contract was not a true CIF sale. The parties concluded a contract for the sale of grain CIF Antwerp as per the terms of the London Corn and Trade Association's standard form contract. The parties agreed that the seller could demand payment against either a bill of lading and insurance policy or a delivery order and insurance certificate. The contract also provided that the condition of the grain was to be guaranteed on arrival and that the seller was to pay for any deficiencies in weight delivered. The seller shipped a bulk shipment of grain of which only a proportion was sold to the buyer. The bill of lading, however, was evidence of the whole shipment. As it referred to goods not included in the sale, the seller performed by means of a delivery order and insurance certificate. The buyer subsequently paid on tender of these documents. However, Germany invaded Belgium and the sellers directed the vessel to Lisbon, where it was sold. The buyer brought an action for the money paid as they never received the goods. The House of Lords held that the terms of the contract were not typical of a CIF contract and that they also did not constitute a modified CIF contract. Because the seller did not provide a bill of lading but merely a delivery order, both transfer of property and possession was postponed until delivery was taken in Antwerp, which never happened. The contract was therefore not a CIF contract but a contract to deliver "ex ship" at Antwerp.

The mere fact that there is a reference to delivery or arrival in a CIF contract neither affects its status as a CIF contract,[96] nor automatically turns it into a destination contract. Moreover, it is standard practice that the CIF term is followed by a reference to the port of destination. This reference merely refers to the contractual destination of the vessel and the seller's obligation to conclude a contract of carriage to such destination at his expense and to deliver the goods to the ship destined for such destination.[97] It does not *per se* change the point of delivery for purposes of the passing of risk.

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[93] In *Karinjee Jivanjee & Co v William F Malcolm & Co* (1926) 25 Ll L Rep 28 it was held that this is a contingent CIF contract.
[94] *Denbigh Cowan & Co v Atcherley & Co* (1921) 90 LJKB 836 (CA). See also the discussion on CIF variants 5 5 2 *infra.*
[95] *Supra* 309.
[96] Sassoon *CIF and FOB Contracts* paras 14-15. See also the discussion on CIF out-turn clauses 5 5 2 *infra.*
[97] Treitel "CIF Sales" in *Benjamin's Sale* para 19-072 submits that a CIF sale involves 3 stages of delivery, namely "provisional delivery" on shipment; "symbolic delivery" on tender of documents; and

In some cases the contract is referred to as a C&F contract. Such a contract will still contain the usual obligations of a CIF contract, the only difference being that the insurance is arranged by the buyer. The seller is therefore obliged to give the buyer such information as is necessary for him to arrange insurance.[98] Cases are also reported where the CIF term is supplemented by the addition of one or more letters, for example CIF & E;[99] CIF & C[100] or CIF C & I.[101] These refer to additional costs which are to be borne by the seller. However, their precise meaning is not clear, as they have not as yet been defined in any authoritative text.[102]

Where there is no intention to vitiate the standard meaning, the normal consequences of the CIF term will determine the obligations of the seller and buyer. As is the case with the FOB term, it is also the duty of the seller to ship the goods. But what does that mean in the context of the CIF term? In English law "shipment" means the loading of the goods onto a ship.[103] Evidence of a custom in the American timber trade that "shipment" could also mean loading into railway cars in the interior of the country or loading on cars at the saw mills from which the timber came, was held to be inconsistent with the nature of the CIF term under English law.[104] Although this might suggest that the seller must in every case load goods aboard a ship, this is not completely true as a seller can normally perform a CIF contract in one of two ways; either by shipping the goods himself or by purchasing them afloat. The seller

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"complete delivery of the cargo" when the goods are handed over to the buyer at the destination. Para 19-073 explains that the third stage of delivery is a negative obligation as it entails that the seller should refrain from interfering with the contract of carriage so as to prevent the buyer from receiving the goods at the agreed destination.

[98] Sassoon *CIF and FOB Contracts* para 20; Atiyah et al *Sale of Goods* 433; Treitel "Other Special Terms and Provisions in Overseas Sales" in Guest 7th ed (2006) paras 21-012-21-013; Murray et al *Schmitthoff's Export Trade* paras 2-038-2-039. The contract may require the seller to insure the goods at the buyer's request and for his account. Property and risk normally pass in the same manner as under a CIF term. The only exception relates to the duty of the seller to give notice to the buyer under s 32(3) SGA 1979 to enable him to insure the goods. This duty does not apply under the CIF sale because of the seller's duty to insure, but it does apply in the case of a C&F sale.

[99] "Costs, insurance freight and exchange" could mean one of two things. It is sometimes said that it refers to a banker's commission or collecting charge which is included in the price, whilst others maintain that it refers to the seller's obligation to absorb the exchange rate risk. To avoid misunderstanding, parties should clarify their intentions when using such ambiguous terms.

[100] "Costs, insurance, freight and commission". The commission referred to is the exporter's commission which he charges when acting as a buying agent for the overseas buyer. This commission is charged by export or confirming houses.

[101] "Costs, insurance, freight, commission and interest". The intention is that the buyer shall not be called upon to reimburse the seller for the cost of discounting any bill with a bank. This clause is used where goods are exported to distant places and some time elapses before the bill is settled. In these cases, the bank charges the seller commission and interest on the bill until payment is received.

[102] Sassoon *CIF and FOB Contracts* para 21.

[103] Sassoon *CIF and FOB Contracts* para 52; *Humphrey v Dale* (1857) 7 E&B 266 275; *Palgrave Brown & Sons Ltd v SS Turid* [1922] 1 AC 397 406.

[104] *Mowbray Robinson & Co v Rosser* (1922) 91 LJKB 524 (CA).

can therefore also discharge this obligation by acquiring goods that have already been shipped by someone else.[105]

Delivery of the goods on board the vessel, followed by the delivery of the correct documents, is considered to be complete performance by the seller of his duties under a CIF contract. In normal C&F and CIF sales contracts governed by English law, the risk of loss will pass from the seller to the buyer on shipment of the goods[106] or as from shipment.[107] The buyer, therefore, bears all risk of the goods from the time when they have passed the ship's rail at the port of shipment. If the goods are lost at sea, the buyer is still bound to pay the price but he will have the benefit of the insurance policy.[108] However, when it comes to the transfer of risk, the practicability of the ship's rail as the dividing point can once again be questioned, especially in light of modern methods of containerisation[109] and trade usages at different ports. Although the ship's rail is traditionally considered to be the point of delivery, commercial practice is also not consistent in this regard.

In the case of a CIF sale, there exists a dichotomy between risk and property.[110] Risk is commonly separated from property inasmuch as risk passes on shipment,[111] whilst property only passes when the transport documents are transferred and the goods are paid for.[112] If the bill of lading is taken in the seller's name, property passes conditionally.[113] If the bill is taken in the buyer's name, the *prima facie* rule is that

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[105] Tiplady *Introduction to the Law of International Trade* (1989) 48; Ademuni-Odeke *International Trade* 85.

[106] Atiyah et al *Sale of Goods* 430; Griffin *Law of International Trade* 95; Murray "Risk of Loss of Goods in Transit: A Comparison of the 1990 INCOTERMS with terms from other voices" 1991 (23) *U Miami Inter-Am L Rev* 93 116.

[107] That will be the case where goods are sold in transit and they are not totally lost. See Treitel "CIF Sales" in *Benjamin's Sale* paras 19-110, 19-113; Griffin *Law of International Trade* 96.

[108] Atiyah et al *Sale of Goods* 430; Murray et al *Schmitthoffs Export Trade* para 2-034. A claim against the carrier is also a possibility. See Murray et al *Schmitthoffs Export Trade* paras 2-029-2-030.

[109] It is, therefore, important that the seller does not make use of CIF in these instances, but elects to contract on the CPT or CIP terms. See 5 6 *infra*.

[110] Although s 32(1) SGA 1979 states that delivery to the carrier is *prima facie* deemed to be delivery to the buyer, it does not apply to CIF contracts where delivery only occurs on delivery of the shipping documents. Atiyah et al *Sale of Goods* 430

[111] The seller's obligation to insure the goods is generally regarded as evidence of an intention to exclude the general rule that risk follows property. See Treitel "CIF Sales" in *Benjamin's Sale* para 19-110.

[112] Atiyah et al *Sale of Goods* 431; Murray 1991 (23) *U Miami Inter-Am L Rev* 116; *Cheetam & Co Ltd v Thoparaham Spinning Co Ltd* [1964] 2 Lloyd's Rep 17; *Ginzberg v Barrow Haematite Steel Co Ltd* [1966] 1 Lloyd's Rep 343. The same applies to the C&F variation. See *The Aliakmon* [1986] AC 785.

[113] Treitel "CIF Sales" in *Benjamin's Sale* para 19-099; *E Clemens Horst Co v Biddell Bros* [1911] 1 KB 934 956, 959. See also 2 2 1 1 (i) *supra* for a discussion on passing of property under FOB terms. Treitel "CIF Sales" in *Benjamin's Sale* para 19-015 distinguishes between appropriation in the contractual sense, where the seller undertakes to deliver particular goods or goods forming part of a larger identified bulk, and appropriation in the proprietary sense of the word (so-called "unconditional appropriation"). A number of standard contracts formulated by trade associations, such as those of the Grain and Feed Trade Association (GAFTA) and the Federation of Oils, Seeds and Fats Association

delivery to the carrier is deemed to be unconditional appropriation.[114] Section 19(3) SGA provides that, if the seller transmits the bill of exchange to the buyer together with the shipping documents, the property does not pass unless the buyer accepts the bill of exchange or pays the price. However, transfer of property depends on the intention of the parties. Therefore, there have been a few cases where the property has been held to pass at some other time than the transfer of documents. For example, where the seller was not concerned about immediate payment because the sellers and buyers were both companies in the same corporate group, it was held that property passed on shipment or at the latest on delivery of the bill of lading even though no price was paid.[115] In modern days, a practical issue often causes property to pass at another time than the transfer of the documents. Bills of lading are sometimes issued very late, resulting in the cargo arriving long before the documents. In such instance, the seller can instruct the carrier to deliver the goods, normally against payment. Property will subsequently pass to the buyer on delivery of the goods.[116] Where specific goods are sold and paid for before shipment, the property may pass before shipment and it is then also possible for the risk to pass with property but before shipment.[117]

#### 2 2 1 2 Destination contracts

Under a destination contract the seller's duty to deliver is complete once the goods are delivered to a particular destination. This represents the most favourable arrangement for a buyer and the most onerous arrangement for the seller.[118] Destination or arrival contracts often find expression in terms such as "ex ship", "ex quay", "*franco domicile*", "free delivery" or "out-turn".[119] Under these terms the goods are at the seller's risk and expense until placed at the buyer's disposal at the named

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(FOSFA), request a notice of appropriation; ie a communication from seller to buyer that the goods have been shipped. See also Ademuni-Odeke *International Trade* 66; Griffin *Law of International Trade* 90-95.

[114] S 18 Rule 5(2) SGA 1979.

[115] *Cargo Owners Albacruz v Owners Albazero (The Albazero)* [1977] AC 774; Treitel "CIF Sales" in *Benjamin's Sale* para 19-103.

[116] Atiyah et al *Sale of Goods* 432.

[117] Treitel "CIF Sales" in *Benjamin's Sale* para 19-114. However, it is submitted that even in these cases, risk should only pass on shipment as that is usually the time when the buyer's insurance cover begins, which in itself will be evidence of the existence of an intention to exclude the general rule. The parties can, however, expressly provide that risk could pass before shipment, eg when the goods are placed alongside the vessel. Such an agreement would, however, change the nature of the CIF term.

[118] In regard to payment, this arrangement could be quite lucrative for the seller since he will receive more if he does more.

[119] Note, however, that "out-turn" clauses do not necessarily have to apply to destination contracts. See the discussion on CIF out-turn clauses 5 5 2 *infra*.

place of destination. For that reason it has been observed that they are not frequently used in British export trade practice, except where the parties have agreed on the delivery of goods of relatively small size by air.[120]

In the case of delivered or out-turn ex ship contracts, property will often not pass until the goods are delivered to the buyer's storage facility or trucks at the port of discharge.[121] Normally risk follows property unless the parties have agreed otherwise.[122] However, destination sales can present an exception to the *res perit domino* principle. Where the seller agrees to dispatch specific goods at his own risk to the buyer, property passes before risk occurs. Section 33 SGA 1979 provides for cases where the seller undertakes to deliver the goods at his own risk to a place different from that where they are at the time of conclusion of the contract. In these cases, the seller will carry the risk to deliver it to that destination but the buyer will carry the risk for deterioration incidental to the carriage of the goods, unless otherwise agreed. Section 33, in effect, splits the risk of deterioration during transit so that the seller bears the risk of what may be called "extraordinary" deterioration due to an accident or casualty. The buyer bears the risk of what may be called "necessary" deterioration, which any goods of the contract description must necessarily suffer in the course of transit.[123] This rule, however, is subject to the seller's agreement, which means that it has a restricted scope in international sales. Under "ex ship out-turn" contracts, the seller is obliged to deliver the goods at the port of discharge. Risk of destruction will pass at the delivery stage. Risk of contamination or deterioration during the voyage, however, will fall on the buyer.[124]

Once again trade terms play an important role in the context of destination contracts. Under the DDU term, in English law, the buyer will undertake the costs of importing

[120] Murray et al *Schmitthoff's Export Trade* para 2-045. See also in general, Griffin *Law of International Trade* 97-98.
[121] S 17(1) and s 18 Rule 5(2) SGA 1979; Bassindale 1993 4(2) *ICCLR* 52; Treitel "Special Terms" in *Benjamin's Sale* para 21-020. This is the case even if the contract provides for payment against documents and the seller transfers a bill of lading to the buyer, unless the bill was delivered with the intention to transfer property. However, in *Philip Head & Sons Ltd v Showfronts Ltd* [1970] 1 Lloyd's Rep 140 144, goods were stolen after they had been delivered to the buyer's garage. The court, however, held that the goods were not in a "deliverable state" and risk therefore never passed to the buyer.
[122] S 20(1) SGA 1979.
[123] Atiyah et al *Sale of Goods* 357; Treitel "Risk and Frustration" in *Benjamin's Sale* para 6-022. Defects in the goods, which existed at the commencement of the transit are not covered by this provision and remain at the risk of the seller.
[124] See 5 5 2 *infra* for a discussion on CIF out-turn clauses which are regularly used in the oil trade.

the goods, but costs linked to delivery of the goods as well as the risk of loss or damage to the goods are on the seller until arrival at the destination point.[125]

### 2 2 1 3 Residual cases

In cases where the goods are to be collected from the seller's business premises ("ex store"), his place of manufacture ("ex works") or a third party's warehouse ("ex warehouse"),[126] the passing of risk is not dependent on delivery but on the transfer of property from the seller to the buyer.[127] In the case of ascertained goods, risk usually transfers at the conclusion of the contract,[128] and in the case of unascertained goods, when the goods are unconditionally appropriated to the contract by either the seller or the buyer with the consent of the seller.[129] Consent can be given expressly or impliedly.[130] If the goods are not appropriated to the contract, risk will pass when the goods are handed over to the buyer or to a carrier or bailee if the right of disposal is not reserved.[131] The parties can, however, deviate from the *prima facie* rule. Normally, property and risk will only pass when delivery and payment has taken place.[132]

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[125] Murray et al *Schmitthoff's Export Trade* para 2-045. No clarity exists on the specific point of delivery under arrival terms inasmuch as the obligation to unload the goods from the arriving vehicle is not discussed in any detail. It is therefore not clear precisely when risk passes to the buyer, for instance in the case of "delivery at frontier" (DAF); "delivery duty paid" (DDP) or "delivery duty unpaid" (DDU) contracts.

[126] Where goods are kept in the possession of a third party, s 29(4) provides that delivery will not take place unless the third person acknowledges to the buyer that he holds the goods on his behalf.

[127] S 20(1) SGA 1979.

[128] S 20(1), 20A and s 18(1) Rule 1 SGA 1979. However, if the seller is obliged to package the goods, s 18(1) Rule 2 determines that property will not pass until the goods are put into a deliverable state.

[129] S 20(1), s 18 Rule 5(1) SGA 1979.

[130] *Pignatoro v Gilroy* [1919] 1 KB 459 462. Implied appropriation can be given through mere silence or by means of a notice of appropriation. Treitel "Special Terms" in *Benjamin's Sale* para 21-005.

[131] S 18 Rule 5(2) SGA 1979. This is normally the case where the seller agrees to manufacture goods and deliver them "ex works". In this case, the sale is one for unascertained future goods which have to be unconditionally appropriated to the contract for property to pass. If after manufacture, the goods are packed and labeled with the buyer's name and the buyer subsequently agrees to come and take them, the goods are appropriated for purposes of the passing of property. If the goods are in a warehouse, property normally passes when the goods are separated from the bulk or through the process of exhaustion. See Treitel "Special Terms" in *Benjamin's Sale* paras 21-003-21-004, 21-007. In British practice, the obligation to notify the buyer that the goods are put at his disposal is generally presumed to arise only when it is stipulated in the contract or where the contract does not stipulate the locality of the seller's works. See Murray et al *Schmitthoff's Export Trade* para 2-002 n 8.

[132] Treitel "Special Terms" in *Benjamin's Sale* para 21-005.

**2 2 1 4 Sales in transit**

The Sale of Goods Act 1979 does not address sales in transit as such. In English law, transit risk normally comes into play where a CIF term has been introduced into the contract of sale.[133] According to *The Julia*,[134] risk in CIF sales normally passes "on shipment or as from shipment". If goods, which are already damaged during the voyage, are sold in transit on CIF terms, the risk may pass retroactively to the buyer "as from shipment".[135] Out-turn contracts are often regarded as an exception to the general rule under CIF. It is argued that in these cases the seller is obliged to physically deliver the goods at the port of discharge. Risk of loss and destruction will therefore only pass at that point and not at shipment as is normally the case under CIF contracts.[136] This will apply to both specific and unascertained goods.

Where the contract is not concluded on the basis of a trade term, section 20(1) and section 18 Rule 1 SGA 1979 provide that, in the case of the sale of specified goods in transit, risk passes on the conclusion of the contract. However, sales in transit normally entail the sale of commodities, such as a certain number of barrels of crude oil, or fungible goods forming part of a larger bulk, such as a specific quantity of wheat which is not yet segregated from a larger load on board a particular vessel. As already indicated,[137] problems arise from the sale of an undifferentiated part of a larger bulk, where part of the bulk has deteriorated or has been destroyed, or when a single consignment is split up for resale to several buyers. These problems originate in the basic rule that property in goods cannot pass until the goods are ascertained.[138] The situation is particularly difficult for commodity traders when goods are lost or damaged while in transit.

In the case of a sale for unascertained goods in transit, section 16 of the Act has to be read with Rule 5(1) of section 18. This states that, where there is a contract for the sale of unascertained goods by description, such as 5000 barrels of crude oil to be

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[133] Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 114-115.
[134] *Supra* 309.
[135] Bassindale 1993 4(2) *ICCLR* 55; Treitel "CIF Sales" in *Benjamin's Sale* paras 19-112-19-113. However, where the goods are already lost at the time of conclusion of the contract, the decision in *Couturier v Hastie* (1856) 5 HL Cas 673 as well as s 6 SGA 1979, determine that the agreement is extinguished, leaving the risk with the seller. Strictly speaking, this case is not an example of passing of risk but one of frustration.
[136] Bassindale 1993 4(2) *ICCLR* 55. *Cf* also s 33. For a general discussion on CIF terms, see 2 2 1 1 (ii) *supra* and 5 5 2 *infra* for a discussion of CIF out-turn clauses where it is concluded that the point where risk passes is not to change as a result of this variation.
[137] See 2 2 1 *supra*.
[138] S 16 SGA.

delivered in July, and those goods are "unconditionally appropriated" to the contract, property will pass when such appropriation takes place. The rule, however, does not define unconditional appropriation. One possible solution is to look for some act of appropriation to allocate the deteriorated portion to a particular buyer. This will normally vary according to the type of goods in question and the general circumstances of the case.[139] Another possibility is to provide expressly in the contract for pro rata division among the various buyers.[140]

Where the ascertainment of the goods depends upon them being severed, weighed, measured, or in some way separated by the seller from the bulk, no property can pass until the required task has been completed.[141] Nor will any property pass where the power of separation is vested in a third party or in the buyer, unless and until such power is exercised. Further guidance is provided in section 18 Rule 5(2). Where the seller delivers goods to the buyer or to a carrier for the purpose of transmission to the buyer and does not reserve the right of disposal, he is taken to have unconditionally appropriated the goods so that property will pass. But when does a seller reserve his right of disposal? It is generally accepted that when a seller delivers a document of title, such as a bill of lading, he does not reserve his right of disposal, unless the bill is made out to himself or his order. In contrast to judgements of the United States courts, English courts have refused to treat a delivery order as a document of title.[142] In the case of an undifferentiated part of a bulk shipment, tender by the seller of a delivery order instead of a bill of lading does not suffice for property in the goods to pass, since the goods remain unascertained for lack of unconditional appropriation.[143] Where the bill of lading refers to the whole shipment and not to the proportion of the bulk destined for a particular buyer, it would still mean that property cannot pass until the goods have been identified and segregated at a final discharge port.[144]

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[139] Atiyah et al *Sale of Goods* 334-339. Before the SGA was passed, there was a dichotomy between the common law and equity on the question of appropriation. While common law insisted on identification, equity was less stringent. In the post-Act era, the rules under the Act appear to be complete and exclusive statements of the legal relations both in law and equity. See Atiyah et al *Sale of Goods* 351-352.

[140] Grewal (1991) 14 *Loy LA Int'l & Comp LJ* 117; Bassindale 1993 4(2) *ICCLR* 53.

[141] S 18 Rules 2 & 3 SGA 1979.

[142] Grewal (1991) 14 *Loy LA Int'l & Comp LJ* 116; Treitel "Risk and Frustration" in *Benjamin's Sale* para 6-005.

[143] However, in the case of *Sterns v Vickers supra,* the Court of Appeal held that the risk of deterioration in quality of an unascertained quantity of spirit in an identified storage tank passed to the buyers because they were in receipt of a delivery order which gave them an immediate right to possession. The House of Lords seem to have confirmed this principle in *The Julia supra* 312, 319. See 3 3 2 1 *infra* for a discussion of the case.

[144] Bassindale 1993 4(2) *ICCLR* 52.

However, even in the absence of any act of appropriation, it has been found that, if before the ship reaches its final destination, the remainder of the bulk has been discharged at other ports, leaving on board only the quantity sold to the buyer at the final destination, ascertainment will take place through exhaustion.[145] Similarly, if the buyer acquires the remainder of the cargo from the person previously entitled to it before the ships arrives at its final destination, the goods will become ascertained by consolidation.[146]

Fortunately, the Sale of Goods (Amendment) Act 1995 clarified the law relating to the sale of unascertained goods forming part of an identified bulk and the sale of undivided shares in goods. Section 20A provides that, where goods are sold as a specified quantity of unascertained goods that form part of a bulk,[147] the property in such goods will now pass when the goods meet the following conditions, namely, (a) that they form part of an identified bulk either in the contract or by subsequent agreement between the parties; and (b) that the buyer has paid the price for some or all of these goods. Section 16 of the 1979 Act was accordingly amended to make it subject to the provisions of section 20A.

To provide additional clarification, section 18 Rule 5 SGA 1979 was also amended. Subsection 3 now provides that, if a buyer concluded a contract for the sale of a specified quantity of unascertained goods in a deliverable state forming part of a bulk identified either in the contract or by subsequent agreement, and the goods are reduced to that quantity or even less, whilst the buyer under that contract is the only buyer to whom goods are due out of the bulk, the remaining goods will be appropriated to that contract and the property in those goods then passes to that buyer.[148]

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[145] Treitel "Overseas Sales" in *Benjamin's Sale* para 18-288; Bassindale 1993 4(2) *ICCLR* 52.
[146] Grewal (1991) 14 *Loy LA Int'l & Comp LJ* 116-117.
[147] "Bulk" is defined in s 61(1) SGA 1979 as "a mass or collection of goods of the same kind which – (a) is contained in a defined space or area; and (b) is such that any goods in the bulk are interchangeable with any other goods therein of the same number or quantity."
[148] Subsection 4 envisages a similar result for a buyer under separate contracts if the same circumstances exist. Treitel "Overseas Sales" in *Benjamin's Sale* para 18-288 points out that subsection 3 may be slightly misleading as the whole of s 18 applies only if no "other intention" appears. In the case of overseas sales such an "other intention" that property is not to pass until payment has been made or is adequately assured is commonly inferred from the surrounding circumstances.

### 2 2 1 5 Passing of risk in cases of breach of contract

Section 20(2) SGA 1979 provides that, where delivery has been delayed through the fault of the buyer or the seller, the goods will remain at the risk of the party at fault in regard to loss that "might not have occurred but for such fault." Therefore, if the seller delivers the goods late, the risk will be on the seller as from the moment he is in delay to make delivery,[149] whilst if the buyer fails to take delivery in time, risk will pass to him as from the moment he fails to take delivery,[150] or if he fails to give instructions for shipment, the risk may pass before shipment because delivery was delayed because of the buyer's fault.[151] It should be noted that the party at fault is not liable for all risks, but only for those which occurred due to that fault.

In respect of contracts where the seller is required to conclude a contract of carriage on behalf of the buyer, such as in the case of the classic FOB contract, it is important that the contract must be reasonable, having regard to the nature of the goods and the other circumstances of the case.[152] If the seller omits to do so, and the goods are lost or damaged during their transportation, the buyer may refuse to accept delivery to the carrier as delivery to himself,[153] which means that he may reject the goods or he may accept the goods and claim damages.[154]

Section 32(3) SGA, furthermore, provides that in cases where the goods are sent to the buyer by a route involving sea transit, the seller must give the buyer notice to insure the goods. If he fails to do so, the goods will be at the seller's risk during their transit.[155]

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[149] In practice, however, the goods will be insured by the party in possession and it will make no difference whether delivery to a particular buyer is delayed.
[150] *Demby Hamilton & Co Ltd v Barden* [1949] 1 All ER 435.
[151] Treitel "FOB Contracts" in *Benjamin's Sale* para 20-092. In respect of a CIF sale, for example, the seller could interfere with the contract of carriage and so delay the actual delivery of the goods. S 20(2) SGA 1979 places the risk of delay on the seller even after shipment. Risk may also pass to the buyer before shipment, where the contract gives the buyer a choice of destinations but he delays to inform the seller of his choice, resulting in a delay in shipment. See Treitel "CIF Sales" in *Benjamin's Sale* para 19-121.
[152] This will be determined in light of the circumstances that existed at the time when the contract of carriage was concluded and not at the date of the contract of sale. See *Tsakiroglou & Co v Noblee Thorl GmbH* [1962] AC 93.
[153] Under S 32(1) SGA 1979, if the seller has to send the goods to the buyer, delivery to the carrier is deemed to be delivery to the buyer.
[154] Atiyah et al *Sale of Goods* 422-423. For application of the rule, see *Thomas Young & Sons Ltd v Hobson & Partners* (1949) 65 TLR 365; *The Rio Sun* [1985] 1 Lloyd's Rep 350.
[155] Atiyah et al *Sale of Goods* 426 points out that, in practice, this provision is not of much importance as in most cases the buyer will already have enough information to have the goods insured.

In accordance with the decision in *Head v Tattersall*,[156] in cases where non-conforming goods are damaged or lost, the risk of such loss or damage will remain with the seller if the buyer has reserved a right of rejection, independent of the fact whether the damage is attributed to the breach of contract or not.[157] However, if the buyer accepts the goods, the risk passes to him since he lost his right of rejection at the moment of acceptance. In cases where the goods are repaired or replaced, the risk is on the seller whilst the goods are in transit to or from the place of repair because the transportation is caused by the seller's initial non-conformity.[158]

### 2 2 2 American law

Sections 2-509 and 2-510 of the Uniform Commercial Code (UCC) contain the basic risk of loss provisions. The passing of the risk of accidental disasters is regulated by section 2-509, and section 2-510 regulates the effect of breach on the passing of risk. The National Conference of Commissioners on Uniform State Laws (NCCUSL) approved amendments to the UCC in August 2002, which altered the content of Article 2 substantively and, therefore, also had an influence on the risk provisions in American law. These amendments were approved by the American Law Institute (ALI) in May 2003 and the final revision issued in February 2004.[159] For the sake of clarity, the revised version of the UCC will be referred to as the 2003 version, and the previous version as the 2001 version.

These default provisions on risk are subject to contrary agreement of the parties.[160] Such "contrary agreement" can be found either in the form of a clause specifying the intention of the parties in regard to the passing of risk, or a trade term such as FOB

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[156] *Supra.*

[157] Atiyah et al *Sale of Goods* 356; Treitel "Risk and Frustration" in *Benjamin's Sale* para 6-011; *Bostock & Co Ltd v Nicholson & Sons Ltd* [1904] 1 KB 725.

[158] Reynolds "Remedies in Respect of defects" in Guest (ed) *Benjamin's Sale* 7th ed (2006) para 12-085.

[159] As of June 26, 2009 only 3 state legislatures (Kansas, Nevada and Oklahoma) have considered bills to enact the 2003 revisions to art 2. In 2005, Oklahoma made some amendments to their Commercial Code to the effect that the definition of "goods" should not include "information". No other amendments were made that introduced any other part of the 2003 amendments. Kansas and Nevada never adopted their bills. No other state has enacted the 2003 amendments yet. See *ABA Business Law Section Summer 2009 Developments Reporter* http://www.abanet.org/buslaw/committees/CL190000pub/newsletter/200907/subcommittees/developments.pdf (accessed 24-08-2009). Also note that the USA is a Contracting State to the United Nations Convention on Contracts for the International Sale of Goods (CISG) and that it therefore forms part of its national law on the regulation of international sales where applicable.

[160] S 2-509(4) UCC. *Forest Nursery Co v IWS Inc* 534 NYS 2d 86 (NY Dist Ct 1988) emphasised that derogation by agreement should be made in unambiguous language. There is also a possibility that the risk rules may be varied through estoppel. See in this regard White & Summers *Uniform Commercial Code I* 4th ed (1995) 247-248. S 2-303 UCC provides that the parties can agree to divide the risk between them by splitting the costs of the damage.

and CIF incorporated into the contract. It can also be derived[161] from circumstances of the case, a trade usage or practice,[162] a course of dealing[163] or a course of performance.[164]

Section 2-509 UCC divides sales contracts into three basic categories and provides rules for the allocation of risk of loss in each case. Subsection (1) covers those cases in which the "contract requires or authorizes the seller to ship the goods by carrier". Subsection (2) covers cases in which "goods are held by a bailee to be delivered without being moved". Subsection (3) is the residual clause which covers all other cases, for example those cases in which the buyer is, in terms of the contract, obliged to pick up the goods at the seller's place of business.

The provisions of the Code will subsequently be discussed with reference to these situations.

### 2 2 2 1 Shipment contracts

According to section 2-509(1)(a) UCC (2003), where the contract requires or authorises the seller to ship the goods by carrier[165] and it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the

[161] Commentary 5 to s 2-509 UCC (2003).
[162] Revised s 1-303(c) UCC (2001) provides that "[a] usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."
[163] Revised s 1-303(b) UCC (2001) defines "course of dealing" as "a sequence of previous conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."
[164] Revised s 1-303(a) UCC (2001) states that "[a] 'course of performance' is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection."
[165] The Code does not define "carrier" and it is therefore not always clear how far the term reaches. According to White & Summers *Uniform Commercial Code I* 255-256 it covers railroads, commercial air carriers and truckers. Note that s 2-509(1) UCC only covers cases where the contract requires or authorises the seller to ship the goods by means of a carrier. If the contract obliges the seller to ship the goods in its own truck, the risk of loss would be governed by subsection (3) not by subsection (1), for there would be no shipment by a carrier.

goods[166] are delivered[167] to the carrier, even if the shipment is under reservation in terms of section 2-505.[168] Section 2-509 is limited to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on the effect of breach on risk of loss under section 2-510 UCC.[169]

Subsection 1 applies where the contract "requires or authorises" shipment of the goods. For the goods to be "delivered to the carrier" under paragraph (a), firstly; a contract must be entered into with the carrier which will satisfy the requirements for shipment by the seller as envisaged by section 2-504. Apart from putting the goods in the possession of the carrier, it is also necessary that the seller obtains and promptly delivers or tenders in due form any documents that the buyer may need to receive possession of the goods,[170] and gives prompt notice of shipment to the buyer.[171] Section 2-504 has been amended to make clear that under a shipment contract, the seller must put the carrier in the possession of conforming goods.[172]

Because the provisions of subsection 1 are subject to “contrary agreement”,[173] it is possible to deviate from the general rule by agreement. Shipment contracts are often made subject to an “FOB place of shipment” term or a CIF or C&F term. These trade

[166] S 2-103(k) UCC (2003) defines goods as “all things that are movable at the time of identification to a contract of sale. The term includes future goods, specially manufactured goods, the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-107. S 2-105(1), furthermore, provides that “[g]oods must be both existing and identified before any interest in them may pass. Goods that are not both existing and identified are ‘future’ goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.”

[167] The 2001 version referred to “duly delivered.” However, the word “duly” was often misconstrued and was consequently deleted from the 2003 version. See Gabriel & Henning *Analysis of the 2003 Amendments to Uniform Commercial Code Articles 2 and 2A* (2004) para 16 04.

[168] Shipments under reservation are intended to provide the seller with a security interest in the goods. This interest is obtained if the goods are identified and shipped under a negotiable bill of lading to the order of the seller. Also note that the American risk rule differs from that of the English law in this respect. Reservation of the right to disposal prevents the passing of risk in English law.

[169] See 2 2 2 6 *infra*.

[170] S 2-504(b) UCC. If any other documents are required by the agreement or by trade usage, such documents should also be delivered.

[171] S 2-504(c) UCC; *La Casse v Blaustein* 93 Misc 2d 572, 403 NYS 2d 440, 23 UCC 907 (1978); *Rheinberg-Kellerei GmBH v Vineyard Wine Co* 53 NC App 560, 281 SE2d 425, 32 UCCRS 96. The Official Comment to § 2-504 UCC (2003) indicates that the standard and acceptable manner of notification in open credit shipments is the sending of an invoice, and in the case of documentary contracts, it is the prompt forwarding of the documents referred to under paragraph (b) of this section.

[172] S 2-504(a) UCC. This amendment clarifies the position under the previous version where it was not always clear whether conforming goods were required. The general rule on tender under s 2-503 UCC has always required conforming goods, but in s 2-601 the issues of tender and conformity were separated, which gave rise to uncertainty. The addition of the word “conforming” accords with the sections on risk of loss when goods are being shipped, on tender of delivery, and on the buyer’s right to reject; each of which provides that it is the seller’s obligation to make available to the buyer goods that conform to the contract.

[173] S 2-509 (4) UCC. See 2 2 2 *supra*; Official Comment 5 to s 2-509 UCC (2003) for the meaning of “contrary agreement”.

terms[174] have been statutorily defined by Article 2 UCC,[175] but were repealed by the 2003 revisions because of their inability to keep up with developments in commercial practice and usage.[176]

Before the 2003 revisions, section 2-509(1) had to be read in conjunction with section 2-319 on FOB and FAS terms, as well as with section 2-320 on CIF and C&F. These provisions were more explicit statements of the generalised terms of section 2-509(1) UCC.[177]

### (i) FOB contracts

Under the 2001 version, section 2-319 UCC regulates the definitions of FOB in American law. The section provides for three types or variants of FOB terms, viz "FOB place of shipment", "FOB place of destination" and "FOB vessel, car or vehicle". The last variant indicates that in American law, the FOB term is not restricted to waterborne transportation and is therefore not merely used as a maritime term.[178]

The general rule on FOB contracts states that, in the absence of a contrary agreement, the term "FOB place of shipment" means that the risk of loss passes to the buyer upon delivery of the goods to the carrier. In terms of section 2-319(1)(a), when the term is "FOB place of shipment" the seller has to ship the goods in the manner provided for in section 2. Section 2-319(1), therefore, has to be read in conjunction with sections 2-504 and 2-503. Section 2-504 requires that the seller must put the goods in the possession of such carrier and enter into a contract of carriage. This obligation does not entail loading the goods.[179] The seller only bears the expense of putting the goods in the possession of the carrier. At the same time,

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[174] In American law, trade terms are often referred to as "delivery terms", "sales terms" or "shipping terms".

[175] They are "Ex ship", "FOB Place of Shipment", "FOB Vessel", "FOB Place of Destination", "FAS Vessel", "CIF" and "C&F". These definitions are contained in ss 2-319, 2-320, 2-322, 2-324 UCC (2001).

[176] The UCC definitions represent current commercial practice that existed in 1952. Those practices have changed since then and the INCOTERMS definitions are now closer to current commercial practices. See Spanogle "INCOTERMS and UCC Article 2 - Conflicts and Confusions 1997 (31) *Int'l L* 111 131.

[177] Because no state has enacted the 2003 amendments up to 2009, this is for all practical purposes still the legal position that applies in the United States.

[178] Folsom *International Business Transactions I* 2nd ed (2002) para 2 24.

[179] The obligation to arrange for carriage deviates from the strict FOB term known to English law but is closer to the other two variants, namely the classic and the additional services variants. However, because the seller is not obliged to load the goods, it is not consistent with the understanding of the FOB term under English law at all. This variation is also not restricted to waterborne transportation.

he also carries the risk of putting same in the carrier's possession. This means that after this point all expenses and risk are carried by the buyer, unless otherwise agreed to by the parties. Usually the seller must also arrange insurance coverage, unless instructed otherwise by the buyer.[180]

The UCC only requires the commencement of the loading process if the term is "FOB vessel, car or other vehicle" and then the seller bears the expense and risk of loading the goods on board.[181] The "FOB vessel" term requires waterborne transportation and is equivalent to the English FOB term. Section 2-319(1)(c) states that the seller must, in addition to putting the goods in the possession of the carrier, at his own expense and risk load the goods on board. If it is a "FOB vessel" term, the buyer must name the vessel. No reference is made to the ship's rail, but only to the duty to "load the goods on board". Folsom,[182] on the other hand, states that under this particular variant, it is the seller's obligation to deliver the goods to a named ship's rail but he does not have to arrange transportation to a final destination. Other modifications of the FOB term, such as FOBST, are also well known in American law. This is considered to be a maritime variation of the standard FOB term and is commonly understood to mean that the seller is responsible for stowing and trimming the goods, which is to prepare the cargo and the vessel's holds to ensure efficient, safe loading.[183]

Although the "FOB seller's place of business" variant is not mentioned in section 2-319, scholarly opinion indicates that such a contract is also considered a shipment contract, but one where the seller is not obliged to deliver at a particular place. The seller's only obligations here are to conclude an appropriate contract for shipment and to deliver the goods to the carrier.[184] Where the contract involves delivery at the seller's place of business or at the *situs* of the goods, a merchant seller cannot

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[180] Folsom *International Business Transactions I* para 2 24. Also See Ademuni-Odeke "Insurance of FOB Contracts in Anglo-American and Common Law Jurisdictions Revisited: the Wider Picture" 2007 (31) *Tul Mar LJ* 425 on insurance of FOB contracts in general. This obligation is in line with the "additional services" variant known to English law.

[181] Murray 1991 (23) *U Miami Inter-Am L Rev* 93 103. The same requirement is found under a private compilation of trade term definitions applied in the USA, namely the 1941 Revised Foreign Trade Definitions for "FOB Vessel (named port of shipment)". See 5 2 2 *infra* for a discussion on private trade term definitions.

[182] *International Business Transactions I* para 2 26.

[183] Lord *Williston on Contracts XVIII* 4th ed (2001) para 52:11; *Camden Iron & Metal Inc v Bomar Resources Inc* 719 F Supp 297, 12 UCC Rep Serv 2d 398 (DNJ 1989); *Minex v International Trading Co of Va* 303 F Supp 205 (ED Va 1069). See also the general discussion on FOB variants 5 5 1 *infra.*

[184] White & Summers *Uniform Commercial Code I* 253. See also *United National Industries Inc v Pool Mart Inc* 449 F Supp 583 (ED Mo 1978) (contract with the term "FOB factory"); *Miami Paper Corp v Magnetic Inc* 591 F Supp 52 (SD Ohio 1984) (contract with term "FOB seller's place of business"); *AM Knitwear Corp v All American Export-Import Corp* 41 NY 2d 14, 390 NYS 2d 832, 359 NE 2d 342, 20 UCC Rep Serv 581 (1976) ("FOB Plant").

transfer risk of loss and it remains upon him until actual receipt by the buyer, even if full payment has been made and the buyer has been notified that the goods are at his disposal. In the event of breach by the buyer, the seller will be protected in terms of section 2-510. The underlying theory of this rule is that a merchant who is to make physical delivery at his own place maintains control of the goods in the interim and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.[185]

### (ii) CIF contracts

Section 2-320 UCC (2001) regulates CIF and C&F sales. It requires the seller to deliver the goods to the carrier at the port of shipment and bear the risk of loss only to that port but the freight costs and insurance to the port of destination.[186] No mention is made of the ship's rail.

Comment 1 to section 2-320 UCC (2001) states that the risk of subsequent loss or damage to the goods passes to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods.[187] It proceeds to state that delivery to the carrier is delivery to the buyer for purposes of "risk and title". Murray[188] argues that "delivery to the carrier" does not necessarily mean delivery to the actual carrier that is to handle the shipment of the goods to its final destination. A Florida appellate court in *Kumar Corp v Nopal Lines Ltd*[189] cited Comment 1 to section 2-320 UCC and held that the risk of loss through theft passed to the buyer when the goods were delivered to a cargo handler in the shipment port. In this case, the goods were stolen from the cargo handler's premises. However, the court made no attempt to

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[185] Official Comment 3 to § 2-509(1) UCC (2001). Oberman *Transfer of risk* text accompanying n 214. The distinction between merchant and non-merchant sellers was abolished by the 2003 amendments. See 2 2 2 4 *infra.*

[186] Folsom *International Business Transactions* para 2 27.

[187] In *Accord Madeirense do Brasil S/A v Stulman-Emrick Lumber Co* 147 F 2d 399 402 (2d Cir), the court held that "commercial usage, recognized by the courts and text writers, is that under a c.& f. contract the seller fulfils his duty on shipment of the goods and the risk thereafter is on the buyer unless other terms of the contract indicate a contrary intention." This statement was quoted with approval in *Phillips Puerto Rico Core v Tradax Petroleum Ltd* 782 F 2d 314 (2n Cie 1985). In *International Commodities Export Corp v North Pacific Lumber Co Inc* 764 F Supp 608, 15 UCC Rep Serv 2d 825 (D Or 1991), it was held that in a C&F contract for the sale of beans, the risk of deterioration or loss shifted to the buyer upon presentation of the documents in good order at the place of shipment, and whatever happened to the beans on board the vessel or after their delivery at the port of destination was not the seller's responsibility.

[188] 1991 (23) *U Miami Inter-Am L Rev* 111-114.

[189] 462 So 2d 1178, 41 UCC Rep Serv 69 71 (Fla Dist Ct App 1985).

reconcile the comment with the text of the Code section. In a case where the goods reached the destination city but were hijacked before actual delivery was made to the buyer, the same Florida appellate court applied the same reasoning but without citing its prior decision.[190]

The situation is even more intricate when goods are damaged in transit. In *York-Shipley Inc v Atlantic Mutual Insurance Co*,[191] the seller delivered a boiler to a carrier in Miami by virtue of a CIF Guatemala sale. The boiler was damaged in transit and the court held that once the goods are put in the possession of the carrier,[192] the seller no longer had any interest in them. Risk passes on delivery to the carrier in a CIF sale. This principle was reiterated seven years after the *York-Shipley* decision when it was cited with approval in *Sig M Glukstad Inc v Lineas Aeraeas Paraguayas.*[193] Four years later, in *William D Branson Ltd v Tropical Shipping & Construction Co*,[194] the Federal District Court for the Southern District of Florida also cited the *York-Shipley* decision when it held that the risk of loss passes to the seller upon shipment if the seller has performed all his obligations with respect to the goods. Murray[195] points out that thereafter the court proceeded to confuse the risk issue. Although they came to the right conclusion, it was for the wrong reason. Tomatoes were shipped from Miami to Bridgetown, Barbados. The tomatoes were rejected on arrival as being spoilt, and the court held that the risk of loss in transit fell on the seller. It is Murray's argument that the court failed to acknowledge that this was a CIF contract in accordance with section 2-321(2) UCC, which determines that risk of ordinary deterioration caused by the transportation remains on the seller, whilst risk of loss still passes to the buyer. Moreover, if non-conforming goods were shipped, the risk of loss would remain on the seller in accordance with section 2-510.[196]

Under the 2001 version of the Code, the UCC provides for a range of CIF variants. Section 2-324 UCC (2001) leaves the risk of loss in a "no arrival, no sale" contract explicitly on the seller.[197] In the case of CIF or C&F "Net Landed Weights", "Payment

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[190] *Ladez Corp v Transportes Aereos Nacionales SA* 476 So 2d 763 765; 42 UCC Rep Serv 133 135-136 (Fla Dist Ct App 1985).
[191] 474 F 2d 8 9, 12 UCC Rep Serv 124 (5th Cir 1973).
[192] The court also noted that the seller has a duty to load in terms of § 2-320 UCC.
[193] 619 F 2d 457, 29 UCC Rep Serv 504 (5th Cir 1980).
[194] 598 F Supp 680 681, 682-683, 40 UCC Rep Serv 883 884, 885-886 (SD Fla 1984).
[195] 1991 (23) *U Miami Inter-Am L Rev* 114.
[196] *Larsen v AC Carpenter Inc* 620 F Supp 1084, 2 UCC Rep Serv (EDNY1985), aff'd 800 F 2d 1128 (2d Cir 1986).
[197] See 2 2 2 5 *infra* for a discussion on s 2-613 UCC.

on Arrival", "Warranty or Condition on Arrival" and "out-turn quantity and quality" contracts, section 2-321 UCC (2001) splits the risk by placing the risk of ordinary deterioration[198] associated with the transportation of the goods, such as shrinkage, on the seller, and the risk of accidental loss on the buyer. The official comment (2001) makes it clear that these variations do not change the legal consequences of the CIF or C&F term in so far as the passing of marine risk to the buyer at shipment is concerned. The section merely deals with variations of the CIF contract which have evolved in mercantile practice and provide for a shift to the seller of the risk of quality and weight deterioration during shipment.[199]

### 2 2 2 2 Destination contracts

Section 2-509(1)(b) UCC (2003) stipulates that, if the contract requires that the goods should be delivered at a particular destination "and the goods are tendered there while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there so tendered as to enable the buyer to take delivery."[200] Tender of delivery is accomplished when the seller puts and holds conforming goods at the buyer's disposition and gives the buyer any notification reasonably necessary to enable the buyer to take delivery.[201] If the contract requires the seller to deliver documents, the seller must tender the specified documents of title in correct form.[202]

Under the 2001 version, in the case of contracts subject to delivery terms indicating a certain destination, such as "FOB the place of destination", "FOB the buyer's place of

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[198] In general, the UCC does not distinguish between deterioration, damage or loss when it comes to the passing of risk. Under pre-Code law, the risk of normal deterioration during shipment coincided with the passage of title and consequently also with the passage of risk. If the goods were merchantable at the time of shipment, the buyer was deemed to have received goods in conformity with the contract. The position under the UCC is not much different, except that it does not link the passing of risk to passing of ownership. If goods are such that they normally deteriorate during transportation, the buyer will carry that risk unless he provided for one of the above stated CIF variants. For a discussion on risk of deterioration during shipment, see Lord *Williston on Contracts XVIII* para 52:32. *Cf* also s 2-613(b) UCC for the effect of deterioration in the context of frustration.

[199] See the discussion on trade term variants 5 5 2 *infra.*

[200] The 2001 version requires the goods to be "duly" tendered. See the judgement in *Pestana v Karinol Corp* 367 So 2d 1096 (Fla Dist Ct App 1979), which deals with the difference between shipment and destination contracts.

[201] S 2-503(1) UCC. Tender must be at a reasonable hour and the goods must be kept available for a reasonable time to enable the buyer to take possession. Comment 3 to the section states that usage of trade and the circumstances of the case determine what would be a reasonable hour and time. Lord *Williston on Contracts XVIIII* para 52:31 contends that due tender of delivery in order to pass risk, occurs when the goods have arrived by carrier at the destination and the buyer has been notified during business hours that he can take delivery, even if it is not then convenient for the buyer to unload.

[202] S 2-503 (5)(a) UCC.

business" or "FOB ex ship",[203] section 2-509(1)(b) has to be read in conjunction with the provisions on FOB terms in section 2-319 UCC (2001).[204] Under a contract calling for "FOB point of destination", the risk remains on the seller during transportation of the goods.[205]

### 2 2 2 3 Bailment contracts

Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, section 2-509(2) UCC (2003) provides that the risk of loss passes to the buyer on his receipt of possession of a negotiable document of title covering the goods;[206] or on acknowledgement by the bailee to the buyer of the latter's right to possession of the goods;[207] or after the buyer's receipt of a non-negotiable document of title or other direction to deliver in a record as provided in section 2-503(4)(b).[208] In the latter case, the provisions on tender of delivery as stipulated in section 2-503(4)(b) apply to determine the point of transfer of risk.

If the tender is through notification by the bailee of the buyer's rights in the goods, courts had wrestled with whether, in order to complete the tender of the delivery, the bailee's acknowledgment had to be to the buyer.[209] The amendment to section 2-503(4)(a) answers that question in the affirmative.[210] Accordingly, section 2-509(2)(b) now requires that when the goods are in the possession of a bailee to be delivered without being moved, and the tender is based on notification of the bailee, the bailee must acknowledge to the buyer that the buyer has the right to possess the goods.

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[203] This term used to be regulated by s 2-322(2)(b) UCC, which determined that risk of loss does not pass until the goods leave the ship's tackle or are otherwise properly unloaded. Lord *Williston on Contracts XVIII* paras 52:12, 52:31.

[204] The same applied to "FAS vessel at a named port", which is also considered a destination term and is regulated by s 2-319(2) UCC (2001). Reynolds *INCOTERMS for Americans: Fully Revised for INCOTERMS 2000)* (1999) 108 is of the opinion that DDU terms are only suitable when the seller has concluded a so-called "through contract of carriage". Because American exporters are far from most of their trading partners, it usually means that the goods are to be transported on the basis of several contracts of carriage or at least by means of several modes of transport, which increases the risks of damage due to handling and re-handling of the goods.

[205] *Rheinberg-Kellerei GmBH v Vineyard Wine Co supra*; *Ladez Corp v Transportes Aereos Nacionales SA supra.*

[206] S 2-509(2)(a) UCC.

[207] S 2-509(2)(b) UCC; *Whately v Tetrault* 29 Mass App Dec 112, 5 UCCRS 838.

[208] S 2-509(2)(c) UCC.

[209] *Jason's Foods Inc v Peter Eckrick & Sons Inc* 774 F 2d 214 (7th Cir 1985). The wording of the 2001 version of s 2-509(2)(b) UCC simply stated "on acknowledgement by the bailee of the buyer's right to possession of the goods."

[210] Ss 2-509(2)(b) and 2-503(4)(a) UCC. See also Gabriel & Henning *Analysis of the 2003 Amendments* para 16 05.

Furthermore, if tender is made through a delivery order, such delivery order need not be in writing, as was required by the 2001 version, but must be in a so-called "record".[211] This amendment to section 2-509(2)(c) is in line with developments in electronic commerce and the recognition of electronic records by the Code. This amendment is also in line with the amendment of section 2-503(4)(b), which states that, where the goods are in the possession of a bailee to be delivered without being moved and tender is to be made by a delivery order, the delivery order may be in a record rather than a written direction.[212]

Since the word "bailee" is not defined in Article 2 UCC, it is not clear whether a seller who retains possession of goods after tender to the buyer becomes a bailee.[213] A Texas Court of Appeal[214] has indicated that it is against public policy and the underlying policies of the UCC to argue that sellers who retain possession of the goods are bailees for risk purposes. White and Summers[215] hold that a seller should never be regarded as a bailee since he would then be able to shift the risk to the buyer by simply acknowledging the buyer's right to possession. People in possession of the goods are in the best position to protect and insure the goods against loss and should therefore carry the risk.

### 2 2 2 4 Residual cases

Section 2-509(3) UCC (2003) acts as a residual clause which covers scenarios that do not fall within the scope and application of other provisions. Generally speaking this subsection applies to contracts where the seller has agreed to deliver the goods to the buyer with his own vehicle or the buyer has agreed to pick up the goods at the seller's place of business.[216] The rule provides that risk of loss passes to the buyer on his receipt of the goods.

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[211] SS 2-509(2)(c) and 2-503(4)(b) UCC.
[212] Subject to Article 9, s 2-503(4)(b) UCC provides that, whilst between the seller and the buyer the risk of loss remains on the seller until the buyer has had a reasonable time to present the document or direction, the buyer's rights against all third parties are fixed as of the time the bailee receives notice of the transfer.
[213] The facts of *Courtin v Sharp* 280 F 2d 345 (5th Cir 1960), cert denied 365 US 814 (1961) illustrate the problem. In this case the parties agreed that the seller would hold a colt for the buyer. The colt was killed during this time without any fault of the seller's, who then sued the buyer for payment of the purchase price. The court of appeal confirmed the ruling of the district court that the sale of the colt was complete before its death and that the risk had therefore passed.
[214] *Caudle v Sherrard Motor Co* 525 SW 2d 238 (Tex Ct App 1975).
[215] *Uniform Commercial Code I* 257.
[216] Stocks "Risk of Loss under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods: A Comparative Analysis and Proposed Revision of UCC

Under the 2001 version, the residual clause establishes two sets of rules; one rule for the merchant[217] seller and another for non-merchant sellers. In the case of a merchant seller, the risk remains on the seller until the buyer receives the goods. In other cases where the seller is not a merchant, the risk passes to the buyer on tender of delivery. "Receipt" means "taking physical possession of the goods"[218] and, therefore, a merchant seller who retains physical possession may bear the risk of loss long after title has passed and long after it has received its money. That would also cover the case where the seller ships in its own truck and does not use a carrier.[219] Although receipt is defined as taking physical possession, interpretative difficulties still exist, especially where the seller acts as the buyer's agent. Courts have been advised that when considering these questions, they should keep in mind the policy of the Code to retain the risk on the insured seller,[220] except in extraordinary cases such as where the buyer and seller formally change their relationship and the buyer pays the seller to keep an item.[221]

Because parties involved in international trade are normally merchants, the distinction between merchant and non-merchant sellers was strongly criticised,[222] and hence has been abolished by the 2003 revision. The assumption that the seller will, in most cases, carry insurance on goods that are under his control, also applies to non merchants. The amendment, therefore, reflects more accurately the expectation of both the seller and the buyer.[223] It is in line with the underlying approach of the UCC to place risk on the party most likely to insure, who is normally the party in possession of the goods. The amendment causes the risk of loss to pass to the buyer on receipt of the goods in all cases, and not just when the seller is a merchant.

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Sections 2-509 and 2-510" 1993 (87) *Nw UL Rev* 1415 1433. According to Reynolds *INCOTERMS for Americans* 35, 46-47, US traders do little business internationally on an "Ex Works" basis, except for exports to Canada where export clearance is automatic. The reason is that US custom regulations require some presence in the United States to arrange for export clearance and, therefore, a buyer in a foreign country cannot be the "exporter of record".

[217] **"**Merchant" is defined in s 2-104 UCC as "a person that deals in goods of the kind or otherwise holds itself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that holds itself out by occupation as having the knowledge or skill."

[218] S 2-103(1) UCC.

[219] White & Summers *Uniform Commercial Code I* 259.

[220] The official comment to s 2-509 UCC (2001) states that, since the seller is in control of the goods, he is expected to insure his interest, whilst it is unlikely that the buyer will carry insurance on goods that are not yet in his possession.

[221] White & Summers *Uniform Commercial Code I* 259.

[222] See Stocks 1993 (87) *Nw UL Rev* 1434.

[223] Gabriel & Henning *Analysis of the 2003 Amendments* para 16 04.

### 2 2 2 5 Sales in transit

This issue is not addressed by American law; neither legislatively, nor through the case law.[224] However, the official comments to the 2001 version of the UCC address this type of risk, albeit not satisfactorily.

Official Code Comment 2 to section 2-509 UCC (2001) mentions the passing of risk in cases where goods are already in transit.[225] It states that, where the seller "buys the goods afloat" and then resells them, "the risk will not pass retroactively to the time of shipment". The only requirements are that the goods should be properly shipped and also that they should be identified to the contract. Risk will only pass retroactively to the moment of shipment if the parties agreed thereto. The comment does not indicate whether risk passes at the conclusion of the contract of sale or only at the moment of handing over the goods in the port of destination.

Since there is no special rule that regulates the passing of risk where goods are bought afloat, the existing rules on risk should be applied to the contract. If viewed as a bailment situation, the risk of loss would pass upon the buyer's receipt of a negotiable document of title; on acknowledgement by the carrier of the buyer's right of possession; or after the buyer's receipt of a non-negotiable document of title as provided for in section 2-503(4)(b). In other words, risk would pass sometime during transit, making it almost impossible to know whether the damage occurred before or after transfer of risk.[226] Alternatively, if viewed as a shipment contract, section 2-509(1)(a) indicates that risk of loss may pass to the buyer when the goods are delivered to the carrier. A third opinion is that the residual rule of section 2-509(3) UCC should be applied in cases of sales in transit.[227]

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[224] Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 108; Murray 1991 (23) *U Miami Inter-Am L Rev* 127.

[225] This comment is not repeated in the 2003 Official Comments. No reference is made to sales in transit at all. Once the 2003 revision is enacted by a state, the 2001 comments merely have the status of legislative history.

[226] Stocks 1993 (87) *Nw UL Rev* 1432-1433 suggested that s 2-509(2), dealing with the bailee situation, should have been revised to place the risk retroactively on the buyer from the time the goods are shipped, because he is usually in a better position to salvage the damaged goods, assess the loss and institute a claim against the insurer. However, the 2003 revision did not address this issue at all and the amended UCC still does not regulate the passing of risk for sales in transit.

[227] Renck *Der Einfluß der INCOTERMS 1990 auf das UN-Kaufrecht: Eine Untersuchung zu den rechtlichen Wirkungen der INCOTERMS 1990 im Recht des internationalen Warenkaufs* LL M thesis Hamburg (1995) 218. His argument is based thereon that the UCC's risk provisions are built on the basis that risk only passes when the goods are in the possession of the buyer and that this principle should therefore be applied to sales in transit as well.

Scholarly opinion on this problem is also scarce.[228] Grewal[229] contends that, if goods are sold in transit and they are identified and in existence, the risk will pass when the contract is concluded. Sales in transit very often involve the sale of an undivided share of a larger bulk. If identification is required for the risk to pass, the next problem is to identify the goods in these instances. Identification can be made at any time and in any manner explicitly agreed to by the parties.[230] Comment 5 to section 2-501 UCC suggests that in cases involving fungible goods, identification occurs with the mere reference in the contract to an undivided share in an identified fungible bulk.[231] If one reads section 2-105(3) together with section 2-501, it appears that the risk in a portion of an undivided mass of fungible goods[232] is shared equally as the buyers are owners in common.[233] It is also said that, in view of the limited effect given to identification by section 2-501, the general policy is to resolve all doubts in favour of identification. Grewal[234] suggests that, even though there is no specific statutory language that can support this conclusion, this comment should be given judicial approval in the light of the construction of section 2-501.

The main problem with Grewal's argument is that it allows risk to pass in mid-shipment, which is impracticable since it is either difficult or impossible to establish precisely when damage or loss occurs during the transportation. In a multiple sale situation, once the goods are identified to the contract, the ultimate buyer assumes the risk in the goods without knowledge of their condition at the time of contracting. This situation can give rise to practical difficulties if the goods have already been damaged at the time of conclusion of the contract in transit. Section 2-613 regulates situations where the continued existence of the goods is undertaken by the seller but the goods suffer damage, without fault of either of the parties, before risk passes to the buyer. The effect is that the contract will either be terminated, or if the loss is partial or the goods have deteriorated to the extent that they no longer conform to the contract, the buyer may demand inspection and may at his option treat the contract as terminated or take over the surviving goods at a fair adjustment. However, this

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[228] Renck *Der Einfluß der INCOTERMS* 217.
[229] 1991 (14) *Loy LA Int'l & Comp LJ* 108-109.
[230] S 2-501(1) UCC. Comment 2 to s 2-501 states that "[i]t is possible … for the identification to be tentative or contingent." By identifying existing goods as goods to which the contract refers, the buyer obtains an insurable interest. In the absence of any explicit agreement on identification, the rules of paragraphs (a) –(c) will apply.
[231] *Cf* s 2-105(3) UCC which provides for the possibility of selling any agreed proportion of an identified bulk of fungible goods or any quantity thereof agreed upon by number, weight or other measure.
[232] The key to interpreting these provisions is the definition of "fungible goods". Fungible goods are "goods of which each particle is identical with every other particle such as grain and oil." See *Mississippi State Tax Comm'n v Columbia Gulf Transmission Co* 161 So 2d 173 178 (Miss 1964).
[233] Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 110.
[234] 109.

provision will only provide relief for the buyer if it can be proven that the loss or damage had occurred before risk passed to the buyer.

### 2 2 2 6 Effect of breach on risk of loss

Section 2-510 UCC (2003) deals with the effect of either party's breach on the passing of risk as regulated by section 2-509. The point of departure is that the party in breach should bear the risk of loss irrespective of whether such breach was the cause of the loss.[235]

The effect of a seller's breach is governed by sections 2-510(1) and (2). Where the seller has tendered non-conforming goods that give rise to a right of revocation by the buyer, section 2-510(1) provides that the risk of loss remains on the seller until cure or acceptance.[236]

Section 2-510(2) covers the situation in which the buyer has accepted non-conforming goods without discovering a latent defect or where he was promised that a patent defect would be cured by the seller but it never happened. Under these circumstances the buyer may "rightfully revoke" acceptance. The buyer's revocation must occur "within a reasonable time … and before any substantial change in condition of the goods not caused by their own defects."[237] Risk of loss will revert back to the seller to the extent of any deficiency in the buyer's insurance coverage.[238]

The effect of a buyer's breach is governed by section 2-510(3). If the buyer breaches his obligation before risk of loss has passed to him, for example by wrongfully refusing to take delivery, and the goods are still under the control of the seller, but his insurance cover seems to be deficient, it is possible that the seller may treat the risk

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[235] Stocks 1993 (87) *Nw UL Rev* 1435.

[236] *Larsen v AC Carpenter Inc* 620 F Supp 1084, 2 UCC Rep Serv 1089-90 (EDNY 1985), judgement aff'd, 800 F 2d 1128 (2d Cir 1986). This rule overrides the general rules on breach. Even in the case of a "FOB place of shipment" sale, the risk of loss will not pass to the buyer upon the seller's delivery of the goods to the carrier if the seller has not shipped conforming goods or if he has failed to meet any other contractual obligations, such as correct packaging, shipping by a particular method or purchasing insurance. See Lord *Williston on Contracts XVIII* para 52:34.

[237] See *Meat Requirements Coordination Inc v GGO Inc* 673 F 2d 229 230 (8th Cir 1982).

[238] This provision is designed to preclude the buyer's insurance company from asserting that it has subrogated to the buyer's right to pursue a claim for breach of contract. See Lord *Williston on Contracts XVIII* para 5:34.

of loss as resting on the buyer for a commercially reasonably time to the extent that his insurance cover is deficient.[239]

### 2 2 3 German law

The 2001 Act to Modernise the Law of Obligations (*Schuldrechtsmodernisierungsgesetz*) effected a general revision of the German Civil Code (*Bürgerliches Gesetzbuch, BGB*).[240] It brought significant changes to the Second Book dealing with the Law of Obligations. The incongruence between general rules on the one hand, and the rules on specific contracts on the other, was regarded as one of the defects of the old Code. The intention with the revised version was to "overhaul" the law on specific contracts and sale in order to harmonise and streamline them with the rules of the more abstract general law of obligations. The intention was also to bring the provisions in line with modern international and European developments. The content of the revised version was, therefore, heavily influenced by the UN Convention on Contracts for the International Sale of Goods, the EC Consumer Sales Directive as well as the UNIDROIT Principles of International Commercial Contracts and the European Principles of Contract Law.[241]

The legal position regarding the effect of initial impossibility on the obligation was significantly changed by the new BGB. Section 311a (1) of the BGB deviates from the old Code[242] and the Roman maxim *impossibilium nulla est obligatio* by stating that neither a contract nor a single obligation is void because of initial impossibility. Impossibility[243] now merely functions as a defence against a claim for specific performance. In such an event, impossibility is treated as an impediment to performance which does not affect the validity of the contract as such. Therefore, if performance is impossible at the conclusion of the contract or thereafter becomes

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[239] *Multiplastics Inc v Arch Industries* 348 A 2d 618 619 (Conn 1974).

[240] The new version of the BGB came into force on January 1st, 2002. Also note that Germany is a Contracting State to the CISG, which means that the Convention forms part of its national law.

[241] Haas et al *Das neue Schuldrecht* (2002); Schlechtriem "The German Act to Modernize the Law of Obligations in the Context of Common Principles and Structures of the Law of Obligations in Europe" 2002 *Oxford U Comparative L Forum* http://www.oucif.iuscomp.org (accessed 27-06-2009) 2; Büdenbender "*Das Kaufrecht nach dem Schuldrechtsreformgesetz*" Part 1 2002 *DStR Heft 08* 312 312-313.

[242] S 306 aF (*alte Fassung*).

[243] Impossibility (*Leistungshindernis*) covers both objective and subjective impossibility. S 275 para 1 BGB deals with cases of absolute impossibility, whilst paras 2 & 3 deal with situations of so-called "practical" and "moral" impossibility, eg where the debtor's expenditure in delivering the goods is in gross disproportion to the creditor's interest in performance. See Markesinis et al *German Law of Contract: A Comparative Treatise* 2nd ed (2006) 408-409, 413-418; Zumbansen "The Law of Contracts" in Reimann & Zekoll (eds) *Introduction to German Law* 2nd ed (2005) 179 195.

impossible due to an event of accidental nature for which neither the seller nor the buyer has to accept liability, section 275(1) BGB determines that the seller will be released from his obligation to perform,[244] except for goods in kind.[245] At the same time he will also lose his right to claim the purchase price according to section 326(1) BGB.[246]

Sections 446 and 447 regulate the passing of risk in the case of sales contracts, which function as exceptions to the general provisions of section 326 BGB. The risk rule entails that once the risk of accidental destruction of or damage to the goods has passed to the buyer he will bear the price risk by remaining bound to pay the purchase price. Apart from the introduction of the third sentence to section 446 and a revision to the general concept of breach, the revised BGB brought no major changes to the legal position on the passing of risk.[247]

The German Civil Code's understanding of risk in the context of price risk (*Preisgefahr*) refers to accidental loss of or damage to the goods. But what precisely comprises "accidental loss or damage"?[248] Although this concept is generally understood as loss or damage outside the control of the buyer and seller, differences in opinion exist in the context of goods which are to be transported. One opinion is that section 447 should only comprise typical transport risks fully or partly caused by the carriage.[249] Examples are accidental loss or damage as a result of theft, accident or by temperature, or delivery to the wrong recipient. A contrary view is that when the carriage takes place at the request of the buyer, he should be treated as if the goods have been handed over to him and he should therefore be liable for all risks from the time of handing over the goods to the carrier, such as delay, loss or damage

[244] The debtor is released from the risk of performance (so-called *Leistungsgefahr* or *Sachgefahr*), that is the risk of still having to perform in terms of the contract. See Markesinis et al *German Law of Contract* 409-410.
[245] A seller of generic goods (*Gattungschuld*) is not released from his obligation to perform unless all objects belonging to the class become extinct (s 243 (1) BGB). If the goods have been appropriated to the contract by singling them out (*Konkretisierung*) or the seller has done everything necessary to effect delivery of the object at the agreed place of performance, s 243 (2) BGB determines that the obligation is reduced to an obligation to deliver a specific object and risk will pass to the buyer. What is required from the seller to effect performance depends on whether the contract is for a *Holschuld*, *Bringschuld* or *Schickschuld*. See Haas et al *Schuldrecht* 250 para 364; Markesinis et al *German Law of Contract* 410.
[246] This type of risk is referred to as the risk of counter-performance (*Gegenleistungsgefahr or Preisgefahr*). The rationale is that it would not be fair to shift the risk of impediments to performance to the creditor if he is not responsible for the impediment. See Markesinis et al *German Law of Contract* 410.
[247] Haas et al *Schuldrecht* 251 para 368.
[248] S 226 BGB.
[249] Romein *The Passing of Risk: A comparison between the passing of risk under the CISG and German law* LL M thesis Heidelberg (1999) http://www.cisg.law.pace.edu/cisg/biblio/romein.html (accessed 28-02-2009) ch 3 B III.

to the goods caused by a defect at the time of handing over for carriage, unusual problems during transport or costs which occur because the goods must be diverted, stored or reloaded or an emergency sale in the case of war. According to Romein[250] the latter view would accord far better with the general idea embodied in section 447 BGB, namely to have to pay the purchase price even where one does not receive the goods, and not merely to carry the risk of danger to the goods as a result of their carriage. Romein's interpretation could be open to criticism, especially in so far as it refers to defects which existed in the goods at the time they are handed over to the carrier. Damage and loss occasioned by defects are not accidental damage and should be treated as consequences of breach of contract.[251]

As a point of departure, German law determines that the risk is to be carried by the person in control of the goods. Risk normally passes when the goods are handed over to the buyer, except for situations where the buyer has requested the goods to be forwarded to him. In the latter case, risk passes on delivery to the carrier.

#### 2 2 3 1 Shipment contracts

Section 447 applies in the case of a so-called "forwarding debt" (*Versendungskauf* or *Schickshuld*).[252] Except for a few minor editorial changes, the new section 447 is essentially the same as the previous version.[253]

Section 447 requires that, if at the buyer's request, the seller dispatches the thing sold to a place other than the place of performance, the risk passes to the buyer when the seller has handed the thing over to the carrier.[254] In these instances, the goods are to be forwarded to a different place than where performance of the contract is to take place (the so-called *Erfüllingsort*). The *Erfüllingsort* is the place at which the debtor (seller) takes the last and decisive step to effect performance in

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[250] *Passing of Risk* ch 3 B III.
[251] See 2 2 3 5 *infra.*
[252] There is a presumption that sales are normally *Holschulden* where the obligation is on the buyer to collect the goods from the place of performance. See 2 2 3 3 *infra.*
[253] Faust "Section 447 BGB" in Bamberger & Roth (eds) *Kommentar zum Bürgerlichen Gesetzbuch I* (2003) para 1. If the *Schickschuld* relates to consumer goods, s 447 does not apply since consumer goods are regulated separately by Section 8 Title 1, sub-title 3 BGB.
[254] S 447(1) BGB reads:

> *"Versendet der Verkäufer auf Verlangen des Käufers die verkaufte Sache nach einem anderen Ort als dem Erfüllingsort, so geht die Gefahr auf den Käufer über, sobald der Verkäufer die Sache dem Spediteur, dem Frachtführer oder der sonst zur Ausführung der Versendung bestimmten Person oder Anstalt ausgeliefert hat."*

order for the buyer to acquire possession and ownership of the goods.[255] The place of performance can be determined by contractual arrangement between the parties or can be deduced from the circumstances of the case or from commercial practices and customs. When the place of performance cannot be determined according to these rules, section 269(2) BGB determines that the place of performance is the place where the seller had his place of business at the conclusion of the sales agreement.[256] It is clear from section 447, that the place to which the goods are to be dispatched is not the same as the place of performance. If the place of performance was contractually agreed upon,[257] section 447 will only find application if the terms of the contract are varied in that the buyer requests[258] that the goods are to be sent to a place other than such agreed upon place.[259] If the parties agreed on delivery to the buyer's domicile but the buyer subsequently requests that delivery is to be made to another place, the risk will pass when the goods are handed to the carrier.[260] If the place of performance was not agreed upon, it is assumed that the seller's place of business will be the designated place of performance. Therefore, if the contract did not originally provide for the goods to be forwarded, but the buyer later on varies the terms of the contract by requesting that the goods are to be forwarded to his residence or place of business, instead of him collecting them at the place of performance, the risk will pass when the goods are handed over to the carrier.[261]

The rationale behind section 447 is that the seller is normally not obliged to forward the goods to the buyer and should therefore not be charged with the transport risk. It has been argued that when the buyer requires the goods to be forwarded to him, the seller should not be burdened by extending the risk to the moment of receipt by the

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[255] Markesinis et al *German Law of Contract* 357-358.

[256] Westermann "Section 447 BGB" in Westermann et al (eds) *Münchener Kommentar zum BGB III* 4th ed (2004) para 4; Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 5. In commercial trade, the contract is normally treated as a forwarding debt. See BGHZ 113, 106, 110 = NJW 1991 915, 916; LG Köln NJW-RR 1989 1457.

[257] Where a contract provides that the goods are to be delivered to the buyer's place of residence (a so-called *Bringschuld* or debt discharged at creditor's domicile), s 447 will not apply, as that would constitute delivery at the agreed upon place of performance. In such a situation s 446 applies. See 2 2 3 2 *infra*; Haas et al *Schuldrecht* 252 para 374; Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 5; Westermann "Section 447 BGB" in *Münchener Kommentar* para 7. There is no requirement that the goods have to travel across "borders". The provision also applies when the goods are forwarded within one place, for example from one place within a town or city to another place in that same town or city. See Haas et al *Schuldrecht* 252 para 375; *Münchener Kommentar* s 447 BGB para 7; Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 6.

[258] The word "request" does not envisage a unilateral act on the part of the buyer. It is expected that the seller complies with the request whereby the terms of the contract are varied through tacit agreement of the parties.

[259] S 269(3) BGB states that the mere fact that the seller has agreed to pay the costs of dispatch does not necessarily mean that the place to which the dispatch should be made is the place of performance.

[260] Foster *German Legal System & Laws* 2nd ed (1996) 266.

[261] Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* Para 7. The original *Holschuld* is then transferred into a *Schickschuld.*

buyer.[262] Another opinion[263] states that the seller, as the organiser of the transport is in a better position to control and insure the risk during carriage. Followers of this opinion suggested that the rule in section 447 should be struck from the revised BGB. The legislature, however, decided to maintain the *status quo*, except in relation to consumer goods where section 446 now applies.[264]

According to the case law, the risk only passes to the buyer under section 447 if the buyer has agreed to the dispatch of the goods.[265] A contractual obligation or a trade usage to that effect also suffices.[266] Where goods are forwarded without or against the buyer's will, risk will not pass at the moment when the goods are handed to the carrier.[267] This prevents the seller from saddling the buyer with the transport risk where he is otherwise willing to collect the goods at the seller's premises. Section 446(1) BGB should apply if the buyer had not agreed to the dispatch, which means that risk only passes when the goods are received by the buyer.[268]

Normally transportation of the goods to the place of performance, such as from the place of manufacture to the place of business of the seller, is for the seller's risk.[269] However, if the goods are sent to the buyer from another place as the place of performance, section 447 will apply if the buyer agreed to the shipment.[270]

According to section 447(1), the risk passes to the buyer as soon as the seller has handed over the goods to the forwarder, carrier or other party designated to dispatch the thing. The goods are considered to be handed over when the seller has done everything he should for delivery to be effected to the buyer. The seller, therefore, has to conclude the contract of carriage and physically hand over control of the

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[262] Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 1.
[263] The commission responsible for drafting the revised *Schuldrecht* held this opinion.
[264] Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 2; Westermann "Section 446 BGB" in *Münchener Kommentar* para 14; Haas et al *Schuldrecht* 252 para 373. In regard to consumer goods, see s 474(2) BGB.
[265] Westermann "Section 447 BGB" in *Münchener Kommentar* para 5; RGZ 111, 23; BGH NJW 1965 1324; BGH WM 1978 978; BGHZ 13, 106, 110.
[266] Westermann "Section 447 BGB" in *Münchener Kommentar* paras 8-9;
[267] Westermann "Section 447 BGB" in *Münchener Kommentar* para 8; Faust "Section 447 BGB" in *Bamberger/Roth Kommentar* para 7.
[268] S 447(2) also provides that, if the buyer gives specific instructions on the method of dispatch and the seller deviates from this instruction without any urgent reason, the seller will be held liable for any damage arising from such failure. See Westermann "Section 447 BGB" in *Münchener Kommentar* para 9.
[269] Westermann "Section 447 BGB" in *Münchener Kommentar* para 4.
[270] Westermann "Section 447 BGB" in *Münchener Kommentar* para 5; Haas et al *Schuldrecht* 252 para 376.

goods to the carrier, and the latter should obtain control of the goods.[271] Handing over the goods does not mean transferring property in the goods.[272]

Who will qualify as "carrier" for purposes of section 447(1) BGB? The concept includes a forwarding agent, the carrier or another person or body designated to carry out the shipment. However, at first, the case law did not accept that handing over the goods to parties for whom the seller is responsible would cause the risk to pass to the buyer. In such cases, the goods will remain in the control of the seller, since control can only be transferred effectively to an independent party. Some academic writers still support this view.[273] However, a judgement of the *Reichsgericht*[274] has held that the risk is regulated by section 447 even if the carriage is conducted by the seller's own personnel. The seller, however, remains liable for loss or damage caused by the fault of his employees in terms of section 278 BGB. If the carriage is to be undertaken partly by the seller's own personnel and partly by an independent carrier, the risk will be carried by the seller up to the point where the goods are handed over to the independent carrier. [275]

For the risk to pass under section 447(1) the goods must also be ascertained. Section 447 BGB refers to "the thing sold" ("*der verkaufte Sache*"), which indicates that the risk can only pass to the buyer when an identified article is handed over to the carrier.[276] When the contract involves carriage, identification usually occurs when the goods are handed over to the carrier and the goods are marked by consigning them to the buyer or by issuing a waybill which identifies the buyer as the recipient. The dispatch of a consignment notice may also, by way of trade custom, identify the goods with retroactive effect to the time when the goods were handed over to the carrier.[277] Where the seller delivers to the carrier bulk goods of the same kind, such

[271] Westermann "Section 447 BGB" in *Münchener Kommentar* para 14; Roemein *Passing of Risk* ch 3 B II para 4.
[272] Delivery for purposes of transferring property is regulated by s 929 BGB.
[273] Haas et al *Schuldrecht* 252-253 para 377 also argue that transportation by the seller's personnel could constitute a debt discharged at domicile (*Bringschuld*), which is not covered by s 447. In that case the seller carries the transport risk.
[274] RGZ 96, 258 (Sept 19th, 1919).
[275] Westermann "Section 447 BGB" in *Münchener Kommentar* paras 16-17.
[276] S 433 BGB refers to the seller's contractual duty to hand "the thing" over, which implies identification or appropriation to the contract. In the case of a generic sale (*Gattungschuld*), s 243(2) provides that, if the seller has singled out the thing or has done what is necessary on his side to provide such a thing, so-called *Konkretisierung*, the obligation is limited to that thing and the seller has fulfilled his delivery obligation. Appropriation depends on the nature of the contract.
[277] Such as in the case of an FOB or a CIF sale. However, it is a prerequisite that the notice is dispatched in due time and that the seller was in good faith at the time of sending the notice or other documents. He should, therefore, have been unaware of any damage to the goods and should not be in a position to have known that they were damaged or lost. The dispatch of an endorsed bill of lading also causes the risk to pass retroactively.

as coal, oil or grain destined for several buyers, identification occurs only when each buyer's portion is ascertained. When the contracting parties have agreed to a collective cargo or when this is usual in a particular trade, identification takes place and the risk passes when the goods are handed over to the carrier. The buyer then bears the risk of full or partial loss of the collective cargo. Partial loss will be shared by the buyers in accordance with each one's share in the collective cargo. [278]

Under the old Code, the provisions of section 447 have also been applied in the context of distance sales where goods have to be sent by mail to the buyer's place of business.[279] The *Landesgerichtshof* of Berlin[280] held that in the case of an Internet sale the parties have agreed to a *Versendungskauf*. This means that the risk transfers to the buyer when the seller handed over the goods "*zur Versendung bestimmten Person*". In this case, a Rolex watch was auctioned on the "Ebay" website. The watch had to be handed to the Post Office for dispatch to the buyer.[281] However, the seller did not hand over the goods to the Post Office personally, but relied on a third party to do it on his behalf. The buyer alleged that the parcel he had received contained an empty box and that the watch was missing. As a result he claimed restitution of the purchase price he had already paid. The court held that on the facts of the case the seller never performed his obligation to send the watch and that the risk of loss of the goods, therefore, remained on the seller.

Similar facts appear from another decision heard by the *Bundesgerichtshof* in the same year.[282] In this case, the claimant ordered a video camera by email from a mail order business in electronic equipment. The purchase price was paid and the defendant dispatched the goods by courier to the claimant. However, the claimant alleged that he never received the camera. He demanded a new camera but his claim failed. The court found that the lower court had erred in applying section 447, which deals with the risk of counter-performance, whilst the claimant's claim was based on the risk of performance and the effect of impossibility on that. The lower court also erroneously applied the new BGB to the case. Notwithstanding, the case

[278] Roemein *Passing of Risk* ch 3 B II para 6.
[279] It is interesting to note that Markesinis et al *German Law of Contract* 917 translate the heading of s 447 as "Passing of risk in case of postal purchase by dispatch". This might present some indication that the provision often finds application in this context. *Cf*, however, section 474(2) BGB which provides that the risk in sales of consumer goods are to be regulated by section 446. The BGB also contains specific provisions on distance sales that regulates a cooling-off period within which the buyer may still cancel the contract.
[280] In a case heard on October 1st, 2003, Berlin "*Gefahrübergang bei 'ebay'-Kauf*" NJW 2003 3493; MMR 2004 189. Note, however, that this case was decided under the old Code.
[281] S 447(1) refers to a "body" which includes the postal service.
[282] NJW 2003 3341 (16 July 2003).

provides valuable insight into the regulation of risk under the new BGB. Under the new Code, section 474(2) provides that the risk in consumer goods, such as goods bought over the Internet or from a mail order business, is no longer regulated by section 447. Risk will only pass in pursuance of section 446 on delivery of the goods to the buyer. If the goods are not received by the buyer, the risk will not pass to him and he will not have to pay for them.

Where, as is often the case in international transactions, the parties resort to trade terms, such terms will prevail over section 447 BGB.[283]

### (i) FOB contracts

According to Groβmann-Doerth,[284] trade usage is the primary source for determining the legal content of trade terms in German law. Section 346 of the German *Handelsgesetzbuch* (HGB) provides for trade usages (*Handelsbräuche*) to be taken into consideration in interpreting the conduct of traders. Trade terms are, therefore, generally interpreted with reference to trade usage or even customary law.[285] However, these usages tend to differ from one place to the other and also from one branch of trade to another, and consequently give rise to divergent and clashing interpretations. In German law, such instances will be addressed with reference to the so-called *Grundsätze über die Kollision von Handelsbraüche*.[286] Where no trade usage exists, it is possible to interpret a trade term with reference to *Allgemeine Geschäftsbedingungen* (AGB),[287] TRADE TERMS[288] or INCOTERMS.[289]

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[283] Westermann "Section 447 BGB" in *Münchener Kommentar* paras 3, 10-13.
[284] *Überseekauf I* (1930) 147.
[285] Hopt "Section 346 HGB" in Baumbach & Hopt (eds) *Kommentar zum Handelsgesetzbuch* 31st ed (2003) para 39; Kort "Section 346 HGB" in Ebenroth, Boujong & Joost (eds) *Handelsgesetzbuch* 1st ed (2001) para 82.
[286] Kort "Section 346 HGB" in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 82.
[287] The so-called *AGB Gesetz*. Although many jurists favour this notion, Renck *Der Einfluß der INCOTERMS* 28-31 contends that the requirements of the *AGB Gesetz* excludes this possibility.
[288] This is a codification of national trade terms as understood in various national legal systems, compiled by the ICC in 1953. It comprised definitions for trade terms in a particular country. TRADE TERMS are to be distinguished from INCOTERMS. Where the latter endeavour to provide a codification of international trade usage, TRADE TERMS only codified the trade usages of a particular country. See 5 2 3 1 *infra.*
[289] Hopt "Section 346 HGB" in *Baumbach/Hopt Kommentar* para 39; Westermann "Section 447 BGB" in *Münchener Kommentar* para 10 points out that party agreement and mandatory statutory law will still enjoy precedence over standardised international definitions such as INCOTERMS. However, the German Supreme Court has on occasion concluded that an FOB term without any specific reference to INCOTERMS is to be interpreted with reference to INCOTERMS. BGH 18 June 1975, VIII ZR 34/74 NW 917. See also 7 2 1 *infra*.

Under German law, the FOB term was for many years merely construed as a price term and little effect was given to the delivery aspect of the term. Section 447 BGB provides that risk passes on delivery to the carrier, which, strictly speaking, could be an inland carrier and not the ship which is to transport the goods for the main part of their carriage. If that is the case, the buyer would carry the risk during transmission of the goods to the ship. However, in 1924, after a long struggle by the commercial community, the German courts recognised and enforced the meaning afforded to the FOB term by trade usage for the first time.[290]

German law defines the FOB term as meaning *frei an Bord (benannter Verschiffungshafen)*.[291] Trade usage determines that the goods are to be handed over to a carrier at the named port of shipment. The obligation to conclude the contract of carriage is normally that of the buyer, unless the seller has specifically agreed to it.[292] It is the seller's obligation to deliver the goods on board. The seller performs his delivery obligation when the goods cross the ship's railing. Furthermore, the seller has to carry all costs and risks up to this point.[293] Risk accordingly passes from the seller to the buyer when the goods cross the ship's rail in the port of shipment. [294] Apart from being a delivery term, the FOB term is also considered to be a price term which includes the costs of transporting the goods *bis an Bord.*[295]

### (ii) CIF contracts

Under German law, the CIF term refers to *Kosten, Versicherung, Fracht* with reference to a particular port of destination. By virtue of trade usage, it is the duty of the seller to bring the goods to the port of destination by arranging for the carriage and paying the costs therefore. He must also take out insurance on the goods.[296] The seller is obliged to deliver the goods on board the vessel in the port of shipment[297] and he is responsible for the loading costs.[298] Emphasis is placed on delivery of the

[290] Sassoon *CIF & FOB Contracts* para 598; RGZ 106, 212 *et seq.*
[291] Kort ‘‘Section 346 HGB” in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 91.
[292] Renck *Der Einfluß der INCOTERMS* 80, 111-112.
[293] Kort ‘‘Section 346 HGB” in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 91.
[294] Westermann “Section 447 BGB“ in *Münchener Kommentar* para 11.
[295] Groβmann-Doerth *Überseekauf I* 147; HansOLG GZ 1017 Nr 35.
[296] Kort ‘‘Section 346 HGB” in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88. This source also mentions that the seller is responsible for the costs of off-loading, which is different from the position under English and American law.
[297] Renck *Der Einfluß der INCOTERMS* 110 n 323.
[298] Kort “Section 346 HGB” in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88.

documents instead of the goods. Trade usage provides that a CIF sale is a sale of documents instead of a sale of actual goods.[299]

Apart from being a cost term, CIF also regulates the passing of risk.[300] Risk passes to the buyer at the moment of shipment in the port of shipment,[301] which is when the goods cross the ship's rail,[302] unless the parties have provided for the risk to pass at another place. It is possible to postpone the passing of risk to a later point by agreement, for example by adding the words *ab Kai*. The effect is that the seller will carry the risk until the goods are off-loaded and placed at the disposal of the buyer at the named quay.[303] However, this variation affects the normal character of the CIF sale as a shipment contract and turns it into a destination contract.

### 2 2 3 2 Destination sales

Section 446 BGB regulates situations where the goods are to be delivered to the place of business of the buyer, such as in the case of a debt payable at buyer's domicile or a *Bringschuld*, or where it is to be delivered to another place, such as the place of business of the manufacturer.[304] Section 446 (first sentence) states that the risk passes when the goods are handed over to the buyer or to its agent at the agreed place.[305] Although possession is required for the risk to pass, it also suffices when the seller makes the goods available at the agreed place where the buyer is able to collect them without further assistance of the seller.[306] Section 446 (third sentence)[307] provides that when the buyer fails to take over the goods timeously, he is in delay and it will then be deemed that delivery has taken place and the risk will pass. In the case of a *Bringschuld* consisting of generic goods, appropriation will be considered to have taken place when the goods had been placed at the disposal of

[299] BGH Urt v 15.1.1864-VIII ZR 112/62, MDR 1964, 497; Kort "Section 346 HGB" in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88; Hopt "Section 346 HGB" in *Baumbach/Hopt Kommentar* para 40.
[300] RG Urt v 8.6.1918 – I393/17, RGZ 93,166,168.
[301] Kort "Section 346 HGB" in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88.
[302] Westermann "Section 447 BGB" in *Münchener Kommentar* para 12.
[303] RG Urt v 4.2.1916 – II 409/15, RGZ 88, 71, 73; Kort "Section 346 HGB" in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88.
[304] Westermann "Section 446 BGB" in *Münchener Kommentar* para 4.
[305] "*Mit der Übergabe der verkauften Sache geht die Gefahr des zufälligen Untergangs und der zufälligen Verschlechterung auf den Käufer über.*"
[306] Roemein *Passing of Risk* ch 3 D III para 2. See also n 315 *infra.*
[307] *"Der Űbergade steht es gleich, wenn der Kaufer im Verzug der Annahme ist."*

the buyer but he failed to take them over in time.[308] The risk will also pass to the buyer at that moment.

Parties may agree that the risk will pass "*ab Kai… benannter Hafen*" (*ex quay*).[309] In that case risk will pass to the buyer when the goods are made available on the quay in the port of destination. Under this term, as well as other *Ankunftklauseln* (arrival terms) such as "ex ship" (*ab Schiff*) or "DDU (*geliefert unverzollt benannter Bestimmungsort*)", the seller carries the costs and risks until arrival at the port or place of destination.[310]

### 2 2 3 3 Residual cases

Normally contracts are regarded as *Holschulden*, requiring the buyer to collect the goods. Where the contract does not provide for the goods to be forwarded to the buyer, the passing of risk is regulated by section 446.[311] The first and second sentences of the new section 446 are still essentially the same as the previous version; the general idea being to allocate the risk to the person having custody over the goods.[312] According to section 446 BGB, the risk passes to the buyer on handing over the goods to him. From that moment on all benefits related to the goods accrue to the buyer and all charges are for his account.

This provision presumes that a valid contract of sale has been concluded.[313] The second requirement is that the goods are to be handed over to the buyer.[314] The buyer has to acquire direct possession or actual control of the goods.[315] It does not

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[308] Roemein *Passing of Risk* ch 3 A II para 1(b).
[309] Kort "Section 346 HGB" in *Ebenroth/Boujong/Joost Handelsgesetzbuch* para 88; RG Urt v 4 2 1916-II 409/15, RGZ 88, 71, 73.
[310] Hopt "Section 346 HGB" in *Baumbach/Hopt Kommentar* para 40; Westermann "Section 447 BGB" in *Münchener Kommentar* para 12.
[311] Faust "Section 446 BGB" in *Bamberger/Roth Kommentar* para 4.
[312] para 1.
[313] Westermann "Section 446 BGB" in *Münchener Kommentar* paras 5-6.
[314] para 7.
[315] According to s 854(1) BGB, possession is acquired by attaining actual control of the goods. According to s 854(2) BGB, an agreement to acquire possession of the goods suffices when the buyer is able to control the goods; for example, when the goods are freely accessible or when they are delivered to an agent, assistant or employee of the buyer. It is doubtful whether indirect control or possession suffices for delivery as meant under s 446. See also BGH NJW 1983 627 *et seq*; Roemein *Passing of Risk* ch 3 D I para 3. In regard to the attainment of indirect possession, one must distinguish between the situation where the seller is merely bound to transfer ownership according to ss 930 and 931, and not to deliver the goods, and the situation where he is bound to deliver the goods and therefore also to transfer actual control. According to Westermann "Section 446 BGB" in *Münchener Kommentar* para 7, when ownership is transferred without an obligation to deliver, risk can pass if the parties have agreed

suffice to place the goods at the mere disposal of the buyer. If the buyer does not take over the goods, he will be in default of acceptance, in which instance the risk will pass to the buyer in terms of section 446 (third sentence).[316] When the sold goods are in storage, the contract does not involve carriage. Risk will, therefore, also pass when the goods are handed over to the buyer in terms of section 446 BGB. Current opinion holds that, since a warehouse warrant to order issued by the storekeeper represents the goods, it causes the risk to pass to the buyer in terms of section 424 HGB. The case law does not regard the handing over of a delivery certificate in the same light as a warehouse warrant; resulting in the seller having to bear the risk until the goods have actually been handed over to the buyer.[317]

### 2 2 3 4 Sales in transit

In German law, a distinction is made between floating and rolling goods. The BGB does not expressly regulate floating goods. Section 447 does not apply to floating goods because the goods are already in the possession of the carrier at the time of the sale.[318] Carriage, therefore, does not take place "at the request of the buyer".[319] According to the case law, the risk does not pass to the buyer in terms of section 446 either until the endorsed bill of lading has been handed over to him.[320] This means that the risk is split between the seller and buyer at that point in time. However, in instances where the buyer has agreed thereto, either expressly[321] or tacitly, the risk passes retroactively to the buyer to the moment the goods are loaded, unless the seller knew or ought to have known about the loss of or damage to the goods at the time of conclusion of the contract.[322] This approach is justified by the argument that it

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that indirect possession suffices, such as in the case of the sale of a house which is let to a lessee, but if the obligation is to deliver the goods, actual possession is required for the risk to pass in terms of s 446.

[316] This is in accordance with the seller's right to counter-performance mentioned in s 326(2) BGB. See Westermann "Section 446 BGB" in *Münchener Kommentar* para 8.

[317] Roemein *Passing of Risk* ch 3 D II para 2.

[318] Renck *Der Einfluß der INCOTERMS* 215; Westermann "Section 447 BGB" in *Münchener Kommentar* para 5.

[319] S 447 could apply if the goods have to be redirected for purposes of the buyer. That would be seen as a situation where the buyer has agreed to the dispatch of the goods to another place as the place of performance. See Westermann "Section 447 BGB" in *Münchener Kommentar* paras 5 & 13; BGHZ 50, 32, 36 = NJW 1968 1569.

[320] Renck *Der Einfluß der INCOTERMS* 215; RGZ 52, 352, 354; *Schiedsspruch des Schiedsgericht der Hamburger freundlichen Arbitrage vom* 23.06.1971.

[321] For example by incorporating a trade term such as CIF into the contract. In that case, risk will pass retroactively to the time when the goods crossed the ship's rail in the port of shipment. If the contract is concluded on the basis of a destination term, such as "ex ship" or "ex quay", risk will pass when the goods reach that destination. In the case of international sales, risk could also be regulated by other supranational regulations such as the CISG to which Germany is a contracting state. See Westermann "Section 447 BGB" in *Münchener Kommentar* para 13.

[322] Renck *Der Einfluß der INCOTERMS* 216.

is often unclear when the floating cargo was lost or damaged. Disputes between the contracting parties are therefore prevented.[323]

With the sale of rolling goods, section 447 is not directly applicable either. The carriage does not take place "at the request of the buyer" and the goods are already in the possession of the carrier at the conclusion of the contract. In most instances of sales in transit, the passing of risk will be regulated by section 446.[324] However, according to judgements of the BGH,[325] section 447 is applicable by analogy. As a rule, the buyer normally requests that the goods are to be delivered at a specific place, usually his place of business. The seller fulfils his contractual obligations by giving these instructions to the carrier. The passing of risk is therefore tied to the instruction. The risk passes to the buyer at the time when the instructions for delivery of the goods at the buyer's domicile or to a nominated third person are given to the carrier, provided those instructions are given effectively.[326] There is, however, no clarity as to when the risk passes where the contract concerns the sale of rolling goods and it is concluded on the basis of a trade term such as FCA or CPT.[327] The *Bundesgerichtshof* held that in the case of rolling goods, the clause "*frei Waggon*" merely functions as a price term and does not regulate aspects such as delivery or passing of risk.[328]

There are no special provisions for the sale of unidentified goods in transit. In the case of floating goods, the risk passes when the bill of lading is handed over to the buyer. The bill of lading indicates the goods and therefore appropriates the goods to the contract. The bill also represents the goods and delivery of the bill constitutes symbolic delivery of the goods. Risk, therefore, passes in terms of section 446 when the bill is handed over to the buyer. With rolling goods, risk will pass at the time the instruction for delivery of the goods is given to the carrier.[329] Once again, that is the time that the goods are appropriated to the contract.

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[323] Roemein *Passing of Risk* ch 3 C II para 1.
[324] BGHZ 113, 106, 110 = NJW 1991 915; BGH NJW 1965 1324.
[325] BGHZ 50, 32, 36 = NJW 1986 1569; KG OLGE 8, 62; Westermann "Section 447 BGB" in *Münchener Kommentar* para 5.
[326] Renck *Der Einfluß der INCOTERMS* 216; Roemein *Passing of Risk* ch 3 C II para 2.
[327] Renck *Der Einfluß der INCOTERMS* 216.
[328] BGHZ 50, 32, 36 = NJW 1986 1569. See, however, Westermann "Section 447 BGB" in *Münchener Kommentar* para 13.
[329] Roemein *Passing of Risk* ch 3 C II para 3. See also Westermann "Section 447 BGB" in *Münchener Kommentar* para 15.

### 2 2 3 5 Breach of contract

The *Schuldrechtsmodernisierungsgesetz* introduced a general concept of breach. Breach is simply defined as a deviation from the content of an obligation (so-called *Pflichtverletzung*), irrespective of the form, whilst the content of an obligation is determined by the law or by the agreement of the parties. However, when the seller has breached the contract, German law distinguishes between instances where the seller delivers non-conforming or defective goods and other forms of breach.[330] Non-conformity should exist at the moment when the risk passes. Even though the risk has passed to the buyer, he retains his general contractual remedies for breach under section 437, such as a right to demand cure, to withdraw from the contract, to claim a reduction in price or to demand damages. However, if loss or damage is a result of the non-conformity and the contract is cancelled, the risk will pass back to the seller *ex tunc* and the buyer will not be obliged to pay the purchase price. If the goods are lost or damaged independently of the defect, it is doubtful whether the risk will revert to the seller.[331]

If the seller deviates from the buyer's delivery instructions, risk will not pass under section 447, and, furthermore, the seller will be liable for any damages that result from such deviation by virtue of section 447(2).[332] If the buyer is in delay of acceptance, section 446 (third sentence) states that "it is equivalent to handing over" the goods and it results in the risk passing to the buyer. The third sentence was added by the *Schuldrechtsmodernisierungsgesetz*. This provision follows the basic rule set out in section 326(2) first sentence, which states that the buyer will still be liable for counter-performance if he delays acceptance of the seller's performance.[333] Even though the buyer is in delay regarding acceptance of the goods, the risk of loss or damage still passes to him on delivery, and the seller will be released from his obligation to perform in terms of section 275 BGB. If compared to the legal position on *Annahnmeverzug* under section 324(2) of the old Code, the addition of the new sentence brought nothing new.[334]

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[330] Renck *Der Einfluß der INCOTERMS* 234; Markesinis et al *German Law of Contract* 428.
[331] Renck *Der Einfluß der INCOTERMS* 234; Roemein *Passing of Risk* ch 3 E II.
[332] Westermann "Section 447 BGB" in *Münchener Kommentar* paras 21-25. In cases where the seller uses his own employees to transport the goods, s 278 will apply.
[333] Westermann "Section 446 BGB" in *Münchener Kommentar* paras 2 & 8.
[334] Faust "Section 446 BGB" in *Bamberger/Roth Kommentar* para 2.

### 2 2 4 South African law

The South African law of purchase and sale to a considerable extent still reflects the Roman-Dutch law of the seventeenth century.[335] This also holds true of the South African doctrine on risk.[336] The rule *emptoris perfecta periculum est emptoris* had its origin in Roman law.[337] This rule deviates from the *res perit domino* principle[338] by stating that risk will pass to the buyer as soon as the contract is *perfecta*,[339] which is when the *merx* is individualised, the purchase price certain and the agreement is not dependent on the fulfilment of any suspensive conditions.

Once risk has passed, the *periculum rei est emptoris* rule provides that the buyer is obliged to pay the purchase price even if the seller is unable to deliver the *merx* or it can be delivered only in a damaged condition.[340] Situations where the destruction of or damage to the *merx* is due to the fault of the seller constitute exceptions to the general rule on risk allocation.[341]

In classical Roman law,[342] the rule was applied to the so-called *Barkauf*, a sale which was characterised by immediate delivery against cash payment, a fully individualised *merx,* an ascertainable price and unconditional operation of the agreement.[343] Despite the development of more sophisticated forms of *emptio venditio* where delivery and the passing of ownership are postponed to a point after the conclusion of the sale, the risk rule persisted in its original form.[344]

Although the risk rule seems in conflict with the modern perspective of a contract as a reciprocal agreement involving conditional synallagma, it should be kept in mind

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[335] Lotz "Purchase and Sale" in Zimmermann & Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) 361.
[336] Bauer *Periculum Emptoris: Eine Dogmengeschichtliche Untersuchung zur Gefahrtragung beim Kauf* (1998) 26, 265.
[337] *Inst* III 23 3; *D* 18 6 8 *pr*.
[338] *Van Wyk v Herbst* 1954 2 SA 571 (T) 574; *Pahad v Director of Food Supplies & Distribution* 1949 3 SA 695 (A) 709. For explanations of the rule by the common law writers, see in general, Hackwill *MacKeurtan's Sale of Goods in South Africa* 5th ed (1984) 178; *Grobbelaar v Van Heerden* 1906 EDC 229.
[339] *D* 18 6 8 *pr*; *BC Plant Hire t/a BC Carriers v Grenco (SA) (Pty) Ltd* 2004 4 SA 550 (C) 563.
[340] Kerr "Sale" in Joubert (ed) *LAWSA XXIV* rev (2000) para 120; *Inst* 3 23 3; Voet *Commentarius* 18 6 1.
[341] Kahn et al "Sale" in Kahn (ed) *Principles of the Law of Sale & Lease* (1989) 1 35; *Gengan v Pathur* 1977 1 SA 826 (D); *Kistasamy v Pillay* 1979 3 SA 1350 (N).
[342] For a long time it was believed that the rule was unknown to classical Roman law and that it was of Bizantine origin. See Mostert et al *Die Koopkontrak* (1972) 82 n 3. In a comprehensive study on the history of the risk doctrine, Bauer *Periculum Emptoris* corrects this notion. See also Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 282.
[343] Bauer *Periculum Emptoris* 27-30, 253.
[344] 73, 253.

that these concepts were unknown to classical Roman law. They were only later introduced on a case to case basis in reaction to the notion of good faith and were further developed on the foundation laid down in the *Corpus Iuris*.[345] Moreover, in classical Roman law the unfairness of the *periculum emptoris* principle was balanced by the counterweight of the *custodia* liability of the seller. Liability for *custodia* puts the seller in a position similar to someone who holds something on behalf of someone else. The only circumstance that was excluded from *custodia* was *vis maior*; the latter being covered by the risk rule.[346]

Moreover, the operation of the risk rule was closely connected to the nature of the agreement in classical Roman law. In those times, an agreement had not merely an obligationary but also a proprietary effect in so far as it operated *inter partes*. By virtue of the agreement the buyer acquired an economic or proprietary interest in the *merx*.[347] This explains why individualisation of the *merx* was required as a prerequisite for the contract being perfected. It also explains the *custodia* liability of the seller.[348] The buyer's economic interest in the *merx* furthermore results in an entitlement to any benefit which may accrue after perfection of the contract.[349] It could therefore be argued that it is only fair that the buyer should also carry the risk of accidental destruction or damage as from the moment of perfection.[350]

South African law inherited this risk regime. Therefore, when a contract of sale is concluded under South African law, the moment of perfection is decisive for the passing of risk. The risk for accidental loss will therefore not always pass to the buyer immediately nor necessarily remain on the seller until delivery or the transfer of ownership of the *merx* to the buyer. Risk may even pass before the goods are delivered.

"Risk" refers to events extraneous to the seller that may cause damage to or destruction of the *merx* or any disadvantage attaching to it. These events are not

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[345] 78, 253.
[346] 59-63, 76, 253; Zimmermann *Law of Obligations* 287.
[347] Bauer *Periculum Emptoris* 79.
[348] 77. The *custodia* liability of the seller will be discussed in more detail in the critical analysis 3 3 2 4 *infra*.
[349] *Commodum eius esse debet, cuius periculum est. De Kock v Fincham* 1902 19 SC 136; *Walker v Wales* 1922 CPD 49; *Meintjes v Manley & Co* 1922 CPD 151; *Kidney v Garner* 1929 CPD 163. This includes not only the civil and natural fruits of the *merx* but also the so-called substitutionary *commodum*, such as compensation for a *merx* that is expropriated. See *Mnyandu v Mnyandu* 1964 1 SA 418 (N). It does, however, not include compensation derived from insurance taken out on the *merx* by the seller. See *Van Deventer v Erasmus* 1960 4 SA 100 (T).
[350] See 3 3 2 4 *infra* for contrary opinions which state that the rule operates unfairly and arbitrarily.

restricted to typical *vis maior* situations such as storms and earthquakes, but include any accidental destruction or deterioration of the *res vendita* such as *casus fortuitus*.[351] The Roman-Dutch authors refer to instances where an animal or slave dies after conclusion of the contract of sale, a house burns down or collapses after its sale, a ship becomes shipwrecked or wine turns musty.[352] Deterioration by passage of time or as a result of a defective container as well as loss due to theft are included in the range of incidents that will qualify as risk.[353] South African case law yields expropriation of the *merx* and the imposition of excise duty as further examples.[354]

The rules regarding transfer of risk are regarded as the natural consequences (*naturalia*) of the contract of sale which the parties may modify or exclude through express or tacit agreement,[355] for example by using trade terms. In the case of FOB and CIF contracts, for instance, there is a tacit agreement that the seller will carry the risk until the goods are placed on board the ship. The general rule is also subject to any statutory rule to the contrary.[356]

**2 2 4 1 When does a contract of sale become *perfecta*?**

The contract of sale is *perfecta* when the price (*pretium*) is determined, the *merx* definite and identified and the contract not subject to a suspensive condition.[357] However, because accidental disasters can either destroy the *merx* or merely damage or cause deterioration in quality, the varying effect of the consequences of the event must also be borne in mind.

It should be noted that a discussion of the South African law on risk is hampered by the fact that its common law background is not always clear and easy to understand. Divergent accounts are given of the theoretical history of the risk doctrine. The

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[351] Kerr *LAWSA XXIV* para 122; Lotz "Purchase and Sale" in *Southern Cross* 383; Zulman & Kairinos *Norman's Law of Purchase and Sale in South Africa* 5th ed (2005) para 10 6.
[352] Voet *Comm* 18 6 1.
[353] Kerr *LAWSA XXIV* para 122; Kerr *The Law of Sale and Lease* 3rd ed (2004) 237.
[354] *Marais v Deare and Dietz* 1878 Buch 168; *Poppe Schunhoff and Guttery v Mosenthal & Company* 1879 Buch 91; *Taylor & Co v MacKie Dunn & Co* 1879 Buch 166; *Rood's Trustees v Scott and De Villiers* 1910 TPD 47; *Snyman v Fowlds* 1950 3 SA 74 (T).
[355] Kerr *LAWSA XXIV* para 120; De Wet & Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 5th ed (1992) 351; Voet 18 6 5; *Van Wyk v Herbst supra* 574.
[356] Such as s 59 of the Customs and Excise Act 91 of 1964.
[357] *Cf* also *D* 18 6 8 *pr*; *Inst* 3 23 3; De Groot *Inl* 3 14 34; Voet 18 6 1; Van Leeuwen *CF* 1 4 19 5; Pothier *Traité du contrat de vente* para 309; Van der Linden *Koopmans Handboek* 1 15 9; Mostert et al *Koopkontrak* 84-90; Kerr *LAWSA XXIV* para 123; Kerr *Sale and Lease* 237-238; Zulman & Kairinos *Norman's Purchase and Sale* paras 10 2, 10 8; *Mulder v Van Eyk* 1984 4 SA 204 (SE) 207E-F; *BC Plant Hire CC t/a BC Carriers v Grenco supra* 563F-H.

Roman-Dutch authors developed theoretical explanations for the doctrine, which unfortunately resulted in contradictory treatments of the rules on risk[358] and complicate its understanding. Despite the overall unease with which legal scholars attempt to explain the doctrine, it has remained firmly imbedded in our law and its retention never really questioned.[359]

In what follows, the requirements for a contract to become *perfecta* will be discussed in more detail.

### (i) The purchase price should be determined

This requirement for the contract to be perfected is met when the price is fixed in the contract. Alternatively, if it is possible to determine the price by means of an easy calculation or if a third party is to determine the price, the requirement is met on determination of the price.[360] In certain instances the goods have to be weighed, measured or counted before the price can be ascertained and the contract perfected.[361]

Why is the passing of risk suspended until the price is ascertained even though the contract would otherwise be valid?[362] The *ratio* lies in a practical consideration. If the

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[358] Bauer *Periculum Emptoris* 21-25,127-133, 259-260.

[359] Except for a very early attempt by Morice "The Risk of the Thing Sold" 1912 *SALJ* 239 244-245 to advocate a link between risk and delivery. For a more recent critique by a German scholar, see Bauer *Periculum Emptoris*. See also 3 3 2 4 *infra*.

[360] Mostert et al *Koopkontrak* 84. Lehmann "Purchase and Sale" in Du Bois (ed) *Wille's Principles of South African Law* 9th ed (2007) 888 894-895 points out that it is not enough that the price is merely determinable. If the price is not yet fixed and the goods are destroyed before they have been appropriated, it is impossible to determine whether the goods were the subject of the sale or not. De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 348-349 state that the price should either be fixed or capable of being fixed through easy calculation. Although this may at first glance sound that it is enough that the price is only capable of being fixed, a closer reading of the text shows that they also require that the price should have been determined before the goods were destroyed, for the risk to pass.

[361] De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 348-349 state that in the case of a sale *ad mensuram*, where the price is to be determined only after the goods have been weighed, measured or counted, and the goods are destroyed before they are appropriated, it means that they cannot be weighed, measured or counted and therefore the price cannot be determined. In these instances the risk remains with the seller. In cases where the goods are merely damaged or have deteriorated, they are still capable of being appropriated and therefore the risk will pass. See also Kerr *LAWSA XXIV* para 123; *Jamieson & Co v Goodliffe* 1881 1 SC 206 220-221; *Poppe Schunhoff & Guttery v Mosenthal supra*; *Taylor & Co v Mackie Dunn & Co supra*; *Montgomerie v Rand Produce Supply Co* 1918 WLD 167. Although the court in *Page v Blieden & Kaplan* 1916 TPD 606 610-611 stated that the contract is *imperfecta* before determination of the quantity, it unfortunately confused the passing of property with the passing of risk. This case, therefore, does not provide good authority for the law on sales *ad mensuram.*

[362] The *merx* should be certain or merely ascertainable for the sale to be valid. See Hamman *Die Risiko by die Koopkontrak in die Suid-Afrikaanse Reg* LL D published dissertation Leiden (1938) 219; Van

buyer is to assume the risk for the goods and thereby liability for the purchase price, it is not only just but also necessary, that the price and the extent of his liability should be fixed at the moment when the risk passes, that is at the moment that he has to assume liability for the purchase price in the event of accidental destruction or damage. The destruction of the goods frees the seller from his responsibility to deliver, but the loss falls on the buyer and he still has to pay the purchase price. Although the contract is technically valid and enforceable, the buyer's obligation to pay can in practice only be enforced once the price is determined and it is clear for what amount the buyer is to be held liable.[363] In the case of sales *ad mensuram*, where the quantity determines the price, it is necessary that the goods be weighed, measured or counted to determine the total price for which the buyer will be liable in the event of accidental loss or deterioration of the *merx*. If the risk is to pass before appropriation, it could open the door to fraud, especially in instances where only part of a larger bulk has been accidentally destroyed or damaged.[364]

Sales *ad mensuram*[365] entail the sale of bulk goods at a price per unit such as an entire stack of wheat sold at a certain price per unit. In these cases the *merx* is determined but the units are unknown; hence the purchase price can only be determined when the quantity is determined. The contract will only be perfected once the goods are weighed, counted or measured. The sale *ad mensuram* should be distinguished from the sale *per aversionem* where bulk goods are sold for a single and only price; for example, if a stack of wheat is sold for a particular price. In the latter instance the price is determined and risk passes on conclusion of the contract.[366]

Roman law commentators differ on whether the operation of risk in these cases should be treated as a condition and, therefore, whether the risk of destruction (*periculum interitus*) and the risk of damage or deterioration (*periculum deteriorationis*) should be separated or not.[367] The treatment of the risk rule is further

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Niekerk & Schulze *The South African Law of International Trade: Selected Topics* (2000) 54; De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 348.

[363] Hackwill *MacKeurtan's Sale of Goods* 186-187; Hamman *Risiko by die Koopkontrak* 223.

[364] Thomas *Textbook of Roman Law* (1976) 289 explains that appropriation of the quantity to the contract is a consequence of the principle of *bona fides*. See also Morice 1912 *SALJ* 244 for a similar argument.

[365] Also known as sales *ad quantitatem*.

[366] *D* 18 1 35; Voet 18 6 3 4; Pothier *Vente* 309; Van Leeuwen *RHR* 4 17 2 en *CF* 1 4 19 9; Zulman & Kairinos *Norman's Purchase and Sale* para 10 8 3; Kerr *Sale and Lease* 238-239; Hackwill *MacKeurtan's Sale of Goods* 183-184.

[367] Floyd "Enkele opmerkings oor die werking van die risiko-reël by die koop onderworpe aan 'n opskortende voorwaarde en soortgelyke bedinge" 1995 (58) *THRHR* 461 463.

complicated by Roman-Dutch writers, such as Voet and Huber, who held differing interpretations of Roman sources. It is clear that under the common law the distinction between deterioration and destruction became important. When the goods are damaged or have deteriorated in quality, they can still be weighed, measured or counted and the price can accordingly still be determined. Therefore, only events that preclude determination of the price will free the buyer from carrying the risk.[368]

Voet[369] held that where all the wine in a casket was sold and it was stipulated that the price will be adapted in relation to the quantity determined by measurement, the risk passed immediately as the act of measuring is not considered a suspensive condition but a *modus*. However, it has been suggested that Voet might have confused the sale *ad mensuram* with a sale *per aversionem*, where weighing merely serves to confirm the quantity being sold.[370] Hamman[371] agrees that Voet's argument is without substance. If the *merx* was to be destroyed before the quantity was determined, it will be impossible to determine the price. Huber,[372] on the other hand, held that the risk of destruction and deterioration only passes when the quantity is determined.[373]

The conceptual differences between Voet and Huber had an effect on the sale *ad gustum* as well.[374] Under this type of sale the buyer has to approve the goods, for example by tasting wine to see whether it has turned sour or musty.[375] Once again, it is not clear whether such stipulation was treated as a suspensive or a resolutive condition under Roman law.[376] According to Voet's understanding of the risk doctrine, risk of deterioration passes on conclusion of the contract, unless it is a case where the sale is subject to the buyer's right of approval. The right of approval is seen as a suspensive condition.[377] Risk of destruction on the other hand, rests on the seller until the quantity of the goods is determined by weighing, measuring or counting and

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[368] *D* 18 1 34 5; De Groot *Inl* 3 14 35; De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 349; Hamman *Risiko by die Koopkontrak* 25, 89-90, 92-93, 220-224.
[369] 18 6 4.
[370] Floyd 1995 (58) *THRHR* 466-469; Zulman & Kairinos *Norman's Purchase and Sale* para 10 8 3 5. See also Zimmermann *Law of Obligations* 284-287 for a discussion on the legal position of sales of wine under Roman law.
[371] *Risiko by die Koopkontrak* 20, 92, 219.
[372] 3 5 25.
[373] Floyd 1995 (58) *THRHR* 466 is of the opinion that Huber probably had the limited generic sale in mind.
[374] Bauer *Periculum Emptoris* 162-167, 260.
[375] *D* 18 6 1 *pr*.
[376] Floyd 1995 (58) *THRHR* 465.
[377] Voet 18 6 3; Kerr *Sale and Lease* 240. According to Hackwill *MacKeurtan's Sale of Goods* 181 it will depend on the circumstances of the case whether a right of approval should be treated as a conditional sale.

is not dependent on the right of approval.[378] Huber,[379] however, argues that the risk of both deterioration and destruction passes on determination of the *merx,* irrespective of whether the buyer exercised his right of approval or not.

Van Leeuwen[380] states that for both the sale *ad mensuram* and the generic sale, the determination of the quantity should be treated as a suspensive condition. Kerstemann,[381] also considers measurement to function as a suspensive condition. The French writers, Pothier[382] and Troplong,[383] merely state that the sale becomes *perfecta* when the goods are measured, weighed or counted. In the case of a generic sale, the *merx* becomes determined once it is weighed, measured or counted, whilst in the case of a sale *ad mensuram*, the quantity and price becomes certain on weighing, measuring and counting. No mention is made of a conditional construction in the case of a sale *ad mensuram*.

But is there support in South African law for the conditional construction in the case of sales *ad mensuram*? Wessels[384] seems to support it. Hamman,[385] on the other hand, is opposed to such a construction. He contends that the method by which the price is to be determined should be considered a condition which suspends the contract from being perfected and, therefore, also the passing of risk, but that it does not function to suspend the operation of the contract as such.[386] If the goods are destroyed, the price can no longer be determined, but if they are merely reduced in value, the price is still capable of determination. The risk of destruction is therefore on the seller, but in the case of deterioration the risk is on the buyer.[387] With reference to the common law writers Van Leeuwen and Voet, De Wet and Van Wyk[388] also state that the sale *ad mensuram* is considered a conditional sale. However, it seems that they agree with Hamman that the "condition" does not suspend the contract but merely the determination of the price and therefore the

[378] Voet 18 6 4.
[379] 3 5 26.
[380] *CF* 1 34 19 9, *RHR* 4 17 2 with reference to *D* 18 1 35 5 and *C* 4 48 2.
[381] *Hollandsch rechtsgeleert woordenboek* "Koop". The same position applied in Roman law. See Floyd 1995 (58) *THRHR* 463-464 for a discussion of the Roman law.
[382] *Vente* 309.
[383] *Vente* 94.
[384] Roberts (ed) Wessels" *Law of Contract in South Africa II* 2nd ed (1951) paras 4958-4959, 4964.
[385] *Risiko by die Koopkontrak* 23-24.
[386] See 2 2 4 1 (iii) *infra* for a discussion on the difference between Roman law and South African law as regards the operation of the suspensive condition.
[387] *Risiko by die Koopkontrak* 219-220.
[388] *Suid-Afrikaanse Kontraktereg I* 349.

passing of risk.[389] Kerr[390] states that the contract exists before the measuring, weighing or counting takes place but that the contract is not perfected and the risk therefore cannot transfer to the buyer until the price is determined. He explains this position with reference to the French writer Pothier[391] and expresses doubt as to whether the rules on weighing, measuring and counting should be regarded as falling within those on suspensive conditions.[392] Norman[393] does not refer to the conditional construction either. He too finds support in the writings of Pothier, who did not refer to a suspensive condition. The same applies for MacKeurtan.[394]

### (ii) The *merx* must be determined

That means that the goods should be identified and their quality and quantity should also be determined.[395] Before identification of the *merx*, it is practically difficult for the buyer to protect his economic interest in the sale. The obligation to deliver is delineated with reference to the object of delivery, the *merx*. Before its determination, the buyer merely has a right to the delivery of an object that is indeterminate. Only when the object is determined or identified, his right becomes practically enforceable in so far as a claim for specific performance is concerned.[396]

In the case of sales *ad mensuram* and generic sales, the risk of destruction and deterioration passes when the weighing, measuring, counting or individualisation has occurred.[397] In the case of a sale *per aversionem*, risk will pass on conclusion of the contract.[398] In so far as future goods are concerned, a distinction is made between the *emptio rei speratae* and the *emptio spei.* In the case of the *emptio rei speratae,* the contract can only become *perfecta* after the goods have come into being and they are counted, weighed or measured; whilst in the case of an *emptio spei*, the sale is not conditional on the goods coming into existence. In this case the buyer has to pay the purchase sum even if the goods do not materialise.[399]

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[389] In n 220 they approve Hamman's criticism of Voet's construction.
[390] *Sale and Lease* 238-239.
[391] *Vente* 309.
[392] *Sale and Lease* 238 n 30.
[393] Zulman & Kairinos *Norman's Purchase and Sale* para 10 8 3.
[394] Hackwill *MacKeurtan's Sale of Goods* 184-186.
[395] *Grobbelaar v Van Heerden supra.*
[396] Kerr *Purchase and Sale* 238. That is also the moment when the buyer obtains an insurable interest.
[397] *D* 18 1 35 7; Hamman *Risiko by die Koopkontrak* 225.
[398] Hamman *Risiko by die Koopkontrak* 236.
[399] 237-238.

If unascertained goods are sold, such as 100 bottles of wine held in a particular wine cellar, the risk will not pass until the goods are appropriated to the contract.[400] The same principle applies to a sale involving a selection. Until the selection is made the risk will not pass.[401] If the goods are destroyed before appropriation, it is impossible to determine whether such goods were the subject of the sale or not.[402] If it is an alternative sale, the *merx* will be undetermined up to the moment that the choice is made or the other alternative is lost or destroyed.[403] In the case of a limited generic sale where the *merx* is a quantity of goods from a certain class, grade or description, the *merx* will only be determined once the *merx* is individualised. Where a number of units from a bigger bulk are bought for a specified price per unit, the particular goods have to be separated from the rest to be identified.[404] Whether identification should constitute a bilateral act or whether unilateral appropriation suffices is a question that is not always easy to answer.[405] MacKeurtan,[406] Morice[407] and Hamman[408] are all in favour of bilateral appropriation. The case law, however, seems to accept unilateral appropriation.[409]

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[400] Hackwill *MacKeurtan's Sale of Goods* 188.

[401] 189.

[402] Lehmann "Purchase and Sale" in *Wille's Principles* 895; Roberts (ed) Wessels' *Contract II* paras 4960-4961.

[403] Voet 18 6 3; Zulman & Kairinos *Norman's Purchase and Sale* para 10 13; Kerr *Sale and Lease* 242.

[404] Hackwill *MacKeurtan's Sale of Goods* 189. Identification can take place through counting, weighing or measuring. See Kerr *Sale and Lease* 238; Zulman & Kairinos *Norman's Purchase and Sale* para 10 8 3 5.

[405] Under SA law, "identification" and "appropriation to the contract" both refer to the requirement that the *merx* should be determined for purposes of passing risk. It, therefore, does not have the same meaning as under English law where unconditional appropriation is required for ownership to pass. See *R v Nel* 1921 AD 339 in this regard. Morice 1912 *SALJ* 243 claims that unilateral appropriation may be sufficient to transfer risk as the general common law rule merely states that the goods should be weighed, measured and counted for the risk to pass. De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 350 also seem to be in favour of unilateral appropriation.

[406] Hackwill *MacKeurtan's Sale of Goods* 189.

[407] 1912 *SALJ* 244-245. He states that, in the interest of justice, the buyer should consent to unilateral ascertainment in cases where distance prevents him from being present for appropriation purposes.

[408] *Risiko by die Koopkontrak* 220, 225, 233-235. Bilateral appropriation is required to prevent fraud and will also assist the seller in proving that identification has taken place. He agrees that it is sometimes practically impossible for the buyer or his agent to be present at individualisation. In these instances, the seller should be authorised to individualise the goods and to inform the buyer accordingly.

[409] *Taylor & Co v Mackie Dunn & Co supra*. However, in *Stewart v Benjamin* 1871 2 R 58, the court held that on grounds of a practice in the wool trade, appropriation was subject to approval. It is therefore not clear whether this case provides sufficient authority to support a general requirement of bilateral appropriation. See Morice 1912 *SALJ* 243-244 for a critical discussion of this case. Hamman *Risiko by die Koopkontrak* 229-230, however, states that Juta JP could not find any authority in Roman Dutch law that the buyer should have knowledge of the act of individualisation. The decision, therefore, does not seem to provide any authority for such a requirement. The judgement in *Horne v Hutt* 1915 CPD 331 indicates that the Roman-Dutch authorities simply adopted the Roman law texts which required bilateral appropriation. Zulman & Kairinos *Norman's Purchase and Sale* para 10 9 hold that, on the basis of usage, an implied term should be read into every contract to the effect that the purchaser has waived his right to be present. If delivery is to be made to a carrier, the purchaser impliedly consents that placing goods of the contract description on the carrier is sufficient evidence of *bona fide* appropriation. See also *Thomas & Co Ltd v Whyte & Co Ltd* 1923 NPD 413 420-421.

In so far as the risk rule is concerned, it seems that the common law treated the sale *ad mensuram* to a large extent as a conditional sale.[410] Voet[411] states that in the case of a limited *genus* sale, such as the sale of some wine from a casket, the risk of destruction only passes on identification, but that the risk of deterioration in quality already passes on conclusion of the contract, unless the sale was made contingent on the right of approval. De Groot[412] also suggests that the risk for damage and deterioration may pass when the goods are not identified, but that the risk of destruction will only pass on identification. It is not clear whether he had a generic sale or a sale *ad mensuram* in mind.[413]

### (iii) The agreement must not be subject to a suspensive condition

Prior to fulfilment of a suspensive condition, the contract of sale is not *perfecta*.[414] In accordance with the common law, South African law merely suspends the operation of the obligation pending the fulfilment of a suspensive condition.[415] When the condition is fulfilled, the risk for destruction and deterioration passes to the buyer. If the goods are destroyed pending the fulfilment of the suspensive condition, the risk remains with the seller.[416] However, if the *merx* is damaged before the condition fulfils, the *merx* can still be delivered once the condition is fulfilled. This means that the risk for deterioration will fall on the buyer if the condition is fulfilled.[417] The risk is therefore split according to the fate of the *merx*.

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[410] Floyd 1995 (58) *THRHR* 469.
[411] 18 6 4.
[412] 3 14 35.
[413] Floyd 1995 (58) *THRHR* 468.
[414] *Schultz v Morton* 1918 TPD 343; *Fazi Booy v Short* 1882 2 EDC 301; *De Wet v Zeeman* 1989 2 SA 433 (NC).
[415] See *Tuckers Land & Development Corporation (Pty) Ltd v Strydom* 1984 1 SA 1 (A) and the criticism expressed against *Corondimas v Badat* 1946 AD 548, where the Appellate court held that a suspensive condition prevents the coming into existence of a sale until the condition is fulfilled.
[416] Pothier *Vente* 312 states that, if the thing is destroyed pending fulfilment of the condition, the risk falls on the seller even if the condition fulfils, since fulfilment cannot confirm the sale of something that no longer exists. However, this statement is sometimes criticised in so far as it does not take into consideration the retroactive effect of a fulfilled condition. See 3 3 2 4 *infra*.
[417] Kerr *LAWSA XXIV* para 124; Roberts (ed) *Wessels' Contract I* paras 1296, 1387; Floyd 1995 (58) *THRHR* 462; *Mulder v Van Eyk supra*; Voet 18 6 5; Pothier *Obl* 219. This is the result of the fulfilment of the condition, which renders the obligation *perfecta* with retroactive effect to the time of conclusion, resulting in the risk being allocated to the buyer as from conclusion of the contract. See *Tuckers Land & Development Corp v Strydom supra*; *Dharsey v Shelley* 1995 SA 58 (C) 64.

The explanation for splitting the risk of destruction and damage between the seller and the buyer is not always easy to understand and the various approaches are hard to reconcile. This reveals certain difficulties in South African law.[418]

According to one view, the principal factor when determining the risk in the event of a sale subject to a suspensive condition is whether the condition remains capable of fulfilment and whether it is in fact fulfilled. MacKeurtan[419] argues that loss or destruction of the *merx* renders the condition impossible of fulfilment and therefore the risk remains on the seller, whilst damage does not render the condition impossible of fulfilment. When the condition is fulfilled, the risk for deterioration passes onto the buyer with retroactive effect as from the conclusion of the contract.[420] Norman,[421] on the other hand, holds that, where the *merx* is destroyed, the condition can still be fulfilled if it is not dependent on the existence of the *merx*, but there will be no *merx* to sell. The risk will therefore fall on the seller. The common law also held that, if total loss occurred before fulfilment, the hope of an obligation ceases to exist when the destruction occurs.[422] If the *merx* is merely damaged but the condition fulfils, the risk of deterioration falls on the buyer as the agreement is rendered enforceable with restrospective effect to the time that the *merx* was still intact.

In the event of a resolutive condition, the sale is complete once the subject-matter and price is determined.[423] The risk therefore passes to the buyer and remains with the buyer if the condition fails.[424] If the *merx* is destroyed in the time pending fulfilment of the condition, the buyer will carry the loss because the condition is no longer capable of being fulfilled.[425] The risk of damage also remains on the buyer if the condition does not fulfil.[426] Should the condition fulfil, the contract is extinguished and restitution will take place.[427] But is the risk of loss or deterioration in value now

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[418] Lambiris "The incidence of risk in conditional sales" 1984 *SALJ* 656; Bauer *Periculum Emptoris* 205. See 3 3 2 4 *infra* for criticism on the splitting of risk in modern sales law.
[419] Hackwill *MacKeurtan's Sale of Goods* 180-181. Hamman *Risiko by die Koopkontrak* 240 holds the same view.
[420] See Lambiris 1984 *SALJ* 665 for criticism towards this argument. See also 3 3 2 4 *infra.*
[421] Zulman and Kairinos *Norman's Purchase and Sale* para 10 8 2; *De Groot Inl* 3 14 34, 3 14 35; Voet 18 6 5; *Fazi Booy v Short supra* 305; *Mulder v van Eyk supra* 207E-G.
[422] Kerr *LAWSA XXIV* para 124; *Inst* 3 15 4; Voet *Comm* 18 6 5; Pothier *Obl* 219; *Macduff & Co Ltd (in liq) v Johannesburg Consolidated Investment Company Ltd* 1924 AD 573 607.
[423] *Mnyandu v Mnyandu* 1964 1 SA 418 (N) 422 H.
[424] Voet 18 3 1; *Keyter v Barry's Executor* 1897 Buch 175; Zulman & Kairinos *Norman's Purchase and Sale* para 10 11 1; Kerr *Sale and Lease* 241.
[425] Mostert et al *Koopkontrak* 90; Hackwill *MacKeurtan's Sale of Goods* 182.
[426] Mostert et al *Koopkontrak* 90; Hackwill *MacKeurtan's Sale of Goods* 182.
[427] Mostert et al *Koopkontrak* 88-89. Kerr *Sale and Lease* 241 states that destruction of the *merx* may prevent fulfilment of the condition, which could affect restitution. He refers to an example of a painting

that of the seller or the buyer? There seems to be no agreement on this. One viewpoint is that the seller carries the risk of deterioration but the buyer that of loss;[428] another is that the risk of loss and damage is on the buyer and that he should compensate the seller;[429] whilst a third contends that the risk for both loss and damage is that of the seller.[430]

It should, however, be kept in mind that parties are always free to regulate the incidence of risk and thereby override the legal effect of the default rule. If the goods are then destroyed or damaged *pendente conditione*, the passing of risk will be regulated by the agreement of the parties.[431]

### 2 2 4 2 Contracts which involve the carriage of goods

South African law does not distinguish between contracts that involve carriage and so-called residual cases. Neither does it explicitly refer to sales in transit. The general rule, therefore, will apply to all these instances, unless the parties have agreed otherwise. In cases of ascertained goods, the contract can become *perfecta* even before the goods are handed over to the carrier.[432] That would mean that the risk passes to the buyer before he has direct or indirect physical possession of the goods and whilst they are still under the control of the seller.[433] In instances where the goods are not yet individualised, such as in the case of goods in kind, individualisation could take place when the goods are handed over to the carrier.[434] MacKeurtan,[435] however, argues that this depends on whether our law requires unilateral or bilateral appropriation of the goods to the contract. If the contract is unconditional or a suspensive condition has been fulfilled, the risk will pass to the buyer, provided of course that the price and the *merx* have been determined as well.

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being destroyed before the resolutive condition that is to be certified as an original, is fulfilled. The risk of loss remains with the buyer.

[428] Mostert et al *Koopkontrak* 90; Hamman *Risiko by die Koopkontrak* 251.

[429] Zulman & Kairinos *Norman's Purchase and Sale* para 10 11 2

[430] Hackwill *MacKeurtan's Sale of Goods* 182.

[431] Voet 18 6 5.

[432] *Stein & Hunter & Eckersley* 1893 7 HCG 4.

[433] Because ownership in movable goods passes through delivery of the goods (whether that is actual or symbolic delivery by means of handing over shipping documents) and the required intention to transfer and receive ownership in the goods, it may also happen that risk may pass before ownership passes. See Van Niekerk & Schulze *South African Law of International Trade* 55-60.

[434] *Montgomerie v Rand Produce Supply Co supra* 170. That is to say, if unilateral appropriations suffices. In an *obiter dictum* in *Stephen Fraser v Clydesdale Transvaal Colleries Ltd* 1903 TH 121, the court, however, adopted the English rule that, if the seller undertakes to deliver at a distant place, the seller assumes the risk of carriage since the carrier acts as the seller's agent.

[435] Hackwill *MacKeurtan's Sale of Goods* 195-198. See also the discussion on unilateral and bilateral appropriation 2 2 4 1 (ii) *supra.*

If the condition fulfils at a later stage, the question is whether the risk will pass retroactively to the conclusion of the contract or only to the moment that the condition is fulfilled. In pursuance of the common law authorities, it is believed that the risk of destruction will pass once the contract is *perfecta*, but that the risk of deterioration will pass with retroactive effect to the time of conclusion of the contract of sale.[436]

### 2 2 4 2 1 Shipment and destination contracts

Roman and Roman Dutch law do not refer to contracts that involve the carriage of goods. Van Leeuwen[437] is the only Roman-Dutch writer who refers to sales where the goods are to be transported to the buyer. It is his contention that if someone buys wine or wheat that are to be transported to the buyer, the risk of destruction falls on the seller if the goods are destroyed during the carriage. He does not specifically refer to instances where the wine or wheat deteriorates in quality.

Van Leeuwen holds that a sale which is dependent on an agreement to transport the goods is a conditional sale.[438] That would mean that if the goods are safely delivered to the buyer, he will carry the risk as the condition of carriage has been fulfilled. However, Floyd,[439] rightly points out that an agreement to transport the goods cannot constitute a suspensive condition, since the contract of sale is not dependent on the contract of carriage and is concluded beforehand. Hamman,[440] however, doubts whether Van Leeuwen meant the seller would carry the risk of destruction and deterioration of goods for the period that they are to be transported. It is Hamman's argument that Van Leeuwen either meant that the goods are sold under condition that they are safely delivered to their destination, or that the wine and wheat are still unspecified goods which only become specified on delivery to the buyer.

In *Jamieson & Co v Goodliffe*[441] the contract of sale contained a term that maize would be delivered to the Cape Town harbour, alternatively next to a certain vessel in

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[436] Lambiris 1984 *SALJ* 656. Zulman & Kairinos *Norman's Purchase and Sale* para 10 20 point out that, if the seller undertakes to deliver the goods himself, he will be liable for loss or damage if he did not exercise due diligence in transporting the goods. See *Western Produce v Cedarmont Store* 1929 TPD 741. It could also be argued that in these instances he undertakes the liability of a carrier for any damage to the goods that are conveyed. See *Stocks & Stocks (Pty) Ltd v TJ Daly & Sons (Pty) Ltd* 1979 3 SA 754 (A).
[437] *RHR* 4 17 2; *CF* 1 4 19 5.
[438] With reference to *C* 4 48 6; *D* 18 6 8.
[439] 1995 (58) *THRHR* 469.
[440] *Risiko by die Koopkontrak* 83.
[441] *Supra.*

Algoa Bay if the vessel could proceed to Algoa Bay in Port Elizabeth. Either way the goods were to be approved in Cape Town. The price was determined as 11s per 100lb duty paid, payable by draft at seven days with shipping documents attached. The vessel arrived in Cape Town with 400 tons on board. Two hundred tons were discharged and the purchasers approved the remaining 200 tons in terms of the contract. The sellers took out a bill of lading in their own name for the balance and the ship left for Port Elizabeth. The vessel went ashore and the maize was lost. The sellers sued on the draft and recovered the purchase price. The Court held that the words "to be delivered alongside the vessel in Algoa Bay" did not create a suspensive condition that had to be fulfilled before payment could take place.[442] According to Hamman,[443] the maize became specific goods when it was approved by the buyers in Cape Town and the risk therefore passed to them.[444]

The reasoning of the court in *Tiran v Eales & Harris*,[445] where the contract was also for the delivery of maize at the buyer's destination, indirectly supports the view that in respect of unascertained goods, the risk falls on the buyer during transit if the seller could prove that the shortage in goods was not due to the fault of the railways. On the facts, the court held that the railway acted as the agent of the seller.[446] No mention was made of Van Leeuwen, although Van Leeuwen's argument did have some influence on other early South African judgements.

In the case of *Birbeck & Rose-Innes v Hill*,[447] oil had to be transported CIF a German steamboat from New York to Cape Town. Due to the outbreak of the First World War the vessel was taken captive for an undetermined time. The seller sued for payment of the purchase price. With reference to Van Leeuwen,[448] Gardiner J held that the sale was concluded on the condition that the goods will be handed over in the port of destination on strength of the CIF term. During carriage, the seller carried the risk for

[442] 221-222, 225.
[443] *Risiko by die Koopkontrak* 265-268.
[444] Hackwill *MacKeurtan's Sale of Goods* 196 argues that on approval by the buyer, the appropriation became irrevocable. He is generally in favour of bilateral appropriation. On 198 he suggests that if the parties wanted to deviate from the ordinary risk rule, they should contractually have provided for the safe delivery of the goods to the destination or they should have subjected the sale to a suspensive condition to that effect. See also Mostert et al *Koopkontrak* 97. In *Horne v Hutt supra*, the court held that the risk rule can only be varied by clear and specific agreement and cannot be inferred from an undertaking that payment is to be made on delivery.
[445] 1916 CPD 529, approved in *Western Produce v Cedarmont Store supra.*
[446] The seller never proved the reason for the shortage. Nothing was directly said about the passing of risk, though.
[447] 1915 CPD 687 708-710.
[448] *CF* 1 4 19 5-8.

the safe arrival of the goods at their destination.[449] This decision is directly opposed to earlier decisions such as *Jamieson & Co v Goodliffe*,[450] where it was held that the buyer carried the risk of ascertained goods. The *Birbeck dictum* was subsequently criticised[451] and rejected.[452] The main point of criticism relates to the fact that the contract was concluded on a CIF term. In the case of a CIF sale, both parties consent that appropriation takes place on delivery of the goods to the ship. This means that the *merx* is determined, the contract *perfecta* and that risk passes to the buyer upon shipment.[453] Moreover, once the parties have agreed on a trade term, there is no need to refer to the default rule on risk to determine when risk passes. Under a CIF sale, risk will pass in accordance with trade practice which determines that risk transfers once the goods pass the ship's rail.[454]

Van Leeuwen's argument was also applied in *Montgomerie v Rand Produce Supply Co*,[455] which dealt with an FOR sale of maize *ad mensuram*. Delivery was to be "free on rail" at a station named and payment was to be made against railway consignment notes. Before being sent by rail, the maize became musty. Ward J's decision is based on the contention that the seller carried the risk at the time the maize became musty. On the basis of Van Leeuwen he argues that the risk is with the seller until the goods are delivered to the railways at the station named by the buyer together with the consignment notes. Until the goods are delivered the quantity is unknown. If the goods are destroyed before they are delivered to the railways, no obligation to pay can arise. Voet's exception, dealing with deterioration in value in the case of conditional sales, will only apply once the maize is delivered to the railways. Floyd[456] is of the view that the court applied the risk rule incorrectly as regards suspensive conditions. Van Leeuwen only referred to destruction and not to deterioration as such, and can therefore not be used in support of the court's argument. However, it should be pointed out that it is not necessary to make use of a suspensive condition construction when the parties have agreed on a trade term. The

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[449] De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 351 n 236 find it difficult to follow Gardiner J's reasoning since any condition would have been fulfilled when the seller paid the costs of insurance and carriage and handed the goods over to the carrier.
[450] *Supra*; *Stein & Hunter v Eckersley supra*; *Arkell and Douglas v Nourse* 1897 4 OR 435. Hamman *Risiko by die Koopkontrak* 272, 274; Floyd 1995 (58) *THRHR* 461 471.
[451] *Yamamoto v Rand Canvas Company* 1919 WLD 100 103; *Lockie v Epstein* 1921 EDL 154 157, 159-160.
[452] *Thomas & Co Ltd v Whyte & Co supra.*
[453] 418, 421 *et seq*.
[454] Tatham J in *Thomas & Co v Whyte & Co supra* argued that there is no difference between Roman Dutch law and English law when it comes to the passing of risk under a CIF contract. The same conclusion was reached in later decisions. *Cf Frank Wright (Pty) Ltd v Corticas "BCM" Ltd* 1948 4 SA 456 (C); *American Cotton Products Corporation v Felt and Tweeds Ltd* 1953 2 SA 753 (N).
[455] *Supra* 170-171.
[456] 1995 (58) *THRHR* 472.

trade term supersedes the default rule on risk and will determine when risk passes to the buyer.[457]

The mere fact that the seller undertakes to deliver the goods at a particular place does not mean that the seller carries the risk until delivery at that place.[458] Risk can pass to the buyer before the time of delivery once the contract becomes *perfecta*. However, under influence of English law, the South African case law has on occasion also confused and merged the notions of delivery and passing of risk.[459] Although risk of accidental destruction or damage often passes before delivery, the seller still has a duty to care for the goods until delivery. The place of delivery is determined contractually, and where it involves carriage, it often entails that delivery will take place at a port of shipment, a railway station or an airport. Normally parties agree on a trade term to regulate the place of delivery as well as the passing of risk. In these instances the parties agree to deviate from the normal rules on risk contractually.[460]

What follows, is a discussion of the South African law in regard to trade terms, with specific reference to FOB and CIF contracts.

### (i) FOB contracts

The South African case law on FOB terms hardly discusses the issue of risk.[461] It mainly focuses on the duty to deliver and the costs connected to delivery. A seller who undertakes to deliver goods free on board is responsible for the cost of

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[457] De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 351 n 236 are also of the opinion that an FOR sale cannot constitute a conditional sale since it is not clear what the condition is in a case such as *Montgomerie supra.* Zulman & Kairinos *Norman's Purchase and Sale* para 10 20 3 argue that the court's inference of an agreement varying the risk rule is doubtful, especially in light of *Horne v Hutt supra*, where it was held that it can only be done by clear and specific agreement.

[458] Hamman *Risiko by die Koopkontrak* 273-275; De Wet & Van Wyk *Suid-Afrikaanse Kontraktereg I* 351. Zulman & Kairinos *Norman's Purchase and Sale* para 10 20 indicate that where the seller undertakes the duty of delivery at a place other than that of sale or manufacture, it does not *per se* affect the rules on the passing of risk, except that the seller assumes the duty of a carrier and is therefore judged according to the standards of care applied to a carrier.

[459] *Stephen Fraser & Co v Clydesdale Transvaal Colleries Ltd supra*. However, this notion was corrected at the next opportunity in *Tiran v Eales & Harris supra* where the case dealt with similar facts.

[460] Hamman *Risiko by die Koopkontrak* 276.

[461] Van Niekerk & Schulze *South African Law of International Trade* 57 state that in the case of an FOB sale of specified goods, risk generally passes when the contract is concluded, or in the case of unascertained goods, as soon as they are appropriated and the contract becomes perfect. Although this is the default common law position on risk in South African law, it does not apply to FOB contracts as such. Trade terms constitute a contractual deviation from the default position on risk, resulting in risk being regulated by trade usage. This deviation does not merely take place when the parties have agreed on INCOTERMS, as the writers suggest. The agreement to deviate from the common law rule is signified by the incorporation of the FOB trade term, independent of a reference to INCOTERMS.

transporting the goods to the ship and putting them on board.[462] In *Poort Sugar Planters (Pty) Ltd v Umfolozi Co-operative Sugar Planters Ltd*,[463] the Appellate Court held, on the facts of that particular case, that the word "free" in the term "free at loading point" denotes that "all expenses in getting the cane to the 'loading point'[464] must be borne by the grower". Under a standard FOB sale, delivery is effected by the seller when the *merx* "crosses the rail, that is to say when it is loaded aboard the vessel on which it is to be shipped."[465] In *Anderson & Coltman Ltd v Universal Trading Co*,[466] it was held that delivery "into the ship" in accordance with the contract constitutes delivery to the buyer's agent. Normally, the buyer under an FOB sale is liable for the freight and for the making of the contract of carriage, although the seller may often do so on his behalf on reasonable terms. Under these circumstances the carrier of the *merx* is the agent of the buyer.[467] The seller must give the buyer notice of the shipment in order for the latter to insure the goods if such insurance is usual in the trade in question.[468]

It is also possible to deviate contractually from the normal consequences of the FOB term. A seller can reserve transfer of possession, for example by taking the bill of lading for his own order. This situation formed part of the facts of *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola.*[469] In this case, Corbett JA (as he then was) had to consider whether ownership had passed from the seller to the buyer and, therefore, when delivery of possession took place. The sale in this particular case was for maize to be delivered "free on board unstowed and untrimmed the vessel presented by the buyer". The contract, furthermore, provided that a bill of lading would be proof of delivery and that risk would pass on delivery. Corbett JA held that, since the contract provided for the bill of lading to be taken to the order of the seller, delivery did not take place when the maize was loaded aboard the vessel as is normally the case in FOB sales. Delivery could not take place until the bill of lading was handed over, duly endorsed in blank, by the seller to the buyer's bank. Transfer of the bill of lading would represent symbolic delivery of possession to the buyer, divesting the seller of control and relinquishing his *animus possidendi.* Transfer of risk

[462] Kahn et al "Sale" in *Principles of the Law of Sale & Lease* 42. The purchaser is obliged to name the ship, unless the clause refers to a particular port rather than a ship. *Cf Murray & Co v Stephan Bros* 1917 AD 243.
[463] 1960 3 SA 585 (A) 596.
[464] The Court held that the words "free at loading point" meant "free on rail at Candover".
[465] *Chong Sun Wood Products Pty Ltd v K & T Trading Ltd & anor* 2001 2 SA 651 (D) 656.
[466] 1948 1 SA 1277 (W) 1281. It was also held that ownership passed on delivery as the price was already paid.
[467] *Tiran v Eales & Harris supra*.
[468] *Arkell & Douglas v Nourse supra*.
[469] 1976 4 SA 464 (A) 491-496.

would therefore also be postponed until delivery takes place. However, for cases where the parties have not agreed otherwise, this case confirms the general legal position that delivery takes place when the goods are delivered on board the vessel and that risk will pass at that time.

All expenses up to and including shipment, fall within the price quoted FOB.[470] However, even here certain deviations from the standard norm are apparent. In the case of *Patensie Sitrus Behered Bpk v Competition Commission*,[471] Selikowitz JA referred to the calculation of the price received by citrus producers when exporting their crop abroad. The learned judge defined the FOB costs in this particular context as "[t]he costs of shipping, handling, storage, loading and insurance from the point of intake until the fruit is loaded into the ship or aeroplane"[472] where it was to be received by a marketing agent. In this case, unlike FOB sales in general, the seller remained liable for sea or air freight as well as import duties and so-called "overseas costs", which include clearance, storage and cooling costs as well as transportation to the point of sale. Risk also did not pass on shipment, as is normally the case. The reason for such deviation is to be found in the fact that in this particular case there was no contract of sale between the producers and the marketing agent. The agent only acted on behalf of the producer to market its produce abroad. It is therefore understandable that the producer carried the risk even beyond the point where the marketing agent received the goods at the port or airport.[473] Insurance costs are normally not part of the seller's obligations, but in light of the facts of this case, it is also understandable that the producer will insure the fruit as they are not sold yet. Although the observations made by the judge of appeal in connection with the FOB term are merely *obiter dicta*, since the matter mainly dealt with an appeal against an order of the Competition Tribunal, it might at the same time be an indication that in the export trade of citrus fruit, the understanding of the FOB term may deviate from the general understanding of the term, to the extent that it may even contain more characteristics of a CIF sale. Apart from that, it appears that in this specific type of trade, the term is not used as a trade or delivery term that regulates the point where delivery takes place and risk transfers, but merely as a price term, indicating the

[470] In the case of a seller who undertakes to deliver goods free on rail, he has to place them in railway trucks at his or her own risk and cost. By using an analogous interpretation to the term "free on rail", it can be concluded that under an FOB contract, South African law requires the seller to bear the costs of loading the goods on board the vessel. *M Leviseur & Co v Friedman* 1922 OPD 182; *Gibson v Arnold & Co (Pty) Ltd* 1949 4 SA 541 (T).
[471] 2003 6 SA 474 (CAC).
[472] 486.
[473] It should also be noted that FOB terms should not be used for carriage by air since they are aimed at maritime transport.

costs to be borne by the seller until loading onto the means of international transportation. The court's reasoning would therefore not present any authority for the legal position on the passing of risk under FOB terms.

In summary, it can be concluded that the case law on FOB terms is relatively scarce in South Africa and that references to these terms are mostly *obiter*. The majority of reported cases deal with passing of ownership,[474] or the buyer's obligation to name the vessel,[475] whilst others merely refer to the price of the goods sold as an FOB price, without really discussing the obligations of the parties or the content of the trade term.[476] Many of the cases rely on English authorities, which indicate that the courts lean strongly on English law when it comes to FOB terms.[477] It also appears from the cases that the FOB term is sometimes used in connection with other modes of transport, apart from its standard use in maritime transport.[478]

### (ii) CIF contracts

South African courts give effect to the CIF term "broadly in conformity with its nature under English law."[479] It is said that the nature of the CIF contract "is firmly established by commercial usage".[480] The ordinary obligations of the seller are: (1) to ship the goods at the port of shipment in accordance with the contract; (2) to procure a contract of affreightment for delivery of the goods at the agreed destination; (3) to arrange insurance for the goods; (4) to invoice the goods to the buyer; and (5) to

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[474] *Anderson & Coltman Ltd v Universal Trading Co supra; Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola supra; Chong Sun Wood Products Pty Ltd v K & T Trading Ltd supra.* Usually risk and ownership do not pass simultaneously under a FOB sale, but may do so in exceptional cases. The agreement of the parties will be the decisive factor in every case. See also Van Niekerk & Schulze *South African Law of International Trade* 57-58.

[475] *Veneta Mineraria Spa v Carolina Colleries (Pty) Ltd* 1985 3 SA 633 (D).

[476] *Nuclear Fuels Corporation of SA (Pty) Ltd v Orda AG* 1996 4 SA 1190 (A); *EBN Trading (Pty) Ltd v Commissioner of Customs and Excise* 2001 2 SA 1210 (SCA); *Patensie Sitrus Behered Bpk v Competition Commission supra.*

[477] *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola supra; Poort Sugar Planters (Pty) Ltd v Umfolozi Cooperative Sugar Planters Ltd supra.*

[478] *Cf Patensie Sitrus Behered Bpk v Competition Commission supra.*

[479] Per Corbett JA in *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola and ors supra* 491. See also in this regard *Juta & Co Ltd v Rorich* 1924 TPD 730 737; *Thomas & Co Ltd v Whyte & Co Ltd supra* 421. The facts of *Savage & Lovemore Mining (Pty) Ltd v International Shipping Co (Pty) Ltd* 1987 2 SA 149 (W) show that the parties can elect to have a trade term defined by means of INCOTERMS. In this particular case the goods were sold C&F Rotterdam and the contract expressly indicated that the term would have the meaning assigned to it under INCOTERMS 1980, a copy of which was attached to the contract. The court merely referred to this aspect in its exposition of the facts. INCOTERMS played no role in the outcome of the case as the dispute dealt with a discrepancy between the description of the goods in the contract of sale and that in the shipping documents.

[480] As per Searle J in *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 463-464; *Chattanooga Tufters Supply Co v Chenille Corp of SA (Pty) Ltd* 1974 2 SA 10 (E).

tender to the buyer as soon as is reasonably possible after shipment, the documents in a valid and effective condition.[481] These essential features of a CIF contract are derived from mercantile custom in so far as they are not varied by agreement of the parties, through business practices established between the parties or by usage of a particular trade.[482]

In *Thomas & Co Ltd v Whyte & Co Ltd*,[483] the court declined the view expressed in the *Birbeck* judgement referred to above[484] and held that in a CIF contract the risk passed as soon as appropriation of the goods took place on shipment. More recent South African cases do not refer to the obligation of delivery as being completed when the goods are delivered to the ship or when they cross the ship's rail. The majority of cases concentrate on the concept of constructive delivery by means of delivery of the shipping documents such as the bill of lading to the buyer or the buyer's agent.[485] The seller's obligation is considered to be performed on delivery of the documents and not by the actual physical delivery of the goods.[486] Failure to deliver the shipping documents constitutes breach of contract, entitling the buyer to a claim for damages. As for the place of tender of the documents; the obligation is to deliver at the place of the buyer unless the parties have agreed otherwise, or if the place is determined by trade usage or a course of business which exists between the parties.[487] Because the risk of loss or damage is covered by insurance, this aspect is generally not discussed by the South African case law.[488] Risk is separated from ownership. Whilst risk passes upon shipment of the goods, ownership only passes on delivery of the bill of lading against acceptance of the bill of exchange or payment of the contract price.[489]

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[481] *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 464.
[482] 463-464.
[483] *Supra* 422.
[484] 2 2 4 2 1 *supra*.
[485] *Garavelli and Figli v Gollach and Gomperts (Pty) Ltd* 1959 1 SA 816 (W) 821; *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 464; *Thomas & Co v Whyte & Co supra*; *Standard Bank of SA Ltd v Efroiken & Newman* 924 AD 171 190; *Lockie Bros v Epstein supra*.
[486] *Chattanooga Tufters Supply v Chenille Corp of SA supra* with reference to *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 463-464.
[487] *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 463; *Chattanooga Tufters Supply Co v Chenille Corp of SA supra* 15.
[488] This aspect was considered to be immaterial on the facts of the case in *Frank Wright (Pty) Ltd v Corticas 'BCM' Ltd supra* 464.
[489] *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola supra* 492-493; *Barlows Tractor & Machinery Co v Oceanair (Transvaal) (Pty) Ltd* 1978 3 SA 175 (W); *American Cotton Products Corp v Felt & Tweeds supra.* See also *Van Niekerk & Schulze South African Law of International Trade* 59-60.

### 2 2 4 2 2 Residual cases

In all other cases which do not involve the carriage of goods, such as where the buyer is to collect the goods, the general rule on risk applies, namely that risk is transferred once the sale is perfected. In the case of ascertained goods, application of this rule can result in the risk passing before the buyer is in possession of the goods; that is, whilst he is not yet in control of the goods. Normally the parties will provide for the passing of risk through agreement or by means of a trade term or other trade practice or usage.

### 2 2 4 2 3 Sales in transit

Sales in transit are also regulated by the general rule. Since these types of sales normally involve the sale of fungibles, the requirement of individualisation will be the biggest stumbling block. When goods which are separately stowed in separate holds or containers are sold during transit, the contract will be *perfecta*, as the goods would be identified when delivered to the carrier; provided of course that the price is determined and the sale unconditional. In other instances, the passing of risk is deferred until the moment of physical delivery to the buyer to satisfy the requirement of identification and individualisation. If all the requirements for the sale becoming perfected are met before the sale in transit is concluded, risk passes to the buyer on conclusion of the contract for the sale in transit. Under South African law, if the contract was perfected at conclusion, the buyer would, for all practical purposes, carry the risk of damage or destruction as from the moment the goods are delivered to the carrier for the duration of their carriage, simply because he will be unable to prove whether the goods were undamaged at the time his particular contract of sale was concluded. If the contract is subject to a suspensive condition, the double risk rule will distinguish between destruction and damage. However, because sales in transit present problems in establishing when the loss or damage occurred during the transit, it means that the buyer will be saddled with both types of risk if the condition fulfils.

Because the parties are free to deviate from the risk rule by agreement, risk can pass at any point as mutually agreed on. In most cases, the contract will be regulated by a trade term, such as CIF, which normally places the risk on the buyer as from shipment. It is said that in instances of sales in transit, the risk cannot pass as from

shipment as there was still no contract of sale at the time when the goods were loaded on board. A specific act of appropriation is acquired for the risk to pass, which can be found in the seller's notification to the buyer of the ship's name on which the goods are being carried. As from that moment the buyer will carry the risk. Where the goods form part of a larger bulk, the buyers will carry the risk proportionally. [490]

### 2 2 4 2 4 Cases that involve breach by one of the parties

In the event of *mora debitoris* where the seller fails to deliver the goods, the risk will remain with the seller, excluding risk for disasters that would have struck the goods even if they were delivered in time.[491] The same applies to cases of *mora creditoris*, where the seller fails to co-operate to make payment possible. If the buyer falls into *mora debitoris* for failure to pay or into *mora creditoris* as a result of his failure to take delivery of the goods, he will carry the risk. *Mora creditoris* on the side of the buyer lowers the duty of care of the seller from *culpa levis* to fraud and gross negligence.[492]

[490] Hamman *Risiko by die Koopkontrak* 287-288. Mostert *et al Koopkontrak* agrees that the buyer carries the risk from the moment the ship was named, even when the goods were not individualised at that moment.

[491] These are the typical *vis maior* situations. Voet 18 6 2; Grotius 3 14 34; Pother *Vente* 58; Lotz "Purchase and Sale" in *Southern Cross* 373; Zulman & Kairinos *Norman's Purchase and Sale* para 10 18 1.

[492] Pothier *Vente* 55; De Groot *Inl* 3 14 34; Van Leeuwen *RHR* 4 17 2; *CF* 1 4 19 5; Voet 18 6 2; Lotz "Purchase and Sale" in *Southern Cross* 373; Zulman & Kairinos *Norman's Purchase and Sale* para 10 18 2; Hackwill *MacKeurtan's Sale of Goods* 180.

# CHAPTER THREE
# EVALUATING NATIONAL RISK OF LOSS APPROACHES

## 3 1 Introduction

National risk regimes take on one of three fundamental premises as their point of departure, namely that risk passes on the conclusion of the contract, the transfer of ownership or the transfer of possession.[1] English law links transfer of risk to transfer of ownership, whilst American and German law focus on the transfer of possession. The South African risk rule is unique inasmuch as it remains true to its romanistic origins. It is important to realise that although these models originated in trade conditions that were completely different from those that exist today,[2] they continue to find application to this day. This raises the question whether they are still able to meet the modern realities of international trade and requires that the adequacy and efficacy of national risk regimes be evaluated against the needs of modern day international sales.

## 3 2 Scholarly opinion on the risk rule in international context

Roth[3] points out that domestic legislation and other legal rules are so seriously outdated and removed from commercial reality that there is a need for a practical orientation to the legal provisions on risk.[4] This is evident from the fact that it becomes more and more necessary for judges to attempt to determine speculative and non-existent states of mind in order to secure an effective and satisfactory result. Under English law, for example, the courts frequently have to displace the statutory provision linking the passing of risk to property by inferring a contrary intention of the

[1] Von Hoffmann "Passing of Risk in International Sales of Goods" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 265 267-269; Schmitthoff "The Risk of Loss in Transit in International Sales" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 277. Even though they are identified as three separate theories or models, they tend to overlap inasmuch as the characteristics they display are all related.

[2] Enderlein & Maskow *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods* (1992) 255; Schmitthoff "Risk of Loss in Transit" in *Select Essays* 278 argues that international sales often deal with unascertained or generic goods where the traditional theories do not apply.

[3] "The Passing of Risk" 1979 (27) *Am J Comp L* 291 293.

[4] *Cf* De Vries "The Passing of Risk in International Sales under the Vienna Sales Convention 1980 as compared with Traditional Trade Terms" 1982 (17) *Eur Trans L* 495 496; Goldštajn "Usages of Trade and Other Autonomous Rules of International Trade According to the UN (1980) Sales Convention" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 55 60.

parties.[5] Ernst Rabel[6] shared the same sentiments almost a century ago when he suggested that it was time to abandon the "awful relics from the dead past."

In practice, most international sales are regulated by trade terms,[7] which once again show that parties elect to deviate from the standard rule. Scholarly opinion holds that this practice in itself is a clear indication that merchants do not believe that the traditional theories as embodied in the national risk regimes are suitable for modern commercial practice.[8] The three traditional models, namely conclusion of the contract, passing of ownership and physical possession of the goods can be criticised for various reasons.

From the point of view of an international sale, the conclusion of the contract is unsuitable for allocating the passing of risk. In general, international contracts are distance sales relating to non-specific or unascertained goods. At the time the contract is concluded the goods are often not identified or even manufactured and, therefore, incapable of being delivered to the buyer at conclusion of the contract.[9] Even if the seller has control over the goods, it is not desirable that the buyer has to bear the risk for goods that are not under his control. This could lead to serious disputes and litigation where the buyer could always argue that the seller did not exercise due diligence in protecting the goods from danger.[10]

A model linking transfer of risk to the transfer of ownership is not practical either. It is in conflict with what happens in practice, especially in the context of international sales. At conclusion of the contract, the seller might not be the owner of the goods sold to the buyer. Moreover, in the international context goods are often sold a number of times while they are in transit, which makes physical delivery impossible at the moment of conclusion of the contract. The rationale for this theory is that the transfer of risk is a sanction for the tardiness of the buyer in collecting the goods.[11] However, one can only blame the buyer for not taking immediate possession of the purchased goods if the seller has ownership and if he can acquire physical

[5] Roth 1979 (27) *Am J Comp L* 293. He claims that the same situation applies in the case of the BGB.
[6] "The Hague Conference on the Unification of Sales Law" 1952 (1) *Am J Comp L* 58 61.
[7] Goodfriend "After the Damage is Done: Risk of Loss Under the United Nations Convention on Contracts for the International Sale of Goods" 1984 (22) *Colum J Trans L* 575 578. See 7 1 *infra*.
[8] Enderlein & Maskow *International Sales Law* 256.
[9] 255.
[10] Valioti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000* LL M thesis Kent (2003) http://cisg3.law.pace.edu/cisg/biblio/valioti.html (accessed 01-04-2009) ch 1 C (iii).
[11] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 270.

possession of the goods at the date of the contract. This model is only suitable in those situations where the seller is already the owner or has control over the goods and, therefore, inappropriate as basis for a general default rule applicable to a number of different situations. Furthermore, tying the passing of risk to passing of ownership is inappropriate for international sales because the moment of passing of ownership is subject to a widely divergent range of regimes in various countries. Moreover, passing of ownership entails legal, political, ideological and security considerations which do not necessarily apply to the passing of risk.[12] Since the policy considerations underlying risk and ownership are completely different, it would be highly artificial to link passing of risk to passing of ownership.

The theory, furthermore, does not correspond to practices in the sale of goods whereby the seller maintains ownership over the goods while the goods are in the possession of the buyer. In these instances the seller will bear the risk of the goods that are under the control of the buyer, which is an undesirable state that could lead to much litigation.[13]

Linking risk allocation to physical possession is considered to be the most fair and reasonable model. The party in possession is usually also the one who is in the better position to protect the goods against damage or to sue for damages. He is also the party who is insured or at least can obtain insurance easily. It therefore makes sense that he should also bear the risk.[14]

Linking passing of risk with delivery of possession has been praised by several authors, but it has also been criticised for practical and theoretical reasons. Although this policy could be suitable for a simplified model of a sales contract, it has been said that it is not very helpful in so far as international sales involving the carriage of goods are concerned. During the time of carriage neither the seller nor the buyer is in physical possession of the goods; only the carrier is. It seems at first glance to be unfair for the buyer to carry the risk from the time that the goods are delivered to the carrier, given that the goods are neither under his direct control nor that of the seller.[15] It has been suggested that the general criterion of risk allocation rather has

[12] Enderlein & Maskow *International Sales Law* 255. The issue of passing of ownership is so delicate and intricate that the drafters of the CISG could not obtain consensus on a unified rule regulating the passing of ownership and therefore decided to omit this topic from the scope of the Convention.
[13] Valioti *Passing of Risk* text following upon n 63.
[14] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 269-270; Valioti *Passing of Risk* text accompanying n 66.
[15] Valioti *Passing of Risk* paragraph preceding n 67.

to be adapted to the transport situation.[16] Allocating risk to the party contractually bound to pay the cost of transportation is one possibility.[17] However, in general, this does not provide a suitable solution because it neither corresponds with contractual nor commercial practice. If the parties agreed that the buyer would repay the seller for carriage and insurance expenses and the buyer would assume the risk during carriage, such an obligation can be very onerous for the buyer. He would not be able to calculate the costs in advance and would therefore not know whether the seller charged him an unreasonably high fee. Often sellers are able to negotiate discount rates with carriers and insurers, which makes it more advantageous for a buyer to shift the burden of payment of transport and insurance costs to the seller. If a seller would then also have to assume the additional burden of carrying the risk during carriage, it would discourage sellers from accepting the obligation of paying for carriage and insurance. Commercial usage in the form of the CIF trade term, for example, dissociates the passing of risk from the obligation to pay transport costs, which underlines the inability of this theory to keep up with commercial practice.[18]

The main theoretical argument against a link between delivery and risk is that the concept of delivery may be used for the solution of different legal issues and that such an approach disregards the fact that different policies may rule different issues. Using the same concept in different senses, renders it abstract, complex and impractical.[19] The use of "delivery" in the 1965 Hague Sales Laws illustrates this point.[20] Under this law, delivery was used to refer to the performance of the seller's obligations, which at the same time requires that conforming goods should be delivered (article 30).[21] It is also used to indicate when risk passes from seller to buyer (article 97(1)); the date of payment of the purchase price (article 71) and the moment of identification of unascertained goods to the contract. A theory connecting the passing of risk to delivery could be a viable solution, provided that the concept of delivery is well defined, only focuses on control of the goods and does not include issues that do not relate to the notion of risk.

[16] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 272-273.
[17] This had been the rule of the US Uniform Sales Act, § 19(5), before the UCC came into force.
[18] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 273-275.
[19] 275-276.
[20] Secretary-General UNCITRAL *Recommendations on Pending Questions UNCITRAL Yearbook Volume VI Doc A(10)(b*) paras 201-205 in Honnold *Documentary History of the Uniform Law for International Sales* (1989) 233-234.
[21] Under some domestic systems, such as for example the English and French laws on sale, delivery also entails the handing over of conforming goods.

Another view is to link the passing of risk to the handover of transport documents, because the seller who keeps the transport documents in hand reserves control over the goods. The buyer only obtains control of the goods when he receives the transport documents. However, linking the passing of risk to the surrender of documents can give rise to practical difficulties, especially if it is not clear when the damage to the goods occurred. Determining this moment exactly is a typical difficulty associated with international sales, especially when the goods are containerised and the damage is only discovered on arrival at their destination. Once again commercial practice indicates its opposition to such an approach as the CIF term, for instance, separates the passing of risk from the handing over of transport documents.[22]

Scholarly opinion accordingly concludes that an effective international risk rule should not be formulated with reference to traditional concepts or theories. Trade terms show that commercial practice has accepted none of the traditional theories of risk. In the international context, default rules on risk should be regulated according to an autonomous approach which is aimed at addressing trade requirements and the commercial needs of international sales.[23] Enderlein and Maskow[24] suggest that the risk rule should meet the needs of the modern day trade situation, without being burdened by the interests and ideologies of different national legal systems. In the same vein, Goodfriend[25] requires that risk of loss rules should be "clear, predictable, efficient and equitable" and "consonant with contemporary international trade practices". Oberman[26] states that "the unwritten rules of commerce dictated … effective and efficient rules" that should be clear and coherent. Roth[27] is of the opinion that an effective international risk rule should be practically oriented and based on commercial practices and reflect the most common intentions of parties to an international contract of sale. It should also be certain and clear in its formulation to ensure legal certainty and predictability without being static and inflexible.

These requirements will now be discussed in more detail.

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[22] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 277-278.
[23] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 296-298. Schmitthoff "Risk of Loss in Transit" in *Select Essays* 278. For a contrary opinion, see Rosett "Unification, Harmonization, Restatement, Codification, and Reform in International Commercial Law" 1992 (40) *Am J Comp L* 683 687.
[24] *International Sales Law* 256-257.
[25] 1984 (22) *Colum J Transnat'l L* 577, 605.
[26] *Transfer of risk from seller to buyer in international commercial contracts: A comparative analysis of risk allocation under the CISG, UCC and INCOTERMS* LL M thesis Laval (1997) http://www.cisg.law.pace.edu/cisg/thesis/Oberman.html (accessed 25-02-2009) text accompanying n 5.
[27] 1979 (27) *Am J Comp L* 292-294.

### 3 2 1 Considerations of efficiency

Risk manifests itself in accidental happenings for which none of the parties can be blamed, and the question is whether it ought to be legally allocated to one or other of the parties under a risk regime. There is a view that the risk rule should not so much serve the purpose of equity as that it should be useful,[28] that is that the rule should be "advantageous", "profitable" or "beneficial".[29] "Usefulness", therefore, implies the most cost effective result for both the seller and buyer, which can be equated to the notion of efficiency.

In the commercial context, efficiency can be defined as "the goal to minimize the costs of negotiating, performing and enforcing exchanges and to maximize the net gains realized by both parties."[30] This definition is based on the economic theory of law, which suggests that an efficient legal rule is one that involves the lowest transaction costs. Although an economic analysis of the problem of risk does not constitute the main focus of this study, an international transaction is in the first instance a financial endeavour.[31] The limitation of transaction costs is therefore an important aspect that needs to be kept in mind when drafting a commercial contract or formulating a rule that is to regulate a commercial transaction.

Against this background Stocks[32] is of the view that the risk-allocating rule should attempt to reduce individual bargaining and to place liability on the party generally perceived to be "in the best position to prevent avoidable losses." The goal of reducing avoidable losses is based on the assumption that the cost of prevention will be less than the value of the goods saved. The goal therefore is to formulate a default rule that places the risk on the party best equipped to deal with the loss.[33]

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[28] Enderlein & Maskow *International Sales Law* 256.

[29] According to the definition provided by the *Oxford Electronic Dictionary (OED Online)* http://dictionary.oed.com.ez.sun.ac (accessed 30-10-2009).

[30] Speidel "Revising article 2: Some Emerging Problems" 1991 *Com L Ann* 51 53-54. See also the discussion on economic efficiency 1 2 1 *supra*.

[31] See 1 2 1 *supra*.

[32] "Risk of Loss under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods: A Comparative Analysis and Proposed Revision of UCC Sections 2-509 and 2-510" 1993 (87) *Nw UL Rev* 1446. See also, Note "Risk of Loss in Commercial Transactions: Efficiency Thrown into the Breach" 1979 (65) *Va L Rev* 557 560.

[33] For Stocks 1993 (87) *Nw UL Rev* 1415 1446, efficiency also includes so-called "efficient breaching behaviour". The default rule should provide for the possibility of breach if such breach entails that resources are diverted to their most valuable uses. If the breaching party can compensate the injured party and still accrue benefits for himself, the rule is considered to be efficient. This means that the breaching party should only absorb the actual costs of the breach. See also, Note 1979 (65) *Va L Rev* 560-561.

De Vries[34] believes that in international trade the point where risk passes is not a matter of principle, but rather a matter of expediency in relation to the duties undertaken by either party in respect of the carriage envisaged.[35] "Expediency" refers to the suitability of the rule in a given situation. De Vries links the suitability of the rule to the party who is in the best position to hold the carrier responsible for loss or damage to the goods. It is his argument that international commercial practices, as generally evidenced by trade terms, indicate that in most cases where the seller undertakes to arrange for carriage, it is expedient that the seller continues to bear the risk during the transportation and therefore during the time that the carrier is responsible towards the seller.[36] Stocks[37] also places emphasis on the carriage aspect. He suggests that an appropriate risk of loss rule should be easily identifiable with reference to the type of commercial situation involved. The risk rule should therefore distinguish between shipment, destination and residual contracts.

An effective and efficient risk rule should also be oriented towards the requirements of trade in general. Policy considerations require that a useful allocation of risk in the international context consists of balancing the respective inconveniences of the buyer and seller.[38] Three distinctive criteria that should function as underlying trade requirements for an effective international risk rule are identified:[39]

Firstly, the rule governing the passing of risk should be applied in such a way that the party who is best placed to have the goods in safekeeping or who can exercise control[40] over them is the one to bear the risk. That person is usually best equipped

[34] 1982 (17) *Eur Trans L* 512-515.
[35] On 514 he states that "as a rule passing of the risk is, in international trade, closely related with two points of view, viz first: whether the seller is no longer to be made responsible for completing his part in the arrangements to be made so as to ensure the goods to be forwarded, and second: which one of the parties is best placed to make the carrier answerable and to expedite onward carriage." In general, care of the goods is entrusted to the carrier, whose obligations are undertaken towards the shipper. The shipper is able to institute a action for damages against the carrier if the goods are damaged or lost during carriage due to the carrier's negligence.
[36] Exceptions are the CIF and CIP terms, where the risk transfers on shipment. However, under the CIF and CIP terms, the shipper's claim towards the carrier is available to any holder of the bill of lading. There is therefore no need to keep the seller burdened with the risk of the goods. See De Vries 1982 (17) *Eur Trans L* 513-514, as well as the discussion on the development of trade terms 1 3 2 *supra*.
[37] 1993 (87) *Nw UL Rev* 1448.
[38] Letting the seller suffer the loss would make the transaction with the insurance company more difficult. First of all the seller has to be informed of the damage by the buyer and then has to recover the damage from the insurance company, which not only complicates the process but can also delay it. See Enderlein & Maskow *International Sales Law* 256; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 298.
[39] Enderlein & Maskow *International Sales Law* 257-258.
[40] Control can mean physical possession of the goods, the power to take possession upon demand, or the power to direct shipping arrangements.

to protect the goods or to save them from imminent danger, and has an incentive to do so if he bears the risk.

A second criterion is that the risk be borne by the party who can insure the goods most easily and less expensively and is in the most favourable position to submit an insurance claim. The party who has the goods in safekeeping or has control over them is normally that person and will also be the least-cost insurer.[41] In situations where a third party, in particular a storekeeper or a carrier, has the goods in safekeeping, Enderlein and Maskow[42] suggests that the entire course of transportation, or at least parts of it which are clearly delimitable, should be covered by one insurance policy to ensure the possibility of control over and safekeeping of the goods while they are on their way.

The third criterion refers to the ability to assert claims against a carrier. The party who receives the goods from the carrier is best equipped to salvage the goods and institute the insurance claim. The buyer will be in possession of a bill of lading which will entitle him to a claim against the carrier if such bill does not bear a clause or notation which declares the apparent condition of the goods defective but is presented as a clean bill of lading. Therefore, the main question concerning risk allocation is whether it is easier for the seller or the buyer to claim compensation for loss and damage from the insurance company. Where goods are to be transported, the buyer is usually the first person to discover transit damage and he is, therefore, in the better position to assess damage and to institute a claim against the carrier or insurer.[43]

The policy considerations referred to above dictate that the buyer would be in the best position to carry the burden of transit risk. Moreover, commercial practice

[41] Stocks 1993 (87) *Nw UL Rev* 1440 suggests that a survey of risk of loss and insurance practices in various commercial settings is needed to prove that the party in control is in fact the least cost-insurer. Because such a survey is not practical in the context of a study such as this, it is necessary to evaluate this assumption with reference to other factors. In order to do this, Stocks applies an argument based on economic sensibility, which reduces transaction costs. The person in control of the goods is likely to have more accurate information concerning the conditions under which they are being held. The accuracy of such information and the ease with which it can be collected should therefore translate into lower insurance costs.

[42] *International Sales Law* 257-258.

[43] Honnold "Risk of Loss" in Galston & Smit (eds) *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (1984) para 8 02 (b); Honnold *Uniform Law for International Sales under the 1980 United Nations Convention* 3rd ed (1999) para 367; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 297.

accords with this rule inasmuch as the shipment terms also place the risk of casualty during carriage on the buyer.[44]

In addition to the above stated criteria, there is general agreement between scholars that the risk should not pass during transit and therefore that risk should also not be split between seller and buyer during transit.[45] Changes in the traditional modes of transportation have made it increasingly difficult to specify the point at which damage occurs. Cargo sealed in containers may be damaged at any point in a multimodal transportation chain. Damage to goods inside the container through water seepage, improper stowage or temperature variations cannot be pinpointed in time if they occur in a sealed container. When the risk is split between the seller and buyer at some point during transit and it is impossible to determine precisely when damage occurred, it could mean that the buyer will carry the risk for damage or loss that occurred at a time when the goods were not under his control but still under that of the seller.[46] That could lead to inequitable results and be counter-productive to the efficiency of the contract. Policy considerations, therefore, dictate that risk should not be split and should rather remain on one party for the entire duration of the journey.

A related policy consideration is to avoid holding the buyer responsible for damage or loss that occurred too far back in the transportation chain, especially to a time when the goods were still effectively under the seller's control.[47] A similar situation could occur in a "chain transaction" in the form of a documentary sale. In these instances goods are sold a couple of times whilst in transit.[48] Although risk technically only passes to the end buyer when he concludes his particular contract of sale or takes delivery of the transport document, the goods could still have been damaged at an earlier stage of the carriage and the end buyer will have to carry the risk for that as well. Goodfriend[49] points out that any legal rule specifying a point in time when risk will pass between the time goods are loaded into a container by the seller and the time they are unloaded by the buyer, may disadvantage the buyer. For all practical

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[44] Honnold *Uniform Law* para 367.
[45] Nicholas "Article 67" in Bianca & Bonell (eds) *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (1987) para 3 1.
[46] Goodfriend 1984 (22) *Colum J Transnat'l L* 579-580; See Valioti *Passing of Risk* text accompanying n 292.
[47] Goodfriend 1984 (22) *Colum J Transnat'l L* 580.
[48] See Bridge "The 1973 Mississippi Floods: 'Force Majeure' and Export Prohibition" in McKendrick (ed) *Force Majeure and Frustration of Contract* 2nd ed (1995) 287 288-290 for a general discussion on how the GAFTA 100 standard contract, concluded on the basis of a CIF term, functions as a chain or string contract.
[49] 1984 *Colum J Trans L* 579-580, 589. See also Nicholas "Article 67" in *Bianca & Bonell Commentary* para 3 1.

purposes the risk of loss will be left on the buyer for the entire period of carriage. Although policy considerations indicate that the buyer is usually in the better position to institute the insurance claim and salvage the goods, and that it is prudent not to split the risk, it is also not equitable to hold a party liable for damage that occurred at a time before it assumed responsibility for the risk.

Although the stated requirements seem sound and reflect valuable policy considerations, it should be kept in mind that they were formulated a few decades ago. Do these norms still reflect modern commercial practices or are they synonymous with trade patterns of earlier times?[50] The types of goods involved in international trade and the modes of their carriage have changed significantly in the last couple of decades. International trade used to be dominated by bulk shipments of minerals, oil and other natural resources and raw materials. Today international sales involve different types of goods, which include perishable agricultural goods such as fresh fruit, vegetables, wine and flowers, as well as electronic and other high-technology equipment for industrial and business purposes. The different types of goods increase the forms in which damage can materialise during transportation. The question is how these aspects may influence the policy considerations underlying the risk rule.

Honnold[51] is of the view that a policy placing the risk on the buyer because he is the best person to determine the damage and salvage the goods, is efficient and cost effective in the case of the traditional type of international sale, which consists of raw materials such as bales of jute or hemp. When these types of goods are damaged by sea-water, the buyer can sort out and salvage or dispose of the damaged goods. To place the burden of transit risk on the buyer makes sense in such a context. However, when it comes to high-technology equipment which is damaged in transit, other policy considerations apply. Repair may require replacement parts and techniques that only the seller can supply. Moreover, control of transit damage for delicate machinery depends on the adequacy of the seller's packing and packaging. Honnold suggests that in these types of sales, a case can be made out for placing the responsibility for transit damage on the seller.

[50] Honnold "Risk of Loss" in *International Sales* para 8 02 (b).
[51] Para 8 02 (b).

Enderlein and Maskow,[52] however, reject this argument. They contend that the consideration as to who is best able to repair the goods should be of no relevance in determining the passing of risk. Moreover, it is not viable for a uniform risk rule applicable to international sales law to go beyond a general default rule. Although different types of goods may require different measures, variations in the risk rule that caters for different types of goods will complicate matters unnecessarily and vitiate simplicity and certainty. These situations can be adequately addressed through party agreements that provide for special circumstances.[53]

Multimodal and container transport situations are characterised by conflicting policy and factual concerns. Ordinarily the buyer is in the better position to deal with the damage. To place transit risk on the buyer is especially efficient in the context of container transport. It makes sense to place the risk of loss on the party who is in the best position both to institute insurance claims and to salvage what may be useful of the damaged goods. The additional advantage of this approach is that there is no need to establish the precise moment when the damage occurred, which is nearly impossible where the goods are containerised.[54] The negative side to this approach, however, is that the buyer is not in physical control of the goods during transit and therefore not in the position to protect them against dangers.

Goodfriend,[55] on the other hand, argues that it would make more sense to leave these risks on the seller. Transaction costs can be reduced by the seller obtaining blanket policies for all shipments of goods, rather than each buyer carrying individual policies for each transaction. By minimising the insurance component in the costs of goods, loss is allocated in the most cost-effective manner. However, this argument violates established commercial patterns and practices and should be rejected. A consideration of trade terms reveals that commercial custom and practice favour placing transit risk on the buyer.[56] Under the traditional CIF term, the seller's price includes the freight but the risk of casualty during carriage is still on the buyer. Even under more modern INCOTERMS such as CIP and CPT, which reflect modern

[52] *International Sales Law* 258.
[53] See Honnold *Uniform Law* para 368 2 for comments on so-called "hi-tech" goods and contract drafting.
[54] Valioti *Passing of Risk* text accompanying nn 290 & 291.
[55] 1984 (22) *Colum J Transnat'l L* n 20.
[56] Honnold *Uniform Law* para 367.

transport and containerisation practices, the buyer bears all risks for goods after they are delivered into the custody of the first carrier.[57]

### 3 2 2 Reflecting common intentions of the parties

An effective and efficient default rule on risk should conform to the parties' common assumptions or intentions as reflected in the term upon which most parties would have agreed in a negotiated agreement. If a default rule reflects the common intentions of both parties it can minimise unnecessary bargaining and thereby reduce transaction costs and increase efficiency.[58]

### 3 2 3 Certainty, clarity and predictability

Goodfriend[59] identifies clarity and predictability as requirements for an effective risk of loss rule. Stocks[60] also measures the efficiency of a risk of loss rule with reference to the extent that it serves the goal of clarity. Clarity avoids uncertainty, which can prevent inefficiencies. It reduces the need for the parties to incur transaction costs in negotiating and drafting a risk rule in an attempt to reduce uncertainty. Even though a rule reflects sound policy considerations it could still fail the efficiency test if it is drafted in an unnecessarily technical fashion, devoid of clarity and predictability. To realise the practical policies underlying a rule, an efficient risk rule should therefore not be unduly technical in its formulation.[61]

Clarity could also facilitate the performance of the contract. Stocks[62] links clarity to what he calls the "administrability" of a rule. This refers to the opportunity to understand and apply a particular rule with ease. If risk is allocated clearly, the parties will know who bears the risk at any given moment. When a problem arises, the risk of loss provisions can be applied to sort out the legal obligations of the parties, thus saving time and potential litigation costs. Predictability of the possible

[57] A4, A5 clauses. In the case of the CIF and CIP terms, the seller has an obligation to take out minimum insurance coverage on the goods.
[58] Stocks 1993 (87) *Nw UL Rev* 1445-1446; Roth 1979 (27) *Am J Comp L* 293; Note 1979 (65) *Va L Rev* 558-559; Ayres & Gertner "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" 1987 (99) *Yale LJ* 87 89-90.
[59] 1984 (22) *Colum J Transnat'l L* 577, 605.
[60] 1993 (87) *Nw UL Rev* 1445
[61] Roth 1979 (27) *Am J Comp L* 293-294; Goodfriend 1984 (22) *Colum J Transnat'l L* 605.
[62] 1993 (87) *Nw UL Rev* 1448.

outcome of litigation can also reduce the likelihood that litigation will occur in the first place. Furthermore, the less uncertainty is generated by a provision, the easier it is to apply the rule. Once again, this may contribute to the reduction of transaction costs and therefore to the overall efficiency of the transaction.

## 3 3 Evaluating national risk regimes

### 3 3 1 Criteria for evaluation

After having discussed the requirements for an effective international risk rule, it becomes clear that these requirements largely repeat the general features of an effective international sales law regime as identified and discussed in Chapter One.[63]

Firstly; "considerations of efficiency" refer to aspects that are capable of influencing the efficiency of a transaction, such as usefulness, expediency, international commercial practices and policy considerations of international trade. These aspects correspond directly with the need that international sales law should be regulated by efficient default rules[64] which accommodate mercantile custom and trade usage and are cognisant of commercial realities.[65]

Secondly; scholars require that an effective default risk rule should reflect the most commonly occurring intentions of the parties to international sales contracts. This conforms to the need that international sales law should minimise transaction costs by providing effective default rules of substantive law that reflect the most likely outcome had the parties negotiated on the issue.[66]

Thirdly; certainty, clarity and predictability of legal rules are requirements for both an efficient international sales law regime and an effective international risk rule.[67]

It is, therefore, appropriate to apply the needs of international sales law, as identified by this study, as criteria for evaluating the efficiency of the national risk rules discussed in Chapter Two.

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[63] *Cf* 1 2 *supra.*
[64] *Cf* 1 2 1 *supra.*
[65] *Cf* 1 2 3 *supra.*
[66] *Cf* 1 2 1 *supra.*
[67] *Cf* 1 2 2 *supra.*

### 3 3 2 Evaluation

#### 3 3 2 1 English law

In English law, risk generally passes when ownership is transferred. The property rule is unsatisfactory in the first instance because in many cases it is difficult to state with precision when property has passed.[68] The discussion of the English risk rule in Chapter Two[69] showed that the passing of property depends on the circumstances of the case and the intention of the parties to the contract. This, in turn, is determined with reference to a range of rules aimed at ascertaining such intention. This method often amounts to an arbitrary shifting of risk.

Secondly, policy considerations indicate possession and control as important criteria that should be taken into consideration when regulating the legal aspects of international sales. Once property has passed to the buyer, the buyer must pay the price if the goods are damaged or destroyed without fault on the part of the seller, even though the buyer neither took possession nor was entitled to it. Moreover, the English rule on risk is not consistent in its application of the property rule as a criterion for the passing of risk. English law distinguishes between consumer and non-consumer sales. Whilst non-consumer sales are regulated by the property rule, risk passes on delivery in the case of consumer sales.[70] Atiyah[71] opines that the latter rule "seems eminently sensible, as it is likely to accord … with the need for a clear rule as to when risk has passed." This statement indicates that the traditional risk rule is not always clear and easy to understand. A further "exception" to the ownership rule exists in cases of non-consumer sales where the goods are transported by a carrier. As the goods are considered to be unconditionally appropriated to the contract when they are delivered to the carrier without reservation of the right of disposal, property and risk may pass on delivery to such carrier.[72] This rule is linked to the rule in section 32(1) SGA 1979, which states that delivery to the carrier is *prima facie* deemed to be delivery to the buyer. The rules of section 32 were

[68] Grewal "Risk of Loss in Goods Sold in Transit: A Comparative Study of the UN Convention on Contracts for the International Sale of Goods, the UCC and the British Sale of Goods Act" 1991 (14) *Loy LA Int'l & Comp LJ* 93 113-114. See also 3 2 *supra* where it is indicated that a model which links risk to ownership is unsuitable for international sales.
[69] 2 2 1 *supra*.
[70] S 22(4) SGA 1979. This distinction was introduced by the EEC Sale and Supply of Goods Consumer Regulations of 2002.
[71] *The Sale of Goods* 11th ed (2005) 359.
[72] S 18 Rule 5(2) SGA 1979.

developed in the context of commercial sales,[73] which present further evidence that the connection of property and risk does not function effectively in all situations and that there is a need for a different approach when it comes to commercial transactions.

Because the English risk rule amounts to a basic rule qualified by a range of "exceptions," it can be confusing for an international trader who is not familiar with English law. In this respect the risk rule suffers from a serious defect inasmuch as it creates uncertainty where certainty is crucially important. A lack of clarity creates problems in performing and enforcing the contract, which means that the rule is not administrable in a cost-effective way.

Under modern conditions the risk of accidental destruction is normally covered by insurance. This study has found that in modern international trade, the question of who should bear the risk should be connected to who should be required to insure the goods.[74] The property rule places the risk of loss on the party least likely to insure[75] and it is therefore doubtful whether it is always the right or best solution. Such a rule is clearly in conflict with policy considerations requiring that the person in possession or control is the one best placed to insure the goods. In the case of commercial or bulk sales, where possession and ownership are often separated because of a reservation of title, the party with physical possession, and not the owner, would be the appropriate person to insure. In practice, that is also the person who is insured in most instances. However, commercial practice may rebut the *prima facie* presumption that the person in possession, such as a carrier for example, should insure.[76] In a typical CIF sale, risk transfers on shipment irrespective of whether ownership passes or not. The seller has to take out basic insurance cover on the goods up to delivery at the port of destination in both events. The same applies to FOB contracts, where risk and property generally transfer on shipment. The problems linked to passing the ship's rail often make it difficult to determine when risk passes and who has to insure the goods. Although there is no general duty on the seller to insure the goods under an FOB term, modern commercial practice requires that the seller should insure the goods to protect his interest should the

[73] Atiyah et al *Sale of Goods* 360.
[74] 3 2 1 *supra.*
[75] Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 93 114; Goode *Commercial Law* 3rd ed (2004) 242.
[76] Atiyah et al *Sale of Goods* 358.

goods be lost or damaged during transportation and the buyer failed to do so.[77] There is therefore no clear indication that commercial practice links the duty to insure to ownership or to physical possession or control. What it does indicate, though, is that commercial practice separates the transfer of property from the transfer of risk.

The inadequacy of this approach is furthermore evidenced by the fact that the courts often have to adjust the basic rule to provide a solution in line with commercial reality and expectations.[78] Problems which prevent the passing of property can affect the question of risk. The courts, therefore, have acknowledged situations where the risk can pass before the passing of ownership, even in the absence of agreement in that regard. The best example is *Sterns Ltd v Vickers Ltd.*[79] The defendants in this case sold to the plaintiffs 120 000 gallons of spirit, which was part of a total quantity of 200 000 gallons in a storage tank belonging to a third party. The plaintiffs obtained a delivery order which the third party accepted. For their own convenience the plaintiffs left the spirit in the tank for the time being. The spirit deteriorated in quality between the sale and the time the plaintiffs took delivery. In English law, a delivery order does not qualify as a transport document which relinquishes the right of disposal.[80] The Court of Appeals, however, held that risk did pass to the buyers. In *The Julia*[81] the court approved this principle and stated that, where the buyer is considered to have "an immediate and practical interest in the goods," such as in the case of the acceptance of a delivery order, risk will pass without property passing at the same time.

The *Sterns* case raised many issues which are closely related to the difficulties regarding the passing of property. At the time the case was heard, a sale of an unidentified part of a bulk could not be treated as passing property under English law. Section 16 SGA prevented the passing of property until the goods were ascertained. Although property could technically not pass, the goods for all practical purposes belonged to the buyers. Acceptance of the delivery warrant was the crucial factor here since it gave the buyer a right to possession. The buyers elected to keep the spirit in the storage tank for their own convenience. This was not a case where the seller failed or neglected to identify the goods from the bulk. Neither was it a situation

[77] Ademuni-Odeke "Insurance of FOB Contracts in Anglo-American and Common Law Jurisdictions Revisited: the Wider Picture" 2007 (31) *Tul Mar LJ* 425.
[78] Goode *Commercial Law* 246-248.
[79] [1923] 1 KB 78.
[80] Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 116.
[81] Per Lord Normand in *Comptoir d'Achat et de Vente du Boerenbond Belge SA v Luis de Ridder Limitada (The Julia*) [1949] AC 293 319.

where it is fair to hold the seller still responsible to safeguard the goods. In a situation such as this, the buyer should arrange to keep the goods safe. It seems commercially desirable that they should be treated as being at the buyers' risk, as the court indeed held, since delivery of the goods entails the transfer of control.

The Sale of Goods (Amendment) Act 1995 amended the law so that property in an undivided share can now pass before ascertainment of the goods if it is a sale of a specified quantity; the bulk is identified; and the buyer had paid for some or all of it.[82] Although the amendment clarified the law in regard to the sale of unascertained goods forming part of an identified bulk and the sale of undivided shares in goods, it still does not address all the problems of the English risk rule. It does not address the consequences of the loss, destruction, damage to or deterioration of a part of a bulk consignment only. If the seller sold shares amounting to the whole of the bulk, the logical result would be that each buyer will share the risk *pro rata* to the extent of his share in the bulk. However, where the seller has agreed to sell only part of the bulk, the situation is more intricate. Benjamin[83] suggests that it depends on the percentage of the bulk that remains unscathed and whether that is sufficient to satisfy the buyer's claim. If the damage or loss affects a greater quantity than the buyer's share, the buyer would have to pay the full contract price but would only be entitled to the remainder of the goods. On the other hand, when property in the goods has already passed to him, it is possible to argue that the buyer should carry the risk *pro rata* to his share in the undivided goods. It therefore seems that there is no clear solution to this problem.

Despite the amendment, the basic link between risk and ownership still remains, which is not suitable to the commercial realities of international sales where ownership often does not pass with the transfer of control or possession. For example, in the case of a reservation-of-title clause or a seller obtaining a bill of lading in his own name or that of his order, property and risk will not transfer on delivery to the carrier, which means that the seller will carry the risk of goods which are no longer in his possession. Courts often have to infer an intention that the

[82] S 20A SGA 1979. Guest "Risk and Frustration" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) para 6-006 points out that, strictly speaking, property can only pass when the goods are separated from the bulk or appropriated to the contract. S 20A merely provides for property in an undivided share and does not provide sole property until the bulk is divided. It could therefore be argued that risk only passes when sole property is transferred. If the entire bulk is not damaged or deteriorated but lost or destroyed, it could also be argued that the doctrine of frustration should apply, in which case an apportionment of the loss is to be awarded under the Law Reform (Frustrated Contracts) Act 1943. It is his contention that the courts will mostly follow the principle developed in *Sterns v Vickers supra*.
[83] Guest "Risk and Frustration" in *Benjamin's Sale* para 6-008.

parties wanted to depart from the basic risk rule merely to secure an effective and satisfactory result. In many cases this will be an imputed rather than a tacit intention. That in itself is contrary to the notion of a contract being the expression of a mutual bargain. Moreover, a rule which is in need of interpretation does not enhance clarity and legal certainty and is not a reflection of the usual intention of the parties to the contract; both of which were identified as requirements for an efficient rule on risk. If the law needs to provide exceptions to the ownership model to address the needs of commercial practice, such as when goods are to be transported by carrier, why cling to ownership as the basic point of departure for determining the passing of risk?

A further point of criticism is that section 33 SGA splits the risk of deterioration between the seller and the buyer in instances where the seller undertakes to deliver the goods to the buyer at his own risk and the deterioration is "necessarily incident to the course of transit". This provision does not cover cases where deterioration is caused by the defective condition of the goods. Policy considerations informing international trade normally militate against the splitting of risk. It has been asked whether it is necessary to have a separate ruling in regard to deterioration, whilst the issue is in any event mostly addressed with reference to whether the seller has continuously warranted the condition of the goods.[84] Destination sales form a significant portion of international sales and apart from undermining policy considerations which are firmly opposed to splitting of risk, it complicates matters as it entails an investigation into the nature and the cause of deterioration. Moreover, this provision places the buyer at a disadvantage.[85] Whilst the point of departure of this provision is that the seller undertakes to deliver the goods at his own risk, why the need to differentiate between different types of deterioration in determining his liability if this was his own choice to accept liability? The fact that this provision provides for qualification by means of party agreement might be interpreted as an acknowledgement of its prejudice towards the buyer.

Under English law, the interrelation of the doctrines of passing of risk and frustration tends to complicate matters even further.[86] Especially in the context of specific and

[84] Atiyah et al *Sale of Goods* 357.
[85] Ademuni-Odeke 2007 (31) *Tul Mar LJ* 439-440.
[86] Both doctrines deal with the accidental destruction or deterioration of the *merx* subsequently to the conclusion of the contract. Under English common law, a contract for the sale of specific goods may be frustrated by an event which destroys the basis of the contract and radically alters the obligations of the parties, provided that the event occurs before property and risk pass to the buyer. A failure of consideration or an implied term that the contract will be frustrated if its purpose is not achieved, will suffice. See Guest "Risk and Frustration" in *Benjamin's Sale* para 6-034; Atiyah et al *The Sale of Goods* 11th ed (2005) 361-362.

unascertained goods the distinction is very difficult to draw. The Sale of Goods Act 1979 fails to make any distinction between different types of unascertained goods and tends to cover merely generic goods.[87] This aspect contributes to the lack in certainty and clarity.

Finally, it is important to note that in most instances parties elect to deviate from the default rule by concluding their contracts on the basis of a trade term. The discussion on trade terms under English law[88] showed that commercial practice separates the notion of property transfer from the transfer of risk. This means that commercial practice does not indicate any need for such a connection. The use of trade terms, furthermore, indicates the inadequacy of the default rule inasmuch as it does not reflect the most common intention of the parties had they had the opportunity to negotiate the aspect of passing of risk. An effective and efficient default rule should be able to provide legal certainty and reduce transaction costs, which the English rule generally does not succeed in doing.

#### 3 3 2 2 American law

Section 2-509 of the Uniform Commercial Code generally adheres to the policy considerations of control and the correlation between control and insurance. The underlying theory of this section is therefore in conformity with common commercial and insurance practice.[89] In essence, the party in control of the goods bears the risk of loss. In American law, control can mean physical possession of the goods, the power to take possession upon demand, or the power to direct shipping arrangements.[90] The assumption is that the party who is in control is in the best position to protect the goods and to avoid loss and, in most cases, is also the least-cost insurer. A merchant who is to make physical delivery at his own place of business continues to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely

[87] Generally, the sale of generic goods cannot be frustrated, but if the parties have contracted on specific generic goods, such as agreeing to sell a crop to be grown on a specific field, the contract can be frustrated if the crop is destroyed. See *Howell v Coupland* (1896) 1 QBD 258; Guest "Risk and Frustration" in *Benjamin's Sale* para 6-041.
[88] See 2 2 1 1 (i) & (ii) *supra*.
[89] Official Comment 1 to s 2-509 (2003).
[90] Stocks 1993 (87) *Nw UL Rev* 1440.

unlikely that he will carry insurance on goods not yet in his possession.[91] Therefore section 2-509 reduces avoidable losses by providing incentives to parties to protect goods at the least cost.[92]

However, in section 2-510 UCC the underlying assumptions of control and insurance are replaced by a policy based on breach. This provision has been criticised on numerous occasions.[93] There is no justification for the switch, aside from the notion that it is unfair for the injured party to bear the risk of loss. Firstly, the rule is inconsistent with the general underlying policy of section 2-509. It places the risk on someone who does not have possession or control and who would be least likely to insure.[94] The need to prevent economic loss does not diminish upon the other party's breach. The underlying assumptions of control and insurance give parties the proper incentives to treat even damaged goods with care, thus minimising overall loss. These policy considerations should dictate the risk rule in the event of breach as well.[95]

Section 2-510 is furthermore problematic because it favours the seller. Under section 2-510(2), the seller is only responsible for making up the deficiency in the buyer's insurance coverage. Thus, to the extent that a seller is aware that the buyer has insurance, the seller has an incentive to ship goods with known latent defects or to renege on a promise to cure defects without paying the full cost of the breach. In addition, section 2-510(3) does not provide that the buyer only absorbs the actual costs of the breach. If the buyer breaches the contract before the risk of loss has passed to him, this provision places the risk of loss on the buyer for a commercially reasonable time to the extent of any deficiency in the seller's insurance coverage. Thus, the buyer must consider not only the costs associated with the risk of loss for a reasonable time beyond the agreed delivery date, but also the additional risks associated with destruction of the goods prior to that time.[96]

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[91] Comment 3 to s 2-509 (2001). According to Stocks 1993 (87) *Nw UL Rev* 1440, 1449 this assumption on insurance makes economic sense as the party who is in control is likely to have the most accurate information on the conditions under which the goods are kept.
[92] He can take precautions that the goods are properly stored and he can insure against their loss. Stocks 1993 (87) *Nw UL Rev* 1449.
[93] Rusch "The Relevance of Evolving Domestic and International Law on Contracts in the Classroom: Assumptions about Assent 1998 (72) *Tul L Rev* 2043 2071.
[94] White & Summers *Uniform Commercial Code I* 265.
[95] During the revision process, the 1997 draft proposed an amendment to the provision on breach so that it could be tailored more closely with policy considerations. However, these proposals did not make it to the final draft. See Rusch 1998 (72) *Tul L Rev* 2071-2073.
[96] Stocks 1993 (87) *Nw UL Rev* 1442, 1449; Note 1979 (65) *Va L Rev* 570-571.

For the most part, however, risk allocations conform to those which the parties would have agreed to had they negotiated on them, and to reflect the underlying assumptions of control and insurance. In the case of shipment contracts, risk passes on delivery to the carrier, whilst in the case of destination contracts, it passes when the goods are tendered to the buyer to enable him to take possession. In both cases it is reasonable to assume that the buyer would have arranged to insure the goods from the time that the seller completes his performance. The same applies for the bailee situation. Once the buyer obtains a document of title or receives notice from the bailee that he may pick up the goods, the buyer is empowered to take possession upon demand and is in control of the goods. The possible exception is that of the non-merchant seller and a non-merchant buyer in the case where the seller sends the goods in his own vehicle or the buyer is to pick up the goods from the seller's place of business. Section 2-509(3) UCC (2001) places the risk of loss on the non-merchant seller until his tender of delivery to the buyer. This rule has been criticised. It would be more reasonable if the risk of loss is to remain on the seller who is in control of the goods until the buyer receives them. The position was adjusted by the 2003 revision when the distinction between merchant and non-merchant seller was eliminated. Risk now passes on receipt, regardless of the status of the seller.

Except for a few ambiguities and a lack of definitions for concepts such as "carrier" and "bailee", commentators agree that, in general, section 2-509 UCC allocates risk and indicates the consequences of bearing risk clearly. The rules provide for different situations of transportation, which make it relatively easy to determine which risk of loss rule applies to a particular situation. It, therefore, satisfies the requirement of clarity. The UCC provisions have generated much less litigation than their predecessors,[97] which may be an indication of their general efficiency. The 2003 revision also endeavours to clarify some of the problems that existed under the old version such as clarifying the position of the acknowledgement given by the bailee to the buyer in respect of his right to possession and removing the differentiation between merchants and non-merchants in the context of the residual rule. However, uncertainty as to whether a seller who retains possession of the goods after tendering the goods to the buyer, can qualify as a bailee, still remains.

One definite shortcoming when it comes to international sales, is the fact that section 2-509 fails to allocate risk of loss when goods are sold in transit. This aspect is still

[97] Stocks 1993 (87) *Nw UL Rev* 1448-1449.

not addressed by the 2003 revision. Sales in transit count for a significant number of international transactions. An effective and efficient risk of loss regime should, therefore, provide clear and effective rules for regulating sales in transit.

Section 2-509 UCC, furthermore, underwrites the contractual approach which permits parties to deviate from the standard rule when it seems appropriate to do so.[98] Parties are allowed to regulate the passing of risk through agreement or by means of trade terms. Hence, party autonomy and flexibility form part of the cornerstones of the American risk rule. The possibility of deviating from the default rule by means of trade terms acknowledges the value of mercantile custom and trade usage. However, the 2003 revision of Article 2 brought a major change for purposes of the risk rule by eliminating the statutory trade term definitions contained in sections 2-319 through to 2-324 of the previous version. The rationale for eliminating these terms is that statutory definitions of trade terms in commercial codes, sales law statutes or conventions become archaic and out of step with the realities of modern commercial practices, both domestic and international.[99] New developments in commercial practice necessitate that trade terms definitions are adapted and amended on a constant basis to reflect the developments in technology, containerisation and transportation methods. In addition, it is often necessary to create new terms to cater for new situations and circumstances. The statutory terms defined in the UCC (2001) are primarily associated with water-borne traffic and do not include terms associated with air freight, containerisation or multi-modal transportation practices.[100] If trade term definitions are contained in statutory law, it necessitates the amendment of such laws from time to time to keep up with developments in international commerce. This can be a long and often complicated process. For practical reasons it is, therefore, not prudent to include these definitions in general sales law statutes. Seeing that the CISG was used as a basis for the 2003 revision of the UCC, it is not surprising to find that trade term definitions have been deleted from the Code, since the same reasons for their elimination precluded the inclusion of trade term definitions in the CISG.[101]

[98] Official Comment 1 to s 2-509 (2001) stated that the theory underlying this section is the acceptance of the contractual approach rather than the arbitrary shifting of risk with the property in the goods, which had been the case under the UCC's predecessor, the Uniform Sales Act.
[99] Rusch "Is the Saga of the Uniform Commercial Code Article 2 Revisions Over? A brief look at what NCCUSL finally approved" 2003 (6) *Del L Rev* 41 61; Rusch 1998 (72) *Tul L Rev* 2064; McLaughlin & Cohen "Summarizing Key revisions to UCC Article 2" 7/9/2003 *NYLJ* 3 (col 1).
[100] Folsom *International Business Transactions I* 2nd ed (2002) 114, 116.
[101] Rusch 1998 (72) *Tul L Rev* 2062-2063.

However, the down-side to this argument is the lack of certainty and predictability that arise in the absence of clear and precise statutory definitions.[102] It is submitted that once trade terms are no longer defined by the provisions of the Uniform Commercial Code, the point of reference for their content and meaning will shift to either a course of dealing between the parties or a usage of trade in that specific branch of the trade. The official codified definitions represent mercantile customs and practices as they are known and regularly observed within the United States. These practices will remain and will develop as time goes on, despite the elimination of the statutory definitions. Moreover, American courts[103] have on more than one occasion held that INCOTERMS constitute international usage in the sense of article 9(2) CISG. By means of analogy, it is possible to argue that in the absence of express statutory definitions, trade terms will be interpreted in accordance with INCOTERMS, especially in the context of international sales. This argument is further supported by the fact that the other source of trade term definitions in American law, the American Revised Foreign Trade Definitions (1941), is gradually being replaced by INCOTERMS.[104] In the absence of codified trade term definitions, the status of INCOTERMS could be elevated to that of an unofficial but principal source of trade term standardisation.[105]

#### 3 3 2 3 German law

The BGB also follows the model of control and possession. The point of departure in German law is that risk passes when identified goods are handed over to the buyer. Section 446 places great emphasis on control or direct possession. When the goods are to be transported, a distinction should be made between contracts that provide for the goods to be delivered to the buyer (so-called destination sales or

[102] At the time of its drafting, the law of sale in the United States was very confusing and Article 2 of the UCC sought to achieve some clarity and certainty. White & Summers *Uniform Commercial Code* 248-259.

[103] CLOUT Case No 447 (*St Paul Guardian Insurance Co et al v Neuromed Medical Systems & Support et al* 2002 WL 465312 (SD NY 2002), judgment aff'd, 53 Fed Appx 173 (2d Cir 2002), 2002 US Dist LEXIS 5096) http://cisgw3.law.pace.edu/cases/020326u1.html (accessed 20-08-2009); CLOUT Case No 575 (*BP Oil International Ltd v Empresa Estatal Petroleos De Ecuador* 332 F 3d 333 (5th Cir 2003) 338, 200 ALR Fed 771, Federal Appellate Court [5th Circuit] United States 11 June 2003) http://cisgw3.law.pace.edu/cases/030611u.html (accessed 21-08-2009); *China North Chemical Industries Corp v Beston Chemical Corp* 2006 WL 295396 (SD Tex 2006) US Federal District Court Texas 7 February 2006 http://cisgw3.law.pace.edu/cases/060207u1.html (accessed 02-06-2009).

[104] Frécon "Practical Considerations in Drafting FOB Terms in International Sales" 1986 (3) *Int'l Tax & Bus Law* 346 n 4.

[105] Spanogle "INCOTERMS and UCC Article 2 - Conflicts and Confusions" 1997 (31) *Int'l L* 111 131-132 states that INCOTERMS are much closer to current commercial practices in the United States than the UCC definitions. He suggests that INCOTERMS can be used as a source of guidance for courts until the American transport industry develops a statement of customary meanings of commercial terms.

*Bringschulden*) and cases where at the request of the buyer the goods are forwarded to a place other than the usual or the agreed upon place of delivery (shipment sales or *Schickschulden*). In the former case, risk will only transfer on handing over the goods to the buyer under section 446 BGB, whilst in the latter case, section 447 provides that risk passes on delivery to the carrier. The ratio for the risk rule lies in the general idea of allocating risk to the person who has the goods in custody. As the person in control is also the one who is able to insure the goods and institute any claims for loss or damage, the German risk rules are generally based on sound policy considerations.

However, the efficiency of the German risk rule may be questioned on other grounds. The application of sections 446 and 447 BGB is not always very clear and may give rise to uncertainty and problems of interpretation, especially for someone who is not well versed in German law. The BGB provides no clear division between contracts which provide for carriage of the goods and those that do not. Even if the seller is to transport the goods by a carrier to a particular destination, the general rule on risk, namely that risk passes on handing over the goods to the buyer in terms of section 446, applies.

The application of section 447, on the other hand, is dependent on the post-contractual request of the buyer to deviate from the contractual place of performance by forwarding the goods to another place as the stipulated place of performance. At first glance this provision is not easy to understand, which may influence its efficiency adversely. It presupposes a basic comprehension of the concept “place of performance”. Although this is the place where the seller’s delivery obligation is to be fulfilled, it is not necessarily the place where the goods are to be handed to the buyer. In the absence of party agreement or trade usage, the place of performance will be deemed to be the residence or place of business of the seller.[106] This implies that the buyer will collect the goods or arrange for carriage of the goods to his place. As the seller is normally not under a duty to forward the goods to the buyer, he should therefore not be burdened by the transport risk; hence the “exception” of section 447 when the goods are to be forwarded to another place at the request of the buyer.

[106] S 269 BGB.

Despite some criticism and proposals that the provision should have been repealed, the revision of the BGB brought no change to the wording of this provision apart from removing consumer goods from the ambit of section 447; the result being that risk in these goods will pass on them being handed over to the buyer.

Moreover, there is uncertainty as to whether section 447 will apply when goods are dispatched from another place as the place of performance, such as from the place of manufacture or from a warehouse. The prevailing view seems to be that it will be the case if the forwarding takes place at the request of the buyer. Uncertainty also exists as to whether risk will transfer under section 447 when the goods are being transported by the seller's own staff and not by an independent carrier.

When it comes to sales in transit, matters are no less complicated. There is no specific provision which provides for sales in transit. A distinction is made between floating and rolling goods. Since the goods are already in the process of being transported, the carriage is not undertaken on the request of the buyer and section 447 could therefore not apply. These cases should therefore be dealt with under the residual rule of section 446. The discussion of the German risk rule indicated that the rules pertaining to sales in transit are to a large extent interpreted and developed through case law. The courts tend to apply section 447 to rolling goods by means of a process of analogy. However, the logic of this process is not easy to understand if one takes into consideration that this type of transportation situation is based on the same underlying conditions of a so-called *Bringschuld* which is regulated by section 446. Moreover, in the case of both rolling and floating goods, risk does not pass until the bill of lading is handed to the buyer or the delivery instruction is given to the carrier, unless there was an agreement that risk would pass at the moment of loading onto the carrier. In that instance risk will pass retroactively to the moment of handing over the goods to such carrier. In the absence of such an agreement, the risk would be split at some point during the transportation of the goods, which is an commercially unsound practice as it is often impossible to establish when containerised goods have been damaged during transit.

Although the German rule on risk is based on sound policy considerations of control and possession, the content of section 447 BGB is uncertain and unpredictable, which is not conducive to international trade. Uncertainty increases transaction costs, which in turn affect the commercial and economic efficiency of the contract adversely. Moreover, the legal position pertaining to commercial contracts under

German law strongly depends on judicial interpretation of the statutory provisions of both the Civil and Commercial Codes. These codes are not easily accessible due to language constraints and English commentaries are not readily available. In practice, risk is often regulated by trade terms, which is an indication that parties elect to rather make use of trade usage or INCOTERMS than of the rules of the German Civil Code. This could be an indication that the default rules on risk are not consonant with commercial practice.

### 3 3 2 4 South African law

The risk regime of South African law has been critically assessed as strange[107] and illogical.[108] The doctrine is perceived as operating unfairly and arbitrarily in certain circumstances,[109] and its rules as incapable of being related to an underlying theoretical principle.[110] Not a single one of the three basic models have any characteristics that are remotely linked to the South African risk rule.

An analysis of South African textbook writers' treatment of the rule reveals a number of difficulties and inconsistencies.[111] The set of rules that make up the South African risk doctrine is inherently complex. It is based on the principle that the risk for accidental disaster passes to the buyer once the contract is *perfecta.* In view of its divergence from the *res perit domino* principle, the rule has been regarded as an anomaly.[112] The reasons for the seller's immunity and the buyer's continued liability have for generations been explained by jurists, but none of them very successfully.[113] Voet[114] gave two reasons. The one is that the buyer acquires the benefits of the contract on conclusion and that he therefore should also acquire the risk. Risk does not necessarily pass on conclusion but is dependent on the contract being perfected;

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[107] Mostert et al *Die Koopkontrak* (1972) 80.
[108] Lotz "Purchase and Sale" in Zimmermann & Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) 361 384.
[109] Mostert et al *Koopkontrak* 81.
[110] See Zeffertt "Note to *Schultz v Morton*" in Kahn (ed) *Contract and Mercantile Law through the Cases II* 2nd ed (1985) 184 185; Mostert et al *Koopkontrak* 80-81; *Pahad v Director of Food Supplies & Distribution* 1949 3 SA 695 (A) 709-710.
[111] Lambiris "The incidence of risk in conditional sales" 1984 *SALJ* 656.
[112] Hackwill *Mackeurtan's Sale of Goods in South Africa* 5th ed (1984) 178; Zulman & Kairinos *Norman's Law of Purchase and Sale in South Africa* 5th ed (2005) para 10 1; Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 283; Evans-Jones & Smith "Sale" in Zimmermann et al (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) 271 299.
[113] Hackwill *MacKeurtan's Sale of Goods* 178. See also the assessment of Kotzé JP in *Grobbelaar v Van Heerden* 1906 EDC 229 232.
[114] 18 6 1.

however, this argument assumes that it is only fair if the buyer would carry the losses if he is to receive the benefits. The other reason given by Voet is that the seller is discharged from his obligation to deliver when the *merx* is destroyed. That still doesn't explain why the buyer remains liable for payment as the normal consequence would be that the buyer is also relieved from his obligations due to supervening impossibility of performance. Pothier[115] tried to explain the rule by means of very subtle reasoning. He stated that the buyer's obligation to pay is the consideration for the seller's obligation to deliver and not for the delivery as such. If the seller's obligation to deliver is extinguished by the destruction of the *merx*, the buyer is not simultaneously released from his obligation to pay. This explanation does not make sense in light of the reciprocal nature of a sale and the rules of supervening impossibility. According to Gluck,[116] if the seller is liable for loss occasioned by his lack of care, it is only fair and equitable that he will be entitled to his money when the loss is not due to his default. Van Leeuwen refers to the buyer's right to become owner and that he ought to be considered an owner and, therefore, should carry the risk of an owner. [117]

Concerns about the basis of the risk rule are not restricted to academic commentators. Van den Heever JA in an *obiter dictum* in *Pahad v Director of Food Supplies and Distribution*[118] also portrayed the rule as an arbitrary one that could not be justified on equitable grounds. According to him the rule originated in "an accident of history", namely the inability of the Byzantines to understand the role of delivery in respect of the transfer of ownership. The compilers of the *Corpus Iuris* obscured the fact that under the classical law an unforeseen event for which no party was responsible would result in the sale falling through and both parties being released from liability.

An investigation into whether the rule is indeed illogical, arbitrary and unfair should perhaps start at the roots of the rule, namely the classical Roman law. Martin Bauer,[119] in his study of the doctrinal history of the rule *periculum rei est emptoris*, corrects the notion that the risk rule was unknown in classical Roman law.[120] According to Bauer the classical doctrine made perfect sense in its time, judged from a socio-economic perspective and in light of an understanding of the nature of a sale

[115] *Vente* 307.
[116] Moyle *Contract of Sale in the Civil Law* 90-91.
[117] See Hackwill *MacKeurtan's Sale of Goods* 178-179 for additional explanations.
[118] *supra* 709-710.
[119] *Periculum Emptoris: Eine Dogmengeschichtliche Untersuchung zur Gefahrtragung beim Kauf* (1998).
[120] See Zimmermann *Law of Obligations* 282 for a similar conclusion.

in classical times. Initially the Roman legal system made use of sales where the *merx* was fully individualised, the price immediately ascertainable, no conditions affecting its operation were attached and delivery took place immediately against cash payment (the so-called *Barkauf*). Where conclusion coincides with performance, it is only natural to allocate the risk to the buyer at the earliest possible time, namely at conclusion.[121] Even when sales became more sophisticated, inasmuch as delivery took place after conclusion of the sale, the risk rule associated with the *Barkauf*, namely that the buyer carries the risk from perfection of the contract, persisted.

The risk rule of classical Roman law was directly linked to how the legal nature of a sale was seen at the time. The agreement of the parties not only had an obligationary quality but also a proprietary effect, resulting in the buyer becoming directly interested in the *merx* as a so-called beneficial or economic owner and the seller abandoning any economic interest in the thing. Although the risk passed immediately on conclusion, the seller had to take care of the *merx* until it was handed over to the buyer. The *custodia* liability of the seller counter-balanced the early passing of risk to the buyer, resulting in the seller only being excused in cases of *vis maior*. Bauer demonstrates that the degeneration of the *custodia* principle through the different periods of development to a fault theory disturbed the inner balance of the risk allocation in sale.[122] The result was that placing the risk on the purchaser at an early stage and prior to the passing of ownership could not be justified any longer by assigning liability to the seller independently of fault on his part.[123] The progressive understanding of sale as a reciprocal agreement contributed to the perception of the rule as anomalous and unfair in its operation.[124] Although Roman Dutch authors have attempted to explain the doctrine and these explanations have to some extent been followed in South African law, Bauer agrees that none of them are satisfactory.[125]

Since the rule is not linked to the notions of safekeeping, control and insurance, the South African risk rule is not based on sound policy considerations of international trade. The rule can lead to unfair results as the buyer may carry the loss of goods of which he is neither in possession nor capable of controlling. This aspect further

[121] Bauer *Periculum Emptoris* 30, 73-74, 253; Zimmermann *Law of Obligations* 290-291.
[122] Zimmermann *Law of Obligations* 292 points out that Justinian abolished the concept of *custodia* and replaced it with *culpa in custodiendo*. In modern times the *custodia* duty has been watered down to that of *culpa levis*. See also Lotz "Purchase and Sale" in *Southern Cross* 361.
[123] Bauer *Periculum Emptoris* 81-86, 107-112, 195-196.
[124] 196-197.
[125] 191.

complicates the question as to which party is best suited to insure the goods against loss or destruction.

The risk rule is not only strange, but this study has shown that it is also difficult to apply because of the three requirements that have to be met. A particularly problematic aspect is that pending fulfilment of a suspensive condition, the risk of destruction of and damage to the *res vendita* is split between respectively the seller and the buyer. South African commentators have been unable to find a satisfactory explanation for this rule.[126] The view that loss or destruction of the goods renders the condition impossible of fulfilment[127] does not always present a good enough reason. It is not entirely true that all instances of destruction of the *merx* will render the fulfilment of the condition impossible. In some instances the uncertain future event on which the condition is based does not depend on the existence of the *merx.* In those cases the contract may still become *perfecta* even though the *merx* is destroyed. Where the condition is fulfilled but the *merx* has been destroyed, the contract is extinguished due to supervening impossibility of performance. In those instances the risk will remain with the seller, but as a result of impossibility and not through application of the risk rule.[128] Lambiris,[129] however, contends that an argument based on impossibility ignores the principle of retroactivity which implies that on fulfilment of the condition the contract is rendered *perfecta* retroactively. If the condition is fulfilled and the *merx* was in existence at the conclusion of the sale, subsequent destruction should logically not have any influence on the passing of risk as the *merx* existed at the time of conclusion. This is the position that applies when the *merx* is damaged. There is no apparent explanation why the principle of retroactivity is applied to situations where a suspensive condition is fulfilled and the *merx* is damaged, but is not applied when the *merx* is destroyed.[130]

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[126] Lambiris 1984 *SALJ* 656; Floyd "Enkele opmerkings oor die werking van die risiko-reël by die koop onderworpe aan 'n opskortende voorwaarde en soortgelyke bedinge" 1995 *THRHR* 461; Lotz "Purchase and Sale" in *Southern Cross* 384.

[127] Hackwill *MacKeurtan's Sale of Goods* 181. Damage, on the other hand, does not render the condition impossible of fulfillment and one therefore has to wait to see whether the condition is fulfilled or not.

[128] Zulman & Kairinos *Norman's Purchase and Sale* para 10 8 2.

[129] 1984 *SALJ* 658-659.

[130] Roberts (ed) *Wessels' Law of Contract in South Africa I* 2nd ed (1951) para 1388. Lambiris 1984 *SALJ* 661 attempts to develop an elaborate restatement of the position where the sale is qualified by a suspensive condition where he does not distinguish between loss and damage. However, Mendelowitz "The 'Parol Evidence Rule' and Suspensive Conditions in Contracts" 1978 (95) *SALJ* 32 46 is of the opinion that it would be contrary to the notions of justice and equity to place the risk on the buyer if the contract cannot be fulfilled due to the destruction of the *merx.*

The most sensible explanation is found in the historic origins of the rule. Under classical Roman law the fulfilment of a condition operated *ex nunc* and not retrospectively as we know it today. Furthermore, a condition was not only regarded as suspending the operation of the transaction, but also the coming into existence of the sale as a legal act. Therefore, if the *merx* was destroyed and it rendered the fulfilment of the condition impossible, the sale never came into existence.[131]

The conditional argument is also used by some Roman Dutch commentators to explain the requirement that the goods have to be weighed, measured or counted in the case of a sale *ad mensuram*.[132] However, this argument cannot be supported. The requirement of weighing, measuring or counting is not a condition in the technical legal sense which will result in suspending the operation of the contract but only serves to prevent the sale from being perfected.[133] In the case of a true suspensive condition the operation of the agreement is suspended pending the fulfilment of an uncertain future event. In the case of sales *ad mensuram* where the goods have to be weighed, measured or counted there is no uncertain future event that suspends the operation of the agreement. The parties are capable of weighing, measuring or counting the goods and it can be done at any time.

Although the risk rule made sense in classical times, this affords no guarantee that it does so today. Bauer[134] concludes that the doctrine in its present form is arbitrary and without foundation. He suggests that this part of our law is in need of reform. It is Bauer's contention that risk should pass with the transfer of ownership.

It is agreed that the complexity of the rule leads to uncertainty, making it inefficient in its application and administration. The general idea of law reform should, therefore, be welcomed. However, the approach suggested by Bauer cannot be supported in the present context. Linking the passage of risk to ownership in the case of international sales will not present a viable solution, especially since ownership and possession do not always go hand in hand. It is suggested that the rule should follow

[131] Bauer *Periculum Emptoris* 31-37.
[132] *D* 18 1 35 5. See 2 2 4 1 (i) & (ii) *supra.*
[133] Hamman *Risiko by die Koopkontrak in die Suid-Afrikaanse Reg* LL D dissertation Leiden (1938) 219; Mostert et al *Koopkontrak* 85 n 1. Hackwill *MacKeurtan's Sale of Goods* 186 also refers to a so-called "quasi conditional" argument but he rejects that immediately. On 187 he explains that an agreement to suspend the risk is implied from the fact that the price has not been agreed on.
[134] *Periculum Emptoris* 193-197.

the notions of control and insurance and should, therefore, be linked to possession.[135]

### 3 4 Conclusion

A consideration of a number of national risk regimes yields the conclusion that domestic systems are generally not well suited to the needs of international transactions. However, in so far as the rules on risk are concerned, section 2-509 UCC as well as the risk rules of sections 446 and 447 BGB rate higher than the provisions of English or South African law. By adhering to the assumptions of control and insurance, the provisions of American and German law underwrite policy considerations which are oriented towards the requirements of international trade. Transfer of risk rules based on the criterion of possession, safekeeping and control are calculated to place the loss where the insurance lies. However, although these rules reflect sound policy considerations, it does not automatically follow that they are efficient risk regimes in the context of international sales. They still fail to provide for sales in transit as well as the specific needs of modern container transport. Moreover, the German risk rule rates below the American rule when it comes to clarity, certainty and predictability. Amongst the rules analysed in this discussion, the American rule provides the clearest exposition of different transport situations, although it still does not cater for sales in transit and the challenges of modern transportation techniques.

In summary, the analysis of the risk regimes in four domestic systems has shown that their provisions are often ignorant of the needs of modern commerce in general and international sales in particular. The theoretical frameworks on which the English and South African models are based reflect outdated policy considerations aimed at a commercial setting that is far removed from that which prevails today. Judged from an international perspective, national rules are in most instances foreign to at least one of the parties to the contract. The problems relating to accessing the law of a foreign system, together with the uncertainty created by rules which are drafted in a

[135] Morice "The Risk of the Thing Sold" 1912 *SALJ* 239 245 already advocated such an approach in the early years of the 20th century. He holds that legal reform "generally involves the sweeping away of subtleties and distinctions in principles and practices which appear to have a natural attraction for the legal mind" and that it is therefore sensible to move away from "the subtlety which separated the risk of the thing sold from its possession". See also Evans-Jones & Smith "Sale" in *Mixed Legal Systems* 299-300. S 19(2)(c) Consumer Protection Act No 68 of 2008 provides for the risk to remain on the seller until the buyer accepts delivery of consumer goods, which signifies a deviation from the normal rule on risk due to policy considerations.

way that is not always easy to understand or apply, such as in the case of the South African, German and even the English rules, are not conducive to international trade. Uncertainty on the content of foreign law, coupled with the legal costs involved in negotiating and executing the transaction result in economic inefficiency. The same goes for rules that do not provide for commercial usages and practices. The fact that most international sales contracts are concluded on the basis of trade terms is a further indicator that the national law regimes on risk do not reflect mercantile custom adequately.

A rule that regulates the passing of risk in the international sales context should be separated from the underlying policies of national legal systems and should aim to address the needs and policy considerations of international sales as identified in this study. Such a rule should be oriented towards notions of control, safekeeping and possession, avoid splitting the risk during transportation and burdening a party with damage or loss which occurred too far back in the transport chain. An increase in sales in transit due to developments in the field of transportation and containerisation require and necessitate a standard rule for transit risks. It is important that the legal rules regulating passing of risk should facilitate all types of sales effectively and efficiently. The risk rule should be a clear and concise rule which reflects the common intention of most parties to a contract, should they have had the opportunity to bargain on it. At the same time it should also recognise the importance of party autonomy and allow parties to deviate from the rule when the occasion demands it. In so far as a default rule cannot accommodate mercantile custom across all branches of the trade, it should provide for the possibility that trade usages and practices may override the default regulation on risk. In the final instance, to be effective and efficient in the international context, risk of loss rules have to be harmonised to promote legal certainty and predictability and thereby increase the economic efficiency of the transaction.

# CHAPTER FOUR
# HARMONISATION IN INTERNATIONAL SALES

## 4 1 Introduction

One of the functions of a sales law regime is to facilitate transactions by means of clear and effective default rules that minimise the costs of negotiating, drafting and executing the contract.[1] In the context of international sales this basic function may be compromised by the international character of the transaction. International private law rules are often difficult to apply; increasing transaction costs and decreasing the economic efficiency of the transaction. To minimise the risks[2] associated with such transactions and maximise their efficiency, legal rules[3] and mercantile practices pertaining to international sales should be harmonised. Harmonisation facilitates legal certainty and predictability, and by making international contracting easier, prevents disputes and costly legal actions.[4]

The discussion commences by clarifying the notion of harmonisation. This is followed by an overview of scholarly opinions on the value of legal harmonisation. The goals and objectives of harmonisation instruments are established whereafter different methods for the harmonisation of sales law are examined. The discussion also endeavours to establish whether there is a single optimal method for harmonising sales laws effectively and efficiently.

## 4 2 Harmonisation of sales law

### 4 2 1 Defining the concept

Harmonisation can be described as bringing the legal provisions or processes of two or more legal systems closer to one another or seeking to achieve equivalence

[1] See 1 2 *supra* for a discussion on the features of effective international sales law.
[2] The term "risk" is here used in the broader sense of the word to include different forms of risk as discussed in 1 6 3 *supra*.
[3] Whether those are international private law rules or rules of the substantive law.
[4] Leebron "Claims for Harmonisation: A Theoretical Framework" 1996 (27) *Can Bus Law J* 63 76-77.

between them.[5] Although harmonisation can cover any branch of the law,[6] for purposes of this study the focus will be confined to harmonisation of the law of international sales.

The ideal of a unified sales law has also attracted much interest. But what is the relationship between the concepts of harmonisation and unification?[7] Are they synonymous with each other? Many scholars seem to use these terms interchangeably,[8] whilst others argue against this use.[9]

Unification has been described as "synthesising a single law from divergent national laws governing a particular problem"[10] and international unification as the "adoption of an agreed set of rules, standards or guidelines for application to transnational transactions."[11] In international trade, unification can be achieved through international custom and usages, by international agreement within the framework of professional organisations or between states by means of an international convention.[12]

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[5] Zaphiriou "Unification and Harmonization of Law relating to Global and Regional Trading" 1994 (14) *N Ill U L Rev* 407 416. Harmonisation may have both a normative and a non-normative component. The normative component requires that harmonisation of different laws or policies should result in at least one society's laws or policies conforming to a better standard. The non-normative component is the mere claim that the laws or policies of two societies should be made the same. See in this regard Leebron 1996 (27) *Can Bus Law J* 73-75.

[6] For example, contract and sales law, international trade law banking law, securities regulation, intellectual property law, labour law, environmental law, food safety laws, product standards and liability law.

[7] However, this is not the only relationship that is not clearly defined. The relationship between harmonisation of the law and concepts such as co-ordination of law, standardisation of law, approximation of law and modernisation of law, all deserve clarification. Calus "Modernisation and Harmonisation of Contract Law" 2003 *Unif L Rev* 155 155-156.

[8] Walt "Novelty and the risks of Uniform Sales Law" 1999 (39) *Va J Int'l L* 671 674 n 4. Leebron 1996 (27) *Can Bus Law J* 71-71 defines unification as "harmonisation with a zero margin for difference", which implies that unification is a form of harmonisation and that they are synonymous concepts.

[9] Although trade experts use these terms interchangeably, Cutler *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* (2003) 192 holds that they have different meanings and require different strategies from the public and private actors who are to achieve the harmonisation or unification result. According to Rosett "Unification, Harmonization, Restatement, Codification and Reform in International Commercial Law' 1992 (40) *Am J Comp L* 683, experience has shown that unification does not always produce harmonisation. See also Rosett "Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods" 1984 (45) *Ohio St LJ* 265 267, where he states that world law harmonisation and codification are not identical concepts. According to Farnsworth "Unification and Harmonisation of Private Law" 1996 (27) *Can Bus Law J* 48 49, the UNIDROIT Principles of International Commercial Contracts are "more an exercise in harmonisation as unification", which implies that he sees them as separate concepts. See also Ferrari "Defining the Sphere of Application of the 1994 UNIDROIT Principles of International Commercial Contracts" 1995 (69) *Tul L Rev* 1225 1226, who distinguishes between the "unification or harmonization of substantive rules" and the "unification of rules of private international law".

[10] Note "Unification and Certainty: The United Nations Convention on Contracts for the International Sale of Goods" 1984 (97) *Harv L Rev* 1984 n 2.

[11] Zaphiriou 1994 (14) *N Ill U L Rev* 407.

[12] Zaphiriou 1994 (14) *N Ill U L Rev* 407; Rosett "The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts" 1998 (46) *Am J Comp L* 347 350-355. See also Horn "Uniformity and Diversity in the Law of International Commercial Contracts" in Horn

Zaphiriou is of the opinion that harmonisation does not lead to a set of agreed rules as would be the case with unification. It merely "directs a change of rules, standards or processes in order to avoid conflicts and bring equivalence."[13] Harmonisation may be achieved by international agreement between states or by mandate of a regional supranational institution. Harmonisation of legal rules can also entail revisions to national laws to bring them in line with the realities of modern international trade and thereby ensuring greater harmony between domestic sales laws.[14]

For Leebron,[15] harmonisation contemplates greater similarity of rules but not necessarily to the degree that they are identical or unified. The concept embraces the possibility of different degrees of similarity, ranging from no deviation from the agreed-upon standards to broad deviations from the norm. Although unification aims to replace multiple and different rules with a single uniform rule, not all efforts to unify amount to complete unification. Differences in implementation and effects are therefore permitted.

Mistelis agrees that harmonisation is not synonymous with unification, but regards it as a process which may result in unification of law, subject to the fulfilment of a number of conditions. Examples of such conditions are wide or universal geographical acceptance of the harmonising instrument and a wide scope which effectively substitutes all pre-existing law. He points out that "to the extent that harmonisation of law is sporadic and incomplete, most harmonising laws are in practice designed to work within and with existing laws."[16] In most cases, harmonisation instruments will only function effectively and efficiently when they are supplemented by or work in conjunction with other legal rules. The same can be said of unification instruments. The United Nations Convention on Contracts for the International Sale of Goods (CISG) represents unified sales law which have to be

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& Schmitthoff (eds) *The Transnational Law of International Commercial Transactions II* (1982) 3 14-15; Schmitthoff "Nature and Evolution of the Transnational Law of Commercial Transactions" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 231 234-239.

[13] 1994 (14) *N Ill U L Rev* 407.

[14] Revisions of national commercial laws are often undertaken with reference to harmonised law such as the CISG, the UNIDROIT Principles or INCOTERMS. The 2003 revisions to Art 2 of the Uniform Commercial Code and the 2001 revised German Law of Obligations are examples of domestic law revisions which have been influenced by international harmonised law. See Goode "Insularity or Leadership? The Role of the United Kingdom in the Harmonisation of Commercial Law" 2001 50(4) *ICLQ* 751 759; Rosett 1998 (46) *Am J Comp L* 352.

[15] 1996 (27) *Can Bus Law J* 71-72.

[16] Mistelis "Is Harmonisation a Necessary Evil? The Future of Harmonisation and New Sources of International Trade Law" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 3 para 1-003.

supplemented by national law or custom in situations not covered by the provisions of the Convention.[17]

Inasmuch as standardisation is a method to obtain greater similarity or equality between rules or practices, it is also a form of harmonisation. At the same time standardisation has much in common with unification and, in most instances, can even be equated to unification. Standardisation implies some form of agreed standard which confers similarity on different rules or practices. In the international sales context, INCOTERMS and the UNDROIT Principles of International Commercial Contracts are well-known examples of the standardisation of commercial practice. INCOTERMS standardise the definitions of commercial trade terms with reference to prevailing commercial practice. Standardisation efforts include also uniform contract forms or standard contract terms, commonly referred to as "boilerplate" terms, which dispense with the need to negotiate a contract.[18]

The question whether unification and standardisation are different concepts is to a large extent one of semantics. Differentiation may be important from the perspective of enforceability, which in turn influences the choice of agencies involved in these processes. Standardised rules or practices, thus, have no legal status unless they are incorporated into a contract of sale through agreement or trade usage or introduced into a domestic legal system through legislation. Generally speaking standardisation measures are formulated by private non-government agencies without legislative powers. Unification instruments in the form of international conventions, on the other hand, enjoy automatic application once the instruments are internalised into domestic law by state ratification or accession and are mostly formulated by a supra-national or regional authority. However, this distinction is not watertight. It is impossible to argue that all forms of unification are introduced by states or that standardisation is always a private endeavour. Moreover, the operation

[17] Arts 4 and 7(2) CISG. Also see ch 7 *infra*.

[18] For example, the ICC Model International Sale Contract and other standard form contracts such as the General Conditions of Sale and Standard Form Contracts sponsored by the United Nations Economic Commission for Europe (UN ECE) for traders from their member countries, eg ECE Form 188 General Conditions for the Supply of Plant and Machinery for Export, or standard contracts for particular trades such as those in durable consumer goods, cereals, citrus fruit, solid fuels, sawn softwood etc. Other examples are standard form contracts of trade associations, such as the London Commodity Merchants for the trade in wool, cotton, fur, jute, rubber, cocoa and sugar, or that of the Grain and Feed Trade Association (GAFTA London), the Federation of Oil, Seed and Fats Association (FOSFA London), *Verein der Getreidehändler der Hamburger Börse* (Germany), the *Comité van Graanhandelaren* (Netherlands) or trade associations in the United States dealing with sales in hay, textiles, silk and cotton. In general, see also Garro "Rule-setting by Private Organisations, Standardisation of Contracts and the Harmonisation of International Sales Law" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 310 paras 22-005-22-008; Murray et al *Schmitthoff's Export Trade: The Law and Practice of International Trade* 11th ed (2007) paras 32-011-32-012.

of unified law is to a large extent still dependent on the will of the parties. Many unified laws or conventions contain non-mandatory rules that function as default rules which can be excluded by the parties to a contract, either partly or in whole.[19] It is also possible that the provisions of a convention, such as the CISG for instance, could by party agreement be made to apply to a contract in situations to which it would not otherwise apply.[20]

In this study the term "harmonisation" will accordingly be used as a blanket term. It covers all methods and techniques of sales law harmonisation which endeavour to alleviate the differences between laws and legal systems in order to enhance their efficiency.

### 4 2 2 The harmonisation debate

Reactions to harmonisation efforts tend to vary towards extremes. Not everyone believes that harmonisation or unification will provide a solution to the problems of international sales law. Trade theorists, for example, view harmonisation with scepticism.[21] Even though it is recognised that harmonisation has value in reducing the costs of international transactions, harmonisation claims may impose unacceptable underlying costs which should be taken into consideration as well.

It is often very hard to convince national legislatures to take an interest in proposals for harmonisation.[22] The risk of inefficient rules, differences in implementation and

[19] For example Art 6 CISG. Sheaffer "The Failure of the United Nations Convention in Contracts for the International Sale of Goods and a Proposal for a New Global Code in International Sales Law" 2007 (15) *Cardozo J Int'l & Comp L* 461 464 points out that parties often choose to contractually opt out of the entire Convention in favour of national laws that are more familiar to them.

[20] Hugo "The United Nations Convention on the International Sale of Goods: Its Scope and Application from a South African Perspective" 1999 (11) *SA Merc LJ* 1 25-26. In these instances the provisions of the Convention will apply as contract terms and not as a convention.

[21] Leebron 1996 (27) *Can Bus Law J* 64.

[22] A typical example is the ongoing reluctance of the United Kingdom and South Africa to ratify the CISG. Although the British government announced in 1997 that it is in favour of ratification, it has not yet taken any formal action. The vested interests of commercial trade associations and the British legal establishment in the protection of the role of English law in international trade are some of the main reasons for Britain not ratifying the Vienna Sales Convention. See Linarelli "The Economics of Uniform Laws and Uniform Lawmaking" 2003 (48) *Wayne L Rev* 1387 1426-1442 for a discussion of more reasons, and in general Goode 2001 50(4) *ICLQ* 751. In regard to South Africa's failure to ratify, see the arguments of Eiselen "Adoption of the Vienna Convention for the International Sale of Goods (CISG) in South Africa" 1999 (116) *SALJ* 323; Eiselen "Adopting the Vienna Sales Convention: Reflections Eight Years down the Line" 2007 (17) *SA Merc LJ* 14 in favour of ratification, whilst Lehmann "The United Nations Convention on Contracts for the International Sale of Goods: Should South Africa Accede?" 2006 (18) *SA Merc LJ* 317 holds that it is not in SA's best interest to accede since there is no real proof that the Convention is capable of enhancing international trade or legal certainty.

uncertainty because of a lack of precedent and learning effects[23] are regarded as factors that diminish the apparent value of harmonisation efforts.[24] Irresolvable differences between different legal, economic and social systems can stand in the way of real unification of law and may result in negotiated compromises that sidestep the real issues.[25] It is also argued that too much weight is attached to the legal aspects of trade, whilst in most instances transactions are performed without any legal problems. The costs of legal advice are usually a once-off expense and if legal problems do emerge later on, they are mostly solved by the contractual law which the parties have created between themselves, either through negotiation or by general conditions and standard contract terms.[26] It has also been suggested that the parties to a contract of sale can themselves do much about the problems typical of international sales; thereby obviating the need for an international convention or other form of unification.[27] Parties may structure the transaction in such a manner that it will be subject to only one legal system. They may furthermore use standard forms[28] or terms which will prevail regardless of what legal system governs the transaction, for example so-called "boilerplate" terms.[29] Parties can also choose the law which is to govern their transaction, regardless of which law might otherwise apply. Moreover, the parties can choose a forum or they can provide that all disputes are to be submitted to arbitration.

On the other hand, those involved in day-to-day international trade are more enthusiastic about harmonisation. They argue that it will alleviate the general

[23] Learning effects are so-called "externalities" that involve transaction costs in trying out novel legal rules which are yet to be judicially interpreted. In such instances, parties have to plan for a broader range of contingencies because the outcome of litigation is unpredictable. See Walt 1999 (39) *Va J Int'l L* 692-697; Gillette "Harmony and Stasis in Trade Usage for International Sales" 1999 (39) *Va J Int'l L* 707 729-730.

[24] Walt 1999 (39) *Va J Int'l L* 672-673. See also Leebron 1996 (27) *Can Bus Law J* 103-107 for further arguments on the so-called "costs of sameness", such as the stifling of innovation due to the difficulties involved in changing harmonised law. He argues that many of these costs can be avoided by adopting non-mandatory flexible rules which merely provide a common framework law.

[25] Rosett 1992 (40) *Am J Comp L* 688. Many of the CISG's provisions are examples of so-called "diplomatic compromises" which lead to problems in interpretation, especially in light of the Convention's mandate of autonomous interpretation on the basis of its international character.

[26] Hartkamp "Modernisation and Harmonisation of Contract Law: Objectives, Methods and Scope" 2003 *Unif L Rev* 81 82-83.

[27] Farnsworth 1996 (27) *Can Bus Law J* 52-54; Farnsworth "Recent Trends in International Sales Law" in Peng Kee et al (eds) *Current Developments in International Transfers of Goods and Services* (1994) 3 7-20.

[28] They are used by all large manufacturers, such as IBM, Philips, Sony and Grundig, as well as by large trade associations. See n 18 *supra* for examples of standard form contracts used by trade associations.

[29] Garro "Rule-setting by Private Organisations" in *Foundations* paras 22-006, 22-008. Examples include the ICC Force Majeure and Hardship Clauses (2003), INCOTERMS, exemption of liability clauses and choice-of-law or choice-of-forum clauses.

problems connected to different national regulatory rules.[30] International economic relations will not function smoothly, or properly, unless the laws and policies of different jurisdictions are brought closer together. In essence, all arguments in favour of harmonisation boil down to economic efficiency. International harmonisation or unification enhances efficiency by reducing transaction costs.[31] The convergence of legal systems and the harmonisation of commercial law are said to create a healthy competitive environment for international trade.[32] Claims for harmonisation of national laws and policies are also linked to claims ascertaining the need for so-called "fair trade". Harmonisation affords a mechanism through which differences in legal and other regimes are eliminated and the playing field levelled.[33] This is especially so in situations where one of the parties suffers from some disadvantage in bargaining power, for example where exporters from developing countries try to break into first world markets.[34]

To sum up; despite opinions that unification of the law is not always advantageous, there is a widely shared view that it could be useful[35] and that there is a general need to harmonise the private law rules that govern international transactions.[36]

This study departs from the premise that harmonised law is essential to address the needs of international sales law. The analysis on the regulation of price risk, conducted in Chapters Two and Three of this study, concluded that the differences between national risk regimes as well as the differences in trade term meanings create uncertainty and a lack of predictability, which can be detrimental to the economic efficiency of an international sales contract. Even where the contract includes a choice-of-law clause it does not always mean that both parties are equally familiar with the content of the legal rules of the chosen system. Moreover, choice-of-law clauses are only efficient if the costs involved in obtaining information on the relevant legal system are low.[37]

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[30] Leebron 1996 (27) *Can Bus Law J* 64.
[31] Walt 1999 (39) *Va J Int'l L* 671-672; Leebron 1996 (27) *Can Bus Law J* 64; Linarelli 2003 (48) *Wayne L Rev* 1387. See also the discussion 4 2 3 3 *infra.*
[32] Hartkamp 2003 *Unif L Rev* 82; Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para1-009.
[33] Leebron 1996 (27) *Can Bus Law J* 64.
[34] Horn "Uniformity and Diversity" in *Transnational Law II* 16-17. International conventions, model laws and restatements can provide ready-to-use rules which developing countries can adopt into their own domestic legal systems to make them more efficient. See Linarelli 2003 (48) *Wayne L Rev* 1409.
[35] Hartkamp 2003 *Unif L Rev* 81, 83; Farnsworth "Modernization and Harmonization of Contract Law: an American Perspective" 2003 *Unif L Rev* 97 98.
[36] Farnsworth 1996 (27) *Can Bus Law J* 51.
[37] On the efficiency concerns generated by a contractual choice of law, see Linarelli 2003 (48) *Wayne L Rev* 1406-1410.

### 4 2 3 Goals and objectives of harmonisation instruments

Harmonisation instruments have certain goals and objectives. One of these is to create greater similarity; the other is to promote law reform. The ultimate goal, however, is to enhance the legal and economic efficiency of transactions by creating an effective legal framework within which international sales can take place.

#### 4 2 3 1 Creating similarity

Where there are international differences in national legal rules and systems, the aim is to adopt common principles of law or, at least, to create more similarity.[38] This will be done, either by making the domestic laws of different countries more similar, or by creating an international unified regime through unification or standardisation. The degree to which similarity is achieved will in the end depend on what is practically feasible in the circumstances.

#### 4 2 3 2 Law reform

When existing law cannot cope with evolving commercial practices and trade requirements, harmonisation instruments can facilitate law reform. Harmonisation seeks to produce "neutral law"[39] which can create a legal framework tailor-made for international transactions. Once a provision has been adopted at international level, reform can be achieved more readily, especially in countries where law reform is a complicated matter.[40] In a field where national law is non-existent, harmonisation can fill the legal vacuum by providing framework rules within which the new rule can be formulated.[41] Even where national law exists, international unification efforts can assist in revising domestic laws to bring them in line with current international practices.[42]

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[38] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-047; Andersen "Uniformity in the CISG in the First Decade of its Application" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 289 para 20-005.

[39] The CISG is an example of neutral law which seeks to present a compromise between the civil and common law.

[40] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-047.

[41] For example; in the field of electronic transactions, the UNCITRAL Model Law on Electronic Commerce (1985) presented an ideal model for law reform in many countries, including South Africa.

[42] The CISG, for example, influenced the 2001 revision of the German Civil Code and the 2003 revision of Article 2 of the American UCC. This method presents an example of the so-called "top-down

#### 4 2 3 3 Promoting efficiency

Harmonisation is said to produce important efficiencies. By lifting barriers caused by different legal systems, harmonisation can facilitate international commerce and make transnational activities more efficient.[43] Comparative studies have identified a tendency towards the harmonisation of different legal systems, which can be ascribed to a general impulse towards the economic efficiency of legal rules.[44] Legal rules and institutions are instruments through which efficiency is achieved, and that explains why systems generally evolve in the same direction.[45] If the content of legal rules is the same, or at least more similar, they will be easier to understand and will be able to fulfil the need for certainty, clarity and predictability[46] which is identified by this study as one of the imperatives of international sales law.[47] Increased predictability and legal certainty will reduce legal risk and transaction costs, which, in turn, will increase the overall efficiency of the contract and facilitate international trade.[48]

The unification of commercial law, furthermore, contributes to the reduction of the costs of doing business by reducing the potential for conflict of legal systems.[49] The transaction costs of doing business internationally involve that one first has to go through a conflict-of-law analysis to determine which country's law governs the contract, and thereafter to establish the applicable substantive law. In most instances, these rules will be foreign to at least one of the parties to the contract. In the context of international sales, effective harmonisation will probably not be able to dispense with all problems connected to conflict-of-laws and forum shopping *in toto*,[50] but will at least reduce it to a significant extent.

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approach" where harmonisation at the universal level influences law reform on the domestic level, resulting in national systems moving closer together.

[43] Walt 1999 (39) *Va J Int'l L* 671-672; Cutler *Private Power and Global Authority* 206-207; Linarelli 2003 (48) *Wayne L Rev* 1392, 1395-1417. Some argue that harmonisation measures can even facilitate and expand capitalism transnationally. See Cutler *Private Power and Global Authority* 181-182.

[44] Mattei "Efficiency in Legal Transplants: An Essay in Comparative law and Economics" 1994 (14) *Int'l Rev L & Econ* 3 6-8. Convergence of legal systems may be explained by theories of legal transplantation and economic efficiency. Change in a given legal system is often the result of "borrowing" from another legal system what is deemed to be an efficient legal rule in that system.

[45] De Geest & Van den Bergh (eds) *Comparative Law and Economics I* (2004) Introduction xi. See also 1 2 1 *supra.*

[46] Andersen "Uniformity in the CISG" in *Foundations* paras 20-006-20-007.

[47] See 1 2 2 *supra.*

[48] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-047; Leebron 1996 (27) *Can Bus Law J* 64-65; Calus 2003 *Unif L Rev* 157.

[49] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-047.

[50] The CISG is an example of unified sales law which does not deal with all issues relevant to a sales transaction. This necessitates the application of conflict-of-laws rules to determine the legal position on issues such as validity or the transfer of property.

## 4 3 Methods of harmonising international sales law

### 4 3 1 Custom as a form of harmonisation

Although states are normally the formal participants in international negotiations on unification, harmonisation efforts are mostly driven by the private sector. International merchants, private business associations, banks, insurance companies, accountants, international lawyers and other professionals consult with governments and provide them with their views and expert opinions.[51] Apart from their input in the harmonisation efforts of states, merchants have always engaged in so-called "private rule-making" through the application of their own practices and customs. The repetition of business transactions leads to the creation of commercial practices and customs, which in time harmonise the way in which international business is conducted.[52]

Already during medieval times, uniformity was achieved through the universality of merchant customs.[53] The earliest efforts to harmonise substantive commercial law date back to the late nineteenth century and consisted of self-regulatory initiatives, mostly undertaken by private merchant associations.[54] These associations were initiated by the business communities themselves with the aim of establishing norms to be adopted voluntarily by all members.[55] Standard contracts developed by these associations often incorporate existing commercial customs or set norms in a specific trade.[56] Standardised contracts are, therefore, a major factor contributing to the

[51] Cutler *Private Power and Global Authority* 193-204 refers to them as the "transnational capitalist class" or "mercatocracy". Because of their links to transnational capital, their expert knowledge and their influence on governments, they constitute the main drivers of the harmonisation process. See also Levit "A Bottom-up Approach to International Lawmaking: the Tale of Three Trade Finance Instruments" 2005 (30) *Yale J Int'l L* 125.

[52] Eisemann "INCOTERMS and the British Export Trade" 1965 *JBL* 114 121. INCOTERMS and the UCP are examples of international customs which are formulated and standardised by an international agency but originated from the repetitive observance by merchants of these customs. It has been said that the contract practices underlying the FOB and CIF terms have gained the status of international custom. Perales Viscasillas "Comments on the draft Digest relating to Articles 14-24 and 66-70" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 259 300. See also the discussion 7 2 2 *infra*.

[53] The so-called *lex mercatoria* or international law merchant.

[54] For example; the Association of Corn Merchants of Hamburg (1868), also known as the Hamburg Cotton Bourse, the Bremen Cotton Exchange or Bremen Cotton Bourse (1872), the Silk Association of America (1873), the London Corn Trade Association (1877), the Grain and Feed Trade Association (GAFTA) and the Federation of Oils, Seeds & Fats Association (FOSFA). These trade associations generate uniform commercial norms.

[55] Cutler *Private Power and Global Authority* 208.

[56] Basedow "The State's Private Law and the Economy – Commercial Law as an Amalgam of Public and Private Rule-Making" 2008 (56) *Am J Comp L* 703 708-709 is of the opinion that nowadays commercial custom seldom develops spontaneously, but that business associations draft standard terms which over time may develop into custom.

harmonisation and unification of commercial law.[57]

International business organisations, such as the International Chamber of Commerce (ICC), individuals and transnational corporations all play a significant, and sometimes major, role in the harmonisation process.[58] The ICC was founded in 1919, as a private non-governmental organisation, representing business internationally. Consisting of representatives from business enterprises and associations in more than a hundred countries, the ICC is today one of the most influential forces in shaping international trade.[59]

Moreover, many rules of substantive commercial law originated in a course of dealing or practice which existed between individual parties who are also influential business enterprises. Over time, such courses of dealing developed into trade usages (custom or *Handelsbrauch*) and eventually became abstract rules of law.[60] In the legal order, trade usage or custom stands between the abstract rules of law and the factual practices or courses of dealing established between parties who do business with each other on a regular basis.[61]

For purposes of clarity, it is necessary to point out that this study uses "mercantile custom" as an all-inclusive or "blanket" term, encompassing customs, usages of

[57] According to Linarelli 2003 (48) *Wayne L Rev* 1439-1440, research conducted in the USA has shown that traders prefer to use standard form contracts instead of relying on unwritten customs. For a similar view, see Bernstein "Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms" 1996 (144) *U Pa L Rev* 1765. Informal trade usages are replaced by more formal rules of trade organisations because they are more precise and better tailored to a particular trade and its needs.

[58] They also play an important role in the process of private law-making. See Basedow 2008 (56) *Am J Comp L* 709. In general, on standard contracts and terms, see Garro "Rule-setting by Private Organisations" in *Foundations* paras 22-001-22-002. Promulgation by an international agency or recognition by the international business community can determine the legitimacy of a set of standard terms or a standard contract as a source of law.

[59] Being a private business organisation, the ICC facilitates trade by drafting standard rules and procedures which parties adopt voluntarily. Examples are: the ICC Model Sale Contract, INCOTERMS, the Uniform Customs and Practices for Documentary Credits (the UCP 600 and e-UCP) and Guidecs on arbitration and electronic commerce. The ICC has no legislative powers and its instruments cannot automatically become part of the law of a state. Before a harmonisation initiative undertaken by the ICC can be enforced, either a national government has to formulate laws giving effect to it, or the instrument should be incorporated into a contract of sale through party agreement. *Cf* 4 4 1 4 *infra.*

[60] Schmitthoff *International Trade Usages* report published by the Institute of International Business Law and Practice (1987) para 4; Garro "Rule-setting by Private Organisations" in *Foundations* paras 22-012-22-014. This transition takes place over a long period of time. Custom is the natural result of human nature to imitate and to resort to habit. Common law legal systems are largely based on custom. See Braybrooke "Custom as a Source of English Law" 1951 (50) *Mich L Rev* 71 n 4, 73, 86. Even statutes are often mere codifications of customary law.

[61] Schmitthoff *International Trade Usages* paras 5 & 6.

trade as well as trade practices.[62] Defining mercantile custom is no easy task. Some legal systems refer to it without attempting to define them.[63] German law, for example, provides for trade usages in section 346 HBG simply by stating:

> *"Unter Kaufleuten ist in Ansehung der Bedeutung und Wirkung von Handlungen und Unterlassungen auf die im Handelsverkehr geltended Gewohnheiten und Gebräuche Rücksicht zu nehmen."*

The same is true for instruments used in international trade such as the UNCITRAL Model Law on Commercial Arbitration of 1985. Article 28(4) of the Model Law reads:

> "In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."

Traditionally, trade practices referred to the practices which contract parties have established between themselves over a period of time to the extent that they create an expectation that this conduct will be continued.[64] They are also referred to as courses of dealing.[65] Trade usage refers to usages and practices which have originated in a particular place or trade and have been applied by merchants in that trade on a regular basis in a geographically large area, to such an extent that they are well-known and consequently expected to be adhered to by merchants engaged in that particular trade.[66] To that extent, trade usage may also constitute custom.

Some legal systems differentiate between the requirements for custom and trade usage, however. English law, for example, requires that custom should have existed "from time immemorial," whilst that is not required of a usage. Secondly, although it is not necessary that a usage should be confined to a limited locality, it is a requirement for a custom. Thirdly, trade usage will not be sanctioned if it is contrary to the positive

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[62] See Goode "Usage and Its Reception in Transnational Commercial Law" 1997 46(1) *ICLQ* 1 n 20, where he refers to the "linguistic ambiguity" of the terms "usage" and "custom". Traditionally, a distinction was made between them, but they can also be used interchangeably.
[63] Schmitthoff *International Trade Usages* para 9.
[64] Pamboukis "The Concept and Function of Usages in the United Nations Convention on the International Sale of Goods" 2005-06 (25) *J L & Com* 107 113.
[65] *Cf* s 1-303(b) UCC (2001) which defines "course of dealing" as "a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and conduct."
[66] Pamboukis 2005-06 (25) *J L & Com* 111.

law, whereas custom is by nature inconsistent with the general rules of the realm.[67] Nowadays, these terms are used interchangeably.[68] Although an immemorial local custom may have the force of law independently from the contract,[69] in English law, usages have mostly been relegated to an implied term and further limited by the binding force of precedent in the courts.[70] They are therefore not considered to have any independent normative force, although they are a source of obligation in commercial contracts and are employed to interpret the terms of a contract.[71] To be effective, such usages must conform to the mandatory law; be reasonable; reflect a consistent practice; be generally known or known to the party against whom it is invoked; and be certain and consistent with the terms of the contract.[72]

American law, on the other hand, not only recognises trade usages, but also defines them. Revised section 1-303(c) UCC (2001) provides that:

> "[a] usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."[73]

Under American law the concepts are not as clearly defined as under English law. Although customary law is recognised as an independent source of law, both custom and trade usage may function as evidence for the interpretation and supplementation of contracts under the UCC and the common law.[74] The requirements for custom as

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[67] Baker "Custom and Usage" in Lord Mackey of Clasfern (ed) *Halsbury's Laws of England XII(1)* 4th ed (1998) paras 601, 605. In general, see also Braybrooke 1951 (50) *Mich L Rev* 71 on English customary law.

[68] Goode *Commercial Law* 3rd ed (2004) 88 n 142. Although Baker "Custom and Usage" in *Halsbury's Laws of England* XII(1) paras 601, 651 acknowledges that the terms are used interchangeably, he is of the opinion that they are distinct in law.

[69] Baker "Custom and Usage" in *Halsbury's Laws of England XII(1*) para 601.

[70] Dalhuisen "Custom and Its Revival in Transnational Private Law" 2008 (18) *Duke J Comp & Int'l L* 339 n 7, 358; Basedow 2008 (56) *Am J Comp L* 706; Goode *Commercial Law* 13; Baker "Custom and Usage" in *Halsbury's Laws of England XII(1)* para 605.

[71] Goode *Commercial Law* 13, 88 n 144.

[72] Goode *Commercial Law* 13, 88. Baker "Custom and Usage" in *Halsbury's Laws of England* XII(1) para 650 defines usage as "a particular course of dealing or line of conduct which has acquired such notoriety that, where persons enter contractual relationships of the particular kind, or in the particular place, to which the usage is alleged to attach, those persons must be taken to have intended to follow that course of dealing or line of conduct, unless they have expressly or impliedly stipulated to the contrary." See also paras 656-661 for a discussion on the characteristics of usage.

[73] S 222 of the American Restatement (Second) of Contracts defines "trade usage" in virtually the same language.

[74] See revised ss 1-103 & 1-303(c)-(e) UCC (2001). Revised s 1-103(a) provides that the UCC should be "liberally construed to promote its underlying purposes and policies" of which is mentioned the "continued expansion of commercial practices through customs, usages and agreement of the parties". The separate reference to customs and usages presupposes a difference between the two concepts. Revised s 1-103(b) also provides that the law merchant may supplement the provisions of the Code.

set down in English law are rarely applied in the United States. The UCC abandoned the English test for custom, namely that it should be "ancient or immemorial".[75] It is merely required that trade custom or usage must be definite and have been in use for a considerable length of time to the extent that any one who is engaged in that trade may reasonably be supposed to know it and to be giving words a meaning in accordance with it.[76] Overall, in the context of international trade, American scholarly writing mostly refer to "trade usage" instead of "custom".

German law distinguishes between trade usage (*Handelsbrauch*)[77] and customary law (*Gewohnheitsrecht*). Although both have their origins in a continued or extended and recognised practice,[78] *Handelsbrauch* merely requires that a uniform practice should be followed,[79] whilst *Gewohnheitsrecht* also requires the universal observation of such practice (the so-called *opinio necessitatis*).[80] Customary law has the force of law, whilst trade usage is not enforceable *per se*. To that extent there should be a widespread conviction or recognition in a geographic area or a particular sphere of the trade that the custom is a valid and binding rule of law for it to apply as customary law.[81] Civil law countries largely consider usage as an issue of contract interpretation,[82] which means that trade usage mainly functions as an implied term in German law.[83] Apart from that, German law also acknowledges a category of trade usage which is known to a whole sector of the economy and is practiced by traders voluntarily and in a uniform way. These are the trade usages referred to in section 346 of the *Handelsgesetzbuch*. Usage of this kind is binding on the parties even if

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Revised s 1-103(d) states that trade usages, customs and practices may be used to "give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement." The same dual function is articulated by s 222(3) of the Restatement (Second) of Contracts. See also Kniffin "Interpretation" in Perillo (ed) *Corbin on Contracts V* (1998) paras 24:10, 24:13; Farnsworth *Contracts* 3rd ed (1999) 484-484.

[75] *Threadgill v Peabody Coal Co* 34 Colo App 203 526 P 2d 676 (1974).

[76] Kniffin "Interpretation" in *Corbin on Contracts V* para 24:15; Farnsworth *Contracts* 485-486.

[77] S 346 HGB.

[78] Foster *German Legal System & Laws* 2nd ed (1996) 58-60.

[79] The German Supreme Court RGZ 110, 47 requires "*durchgehende Zustimmung und Rechtsüberzeugung der beteiligten Kreise sowie einen angemessenen Zeitraum der Übung*."

[80] Renck *Der Einfluß der INCOTERMS 1990 auf das UN-Kaufrecht: Eine Untersuchung zu den rechtlichen Wirkungen der INCOTERMS 1990 im Recht des internationalen Warenkaufs* LL M thesis Hamburg (1995) 20, 22; Said *Das Risiko der Erteilung von Exportgenehmigungen nach den INCOTERMS, verglichen mit dem BGB* LL D dissertation Trier (1993) 31-32.

[81] This is the view of the Federal Constitutional Court (BVerfGE 57, 134) and the Federal Court of Justice (BGHZ 40, 26). See Foster *German Legal System & Laws* 59-60

[82] Dalhuisen 2008 (18) *Duke J Comp & Int'l L* 359; Köndgen & Borges "Commercial Law" in Reimann & Zekoll (eds) *Introduction to German Law* 2nd ed (2005) 121 124-125. Trade usage may play a similar role as good faith in contract interpretation. It is the same as the *Verkehrssitte* concept of ss 157 & 242 BGB. See Koller "Section 346" in Staub (ed) *Handelsgesetzbuch Großkommentar IV* 4th ed (2004) para 1; Kort "Section 346 HGB" in Ebenroth, Boujong & Joost (eds) *Handelsgesetzbuch* 1st ed (2001) para 1. Although s 346 distinguishes between *Gewohnheiten* and *Gebräuchen*, they are used as synonyms to refer to the notion of *Handelsbrauch*.

[83] Basedow 2008 (56) *Am J Comp L* 706.

they do not know it, and it takes precedence over dispositive but not over mandatory provisions of statutory law.[84]

As for South African law, an early decision of the Appellate Court ruled that substantially there is no difference between English law and Roman Dutch law regarding the existence of a custom.[85] The only real difference is that Roman Dutch law is satisfied if the custom is simply old, whilst English law requires an immemorial origin. The distinction between custom and trade usage was at first followed by the South African case law[86] but was later rejected.[87] It now appears that there is no distinction.[88] The requirements for trade usage are that the usage should be universally and uniformly observed within the particular trade concerned, long-established, notorious, reasonable and certain, and does not conflict with the positive law or with the provisions of the contract.[89]

In *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration*,[90] Corbett AJA classified terms implied by trade usage as terms implied by law. Christie,[91] however, contends that trade usage "really occupy an intermediate position between terms implied by law and tacit terms." If the trade usage is known to both parties, their knowledge is one of the surrounding circumstances and the trade usage is incorporated into their contract as a tacit term as part of their presumed intention. However, if one of the parties did not know of the trade usage it could still be incorporated as an implied (tacit)[92] term. Christie holds that the proper inquiry would be to establish whether the party professing ignorance has so conducted himself that the other party, on the principle of quasi-mutual assent, is entitled to assume that he knew of the trade usage and intended to incorporate it tacitly in the contract.[93] According to Christie, this is the test which the courts carry out in most instances

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[84] Basedow 2008 (56) *Am J Comp L* 706-707. See also Koller "Section 346" in *Großkommentar* para 4

[85] *Van Breda v Jacobs* 1921 AD 330.

[86] *Frank v Ohlsson's Cape Breweries Ltd* 1924 AD 289 295; *Coutts v Jacobs* 1927 EDL 120 128.

[87] *Catering Equipment Centre v Friesland Hotel* 1967 4 SA 336 (O);

[88] *Tropic Plastic and Packaging Industry v Standard Bank of SA Ltd* 1969 4 SA 108 (D); *Barclays Bank International Ltd v Smallman* 1977 1 SA 401 (R). Christie *The Law of Contract in South Africa* 5th ed (2006) 163, however, is still in favour of such a distinction.

[89] *Crook v Pedersen* 1927 WLD 62 71; *Golden Cape Fruits (Pty) Ltd v Fotoplate (Pty) Ltd* 1973 2 SA 642 (C) 645.

[90] 1974 3 SA 506 (A) 531.

[91] *Law of Contract* 161, cited with approval in *Blumberg v Wilkinson* 1995 4 SA 403 (W) 409.

[92] South African terminology can cause confusion. "Implied terms" and "tacit terms" are often used interchangeably as a result of English law influence. In English law, "implied terms" denote terms that form part of the tacit agreement of the parties. In SA law, "terms implied by law" or "implied terms" refer to terms that have autonomous application independently of the express or tacit agreement of the parties, whilst "tacit terms" are based on implied or tacit agreement of the parties.

[93] See Kerr "To Which Category of Provisions of a Contract Do Provisions Originating in Trade Usage Belong? Problems in regard to Quasi-Mutual Assent" 1996 (59) *THRHR* 331 332 for criticism against this construction.

where terms are implied by law. He is, however, of the opinion that the result should not be classified as a term implied by law, since the enquiry has been an exercise concerned with the common intention of the parties rather than the imposition of a rule of law of general application.[94] If the term has not developed into a rule of law, the court cannot take judicial notice of it and it has to be established by evidence. Kerr,[95] however, rejects Christie's notion of a distinct category. He distinguishes between terms expressly or impliedly (tacitly) agreed upon and so-called "residual terms".[96] It is his argument that the notoriety, reasonableness and time requirements for trade usage will differ depending on whether the usage is incorporated into the contract as a contractual term or whether it is incorporated as a so-called "residual term". In the latter case, the requirements are more stringent because any person dealing in that particular branch of the trade is presumed to have knowledge of the trade usage even if he had no knowledge of the usage. Apart from trade usages, South African law also acknowledges the independent character of customary law outside the contractual context. In *Van Breda v Jacobs*,[97] the Appellate Court ruled that a custom could be a source of law if it meets the above stated requirements for trade usage.[98]

The UN Convention on Contracts for the International Sale of Goods provides for trade usages in article 9. No effort is made to define the concept; although certain requirements are stated for its operation. Article 9(1) requires that the parties to the contract will be bound by usages "to which they have agreed and by practices which they have established between themselves."[99] This paragraph provides for the consideration of trade usages and practices on the basis of party intent.[100] In contrast to the subjective approach of paragraph 1, paragraph 2 provides that usages "of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved

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[94] Christie *Law of Contract* 162.
[95] *The Principles of The Law of Contract* 6th ed (2002) 380-381; Kerr 1996 (59) *THRHR* 331-333. See also Kerr "Trade Usage and Custom" 1970 *SALJ* 403 405-407.
[96] "Residual terms" are terms implied by law.
[97] *Supra.*
[98] S 231(4) of the Constitution also recognises the force of customary law, both local and international.
[99] For a practice to be established, the case law requires a long-lasting contractual relationship which involves a number of sale agreements. *Landgericht Zwickau* Germany (*chemical products* case) 19 Mar 1999 http://cisgw3.law.pace.edu/cases/990310g1.html (accessed 12-05-2009); CLOUT Case No 217 (*Handelsgericht Aargau* Switzerland 26 Sept 1997) http://www.unilex.info/case.cfm?pid=1&do=case&id=404&step=Abstract (accessed 12-05-2009); CLOUT Case No 360 (Lower Court Duisberg Germany 13 April 2000 - *pizza cartons* case) http://cisgw3.law.pace.edu/cases/000413gl.html (accessed 12-05-2009); CLOUT Case No 221 (*Zivilgericht des Kantons* Basel-Stadt Switzerland 2 Dec 1997). See also the 2008 UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods http://cisgw3.law.pace.edu/cisg/text/digest-art-09.html (accessed 12-05-2009) para 7.
[100] Art 8 CISG, in turn, provides guidelines on determining the intention of the parties to the contract.

in the particular trade concerned" will automatically become applicable to the contract, unless the parties have agreed otherwise. This is a more objective approach where contract supplementation takes place independently of the actual intent of the parties.[101] The requirements of these two paragraphs shed some light on the distinction between trade practices and usages. Practices as envisaged by paragraph 1 are established through conduct of the parties to a contract with such frequency that they create a common basis for understanding their future conduct in similar circumstances, whilst paragraph 2 indicates that trade usage entails conduct which is regularly observed in a particular trade over a geographically large area to the extent that merchants in that particular trade are expected to have knowledge of a particular usage.[102]

Article 1 9 of the UNIDROIT Principles of International Commercial Contracts (2004) displays virtually the same requirements as article 9 of the CISG, except that article 1 9(1) UNIDROIT Principles merely states that the parties "are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable." It is not required that the parties should have known or should be supposed to have known of the trade usage for it to become applicable. If a particular usage is widely known it can be assumed that all parties doing business in that specific trade should have knowledge of it if such usage is a reasonable one.

Despite differing requirements in different legal systems and a general lack of clear definitions, it can be concluded that both mercantile custom and trade usage consist of conduct or practices which have been in existence for a long time in a given geographical area or trade, are well-known and are regularly followed by merchants in that area or trade. But what is the relevance and value of mercantile custom in the context of international sales? The discussion has shown that it is a common feature of legal systems that established trade usages and practices provide a common basis for interpreting and performing the contract of sale. In so far as trade usages reflect consistent practices which are uniformly followed in a specific area or in a particular trade, they also fulfil a harmonisation function.

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[101] Schmidt-Kessel "Article 9" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) paras 1. *Honnold Uniform Law for International Sales under the 1980 United Nations Convention* 3rd ed (1999) para 118; Bonell "Article 9" in Bianca & Bonell *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (1987) para 2 2 1. Whether art 9(2) confers normative validity on international trade usages is a controversial issue. See 7 2 2 *infra* for a discussion on the various viewpoints in this regard.

[102] Pamboukis 2005-06 (25) *JL & Com* 113-118. See also 7 2 2 *infra.*

Whether mercantile custom constitutes an essential part of the autonomous rules of international trade has always been a matter of controversy.[103] The legislative history of the United Nations Convention on Contracts for International Sale of Goods (CISG) shows that trade usage was one of the "political issues" that generated considerable debate,[104] and the incorporation of trade usages by courts of law has been viewed as "neo-colonialist" and contrary to the principles of party autonomy or economic efficiency.[105] Adherents of the role of mercantile custom regard it as the very basis of modern international commercial law.[106] Opinions range from support for an independent and autonomous body of international commercial law, the *lex mercatoria* based on mercantile customs and usages,[107] to those who restrict the operation of custom to party agreement, municipal law or the ratification of international conventions.[108]

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[103] Pamboukis 2005-06 (25) *JL & Com* 107. See also in general, Wiener *Globalization and the Harmonization of Law* (1999) ch 7.

[104] Bainbridge "Trade Usage in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions" 1984 (24) *Va Jnl Int'l L* 619 635-641; Bonell "The CISG, European Contract Law and the Development of a World Contract Law" 2008 (56) *Am J Comp L* 1 2. See also Cutler *Private Power and Global Authority* 221, who holds that trade terms can assist developed countries in dominating international trade, whilst for developing countries, they may function as barriers preventing them from entering international trade. On the basis of its stronger commercial power, Britain was able to dictate to its trade partners the export of coal on CIF terms and the import of cotton on an FOB basis. This way they were able to expand their merchant marine as they could choose the shipowner who is to ship the goods.

[105] Cutler *Private Power and Global Authority* 216; Gillette "The Law Merchant in the Modern Age: Institutional Design and International Usages under the CISG" 2004 (5) *Chi J Int'l L* 157 158; Katz "The Relative Costs of Incorporating Trade Usage into Domestic versus International Sales Contracts: Comments on Clayton Gillette, Institutional Design and International Usages under the CISG" 2004 (5) *Chi J Int'l L* 181 182.

[106] Goldštajn "Usages of Trade and Other Autonomous Rules of International Trade According to the UN (1980) Sales Convention" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* 55 56 and Gillette 1999 (39) *Va J Int'l L* 710 both hold that custom is part of the law of international sales. De Ly "Sources of International Sales Law: An Eclectic Model" 2005-06 (25) *J L & Com* 1 5, however, is of the opinion that, apart from closed business environments, globalisation and technological changes cause custom and usage to increasingly lose their relevance. He is of the view that a course of dealing between the same parties is much more relevant in the modern trade situation.

[107] The so-called autonomist approach holds that the *lex mercatoria* is an autonomous a-national self-generating system of laws that exist independently of any national legal system. This system of law is created by the mercantile community itself and consists of practices, usages and customs supplemented by the general principles of law recognised by merchants. See Berman & Kaufmann "The Law of International Commercial Contracts (Lex Mercatoria)" 1978 (19) *Harv Int'l LJ* 221 272-277; Wiener *Globalization* 161-162. The idea of a legal order designed for transnational transactions dates back to the *ius gentium* developed by the *praetor peregrinus*, who devised rules that had a universal purport to govern disputes with and between non-Romans. See Kunkel *An Introduction to Roman Legal and Constitutional History* 2nd ed (1972) 76-77.

[108] The positivist approach, on the other hand, recognises the transnational nature of the *lex mercatoria* but only as a result of ratification by states; either by means of conventions or the municipal law. See Maniruzzaman "The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration" 1999 (14) *Am U Int'l L Rev* 657 671-672. This is also the approach advocated by Schmitthoff. He includes international custom as formulated by international agencies, such as the ICC, in the list of sources of transnational law. See Schmitthoff "The Unification of the Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 170 171-172; *International Trade Usages* paras 64-74; Wiener *Globalization* 163-167.

The traditional *lex mercatoria*, or so-called international commercial law of the Middle Ages, consisted of a body of law based on usages created by the merchants' courts in order to solve problems related to commerce.[109] Whether the law merchant as a supra-national law of international trade still exists in some form or other is an issue of much debate.[110] For present purposes, it is sufficient to say that there are a number of scholars who believe in the existence of such an independent and autonomous body of international commercial law.[111] It should also be noted that there is a practice amongst international commercial arbitrators to resort to a so-called new *lex mercatoria*, consisting of internationally accepted principles of international trade, based on mercantile customs and usages.[112]

Despite divergent opinions, mercantile custom plays a significant role in international sales.[113] Where a practice in a particular trade has become harmonised to the extent that it has developed into a trade usage or custom, it is no longer necessary for parties to explicitly agree on a term. Custom protects the expectations of parties who anticipate compliance by others engaged in the same trade; thereby reducing transactions costs and enhancing the economic efficiency of the transaction.[114] Custom is more susceptible to commercial needs and developments and normally represent superior practices, which can enhance the economic efficiency of the contract. Mercantile custom is by its very nature dynamic and constantly changing to adapt to the needs of the trade.[115] Custom also provides a good example of how the commercial community can shape legal rules across national borders and thereby contribute to the harmonisation of sales laws. Having stood the test of time, these practices are presumed to be economically efficient. However, it does not always follow that a common practice allocates the risks inherent in a situation optimally.

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[109] Schmitthoff *International Trade Usages* paras 64-74; Ferrari "Uniform Interpretation of The 1980 Uniform Sales Law" 1994-95 (24) *Ga J Int'l Comp L* 183 183-186; Bainbridge 1984 (24) *Va Jnl Int'l L* 624-628. After the fourteenth century, the law merchant was incorporated into the common law and subsequently had to be proven in a normal court of law. The drive to nationalisation in the nineteenth and twentieth centuries further contributed to the decline of the law merchant, which was substituted by national and regional commercial codes. See Dalhuisen 2008 (18) *Duke J Comp & Int'l L* 340-341; Basedow 2008 (56) *Am J Comp L* 703-706; Wiener *Globalisation* 161-162; Juenger "The *lex mercatoria* and private international law" 2000 *Unif L Rev* 173 for a discussion on the evolution of the law merchant. See, however, Baker "Custom and Usage" in *Halsbury's Laws of England* XII(1) para 662, who argues that there was no unwritten universal law applicable in England.

[110] Le Goff "Global Law: A Legal Phenomenon Emerging From the Process of Globalisation" 2007 (14) *Ind J Global Legal Stud* 119 125-126.

[111] Dalhuisen 2008 (18) *Duke J Comp & Int'l L* 348

[112] Berman & Kaufmann 1978 (19) *Harv Int'l L Jnl* 276-277; Maniruzzaman 1999 (14) *Am U Int'l L Rev* 706.

[113] United Nations *Unification of the Law of International Trade: Note by the Secretariat* Official Records of the General Assembly 20th Session (1968) Doc A/C.6/L.572 para 15.

[114] Gillette 2004 (5) *Chi J Int'l L* 158,160. *Cf* 1 2 3 *supra*.

[115] Dalhuisen 2008 (18) *Duke J Comp & Int'l L* 362-370.

Sometimes network and learning effects preclude the use of an optimal practice in support of the *status quo*.[116]

Another benefit of relying on custom is that it trumps national law, obviating the need to resort to the rules of private international law.[117] However, this benefit does not come without dangers of its own. The judicial recognition of and the interpretation of custom can present obstacles similar to those inherent in divergent legal rules. Courts and arbitrators have to establish the common understanding of custom amongst merchants, shipowners, marine insurance underwriters, bankers and others engaged in international trade.[118] Unless a judge or arbitrator is familiar with the content of a particular custom, expert evidence is required to give meaning to it.[119] Its interpretation is furthermore complicated by the fact that the common understanding of custom tends to shift as commercial practices evolve in reaction to changing commercial realities. This is particularly true in the context of trade terms. Trade terms represent commercial trade usages and practices which may differ from country to country or from one branch of the trade to another. The understanding of a custom often depends on the locality in which the usage occurs or the type of trade in which it is used. It may also evolve as transportation practices develop, such as in reaction to the container revolution or the advent of multimodal transport for example.[120] Since there is in general no consistent and universal understanding of trade usage or custom in so far as the concepts of delivery and the passing of risk are concerned, it is not possible to attach a universal or common meaning to most trade terms used in modern international trade.[121] Therefore, when it comes to trade terms, the role of custom as a form of harmonisation is limited. The lack of universal agreement on the meaning of trade terms affects their economic efficiency and emphasises the need for trade term standardisation to ensure certainty and predictability. The ICC has consequently endeavoured to harmonise and standardise international custom by providing a codification of trade term definitions in the form of INCOTERMS.[122] This codification will be discussed in more detail in the next chapter.

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[116] Gillette 1999 (39) *Va Jnl Int'l L* 709-712, 721-732.
[117] 724.
[118] Berman & Kaufmann 1978 (19) *Harv Int'l L Jnl* 254; Gillette 2004 (5) *Chi J Int'l L* 158, 164-166.
[119] Berman & Kaufmann 1978 (19) *Harv Int'l L Jnl* 275.
[120] *Cf* 1 3 3 *supra* & 5 2 3 1 *infra*.
[121] Except perhaps for the traditional FOB and CIF terms. See 7 2 2 *infra*.
[122] Basedow 2008 (56) *Am J Comp L* 709-710 is of the opinion that INCOTERMS were initially only an attempt to reconcile divergent national understandings in a so-called "deliberate international compromise". The continuous use of these terms, however, gradually transformed them into custom in the course of one or two generations. Dalhuisen 2008 (18) *Duke J Comp & Int'l L* 356 agrees that, although they are normally applied as contract terms, INCOTERMS may also operate as custom.

### 4 3 2 Harmonisation of substantive sales law

Attempts to unify the substantive law on the sale of goods originated when the German scholar Ernst Rabel[123] suggested this possibility to the International Institute for the Unification of Private Law (UNIDROIT). In the early 1930s, UNIDROIT[124] initiated a project under the auspices of the League of Nations to prepare a law unifying the substantive rules governing contracts for international sales. A commission of European scholars under the leadership of Rabel proceeded to draft a preliminary report which was presented in 1935.[125] The work was interrupted by the Second World War, but was resumed in 1951 with a conference at The Hague. Further drafts culminated in a diplomatic conference held at The Hague in 1964 where two conventions were adopted. The Uniform Law on the International Sale of Goods (ULIS) governs the rights and obligations of parties to contracts for international sales, and the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF) the formation of international sales contracts. These conventions, known as the Hague Conventions, came into force in 1972.

However, the Hague Conventions had little success and were adopted by only a limited number of contracting states, mostly from Western Europe.[126] Because the developing and the socialist countries were not sufficiently represented during negotiations, the impression was left that this was a law made for Western Europe.[127] None of the major trading nations, such as the United States of America or France, ratified the conventions; resulting in them never really receiving recognition as instruments of international harmonisation.

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[123] Rabel "*Der Entwurf eines einheitlichen Kaufgesetzes*" 1935 *RabelsZ* 1.

[124] The organisation was first established in 1926 on the basis of a bilateral agreement between the Italian government and the League of Nations, but after the withdrawal of Italy from the League in 1935, the organisation became an independent body in 1940. UNIDROIT is a permanent institution with governmental membership that promotes the harmonisation and unification of private law throughout the world by preparing legal texts setting out uniform rules, such as the Principles for International Commercial Contracts, commonly known as the UNIDROIT Principles. UNIDROIT has also drafted numerous other conventions, model laws, principles and guides.

[125] One of the questions they had to answer was whether unification should focus on the law of obligations as such or merely on international sales. Another question was whether the passing of ownership should be dealt with.

[126] They were adopted by only 9 countries, namely Belgium, Gambia, Germany, Israel, Italy, Luxembourg, the Netherlands, San Marino and the United Kingdom. Belgium, Germany, Italy, Luxembourg and the Netherlands subsequently denounced their ratifications when they ratified the CISG.

[127] Sono "UNCITRAL and the Vienna Sales Convention" 1984 (18) *Int'l Law* 7 12-13; Winship "Private International Law and the UN Sales Convention" 1988 (21) *Cornell Int'l LJ* 487 489-490.

The most important organisation constituted by government representatives, the United Nations Commission on International Trade Law (UNCITRAL),[128] became operative in 1968. It is UNCITRAL's mandate to unify and harmonise international trade law in order to eliminate legal obstacles to international trade and to ensure the development of economic activities on a fair and equal basis.[129] In the context of international sales law its major contribution is the United Nations Convention on Contracts for the International Sale of Goods (CISG).[130]

Unification efforts, however, are not restricted to international conventions. Organisations that promote the harmonisation of private law rules have formulated model laws and general principles, such as the UNIDROIT Principles for International Commercial Contracts,[131] that have proved to be of much value in the revision of domestic laws,[132] the resolution of international disputes[133] and in the interpretation of international uniform law instruments such as the CISG.[134] The UNIDROIT Principles present a general restatement of contract law principles which can apply to commercial contracts by agreement of the parties.[135] The Preamble to the Principles states that they can also apply when the parties to the contract have agreed that their contract will be governed by general principles or the *lex mercatoria*.[136]

Apart from efforts on the universal level, general principles with regional application can also contribute to the harmonisation of contract law. Although principally aimed at the harmonisation of contract law in Europe, the drafters of the Principles for

[128] For a summary of the UNCITRAL approach as well as its working methods and philosophy, see Bazinas "Harmonization of International and Regional Trade Law: the UNCITRAL Experience" 2003 *Unif L Rev* 53; Sono 1984 (18) *Int'l Law* 7.
[129] Sono 1984 (18) *Int'l Law* 8. See also General Assembly Resolution 2205 (XXI) of 17 December 1966 *UNCITRAL Yearbook I* (1968-1979) 65.
[130] UNCITRAL has produced countless other conventions facilitating all aspects of international trade and it is also active in establishing model laws and in preparing legislative guides and recommendations, such as the UNCITRAL Legal Guide on Drawing up International Contracts for the Construction of Industrial Works (1988) and the UNCITRAL Legal Guide on International Countertrade (1992) which deal with aspects that require consideration in the drafting of international business contracts.
[131] 1994 and 2004.
[132] Such as the revised German law on obligations, revised Article 2 of the American UCC, the Chinese contract law, the OHADA Uniform Contract Law and many more. See Bonell 2008 (56) *Am J Comp L* 18-21 for more examples.
[133] Bonell 2008 (56) *Am J Comp L* 24-25; Berman & Kaufmann 1978 (19) *Harv Int'l L Jnl* 276-277; Maniruzzaman 1999 (14) *Am U Int'l L Rev* 706.
[134] Bonell 2008 (56) *Am J Comp L* 25; Bonell "The UNIDROIT Principles of International Commercial Contracts and the Harmonisation of International Sales Law" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 289 paras 21-028–21-044. See also 4 4 2 *infra* for the role that the Principles can play in the context of a Global Commercial Code.
[135] The Principles place considerable emphasis on the value of international custom.
[136] In general, see Rosett "The UNIDROIT Principles of International Commercial Contracts: A new approach to International Commercial Contracts" 1998 (45) *Am J Comp* L 347; Bonell 2008 (56) *Am J Comp L* 16-18. Ferrari 1995 (69) *Tul L Rev* 1230-1231 raises the question whether the Principles may function as a choice of law. In this regard, see also Bonell 2008 (56) *Am J Comp L* 21-24.

European Contract Law (PECL)[137] did not confine themselves to the domestic law of the member states of the European Union in sourcing materials for formulating the principles, but also included materials such as the American Restatement on Contracts and the CISG. However, the European Principles do not cover the ECC directives on consumer sales and many commentators consider them a mere academic exercise in the field of contract law and a preliminary step towards a European Civil Code. Although the idea of a European Code was much alive at the start of this millennium, the European Commission has since then restricted its scope to a common framework of reference, or so-called "toolbox", for the revision of the European consumer *acquis*.[138] The Draft Common Frame of Reference (DCFR) was published in February 2009. Whether the CFR can function as a choice of law to govern the contract in cross-border transactions, and what the precise scope of such an optional instrument will be, is not clear yet.[139]

What is interesting, though, is the manner in which trade usage is dealt with under the CFR. Book Two of the CFR provides for trade usage in article II-1:104. It confirms the position as envisaged by article 9(1) CISG by acknowledging usages which the parties have agreed on or any practices which they have established between themselves. Although it still does not define trade usage, it goes one step further than merely giving effect to usage on the basis of good faith. It seems to confer normative authority to trade usage by stating in paragraph 2 that the parties are bound by a usage which would be considered generally applicable to persons in the same situation as the parties, except where the application of such usage would be unreasonable.[140]

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[137] The project was initiated by the Commission on European Contract Law, also known as the Lando Commission, and was published in 3 volumes in 1995, 2000 and 2003. The Principles endeavour to restate the common core of the European contract law and have also functioned as a model for the revision of domestic laws, such as the German BGB.

[138] In general, see Basedow "The renascence of uniform law: European contract law and its components" 1998 (18) *J Legal Stud* 121; Truilhé-Marengo "Towards a European Law of Contracts" 2004 (10) *ELJ* 463. For a general summary of the process that led to the DCFR, see Bonell 2008 (56) *Am J Comp L* 11-15; European Commission *A More Coherent European Contract Law Action Plan* COM 2003 68 final (12-02-2003); *Green Paper on the Review of the Consumer Acquis* Com (2006) 744 final (02-02-2007).

[139] Bonell 2008 (56) *Am J Comp L* 15-16. For a critical analysis of the DCFR, see Eidenmüller et al "The Common Frame of Reference for European Private Law – Policy Choices and Codification Problems" 2008 (28) *Oxford J Legal Stud* 659.

[140] Drettmann *Would English law in trade usages benefit from adopting a more formal approach such as seen in other jurisdictions as well as in international conventions?* thesis (degree unknown) West-of-England http://www.cisg.law.pace.edu/cisg/biblio/drettmann.html (accessed 30-10-2009) VIII 3.

### 4 3 3 Unification of private international law

Contracts do not function within a vacuum and, therefore, every contract must be governed by a system of law. Because law is territorial in nature and only has force within specified national boundaries, an international contract of sale should be governed by one of the legal systems potentially applicable to it. The multiplicity of legal systems applicable to an international contract of sale has been identified as one of the major legal problems facing international business transactions.[141]

Private international law rules,[142] also known as conflict-of-laws rules,[143] are applied to establish which legal system applies to the contract of sale.[144] Once the governing law is established, a dispute will be solved with reference to that legal system.

However, the rules of private international law are themselves characterised by much uncertainty.[145] Great legal scholars, such as Bartolus of Sassoferato, Friedrich Carl von Savigny and Joseph Story, advocated different opinions on how the rules should be applied.[146] However, different schools of thought hardly serve the needs of international sales, which require certainty and predictability of the legal rules

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[141] See 1 1 *supra*. Even in the case of unified substantive law, the success of such rules depends on their scope of application. Where gaps exist, those gaps will be filled with reference to custom or domestic law. See Art 7(2) CISG for example. An effective international sales regime would therefore require that unified sales law should be supplemented by unified conflict-of-laws rules. In general, on the relationship between uniform law and private international law, see Winship 1988 *Cornell Int'l LJ* 487; Thoma "Relations Between Conflict of Law Rules and Uniform Law" 2000 (53) *RHDI* 169.

[142] Civil law countries tend to refer to "rules of private international law" as the rules that determine the applicable law of a contract. The term was originally coined by Story in 1843, and was later adopted by the earlier English authors such as Westlake and Foote.

[143] Common law countries prefer to use this term or to refer to these rules as "choice-of-law" rules. The latter term should not be confused with the more limited concept of a choice-of-law clause, where the parties to the contract choose the governing law of their contract by agreement.

[144] The two phrases can be used interchangeably. For a contrary opinion, see Winship 1988 *Cornell Int'l LJ* 487 n 1. On private international law, in general, see North & Fawcett *Cheshire and North's Private International Law* 13th ed (1999); Collins (ed) *Dicey, Morris and Collins on The Conflict of Laws II* 14th ed (2006); Forsyth *Private International Law: the modern Roman-Dutch Law including the jurisdiction of the High Court* 4th ed (2003); Edwards "Conflict of Laws" in Joubert (ed) *LAWSA II* 1st reissue (1993); Viejobueno "Private international law rules relating to the validity of international sales contracts" 1993 (26) *CILSA* 172.

[145] Viejobueno 1993 (26) *CILSA* 184. The "proper-law" of the contract refers to the system which the parties intended to have the contract governed by, or where their intention is not expressed or capable of inference, the system of law with which the contract has its closest and most real relationship. This places its emphasis on either the law of the place of contracting (*lex loci contractus*) or the place of performance (*lex loci solutionis*). It is also possible for different parts of a contract to be governed by different legal systems (*dépeçage* or "splitting of the contract"). See also the discussion on the problems involved in applying the rules of private international law 1 1 *supra*. During the 20th century, the introduction of the American conflict-of-laws revolution, which introduced a more flexible and fair approach based on the facts of each individual case, resulted in American and European law on choice-of-law rules to drift apart. In Europe, the classical theory based on vested rights remained in use. This approach favours certainty and predictability. See Rühl "Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency" in Gottschalk et al (eds) *Conflict of Laws in a Globalised World* (2007) 153.

[146] Juenger 2000 *Unif L Rev* 174.

applicable to the contract. Even to this day these differences are not resolved. Moreover, in many instances the application of the rules are based on so-called "connecting factors" which lead to arbitrary results. In addition, the rules often involve parties in problems of jurisdiction and forum shopping. Every country has its own set of private international law rules, which means that their application will depend on the forum or jurisdiction where the case is to be heard. Parties try to circumvent this procedure by agreeing on a forum which would be more favourable to their circumstances in the event of a dispute.[147] Moreover, in practice, judges often resort to a "homeward trend" by applying the law most familiar to them despite the fact that the private international rules of the forum indicates another governing law.[148] In other instances, parties agree on a governing law by means of a choice-of-law clause. Such a choice may favour one of the parties to the contract by choosing that party's domestic law.[149]

The problems involved in establishing and applying the governing law of a contract bring with them the risk of increased transaction costs. Attempts to harmonise and unify the rules of private international law started in 1924 when the International Law Association appointed a committee to prepare a draft text on choice-of-law rules. The Hague Conference on Private International Law[150] took up this work in 1928. A draft was completed in 1931, but it was only approved by the Conference in 1951.[151] The resulting international convention, the Convention on the Law Applicable to International Sales of Goods, was thereafter signed in 1955 and it came into force in 1964 upon the ratification of five states. It is now in effect in only eight states, namely Denmark, Finland, France, Italy, Niger, Norway, Sweden and Switzerland after the ninth state, Belgium, denounced its ratification in 1999. In response to the CISG, the Hague Conference prepared a revision of the 1955 Conflict Convention. In 1985, the Conference adopted the revised text with some amendments, called the Convention

[147] The Hague Convention on Choice of Court Agreements (2005) is aimed at regulating choice-of-forum clauses. As of April 2009, only one more ratification or accession is needed for this convention to enter into force. See http://www.hcch.net/index_en.php (accessed 11-04-2009).
[148] Juenger 2000 *Unif L Rev* 175-176.
[149] *Cf* 1 1 *supra* on transaction costs involved in a choice of law. It is argueable that the economic rationality and efficiency of party autonomy can refute the negative connotations of a choice-of-law clause.
[150] Founded in 1893, the Hague Conference is a permanent body made up of governmental members. Although the organisation devotes itself mainly to unifying conflict-of-laws rules, it also provides international conventions on international commercial and financial law, family law and the law of succession, property related issues, legal co-operation and litigation, as well as the international protection of children.
[151] On the efforts of the Hague Conference, see in general, Lipstein "One Hundred Years of Hague Conferences on Private International Law" 1993 *ICLQ* 553 616-622. See also Thoma 2000 (53) *RHDI* 170 n 6 for the advantages of uniform rules on private international law.

on the Law Applicable to Contracts for the International Sale of Goods (1986). This convention has not come into force yet.[152]

The 1980 EEC Rome Convention on the Law Applicable to Contractual Obligations also contains uniform rules for the determination of the applicable law in contracts with parties from countries in the European Union. Apart from providing unification and codification of the general rules on conflict of laws in the European Union, its purpose is also to inhibit forum shopping and to increase legal certainty.[153] The Convention came into force on April 1st, 1991. At first, the Convention only applied to the then ten Members of the European Community, namely Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands and the United Kingdom. Subsequently, Spain, Portugal, Austria, Finland and Sweden acceded to the Convention. Although the Convention is only open to signature by Members of the European Community, there is nothing that prevents other countries from incorporating the rules and principles of the Rome Convention into their private international law rules.[154] Moreover, the Convention defines itself as being applicable "in any situation involving a choice between the laws of different countries,"[155] that is, as not restricted to a connection with a Contracting State but having universal application. Even if the Convention's choice-of-law rules point to the law of a non-Contracting State, that law is to be applied.[156] On 17 June 2008, a European Community Regulation[157] has been adopted, which will replace the Rome Convention within the Member States of the European Community, except for Denmark, in respect of all contracts concluded after 17 December 2009.[158]

In so far as the private international law of contracts is concerned, European and American law are moving towards similar approaches based on party autonomy and

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[152] To date there are only 2 contracting states, namely Argentina (ratification with a reservation) and the Republic of Moldova (accession). See http://www/hcch.net/index_en.php?act=conventions.statuscid=61 (accessed 30-10-2009).
[153] Collins (ed) *Conflict of Laws II* para 32-012; North & Fawcett *Private International Law* 536.
[154] North & Fawcett *Private International Law* 535-536.
[155] Art 1(1). There is no explanation of this phrase. The Giuliano-Lagarde Report, which was published together with the Convention, states that the relevant situations are ones which involve one or more elements foreign to the domestic system of a country, such as the nationality or residence of the parties to the contract or the place of performance, which result therein that the legal systems of more than one country could be applicable to the contract. See Collins (ed) *Conflict of Laws II* para 32-027. It could also apply to a contract between two territorial units within one country. See Viejobueno 1993 (26) *CILSA* 176.
[156] Arts 2 & 3 Rome Convention.
[157] Regulation EC No 593/2008 of the European Parliament and the Council on the law applicable to contractual obligations. See in general Bonell 2008 (56) *Am J Comp L* 23.
[158] Rome II, Regulation EC 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations provide for proceedings that commence after 11 January 2009 for all Member States, except for Denmark.

the right to choose the applicable law. In Europe, article 3(1) of the Rome Convention regulates the principle of party autonomy, whilst in the United States, the principle is founded in section 187 of the Restatement (Second) of Contracts and revised section 1-301 UCC (2001).[159] The understanding of party autonomy in European and American materials is in accord with one another and leads to similar results. A choice-of-law approach is evident in most international contracts and indirectly facilitates the harmonisation of international law on conflict-of-laws.[160] The convergence between the different systems may be explained by means of an economic argument. It is generally agreed that the freedom to choose the law applicable to a contract presents an efficient approach to the problem of conflict-of-laws. Individuals are rational maximisers of their own welfare and will therefore not enter a choice-of-law agreement unless they believe that it will make them better off, for example because the chosen law is better suited to their needs, is neutral or brings with it an established body of case law which facilitates interpretation and avoids future disputes.[161]

## 4 4 The optimal harmonisation method

### 4 4 1 Criteria for evaluation

Although there is general agreement on the need for harmonisation of the substantive private law rules, there is less agreement on the means by which it is to be achieved. The suitability of a particular harmonisation method depends on a

[159] Previously s 1-105 UCC. As of July 1, 2009, 34 states have adopted revised Art 1. However none of those that have done so, have adopted revised s 1-301. All of them have either retained the previous version or replaced it with a substitute with language consistent with the pre-revised s 1-105. See *ABA Business Law Section Summer 2009 Developments Reporter* http://www.abanet.org/buslaw/committees/CL190000pub/newsletter/200907/subcommittees/developments.pdf (accessed 24-08-2009). Whilst the pre-revised s 1-105 required that the choice of law should have a "reasonable relation" to the law of the state that is chosen and would only apply where so permitted by the applicable law of the contract, such relationship is not required by revised s 1-301, except for consumer sales where this requirement still applies. On the problems experienced with revised Art 1, see in general, Krahmer & Gabriel *Article 1 and Article 2A: Changes in the Uniform Commercial Code Regarding General Provisions of Sales and Leases* unpublished paper presented at symposium on *Emerging Trends in Commercial Law: Surviving Tomorrow's Challenges* hosted by the DePaul Business and Commercial Law Journal on 15-04-2004. http://mytechlaw.lawttu.edu/library/faculty/Faculty%20Scholarship%20Files/Krahmer%DePaul.pdf (accessed 25-09-2009); Rowley & Tweedy *The Often Imitated, But (Still) Not Yet Duplicated Revised UCC Article 1* research paper 08-17 published by the William S Boyd School of Law at the University of Nevada Las Vegas dated 15-05-2008 http://ssrn.com/abstract=1123744 (accessed 25-09-2009). The reluctance of states to adopt revised s 1-301 forced the NCCUSL and the ALI to promulgate a replacement uniform s 1-301 to retain uniformity. The replacement will become effective on 1 January 2010 and retains in essence the former s 1-105 UCC.

[160] In general, see Rühl "Party Autonomy" in *Conflict of Laws* 155-158.

[161] 176-177.

number of factors, which include the nature of the rules that are to be harmonised as well as their economic and social setting. Other factors that are to be taken into consideration are the degree to which harmonisation should be achieved; the scope of the harmonised rule; the enforceability of the particular method and the efficiency of the harmonisation instrument.

#### 4 4 1 1 Nature of the rules, their economic and social setting

Different types of rules require different treatments. One of the factors that should be weighed is whether the rule that is to be harmonised is mandatory or non-mandatory in nature.[162]

It is also important to consider the economic reasons which triggered the harmonisation effort as well as the economic rationale that underpins the set of legal rules which must now be adapted to satisfy the new economic conditions. It is significant to establish why the laws of two or more jurisdictions should be the same. This question is closely connected to why the laws were different in the first place. If the reason for that difference entails additional costs for the process of harmonisation, it might indicate that harmonisation will not create efficient law.[163]

Apart from the economic setting, the social setting in which the laws were created should also be taken into consideration. The relationship of harmonised rules to the system of national law as a whole also plays an important role. Are the harmonised rules linked to general principles and social traditions of the national legal system or are they adapted to new social expectations?[164]

#### 4 4 1 2 Purpose or goal

It should be kept in mind that harmonisation is a means rather than an end. To determine its effectiveness, a harmonisation effort should be judged against some or other asserted purpose. It is the specific purpose that determines whether the form of

[162] Calus 2003 *Unif L Rev* 159. Non-mandatory rules are usually easier to harmonise.
[163] Leebron 1996 (27) *Can Bus Law J* 65.
[164] Calus 2003 *Unif L Rev* 159

harmonisation adopted is best suited to a given case.[165] One of the goals of harmonisation is to eliminate the principal differences between national regulations by creating common rules that present greater efficiency.[166] However, the asserted purpose should not merely be directed at eliminating differences and making rules in all respects similar. The harmonisation effort should be directed at creating an efficient legal framework which will facilitate international sales by addressing the needs of international trade and producing so-called "better law".[167] Efficiency entails the reduction of transaction costs.[168] Where there is certainty as to the content of a legal rule and the outcome of a dispute concerning such rule is predictable, transaction costs will be reduced.[169]

#### 4 4 1 3 Degree and scope

In defining the notion of harmonisation it was established that harmonisation is an instrument through which laws or policies are assimilated.[170] However, it should be remembered that harmonisation does not necessarily entail that all aspects of the laws which are harmonised should be similar; there is still a margin for difference. The degree and scope of the harmonisation effort determine which aspects should be similar and to what extent.

The degree to which a harmonisation instrument continues to tolerate difference is called the harmonisation margin. Unification efforts are in principle aimed at no tolerance and are, therefore, supposed to represent harmonisation with a zero margin of difference. However, in practice, uniform laws are often interpreted differently, which may impede the initial goal of eliminating all differences. However, depending on the purpose of harmonisation, substantial benefits can still be derived from making very different legal rules even slightly more similar. [171]

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[165] Leebron 1996 (27) *Can Bus Law J* 65-66.
[166] Calus 2003 *Unif L Rev* 159.
[167] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-054; Leebron 1996 (27) *Can Bus Law J* 65.
[168] Kronke "International uniform commercial law Conventions: advantages, disadvantages, criteria for choice" 2000 *Unif L Rev* 13 16. See also 1 2 1 *supra*.
[169] Note 1984 (97) *Harv L Rev* 1985; Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-054. See also 1 2 2 *supra*.
[170] See 4 2 1 *supra*.
[171] Leebron 1996 (27) *Can Bus Law J* 72.

The second aspect is the scope of the harmonisation effort.[172] In the context of contract law, "scope" can entail several different meanings, depending on whether one elects to harmonise the entire body of contract law or merely specific parts.[173] Linked to the notion of scope is the scale or the level of the harmonisation effort. It should be considered whether an effort should have world-wide[174] or regional application.[175] The scope of a harmonisation measure, furthermore, depends largely on its specific purpose or aim. Some instruments of harmonisation, such as the CISG for example, endeavour to regulate most of the aspects arising from a sales relationship on a universal scale; whilst others, such as INCOTERMS, only address certain points which require clarification in order to avoid misunderstandings and disputes. Even though harmonisation facilitates international commerce by producing greater efficiency, its real effect depends on the degree and scope of that effort, which, in turn, depends on the institutions involved in undertaking the harmonisation effort.[176]

#### 4 4 1 4 Binding force of the chosen method

It has become customary to distinguish two categories of harmonising instruments, namely hard law and soft law instruments.

The term "hard" refers to the binding nature of the rules. Hard law consists of international conventions, national statutory law and regional or international customary law, which have automatic application to all contracts of sale and therefore are also binding on the parties to the contract.[177] However, in most cases it is possible for parties to amend or exclude the provisions of hard law by means of

[172] 72-73.
[173] Calus 2003 *Unif L R* 161-162.
[174] Eg conventions and resolutions with universal international scope such as the CISG.
[175] Such as regulations and directives of the European Union or regional uniform law such as the Uniform Act on Commercial Law of the Organisation for the Harmonisation of Business Law in Africa (OHADA). On regional harmonisation efforts and the possibility of co-existence with universal instruments of unification, see in general, Ferrari "Universal and Regional Sales Law: Can They Coexist?" 2003 *Unif L Rev* 177; Basedow "Worldwide Harmonisation of Private Law and Regional Economic Integration – General Report" 2003 *Unif L Rev* 31; Bazinas 2003 *Unif L Rev* 53. For a general discussion on the work of the Inter-American Specialised Conferences on Private International Law (CIDIP) in the context of the Organisation of American States (OAS), see Vázquez "Regionalism versus Globalism: a View from the Americas" 2003 *Unif L Rev* 63.
[176] Calus 2003 *Unif L Rev* 157; Linarelli 2003 (48) *Wayne L Rev* 1406.
[177] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-036. The CISG is a typical example of hard law.

contractual stipulation and in some instances it is even possible to opt out of the provisions of a convention *in toto*.[178]

Soft law consists of rules and principles which do not enjoy automatic legal force unless they are incorporated into national law, voluntarily adopted by the parties to a contract or have evolved into customary international law. They are created by organisations which lack so-called "international legal personality" and, therefore, are not automatically enforceable in domestic courts or by international tribunals.[179] Provisions embodied in model laws which have not been adopted as national law, statements of general principles and scholarly restatements of international commercial law which do not conflict with relevant mandatory rules or public policy principles, general conditions for specific transactions, specific model contractual clauses as well as uniform customs and practices all constitute examples of soft law.[180]

Traditionally, hard law options are used for the harmonisation of private international law, whilst soft law options are employed to harmonise substantive law rules. There are, however, no definite criteria in this regard. The CISG is an example of the unification of substantive international sales law by means of a hard law option. The choice between hard law and soft law instruments often depends on the binding force of the harmonised rule, which is to a large extent determined by the legal status of the entity engaged in law creation and its ability to create binding law. Once again, this cannot always serve as the determining criterion. Privately generated soft law is capable of being transformed into hard law through state action, whilst states and organisations with formal authority to bind member states may also engage in the creation of soft law.[181] Furthermore, even though soft law has no automatic legal binding force, it may lead to the development of new international law with binding force.[182]

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[178] For example, art 6 CISG.
[179] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para1-037; Cutler *Private Power and Global Authority* 205; Goode *Commercial Law* 19.
[180] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para1-037. Typical examples are the 1985 UNCITRAL Model Law on Commercial Arbitration, the 1994 and 2004 UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law, as well as the codification of trade usages in the form of INCOTERMS. Model laws are generally aimed at harmonising the rules of specific contractual relations or specific problems of contract law. In contrast to that, the prime aim of general principles is the harmonisation of general parts of the law of contract.
[181] Such as the UNCITRAL Model Law on Commercial Arbitration.
[182] Levit 2005 (30) *Yale J Int'l L* 172-173; Cutler *Private Power and Global Authority* 206.

**4 4 1 5 Efficiency**

The increasing resort to model laws by UNIDROIT, UNCITRAL and other international organisations is evidence that the use of soft law options is gaining favour. Soft law affords maximum scope for the principle of party or merchant autonomy and brings with it the additional advantage of flexibility.[183] Soft-law instruments are accordingly often portrayed as the best method for harmonising contract law.[184] Soft law options also avoid the so-called "pitfalls" of international conventions.[185]

The disadvantages connected to international conventions mean that this is not always the best and most effective way of bringing about harmonisation.[186] To negotiate and draft an international convention is often a lengthy and costly process, And this holds true of subsequent amendments and updates. Although harmonisation of law aims to facilitate efficient and straightforward commercial transactions, the necessity for compromise often frustrates this goal in the case of conventions. Compromises which are acceptable to the majority of negotiating states do not always yield the best results.[187] Conventions therefore often contain rules which are overly general, inefficient and open to interpretation by domestic courts without any guarantees of a uniform result.[188] Issues of sovereignty also arise where treaties are not negotiated by states as equal partners.[189] Positive aspects of uniform law conventions, such as certainty, are often off-set by disadvantages such as a lack of flexibility.[190]

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[183] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para1-049. Cutler *Private Power and Global Authority* 221-222, however, is of the view that developing countries and smaller businesses prefer hard law options because these guarantee access and transparency and reduce transaction costs.

[184] Calus 2003 *Unif L Rev* 160.

[185] In this regard, see in general, Kronke 2000 *Unif L Rev* 16-19; Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-048-1-049; Calus 2003 *Unif L Rev* 159-160.

[186] Sheaffer 2007 (15) *Cardozo J Int'l & Comp L* 461 argues that the CISG failed as a unified sales law.

[187] Farnsworth 2003 *Unif L Rev* 105.

[188] Sheaffer 2007 (15) *Cardozo J Int'l & Comp L* 462. Because harmonisation is not driven by legislative means but by a shared commercial culture and by shared legal literature and education, Rosett 1992 (40) *Am J Comp L* 697 suggests that harmonisation efforts should rather be directed at removing the underlying differences in economic, cultural and political settings within which these rules operate before the legal rules are unified. Unless that is done, these differences will always result in divergent applications of the unified rules. In the same vein, Basedow 1998 (18) *J Legal Stud* 122-123 states that uniform law conventions are "embedded in a national legal environment". Moreover, there is no convention which functions without exceptions and reservations, which further complicates its application.

[189] Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-048 -1-049. Questions of legitimacy, accountability, authority and freedom in a new global order may also arise.

[190] Kronke 2000 *Unif L Rev* 19.

Because international conventions are normally put into operation through an act of state at national level, such as ratification or another implementing act, delays in ratification can result in conventions coming into force long after their creation or even to be postponed indefinitely.[191] A lack of political will to implement the harmonising instrument in national law often results from the choice of an inappropriate type of harmonising instrument. A convention seeking to establish uniform law will only be advantageous if it reduces costs and enhances benefits in a given area of transnational commercial transactions.[192] This also applies to all other methods of harmonisation. Only instruments which succeed in improving economic efficiency and general efficacy of an international business transaction will stand the test of time.

### 4 4 2 A Global Commercial Code

The idea of a so-called "Global Code" to address all aspects of international commercial law in a single instrument was first launched in 1970 when the Secretary-General of UNIDROIT submitted a note to the newly established UNCITRAL.[193] Herein he outlined the reasons justifying such a project as well as its features. What was suggested was a code in the continental sense, composed of a general part dealing with the law of obligations and a special part devoted to specific kinds of commercial transactions. Such a project was initially greeted with some scepticism and only became feasible in later years when UNIDROIT initiated its project on the General Principles of International Commercial Contracts, the UNIDROIT Principles.[194]

In 2000, the then Secretary of UNCITRAL, Gerold Hermann, revived the proposal of a Global Commercial Code.[195] His idea was different from what UNIDROIT had in

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[191] As in the case of the SA government's delay in ratifying the CISG.
[192] Kronke 2000 *Unif L Rev* 16; Mistelis "Is Harmonisation a Necessary Evil?" in *Foundations* para 1-049.
[193] *Progressive codification of the law of international trade* Note by the Secretariat of the International Institute for the Unification of Private Law (UNIDROIT) A/CN 9/L 19 *United Nations Commission on International Trade Law Yearbook I* (1968-1970) 285 *et seq.*
[194] Bonell "Do We Need a Global Commercial Code?" 2000 *Unif L Rev* 469; Bonell "Do We Need a Global Commercial Code?" 2001 (106) *Dick L Rev* 87.
[195] Bonell 2000 *Unif L Rev* 469; 2001 (106) *Dick L Rev* 88; Lando "Principles of European Contract Law and UNIDROIT Principles: Moving from Harmonisation to Unification?" 2003 *Unif L Rev* 123 131. Herrmann advocated this opinion in two papers presented at international conferences, namely *Law, International Commerce and the Formulating Agencies – The future of Harmonisation and Formulating Agencies: The role of UNCITRAL* paper presented at the Schmitthoff Symposium 2000 *Law and Trade in the 21st Century* held at the Centre of Commercial Law Studies London 1-3 June 2000, and *Towards*

mind and more in line with what Clive Schmitthoff suggested some twenty years ago.[196] Schmitthoff proposed developing a universal code of international trade law or a Global Code that would consolidate and systemise a number of existing and future uniform laws in the field of international trade law. This code would not cover general contract law but would only deal with rules relating to commercial transactions.

The notion of a Global Code is supported by a number of scholars. Bonell does not envisage a comprehensive international code to replace all existing national laws, but rather a body of rules relating to the most important commercial transactions.[197] Some of these rules already exist as separate international conventions or model laws; others will have to be added for the purpose. The CISG, various transport law conventions, the Leasing and Factoring Conventions, INCOTERMS and the UCP are examples of international rules that could be integrated into such a code. However, existing rules should not merely be transplanted into the new Global Code but will have to be assimilated to one another as regards terminology and content.[198] Bonell also proposes the formal and universal recognition of the right of parties to an international contract to choose a soft law instrument such as the UNIDROIT Principles to govern their contract, or to declare the Principles automatically applicable unless explicitly excluded through the choice of another governing law. Bonell suggests that the Code should explicitly refer to the UNIDROIT Principles, which will overcome many of the obstacles of determining internationally accepted principles of contract law.[199]

Lando[200] believes that the need for such a code is enhanced by the globalisation of communication methods and commerce in general. The development of a single global market increases the need for a single law. He agrees with Bonell that general principles of contract law should form part of such a Global Code. He advocates that the UNIDROIT Principles should not be relegated to soft law but should be incorporated into the Code and recognised as rules of law binding on the courts. He

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*a Global Commercial Code for Borderless Commerce: Global Commerce Needs Global Law* paper presented at the 10th Biennial Meeting of the International Academy of Commercial and Consumer Law, Pennsylvania State University Dickinson School of Law 9-13 August 2000.

[196] Schmitthoff "The Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 230, Schmitthoff "The Codification of the Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 243 249-251.

[197] Bonell 2000 *Unif L Rev* 473; 2001 (106) *Dick L Rev* 87.

[198] Bonell 2000 *Unif L Rev* 473-474, 480-481; Bonell 2001 (106) *Dick L Rev* 92,100; Bonell 2008 (56) *Am J Comp L* 27-28.

[199] Bonell 2000 *Unif L Rev* 479; 2001 (106) *Dick L Rev* 98; 2008 (56) *Am J Comp L* 21-24, 27.

[200] 2003 *Unif L Rev* 131-133; Lando "CISG and its Followers: Proposals to Adopt Some International Principles of Contract Law" 2005 (53) *Am J Comp L* 379 384-385. He admits that it will probably take a very long time for such a code to materialise.

furthermore contends that a revision to the rules of the CISG and other conventions that were the result of poor compromises should be undertaken before their incorporation into the Global Code.

There are, however, those who still have to be convinced of the need for such a code. Although he agrees that a global code will generate ideas, inspire scholarship, further international cooperation among jurists and produce texts that would be available to developing nations, Farnsworth[201] is of the view that the parties to a contract can, by using standard forms and tailor-made terms, do much towards harmonising general contract law themselves without resorting to unified law. Because of the disadvantages connected to conventions,[202] he considers unified law relatively inefficient.

### 4 4 3 Conclusion

What constitutes so-called "best law" and who will determine what it should be in the context of international commerce? Economic and technical developments of the last decades have created a definite question mark as to whether the CISG model alone is enough to address all the commercial law issues of modern international sales.[203] There is a general view that no single method can be portrayed as the optimal method for harmonising contract law, whether directly or indirectly.[204] A combination of hard law and soft law options would be the optimal solution. If the development of best law lies in the combination of different instruments of harmonisation, multiple organisations and role players may be expected to play a role.[205]

Hartkamp[206] contends that contract law will only be successfully harmonised through some kind of interaction between the binding law in the form of international conventions, directives or ordinances and the general principles of contract law.[207] Conventions and general principles may serve as a model law which could inspire legislators in developing countries, countries in transition or states trying to

[201] 2003 *Unif L Rev* 103-106. See also 4 2 2 *supra*.
[202] See 4 4 1 5 *supra.*
[203] Sheaffer 2007 (15) *Cardozo J Int'l & Comp L* 461.
[204] Calus 2003 *Unif L Rev* 159; Rosett 1998 (46) *Am J Comp L* 349.
[205] Le Goff 2007 (14) *Ind J Global Legal Stud* 119.
[206] 2003 *Unif L Rev* 89.
[207] The European Principles and the UNIDROIT Principles are examples of general contract principles. The first step in acknowledging the UNIDROIT Principles in the development of a world law was the formal endorsement of the Principles by UNCITRAL at its 40th Plenary Session in 2007.

modernise existing legislation and seeking inspiration from common international standards. The CISG and the UNIDROIT Principles have already exerted considerable influence on the reform of a number of legal systems, as is evident from the revised *Schuldrecht* of the German Civil Code (2002) and revised article 2 of the American Uniform Commercial Code (2003). It also had a major impact on the sales section of the revised Dutch *Burgerlijk Wetboek* (1992), on Chinese contract law, the EC Consumer Sales Directive (1999) and the Principles of European Contract Law (1995, 2000 and 2003).[208]

According to Burman[209] commercial law unification should be result and policy driven, so that agreement is measured by economic gains and not merely by the merging of differing standards. Could a particular harmonisation effort, for instance, provide a solution that has not existed before?[210] Harmonisation could address specific needs, such as those created by developments in electronic commerce. Harmonisation efforts should, therefore, not only be evaluated against their ability to make different laws similar, but also with reference to their ability to facilitate international trade in general through efficient legal rules addressing its specific needs and shortcomings.[211] This approach to harmonisation methods reflects a strong efficiency orientated view which broadens the traditional approach aimed at merging existing legal systems and rules in order to reach common denominators between countries. By providing solutions to problems shared by different legal systems, harmonisation facilitates the creation of better law.[212]

In practice, the different methods aimed at harmonising international sales law are not competitive but are mutually supportive and supplementary of each other. In the end the challenge is to use them together to enhance international trade and to produce better law rather than to make a choice between them.[213]

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[208] Bonell 2008 (56) *Am J Comp L* 6, 10, 16, 19.
[209] "Building on the CISG: International Commercial Law Developments and Trends for the 2000s" 1988 (17) *JL & Com* 355 356.
[210] Law reform is one of the goals and objectives of harmonisation instruments. *Cf* 4 2 3 2 *supra*.
[211] Cattaui "Harmonising Commercial Law: Keeping Pace with Business" in Fletcher et al (eds) *Foundations and Perspectives of International Trade Law* (2001) 37 para 3-003 suggests that the purpose of harmonisation is to sustain and facilitate the process of creating wealth, value and jobs and at the same time serving clients, customers, employees, investors and shareholders. Kronke 2000 *Unif L Rev* 20 submits that there are sufficient grounds for not abandoning the convention as a form of harmonisation, but to improve on it by adopting a so-called "commercial approach" rather than seeking mere compromises.
[212] Fentiman "Choice of Law in Europe: Uniformity and Integration" 2008 (82) *Tul L Rev* 2021 warns that "the best result in conflicts terms … [should not be] … subordinate to the higher goal of uniformity." Even though this observation is made in the context of the conflicts-of-laws, it is equally relevant to all harmonisation efforts.
[213] Rosett 1998 (46) *Am J Comp L* 353-354.

# CHAPTER FIVE
# STANDARDISING TRADE TERM DEFINITIONS BY MEANS OF INCOTERMS

## 5 1 The need to standardise

A study conducted by the ICC in the 1920s found that there was no uniform or universal understanding of trade terms amongst merchants.[1] Trade terms were understood differently in different countries, different trades and even from one port to the next because of different practices and customs that exist in different places.[2]

The discussion of the FOB term in English law indicated that FOB "variants" or "types" develop because parties often allocate their respective costs and responsibilities differently from the traditional effect of the term.[3] Differences may also occur between definitions adhered to by national jurisdictions within the same legal family. For example, the traditional meaning of FOB as defined by the English courts[4] is followed in the United Kingdom, Canada and Australia, but in the United States of America, FOB is used in other contexts as well. Before the 2003 revision, "FOB vessel" referred to the regular understanding of FOB as a shipment term, whilst "FOB place of destination" defined FOB as an arrival contract and "FOB place of shipment" did not require the seller to load the goods onto the vessel, which is required under the traditional FOB term.[5] According to American trade usage, shipping costs are also allocated differently depending on the FOB variant.[6]

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[1] Roth & Roth "INCOTERMS: Facilitating Trade in the Asian Pacific" 1997 (18) *U Pa J Int'l Econ L* 731 732-733.

[2] Because trade terms are based on trade usages and practices they are spread through word of mouth, which means that divergent interpretations of the same term can arise easily.

[3] See 2 2 1 1 (i) *supra.* Zeller "Is the Ship's Rail Really Significant?" 2005 (2) *NJCL* 1 3.

[4] According to the traditional view, FOB functions as a shipment term. This is the meaning that is also generally attributed to the FOB term in Europe. See Nienaber *Law and Practice of Export Trade VI: The INCOTERMS 2000 New Rules for the Interpretation of International Trade Terms* Introduction.

[5] Ss 2-319(1)(a) & (b) UCC (2001). See also 2 2 2 1 (i) *supra*. Gabriel "International Chamber of Commerce INCOTERMS 2000: A Guide to Their Terms and Usage" 2001 (5) *VJ* 41 52. See also Murray "Risk of Loss of Goods in Transit: A Comparison of the 1990 INCOTERMS with terms from other voices" 1991 (23) *U Miami Inter-Am L Rev* 93 105-106 for a discussion on the American case law dealing with FOB variants. For example, in *AM Knitwear Corp v All Am Export-Import Corp* 359 N E 2d 342 347, 20 UCC Rep Serv 581 588 (NY 1976), the court held that "[t]he term 'FOB PLANT' is well understood to require delivery to the carrier and does not imply any other meaning". As a consequence, if the goods were loaded in a container supplied by the buyer and the container was stolen before it was delivered to the carrier, the risk of loss would remain on the seller. In *L&L Trading Co v Tenneco Oil Co* 693 F Supp 470 475, 7 UCC Rep Serv 2d 716 723 (ED La 1988), it was held that the term "FOB Refinery" means that the seller has the risk and expense of loading the oil into the buyer's trucks.

[6] Under "FOB Seller's Warehouse", the seller has to pay packaging costs for the inland transportation. Under "FOB Port of Shipment", the seller is liable for packaging costs, for inland transportation,

Sometimes trade usages are limited to a particular trade. The meaning of FOB in the international oil trade differs from that in the Swedish lumber trade for example.[7] In the steel industry, a CIF contract that calls for shipment "September-October" means delivery in October or November.[8] In the oil trade, a trade usage exists according to which an FOB buyer has to give the seller timely notice of loading.[9] In the port of Stockholm, a trade usage exists which determines that if wood products are sold "FOB Stockholm," the buyer has to bear the loading costs into the vessel. Through this trade usage the FOB delivery is converted into an FAS delivery.[10] In the port of Bristol, on the other hand, the point to which the shipper bears the costs depends on the customs of the various shipping companies' conferences. Some of the charges form part of the freight costs to be borne by the buyer.[11] Similarly, in the port of Glasgow, delivery from transit shed to alongside the vessel, making up slings, hooking up and hoisting to the rail of the vessel, are all considered to be part of the freight costs.[12] In the port of Seattle, where the seller pays the cost of handling the goods on the docks, the cost of stevedoring or transferring the cargo from the dock to the ship is also considered to be part of the freight which is paid by the buyer.[13] On the other hand, in the port of Liverpool, the seller is responsible for the goods until placed on board the vessel, including the costs for carriage to Liverpool, cartage, haulage and lighterage as well as wharf handling charges applied by certain conferences together with certain duties.[14]

In many cases merchants are unaware of the differences in trading practice between their respective countries. Even standard contracts of different trade organisations do

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international shipment and freight costs. Under "FOB Vessel or Airport", the seller has to pay packaging costs for inland transportation, whilst other costs such as freight forwarding costs, consular fees, resignment, pier delivery costs, wharfage or air packing costs may be included in the seller's costs, depending on the parties' agreement. Under "FOB Port of Destination", the seller pays all shipping costs, including air or ocean freight transportation, banker surcharges, port congestion as well as insurance and unloading (maritime only) costs. Under "FOB Buyer's Plant", all shipping costs are paid by the seller, including import duties, import broker's fees, cartage from pier (maritime only), inland freight and warehousing. In American law, these terms are defined by statute in s 2-319 UCC (2001). These definitions were repealed by the 2003 revision. However, see the discussion 2 2 2 *supra*, which shows that there is a general reluctance amongst states to enact these revisions. On trade terms in American law, see in general Klotz & Barrett *International Sales Agreements: An Annotated Drafting and Negotiating Guide* (1998) 70-71.

[7] Schmitthoff *International Trade Usages* report published by the Institute of International Business Law and Practice (1987) para 37.

[8] Murray 1991 (23) *U Miami Inter-Am L Rev* 115.

[9] *Scandinavia Trading Co A/S v Zodiac Petroleum SA and William Hudson Ltd: The Al Hofuf* [1981] 1 Lloyd's Rep 81 84.

[10] Schmitthoff *International Trade Usages* 27; Klotz & Barrett *International Sales Agreements* 72-73.

[11] Sassoon *CIF and FOB Contracts* 4th ed (1995) para 468; British Association of Chambers of Commerce "FOB Vessel" (1971).

[12] Sassoon *CIF and FOB Contracts* paras 468-470.

[13] *Meyer et al v Sullivan et al* 181 Pac 847 848 (1919).

[14] Sassoon *CIF and FOB Contracts* para 470; British Association of Chambers of Commerce "FOB Vessel" (1971); *Heskill v Continental Express Ltd* [1950] 1 All ER 1033 1041.

not necessarily treat trade terms and their incidental obligations identically.[15] The UK Grain and Feed Association (GAFTA), for example, has five FOB contracts in the United Kingdom. One of these contracts provide that the buyer has to take out insurance on the goods and supply the seller with conformation thereof at least five days before the vessel should be ready, failing which the seller shall have the right to take out such insurance at the expense of the buyer.[16]

In other words, despite the general aim of trade terms to harmonise trade usage, their effect is limited because of the lack of a common or universal understanding of them. It is also true that the outcome of a dispute on meaning often depends on the place where the dispute is to be resolved and the law applicable at that specific place.[17] In the context of trade terms, this may again imply differences in definition.

Divergent interpretations cause uncertainty and misunderstanding between merchants who do not share the same background and can pose a serious impediment to international trade.[18] Although trade terms reflect the reality of international trade more effectively than national laws, differences in meaning detract from their efficacy as an instrument of harmonisation. There is clearly a need to standardise or codify trade term definitions to increase their overall efficiency. A standardisation instrument can only be effective if it succeeds in creating certainty, clarity and predictability and thereby reduces transaction costs.

The first attempts to codify trade terms were by means of legislation or private definitions.[19] In some countries, such as the United Kingdom, no attempt was ever made to define trade terms by means of legislation. Instead of codified definitions, reliance was placed on an extensive body of explanatory case law,[20] supplemented by private definitions.[21]

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[15] Dasser *INCOTERMS and Lex Mercatoria: Applicability of INCOTERMS in the Absence of Express Party Consent* LL M thesis Harvard (1995) 41.
[16] Ademuni-Odeke "Insurance of FOB Contracts in Anglo-American and Common Law Jurisdictions Revisited: The Wider Picture" 2007 (31) *Tul Mar LJ* 425 456.
[17] The problems involved in establishing the applicable law with reference to conflict-of-laws rules have already been pointed out in this study, and will not be repeated here again. See 1 1 & 4 3 3 *supra*.
[18] ICC *INCOTERMS 2000* (the official rules) Introduction para 1. Valioti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980) and INCOTERMS* 2000 LL M thesis Kent (2003) http://cisgw3.law.pace.edu/cisg/biblio/valioti1.html (accessed 01-04-2009) text accompanying n 34; Reynolds *INCOTERMS for Americans (Fully Revised for INCOTERMS 2000)* (1999) 11.
[19] Dasser *INCOTERMS and Lex Mercatoria* 42-44.
[20] On the treatment of trade terms in English law, see 2 2 1 1 (i) & (ii) *supra.*
[21] See 5 2 2 *infra*.

## 5 2 Efforts to standardise trade term definitions

### 5 2 1 Legislation

Legislative attempts to define the more common trade terms have traditionally been made in national sale of goods acts. However, such rules of interpretation, or so-called "gap-filling" rules, are of course aimed only at a specific country; for example, the definitions found in the Swedish, Norwegian and Danish Sale of Goods Acts of 1905.[22] Before article 2 was extensively revised in 2003, the United States Uniform Commercial Code also contained trade terms definitions in sections 2-319 to 2-321.[23] Spain[24] and Iraq[25] have given statutory effect to INCOTERMS by incorporating them into their municipal law.[26] Most countries have, however, refrained from introducing trade term definitions in any form into national law.[27]

### 5 2 2 Private definitions

Initial attempts to alleviate problems associated with divergent interpretations took the form of private definitions. Such definitions, however, have limited application and function at most as guidelines for merchants involved in export-import trade without enjoying any legal force. Their application is often also restricted to specific localities.

The examples referred to here are by no means exhaustive and serve only to illustrate the point. In 1928, the International Law Association formulated the Warsaw-Oxford Rules which were designed for the interpretation of CIF contracts only. A revised version was adopted in 1932. In 1951, a FOB definition was

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[22] The terms promoted by the now dissolved Countries for Mutual Economic Assistance (CMEA) 1968/1976 used to play a role amongst socialist countries.
[23] See 2 2 2 1 (i) & (ii) *supra* for a discussion on the American position in regard to trade terms.
[24] By Royal Decree of 14 September 1979.
[25] Ss 294-330 Commercial Act 30 of 1984.
[26] Schmitthoff *International Trade Usages* para 39; Schmitthoff "The Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 224; Gabriel 2001 (5) *VJ* n 6; Said *Das Risiko der Erteilung von Exportgenehmigungen nach den INCOTERMS, verglichen mit dem BGB* LL D dissertation Trier (1993) 22-23 n 12. Dasser *INCOTERMS and Lex Mercatoria* 51 also mentions Italy as an example.
[27] INCOTERMS have never been very popular in the common law world. The English Sale of Goods Act 1979 does not contain any trade term definitions. See Irani "INCOTERMS and Other Conditions of Sale" in Peng Kee & Rao Penna (eds) *Current Developments in International Transfers of Goods and Services* (1994) 138 139. Delegates from Great Britain rejected the first edition of INCOTERMS, in 1936, and declared that they would do nothing to promote their use.

introduced in Britain by the Institute of Export.[28] A revised edition of the "FOB vessel" definition was introduced to British export trade by the British Association of Chambers of Commerce in the United Kingdom in 1971.[29] This is a periodically revised publication that outlines the practice which prevails in British ports with respect to the apportionment of liabilities under FOB sales.[30] In later years these definitions have largely been superseded by INCOTERMS.[31]

The Revised American Foreign Trade Definitions were introduced in 1941 by a joint committee representing the Chamber of Commerce of the United States, the National Council of American Importers, and the National Foreign Trade Council.[32] These definitions were directed at the American market and transnational trade with the United States. Today they are rarely used and have to a large extent been replaced by INCOTERMS.[33]

Although they are not trade term definitions in the narrow sense of the word, many standard form contracts of trade associations represent a form of trade term standardisation that brings certainty and clarity for the particular branch of trade regulated by such association. Examples are, the FOB contracts drafted for the London Corn Trade Association; the London Oil and Tallow Trades Association; the Silk Association of America; the Dutch Association for the trade in oils and for the trade in grain delivered from a German seaport; the Refined Sugar Association and the European Coffee Associations' European Contract for Coffee;[34] and the CIF

[28] "Proposed definition of the Term FOB" 1951 (14) *Export* 221. The obligations of the parties under this definition is set out in Sassoon *CIF and FOB Contracts* para 442.
[29] "FOB Vessel" (Rev ed January 1971).
[30] Sassoon *CIF and FOB Contracts* para 440.
[31] Another private initiative is that of *Intraterms*, a set of privately formulated standard terms which are intended to simplify the language connected with the international sale of goods. Although they try to solve the ambiguities in trade terms, they are not restricted to trade terms but cover all the aspects of an international contract of sale. *Intraterms* are based on party autonomy and can be incorporated into a contract in whole or in part. INCOTERMS will automatically override *Intraterms* in so far as the latter are incompatible with any provisions of INCOTERMS. See Hermann *International Trade Terms: Standard Terms for Contracts for the International Sale of Goods* (1994).
[32] These terms follow the same pattern as the definitions of the UCC, ie setting out various FOB points; for example, "FOB Factory"; "FOB Port of Shipment" and "FOB Inland Point of Importation". In terms of these definitions, FOB does not mean "free on board" unless used in conjunction with the word "vessel". Frécon "Practical Considerations in Drafting FOB Terms in International Sales" 1986 (3) *Int'l Tax & Bus Law* 346 348.
[33] Frécon 1986 (3) *Int'l Tax & Bus Law* n 4. Reynolds *INCOTERMS for Americans* 13 indicates that these terms are deficient in that they are nearly 60 years old, largely unknown and by definition "American" in so far as they favour American parties.
[34] See Groβman-Doerth *Das Recht des Überseekauf I* (1930)146-147; Fink "*Reichweite von INCOTERMS im internationalen Zuckerhandel*" 1991 (6) *RIW* 470. See also 4 3 1 *supra* for a general discussion on harmonisation by means of custom and the role that trade associations play in this regard.

contracts promulgated and revised by GAFTA[35] and FOSFA.[36] In some instances these contracts are drafted on a bilateral or multilateral basis[37] and in the case of certain commodities under the auspices of the United Nations.[38]

### 5 2 3 INCOTERMS

INCOTERMS were created when, in 1935, the ICC decided to publish a set of rules governing trade terms which would achieve some form of international standardisation. This was the first attempt to truly standardise and unify the various interpretations given to the obligations of a buyer and seller on an international level. The purpose of INCOTERMS "is to provide a set of international rules for the interpretation of the chief terms used in foreign trade contracts, for the optional use of business men who prefer the certainty of uniform international rules to the uncertainty of the varied interpretations of the same terms in different countries."[39]

#### 5 2 3 1 A brief synopsis of their development

From its inception in 1919, the International Chamber of Commerce (ICC)[40] was concerned with promoting the standardisation of trade terms. At the first ICC congress held in London in 1921, shortly after the First World War, it was agreed to establish a working group to this end[41] and to undertake a comparative study of the meaning of trade terms amongst its member states.[42] After publication of the working

[35] Eg the GAFTA 97 & GAFTA 100 forms issued by the Grain and Feed Association (GAFTA) based in London.
[36] Eg the FOSFA 24 contract issued by the Federation of Oils, Seeds and Fats Associations (FOSFA) based in London.
[37] For example, the 1968 and 1976 unified contract clauses drafted for the members countries of the former Council of Mutual Economic Aid (CMEA).
[38] For example, the UN Economic Commission for Europe's General Conditions of Sale and Standard Forms of Contract for major commodities such as cereals, citrus, timber and the supply of plant and machinery.
[39] ICC *INCOTERMS 2000* (the official rules) Introduction para 1.
[40] The ICC had its origins at a congress in Atlantic City, in October 1919, where it was decided to establish an international chamber of commerce. The congress was attended, not by state representatives, but by people involved in commerce in various countries including delegates from Belgium, France, Great Britain, Italy and the USA. The founding congress took place in Paris in 1920.
[41] Renck *Der Einfluß der INCOTERMS 1990 auf das UN-Kaufrecht: Eine Untersuchung zu den rechtlichen Wirkungen der INCOTERMS 1990 im Recht des internationalen Warenkaufs* LL M thesis Hamburg (1995) 7.
[42] Oberman *Transfer of risk from seller to buyer in international commercial contracts: A comparative analysis of risk allocation under the CISG, UCC and INCOTERMS* LL M thesis Laval (1997) http://www.cisg.law.pace.edu/cisg/thesis/Oberman.html (accessed 25-02-2009) ch 2 Part I B.

group's report in 1923[43] the initial set of standardised terms were introduced in 1928.[44] This first edition of TRADE TERMS consisted of an elaborate explanation of six terms[45] and their interpretations in thirteen countries. The second edition, published in 1929, reflected the views of thirty five countries. This project came to an end in 1953 after a third collection of national interpretations was published.[46] The three successive editions of TRADE TERMS did not attempt a codification of national terms but were solely designed to underline the divergence in interpretations. They paved the way for standardisation with the introduction of the first edition of INCOTERMS in 1936.[47]

INCOTERMS is an abbreviation for "international commercial terms", the official title being "International Rules for the Interpretation of Trade Terms". The first edition[48] of INCOTERMS was followed by a full revision in 1953. The new text was adopted by most delegates to the ICC congress held in Vienna, which gave INCOTERMS international legitimacy. To avoid confusion the congress agreed that the citation of INCOTERMS was to incorporate the year of revision. The 1953 version introduced five of the obligations of the buyer and seller to an international contract and defined them in detail. The new version of INCOTERMS was modified to reflect the practices of international commerce of the time so that more parties to international commercial contracts would adopt them. Where current practices were notably divergent from INCOTERMS, the INCOTERM would reflect the minimum obligation of the seller and buyer, leaving parties free to stipulate obligations beyond the minimum obligations. Nine of the most frequently used commercial terms in international commerce (such as EXW, FAS, FOB, C&F and CIF) were introduced by the 1953 modification.[49]

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[43] ICC Digest No 43.
[44] ICC Brochure No 68.
[45] FOB, FAS, FOT or FOR, Free Delivered, CIF and C&F.
[46] ICC Doc No 16. Countries that participated in this project included Egypt, Australia, Belgium, Denmark, Germany, France, Great Britain, Italy, Yugoslavia, Canada, Marocco, Netherlands, Norway, Austria, Sweden, Switzerland, South Africa and the USA.
[47] Eisemann "INCOTERMS and the British Export Trade" 1965 *JBL* 114 115-116. The first edition of INCOTERMS was approved by the Berlin Congress in 1935. They were published the following year; hence they are known as INCOTERMS 1936. The definitions contained therein included Ex Works, FOR, FOT, free (named port of shipment), FAS, FOB, C&F, CIF, Freight or Carriage Paid to, Free or Free Delivered, Ex Ship and Ex Quay.
[48] The delegates from Great Britain refused to accept the INCOTERMS. Australia had certain reservations and abstained from any decision, whilst Italy accepted but with reservations. See Renck *Der Einfluß der INCOTERMS* 8.
[49] De Ly *International Business Law and Lex Mercatoria* (1992) 173; Oberman *Transfer of risk* text accompanying nn 174-177; De Vries "The Passing of Risk in International Sales under the Vienna Sales Convention 1980 as compared with Traditional Trade Terms" 1982 (17) *Eur Trans L* 495 515. See also Renck *Der Einfluß der INCOTERMS* 9 for a discussion of the 1953 edition.

A third modification of INCOTERMS in 1967, added the so-called “delivered terms” to the list. In contrast to the traditional shipment or dispatch contract where goods had to be delivered across the ship’s rail, risks and costs under destination contracts such as DAF and DDU remain with the seller until much later. The 1977 version of INCOTERMS dealt with the development of air transportation by adding the term “FOB Airport” to its list of terms.

In 1977, because of an increasing need to revise the INCOTERMS to keep pace with new techniques for the transportation of goods, the ICC entrusted Professor Jan Ramberg from the University of Stockholm with a further revision of INCOTERMS. New transportation techniques, the common practice of documentary exchange and electronic transfer of documents were to constitute the focus of the revision. By this time the traditional method of lifting cargo over the ship's side for loading and discharge had been replaced by the container method.[50] One conclusion of the Ramberg report[51] was that the existing version of INCOTERMS was not suited to recent changes in international sales. The ship's rail, which used to be the traditional "critical point" under the FOB, C&F and CIF terms, no longer made sense as a point for the division of functions, costs and risks between the parties as it did not reflect current liner shipping practice, except perhaps for non-containerised or bulk cargo.[52] The traditional port-to-port type of sea transport was increasingly making way for a door-to-door type of transport. The traditional terms could not regulate the transportation of containers effectively, especially where the cargo was not loaded directly on board the ship but had to be stored in a container terminal. As a result, the seller remained liable for the goods until delivery over the ship’s rail, even though they were no longer under his physical control. The use of roll-on and roll-off transport was also not defined under the 1977 edition of INCOTERMS [53]

The report, furthermore, established that the use of bills of lading under the terms FOB, C&F and CIF as documents of proof that the cargo has been loaded and that it is in good order and condition had become redundant since cargo was no longer delivered directly on board but handed over to a transporter. The point at which the transport document is to evidence the good order of the goods shifted from the ship’s

[50] For a discussion on the history and development of containerisation as a transportation technique, see 1 3 3 *supra*.
[51] ICC Doc No 460/234 (10-09-1978).
[52] Since it is virtually impossible to split the costs between sellers and buyers precisely at the moment when the goods pass the ship's rail, this point has become highly artificial. See also 5 5 1 *infra* for a discussion on the shortcomings of the ship's rail in the context of the passing of risk.
[53] Oberman *Transfer of risk* text accompanying nn 178-181.

rail to a seaport or other inland terminal where the containers are stored. Where the goods are placed in a container or unitisation device by the seller or manufacturer and are for the first time unpacked at the final inland point of destination, it is difficult, if not impossible, to satisfy the requirement of a clean bill of lading.[54]

Consequently, the ICC published a revised set of INCOTERMS in 1980, which contained fourteen terms and was strongly influenced by changes in transportation techniques and documentary practices brought by the so-called container revolution. Because the traditional FOB and CIF terms were out of step with reality, this edition necessitated the introduction of new trade terms.

Under two new trade terms, "Free carrier … named point" (FRC),[55] and “Freight, carriage and insurance paid to” (CIP), the ship's rail was replaced as the critical point by a "named point", where the carrier takes the goods into his custody. This is likely to be a cargo terminal at the seaport or even at an inland goods terminal. Under both the amended "Freight or Carriage Paid to" (FCP)[56] and the new CIP term, the critical point is the moment of the delivery of the goods into the custody of the first carrier.[57] Under these two trade terms the seller does not effect delivery at the ship's rail as in the case of FOB and CIF. Delivery occurs when the goods are received into the transportation system, for example when they are delivered to the first carrier, even if that is an inland carrier. These trade terms are particularly suitable for containerised goods, where several modes of transport are used for the carriage of goods and the seller does not want to bear the risk of loss of or damage to the goods up to the point that they are loaded on board the vessel.

The 1980 version also eschewed any reference to a negotiable, on board bill of lading but referred simply to the “usual transport document”. In some instances of maritime transport, this document may still be a bill of lading or a negotiable document with the same legal characteristics, but it is not likely to evidence shipment on board a designated vessel.[58]

Modernised transport techniques were once again taken into consideration by INCOTERMS 1990, particularly with respect to the use of container shipment,

[54] Sassoon *CIF & FOB Contracts* para 22; *ICC Guide to INCOTERMS 1980* 8-9 as reproduced in Sassoon *CIF & FOB Contracts* para 23.
[55] Now discarded in favour of FCA.
[56] Now discarded in favour of CPT.
[57] *ICC Guide to INCOTERMS 1980* 8-9 as reproduced in Sassoon *CIF & FOB Contracts* para 23.
[58] *ICC Guide to Incoterms 1980* 8-9.

multimodal transport and roll-on and roll-off traffic by means of vehicles and railway wagons. Under the 1990 INCOTERMS, the "Free Carrier" term (FRC) not only underwent a name change to FCA, but was also modified to include all types of transport despite the mode or the combination of different modes. Consequently, as a result of these newly defined terms, the terms FOR, FOT and FOB Airport were removed since these terms were based on exactly the same principles as the FCA term, namely by fixing the point for handing over the goods for carriage at a particular place rather than linking it to a means of conveyance. Since the 1990 revision the FCA term became fully adaptable in the sense that it can now be used regardless of the mode of transport.

The DDU term was the only term which was specifically adapted by the 1990 revision to provide for the business demands of traders in the European Union. It was modified to cater for the situation where VAT is accounted for on acquisition of the goods by the buyer.[59]

However, the main underlying reason for the 1990 INCOTERMS was the need to accommodate the use of electronic data interchange (EDI) instead of paper documentation. All terms - except EXW which has no delivery obligation - contain the stipulation that when the parties have agreed to communicate electronically, traditional delivery documents may be replaced by an equivalent electronic data interchange (EDI) message.[60] Unless there is such an agreement, the buyer may still insist on paper documentation.

[59] The DDU term is therefore strongly recommended for intra-EU trading. See Battersby "INCOTERMS in the Single Market" in Debattista (ed) *INCOTERMS in Practice* (1995) 97 106.

[60] Ramberg *Guide to INCOTERMS 1990* (1991) 8. INCOTERMS do not explain how electronic communication should be implemented. That will be governed by the practices which the parties have developed between themselves and by international systems, such as those developed under the auspices of the United Nations, for example EDIFACT (Electronic Data Interchange for Administration, Commerce and Transport) and UNCID (the Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission). To ensure the security of electronic transport documents and to avoid fraud and forgery, safety measures such as BOLERO (the Bill of Lading Electronic Registry Organisation) have also been developed. This system provides for the registration of successive holders of a bill of lading. It is not restricted to transport documents and can be used by everyone involved in the export chain, such as bankers, insurers and customs officials. Additional guidance can be found in legal norms and principles evidenced by the 1990 CMI Rules for Electronic Bills of Lading, arts 16-17 of the 1996 UNCITRAL Model Law on Electronic Commerce and arts 8-10 of the 2008 UN Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea – the "Rotterdam Rules". See also INCOTERMS 2000 (the official rules) Introduction para 19; the A8 and B8 clauses of all INCOTERMS except "Ex Works".

### 5 2 3 2 INCOTERMS 2000

The current edition at the time of this study is INCOTERMS 2000. It should however be noted that the ICC is in the process of revising INCOTERMS. The new edition will presumably come into effect on 1 January 2011.[61]

INCOTERMS 2000 came into effect on 1 January 2000. The task of the Working Party on Trade Terms was to ensure that INCOTERMS 2000 correspond to actual commercial practice, whilst at the same time contending with the reality that commercial practice is not consistent all over the world. To ensure that INCOTERMS 2000 reflect the most common commercial practice, commercial practices in countries that have not always been part of the INCOTERMS elaboration process in the past or where INCOTERMS are not frequently used, were also taken into consideration.[62]

Compared to INCOTERMS 1990, the 2000 revision contains few changes. Substantive changes were made in only two areas. The one area is the customs and payment of duty obligation under the FAS and DEQ terms. The export clearance obligation under FAS is now on the seller whilst previously on the buyer, and the import clearance obligation under DEQ is now on the buyer whilst previously on the seller. The other change is to the loading and unloading obligations under FCA. If delivery occurs at the seller's place, he has the duty to load the goods on the buyer's collecting vehicle, but if delivery occurs at any other place, the seller is not responsible for unloading. The goods are to remain on the seller's vehicle unloaded and are merely placed at the disposal of the carrier or another person nominated by the buyer.[63]

Although INCOTERMS enjoy worldwide recognition, definite efforts were made to ensure that the wording of this version reflects current international trade practice

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[61] See 5 8 2 *infra* for a discussion on the new revision.

[62] For an overview of the revision process, see Wassell "General overview of INCOTERMS 2000" in Ramberg et al *INCOTERMS 2000: A forum of experts* 6-7; Reynolds *INCOTERMS for Americans* iii-iv. Many of the comments related to the use of INCOTERMS 1990 in particular sectors were received from companies on the American continent, such as Chile, Mexico, Peru and the United States. These comments contained proposals for change so that INCOTERMS could better reflect current commercial practices. Important new trading nations, such as China, Japan and India, were also represented during the revision process. In total, the survey was sent out to more than 130 ICC National Committees and members throughout the world.

[63] ICC *INCOTERMS 2000* (the official rules) Introduction para 3; Ramberg *Guide to INCOTERMS 2000* (1999) 11; Ramberg "Why revise INCOTERMS?" in Ramberg et al *INCOTERMS 2000: A forum of experts* (2000) 10-11.

clearly and accurately. The terminology has in some instances been changed with a view to consistency and ease of understanding. The result has been to improve the understanding of FOB, CFR and CIF so that the inappropriate use of these terms can be avoided.[64]

Despite much attention to the FOB term during the preparation of INCOTERMS 2000, no change was in fact made to it. Ever since the 1700s, many port customs and commercial practices have developed around the notion of the FOB point. While acknowledging that an amended wording would better reflect contemporary commercial practice, the drafters concluded that to change a fundamental notion such as the traditional FOB point would lead to even more confusion.[65] Despite the uncertainties surrounding this point, INCOTERMS 2000 still link the delivery point under FOB and CIF to placing the goods on board the ship and the concomitant notion of crossing the ship's rail.[66]

It would have been the ideal for INCOTERMS to specify the duties of the parties in connection with the delivery of the goods in as detailed a manner as possible. It has not been possible, however, to find a consistent commercial practice with respect to the loading of ships under FOB and the unloading from ships under CFR and CIF.[67] The type of cargo and the loading and unloading facilities available in seaports determine the extent of the seller's obligations under FOB and the type of contract he has to procure for the benefit of the buyer under CFR and CIF. In the commodity trade in particular, the exact manner in which the goods are delivered for carriage in FAS and FOB contracts varies in different ports.[68] To avoid being surprised parties are therefore advised to enquire prior to the conclusion of the contract as to the particular customs operating in the port where the goods are to be loaded under FOB. If, for example, the goods are to be loaded on board a ship in the seller's home port and under FOB the buyer has to nominate a ship, he should ascertain the extent to which costs will be included in the FOB freight and whether other additional costs

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[64] Ramberg *Guide to INCOTERMS 2000* 11. See also 5 6 *infra* for a discussion on the incorrect use of certain INCOTERMS.
[65] Ramberg *Guide to INCOTERMS 2000* 14.
[66] Reynolds *INCOTERMS for Americans* 70 mentions that during the talks on the revision of INCOTERMS 2000, Raty, the Finish delegate to the Working Group, shared an anecdote on the origin of the ship's rail, which may explain the relevance and mystique of this point in the division of costs and risks. Before the advent of cranes and other automated loading apparatus, cargo was completely loaded by hand. During the loading process, the stevedores brought their bundles to the ship's side and rested them on the ship's rail. From that point, the ship's crew took over, from where they carried the bundles to their appointed places in the vessel. Hence, the division of costs and risks at this point.
[67] *Cf* 5 4 1 & 5 4 2 *infra*.
[68] *INCOTERMS 2000* (official rules) Introduction para 7. See also 5 1 *supra*.

may be debited to him following the loading of the goods. INCOTERMS take customs of the trade into account by referring to delivery “in the manner customary at the port” in clause A4 of the FAS and FOB terms.[69]

It is true that the traditional FOB point not only produces impracticable results[70] but also does not reflect what actually takes place in seaports under present conditions. The reference to "the manner customary at the port" highlights the problem of using the ship's rail as the determining factor. Although the revision committee realised that this point was actually not the point at which risk passes when commodities such as grain or oil are sold,[71] it was also realised that any attempt at a more precise definition would make it impossible to retain a single definition. To reflect all possible variations would have necessitated a number of variants of the FOB term. A definition encompassing different situations requires abstraction, but this detracts from the guidance that can be derived form the term. It was decided that the best way to accommodate different situations was to retain an abstract formulation and to leave the definition unchanged.[72] Parties, therefore, will have to follow the custom of the port regarding the actual measures to be taken in delivering the goods onboard.[73]

### 5 3 General structure and content of INCOTERMS 2000

Since the 1990 revision, INCOTERMS are presented in a systematic manner. The various trade terms are now grouped into four categories for the purpose of easier reading and understanding. These four groups are the E-terms, F-terms, C-terms and D-terms. The first letter of each trade term is an indication of the group to which the term belongs. According to the single E-term (EXW), the seller makes the goods available to the buyer at the seller’s own premises. Under the shipment terms, delivery takes place when the goods are delivered to the named carrier or placed on board the vessel at the named port of shipment. Under the F-terms (FCA, FAS and

[69] Ramberg *Guide to INCOTERMS 2000* 41.
[70] Not only as regards the division of loading costs, but also in the division of risks when accidents occur during loading. See in this regard 5 4 1 & 5 5 1 *infra.*
[71] It has been suggested that an exception should apply to contracts for the sale of liquid or gaseous products and that where these products are sold on an FOB basis, risk transfers when the subject matter enters the ship's fittings. According to the ICC, this is the rule that applies in the port of Antwerp and elsewhere. See Sassoon *CIF and FOB Contracts* para 577.
[72] Ramberg “Why revise INCOTERMS?” in Ramberg et al *INCOTERMS 2000: A forum of experts* 11-12; *INCOTERMS 2000* (the official rules) Introduction para 9 2.
[73] The practical problem lies in determining who should bear the costs of the services of the stevedoring companies that are responsible for loading the cargo on board the ship. See Ramberg *Guide to INCOTERMS 2000* 41.

FOB), the seller is called upon to deliver the goods to a carrier appointed by the buyer. The main carriage is not paid by the seller. Risk transfers when the goods are delivered to the carrier (FCA), placed on board the ship (FOB) or placed alongside the vessel (FAS). The C-terms (CFR, CIF, CPT and CIP), on the other hand, place the duty to contract for carriage on the seller, but without him assuming the risk of loss of or damage to the goods or additional costs due to events occurring after shipment and dispatch. Similarly to the F-terms, risk passes when the goods are delivered to the named carrier (CPT and CIP) or placed on board the ship (CFR and CIF). Under the destination terms or D-terms (DAF, DES, DEQ, DDU and DDP), delivery takes place when the goods are delivered to the place of destination. Accordingly, the seller has to bear all costs and risks needed to bring the goods to the place of destination.[74]

Each individual term is presented in a logical sequence. The respective obligations of the parties appear under ten headings, representing core aspects of the transaction set out in numbered paragraphs, with each paragraph on the seller's side (A1-A10) "mirroring" the position of the buyer (B1-B10) with respect to the same subject matter. This method clearly indicates how an obligation for one of the parties relieves the other party of that same obligation. It enables the buyer and seller to easily establish their rights and obligations with reference to the corresponding rights and obligations of their trading partner. These obligations entail the duty of the seller to provide the goods in conformity with the contract and the buyer's corresponding duty to pay the price (A1 and B1); obligations to obtain licences, authorisations and formalities (A2 and B2); who is to contract for carriage and insurance of the goods (A3 and B3); when and where delivery is to be made and taken (A4 and B4); the moment of transfer of risk from the seller to the buyer (A5 and B5); the division of costs between the parties (A6 and B6); notices that are to be given to the buyer or seller (A7 and B7); obligations in regard to proof of delivery, transport documents or equivalent electronic messages (A8 and B8); obligations to check the goods; package them and provide the necessary markings (A9 and B9), as well as other obligations (A10 and B10). This approach to presenting the terms, as well as the relative ease with which they can be applied, contributes to their general efficiency.

[74] ICC *INCOTERMS 2000* (the official rules) Introduction para 5; Ramberg *Guide to INCOTERMS 2000* 38-39.

### 5 4 Passing of risk and costs under INCOTERMS 2000

Trade terms determine risk and cost allocation in advance by linking the passing of risk to a precise moment during the physical movement of the goods. Except for the C-terms,[75] costs and risk transfer from the seller to the buyer once the seller has fulfilled his obligation to deliver the goods.[76] The time of delivery is regulated by clauses[77] A4 and B4. Because the time of delivery differs in respect of each type of INCOTERM, the moment that risk passes differs as well.

INCOTERMS cover "price risk"; in other words, whether the buyer will be obliged to pay and the seller entitled to claim the price in case of accidental loss of or damage to the goods.[78] They do not address the risk of non-performance. "Risk" under INCOTERMS therefore covers any physical loss or damage to the goods[79] that is accidental and for which neither of the parties is responsible including that resulting from acts or omissions of third parties.[80]

The discussion will now turn to an analysis of the risk rule under FOB, CIF and DDU as formulated under INCOTERMS 2000.

#### 5 4 1 FOB under INCOTERMS 2000

Clause A4 stipulates that "the seller must deliver the goods on the date or within the agreed period at the named port of shipment and in the manner customary at the port on board the vessel nominated by the buyer." The seller has performed his obligation to deliver when the goods pass the ship's rail at the named port of shipment.[81] The

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[75] Here, the seller's obligation with respect to the costs of carriage and insurance extends to the destination. These terms have two critical points, namely one for the transfer of risk and one for the transfer of costs.

[76] *INCOTERMS 2000* (official rules) Introduction para 8; the A5 & B5 and A6 & B6 clauses of INCOTERMS.

[77] Some sources refer to "sections", eg Ramberg *Guide to INCOTERMS 2000.* For purposes of this study, the term "clauses" have been used throughout.

[78] Ramberg *Guide to INCOTERMS 2000* 60-61. See also 1 6 2 *supra* on the general notion of price risk.

[79] The goods must be duly appropriated to the contract, ie clearly set aside or otherwise identified. *Cf* the B5 clauses of INCOTERMS.

[80] Normally these are the incidents caused by so-called "acts of God".

[81] Preamble to the FOB term; clause A4 FOB. If accidents occur during loading, problems arise as to how the risk of loss of or damage to the goods is to be allocated. A literal interpretation would mean that the risk passes at the exact moment when the goods are hoisted across the ship's rail and it has crossed that particular line. See the discussion 5 5 1 *infra* and 2 2 1 1 (i) *supra*. It has been suggested that the goods should be safely placed on board before delivery is complete. However, this obligation should not include the obligation to secure the goods on deck or in the ship's hold as that would be

A5 and A6[82] clauses indicate that the buyer has to bear all risks of loss of or damage to the goods and all costs from the time that the goods have passed the ship's rail.[83] To this extent, no changes were effected to the FOB term.[84]

The preamble to the FOB term warns parties that if they do not intend to deliver the goods across the ship's rail, the FCA term should be used.[85] In respect of container transport, many of the problems that are experienced with the FOB term[86] can be addressed by using the FCA term instead. The FCA term moves the point of delivery to a carrier at a specific named point. The term distinguishes between two situations, namely where delivery is to be effected at the seller's premises or where the named place of delivery is somewhere else. In the first instance, delivery takes place when the seller loads the goods onto the buyer's collecting vehicle at his premises; whilst in the second situation, the goods are delivered when they are placed at the disposal of the carrier nominated by the buyer without being unloaded from the seller's means of transport.[87] Risk passes at the moment of delivery and is therefore dependent on which of the two situations are applicable.

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covered by the "stowed and trimmed" variants. See Murray et al *Schmitthoff's Export Trade: The Law and Practice of International Trade* 11th ed (2007) para 2-013.

[82] The A6 clause provides that all costs occurring before the goods have passed the ship's rail at the named port of shipment are for the seller's account, whilst costs incurred after delivery are for the account of the buyer. Where applicable, the seller must pay the costs of customs formalities necessary for export as well as all duties and other official charges payable upon export. This rule is subject to the provisions of clause B6, which indicates that the buyer may have to bear additional costs incurred by his failure to give appropriate notice to the seller of the time of shipping and the port of destination in accordance with clause B7. Under the FOB term, the buyer is responsible for the main-carriage contract and to pay the ocean freight charges. The result is that the buyer often has to pay the terminal handling charges (THCs) as well.

[83] Even if damage occurs after the transfer of risk, the seller may still be held responsible for breach of contract if the damage could be attributed to the fact that the goods were not delivered in conformity with the contract or not properly packed. See clauses A1 and A9. Clause B5 also provides for the premature passing of risk where the buyer fails to give notice in accordance with clause B7, or if the vessel nominated by him fails to arrive on time or is unable to take the goods.

[84] See 5 2 3 2 *supra* for a discussion of the revision process.

[85] The FCA term was created in 1980 after it was decided not to have two variants of the FOB term, ie one for the sale of commodities by use of chartered ships and one for manufactured goods. However, in commercial practice the FCA term has developed very slowly because merchants are conservative and because of the ignorance of customs officials. See Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 10-11. See also the discussion on the incorrect use of the FOB term 5 6 *infra*.

[86] These problems are mainly connected to the fact that the risk remains on the seller whilst the goods have left his control long before they cross the ship's rail. See 5 6 *infra*.

[87] Clause A4 FCA.

### 5 4 2 CIF under INCOTERMS 2000

INCOTERMS 2000 brought no change to the CIF term. The risk of loss of or damage to the goods passes to the buyer at the time of delivery.[88] The A4 clause states that the seller's delivery obligation is satisfied when the goods are delivered on board the vessel at the port of shipment on the agreed date or within the agreed period. The preamble to the CIF term and the A5 clause indicates that the seller bears the risks until the goods have passed the ship's rail at the port of shipment.

The new wording of the A6 clause indicates the division of costs explicitly. The seller must pay the costs and freight necessary to bring the goods to the named port of destination. This obligation includes the costs of loading the goods and any charges for unloading at the place of destination which were for the seller's account under the contract of carriage. Where applicable, it also includes the costs of customs formalities necessary for export, as well as all duties, taxes and other charges payable upon export and for their transit through any country if they were for the seller's account under the contract of carriage.[89]

In addition, the seller must take out marine insurance to cover the risks for the carriage. This obligation only requires the seller to procure insurance on "minimum terms".[90] Ramberg[91] believes that this requirement was left unchanged in INCOTERMS 2000 because the term is frequently used for the sale of goods in transit. The goods are sold over and over again while they are at sea, making it impossible for the seller to know from the outset what the insurance requirements of subsequent buyers would be. Therefore, if a buyer wants extended cover, he should ask for it or arrange it himself.

Since the CIF term requires a bill of lading, it should only be used for carriage by sea (port-to-port shipment) or for some form of inland waterway transport. The preamble reminds parties that if they do not intend to deliver across the ship's rail, the CIP term should be used instead.

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[88] Clause B5 provides circumstances which may result in the premature passing of risk because of the buyer's failure to fulfil his obligations properly.
[89] See also the discussion on CIF variants 5 5 2 *infra*.
[90] Such minimum terms are provided by clause C of the 1982 Cargo Clauses of the London Underwriters.
[91] "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 13.

### 5 4 3 DDU under INCOTERMS 2000

The destination term DDU ("delivered duty unpaid … named place of destination")[92] can be used for any mode of transport. The seller has to bear the costs and risks involved in bringing the goods to the country of destination. The destination point is important in these cases for purposes of delivery.

Clause A4 states that "[t]he seller must place the goods at the disposal of the buyer, or at that of another person named by the buyer, on any arriving means of transport not unloaded, at the named place of destination on the date or within the agreed period agreed for delivery." There is therefore no duty on the seller to unload the goods from the vehicle or to pay the costs for unloading. The trade practice in respect of unloading was not considered to be sufficiently clear and undisputed for the drafters to be more specific.[93] The majority of the drafters felt that if the seller does not have to deliver onto the buyer's means of transport, such as where the named place of destination is the seller's carrier terminal, it is not necessary to state precisely the allocation of costs for the loading operations of the collecting vehicle as that will depend on the contract of carriage.[94] Normally the buyer will have to pay for the lift-on, lift-off (lo-lo) charges to load the container on its collecting vehicle. These costs are not included in the freight since the independent handling companies are not easily controlled by the multimodal carriers nominated by the sellers.[95]

The risk of destruction of and damage to the goods passes when the goods are delivered at the place of destination in the aforesaid manner. According to the

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[92] This term was added in 1990. See 5 8 2 *infra* on the possible elimination of the DDU term in the next revision of INCOTERMS.

[93] The Working Group suggested that the FCA term should be copied in regard to the seller having to load the goods on the buyer's collecting vehicle. However, the ICC's International Commercial Practices Commission decided that such an amendment would be too onerous for the seller because there would then be too many variations. In most cases the seller has no control over the different terminals. It was therefore decided that it is safer to say nothing. With the exception of countries and ports where unions are particularly strong, in the case of multimodal transport partly conducted by sea, the handling of the goods to the container yard is controlled by longshoremen. The handling of the goods out of the same container yard is usually controlled by independent handling companies acting on behalf of the receivers, so that the carrier cannot easily offer to load the buyer's collecting vehicle. See Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 16, 35.

[94] Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 34-35. He suggests that the parties should make sure that these provisions of carriage are also clearly mentioned in the contract of sale. This is especially important since liner terms and so-called "manners customary at the port" are starting to fade away in sea transport. More and more shippers negotiate directly with a specific carrier for so-called "all-in" prices door-to-door or door-to-port, which then include contractual provisions on the loading and unloading of the goods.

[95] However, if the trade term specifies "CY (container yard) gate out", the THC (transport handling costs) are included in the costs of carriage at both the loading and unloading ports, although the lift-on, lift-off (lo-lo) costs to load the container on his collecting vehicle will still be borne by the buyer. Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 35-36.

preamble, the goods are to be delivered not cleared for import. There is therefore no specific duty on the seller to have the goods cleared for import. In most instances, delivery may be before or at the customs station. But the parties may use DDU also when the seller undertakes to deliver the goods in the interior of the country. All depends on the place that is indicated after DDU. The contract of sale should then explicitly provide for the costs and risks connected to obtaining import clearance.[96] In countries where import clearance may be difficult and time-consuming, it may be risky for the seller to undertake to deliver the goods at an inland point which is beyond that country's customs-clearance point. Parties are therefore advised not to use DDU in cases where import clearance may be difficult.[97]

## 5 5 Trade term variants

### 5 5 1 FOB variants

Although the ship's rail as a dividing point for risks and costs seems to be a fairly simple solution, it is often not appropriate in practice.[98] It is difficult to separate the loading costs for work performed before the point of passing the ship's rail from that performed thereafter, especially if the whole loading operation is conducted by the same company.[99] It is also impracticable to divide the functions and risks between the parties while the goods are swinging across the ship's rail. The question of the passing of risk can become especially difficult in the context of accidents during loading operations, for example if the ropes break when the cargo is lifted from the shore onto the ship. It has been suggested that where the goods are damaged during the loading process the risk will be on the seller if they fall on the wharf or in the water, whereas it will be on the buyer if they fall on deck.[100] Because it is purely

[96] Parties can agree to deviate from the standard norm. The variant "DDU cleared" requires the seller to clear the goods for import.
[97] *INCOTERMS 2000* Introduction para 9 4; Ramberg *Guide to INCOTERMS 2000* 50.
[98] *Cf* 5 2 3 2 *supra*.
[99] Even though the costs of loading the goods into the ship is to be borne by the seller under an FOB term, in practice, these costs are included in the freight which is to be paid by the buyer. In the case of liner terms, the shipping line normally bill these costs along with the freight charges to the party who is responsible for the main-carriage contract. Reynolds *INCOTERMS for Americans* 70 is of the view that the seller would be responsible for the terminal handling charges and any heavy lift or oversize charges at the port of shipment since he is responsible for loading the vessel,
[100] Valioti *Passing of Risk* text accompanying nn 207-212 and 266-268. It will be difficult to determine the exact time when and place where the goods have landed.

fortuitous on which side of the rail the cargo drops, this does not produce a legally satisfying result.[101]

In principle, such an accident affects both the contract of sale and the contract of maritime carriage by sea. Devlin J (as he then was) in the *Pyrene* case[102] observed that in the contract of carriage by sea, the loading operation has to be considered as an indivisible whole and the carrier's liability for negligence as extending to all stages of that operation, irrespective of whether they occurred before of after crossing of the ship's rail. However, when it comes to the contract of sale the situation is more difficult, especially if the parties have failed to regulate this point in their contract.

According to Schmitthoff two views are possible here.[103] One view suggests that under an FOB contract the goods are at the buyer's risk when they pass the ship's rail so that it is irrelevant whether they reach the ship safely on completion of the loading operation. The other view suggests that the seller has fulfilled his obligations under an FOB contract only if the goods are deposited safely on board the vessel and the loading operation is completed. In Schmitthoff's opinion the latter is the correct view. He suggests that the fortuitous element which Devlin J rejected as a test for the contract of carriage by sea should likewise be rejected for the contract of sale.

The seller and buyer may need to define the point or place of delivery more precisely, since the general definition of delivery given in clause A4 is not always sufficiently detailed. That is understandable because their purpose is to fit into many circumstances and not to address all the variants to the basic rule. Keeping in mind that INCOTERMS provide a set of terms for use in different trades and regions, it is impossible to identify a consistent practice that can be defined with absolute precision. It is therefore necessary to refer to some extent to the custom of the port or of the particular trade or to the practices which the parties themselves may have established in their previous dealings. Whenever uncertainty arises, parties should clarify their legal position by appropriate clauses in their contract. Such provisions in the individual contract would supersede or vary any provision of the various

[101] As Devlin J (as he then was) remarked in *Pyrene v Scindia Navigation* 1954 2 QB 402 419: "Only the most enthusiastic lawyer could watch with 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."
[102] *Supra* 419.
[103] Murray et al *Schmitthoff's Export Trade* para 2-013.

INCOTERMS.[104] The preambles of several INCOTERMS recognise the need to adapt the term. Such options are signalled by the word "however".[105]

In practice, merchants developed trade usage variants to deal with the uncertainties that come with the ship's rail criterion in regard to the division of risks and costs. Whilst INCOTERMS merely reflect the commercial practice most commonly used, trade term variants are aimed at obtaining greater precision[106] and adapting the standard INCOTERM to existing commercial practices.[107] Such additions to the basic term can either add to or derogate from the parties' obligations.[108]

The seller's obligation to place the goods onboard may be extended by a phrase added to the FOB term, for example "FOB stowed" (FOBS), "FOB trimmed" (FOBT) or FOB stowed and trimmed" (FOBST).[109] If the phrase "stowed and trimmed" is attached to FOB, the seller should be responsible for both the stowage and the trimming of the goods on the ship.

"Stowing" means ensuring that the cargo is positioned on board the vessel in such a manner as to be safe during the proposed transit, for example to position the cargo in such a manner that it is distanced from parts of the ship that generate heat and to ensure the stability or balance of the ship. "Trimming" involves the levelling of the cargo during or shortly after loading, so that it is evenly distributed in each hold and throughout the ship as a whole. This process applies only to dry bulk cargoes to ensure the stability and structural strength of the vessel. In the case of some cargoes it also ensures that the holds are more efficiently filled or in others, such as in the case of coal, it can reduce the spontaneous heating of the cargo.[110]

Expenses for stowing and trimming are often shifted between buyer and seller. Normally they are borne by the party interested in the cargo at the relevant time, which is mostly the buyer. In the case of FOBT, FOBS or FOBST the intention is that

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[104] *INCOTERMS 2000* Introduction para 12.
[105] *INCOTERMS 2000* Introduction para 11. *Cf* the EXW, FAS, DAF and DDU terms.
[106] *INCOTERMS 2000* Introduction para 11; Ramberg *Guide to INCOTERMS 2000* 31-33; Raty "Variants on INCOTERMS (Part 2)" in Debattista (ed) *INCOTERMS in Practice* (1995) 151 152-153.
[107] For example, an added obligation for the seller to load the goods on the buyer's collecting vehicle in the case of the EXW term, additional insurance for the buyer in the case of CIF/CIP terms and an added obligation for the seller to pay for costs after discharge in the case of the DEQ term.
[108] Raty "Variants on INCOTERMS (Part 2)" in *INCOTERMS in Practice* 152-153.
[109] These variants of the FOB term are aimed at safety, stress and stability of the goods. Normally, these aspects are the responsibility of the ship master.
[110] Reynolds "Stowing, trimming and their effects on delivery, risk and property in sales 'fobs', 'fobt' and 'fobst' 1994 (1) *LMCLQ* 119 119-120; Klotz & Barrett *International Sales Agreements* 71-72 nn 22 & 23.

such costs should be shifted to the seller.[111] These additional words are primarily aimed at ensuring that the seller has to pay all of the loading costs.

But do these variations have an effect on what constitutes delivery under the contract or on the passing of risk? There is no clarity as to whether a seller will only effect delivery once loading, stowing and/or trimming, as the case may be, have been completed.[112] The majority opinion holds that a resort to trade term variants does not entail changing the meaning of the term. Neither the point of delivery nor the point where risk transfers to the buyer is changed by the variation. It only serves to specify the costs for securing and trimming the goods at the port of loading.[113]

Reynolds,[114] on the other hand, suggests that such variants should actually influence the delivery point. He argues that the seller's delivery obligation is not met until the stowing and trimming have been completed. By adding this function to their standard meaning, trade terms are made more effective as contract terms. He suggests that the law should recognise that parties who insert such clauses into their sale contracts intend to provide for both a physical and a financial obligation, and that their intentions would be frustrated if the term was merely regarded as allocating a financial obligation. He concludes that delivery and passing of risk should be delayed until the stowing and trimming have been completed.[115] However, if the buyer allows the ship to sail beforehand, he waives his rights and thereby assumes the risk. Trade terms are deliberately made part of the contract with the intention that they should be enforced. The law should, therefore, provide the buyer with some leverage, so as to enable him to enforce the additional obligations which were imposed on the seller without having to resort to judicial process. This can be done by postponing, wherever possible, the time of delivery and the passing of risk and property until the seller has

[111] Reynolds 1994 (1) *LMCLQ* 121; Griffin *Day & Griffin The Law of International Trade* 3rd ed (2003) 58.
[112] Ramberg *Guide to INCOTERMS* 2000 32.
[113] Raty "Variants on INCOTERMS (Part 2)" in *INCOTERMS in Practice* 155,161. On 158 he suggests that the variant should follow the reference to INCOTERMS, for example "FOB INCOTERMS 2000 stowed and trimmed".
[114] 1994 (1) *LMCLQ* 121-123, 124-127. This is essentially the same argument as that of Schmitthoff's, referred to above.
[115] Klotz & Barrett *International Sales Agreements* 72 hold that in these cases, it is the intention of the parties that risk should not pass until the seller has completed all his obligations under the agreement. However, they concede that the legal position may not be that clear if the goods are damaged during the seller's trimming operation. To avoid disputes, they advise that parties should provide for the transfer of risk contractually. Treitel "FOB Contracts" in Guest (ed) *Benjamin's Sale of Goods* 7th ed (2006) para 20-090 agrees that the risk should not pass until the goods are stowed. He also recognises that this may cause uncertainty and, suggests that express contractual provisions should regulate the position, or that the risk should pass when the goods are "shipped," ie as soon as the duties of the carrier in respect of lading have begun. However, the suggested solution may be inconsistent with the underlying assumptions of the *Pyrene* case *supra*, namely that risk passes when the seller's duty to load is completed.

performed all his obligations under the contract. The buyer can then reject goods that are not stowed and/or trimmed or that are destroyed or damaged during the stowing and trimming.[116]

Reynolds[117] finds support for his view in an American case, *Minex Shipping v International Trading Company of Virginia and SS Eirini.*[118] In this case, the sales contract provided that bags of cement would be shipped "FOB stowed Polish port". The cement became contaminated during the voyage as a result of soy beans falling on the cement bags.[119] The buyer maintained that the contract term required the seller to sweep, clean and dry the holds of the vessel.[120] However, the court held that the "stowed" term did not impose these duties upon the seller. The seller was merely obligated to place the cement in the holds "in an orderly, compact manner" and "in such a manner as to protect the goods from friction, bruising, or damage from leakage".[121] The court held that when the goods were so placed, the title passed to the buyer with the resulting risks of ownership, and once the cargo was properly stowed, the risk of damage passed to the buyer. This judgement, therefore, seems to lend support to the argument that the additional obligation to stow the goods entails that the critical point for the passing of risk is to be moved to the time when the stowing obligation is properly fulfilled.

In *Camden Iron & Metal Inc v Bomar Resources Inc*,[122] an American court held that FOBST is a common maritime variation of the standard FOB contract which means that in addition to the traditional FOB obligations, "the seller must prepare the cargo and the vessel's holds to ensure efficient, safe loading." In practice, stowing and trimming obligations are executed by stevedoring companies or the crew of the ship on behalf of the seller. In this particular case the contract provided that any damage caused to the ship by the negligence of the stevedores during the loading, stowing, and trimming of the cargo would be for the risk of the seller. The judgement does not provide any authority for the allocation of risk of damage to the goods, however. The

[116] Reynolds 1994 (1) *LMCLQ* 124, 126-127, 130.
[117] 121.
[118] (1969) 303 F Supp 205.
[119] A clean bill of lading was issued on shipment, which indicated that the goods were in apparent good order and condition.
[120] On the facts of the case, the charter party provided for the holds to be swept and cleaned before the commencement of loading. However, this obligation is not one that is automatically assumed by an "FOB stowed" term.
[121] (1969) 303 F Supp 205 208. The court found support for its conclusion in some older authorities, such as *Lawson v Hobbs* 120 Va 690, 91 SE 750 (1917).
[122] 719 F Supp 297 306-307, 12 UCC Rep Serv 2d 398 412 (D NJ 1989).

contract dealt with the sale of scrap metal, which means that there was no need to come to a conclusion on the aspect of risk.

In instances where, as with a CIF sale, a seller concludes the contract of carriage, it is arguable that delivery does not take place until the cargo is stowed and/or trimmed. However, in the case of an FOB sale where the buyer contracts for carriage or where the seller contracts on behalf of the buyer, the seller is unable to control stowage and trimming as there is no contract between him and those responsible for these obligations. Policy considerations of international trade dictate that risk should follow control.[123] Once the goods are delivered across the ship's rail, control is relinquished to the buyer, who will then be protected by marine insurance and the contract of carriage by means of the Hague, Hague-Visby and Rotterdam Rules. On strength of these considerations the stowing and trimming obligation should merely entail an additional financial obligation on the part of the seller and not influence the point of delivery or the passing of risk. It should also be kept in mind that the use of trade terms is subject to the customs of a particular port, which could also influence the understanding of a particular trade term and its variation. In the final analysis it is advisable that parties should explain their intention when using a trade term variation.[124]

Although this study recognises that the ship's rail is impractical as a point for the division of costs and risks, it should also be kept in mind that the FOB term should be used for bulk goods such as grain or coal which are pumped directly into the ship's fittings and not so much for goods that are delivered across the rail. Other cargo, such as containerised goods, should be shipped under more appropriate trade terms, such as FCA for example, where the ship's rail does not play any role. If the correct term is used, there will be no need to deviate from the standard meaning of the FOB term in regard to delivery and the transfer of risk.

[123] One of the principles on which trade terms are based is that the obligations are kept together, namely that whoever has the custody of the cargo also bears the risk. Deviations distort obligations and should only take place for special reasons. See Mikkola "Variants on INCOTERMS (Part 1)" in Debattista (ed) *INCOTERMS in Practice* (1995) 144 147-148. See also the discussion under 3 2 1 *supra.*

[124] For example, by adding a phrase such as "FOB stowed, costs and risks in connection with loading on the seller." See Ramberg *Guide to INCOTERMS 2000* 55.

### 5 5 2 CIF variants

Because the CIF rule may not be suitable for all situations, merchants have sought to tailor the standard-form CIF terms to fit specific commercial conditions. For example, if the goods are sold "CIF landed", the unloading costs including lighterage and wharfage charges are borne by the seller or are included into the sea freight which he has to pay. Another example is "CIF undischarged" or "CIF free out" where the intention is that the seller's obligations are limited to those that are to be effected inside the ship's hold in the port of discharge. Costs for unloading should be borne by the buyer.[125]

Furthermore, CIF variations may involve the use of contract terms which appear to be CIF on their face but which, on closer inspection, are inconsistent or even irreconcilable with the basic premise of a CIF sale, namely that risk of loss falls on the buyer from the moment of shipment. The use of the phrase CIF in such cases will not be sufficient to determine the parties' basic contractual intent.[126]

Deviations from the standard-form CIF contract are common where oil is transported by sea. A common modification is the "out-turn" or "landed weight" clause which relieves the buyer from having to pay on the basis of the quantities shown on the bill of lading, as is normally the case under CIF.[127] These practices evolved because of the potential for losses during the transportation of oil. Such losses can be divided between transportation loss on the one hand, and marine loss on the other. Transportation loss refers to loss in the volume of oil during transit due to evaporation, sludge, accumulation, spillage or measurement error, whilst marine loss covers loss caused by fortuitous events such as vessel destruction, bad weather or war.[128]

Although there is agreement on the fact that unavoidable transportation loss is shifted to the seller, there are conflicting views on the apportionment of other risks. According to one view, other risks pass on shipment as under the normal CIF rule. The out-turn clause is therefore only a price adjustment mechanism with regard to

[125] Raty "Variants on INCOTERMS (Part 2)" in *INCOTERMS in Practice* 156; Ramberg *Guide to INCOTERMS 2000* 33, 55.
[126] See the discussion 2 2 1 1 (ii) for examples of variations that are not true CIF contracts.
[127] Subsequent to the Arab-Israeli war of 1973 and the overthrow of the Shah of Iran, the oil price increased drastically, resulting in the CIF out-turn clause gaining much ground in the international oil trade.
[128] Lightburn and Nienaber "Out-turn clauses in cif contracts in the oil trade" 1987 *LMCLQ* 177 178.

unavoidable transit losses, leaving the risk of marine loss on the buyer. A more far-reaching approach is that an out-turn clause moves the time at which risk of loss, whether marine or transportation loss, passes from the seller to the buyer from the point of shipment to the port of destination. This does away with the need to distinguish between marine loss and transportation loss.[129]

Lightburn and Nienaber[130] prefer the first interpretation because of the need to give effect to the recognised CIF trade term. By choosing CIF as the applicable contract basis a range of obligations is made part of the contract without the use of express words to this effect. No compelling reasons exist for justifying an exception to the normal CIF rules in this case. Traditionally, out-turn terms are a short-hand way of dealing with unavoidable transportation losses as opposed to marine losses. These concepts are clearly recognised in the oil trade and the risks have been extensively analysed by industry specialists. A party seeking to overcome the accepted meaning of a particular term should therefore have the burden of showing that the parties intended to disregard the legal consequences that would normally flow from its use. If parties wish to deviate from the standard meaning they can provide for that through express contractual terms.

Before the 2003 revision, section 2-321 UCC (2001) also reflected the policy decision that the out-turn variant should be construed so as to involve the least possible deviation from the CIF basis, while at the same time taking into account the inevitability of transportation losses. This section deals with CIF or C&F "Net Landed Weights", "Payment on Arrival", and "Warranty of Condition on Arrival" terms. The Official Comment states that the section deals with "variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C.&.F. term as to the passing of marine risks to the buyer at the point of shipment."

The 2001 version of the UCC draws a clear distinction between "CIF out-turn" contracts and "CIF no arrival-no sale" contracts. Section 2-234 leaves the risk of loss in "no arrival, no sale" contracts explicitly on the seller. In the case of "CIF out-turn"

[129] 178-179.
[130] 179.

contracts, section 2-321 splits the risk, by placing the risk of necessary loss ("the risk of quality and weight deterioration during shipment") on the seller, and the risk of extraordinary loss ("marine risks") on the buyer. That this position is well understood and correlates with mercantile expectation is clear from the case law on this provision.[131] It is submitted that the legal position will remain the same even if the 2003 revisions are enacted, as it reflects American mercantile practice and usage in this respect.

There is no statutory provision in the English Sale of Goods Act dealing with CIF out-turn clauses. However, the courts have on several occasions considered clauses which make the amount payable depend on the quantity of goods which actually arrive. A number of cases have held that clauses which shift the risk of loss from the buyer to the seller do not necessarily change the essence of a CIF contract. The Court of Appeals in *Denbigh Cowan & Co v Atcherley*[132] considered that a clause referring to "net loading weight" and a clause stating that "should the goods … not arrive from loss of vessel either before or after declaration … this contract for such portion to be void", did not prevent the contract from being a CIF one.

Although there was no case law available to substantiate their opinions at that time, Lightburn and Nienaber[133] submit that in English law, the out-turn clause does not change the essential CIF basis of the contract and, therefore, should not result in shifting the risk of marine loss. Schmitthoff[134] acknowledges that the variants may create the impression that the contract becomes a destination or arrival contract, but concludes that they merely indicate the seller should allow a price adjustment after the goods have landed and that they do not affect the character of the contract as a true CIF contract.[135] His argument is based on the decision in *Soon Hua Heng Co Ltd v Glencore*,[136] an English case which was decided in 1996, subsequent to the publication of Nienaber and Lightburn's article. The court held that out-turn or similar clauses are normally intended to relate only to the determination of the price. If the goods are lost and the buyer has already paid an estimated price on tender of the documents, he is not entitled to an adjustment, unless he can prove that the shipped goods were less in quantity or quality than he has paid for. The out-turn clause should

[131] 180-181.
[132] (1921) 90 LJKB 836. *Cf* also *The Gabbiano* [1940] P 166 174.
[133] 1987 *LMCLQ* 184-185.
[134] Murray et al *Schmitthoff's Export Trade* para 2-037.
[135] See *Oleificio Zucchi SpA v Northern Sale Ltd* [1965] 2 Lloyd's Rep 496 518; *Oricon Waren & Handels GmbH v Intergraan NV* [1967] 2 Lloyd's Rep 83 94.
[136] [1996] 1 Lloyd's Rep 398.

therefore only apply to cases where the weight difference arises from ordinary circumstances. Such a clause does not entail that the whole of the risk is to remain on the seller until actually delivery, since such an interpretation would mean that the contract would no longer be a CIF contract.[137]

These opinions should be supported inasmuch as they underline the need to preserve the basic character of the CIF term. If the parties intend to shift the point of delivery or the passing of risk for accidental disasters, they should conclude their contract on the basis of an arrival term. Variations of the CIF term should not affect the character of the CIF term as a shipping term where delivery and the passing of risk takes place on shipment. Trade term variations should merely affect the financial obligations of the parties in that the seller has to pay additional costs for unloading of the goods, alternatively that the purchase price should be adapted if the transportation affected the weight of the goods. In the absence of such a variation, the buyer would carry the risk of evaporation or spillage during transportation. The out-turn variant is therefore intended to cover a range of limited events which would otherwise have fallen under the ambit of the risk rule. It should not be used to move the point of delivery or the general point where risk transfers from the seller to the buyer. Moreover, in the case of an out-turn clause, the variation is primarily aimed at a specific type of trade, namely the oil trade, where it reflects the commercial practice of that trade. If the parties want to broaden the scope of the out-turn clause they should choose another term or they should state their intention clearly.

### 5 5 3 Should INCOTERMS clarify the ambiguities of trade term variants?

As is evident from the above discussion, trade term variants create additional uncertainties even though they originate from a need to simplify matters.[138] It has been said that the ICC should take an active role in harmonising such variants. Although INCOTERMS acknowledge the existence of variants, they provide no guidance on how to deal with them. Serious problems may arise when no consistent understanding of the additions can be established. In the case of "EXW loaded" or "FOB stowed", for example, there is no general world-wide consensus that such additions extend the seller's obligations to include both the cost of actually loading the goods and the risk of fortuitous loss of or damage to the goods in the process of

[137] Treitel "CIF Sales" in Guest (ed) *Benjamin's Sale* 7th ed (2006) para 19-006.
[138] Mikkola "Variants on INCOTERMS (Part 2)" in *INCOTERMS in Practice* 145.

stowage and loading.[139] Additions to the C-terms also present many problems. These terms constitute shipment contracts where the seller fulfils his delivery obligations on shipment of the goods. The addition of obligations referring to the destination could suggest that an arrival or destination term was intended. In the result, the seller would be at risk until the goods actually arrive at the destination.

The analysis showed that expressions such as “CIF landed” or “CIF outturn weights” are normally not interpreted as changing the nature of the term. The word “landed” usually refers to the costs of discharge, and “outturn weights” merely signifies that the buyer should pay according to the weight ascertained after discharge so that condensation of the goods during their transport should, for instance, be taken into regard when fixing the price. However, this does not mean that the seller bears the risk of fortuitous loss of or damage to the goods during the carriage.

For these reasons, parties are advised to clarify whether the seller is intended to undertake the responsibilities for loading and stowage operations at his cost or whether this also entails an assumption of risk until the loading and stowage obligations are completed. An additional obligation does not necessarily, nor automatically, change the risk distribution under INCOTERMS. Risks do not follow from functions and costs.[140] If, for example, the parties merely intend to clarify the extent to which the seller should pay for discharge of the goods at the port of destination, it would be preferable to say this explicitly by adding the phrase “discharging costs until placing the goods on the quay for seller’s account” to their contract.[141]

Moreover, in some cases sellers and buyers refer to commercial practice in the liner and charterparty trade. In these circumstances, it is necessary to distinguish between the obligations of the parties under the contract of carriage and their obligations to each other under the contract of sale. There are unfortunately no authoritative definitions of expressions such as “liner terms” and “terminal handling charges” (THCs). Distribution of costs under such terms may differ from place to place and change over time. THCs are sometimes charged as part of the freight and other

[139] *INCOTERMS 2000* (official rules) Introduction para 11.
[140] That is evidenced by the C-terms, where the seller has to pay for the freight to the indicated destination but does not have to assume the risks of loss of or damage to the goods after dispatch from the country of export. Ramberg *Guide to INCOTERMS 2000* 32.
[141] Ramberg *Guide to INCOTERMS 2000* 33.

times billed separately.[142] There is no consistent commercial practice that could be reflected in INCOTERMS.[143] The problem of terminal handling costs can be solved either through party agreement or by customs that exist in some trades or ports.[144]

Although INCOTERMS 2000 do not provide specifically for these commonly used variants,[145] the preambles to the terms alert the parties to the need for special contract terms if they intend their obligations to go beyond the content of a particular INCOTERM.[146] INCOTERMS leave it either to trade usage in a particular trade sector or to the parties themselves to clarify the content of such deviations.

The question is whether trade terms variants should be left to evolve through practice or whether the ICC should take an active role in standardising variants? In the preamble to INCOTERMS, the ICC indicates that there is no universal understanding on whether variations intend to extend the seller's obligations merely with respect to the financial costs such as the costs of stowing and trimming, or whether they also include the risk of fortuitous loss or damage to the goods in the process of having the goods stowed and trimmed. Although the discussion of trade term variants shows a strong need for standardised variations, the standardisation function of the ICC is dependent on the existence of a common and universal practice in regard to a specific variant that would justify its standardisation. Once an universally accepted practice is identified, there is no reason why INCOTERMS could or should not standardise trade term variants as that would increase their overall efficiency.

### 5 6 Incorrect use of INCOTERMS

Although the incorrect use of an INCOTERM can bring about unacceptable and inefficient results, this is not a shortcoming inherent in this form of standardisation. Parties may select an inappropriate term either because they refuse to depart from traditional ways or because of ignorance of the intended application of a term. To

[142] Van de Veire "Problems Related to the FCA Term" in Debattista (ed) *INCOTERMS in Practice* (1995) 113 120.
[143] Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 17.
[144] Van de Veire "Problems Related to the FCA Term" in *INCOTERMS in Practice* 123-124. It is also possible to agree on a cost distribution system, such as COMBITERMS for example. See Ramberg *Guide to INCOTERMS 2000* 65.
[145] When parties use trade term variants, they operate outside the scope of INCOTERMS and therefore contract at their own peril. See Ramberg *Guide to INCOTERMS 2000* 32.
[146] *INCOTERMS 2000* (official rules) Introduction para 11.

guard against such an eventuality, the preambles to the various terms contain suggestions as to when their use is appropriate or not.

Different trading patterns have evolved for different types of cargo in commercial practice. Commodities such as oil, iron-ore and grain are frequently carried in chartered ships which accept the cargo as a full load. In this type of trade the ultimate buyer may not be known, since the goods may be sold in transit. In these cases there is a need to obtain a negotiable transport document such as a bill of lading. Moreover, even if the ultimate buyer is known, he is usually not prepared to accept costs already incurred and risks which may materialise in the seller's country. Maritime terms[147] are the appropriate terms in these circumstances. These terms still provide the basis for the greatest volume of world trade. However, maritime terms are seldom appropriate with respect to the sale of manufactured cargo. Here parties are advised to use one of the INCOTERMS appropriate for delivery at the seller's place, such as EXW or possibly FCA, or terms directed at delivery at the buyer's place, such as the destination terms DDU and DDP. It is also appropriate that the seller only undertakes an insurance obligation for the benefit of the buyer when the goods are intended to be sold in transit. In other cases, it is preferable that the buyer arranges his own insurance in order that the insurance cover can be adapted to his particular needs.[148]

Generally, the seller should take care not to remain at risk after the goods have been handed over to the carrier nominated by the buyer or to a terminal where the goods are to be stowed pending the arrival of the ship. This is especially important when the seller has no possibility to supervise or control the care and custody of the goods, such as when the carrier is obliged to take instructions only from his mandator, the buyer.[149] Similarly, when goods are containerised, the seller effectively relinquishes control when they are handed over at a container terminal or depot. A term whereby the seller stays at risk after the goods have left his direct or indirect control is accordingly to be avoided.

This is particularly important with respect to a choice between the FCA and FOB terms. Merchants tend to use FOB even when goods are not directly loaded onto the

[147] FAS, FOB, CFR, CIF, DES, DEQ are the so-called "maritime terms" aimed at maritime and inland waterway transport only. In the case of sales in transit, the CFR and CIF terms are the appropriate maritime terms.
[148] Ramberg *Guide to INCOTERMS 2000* 18. See also Ademuni-Odeke 2007 (31) *Tul Mar LJ* 425 for a discussion on insurance in the case of FOB contracts.
[149] Ramberg *Guide to INCOTERMS 2000* 15.

ship on arrival at the port of shipment, which is an inappropriate use for this term. The incorrect use of FOB saddles the seller with risks materialising subsequent to handing over the goods to the carrier named by the buyer. FOB is only appropriate where the goods are to be delivered across the ship's rail or directly to or into the ship; when they are tendered to the ship in hoses for liquid cargo; or when they are filled from silos where the cargo is to be carried loose in bulk. It should not be used where the goods are handed over to a carrier for subsequent entry into the ship, for example where they are stowed in containers or loaded on trucks or wagons in so-called roll on-roll off traffic. The preamble of the FOB term accordingly cautions against the use of the term in these cases. In these situations the FCA term would be the appropriate term as it indicates the actual place where the goods are handed over to the carrier.[150]

The same applies to the CIF and CFR terms. These terms are inappropriate if the seller wishes to avoid being at risk after handing over the goods for carriage up to the moment they are loaded on board the ship. The CPT or CIP terms, where risk passes upon handing over to the carrier, should be used instead. With regard to container traffic, handing over normally takes place in the carrier's terminal before the arrival of the ship. When loss of or damage to the goods occurs during the time that the carrier is responsible for the goods, it may in practice be impossible to ascertain whether it has occurred before or after passing the ship's rail. That is why a trade term such as FCA, CPT or CIP, where the risk of loss or damage to the goods passes from the seller to the buyer when the goods are handed over to the carrier, should be chosen.[151]

It may also happen that the parties inadvertently use terms intended for carriage of goods by sea when another mode of transport is contemplated. This may put the seller in the unfortunate position of being unable to meet his obligation to tender the proper document, for example a bill of lading, sea waybill or electronic equivalent to the buyer. To this end the mode of transport is indicated in the preamble of each INCOTERM.[152] If the transport is to be conducted by means of maritime or inland waterway transport, the FOB, FAS, CFR, CIF, DES or DEQ term should be used; whilst in the case of any other mode of transport, including multimodal or

[150] Ramberg *Guide to INCOTERMS 2000* 16; Reynolds *INCOTERMS for Americans* 67, 70. Also see Zeller 2005 (2) *NJCL* 1.
[151] Ramberg *Guide to INCOTERMS 2000* 17.
[152] INCOTERMS 2000 (the official rules) Introduction para 18.

containerised transport, the parties should make use of EXW, FCA, CPT, CIP, DAF, DDU or DDP.[153]

### 5 7 INCOTERMS' limited scope of regulation

INCOTERMS provide clarification regarding certain duties of a seller and buyer.[154] Aspects of the sales contract that are covered are these which may affect the calculation of the price, such as supply and delivery of the goods,[155] transfer of the risk, allocation of costs, procurement of the necessary transportation and insurance documents and other obligations incidental to the export and import of goods such as consular and customs formalities or packaging and marking of the goods. INCOTERMS thus only regulate defined aspects of the contract of sale and not those substantive aspects common to all contracts of sale, such as mistake and other matters affecting the validity of contracts, transfer of property,[156] impossibility of performance, misrepresentation, duties of the seller regarding eviction or the qualities of the goods, the buyer's duty to pay, impediments against performance caused by unforeseen and unavoidable events, breach and remedies for breach of contract. These aspects will still be regulated by means of contractual stipulations or the governing law of the contract.[157] Reference in a contract to a particular INCOTERM is accordingly insufficient to determine the relationship between the parties to a contract of sale fully. INCOTERMS necessarily assume that their rules will be applied in the context of whatever law may be applicable to the sales contract in which the particular INCOTERM is incorporated.

Furthermore, INCOTERMS deal only with the question of whether a party has an obligation to the other party according to the incorporated term. They do not deal with whether it is in terms of commercial practice either common or prudent for a party to

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[153] Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts INCOTERMS 2000* 25.

[154] Although INCOTERMS are primarily aimed at the sale of goods that are to be delivered across national borders, they may also be used in contracts of sale that operate within domestic markets. See *INCOTERMS 2000* (the official rules) Introduction para 1.

[155] INCOTERMS are restricted to sales for tangible goods. They do not apply to contracts for intangibles such as computer software. See ICC *INCOTERMS 2000* (the official rules) Introduction para 1.

[156] *Texful Textile Ltd v Cotton Express Textile Inc* 891 F Supp 1381 1388. It was not even possible to formulate uniform rules on passing of property for purposes of the CISG.

[157] ICC *INCOTERMS 2000* (the official rules) Introduction para 1; Eisemann 1965 *JBL* 117; Ramberg *ICC Guide to INCOTERMS 2000* 11-13; Bergami "INCOTERMS 2000 as a Risk Management Tool for Importer" 2006 (10) *VJ* 273 274-275. In this regard, see also Honnold "Uniform Law and Uniform Trade Terms – Two Approaches to a Common Goal" in Horn & Schmitthoff (eds) *The Transnational Law of International Commercial Transactions II* (1982) 161 171.

take certain measures, even though he has no obligation under the particular INCOTERM to do so in relation to the other party. An example of the latter is the instance of an FOB or a CFR buyer, who has no obligation to the seller to take out insurance. However, since the buyer has to bear the risk of loss of or damage to the goods from the moment they have been loaded on board the ship, it would be normal commercial practice for him to insure against such risks.[158]

INCOTERMS also do not deal with how the goods are to reach the agreed point of delivery, or what a buyer should do after taking delivery. For example, there is no explanation in INCOTERMS that an EXW buyer should arrange for carriage. It is the buyer's choice whether he let the goods remain at the place where the seller is domiciled or to take them to a destination in the same or another country. Likewise, there is no obligation under the D-terms for a buyer to carry the goods further after delivery in the country of destination. Consequently, the words "no obligation" will be found under the B3 headings for these INCOTERMS. Similarly, it is the seller's problem how the goods reach the delivery point and the INCOTERMS do not explain how this should occur.[159]

Although INCOTERMS deal with aspects directly related to delivery of the goods, they only apply to the contract of sale.[160] Even so, the parties' agreement to use a particular INCOTERM has ramifications for related contracts, such as the contract of carriage, contract of insurance and the documentary credit. For example, a seller having agreed to a CFR or CIF contract cannot perform such a contract by any other mode of transport than a contract of maritime carriage, since under these terms he must present a bill of lading or other maritime transport document to the buyer, which is inapplicable if other modes of transport are used. The documents required under the documentary letter of credit also depend upon the intended means of transport.

Berman and Ladd[161] point out that even for aspects that are ostensibly covered by INCOTERMS, a number of questions arise in practice. According to the CIF term for instance, the seller is to procure at his own cost and in a transferable form a policy of marine insurance against the risks of carriage involved in the contract. It is further required that the seller must furnish the buyer, together with the bill of lading and the

[158] See, in general, Ademuni-Odeke 2007 (31) *Tul Mar LJ* 425.
[159] Ramberg *Guide to INCOTERMS 1990* (1991) 11.
[160] *INCOTERMS 1980* (the official rules) Foreword 10.
[161] "Risk of Loss or Damage in Documentary Transactions under the Convention on the International Sales of Goods" 1988 (21) *Cornell Int'l LJ* 423 434-435.

invoice, the insurance policy, or should the insurance policy not be available at the time the documents are tendered, a certificate of insurance issued under the authority of the underwriters and conveying the same rights as if he were in possession of the policy and reproducing the essential provisions thereof. It follows that the buyer, having accepted the documents, must bear all risks of the goods from the time when they have effectively passed the ship's rail at the port of shipment. However, INCOTERMS do not explain what is meant by a marine insurance policy "in transferable form". Suppose the buyer (or his bank) accepts tender of a certificate of insurance and later discovers that the policy was indeed "available". How will that be dealt with? A bank may, for instance, accept the documents and pay under a letter of credit. The buyer fails to pay and the bank, left with the documents, now transfers them to a new buyer. However, the goods are lost at sea, and the insurer states that it will not honour the policy (or certificate) in the hands of the transferee. Who then bears the risk of loss? The authors suggest that in these instances one must look beyond INCOTERMS and trade usages to the law dealing with documentary sales generally, marine insurance, the law of agency and other areas of commercial law.

The question, therefore, is whether their limited scope of regulation is in any way a factor that affects the general efficiency of INCOTERMS as a form of standardisation. Because INCOTERMS deal only with the normal performance of the contract, they serve the ideal of harmonisation to a limited extent only. INCOTERMS nevertheless ambitiously purport to provide a set of international rules for the interpretation of the most important terms used in international trade and are not restricted to particular branches of trade.[162] Although INCOTERMS only deal with certain aspects of the contractual relationship, namely that of delivery and the instances connected thereto, they regulate them in a manner conducive to certainty and clarity and in accordance with international commercial practices.

General conditions of trade, as well as standard commodity contracts issued by trading associations for use in particular trades, often regulate the rights and obligations of the parties in greater detail than INCOTERMS.[163] Since they address the needs of modern international trade more effectively, parties engaged in

[162] Eisemann 1965 *JBL* 116-117.
[163] Hellner "The Vienna Convention and Standard Form Contracts" in Sarcevic & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 335 347-352 discusses the provisions on breach of contract contained in ECE 188. This is an example of how a standard contract can address an issue that is not covered by INCOTERMS.

specialised branches of trade prefer to rely on standard contracts rather than domestic law. Although standard contracts are generally regarded as successful in standardising the respective obligations of parties to a sale, they also have their limitations. Even though such contracts may cover the whole spectrum of contractual rights and obligations, they are themselves applicable only to specific branches of trade. Their application is therefore restricted in the sense that they cannot apply to all contracts of sale, whilst INCOTERMS are a codification of universal scope. Moreover, standard form contracts defer to trade terms when it comes to delivery obligations and regulate them by means of INCOTERMS.[164] In these instances, standard contract forms and INCOTERMS supplement each other to ensure an effective contractual regime for contracts in certain specified trade areas and branches of trade.

Their restricted scope of regulation accordingly does not render INCOTERMS an ineffective form of standardisation. This study submits that efficient harmonisation of law can only take place if instruments of harmonisation and standardisation function in collaboration with other such instruments.[165] An interrelationship between INCOTERMS and other forms of standardisation, such as standard contracts, does not reflect negatively on their efficacy but enhances their overall efficiency. There is, therefore, a necessary and valuable interrelationship between the ICC Rules, on the one hand, and standard contracts, national laws or international conventions on the other. The latter sources provide the general legal context in which INCOTERMS can operate as an effective form of standardisation.

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[164] See Eisemann 1965 *JBL* 117 for standard contracts that incorporate INCOTERMS, eg those used by the cotton-brokers at Le Havre, by the French Jute Manufacturers' Association or the *Mühlenbau und Industrie GmbH* (MIAG) Germany. The standard contracts of trade associations such as GAFTA and FOSFA make extensive use of the FOB and CIF terms but there is no official reference to INCOTERMS in such contracts. Merchants tend to combine INCOTERMS with these standard terms but that it is purely based on party agreement. A perusal of the Green Coffee Association Contract Terms and Conditions (as amended March 2006) http://www/green-coffee-assoc.org/images/finaldraft402.pdf (accessed 30-10-2009) shows that 9 types of contracts are regarded as standard to this specific industry. The distinction between the contracts is based on how costs and risks are divided. The Association provides for FCA, FOB (including FOT "Free on Trailer" and FOR "Free on Railcar"), CFR, CIF DAF, EDK ("Ex Dock), EWH ("Ex Warehouse"), DLD ("Delivered") and SPT ("SPOT") contracts. All of the terms are defined by the Association. No mention is made to INCOTERMS, which is probably understandable as they include terms that are not standardised by INCOTERMS. See Fink 1991 (6) *RIW* 470 for a similar position as regards the standard contracts of the Refined Sugar Association, the European Coffee Associations' European Contract for Coffee and that of the Cocoa Association of London. See also Bernstein "Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms" 1996 (144) *U Pa L Rev* 1765. In an analysis of how arbitrators apply the rules of the American Grain and Feed Association (NGFA), she found that they prefer a formalistic approach to adjudication by staying within the rules of the organisation and not allowing trade custom or usage to vary or qualify the meaning of its rules and contractual provisions.

[165] *Cf* 4 4 3 *supra*.

## 5 8 Evaluation

### 5 8 1 General

INCOTERMS reflect the policy considerations underlying international trade.[166] They are based on considerations of safekeeping and control, namely that risk should pass when control of goods are handed over to the buyer. If the correct INCOTERM is chosen for a particular transport situation, risk will not be split between the seller and the buyer during the transportation of the goods and the seller will not have to carry the risk after he has relinquished control over the goods to a carrier.

INCOTERMS are an effort to standardise commercial practice. It is the task of the ICC to create rules that are appropriate in as many countries and in as many situations as possible. To this end, the rules are in some respects abstract and are sometimes criticised as not providing sufficient guidance to traders. According to the drafters this is "the consequence of capturing in one sentence or in a paragraph the variations in practice that take place in different regions."[167] Because international commercial practices differ considerably it would be impossible to find an absolutely consistent practice that can function as the optimal standard. INCOTERMS represent the most common practice, and if the most common practice does not suit the needs of the specific transaction, the parties are free to adapt the content of the trade term to suit their situation. This is no shortcoming; in fact it provides for flexibility in the transaction and confirms the principle of party autonomy. This study has identified party autonomy and flexibility both as requirements for a successful international sales law regime.[168] Because international trade develops rapidly it is essential that the legal rules regulating these transactions should be flexible and the efficiency of any standardisation effort, such as INCOTERMS, be measured on that basis.

The notion of flexibility also envisages that any standardisation mechanism must be adaptable to changing commercial circumstances. INCOTERMS are regularly adapted and revised to reflect the most current commercial practices. At the same time they do not express mere theoretical improvements that are removed from the realities of everyday commercial activity. Instead, they are based on existing trade practices and accommodate evolving transportation techniques and developments in

[166] *Cf* 1 2 & 3 2 *supra*.
[167] Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 8.
[168] *Cf* 1 2 1 *supra*.

information technology. Although they represent current practice, they never attempt to anticipate any practices.[169] They represent a set of rules that are internationally agreed to be the most common practice in different countries and sectors of the trade at a particular point in time. They are widely adopted and are used in countless international transactions across the world.

However, even though flexibility is a valuable attribute, it should never be over-emphasised to the extent that it detracts from the need for certainty and predictability. Flexibility can only be a yardstick for efficiency if it is linked to the concept of party autonomy. INCOTERMS recognise the important principles of freedom of contract and party autonomy. If a situation requires a deviation, the rules provide for such a possibility. However, INCOTERMS warn parties that when they decide to deviate from the standard form by introducing a trade term variant, they do so at their own risk. Parties are therefore advised to clarify their exact intentions to avoid uncertainty. Difficulties that arise from a failure to do so cannot be considered a shortcoming of INCOTERMS as such. As with all commercial practices, there is no evidence of consistent practice when it comes to variations of standard form terms and INCOTERMS 2000, therefore, do not attempt to address these variations. To do so would only complicate the situation more. The general aim of the present edition of INCOTERMS is to provide a standard definition and not to deal with all the exceptions to the rule.

### 5 8 2 Aspects that may affect the next revision

At the time of this study, the ICC Commercial Law and Practice Committee (CLP) is in the process of revising INCOTERMS 2000.[170] All indications are that the final draft

[169] Irani "INCOTERMS and Other Conditions of Sale" in *Current Developments* 42.

[170] In 2006, the ICC Secretariat circulated a questionnaire to the ICC National Committees and several ICC Commissions, inquiring whether there was any market demand for a revision and, if so, which provisions were in need of revision. Replies were received from 16 National Committees and 16 individuals, of whom the majority (12 National Committees and 15 individuals) indicated that there is no market need for a full revision. However, some of the comments indicated the need for clarification on some points. The Drafting Committee, therefore, proceeded on this premise. See *82 Comments to INCOTERMS Revision* 20 October 2006/EO/ev Document 460-19/82 http://www.iccmex.org.mx/intranet/documentos/82%Comments%20on%INCOTERMS%20Revision.doc (accessed 23-04-2009). On the procedure for the present revision, see Reynolds "Export ABC's: INCOTERMS revision" 15 Jan 2008 *The Journal of Commerce On-line* http://www.joc.com/node/399494 (accessed 20-04-2009).

will be made available during the last quarter of 2010 and the new revisions will come into force on 1 January 2011.[171]

One of the suggestions for the present revision is that any reference to the year should be removed from the title. The intention is to steer away from the expectation that INCOTERMS will be revised every or only once in ten years whereas INCOTERMS could be revised at any time.[172] At this time, indications are that the revised rules will be known as INCOTERMS 3000[173] and that subsequent revisions will refer to INCOTERMS 4000, 5000 and so forth; the numerical progression being in line with the existing practice in the UCP series.[174]

It is speculated that the revision might address, *inter alia*, the clarification of terms that are often misunderstood and misused,[175] the removal of terms that are not frequently used[176] and the addition of terms to reflect current commercial practices.[177]

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[171] Jacobson "INCOTERMS 3000 Scheduled to be Issued in Fall 2010" 11 March 2009 *International Trade Law News* http://www/djacobsonlaw.com/2009/03/INCOTERMS-3000-scheduled-to-be-issued.html (accessed 20-04-2009); ICC *Briefing on INCOTERMS 3000* http://www.seeffw2009.com.mk/docs/presentations/Inc_3000.ppt (accessed 23-07-2009).

[172] Wizard "The Future of INCOTERMS" 31 March 2008 *Boskage Trade News* http://boskagetradenews.blogspot.com/2008/03/future-of-INCOTERMS.html accessed (20-04-2009)*;* Jacobson 11 March 2009 *International Trade Law News*.

[173] ICC *Briefing on INCOTERMS 3000*. Mention is also made of "INCOTERMS 8th edition", which will refer to the number of INCOTERMS versions and will highlight the historical progression of INCOTERMS.

[174] The latest edition is known as UCP 600, whilst the previous edition was called UCP 500. It was subsequently decided to name them INCOTERMS 2010.

[175] An enquiry conducted by the ICC Belgium, found that many of the INCOTERMS are misunderstood and, therefore, used incorrectly. See ICC Belgium *Enquête over de toepassing en de herziening van INCOTERMS 2000* http://www.enquieteiccwbo.be (accessed 18-05-2009). The National Committees of Australia, Japan and Sweden have requested further clarification on which terms are appropriate for which modes of transportation. Indications are that the preambles to each INCOTERM will be reformatted and clarified by the latest revision to this end. INCOTERMS will also be divided into 2 main categories, viz "exclusively maritime" and "not exclusively maritime" terms to further assist users. A "General Guidance" section with definitions and explanations of concepts which apply throughout the INCOTERMS and indicating the practical consequences of using each INCOTERM will replace the Introduction. See *ICC Briefing on INCOTERMS 3000*.

[176] Such as EXW and some of the D-terms. The National Committees of Brazil, France, Australia and Norway have suggested the elimination of the DAF term, whilst those of France and Canada have asked for the removal of the FOB term. At this stage it seems that the EXW and FOB terms will remain but that 2 new terms "DAT (Delivered at Terminal" and "DAP (Delivered at Place)", which will merge the less popular and overlapping DAF, DES, DEQ and DDU terms, may be introduced. See *ICC Briefing on INCOTERMS 3000*.

[177] The introduction of a new "EXW Delivered" term has been suggested. The idea is to facilitate and serve trade practice in China. Companies import goods from various suppliers in China under consolidation and then instruct forwarding agents to accept the goods on their behalf. The forwarding agents issue a cargo receipt or a Forwarder's Cargo Receipt (FCR) and ship the goods to the buyer. The supplier-seller is required to deliver the goods to the nominated forwarder's place, depot or warehouse and the forwarder will unload the goods from the seller's vehicle. It is argued that the existing EXW term is not appropriate in these situations as the seller is not putting the goods at the buyer's disposal but are delivering them to the forwarder. FOB and FCA, in turn, are not appropriate since the seller does not have to load the goods on the ship as is required by these terms. Hence, the suggestion of a new EXW variant. See Lee *"EXW Delivered" to serve China Trade Practice* http://www.tolee.com.exw_delivered.htm (accessed 20-04-2009). Although it is agreed that the EXW and FOB terms are not appropriate in these circumstances, it is difficult to understand why the FCA term

Suggestions not implemented by the 2000 revision and which might now be more practical might be included in this edition. It has also been suggested that a revision of the terms which often give rise to questions or are misused frequently, such as the traditional FOB and CIF terms, might provide the opportunity to define them more clearly.[178] The increased use of the Internet as a means of doing business might require a new term or terms for Internet contracts.[179] Whether there is a need for a separate term for electronic contracts beyond the existing provisions and what the content of such term(s) will be is not clear. Another question is whether INCOTERMS should in fact regulate electronic contracts in any more detail than they already do.[180] INCOTERMS are limited in scope to the delivery obligations of the parties. They have to function in conjunction with other legal rules (national or international) to regulate electronic contracts effectively and efficiently.[181] It is not clear what a new term or terms will add to what is already available.[182]

It has also been argued that security requirements have brought changes to the

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cannot be used. The FCA term entails delivery to a carrier, which is a rather broad concept that includes a forwarding agent. There would therefore not be any need for a new term. In addition, the National Committees of Brazil, Canada and Spain have suggested the introduction of a "C&I (Cost and Insurance)" term, whilst those of Norway, Sweden, Iran and the USA have suggested alterations to the present D-terms or the creation of a new D-term. However, it does not appear as if the drafters are considering the addition of a new EXW term or the inclusion of a C&I term. A new "DAP (Delivered at Place)" term has been put forward, though. DAP means that the seller delivers the goods when the goods are placed at the disposal of the buyer at the named place of destination. The seller has to bear all costs and risks involved in bringing the goods to the named place. There is, however, no obligation on the seller to unload the goods from the means of transportation. DAP is intended to be used for both domestic and international sales. This term will replace the existing DAF, DES, DDQ and DDU terms. See *ICC Briefing on INCOTERMS 3000*. It was later announced that an additional term "DAT (Delivered at Terminal)" is also to be introduced.

[178] Wizard 31 March 2008 *Boskage Trade News*; Reynolds "Export ABC's: INCOTERMS 2010?" 5 July 2007 *The Journal of Commerce Online* http://www.joc.com/node/394436 (accessed 20-04-2009). The idea to revise these terms were rejected during the 2000 revision as being too great a departure from existing practice. It appears that these terms will not apply to containerised goods any longer. Although it is true that the FOB, FAS, CIF and CFR terms should not be used for maritime containerised transport, merchants have pointed out that there are specific practices concerning containerised goods in China. Where these goods are shipped by inland waterways from Guangdong, China, to Hong Kong or Kowloon, it is the practice that the goods will be placed on barges or moved by tugboats to get alongside the small or medium sized cargo ships. This is known as a mid-stream operation. If INCOTERMS are to restrict the use of the above terms to containerised goods, such mid-stream operations could be seen as a violation of the new INCOTERMS. See Lee *Comments on INCOTERMS First Draft* http://www/tolee.com/html/INCOTERMS_3k_draft1.htm (accessed 20-04-2009).

[179] Wizard 31 March 2008 *Boskage Trade News.*

[180] The A8 and B8 clauses of INCOTERMS 2000 already provide the possibility that all paper documents signifying proof of delivery, such as the transport document, can be replaced by electronic data interchange messages.

[181] The legal effect of an electronic bill of lading as a negotiable instrument and an electronic documentary credit has already been effectively addressed by other international instruments, such as the UN Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea – the "Rotterdam Rules" (2008) and the eUCP.

[182] Judging from the 1st draft of INCOTERMS 3000, dated 20 February 2009, it seems the drafters have not suggested the addition of any new terms specifically aimed at electronic commerce. Many countries, such as Denmark, France, Finland and Pakistan, have asked that the revision should take the increasing use of electronic documents into account. The current edition only refers to the use of EDI; hence the new edition will be updated in this regard to include other forms of electronic communication as well. See *ICC Briefing on INCOTERMS 3000*.

relationships and contracts of traders.[183] A major revision is therefore expected on the seller-buyer cargo security obligations,[184] which are linked to the Custom-Trade Partnership Against Terrorism (C-TPAT)[185] and the Authorized Economic Operator (AEO)[186] cargo security regimes. The main issue, however, is whether INCOTERMS should regulate security issues at all. One suggestion is that the security-specific elements of the seller's delivery obligations should firstly be identified. That should be followed by an analysis on how the assignment of responsibility for security issues to the seller can complement cargo security efforts worldwide.

The argument is that INCOTERMS already address functions such as packing of the goods and the conclusion of a contract of carriage. The ICC, therefore, has the ideal opportunity to broaden the scope of the existing functions to include security considerations. The main challenge is to provide rules that complement sovereign national security initiatives while maintaining INCOTERMS' role as a global set of standards that may be used by all countries. It has, furthermore, been pointed out that INCOTERMS already contain terminology that can be applied in this context. The B2 clause of INCOTERMS 2000 requires the buyer to "obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable, all customs formalities necessary for the import of the goods." Moreover, the A10 clause obliges the seller to "render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8 issued or transmitted in the country of delivery and/or of origin) which the buyer may require for the import of the goods and, where necessary, for their transit through any country." These clauses provide a strong foundation for assigning shipment security obligations to the buyer or seller. It should be kept in mind, however, that security-related functions and customs formalities are often treated separately, and that INCOTERMS should therefore

[183] Suggestions that this issue should be addressed by the next revision have been put forward by the National Committees of the UK, Sweden, USA and also by FIATA. See *ICC Briefing on INCOTERMS 3000*.
[184] Wizard 31 March 2008 *Boskage Trade News*; "INCOTERMS 2010" 15 May 2008 *Customs4Trade* http://www.customs4trade.com/customs/INCOTERMS-2010/ (accessed 20-04-2009)
[185] The C-TPAT was developed immediately after the September 11th attacks and is aimed at extending and protecting the US borders to the point of origin for incoming cargo.
[186] The AEO is a concept aimed at the security amendment of the European Community Customs Code (Regulation EC 648/2005). AEO status granted by one Member State to any economic operator that meets certain criteria will be recognised by another Member State. To ensure international recognition, all cargo security regimes should eventually be recognised by the World Customs Organisation.

provide for both. A distinction should also be made between "buyer" and "importer of record" as there are transactions where they are not identical.[187]

Another concern that has been raised is the issue of costs, *ad hoc* surcharges and terminal handling charges (THCs)[188] that transport service providers are forcing on shippers. The members of the Global Shippers' Forum (GSF)[189] unanimously agreed that these costs are not transparent in nature and in some cases are demanded of parties who have no contract of carriage with the service providers.[190] The members of the GSF insist on clarity on these charges and have requested the International Chamber of Commerce to regulate the costs and liability of ambiguous terms, such as THCs, which are used by shipping and third party logistics (3PL) providers[191] to generate additional income.[192]

Shippers have identified key weaknesses in the current edition of the INCOTERMS regarding the FOB and CFR terms. Ambiguities have enabled service providers, who operate as the link between buyers and sellers, to interpret cost liability and cargo responsibility incorrectly when containerised goods are loaded in different circumstances. Major problems have resulted, especially for shippers in Asia, who ship nearly fifty percent of global trade volumes. Shippers are forced to pay undue charges to lines and logistics providers, whilst the buyers who nominate these carriers are unknowingly paying the same costs as a charge hidden in the freight.

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[187] Gardner "A new chapter in INCOTERMS" 15 September 2008 *JOC* http://www.joc.com/node/406076 (accessed 18-04-2009). The First Draft of INCOTERMS 3000 shows under all the B10 clauses an additional obligation on the buyer to provide the seller with cargo security information necessary for the import of goods. In most instances the risk and costs of such security obligations are placed on the buyer in terms of the A10 clauses. Where the seller concludes the contract of carriage, he is in a position to know the security related information required by the carrier and the duty is on him to supply such information at the risk and cost of the buyer.

[188] THCs refer to all charges related to the handling of cargo at the terminal of loading or discharging, operated by or on behalf of the carrier. These charges may be part of the freight agreed upon between shipper and carrier, or the carrier may choose to bill all or part of the THCs separately. Whether THCs are entirely, partly or not at all part of the freight, differs according to the transport mode used. Even within one transport mode, regional differences or differences between individual terminals may exist. THCs may also include the costs of receiving a container at the container terminal, storing it and delivering it to the ship at the port of loading or receiving it from the ship at the discharge port, storing and delivering it to the consignee. See Van de Veire "Problems Related to the FCA Term" in *INCOTERMS in Practice* 120.

[189] The GSF, which consist of North American shippers, the European Shippers' Council, the Japan Shippers' Council and the 20 member Asian Shippers' Council together with the African Union Shippers' Council, represent over 60 maritime countries and 90% of world trade.

[190] The Asian Shippers' Council provided a working group paper to the GSF conference with evidence highlighting the anticompetitive nature of these surcharges. The issue is a global problem that has to be addressed as attempts at dialogue with shipping lines and 3PLs (third party logistics providers) have failed.

[191] 3PLs provide outsourced or third party logistics services to companies by performing activities such as packing, warehousing, distribution or transportation services.

[192] "Global shippers to take up THC and surcharges with the International Chamber of Commerce (ICC)" 24 November 2008 *The Island Online* http://www.island.il/2008/11/24/index.htm (accessed 20-04-2009).

The shippers agree that the ship's rail as the critical point for FOB contracts is more suitable for break bulk cargo. However, they point out that FOB contracts still play a role in container transport, especially in small ports where containers are still loaded on a hook-to-hook basis. Large buyers also shy away from using terms such as FCA or FAS because they feel more secure in using the well-known FOB[193] or CFR terms.

The GSF members have also insisted that trade terms are to be adapted to the practices of modern day trade. Whilst INCOTERMS 2000 warn buyers and sellers to be vigilant in using FOB, CFR and CIF terms when containerised goods are transported, they fail to identify that the conditions of the bill of lading also play a role in determining the parties' cost obligations. The shippers all agree that the critical point of FOB has to be more exclusively defined and that under no circumstances should a party that has physically lost control of the goods remain liable for payment of surcharges and THCs. It is their argument that these charges fall within the contractual obligation of carriage, which has to be interpreted as per the conditions of the bill of lading. INCOTERMS 2000 do not link the division of costs and responsibilities to those stipulated in the bill of lading as the point of cargo acceptance by a 3PL in a seaborne supply chain. The shippers argue that it is vital that terms such as container yard-to-container yard (CY/CY), container freight station-to-container freight station (CFS/CFS) and door/door status on the bill of lading and the full liner terms defined by the Institute of Chartered Shipbrokers[194] should be considered when the buyer and seller are given a definition on terms such as FOB.

Whether the ICC drafting committee will incorporate the proposals of the GSF remains to be seen. The committee has always been adamant that INCOTERMS cannot solve the problem of transport handling costs. Loading costs are split differently in different seaports and there is therefore no consistent practice in this regard. This is one reason why traders are cautioned not to use the traditional FOB, CIF and CFR terms in the case of containerised goods but rather make use of one of the other terms aimed at these types of transportation. Moreover, clause A4 of the FOB term draws the attention to different loading practices in different ports by pointing out that delivery should take place at the named port of shipment "in the manner customary at the port". INCOTERMS cannot solve the problem of loading

[193] Another reason why buyers still insist on using the FOB term instead of FCA is because the buyer does not want to pay for the transport handling costs. See Ramberg *Guide to INCOTERMS 2000* 33.
[194] They provide for different loading conditions in different ports.

costs, as it is a problem of commerce itself.[195] INCOTERMS have no role to play other than codifying and standardising the most common trade practice, and cannot prescribe the division of costs if there is no consistent or common practice. The parties should then negotiate for the price to include certain costs or contractually provide for the division of costs, either by stipulating that the full amount is to be paid by one of the parties or whether such costs are to be split between them according to various customs or methods.[196] Alternatively, parties should choose to transact on an INCOTERM that is more suitable to their particular situation.

As for the alignment of the INCOTERMS to the content of the bill of lading, it must be pointed out that INCOTERMS do not regulate the contract of carriage but merely the obligations of the parties under the contract of sale. The contract of sale is the so-called "steering mechanism" of the international business transaction and it is essential that the terms of the bill of lading dovetail those of the sales contract and not the other way around.[197] Moreover, if the parties wish to extend their financial obligations beyond those stipulated by INCOTERMS, they should indicate their intention in the contract of sale and not merely in the transport document.

If the ship's rail is removed or adapted as the critical point under an FOB term, the point where risk passes will have to change as well. Moving the critical point to when the goods are safely placed on board the vessel might satisfy the requirements for issuing the bill of lading and would remove most of the uncertainties surrounding loading accidents and costs, but it would still not provide a solution for the problem of THCs, which ultimately depend on the transport mode and the customs of the port. In some cases it would be more appropriate to move the critical point to the quay side or to the container terminal where the loading process is commenced. That would entail a differentiation between different FOB situations, which will bring about confusion and cause uncertainties. This will be contrary to the aim of INCOTERMS,

[195] Ramberg "Why revise INCOTERMS?" in *INCOTERMS 2000: A forum of experts* 17-18. The problem should therefore be taken up with the service providers. Alternatively, the parties should provide for the division of costs by agreement.

[196] So-called "free in-free out" terms signify that the costs of loading and discharging are excluded from the freight. Trade term variations such as FOBT and FOBST also deal with the issue of loading costs. See 5 5 1 *supra*; Ramberg *Guide to INCOTERMS 2000* 14-17, 33, 41, 55. According to the 1st Draft of INCOTERMS 3000, clauses A6 and B6 of the CIP term now also provide for handling costs in addition to costs for loading and unloading, which are to be borne by the seller and buyer respectively. The other terms, however, do not differentiate between loading, handling and other costs.

[197] It is necessary to distinguish between the obligations of the parties under the contract of carriage and their obligations to each other under the contract of sale. See 5 5 3 *supra*.

which is to reduce uncertainty and provide clarity.[198] Such a change still does not address the issue of an FOB and a CIF seller being liable for the risk of loss of and damage to goods that are no longer under its control. Moreover, the issue of containerised goods is already addressed by the FCA, CPT or CIP terms, which provide for risks and costs to pass when the goods are delivered into the control of the carrier. It is, therefore, more a matter of educating traders in using the correct term than trying to adapt existing terms to address these needs.[199] These terms have been formulated to codify a universal commercial practice regarding containerised goods independently of the traditional FOB and CIF terms. If the traditional maritime terms are to be amended to address the needs of containerised goods, the need for the so-called "modern" trade terms will fall away and they will have to be discarded eventually. In the end, commercial practice will dictate the way forward.[200]

Some of the replies to the questionnaire sent out in 2006 by the ICC Secretariat to the ICC National Committees and several ICC Commissions indicated that the delivery point under the FCA term gives rise to problems, especially where the named place is anywhere else that the seller's premises.[201] In the latter case the seller has no obligation to unload his means of transport: he has merely to put the goods to the disposal of the buyer. In practice this means the seller does not obtain any proof that the goods have been received by the carrier. This point of criticism is difficult to understand, however, because the onus is on the buyer to prove that he collected the goods or that he never received the goods. The seller's obligation ends the moment that the goods are placed at the buyer's disposal at the named place. It has also been suggested that the words "on the seller's means of transport unloaded" should be deleted and that only the basic notion that delivery is effected when the goods are placed at the disposal of the buyer or his nominated carrier be retained. It is argued that in maritime transportation situations, containerised goods are collected by the buyer's carrier from the container terminal and not from the seller's means of transport. This may be so, but whether this argument warrants an amendment is questionable. The costs for storage at the container terminal and the handling costs to move the goods from the seller's means of transport to the container terminal or yard will be for the buyer's account. This clarification on the

[198] *INCOTERMS 2000* (the official rules) Introduction para 9 1. See also 5 2 3 2 *supra* for the reasons why the FOB term was not changed under the 2000 edition when similar arguments were considered.
[199] This is also the conclusion reached by the ICC Belgium after conducting a survey amongst Belgian traders who trade both domestically and internationally. See ICC Belgium *Enquête.*
[200] The 1st Draft of INCOTERMS 3000 retains the traditional FOB and CIF terms, only with a few clarifications.
[201] *82 Comments to INCOTERMS Revision.*

division of costs under the FCA term was one of the few revisions in the 2000 edition. Again, it seems that the main problem is the failure to apply the INCOTERMS as they are supposed to be applied and that many of the misunderstandings and uncertainties may be addressed by educating merchants on the use of INCOTERMS, and not necessarily by revising them.[202]

### 5 8 3 Conclusion

Few cases are reported where the parties have agreed on the use of INCOTERMS.[203] Although it is difficult to draw any general conclusions from this, it may be fair to say that the scarcity of reported cases is an indication that contracts concluded on the basis of an INCOTERM generate fewer disputes on aspects that are regulated by the compilation.[204] In the majority of reported cases the court or arbitral tribunal based its ruling on the relevant edition of INCOTERMS and there was no need for further debate or argument on the content of the obligation.

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[202] The 1st Draft of INCOTERMS 3000 retains the traditional maritime terms. However, more clarity is provided on when the terms are to be used. First of all, a distinction is made between "multimodal terms" and "maritime-only terms". Furthermore, the preambles to the maritime-only terms now explicitly state that these terms are unsuitable for containerised transport and they indicate which term is to be used instead. Some of the terms have been rewritten to clarify the point where delivery is to take place or risk is to pass, such as in the case of EXW, FAS and FCA, whilst others provide more clarity on who is to qualify as a "first carrier", such as in the case of CIP and CPT.

[203] Apart from databases that collect cases dealing with the CISG, it is quite difficult to find case law dealing with INCOTERMS. The investigation is further impeded by the fact that, in most instances, one has to rely on vague case translations or summaries that lack detail and, therefore, do not always present an accurate account of the ruling. A search of the Pace Law database, http://cisgw3.law.pace.edu (accessed 21-08-2009), using "INCOTERMS" as search query, retrieved 28 case references, of which only 6 indicated that the contract in dispute had been concluded on the basis of an express INCOTERM. Due to poor translation, 1 of these 6 cases is not very clear on whether it deals with an express incorporation. In none of the other 22 cases does it appear that the parties explicitly agreed on the use of INCOTERMS. However, in many of these cases, the court or arbitral tribunal defined the trade term with reference to INCOTERMS, as being a reflection of international trade usages. See for instance, *Cherubino Valsangiacomo SA v American Juice Import Inc* Appellate Court Spain 7 June 2003 http://cisgw3.law.pace.edu/cases/030607s4.html (accessed 2-06-2009); Arbitration proceedings 99/1997 Russia 21 January 1998 http://cisgw3.law.pace.edu/cases981230r1.html (accessed 23-07-2009); Russian Arbitration Court for the Volgo-Vyatsky Circuit (Appellate Court) 20 December 2002 http://cisgw3.law.pace.edu/cases/021120r1.html (accessed 2-06-2009); *Xinsheng Trade Company v Shougang Nihong Metallurgic Products* Higher People's Court of Ningxia Hui Autonomous Region China 27 November 2002 http://cisgw3.law.pace.edu/cases/021127c1.html (accessed 23-07-2009); *Damstahl A/S v ATISrl* Supreme Court Denmark 15 February 2001 http://cisgw3.law.pace.edu/cases/020215d1.html (accessed 23-07-2009); *St Paul Guardian Insurance Co v Neuromed Medical Systems & Support* 2002 WL 465312 (SD NY 2002), judgment aff'd, 53 Fed Appx 173 (2d Cir 2002), 2002 US Dist LEXIS 5096 (United States Federal District Court New York 26 March 2002) http:/cisgw3.law.pace.edu/cases/020326u1.html (accessed 20-08-2009); *BP Oil International v Empresa Estatal Petroleos de Ecuador* 332 F 3d 333 (5th Cir 2003) 338, 200 ALR Fed 771, Federal Appellate Court [5th Circuit] United States 11 June 2003 http://cisgw3.law.pace.edu/cases/030611u.html (accessed 21-08-2009).

[204] *Cf* Erauw "Observations on passing of risk" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 292.

Two arbitral awards handed down by the Russian Tribunal of International Commercial Arbitration deserve further discussion. In both cases the arbitral tribunal applied INCOTERMS, which led to a swift and easy resolution of the dispute. An interpretative ruling by the Russian High Arbitration Court held that the court *a quo* court would have resolved the dispute quickly and effectively if it applied the INCOTERMS on which the parties had agreed. A ruling by the ICC Court of Arbitration will also be discussed, even though the references to INCOTERMS were merely *obiter dicta*. Two other cases will not be discussed in any detail as the dispute did not turn on an aspect covered by INCOTERMS.[205]

In the first case,[206] a contract was concluded on a "CPT – port of designation in Russia" term with reference to INCOTERMS 1990. The seller, a British company, claimed payment of the balance due under the contract from the buyer, a Russian company, after the latter had only made a partial payment. The buyer's defence was that he had deducted the unpaid amount from the purchase price, being the amount payable for customs duties and clearance of the goods. Although the United Kingdom is not a contracting state to the CISG, the parties had agreed on Russian law as the applicable law, which resulted in the CISG being applicable to the contract by virtue of article 1(1)(b) CISG.

The Russian Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry held that there was no factual

[205] In *Arbatax SA Reorganization Proceeding*, the Commercial Court of Argentina (*Juzgado Comercial Argentina*) Buenos Aires 2 July 2003 http://cisgw3.law.pace.edu/cases/030702a1.html (accessed 19-05-2009) had to establish the law governing the currency aspects of the contract. The contract was concluded on the basis of an FOB Montevideo clause "which specifically and materially included terms of the Official Rules for the Interpretation of Trade Terms of the Paris International Chamber of Commerce." The court noted that INCOTERMS do not address the issue of form and exchange rate or payment currency; hence the conflict-of-law rules would have to be applied. In terms of the Argentinean conflict-of-law rules, the CISG would be the governing law and would therefore determine these issues. The court also referred to cases where there is no express reference to INCOTERMS and stated that in those cases the codification would determine the parties' obligations under an FOB clause by virtue of art 9 CISG. A ruling by the Supreme Court Austria 14 December 2004 (*laser devices* case) http://cisgw3.law.pace.edu/cases/04121a3.html (accessed 02-06-2009) also refers to INCOTERMS. Although the translation of the case text states that the contract made an express reference to the INCOTERM CPT ("carriage paid to"), there is no indication of the edition of INCOTERMS which were to apply. The issue in dispute was one of jurisdiction, which is not an aspect regulated by INCOTERMS. It is not clear whether the German court in CLOUT Case 340 (*Oberlandesgericht Oldenburg* Germany 22 September 1998 - *raw salmon* case) interpreted a DDP term by using INCOTERMS, or whether the parties agreed on INCOTERMS. The CLOUT abstract merely refers to the fact that "the seller had to deliver the raw salmon to a specified delivery address, which was other than the Company's place of business, under the Incoterm DDP." The translation of the decision on the Pace Law database http://www.cisgw3.law.pace.edu/cases/980922g1.html (accessed on 12-05-2009) refers to the DDP clause only twice and both times in conjunction with INCOTERMS. The court held that the seller "was obliged under the contract and Incoterms 'DDP' to deliver the goods at his cost and risk to the delivery address."

[206] Russian Arbitration proceedings 220/1996 of 11 April 1997 http://cisgw3.law.pace.edu/cases/970411r1.html (accessed 02-06-2009).

dispute between the parties concerning the delivery of the goods, their quantity and the outstanding balance owed by the buyer. The contract was for goods to be manufactured in Russia, which meant that there was in principle no need to impose customs duties and fees. However, the seller shipped the goods from Finland which led to a re-export and therefore to additional expenses in the form of customs duties. Since the contract had not provided for shipment directly from the manufacturing plant of the goods, and by virtue of the fact that a delivery term used in international trade practice was included in the contract, the tribunal found that there was no indication that the parties intended the goods to be shipped from the Russian manufacturing plant. The term CPT (INCOTERMS 1990) had to determine who was to bear the expenses in connection with customs formalities, payment of all duties, taxes and other state fees due when importing goods into the customs territory of the country of the buyer. The CPT term provides that such costs should be paid by the buyer and that they are therefore not included in the price of the goods. The tribunal furthermore found that the seller had shipped the goods and had delivered all documents as required by the contract and article 30 CISG. The seller was therefore entitled to its purchase price in accordance with article 53 CISG. The seller's claim was granted and the buyer ordered to repay the outstanding balance. In this case, INCOTERMS provided a clear and effective solution to the dispute.

In the second case,[207] a Russian firm bought goods from a Hungarian firm. The parties agreed that the goods were to be delivered "CIP (place of destination in Russia)" as regulated by INCOTERMS 1990. The buyer alleged that he had paid for the goods in advance but never received them on time. The goods had been delayed during their transportation and kept at a customs warehouse at a transit point in Russia due to a failure in carrying out the customs formalities for importing the goods. The buyer demanded a refund of the purchase price as well as penalties for the delay in delivery.

The tribunal held that the CISG applied to the contract as both parties had their places of business in contracting states. In accordance with the CIP term, all the customs formalities in connection with the exporting of the goods are placed on the seller, whilst all formalities for importing the goods into the country of destination, including customs formalities as well as any expenses connected thereto, are for the account of the buyer. In accordance with CIP (INCOTERMS 1990), the seller fulfilled

[207] Russian Arbitration proceedings 27/2001 of 24 January 2002 http://cisgw3.law.pace.edu/cisg/cases/020124r1.html (accessed 02-06-2009).

its delivery obligation when the goods were delivered to the carrier to be transported to the place of destination. On the facts, the seller also fulfilled its obligations in regard to the export formalities, and the goods reached Moscow within the time stated in the contract. The seller, therefore, did not delay delivery and could not be held liable for the delay in the transportation of the goods. The seller also fulfilled his obligations in regard to the handing over of documents relating to the goods when he handed over an air waybill and other documents to the buyer's representative who was authorised to carry out the customs formalities for importing the goods and delivering them to the place of destination agreed upon. According to the B2 clause of the CIP INCOTERM, the buyer had to carry out the formalities required to import the goods and also the attendant costs. The goods had not been delivered to the place of destination because of the buyer's failure to comply with the required import formalities. The tribunal concluded that the seller had fulfilled his obligations under the contract, the CISG and INCOTERMS and that he was not liable for the payment of any penalties. The buyer's demand for restitution of the purchase price was therefore denied. Once again, INCOTERMS contributed to solving the dispute easily and quickly.

The next case[208] involved a sale of medical products by a Russian seller to an English buyer. The parties agreed that the delivery term "CIF (carriage by sea) INCOTERMS-90" would apply to their contract. The contract furthermore stipulated that any dispute would be settled by means of Russian arbitration. The applicable law of the contract, however, was not stipulated. The goods arrived at their destination in an unfit condition. The central issue in this case was whether the goods had been properly packed. According to the seller, the goods had been packed in accordance with "Free car (railroad)" terms. The Russian Arbitration Court rejected the claim for damages based on non-conformity on the grounds that the goods had been delivered in the proper way. The court neither considered the issue of the applicable law nor the contract terms which incorporated INCOTERMS to determine the content of the seller's obligations as regards packaging and delivery.

The High Court of Arbitration of the Russian Federation followed this ruling with an Information Letter directed at the review of disputes involving foreign persons

[208] High Arbitration Court (or Presidium of Supreme Arbitration Court) of the Russian Federation 25 December 1996: Information Letter 10 http://cisgw3.law.pace.edu/cases/961225r1.html (accessed 02-06-2009).

examined by arbitration courts after 1 June 1995.[209] The High Court of Arbitration pointed out that the Arbitration Court *a quo* should have interpreted the terms on the basis of the CIF INCOTERM. Agreement on the use of INCOTERMS entailed agreement on the use of international trade usages, which had to be followed by the court when interpreting the seller's delivery obligation.

In another case,[210] a Korean seller had to provide a quantity of crude metal to a Czechoslovakian buyer. The clause dealing with the purchase price[211] referred to "CNF FO [port, country] INCOTERMS 1990".[212] Payment was to be made by letter of credit which specified 30 September 1991 as the latest date for shipment and 20 October 1991 as the expiry date of the letter of credit. The contract also required a performance bond with a 3 percent penalty if shipment were to be delayed for longer than 15 days after the last day for shipment. Subsequently the shipment and expiry dates were changed to 15 October and 31 October 1991 respectively. At a later stage the expiry date was once again changed to 15 November 1991 but no change was made to the date of shipment. This resulted in discrepancies between the document negotiated by the seller's bank and the terms of the letter of credit in respect of the date of shipping. In actual fact, the goods had been put on board the ship on the 20th of October 1991 whilst the letter of credit indicated 15 October 1991. The vessel became involved in a collision and was grounded, resulting in the buyer cancelling the contract during January 1992. The seller thereafter instituted legal proceedings to demand payment of the purchase price. The seller alleged that the buyer could not avoid the contract before having fixed an additional *Nachfrist* period, alternatively that the declaration of avoidance had been late and therefore without any legal effect.

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[209] "Review of the practice of examination of disputes on matters involving foreign persons, examined by arbitration courts after 1 July 1995" Information Letter of the Presidium of the Higher Arbitration Court of the Russian Federation No 10 dated 25 December 1996. This is merely an interpretive ruling by the Supreme Court on an issue that has arisen in a particular case and is not handed down to dispose of that case.

[210] ICC Arbitration Case No 7645 of March 1995 (*crude metal* case) http://www.cisg.law.pace.edu/cisg/wais/db/cases2/957545i1.html (accessed 23-07-2009).

[211] Although the contract referred to the CNF term under the clause dealing with the price, the arbitral tribunal held that both parties had assumed that the term was not restricted to the price but was to be understood as applying to the contract as a whole.

[212] The arbitral tribunal found that INCOTERMS 1990 did not provide for a term "CNF" but concluded that the term they intended to use was "CFR (… named port of destination)". The middle letter "N" stand for "and", which was the older form of "cost and freight", namely "C&F" or "C and F". The tribunal found that the letters "FO" were a reference to "free out", which are often used to qualify CIF and CFR contracts to the extent that the expenses connected with discharging the goods from the vessel are included in the freight. It should, however, be noted that the tribunal erred in this observation since the general understanding of "free out" is that unloading costs are to be excluded from the freight costs.

The buyer, on the other hand, argued that by incorporating a CFR INCOTERM into their contract of sale, a usage of trade was constituted with the effect that the contract is a fixed term contract. Any time limit indicated in the contract is therefore of the essence, resulting in a fundamental breach of contract if such time limit is not abided by.[213] Although the tribunal acknowledged the possibility of such a trade usage, it ruled that the parties deviated from it by providing for a performance bond to apply after the expiry of a 15 day period from the date of shipping. The Court of Arbitration, furthermore, found that the seller created a situation of uncertainty by submitting shipping documents with a wrong shipping date and also by not advising the buyer of the true shipping date as it was required to do under clause A7 of INCOTERMS. It concluded, however, that 5 days' delay in shipment alone could not warrant avoidance of the contract as shipment had occurred within the hypothetical additional period of time which the buyer would have had to fix if he had immediately known of the delay. However, because the buyer's bank made the seller aware of the fact that the documents were not in order and because the seller still failed to cure the lack of conformity by submitting a new set of documents, the buyer was entitled to avoid the contract after 15 December 1991.

Even though INCOTERMS 2000 do not provide absolute certainty, their use provides a meaningful degree of certainty, predictability and stability which in their absence would have been lacking. That is especially so for parties who do not have a longstanding trade relationship based on an established course of dealing regarding their obligations. INCOTERMS can also provide meaningful assistance to parties who are new to international sales and not well versed in the intricacies of the trade. Merchants from developing countries often conclude international transactions without prior experience and knowledge and are left to the mercy of counterparts from industrialised countries with greater experience and resources. By introducing INCOTERMS to the contract, they can achieve a level of certainty and predictability in regard to the seller and buyer's responsibilities, which otherwise would not have

[213] In *Oberlandesgericht* Hamburg 28 February 1997 (*Iron molybdenum* case) http://cisgw3.law.pace.edu/cases/970228g1.html (accessed 02-06-2009), the German appellate court also ruled that a CIF term entails that the contract is a transaction for delivery by a fixed date and that untimely delivery would amount to a fundamental breach. See, however, Appellate Court Hamburg 12 November 2001 (*memory module* case) http://cisgw3.law.pace.edu/cases/011112g1.html (accessed 21-08-2009) where the appellate court questioned the existence of a trade usage which entails that a C&F sale for seasonal goods is to be considered a so-called "firm deal" and that untimely delivery would therefore automatically constitute a fundamental breach of contract.

existed.[214] Moreover, INCOTERMS reflect a reasonable balance between the interests of the parties, which can avoid disputes. Even if disputes do arise, INCOTERMS substantially reduce the time and effort involved in adjudication by clarifying certain issues. The standardisation of trade terms can, therefore, facilitate international business by minimising transaction costs and reducing trade risk. To that extent they address the needs of international sales as identified in Chapter One of this study.[215]

[214] This is also true for developed countries. In 2008, the Secretary-general of the ICC Belgium noted that there was a definite decline in export transactions in that country. He attributed this to traders who have insufficient knowledge of the correct use of INCOTERMS. See ICC Belgium *Perscommuniqué: een enquête van ICC België* link available from http://www.iccwbo.be/index.html?page=165 (accessed 18-05-2009).
[215] 1 2 *supra*.

# CHAPTER SIX
# PASSING OF RISK PROVISIONS UNDER THE CISG

## 6 1 Introduction

The United Nations Convention on Contracts for the International Sale of Goods (CISG) attempts to unify the substantive law relating to the international sale of goods with a view to certainty and to limit the resort to the rules of private international law to establish the proper law of the contract. The Convention applies to international sales where the parties to the contract have their places of business in so-called "contracting states"[1] or when the application of the rules on private international law leads to the application of the law of a contracting state.[2] It is also only applicable to the sale of specific types of goods.[3] The Convention regulates the formation of the contract of sale, the rights and obligations of the parties thereto, provides remedies for breach and regulates the legal effect of events outside the control of the parties which may prevent performance by rules regarding the passage of risk and the effect of legal impediments to performance.[4] The Convention has on occasion been criticised for not providing certainty as a result of compromise solutions to difficult issues and a failure to define certain key terms and concepts.[5] All in all, however, it has been hailed as a success and a major step towards a unified sales law.[6]

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[1] Art 1(1)(a) CISG. See also Hugo "The United Nations Convention on the International Sale of Goods: Its Scope of Application from a South African Perspective 1999 (1) *SA Merc LJ* 1 7-8; Bridge "Uniformity and Diversity in the Law of International Sale" 2003 (15) *Pace Int'l L Rev* 55 74.

[2] Art 1(1)(b) CISG. Bridge 2003 (15) *Pace Int'l L Rev* 74; Hugo 1999 (1) *SA Merc LJ* 9-10, 20-21, 25-26. The parties can also make the CISG the governing law by virtue of art 6 CISG.

[3] Art 2 CISG excludes certain categories of goods, such as consumer goods for instance. Art 3 provides further exclusions in the event of sales for the supply of goods that are to be manufactured or produced, where the seller does not supply a substantial part of the materials or when the supply does not preponderantly consists of goods instead of labour or other services.

[4] Art 4 CISG. The Convention neither deals with validity or legality issues, nor with the passing of property.

[5] Rosett "Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods" 1984 (45) *Ohio St LJ* 265; Sheaffer "The Failure of the United Nations Convention on Contracts for the International Sale of Goods and a Proposal for a New Global Code in International Sales Law" 2007 (15) *Cardozo J Int'l & Comp L* 461. For a South African perspective, see Lehmann "The United Nations Convention on Contracts for the International Sale of Goods: Should South Africa Accede? 2006 (18) *SA Merc LJ* 317. See also Bridge "A Law for International Sales" 2007 (37) *Hong Kong LJ* 17 17-40, who acknowledges the advantages of the CISG but advocates a distinction between the sale of commodities and manufactured goods. It is his view that the CISG does not present enough certainty for the regulation of commodity sales and is better suited to sales of market-insensitive goods such as manufactured goods. See, however, Singh & Leisinger "A Law for International Sale of Goods: A Reply to Michael Bridge" 2008 (20) *Pace Int'l L Rev* 161 for a critical analysis of Bridge's arguments and their opposing conclusion.

[6] Eiselen "Adoption of the Vienna Convention for the International Sale of Goods (CISG) in South Africa" 1999 (116) *SALJ* 329; Eiselen "Adopting the Vienna Sales Convention: Reflections Eight Years down

The Convention deals with the passage of risk in Chapter IV of Part III in five articles, namely articles 66-70. Article 6 CISG recognises the principle of party autonomy by providing that it is open to parties to exclude the application of the Convention's provisions completely or to vary the effect of specific articles if they so wish. Therefore, in respect of the question of risk allocation, Chapter IV establishes a default position which will apply absent express or implied agreement to the contrary. It is accordingly a matter of interpretation to establish whether the CISG risk regime applies in a particular case. Guidelines for determining the intention of the parties to the contract are provided in article 8 of the Convention. In practice, Chapter IV has limited application since parties to international sales contracts mostly elect to have the issue of risk regulated by means of trade terms such as the ICC INCOTERMS, which is usually seen as an exclusion of the CISG provisions on risk by virtue of article 6.[7] INCOTERMS may also amount to a contractual trade usage and can result in a derogation from the default rules by virtue of article 9(1) CISG in the form of a trade usage agreed upon by the parties, or they may even apply automatically as an international trade usage by virtue of article 9(2) CISG.[8]

The Convention distinguishes between two situations, namely those where the contract of sale envisages that the goods are to be transported (contracts that "involve" carriage) and those where no provision is made for transportation, such as where the seller's obligation to deliver is fulfilled at his place of business or at another place. Article 67 regulates the passing of risk when the contract involves the carriage of goods. When the goods are sold in transit, risk allocation is regulated by article 68. Article 69 regulates the so-called residual instances, for example where the goods

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the Line" 2007 (17) *SA Merc LJ* 14. The number of ratifications alone, totalling 74 States as of 18 May 2009, is evidence of the success of the Convention. See http://www.cisg.law.pace.edu/cisg/countries/cntries.html (accessed 18-07-2009). Amongst the countries that have ratified or acceded to the Convention are some of the world's leading trading nations, such as the USA, Germany, China and Japan. See also Sono "Japan's Accession to the CISG: the Asia Factor" 2008 (20) *Pace Int'l L Rev* 105.

[7] Hager "Article 67" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) para 2; Nicholas "Article 67" in Bianca & Bonell (eds) *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (1987) para 2 1; Honnold *Uniform Law for International Sales under the 1980 United Nations Convention* 3rd ed (1999) para 363; Lookofsky *Understanding the CISG: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods* 3rd ed (2008) 99-101; Enderlein & Maskow *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods* (1992) 257; Kritzer (ed) *Passage of Risk: Comments on passage of risk under national rules, under CISG, under INCOTERMS* http://www.cisg.law.pace.edu/cisg/text/passage.html (accessed 19-06-2009). See also CLOUT Case No 247 (Appellate Court Córdoba Spain 31 October 1997 – *steel profiles* case) http://cisgw3.law.pace.edu/cases/971031s4.html (accessed 11-05-2009). The degree to which the CISG risk rules are replaced by trade terms will be discussed in ch 7 *infra*.

[8] See also the discussion on trade usage in ch 4 *supra* and the interplay between INCOTERMS and the CISG in ch 7 *infra*.

are in storage or where the goods must be collected by the buyer at the seller's place of business or at a place other than his place of business.

In general, the CISG provides that risk passes upon the physical transfer of possession, such as handing the goods over to a carrier or buyer, or when the goods are taken over by the buyer.[9] The rationale is that the party who has control over the goods is better placed to prevent losses or damages to the goods and to limit such consequences as well as to assess the extent and sue for damages when they occur.[10] The Convention does not connect risk to ownership.[11] This is evident from the last sentence of article 67(1), which authorises the seller to retain documents controlling the disposition of the goods, such as shipping documents, as security for payment of the price without affecting the passage of the risk. A contrary rule would lead to the splitting of transit risk when the documents are transmitted while the goods are in transit.[12]

### 6 2 Definition of risk under the CISG

Articles 66-70 of the Convention refer to, but do not actually define "risk". Article 66 CISG refers to "loss of or damage to the goods", which implies that events should take place that will lead either to the destruction of the goods or to damage or deterioration of the goods. Article 68 similarly refers to goods that have been "lost or damaged". Commentators generally agree that the damage or loss causing events should not be brought about by one of the parties to the contract or persons for

[9] The CISG endeavours to divorce the passing of risk from the delivery or *déliverance* concept, which was used in the Uniform Law on the International Sale of Goods (ULIS), by linking it to commercial events that comprise the mere physical handing over of the goods into the possession and care of someone else. See Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 1; Honnold *Uniform Law* para 359; Roth "The Passing of Risk" 1979 (27) *Am J Comp L* 291 295; Sevón *Passing of Risk* published paper contained in *Schweizerisches Institut für Rechsvergleichung* (ed) *Wiener Übereinkommen von 1980, Lusanner Kolloquium 1984* (1985) http://cisgw3.law.pace.edu/cisg/biblio/sevon3.html (accessed 29-10-2009) 191 192-193.

[10] Honnold "Risk of Loss" in Galston & Smit (eds) *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (1984) para 8 02 (1)(b); Honnold *Uniform Law* para 361; Valioti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000* LL M thesis Kent (2003) http://cisg3.law.pace.edu/cisg/biblio/valioti.html (accessed 01-04-2009) text accompanying n 85.

[11] Schlechtriem *Uniform Sales Law – the UN-Convention on Contracts for the International Sale of Goods* (1986) 88; Nicholas "Article 67" in *Bianca-Bonell Commentary* para 2 6; *Secretariat Commentary on art 79* (the draft counterpart of art 67) http://www.cisgw3.law.pace.edu/cisg/text/secomm/secomma-67.html (accessed 29-10-2009) paras 9-10.

[12] Bollée *The Theory of Risks in the Vienna Sale of Goods Convention* published LL M thesis (1999) Paris Pace International Law Review (ed) *Pace Review of the Convention on Contracts for the International Sale of Goods* (1999-2000) http://www.cisg.law.pace.edu/cisg/biblio/bollee.html 248-249 (accessed 23-01-2009) 245 258.

whom they are responsible.[13] The provisions on the passing of risk are concerned with accidental loss or damage which affect the physical condition of the goods,[14] caused by so-called "acts of God", for example fire or storms. They also cover loss or deterioration caused by independent third parties such as thieves and vandals.[15] Situations where the goods could not be found,[16] were stolen, or transferred to another person[17] have also been associated with the loss of the goods. Damage includes physical damage,[18] deterioration,[19] spoilage, confusion or mixing up the

[13] Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 2; Schlechtriem *Uniform Sales Law* 86; Enderlein & Maskow *International Sales Law* 261.

[14] Erauw "CISG Articles 66-70: The Risk of Loss and Passing It" 2005-06 (25) *JL & Com* 203 204 refers to these kinds of risks as so-called "physical risks". On 205 he states that the risk of loss of documents relating to the goods should also be included under the notion of risk. Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 4 states that the CISG's risk rule envisages the "actual impairment" of the goods, which implies physical damage to or loss of the goods.

[15] Romein *The Passing of Risk: A comparison between the passing of risk under the CSG and German law* LL M thesis Heidelberg http://www.cisg.law.pace.edu/cisg/biblio/romein.html (accessed 28-02-2009) ch 1 A I para 2; Valioti *Passing of Risk* text accompanying n 86; Bollée *The Theory of Risks* 274. Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 3 mentions negligence of the carrier as a possible cause for the loss of the goods.

[16] CLOUT Case No 338 (Appellate Court Hamburg Germany 23 June 1998 – *furniture* case) http://cisgw3.law.pace.edu/cases/980623g1.html (accessed 12-05-2009), where furniture which had been stored by the seller in a warehouse disappeared from it after the warehouse had declared its insolvency but before the buyer received the goods and the risk passed to him.

[17] CLOUT Case No 340 (Appellate Court Oldenburg Germany 22 September 1998 – *raw salmon* case) http://cisgw3.law.pace.edu/cases/980922g1.html (accessed 12-05-2009), where the seller sold raw salmon to a processing company which, in turn, sold the same salmon to a third party. After the processing company fell into financial difficulty, the seller sent a confirmation order to the buyer, indicating a delivery address other than the processing company coupled to the DDP INCOTERM. The buyer accepted the confirmation order. The goods were, however, still delivered to the processing company, which at that time was insolvent; resulting in the buyer never receiving the goods. The court held that the seller performed his delivery obligations by delivering the goods and that the risk had therefore passed on delivery and should be borne by the buyer. This decision cannot be supported. By virtue of the INCOTERM, the contract determined a specific place for delivery and the passing of risk. The delivery obligation could therefore only be fulfilled when the goods were handed over at the place indicated in the contract. That would also be the moment when the risk transferred from the seller to the buyer.

[18] CLOUT Case No 360 (Lower Court Duisberg Germany 13 April 2000 - *pizza cartons case*) http://cisgw3.law.pace.edu/cases/000413gl.html (accessed 12-05-2009), dealing with pizza cartons which were delivered to the buyer in a damaged condition as a result of the carrier's conduct. The risk passed to the buyer when the goods were delivered to the carrier.

[19] CLOUT Case No 377 (District Court Flensburg Germany 24 March 1999 – *meat* case) http://cisgw3.law.pace.edu/cases/990324g2.html (accessed 19-07-2009). A German seller delivered meat to a French buyer who refused to pay on grounds that the meat was returned by his customers and was therefore "undetectably perished" when it arrived. The court held that the risk passed when the goods were delivered to the first carrier. The buyer did not object to its quality on arrival and also failed to prove that the meat was non-conforming at the moment the risk had passed. See also CLOUT Case No 191 (*Bedial v Müggenburg* Appellate Court Argentina 31 October 1995 – *dehydrated mushrooms* case) http://cisgw3.law.pace.edu/cases/951031a1.html (accessed 12-05-2009). In this case, a contract for the sale of dried mushrooms was concluded on the basis of a C&F Buenos Aires (no insurance) clause. The mushrooms deteriorated during their transportation to the extent that they were unfit for human consumption. The court held that the risk passed when the goods were handed to the first carrier. See, however, Bridge "The Transfer of Risk under the UN Sales Conventions 1980 (CISG)" in Andersen & Schroeter (eds) *Sharing International Commercial Law across National Boundaries: Festchrift for Albert H Kritzer on the Occasion of his Eightieth Birthday* (2008) 77 81, who is of the opinion that, unlike its predecessor art 96 ULIS, art 66 is confined to instances of loss and damage and does not cover deterioration. Art 96 referred explicitly to "loss or deterioration". He finds support for his argument from Nicholas "Article 67" in *Bianca-Bonell Commentary* para 1 2. A proper reading of Nicholas, however, does not seem to provide any support for this view. Instead, it merely indicates that "deterioration" was replaced by "damage", since the former "might be taken to refer only to natural

goods with other goods. “Risk” is therefore a broad notion which also includes natural processes of decline such as ripening, ageing, softening, leakage, thawing, melting, evaporation, shrinking, loss of weight or of strength or taste, discolouring, oxidation, risk of scratching or otherwise showing wear and tear, sickness or death. These conditions can occur during transportation of the goods or during handling or storage.[20]

Although the case law on article 66 shows that risk is generally understood in this sense, there are also cases where the courts have interpreted it in an expanded sense. Delay by the carrier after the seller has handed the goods to the carrier[21] and the risk of a lack of an attribute, for example that a particular painting might not have been painted by a famous artist,[22] have also been dealt with under the general risk provisions. Instances such as these should strictly speaking not be covered by the risk provisions. The risk rule only applies in situations where the goods are lost or where their physical condition is affected[23] by damage or deterioration. Delay in delivery or a lack of certain attributes neither constitutes loss or damage, nor does it impair the physical condition of the goods. The fact that the painting was not painted by a particular artist is an example of non-conformity for which the seller is liable under article 35 CISG; alternatively it is an instance of misrepresentation, which

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spoilage or evaporation, whereas the article is concerned with all casualties to the goods”, which therefore include deterioration.

[20] Erauw “Observations on passing of risk” in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analyses and Unresolved Issues in the U. N. Sales Convention* (2004) 292 294; Erauw “2005-06 (25) *JL & Com* 204.

[21] See *The UNCITRAL Case Digest of case law on the United Nations Convention on the International Sale of Goods* 2nd ed (2008) Ch IV Passing of Risk http://www.uncitral.org/pdf/english/clout/08-51939_Ebook.pdf (accessed 18-07-2009) para 5, where it refers to CLOUT Case No 219 (Appellate Court Valais Switzerland 28 October 1997 – *second hand bulldozer* case) http://cisgw3.law.pace.edu./cases/971028s1.html (accessed 12-05-2009). The CLOUT abstract does not contain any reference to the issue of risk, but the UNILEX abstract, http://www.unilex.info/case.cfm?pid=1&do=case&id=311&step=Abstract (accessed 18-07-2009), states that the seller has performed its obligation to deliver the bulldozer within the shortest period of time. The risk passed to the buyer when the bulldozer was handed to the carrier and the seller was therefore not liable for any subsequent delay by the carrier.

[22] See *UNCITRAL Case Digest of case law supra* Ch IV para 5, which refers to *Kunsthaus Math Lempertz v Wilhelmina van der Geld* Arnhem District Court Netherlands 17 July 1997 http:cisgw3.law.pace.edu/cases/970717n1.html (accessed 12-05-2009). No UNCITRAL abstract is available, whilst the UNILEX abstract http://www.unilex.info/case.cfm?pid=1&do=case&id=355& step=Abstract (accessed 18-07-2009) indicates that the court dismissed the buyer’s claim based on non-conformity. The court held that by virtue of arts 36(1) and 69(1) CISG, the seller does not bear the risk of non-conformity which arises after delivery. It also found that at the time of delivery there was no indication of any kind that the painting was no longer to be attributed to a particular artist and that the seller had therefore made a conforming delivery.

[23] Hager “Article 66” in *Schlechtriem-Schwenzer Commentary* para 4. Treitel *Frustration and Force Majeure* 2nd ed (2004) para 3-007 also states that risk deals with “supervening events which affect the physical integrity of the subject-matter.”

should be dealt with under the applicable national law since the CISG does not deal with issues of validity or grounds for rescission.[24]

If goods are rendered unusable by inherent characteristics rather than external events, the risk rule should also not find application. Goodfriend[25] uses the example of textiles that fade during a three-month ocean voyage as a result of unstable dyes. In this case the material was not subjected to any external events, such as sea water or wind, which could affect the quality of the dyes. Loss or damage caused by unstable dyes flows from a latent defect in the goods and not from any external event or accident. Risk of loss provisions only allocate loss or damage caused by external events outside the control of the seller or the buyer. In instances where the goods may be lost or become deteriorated due to their inherent characteristics, parties should allocate the responsibility in regard to such characteristics contractually; alternatively it should be allocated by the default rules of the CISG. If the goods do not conform to the quality standard agreed upon in the contract when the risk passed to the buyer, or if they are not fit for the normal purpose for which goods of the same nature are used, a breach of contract within the scope of article 35 has occurred.[26]

The issue becomes more complicated when external events affect the inherent characteristics of the goods, as when textiles dyed with unstable dyes are subjected to sea breezes or the ship is flooded as a result of a storm at sea. If the textiles are destroyed in transit because of an external and accidental event, the risk of loss provisions will be appropriate. In the absence of any proof that the goods were non-conforming at the time that the risk had passed to the buyer,[27] it will be difficult, if not impossible, for the buyer to escape its obligation to pay for the goods.[28]

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[24] Art 4 CISG. See also Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 78-79; Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 295. With analogy to the situation under the CIF term, Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 3 holds that unusual transport costs, such as the costs of a necessary diversion or temporary storage of the goods, should be borne by the buyer as part of the buyer's transport risk. *Cf* INCOTERMS CIF Clause B2. Bollée *The Theory of Risks* 274-275, rightly, points out that although this may be consistent with the practice of international trade, this type of transport risk does not amount to loss or damage to the goods as required by art 66.

[25] "After the Damage is Done: Risk of Loss Under the United Nations Convention on Contracts for the International Sale of Goods" 1984 (22) *Colum J Trans L* 575 581-582.

[26] Even if the risk already passed to the buyer, he will still be entitled to invoke his contractual remedies in case of fundamental breach pursuant to art 70 CISG. Art 36(1) provides the possibility of keeping the seller liable even if the non-conformity only becomes apparent at a later stage.

[27] Art 36(1) CISG.

[28] See the example used by Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 84. Where goods are not transported on a refrigerated vessel as required by the contract and the vessel sinks before the goods can suffer any damage by the heat, the buyer will carry the risk and has to pay the purchase price. However, if the vessel never sank and the goods were damaged due to the seller's failure to have the goods transported on a refrigerated vessel, article 66's exception will apply and the buyer will be able to off-set a claim for breach of contract against the

Similar problems are raised by situations involving evaporation, spoilage or deterioration in the grade or quality of goods such as cotton, liquids or perishable foodstuffs. Article 36(2) CISG states that the seller is liable for non-conformity which exists at the moment that risk passes, even if the non-conformity only becomes apparent at a later stage.[29] It has already been stated that natural decrease or shrinkage and leakage or seepage, which are not allocated in the contract, are incidents covered by the risk rule. The decisive weight is that at the time when the risk passes, resulting in natural variations being at the risk of the buyer.[30] Natural shrinkage or decrease is part of the normal risks of trade and is therefore to be borne by the buyer. However, if variations in quality or quality are the result of inappropriate packaging or containerisation, it could amount to non-conformity, which is covered by the provisions of article 35(2)(d).[31] Article 70 CISG provides that, in the case of fundamental breach of contract, the normal remedies available for breach will remain intact despite the fact that risk has already passed to the buyer. It would depend on the circumstances of the case whether inappropriate packaging or containerisation amounts to a fundamental breach.[32] Moreover, if the seller failed to provide the carrier with special instructions, such as for example to keep the goods at a particular temperature to avoid overheating or thawing, the proviso to article 66 will determine that the risk remains on the seller.[33]

Whether governmental measures such as confiscation and export and import prohibitions constitute “loss of” or “damage to the goods” as stipulated in article 66 is not entirely clear. Those advocating the inclusion of such measures under the sphere of application of article 66 argue that the cause of the loss of or damage to the goods is irrelevant. Once the risk has passed, the buyer has to bear the risk, including the risk of governmental measures.[34] However, this argument cannot be supported. Risk

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purchase price. See the discussion on the interplay between art 36(2) and the proviso to arts 66 and 36 6 3 *infra*.

[29] In order to preserve its remedies, the buyer must observe the examination and notice requirements of arts 38 and 39 CISG.

[30] See the discussion on out-turn clauses 5 5 2 *supra*.

[31] Enderlein & Maskow *International Sales Law* 261 exclude cases of shrinkage or decrease as a result of inappropriate packaging or containerisation from the risk rule. See also the discussion by Erauw “Observations on passing of risk” in *The Draft UNCITRAL Digest and Beyond* 297-298, who refers to instances of non-conformity as so-called “contractual risk” which “trumps the passing of risk.”

[32] Art 25 CISG states that a breach is considered fundamental “if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.”

[33] See discussion 6 3 *infra*; CIETAC Arbitration proceeding China 23 February 1995 (*Jasmine aldehyde* case) http://cisgw3.law.pace.edu/cases/950223c1.html (accessed 12-05 2009).

[34] Enderlein & Maskow *International Sales Law* 261; CLOUT Case No 163 (Budapest Arbitration proceeding VB 96074 Hungary 10 December 1996 – *caviar* case) http://cisgw3.law.pace.edu/cases/961210h1.html (accessed 12-05-2009). A Yugoslavian seller sold

rules only cover damage or loss caused by accidental events which affect the physical condition or existence of the goods.[35] The cause of the loss or damage is therefore pertinent to the application of article 66. Governmental measures, such as confiscation, merely affect the rights related to the goods and do not impair the goods themselves. Moreover, risk is generally assigned to the one who is insured or who can obtain insurance. The fact that there are very few types of insurances available for this kind of risk supports this opinion.[36] An exception, however, is to be made for the confiscation by an enemy country in the case of war. This kind of confiscation equals a physical loss of the goods since the buyer can take out insurance against this type of risk. In such a case the provisions on the passing of risk will apply.[37]

### 6 3 The general rule on risk

Article 66 is the "general" provision which determines that once risk has passed to the buyer, he will be obliged to pay the purchase price[38] despite damage to or the loss of the goods. This rule constitutes an exception to the general synallagma of the contract.

The CISG's risk rule deals with the price risk.[39] Unlike some national legal systems, it

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caviar to a Hungarian buyer. The caviar was delivered to a warehouse in Hungary a day before the UN embargo against Yugoslavia came into effect and was never cleared for customs purposes because of the embargo. The caviar had to be destroyed. The tribunal held that the risk passed when the buyer picked up the goods from the seller, as agreed in the contract, so that he had to bear the loss.

[35] Bollée *The Theory of Risks* 274-275 defines risk as any physical casualty relating directly to the goods, which is not due to an unlawful act or omission of the party who does not bear the risk at the time of the casualty. Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 4 requires the "actual impairment of the goods". Erauw 2005-06 (25) *JL & Com* 205 and "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 296 is of the opinion that the wording of the Convention's risk provisions precludes the inclusion of legal risk under the risk rule. Events such as confiscation or the inability to obtain customs clearance for export could, however, be considered as an impediment in the sense of art 79 CISG. See the discussion 6 3 *infra* on the possibility of invoking the art 79 exception in the context of the risk rule.

[36] Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 4 suggests that the parties should contractually provide for the division of risk in so far as acts of state are concerned.

[37] Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 4; Bollée *The Theory of Risks* 274; Romein *The Passing of Risk* ch 1 A I para 2. *Cf* also the Institute War Clauses (Air Cargo).

[38] This is consistent with the provisions of art 53 CISG. In the case of subsequent damage or loss, the buyer is to seek a remedy against the carrier or insurer. See CLOUT Case No 575 (*BP Oil International Ltd v Empresa Estatal Petroleos De Ecuador* 332 F 3d 333 (5th Cir 2003) 338, 200 ALR Fed 771, Federal Appellate Court [5th Circuit] United States 11 June 2003) http://cisgw3.law.pace.edu/cases/030611u1.html (accessed 21-08-2009). When the risk passes, it also means that all benefits and fruits relating to the goods transfer to the buyer.

[39] Enderlein & Maskow *International Sales Law* 259; Schlechtriem *Uniform Sales Law* 86; Honnold *Uniform Law* para 361; Nicholas "Article 66" in *Bianca-Bonell Commentary* para 2 1; Lookofsky *Understanding the CISG* 100.

does not deal with the passing of risk of non-performance.[40] The last phrase of article 66, however, introduces an exception to the general rule on risk. If the seller causes the loss or damage by his act or omission[41] after the risk has already passed,[42] the buyer will not be obliged to pay the price.[43] In such instance the buyer is entitled to the normal contractual rights for breach under Part III of the Convention[44] if the act or omission amounts to a breach of contract.

Unfortunately, it is not clear what the exact meaning of "act or omission of the seller" is.[45] There are two views in this regard. The first is that by "act or omission" is meant a breach of the seller's obligations under the contract of sale or the Convention.[46] The second approach holds that the "act or omission" of the seller does not necessarily have to constitute a breach of contract, but that it could be any event for

[40] Romein *The Passing of Risk* ch 1 A III; Valioti *Passing of Risk* text accompanying n 79.

[41] In the *Jasmine aldehyde* case (CIETAC arbitration) *supra*, an arbitral tribunal found that the seller's failure to give the carrier agreed instructions on the temperature at which the goods were to be stored during carriage caused the loss in the form of melting and leakage, which was, therefore, due to the omission of the seller. *Cf* arts 80 and 82 CISG for the use of the phrase "act or omission". See also CIETAC arbitration proceeding China December 2005 (*Heat transfer oil furnace* case) http://cisgw3.law.pace.edu/cases/051200c1.html (accessed 29-08-2009), where a furnace which was sold under a CIF contract exploded after installation due to the seller's negligence during the testing period.

[42] Commentators, however, differ on whether the risk remains with the seller (or reverts to him), or whether it still passes to the buyer, who is then relieved from his duty to pay. Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 5 states that the risk does not pass. Erauw 2005-06 (25) *JL & Com* 210 and "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 314, agrees that a dynamic view of the passing of risk rule would hold that the risk remained with the seller. Lookofsky *Understanding the CISG* 100, on the other hand, maintains that "even if the risk has passed in the technical sense", the buyer does not have to pay. He points out that the rules on risk deal with accidental loss or damage, whereas acts or omissions of the seller do not cover accidental incidents. The risk rule should, therefore, not find application in such instances. *The Secretariat Commentary on the 1978 Draft Convention Art 78* (draft counterpart of Art 66 CISG) http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-66.html (accessed 29-10-2009) para 5 indicates that the proviso applies in situations where the risk has already passed. Honnold *Uniform Law* para 362 states that the last part of art 66 causes the seller to be responsible for loss or damage that is due to its act or omission, even after the risk has passed to the buyer. This implies that the risk still passes but that the seller remains liable for the loss or damage. Whether the risk passes or not is mostly of academic importance since the important aspect is the extent of the liability of the buyer and the seller. Schlechtriem *Uniform Sales Law* 87 n 347 agrees that it is essentially a matter of terminology whether the risk does not pass and remains on the seller or whether it passes back to the seller.

[43] Commentators also differ as to whether the seller is allowed to set-off a claim for damages in tort against the purchase price or whether that is confined to the set-off of a contractual claim. Nicholas "Article 66" in *Bianca-Bonell Commentary* para 2 2 states that claims for damages based on contract or delict may be taken into account while the *Secretariat Commentary on Art 78* is not very clear in this respect.

[44] The buyer can avoid the contract in whole or in part (arts 49(1) and 51); ask for substitute goods (art 46(2)); repair of the goods (art 46(3)); a reduction in price (art 50) and/or damages (arts 74-77).

[45] Erauw 2005-06 (25) *JL & Com* 210 concludes that this is "a disturbing exception" and Enderlein & Maskow *International Sales Law* 261 refer to it as "an unfortunate rule".

[46] Enderlein and Maskow *International Sales Law* 261-262. Schlechtriem *Uniform Sales Law* 86 n 346 supports the restrictive interpretation on policy grounds. The extension of the seller's liability for loss of or damage to the goods due to behaviour that would otherwise not have been covered by the contractual remedies of the Convention would undermine the coherence of the buyer's remedies and their underlying principles.

which the seller is responsible and which resulted in the loss of or damage to the goods. In such cases he would be liable under the law of tort as well.[47]

It is submitted that the extensive viewpoint is to be supported, especially if one is to analyse the content of article 66 in relation to other provisions of the Convention that may operate in conjunction with it. The relationship between article 36(2) and the proviso to article 66 becomes important in this context.

The seller is liable for non-conformity which exists at the time that the risk passes to the buyer, even if the non-conformity only becomes apparent after the risk has passed.[48] This indicates that the moment when risk passes is of importance in the determination of non-conformity. If the goods have a latent defect that only becomes apparent after the risk has passed, it has no influence on the passing of risk. Risk still passes to the buyer, who is obliged to pay the purchase price.[49] However, the buyer is entitled to its remedies based on breach of contract in the form of non-conformity.[50] Article 36(2), on the other hand, provides for instances of non-conformity which occur after the risk has already passed and are caused by a breach of any of the seller's

[47] The *Secretariat Commentary on the 1978 Draft Convention Art 78* para 6 indicates that it was not the intention of the drafters of the Convention to limit the scope of the proviso to instances where the seller is in breach of a contractual obligation. Reference is made to the example of a seller under an FOB contract, who damages the goods whilst recovering his containers at the port of discharge. The damage, in this case, is clearly not the result of a breach of contract but constitutes a tort. Although the buyer will not be allowed to institute any remedies for breach of contract, it will, pursuant to art 66, have the right to deduct the damages calculated under the applicable law of tort. See also Nicholas "Article 66" in *Bianca-Bonell Commentary* para 2 2. Honnold *Uniform Law* para 362 welcomes the extended interpretation as "wise". Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 7 agrees that the proviso is not limited to breach of contract by the seller, but warns that it still requires conduct that is contrary to a legal duty. Lawful conduct of the seller, such as exercising his right of stoppage or inspection, which results in loss of or damage to the goods will not prevent the passing of risk. Sevón *Passing of Risk* 196-197 supports the extensive interpretation and claims that there "are good reasons for this position." Unfortunately, he does not elaborate on the reasons. Enderlein & Maskow *International Sales Law* 262-263 are not in favour of extending the rule to torts because that will "require the examination of different conditions." For them, the example provided by the Secretariat Commentary is enough proof that the rule does not meet its objective. The underlying policy of the rule is that the person who is insured should carry the risk. At this point the buyer would have been covered by insurance and it is, therefore, irrelevant whether it is the seller or a third party that damages the goods. Erauw 2005-06 (25) *JL & Com* 210 and "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 316 admits that the inclusion of torts and the concept of set-off may be "odd" because they normally fall otside the scope of the CISG. He argues that the vague wording introduces a fault concept, whilst the CISG is otherwise devoid from any fault principles.

[48] Art 36(1) CISG.

[49] Erauw 2005-06 (25) *JL & Com* 209.

[50] Art 70 CISG provides that the remedies available to the buyer on account of breach are not impaired by the passing of the risk, as long as it is a fundamental breach. However, avoidance or delivery of substitute goods normally depend on the possibility to make restitution of the goods substantially in the condition in which they have been received. If the goods have been destroyed due to an accidental disaster, the buyer is exempted from this requirement by virtue of art 82(2)(a) on grounds that the impossibility to make restitution is not due to the buyer's act or omission. Although art 70 refers to instances of fundamental breach, Bollée *The Theory of Risks* 288-289 points out that it does not mean that the passing of risk impairs the buyer's remedies for non-fundamental breach. See the discussion on breach 6 4 5 *infra*.

obligations,[51] including a breach of any specific guarantee provided by the seller that the goods will remain fit for their ordinary or for some specific purpose or that they will retain specific qualities or characteristics. Both articles 36(2) and the proviso to article 66 therefore apply to situations where the risk has already passed to the buyer.

Although articles 36(2) and 66 may, on occasion, apply simultaneously to a given situation, their general scope of regulation is different.[52] Article 36 deals with the obligation of the seller to deliver conforming goods, whilst article 66 deals with accidental disasters which cause loss of or damage to the goods and its effect on the buyer's obligation to pay the purchase price. At the moment that risk passes, the buyer has to determine whether the non-conformity was the result of a breach of the seller's obligation to deliver conforming goods or an accidental disaster. The exception to the risk rule in the latter part of article 66, however, provides for situations where the seller's conduct or failure to act, and not an accidental event, causes the loss of or damage to the goods. The case law provides an example of such an omission where a seller failed to notify the carrier that the goods had to be transported at a specific temperature and they deteriorated due to overheating.[53] In this instance the goods may have been conforming at the time when they were shipped and the risk passed to the buyer, but as a result of a breach of the seller's collateral obligation to arrange for the goods to be transported at the correct temperature they became non-conforming. The exception discharges the buyer from his obligation to pay the purchase price. However, even if one is to argue that the buyer is not discharged from his obligation, he will still be entitled to the normal remedies for breach of contract by virtue of articles 36(2) and 70 CISG.[54]

Despite the possibility that articles 36(2) and 66 may overlap in certain instances, this will not always be the case. Although non-conformity may be caused by "an act or omission of the seller", the act or omission which causes the damage that ultimately

[51] The seller's delivery obligations are determined with reference to the agreement of the parties (arts 6, 8 and 35(1) CISG); trade usages and practices constituted between the parties (art 9(1) CISG); international trade usages which are widely known in a particular trade and which the parties knew or should have known (art 9(2) CISG), and the provisions of the Convention (art 35(2) CISG).

[52] Schwenzer & Fountalakis (eds) *International Sales Law* (2007) 469 concludes that art 66 is "distinct" from art 36. Enderlein & Maskow *International Sales Law* 262 also argue that the scope of art 66 does not overlap with that of art 36(2) since the seller cannot exempt itself from its liability under art 66 by means of art 79, whilst that is possible in the case of art 36(2).

[53] *Jasemite aldehyde* case *supra*.

[54] Where the seller is entitled to avoid the contract, restitution will take place and the seller will be refunded if he has already paid the purchase price. Where he keeps the damaged goods, he will be entitled to a claim for price reduction by virtue of art 50 CISG.

results in non-conformity of the goods, does not always amount to breach of a contractual obligation and may be caused by other forms of conduct or omissions as well. If it was the intention of the drafters to limit the scope of "act or omission" under article 66 to a breach of contract they would have used the phrase "a breach of obligation" as was done in article 36(2).[55] Moreover, not all forms of damage caused by the seller's act or omission result in non-conformity of the goods to the extent that they are no longer fit for their ordinary use or for any specific purpose known to the seller. Article 66, in general, has a broader scope than article 36(2) CISG, inasmuch as it deals with all forms of loss of or damage to the goods caused by the act or failure to act of the seller, irrespective of whether it is the result of a breach of a contractual obligation or not.[56] An expanded interpretation that extends "act and omission" beyond contractual obligations is therefore to be preferred.

The relationship between article 66 and article 79, which provides for exemption from liability, is also controversial.[57] Does article 79 provide an exception to the allocation of risk? Article 79(1) provides that a party will not be liable for his failure to perform any of his obligations if he can prove that the failure was due to an impediment beyond his control, which he could not reasonably have foreseen or taken into account at the conclusion of the contract or which he could not avoid or overcome.

Both article 79 and the proviso to article 66 require some form of breach of contract. Article 79 exempts a party from his "failure to perform any of his obligations", a notion which is included under the seller's "act or omission" required by article 66. Such a breach would normally give rise to contractual remedies for breach. Article 79, however, provides an exemption from liability for breach, albeit only for claims in damages.[58]

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[55] A proposal to restrict the scope of art 66 to breach of contract was rejected during the deliberations on the Convention. See Honnold *Uniform Law* para 362; Nicholas "Article 66" in *Bianca-Bonell Commentary* para 2 2; Sevón *Passing of Risk* 196. Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 7 indicates that the drafters decided to restrict the scope of art 36(2) to breach of an obligation out of fear that a more extensive rule would render the seller liable for defects caused by non-contractual obligations.

[56] Such as the example referred to by *The Secretariat Commentary on the 1978 Draft Convention Art 78* para 6 referred to earlier on. Nicholas "Article 66" in *Bianca-Bonell Commentary* para 2 2 refers to damage caused to the goods as a result of them not being packaged in the manner required by the contract. Although these facts may give rise to the exception in art 66, this is a typical example where the seller's "act or omission" overlaps with a breach of his contractual duties under arts 35(1), 35(2)(d) and 36(2) CISG and, therefore, does not provide adequate reason for an extensive interpretation. See also CLOUT Case No 724 (Appellate Court Koblenz Germany 14 December 2006 - *bottles* case) http://cisgw3.law.pace.edu/cases/061214g1.html (accessed 18-07-2009).

[57] Bollée *The Theory of Risks* 276-277.

[58] Art 79(5) CISG.

Whether article 79 presents the seller with an exemption from the consequences of article 66 turns on whether the seller can be exempted from liability for the act or omission that caused the loss or damage. The article 79 exemption only applies if the party asserting it can prove certain requirements. Firstly, he should prove that the act or omission was caused by an impediment beyond his control. The exemption would therefore only apply if the seller can prove that the damage was caused by an accidental external event and not by his act or omission. The loss or damage, therefore, would no longer be caused by the act or omission of the seller; resulting in a lack of the causal link for the liability of the seller under article 66.[59] In practice there will be little need to make use of this exemption, as this would normally be a case where the buyer would carry the risk of payment.

The same requirements must be met if the buyer wants to make use of this exemption to escape its failure to pay the purchase price after the risk has already passed. In the first place, there is no impediment that prevents the buyer from paying the purchase price. Secondly, article 79 requires that the buyer "could not reasonably have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences." This requirement is difficult to meet. Insurance or the possibility of insurance is a factor that could avoid proving the requirement. If the buyer was able to take out insurance, he will be prevented from invoking the exemption of article 79.[60] Generally, it can be argued that article 79 will not have much application in the context of article 66 as it merely exempts a party from a claim for damages and would, therefore, not exempt a buyer from his duty to pay, which is considered a claim for specific performance.[61]

### 6 4 Specific rules on risk

Risk passes to the buyer at a specified moment during the transaction. The CISG risk rule distinguishes between situations where the contract envisages that the goods are to be transported and those where the contract does not provide for transportation, the so-called "residual cases". However, for the sake of consistency, the discussion on the CISG risk rule will follow the same format as was used when discussing the passing of risk under national laws by distinguishing between

[59] Bollée *The Theory of Risks* 277.
[60] Honnold *Uniform Law* para 361.
[61] Hager "Article 66" in *Schlechtriem-Schwenzer Commentary* para 7a.

shipment and destination sales, residual cases, sales in transit and cases where a party has breached the contract. The analysis of the Convention's risk provisions will be followed by an evaluation of their efficiency against the commercial objectives and needs of international sales law.

### 6 4 1 Shipment contracts

Article 67 forms the basic provision for the passing of risk and deals with situations where the contract provides that the goods are to be transported from the seller to the buyer.[62] The opening phrase of article 67, that is "if the contract of sale involves carriage of the goods", is a prerequisite for the operation of article 67. These words do not merely mean that as a result of the sale the goods will be moved from one place to another.[63] The term "involves" should be construed as requiring that the contract expressly or implicitly provides for the carriage of the goods.[64] Whether it only covers situations where the seller is required or authorised to ship the goods, or whether the buyer can also arrange for shipment, is controversial.[65] Where the contract does not provide for carriage *per se*, the requirement is met if the seller is authorised to arrange for carriage and in fact does so. Courts and arbitral tribunals often infer such an intention from a trade term incorporated into the contract.[66]

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[62] This provision does not differentiate between carriage by sea, road or air or by a combination of modes.

[63] If that was the case, there would be no scope for the application of art 69 which functions as the residual provision dealing with cases not governed by arts 67 and 68.

[64] The same formula is used in art 31(a) which provides that, if the contract of sale involves carriage of the goods, the seller satisfies its obligation to deliver the goods when it hands them over to the first carrier. Given the identical language, the same interpretation is to be given to this phrase in art 67. *Cf* also CLOUT Case No 360 *supra*.

[65] *The Secretariat Commentary on art 79* (the draft counterpart of art 67) para 2 refers to the seller. It also states that the contract does not involve carriage of the goods if the buyer takes delivery of the goods at the seller's place of business, even though they may be shipped by public carrier, or if the buyer makes arrangements for the goods to be shipped. See also Sevón *Passing of Risk* 197-198; Enderlein & Maskow *International Sales Law* 264; Valioti *Passing of Risk* text accompanying n 100; Hellner "The Vienna Convention and Standard Form Contracts" in Sarcevic & Volken (eds) *International sale of Goods: Dubrovnik Lectures* (1986) 335 344. Nicholas "Article 67" in *Bianca-Bonell Commentary* para 2 2 is of the view that it will "nearly always" mean the seller should arrange for carriage since in those cases in which the buyer is to arrange for collection of the goods, the contract will in practice not specify the means of collection, except for those instances where the buyer has to nominate the ship which the seller has to use. Where the buyer fails to nominate the ship, the seller still carries the risk but by virtue of art 67. See the discussion on destination sales 6 4 2 *infra* for Nicholas' argument in this regard.

[66] De Vries "The Passing of Risk in International Sales under the Vienna Sales Convention 1980 as compared with Traditional Trade Terms" 1982 (17) *Eur Trans L* 497 498-499, however, is critical of this interpretation. He submits that this definition is hardly consistent with the wording of the phrase. It is his argument that all international sales of goods require that the goods are to be transported from one point to another and in that sense all of them "involve" carriage of the goods. The EXW and FAS terms as well as the strict FOB term all "involve" carriage of the goods but does not require the seller to take part in the sending of the goods. Under these terms the buyer undertakes to arrange for the carriage and the seller's obligations are restricted to placing the goods at the carrier's disposal and to assist the buyer in

The first sentence of article 67(1) states that "the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer in accordance with the contract of sale." Should this requirement be interpreted to mean that the risk remains on the seller when he deviates from the contract? The commentators submit that the phrase should not be construed as controlling specifically the issue of breach of contract as that is already provided for in article 70 CISG. The true meaning is that the handing over of the goods should be in accordance with the parties' agreement on carriage as provided for in the contract of sale.[67]

In terms of article 67(1), 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 the carrier. The buyer thus bears the transit risk from the moment the goods are handed to the first carrier. The logic behind this provision is that the buyer is usually in a better position to establish whether damage has occurred as a result of the transportation, to limit the damage, to salvage and, if possible, to repair the remaining goods and institute the insurance claim. Moreover, the rule does not split the risk in cases of multimodal transport.[68]

In terms of the first sentence of article 67(1), the "first carrier" rule applies where the sales contract leaves the determination of the route to the seller's discretion. However, if the contract specifies a place or port through which the goods are to pass, as suggested by the second sentence, the risk does not pass until the goods are handed over to the carrier at that particular place or port. The wording "[i]f the seller is bound to hand the goods over to a carrier at a particular place" is rather broad. It requires an agreement between the seller and the buyer in connection with the place where the handing over to the carrier should take place. However, the Convention does not state when and by what means such an agreement is to be

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obtaining documents for exporting or clearing the goods for export. His interpretation is borne out by the decision of the arbitral tribunal in CLOUT Case No 163 *supra*. In this case, an arbitral tribunal held that the contract involved carriage when it provided that "the buyer shall pick up the fish eggs at the Seller's address and bring the goods to his facilities in Hungary" and the price was stated "FOB Kladovo". This example shows that the tribunal interpreted the phrase rather broadly to include situations where the goods are also to be carried by the buyer or on his instructions. See, however, the discussion 6 5 3 *infra*, where it is concluded that most trade terms are inconsistent with the CISG's risk rules.

[67] Nicholas "Article 67" in *Bianca-Bonnell Commentary* para 1 4; Valioti *Passing of Risk* text accompanying n 101.

[68] Honnold *Uniform Law* para 367; Nicholas "Article 67" in *Bianca-Bonnell Commentary* para 3 1; Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 3. However, depending on the interpretation of "first carrier," situations can arise where the transit risk is split. See 6 5 3 *infra*.

made. It is, therefore, possible to imply such an agreement when the parties have agreed on the use of a trade term specifying the place of delivery.[69]

In both cases envisaged by article 67, the risk is transferred from the seller to the buyer "when the goods are handed over to the … carrier." That immediately raises the question as to who or what qualifies as a carrier? A decision of a German Lower Court[70] concluded that "carrier" in articles 31 and 67 CISG should bear the same meaning. Generally, a carrier is a person or entity who, in terms of a contract of carriage, undertakes to perform or to procure the performance of carriage by rail, road, sea, air, inland waterway or by a combination of such modes.[71] The majority of commentators on the Convention hold that the carrier should be an independent, self-employed entity and that transportation by the seller in his own vehicles, or even by the transport division of the seller's company, will not qualify as carriage.[72] Handing over the goods to the carrier means handing over the control over the goods. The wording of article 67(1) pre-supposes that the carrier is self-employed and independent, as it seems a contradiction to speak of the seller as handing over the goods to himself. [73]

For practical reasons, it is also preferable to leave the risk with the seller while the goods are being transported in the seller's vehicles. Otherwise, there would be a great likelihood of litigation as the buyer could claim that the seller failed to exercise due care and ought to bear liability for loss or damage on the ground of article 66.[74] Where the seller uses his own personnel to transport the goods for part of the way, the risk is split and passes only when the goods are handed over to an independent carrier, which can cause disputes as to the time when damage occurred, especially when the goods are containerised.[75]

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[69] De Vries 1982 (17) *Eur Trans L* 503-504; Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 6; *The Secretariat Commentary on art 79* (the draft counterpart of art 67) para 6.
[70] CLOUT Case No 360 *supra*.
[71] Honnold *Uniform Law* para 369 1.
[72] Enderlein & Maskow *International Sales Law* 265 para 3 1; Bollée *The Theory of Risks* 251-252; Romein *The Passing of Risk* ch 1 B I para 1(a); Honnold *Uniform Law* para 369 1; Honnold "Risk of Loss" in *International Sales* para 8 02 (2)(b).
[73] Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* paras 3, 5; Sevón *Passing of Risk* 199.
[74] Honnold *Uniform Law* para 369 1; Bollée *The Theory of Risks* 252; Valioti *Passing of Risk* text accompanying n 107.
[75] Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 5. Von Hoffmann "Passing of Risk in International Sales of Goods" in Šarčević & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 265 287 is of the opinion that it is not good policy to leave the risk with the seller when he provides his own transportation services. That would mean that the seller is penalised for providing these services quicker and cheaper than those of established transport organisations. This viewpoint is to be supported. Usually the seller will have insurance for that part of the journey, which he can turn over to the buyer in the event of damage to or loss of the goods. Moreover, once goods are loaded and are in transit, it is very difficult to determine when the damage or loss occurred, even if the risk passes

Another controversial issue is whether a freight forwarder is included in the meaning of "first carrier". Opinions also differ on this matter.[76] It has been suggested that handing over the goods to a freight forwarder could cause the risk to pass as it should be considered a first carrier.[77] The decisive criterion is the fact that the seller hands over the goods to an independent entity which takes control over the goods for purposes of their transmission to the buyer. It is possible to argue that this is what happens when the goods are handed over to the freight forwarder as it is then in a position to take care of the goods on behalf of the buyer. On the other hand, if a forwarding agent restricts its responsibilities to merely organising the transport and contracting a carrier, it is argued that the risk will only pass when the goods are delivered to the first carrier itself.[78]

But what is the situation in respect of multiple carriers? Which one is to be considered the "first" carrier? In most cases, the goods are loaded on a train or truck and carried to a nearby port from where they are shipped to another port in the buyer's country. Does "first carrier" refer to the first independent carrier in the chain of transportation or to the first independent carrier responsible for the transnational part of the journey between the country of export and the country of import? Again there are different opinions. Some argue that the first carrier is the first transnational carrier and that risk will therefore only pass when the goods are handed over to this particular carrier, for example an ocean carrier. Policy considerations, however, suggest that the first carrier is the first independent one involved in the transportation of the goods, even if that carrier is an inland carrier.[79] Where different modes of transport are used to convey the goods, it is more equitable to follow the latter approach, because once the goods are loaded it may be difficult to determine when and where the damage occurred, especially when the goods are containerised. Since

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on handing over to the first independent carrier. See also Schlechtriem *Uniform Sales Law* 88, who argues that, where the seller uses his own transportation organisation, it might be worth considering a German *Reichsgericht* decision which deals with a similar provision under § 447 BGB. Here the court stated that, due to the difficulties in delimitation, it is preferable to let the risk pass to the buyer even when the seller's own personnel are employed. It is Schlechtriem's opinion that such a solution is tempered by the fact that the seller will not be exempt from claims for damages under art 79 CISG, since the transportation operations are not "beyond his control".

[76] Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 5 states that the legal position is "unclear". Personally he is in favour thereof that risk would pass to the buyer when the goods are handed over to the freight forwarder.

[77] CLOUT Case No 283 (Appellate Court Köln Germany 9 July 1997 – *video camera* case) http://cisgw3.law.pace.edu/cases970709g3.html (accessed 12-05-2009) implies that delivery to a freight forwarder is the equivalent of delivery to the "first carrier". On the facts of this case delivery could not be proven because the bill of lading, which accompanied the container delivered to the freight forwarder, did not contain the buyer's name as recipient.

[78] Enderlein & Maskow *International Sales Law* 265 para 3 3; Valioti *Passing of Risk* text accompanying n 111 referring to the argument of a Greek scholar, Flambouras.

[79] Enderlein & Maskow *International Sales Law* 265 par 3 2; Sevón *Passing of Risk* 200; Goodfriend 1984 (22) *Colum J Trans L* 595.

the buyer will be the one to discover the damage, he will be in the best position to evaluate the loss, salvage whatever is possible and to institute claims against the insurance company.[80] This rule is practical and efficient, since the splitting of risk is avoided and the buyer bears the risk during the whole transport cycle, both inland and across the sea.[81] If the goods have to be handed over at a particular place, the second sentence of article 67(1) provides that the risk does not pass to the buyer until the goods are handed over to the carrier at that particular place. However, as will appear in more detail in the context of "handing over", this provision can lead to a splitting of risk in cases where the goods are to be delivered to a carrier at a particular place, which is not the first carrier.

Under article 67(1), the risk passes "when the goods are handed over to the … carrier." The CISG avoided the word "delivery" in the context of the passing of risk, because of problems created in this context by the wording of its predecessor ULIS.[82] Delivery as used in the CISG is dealt with in articles 31 and 32. In the context of article 67, "handed over" has the same meaning as in article 31. Articles 31 and 32 provide that, in the absence of a special agreement, "delivery" is to be effected either by "handing the goods over" or by "placing the goods at the buyer's disposal."

The first option envisages that "carriage is involved". When the contract provides for carriage, the obligation to deliver consists of "handing the goods over to the first carrier for transmission to the buyer".[83] "Handing over" denotes a physical act of transfer of possession; meaning that the goods are transferred from the control of the seller to that of the carrier. The goods are therefore considered to be "handed over" when the seller places them into the care or control of a carrier. At the same time it implies an element of co-operation on the part of the buyer, that is "taking the goods over", which is absent in the case of goods being placed at the buyer's disposal. In order to safeguard the buyer's interests, it is essential that the seller ensures that the

[80] Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 4; Valioti *Passing of Risk* text accompanying nn 115 & 116. This rule accords with the INCOTERMS aimed at containerised goods.
[81] Goodfriend 1984 (22) *Colum J Trans L* 595-596.
[82] Art 19(1) ULIS defined delivery as "the handing over of goods which conform with the contract." Art 79(1) ULIS, furthermore, determines that risk passes when delivery of the goods is effected "in accordance with the provisions of the contract and the present Law." The general proposition is subjected to special provisions relating to non-conforming goods, unascertained goods and goods sold in transit. The definition of "delivery" is further qualified in the case of sales involving carriage of the goods. This approach was criticised as "excessively complicated and difficult to understand". See in this regard, Nicholas "Article 67" in *Bianca-Bonell Commentary* paras 1 1 – 1 3. *Cf* also n 9 *supra.*
[83] Art 31(a) CISG.

carrier receives the goods, because delivery to the carrier implies that the goods have left the seller's control irrevocably.[84]

But what precisely does it entail to place the goods under the carrier's care and control? Article 67(1) does not specify the precise moment when "handing over" of the goods to the carrier takes place and the risk consequently passes to the buyer. It is necessary to define the point of delivery more clearly, especially in regard to loading the goods on the means of carriage, as it may cause difficulties of interpretation when the goods are damaged during the loading operation. Does the carrier take over the goods when the loading starts or when the operation is finished? In the case of sea transport, it is sufficient that the goods are unloaded alongside the ship, provided that the carrier takes them into his custody.[85] It does not necessarily mean passing the ship's rail. The CISG's risk rule follows the approach of the modern INCOTERMS, which determines that risk passes when the goods are delivered into the custody of the carrier.[86] This approach differentiates between situations where the duty to load the goods on board the vessel is that of the seller and that of the carrier. Where the seller is responsible for loading, the act of "handing over" will only be completed when the goods are on the vehicle of the carrier that is to take them over. However, when the carrier does the loading himself, handing over is completed when the goods are provided ready for loading or handed over into the care of the carrier. Where the goods comprise several units, which are transported separately, risk will pass per unit.[87] On the other hand, if the seller's duties extend to loading and handling, the goods will only be "handed over" when they are placed on board the ship. The decisive factor is what the parties have themselves agreed in the contract. Party agreement and usages in regard to the place of delivery will take preference over article 31.[88] The provisions of article 31, in fact, seldom find application. In most cases, the parties refer to customary delivery clauses or trade terms, in particular INCOTERMS.[89]

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[84] De Vries 1982 (17) *Eur Trans L* 497. However, if a seller is obliged to place the goods at the buyer's disposal and the buyer then engages a carrier to take delivery of the goods, the seller will not be under an obligation to bring the goods under the custody of the carrier. The carrier now has to take delivery on behalf of the buyer.

[85] Bollée *The Theory of Risks* 253-253. Honnold *Uniform Law* para 368 1 points out that, in situations where the seller has facilities for so-called "dock-side loading" (eg for grains or other bulk commodities), the seller will not "hand over" the goods to the carrier until they enter the ship's hold. *Cf* also the FAS term.

[86] Such as FCA, CPT and CIP.

[87] Enderlein & Maskow *International Sales Law* 266 para 5.

[88] 129 para 1.

[89] Hellner "The Vienna Convention and Standard Form Contracts" in *International Sale of Goods* 342-345. See also the *2008 UNCITRAL Digest of Case law supra* Art 31

A further interpretational difficulty might arise where the seller is bound to hand the goods over at a particular place and he arranges for the goods to be transported there by an independent carrier who is to place them on board the carrier at that place. When does the "handing over" required by article 67(1) take place? It is not clear which sentence of article 67(1) should apply. Are the goods considered to be handed over when the goods are delivered to the first carrier or when that carrier delivers the goods on behalf of the seller to the ship or vehicle at the specified place? The problem, in essence, hinges on the definition of "handing over" and whether it should also mean "cause to hand over"; in other words that a third party, acting on the instructions of the seller may hand the goods over and that risk passes at that moment. On the one hand, it can be argued that the carrier placing the goods on board the vessel on the instruction of the seller is to be treated as the equivalent of the seller handing over the goods, and that the second sentence therefore applies. On the other hand, it could be argued that the seller is not bound personally to hand the goods over at a particular place, but merely to arrange that the goods are so delivered. Then the case would be presumably governed by the first sentence. The second sentence would then apply only where the seller uses his own transport facilities to carry the goods on the first part of their journey. The commentators seem to agree that the first interpretation is to be preferred.[90] If the latter construction would have been the correct one, there would be no reason for the later amendment to the final text of article 67(1), which included the second sentence.[91] It is, therefore, concluded that "handing over" should include the notion of "cause to hand over" on behalf of the seller.

Article 67(2), furthermore, provides that the risk does not pass to the buyer until the goods are clearly identified to the contract. This principle is recognised in many legal systems, as is evident from the discussion on the passing of risk under the national regimes.[92] It is quite common in international sales that the seller ships undivided bulk goods for the performance of several contracts, or even sends such goods off

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http://www.cisg.law.pace.edu/cisg/text/digest-art-31.html (accessed 24-08-2009) paras 3 & 11 and the cases referred to there.

[90] Nicholas "Article 67" in *Bianca-Bonell Commentary* Art 67 paras 2 3-2 4; Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 3; Bolleé *The Theory of Risks* 255-256; Honnold *Uniform Law* para 369 2. Note that the apparent support of Honnold for the latter construction, which Nicholas "Article 67" in *Bianca-Bonell Commentary* refers to in para 2 4, has been clarified by the 3rd ed of Honnold *Uniform Law* para 369 n 9. This is also the viewpoint of the *Secretariat Commentary on art 79* paras 6-7.

[91] See Goodfriend 1984 (22) *Colum J Trans L* 589-597 for a thorough discussion on the legislative history and the policy considerations underlying the rule.

[92] See ch 2 *supra*.

without a buyer.[93] The rule seeks to preclude the seller from falsely claiming in case of loss or damage to his consignment that the lost or damaged goods were those purchased by the buyer.[94]

The identification of the goods to the contract as a requirement for the passing of risk under articles 67-69 can be made in the ways mentioned in article 67(2). However, the list provided in article 67(2) is not exhaustive. It merely states that the goods may be identified "whether by marking on the goods, by shipping documents,[95] by notice given to the buyer or otherwise."[96] Where goods are shipped in bulk, the identification of the goods can be performed by placing appropriate marks on them, such as the address of the buyer, or by sending a notice of consignment. According to article 27 CISG, the notice takes effect at the time of dispatch. The risk passes *ex nunc* to the buyer with the mere dispatch of the notice and not on the receipt thereof. This could necessitate establishing where and when the loss occurred.[97] As a rule, the shipping documents, a bill of lading or (sea)waybill will appropriate the goods to a specific contract.[98]

But what is the position when a collective cargo containing goods of the same kind is shipped in one container or on one ship for several recipients and the container is identified for all contracts? The Convention does not clearly settle the problem. One opinion states that identification of the collective cargo suffices. The buyers form an association for the risk and carry it *pro rata*.[99] Another opinion is that this would not be sufficient for purposes of a clear identification. The identification, and therefore the passing of risk, does not take place until the goods are divided between the buyers at

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[93] This is especially so in the case of fungible goods, such as oil or wheat. See Bridge 2003 (15) *Pace Int'l L Rev* 58-59.

[94] Honnold *Uniform Law* para 371; Nicholas "Article 67" in *Bianca-Bonell Commentary* para 2 7.

[95] In CLOUT Case No 360 *supra*, the court found that the requirement of identification was satisfied by the description of the goods in the shipping documents. CLOUT Case No 253 (Appellate Court Lugano *Cantone del Ticino* Switzerland 15 January 1998 – *cocoa beans* case) http://cisgw3.law.pace.edu/cases/980115s1.html (accessed 11-05-2009) confirms that, for the risk to pass to the buyer on delivery to the carrier, the goods should be identified.

[96] This is similar to the requirements of art 32(1) CISG.

[97] Valioti *Passing of Risk* text accompanying nn 126-127 points towards the dangers of such an approach, which may lead to a splitting of risk. He submits that risk should rather pass with retroactive effect. Although Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 10 admits that this situation may give rise to the splitting of risk, he is of the view that it will be of little relevance in practice since any problems will be significantly reduced by the fact that the decisive moment is the dispatch of the notice and not its receipt.

[98] Schlechtriem *Uniform Sales Law* 89; Sevón *Passing of Risk* 201.

[99] Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 10a; Enderlein & Maskow *International Sales Law* 269-270; Bollée *The Theory of Risks* 257 n 60. According to Lookofsky *Understanding the CISG* 103, a buyer can proportionally bear the risk for his undivided share if that share has somehow been identified to the contract, eg by giving the buyer notice that a particular bulk contains his goods.

the place of destination, unless it can be inferred from the circumstances that the parties have implicitly agreed that the risk would be borne by the buyers.[100]

Finally, it should be noted that the passing of the risk is not prevented by the seller's retention of documents controlling the disposition of the goods.[101]

### 6 4 2 Destination sales

The Convention does not explicitly provide for destination sales requiring the seller to hand the goods over to the buyer at a particular place. In these instances the contract also involves carriage, but is not covered by article 67, because the seller is required to hand the goods over to the buyer and not to a carrier at a particular place.[102] The residual rule of article 69(2) will therefore apply.

Article 69(2) also governs cases where the buyer is bound to collect the goods at a place other than the seller's place of business. This includes a public warehouse or premises where manufactured goods are located. It also applies where the contract of sale requires the seller to hand the goods over to the buyer at a particular place.[103]

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[100] Valioti *Passing of Risk* text accompanying and following upon n 132; Sevón *Passing of Risk* 201-202. Honnold *Uniform Law* para 371 notes that agreement of the parties alone can determine the division of risk.

[101] Art 67(1) CISG third sentence; Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 8; Nicholas "Article 67" in *Bianca-Bonell Commentary* para 2 6; Honnold *Uniform Law* para 370; *The Secretariat Commentary on art 79* (the draft counterpart of art 67) paras 9-10. See also 6 1 *supra*.

[102] Honnold *Uniform Law* para 373. Typical instances are contracts where the goods are to be delivered to the buyer's place of business, or contracts concluded on an "ex ship," "ex quay," "ex warehouse," "free domicile" or "FOB buyer's city" term. The D-terms of INCOTERMS correspond with this provision. See also CLOUT Case No 317 (Appellate Court Karlsruhe Germany 20 November 1992 – *frozen chicken* case) http://cisgw3.law.pace.edu/cases/921120g1.html (accessed 12-05-2009), dealing with the delivery of goods "*frei Haus*" ("free delivery, duty-paid, untaxed").

[103] Honnold *Uniform Law* para 377; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 4. Because art 69(2) is a "catch-all" provision which applies to all cases that involve the carriage of goods that are not covered by art 67, Nicholas speculates in para 3 3 whether it can apply to cases where the seller is required to place the goods on board a ship to be named by the buyer. The discussion on shipment contracts 6 4 1 *supra*, noted the controversy as to whether art 67 also covers situations where the buyer arranges the carriage of the goods. He suggests that art 69(2) might present a solution, especially where the buyer fails to nominate the ship and art 67 does not apply. The only obstacle might be that art 69(2) requires that the buyer should be "bound to take over the goods", whilst in these cases, the buyer does not take over the goods directly but nominates a carrier that will take over the goods. However, if, under art 67, it is possible to argue that "hand over" may include "cause to hand over"; then, similarly, "take over" can include "cause to be taken over". The risk then passes when the delivery is due, which is when the buyer fails to nominate the ship and the buyer is aware that the goods are ready to be shipped. Enderlein & Maskow *International Sales Law* 267 para 7 3, 277 para 6 concur with this view. See also Schlechtriem *Uniform Sales Law* 91 n 374, who argues that a general principle can be derived from arts 67 & 69, namely that the seller no longer bears the risk once he has relinquished control over the goods in accordance with the contract, or when he has been prevented from doing so by the buyer's act or omissions which are not in accordance with the contract. The risk should therefore pass, not only when the buyer fails to take over the goods, but also when the buyer fails to cooperate or fulfill the necessary delivery requirements.

The destination is very often the port nearest to the buyer's place of business. Article 69(2) furthermore extends to cases where the seller transports goods with his own means of transport.[104]

Article 69(2) CISG states that risk passes when delivery is due and the buyer is aware that goods are placed at his disposal at that particular place. In the case of a destination sale, the seller places the goods at the disposal of the buyer at the place of business of the buyer or at a third place, such as the port of destination or a warehouse. In accordance with international trade practice, the seller's obligation ends when the goods are unloaded from the transnational carrier. After that point the seller no longer has the goods in his care. The policy consideration of care and control does not apply in these cases as the seller is in no better a position than the buyer to protect and insure the goods. There is no reason for the risk to remain on the seller.[105] The risk should, therefore, pass as soon as the buyer is in a position to collect the goods.

Four requirements must be met for the risk to pass. Firstly, delivery must be due; secondly, the goods must be placed at the buyer's disposal; thirdly, the buyer must be aware that the goods were placed at his disposal at that particular place; and fourthly, the goods must be identified to the contract.

The requirement that delivery should be due presents a problem when the goods are prematurely placed at the buyer's disposal. In such a case, the buyer does not have to take delivery but may do so if he so chooses. By requiring that delivery be due before risk passes to the buyer, the seller has to carry the risk until the agreed upon delivery date if the buyer chooses not to take delivery until then, even though the goods have been placed at his disposal. A strict interpretation of article 69(2) would suggest that the risk is to remain on the seller if the buyer elects to take delivery before the due date. Policy considerations, however, would caution against such an interpretation.[106]

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[104] Honnold *Uniform Law* para 373.

[105] Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 3; Honnold *Uniform Law* para 377; *Secretariat Commentary on art 81 of 1978 Draft* (counterpart of art 69) http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-69.html (accessed 29-10-2008) paras 4-5; Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 6.

[106] Nicholas "Article 69" in *Bianca-Bonell Commentary* para 3 2 argues that the general principle on which art 69 is based, namely that risk passes to the buyer when he takes over the goods, would be defeated by such an interpretation. See Bollée *The Theory of Risks* 268. In CLOUT Case No 338 *supra*, the court found that the risk of furniture that was lost from a warehouse did not pass to the buyer to whom the storage invoices had been issued on the grounds that delivery was not due and the buyer was not made aware that the goods had been placed in the warehouse. In terms of the agreement,

"Placing the goods at the buyer's disposal" means that the seller must have done everything necessary to enable the buyer to take control of the goods.[107] For instance, when the buyer has to collect the goods at a warehouse, the goods are at his disposal if he can require the warehouseman to deliver them to him. This presupposes that the seller has given instructions to the warehouse keeper or bailee to hold the goods on behalf of the buyer or has handed over an effective delivery order, warehouse receipt or other document that transfers control of the goods to the buyer.[108] Contrary to article 69(1), the risk does not pass when the goods are actually taken over by the buyer, but as soon as the goods are placed at his disposal when delivery is due.[109] Depending on the circumstances, the place of fulfilment of the contract is the place of business of the buyer, the ship in the port of destination or the place of business of the manufacturer.

The buyer must be aware of the fact that the goods are placed at his disposal at that particular place. This must be a positive awareness and can be brought about by a message or the handing over of documents. If the parties have agreed on the time for placing the goods at the buyer's disposal, the seller does not have to send the buyer a notice.[110] In the absence of such an agreement, the seller must notify the buyer that the goods have been placed at his disposal. "Awareness" implies actual knowledge; thus, a notice is ineffective unless received by the buyer. For the passing of risk, the moment in which the message reaches the buyer is decisive and not the

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delivery was to be due on the buyer's demand, who had not made such demand yet. On the other hand, see CLOUT Case No 340 *supra*, where it was held that the risk of loss passed when the seller delivered raw salmon to a processing company because delivery was due and the buyer acquiesced in such delivery.

[107] *The Secretariat Commentary on Draft Art 81* para 7 states that this would normally include identification of the goods, the completion of any pre-delivery preparation by the seller, such as packing, and the necessary notification given to the buyer to enable him to take possession. The steps to be taken depend on the circumstances of the case. *Cf* also CLOUT Case No 338 *supra*, where it was held that according to art 31(a) CISG, the obligation to deliver "consists of taking all steps necessary under the contract".

[108] *The Secretariat Commentary on Draft Art 81* para 8; Sevón *Passing of Risk* 205; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 3; Bollée *The Theory of Risks* 268-269.

[109] In CLOUT Case No 104 (ICC International Court of Arbitration Case No 7197 of 1992 – *failure to open letter of credit and penalty clause* case) http://cisgw3.law.pace.edu/cases/937197i1.html (accessed 18-07-2009), where the seller agreed to deliver the goods under the DAF INCOTERM, the arbitral tribunal found that art 69(2) was applicable. The tribunal, furthermore, held that the seller, who had stored the goods following the buyer's failure to open an agreed letter of credit, bore the risk of loss because he had not placed the goods at the buyer's disposal as agreed upon. Although the *UNCITRAL Digest supra* Art 68 para 6 refers to this case, the UNCITRAL abstract itself makes no reference to art 69. The UNILEX abstract http://www.unilex.info/case.cfm?pid=1&do=case&id=37&step=Abstract (accessed 18-07-2009), however, mentions art 69 and states the *ratio* of the decision. See the criticism expressed against this decision by Perales Viscasillas "Comments on the draft Digest relating to Articles 14-24 and 66-70" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 259 n 67. She is of the view that the tribunal should have taken the buyer's breach in not opening the letter of credit into consideration.

[110] Under Art 33 CISG, when the contracting parties have fixed a date or a period for delivery in the contract or when the period for delivery results from usage or practice, the seller has to place the goods at the buyer's disposal at that time.

moment in which it is sent by the seller.[111] When transport documents are required for handing over the goods, the goods are not placed at the disposal of the buyer until these documents have been handed over to him.[112] The seller, who is obliged to place the goods at the buyer's disposal, is not responsible if the buyer fails to take delivery. He must merely enable the buyer to take delivery at the point where and at the time when the goods are made available to him. It is the buyer's duty to stipulate additional provisions to prevent the goods from being unattended after being placed at his disposal.

Article 69(3) requires that the goods must be identified before the risk can pass.[113] If the seller is bound to hand over the goods to the buyer at the buyer's place of business or at an agreed place, identification takes place there on tender of the goods to the buyer. For the passing of the risk of goods in storage, the storekeeper must acknowledge the buyer's right of possession, or the seller has to hand over documents to the buyer which constitute a promise by the storekeeper to hand over the goods.[114]

In a sale of bulk commodities, the goods must be clearly identified before being placed at the buyer's disposal. The requirement of identification can give rise to problems because the seller has to do everything necessary to enable the buyer to take control of the goods. If the goods are sold in individual units, the seller should identify the particular units to enable the buyer to take control, as loss or damage may affect the different units differently. On the other hand, if the goods are sold by weight or measure from a larger bulk and the seller presents the buyer with a delivery order entitling the buyer to collect the goods immediately, identification or individualisation will not make much of a difference as the loss or damage will affect the whole bulk to the same degree. However, article 69(3) still requires separation or

[111] Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 6; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 3; Valioti *Passing of Risk* text accompanying n 167; Enderlein & Maskow *International Sales Law* 278 para 8. This is contrary to the provision of art 27 CISG. The notice does not have to be sent by the seller but can also originate from the carrier or the warehouse keeper. See also De Vries 1982 (17) *Eur Trans L* 511, who criticises this rule for being "a highly impractical provision" that "puts the buyer in an exceedingly comfortable position".

[112] Roemein *The Passing of Risk* ch 1 D III 1 (bb).

[113] Ziegel *Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods* (July 1981) "Comment to Art 69" para 4 points out that the Convention provides no definition for "identified goods", but that this should not preclude a court from giving it a flexible meaning consistent with the underlying rationale of art 69.

[114] Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* paras 7-8.

at least some form of acknowledgement by the seller that he holds a particular quantity on behalf of the buyer for the risk to pass.[115]

### 6 4 3 Residual cases

Article 69(1) lays down the residual rule on risk in cases not covered by articles 67 and 68. Generally speaking, article 69 applies to all contracts that do not "involve carriage of the goods" by a "carrier" as envisaged by articles 31 and 67 CISG.[116]

According to article 69(1), risk passes to the buyer "when he takes over the goods or, if he does not do so in due time, from the time when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery."[117] Article 69(1) is primarily concerned with contracts in which the buyer is bound to take over the goods at the place of business of the seller.[118] However, article 69(1) is also applicable to the case in which the buyer is not bound to take over the goods at any specified place, since the other provisions of the Convention do not cover such a situation.[119]

Risk passes when delivery is due and the goods have been identified under the contract.[120] If a specific date for delivery is determined and the buyer takes over the goods on that date, the risk passes to him. However, if the buyer is prepared to take over the goods, but the seller is not capable of delivering on that date, the risk will not pass until the time that the buyer is informed that the goods are available and the

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[115] Nicholas "Article 69" in *Bianca-Bonell Commentary* para 3 1 states that, where identification of the goods are for practical purposes inseparable from taking delivery, the goods will be sufficiently identified when the seller has done everything necessary to enable the buyer to take delivery. Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 8 is of the view that where the goods are identified to the contract and thereafter partially lost, the buyer bears the risk *pro rata*; whilst if the whole of the stock is lost, he carries the whole risk. See also 6 4 1 *supra* for a discussion on identification in the context of art 67 CISG.

[116] CLOUT Case No 360 *supra* indicates that art 69(1) applies only if arts 67 and 68 do not apply to the situation, such as when the place of performance is the seller's place of business. See also Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 1; Honnold *Uniform Law* para 373.

[117] Schlechtriem *Uniform Sales Law* 90 contends that it is irrelevant whether the buyer is at fault in failing to take delivery. However, if it is not his fault, art 79 CISG can exempt him from claims for damages. Risk of loss or damage will in any event pass to the buyer. The buyer can also be in default of taking delivery if it is a contractual requirement that he is to nominate a carrier and fails to do that.

[118] This is the typical sale "ex works". See Honnold *Uniform Law* para 373; Enderlein & Maskow *International Sales Law* 274 para 1. However, the "ex works" term differs from art 69(1) insomuch that under EXW, risk passes to the buyer as soon as the goods are put at the disposal of the buyer and not when he takes them over as envisaged by art 69(1).

[119] Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 1; Enderlein & Maskow *International Sales Law* 274 para 1.

[120] Art 69(3) CISG.

goods are actually taken over by the buyer. However, if the buyer takes over the goods before the agreed upon date, the risk passes to him when he takes over the goods. If the buyer delays to take over the goods on the agreed date of delivery, the risk passes, provided that the goods are identified under the contract and the seller has placed the goods at the buyer's disposal at the agreed time. If the goods are to be taken over within a specified period, the risk passes when the buyer takes over the goods, provided that he takes them over before the end of such period. If he fails to take the goods over by that time, he will be in breach of contract and the risk will pass from the time when the goods were placed at his disposal.[121]

To take over the goods entails a change of control over the goods. The buyer or his representative, such as a forwarding agent or carrier, should receive the actual control and possession of the goods. To merely place the goods at the buyer's disposal does not suffice.[122] Once again, the underlying policy consideration is that the party in custody of the goods is in a better position to protect them and take out insurance cover. If the goods are on the seller's premises, they will probably be covered by a standard "building-and-contents" insurance policy.[123]

Article 69(1) leaves room for factual disputes over whether or not transfer of control has occurred. Should the buyer be considered to have taken over the goods as soon as he is handed documents of title such as a bill of lading? It could be argued that article 69(1) does not require physical handling of the goods for the risk to pass. It is, nevertheless, doubtful whether the Convention permits such an interpretation, since it would mean that the goods are taken over as soon as they are placed at the buyer's

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[121] *The Secretariat Commentary on Draft Art 81* para 3; Sevón *Passing of Risk* 204; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 1; Honnold *Uniform Law* para 374; Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* paras 2-3. The notice that the goods are placed at his disposal must come to the knowledge of the buyer and is, therefore, contrary to art 27 at the risk of the seller. Even if the buyer can claim exemption for his failure to take over the goods under art 79, the risk will still pass to him. See Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 99-101 for a discussion on the problems that may arise in connection with the time period within which the buyer must take delivery before he will fall into breach. See also 6 3 *supra* for a discussion on the interplay between arts 79 and 66. By virtue of arts 85 and 88(2) CISG, the seller has a duty to preserve the goods if the buyer fails to take over the goods. Schlechtriem *Uniform Sales Law* 91 points out that the buyer's breach of contract is not restricted to a delay in taking delivery, but also extend to cases where the buyer fails to obtain an import licence in due time. Nicholas "Article 69" in *Bianca-Bonell Commentary* paras 3 3-3 4 also refers to cases where the buyer fails to co-operate in handing over the goods, such as where he fails to nominate the ship. Other types of breach, such as the failure to pay the price where payment and tender of delivery are reciprocal obligations, should however not cause the passing of risk.

[122] Enderlein & Maskow *International Sales Law* 274 para 2. This is also the main difference between art 69(1) CISG and the EXW INCOTERM.

[123] Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 1; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 1; Honnold *Uniform Law* para 375; Bollée *The Theory of Risks* 266. Valioti *Passing of Risk* text accompanying n 159.

disposal.[124] This would be inconsistent with the policy underlying the first part of article 69(1), namely that the seller should bear the risk as long as he has control of the goods and is in a position to protect them.

### 6 4 4 Sales in transit

Article 68[125] determines the passing of risk in regard to goods which have already been handed over to an independent carrier for carriage and which, therefore, are already in transit when the contract of sale is concluded. The basic rule of article 68 (first sentence) states that the risk in goods sold in transit passes *ex nunc* to the buyer from the time the contract for the sale in transit is concluded.[126]

At the Vienna Conference, the drafting of article 68 gave rise to much controversy. The working group's draft reproduced the substance of article 99 ULIS, according to which the risk was assumed retroactively by the buyer from the time the goods were handed over to the carrier under the first sale. Such rule has practical advantages since it prevents the splitting of transit risk. Often it may be impossible to establish the event that caused the damage or when the damage occurred. Moreover, if the damage is partly caused by an event that occurred after conclusion of the transit contract and partly by an event that had occurred beforehand, it will give rise to

[124] Bollée *The Theory of Risks* 266. The second part of art 69(1) makes such a construction dubious as it clearly distinguishes between the activities of making the goods available and taking control of them. See Goodfriend 1984 (22) *Colum J Trans Law* 584-585 for a discussion of this aspect. See also Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 98, who suggests that, for the sake of clarity, "handing over" should be interpreted as having taken place when the buyer leaves the seller's factory or place of business. Difficulties might otherwise arise when the goods are damaged during the process of handing them over to the buyer.

[125] The *UNCITRAL Digest* mentions only 3 cases. None of these cases actually deals with the content of art 68. The reference to art 68 in CLOUT Case No 338 *supra* seems out of place: art 69 should have been referred to. The Vienna Arbitration proceeding S/97 Austria 10 December 1997 (*Schiedsgericht der Börse für Landwirtschaftlichen in Wien*) http://cisgw2.law.pace.edu/cases/971210a3.html (accessed 12-05-2009) only refers to art 68 in connection with the buyer's allegation that the defects occurred after the passing of risk but during their transportation to the place of destination. CLOUT Case No 170 District Court Trier Germany 12 October 1995 http://cisgw3.law.pace.edu/cases/951012g1.html (accessed 12-05-2009) is cited by the *Case Digest* in connection with art 68, but the case abstract and translation contains no reference to art 68. The Pace Law database cites a few additional cases not cited by the UNCITRAL Digest. One example is a CIETAC Arbitration award (CISG/1997/02) http://cisgw3.law.pace.edu/cases/97041c1.html (accessed 18-07-2009), which states that, by virtue of art 68, risk passes on conclusion of the sale in transit. However, most of the cases cited there do not contribute much to the understanding of art 68.

[126] The main problem with this rule is that it must be established when the loss or damage took place, which is very difficult, especially if the goods are transported by sea and are containerised. The risk is split during transit and the rules on the burden of proof ultimately decide which party bears the loss. See Sevón *Passing of Risk* 203; Hager "Article 68" in *Schlechtriem-Schwenzer Commentary* para 3; Enderlein & Maskow *International Sales Law* 270 para 1 1. *Cf* art 23 CISG as to when a contract is considered concluded.

separate claims against the insurer.[127] Nevertheless, some delegates of developing countries objected by arguing that it is unfair to put the risk on the buyer before the conclusion of the contract.[128] As a result, a compromise provision was adopted. The first sentence of article 68 lays down the primary rule that the risk passes "from the time of the conclusion of the contract", but is qualified by the second sentence, which makes the risk pass retroactively (*ex tunc*) from the moment the goods are handed over to the carrier "if the circumstances so indicate".[129] The retroactive passing of risk obviates any difficulties of proof as the parties are normally able to establish the condition of the goods at the time they were handed to the carrier.[130]

If the circumstances so indicate, the buyer takes over the risk from the time when the goods were handed over to the carrier who issued the documents embodying the contract of carriage. Normally that will be the bill of lading in cases involving the sale of floating goods, but it could also be a sea waybill. There is no reference in articles 67 and 68 to "documents controlling the disposition of the goods", and therefore there is no need that the documents should be negotiable documents. It is sufficient that the documents merely prove the existence of the contract of carriage.[131] In the absence of such documents, the rule does not apply. If the transport involves a chain of carriers, as is the case with multimodal transport, it is the handing over to the carrier who issued the documents in question that is relevant.[132]

The only difficulty here lies in the phrase “if circumstances so indicate”. The Convention does not provide any definition for this phrase and it should therefore be

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[127] Nicholas “Article 68” in *Bianca-Bonell Commentary* para 2 1; Hager “Article 68” in *Schlechtriem-Schwenzer Commentary* para 1; Goodfriend 1984 (22) *Colum J Trans L* 586.

[128] The objectors maintained that buyers in developing countries often cannot obtain insurance or may prefer not to insure the goods and to bear the risk themselves. Their argument was that mandatory insurance of the goods would result in a further transfer of resources from third world to developed countries, as the world insurance market is generally controlled by the developed world. It was, furthermore, argued that the rule was irrational and unjust by placing the risk on the buyer before the contract is concluded as, strictly speaking, the buyer would have no insurable interest before conclusion of the contract. On the other hand, those in favour of the rule argued that it represented the usual practice in international trade; that it was essentially a matter of trading and insurance techniques; that any additional risk borne by the buyer would be reflected in the price; and that it is difficult, if not impossible, to establish when damage occurred whilst the goods are in transit. See Hager “Article 68” in *Schlechtriem-Schwenzer Commentary* para 1; Schlechtriem *Uniform Sales Law* 89-90; Bollée *The Theory of Risks* 261; Nicholas “Article 68” in Bianca-Bonell *Commentary* para 1; Honnold *Uniform Law* Art 68 para 372 1; Goodfriend 1984 (22) *Colum J Trans L* 585-589.

[129] This provision precludes any recourse to domestic provisions which declare the contract void if the goods no longer exist at the time of the making of the contract. See Nicholas “Article 68” in *Bianca-Bonell Commentary* para 3 1.

[130] Nicholas “Article 68” in *Bianca-Bonell Commentary* para 2 2; Sevón *Passing of Risk* 203.

[131] Hager “Article 68” in *Schlechtriem-Schwenzer Commentary* para 4a; Sevón *Passing of Risk* 202. It is uncertain whether this provision would apply in cases where no traditional paper documents are used. Schlechtriem *Uniform Sales Law* 90 notes that the Convention did not provide for the possibility that shipping contracts may be recorded and transmitted electronically without any paper documents.

[132] Enderlein & Maskow *International Sales Law* 271 para 4.

interpreted. Generally, the word "circumstances" should be construed as referring to the intention of the parties, whether it is expressed or to be inferred from the circumstances.[133] There is general agreement that this requirement is satisfied where the contract of sale requires the seller to transfer an insurance policy to the buyer or the buyer takes out a retroactive insurance cover, which is possible if he is not yet aware of the loss.[134]

The retroactive passing of the risk under article 68 second sentence only applies in favour of a seller acting in good faith. This is apparent from the third sentence which states that, if at the time of the conclusion of the contract of sale the seller knew or ought to have known that the goods had been lost or damaged and did not disclose that to the buyer, the loss or damage is at the risk of the seller. A problem of interpretation relating to the extent of the seller's risk under the exception arises from the third sentence of article 68. The issue is whether or not the seller is liable for damage which had already occurred at the time of conclusion of the contract and of which the seller knew or ought to have known, or whether he is also liable for damage that occurred after the conclusion of the contract. According to Hager,[135] the legislative history indicates that the intention is to hold the seller liable only for loss which has already occurred at the time of conclusion of the contract and of which he knew or ought to have known. Nicholas,[136] however, opines that the intention is to hold the seller liable for the damage which had occurred when the contract was concluded and for all subsequent damage which is causally connected with the original damage.[137]

Another issue which creates uncertainty is whether the exception also applies to the first sentence, or whether it is restricted to the second sentence. Nicholas[138] contends that the normal interpretation would seem to favour its application to both

[133] Schlechtriem *Uniform Sales Law* 90; Honnold *Uniform Law* para 372 2; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 294; Valioti *Passing of Risk* text accompanying n 142; Nicholas "Article 68" in *Bianca-Bonell Commentary* para 2 2.
[134] Hager "Article 68" in *Schlechtriem-Schwenzer Commentary* para 4; Schlechtriem *Uniform Sales Law* 90; Nicholas "Article 68" in *Bianca-Bonell Commentary* para 2 2; Honnold *Uniform Law* para 372 2. Bolleé *The Theory of Risks* 262 suggests that such an interpretation is consistent with the legislative history of the provision. Furthermore, since contracts of the kind envisaged in art 68 customarily provide for insurance, this interpretation has the effect of making the rule in the second sentence widely applicable. Apart from this, there are very few scenarios where the buyer shall assume the risk retroactively.
[135] "Article 68" in *Schlechtriem-Schwenzer Commentary* para 5; Enderlein & Maskow *International Sales Law* 271 para 5 2.
[136] "Article 68" in *Bianca-Bonell Commentary* para 2 3.
[137] Honnold *Uniform Law* para 372 2 supports this approach but doubts the basis and advisability of a "causally connected" limitation.
[138] "Article 68" in *Bianca-Bonell Commentary* para 2 4; Honnold *Uniform Law* para 372 2; Enderlein & Maskow *International Sales Law* 271 para 5 1.

sentences, but that the history of the provision indicates that it was only to apply to the second sentence. Since the risk passes to the buyer at the time of conclusion of the contract, the goods are in any event at the seller's risk until that moment. Therefore, the exception only relates to sentence two, since the rule of retroactivity introduces an anomaly of risk passing before the contract is concluded. This opinion is to be supported since the first argument would lead to splitting of the risk whilst the goods are in transit, which is undesirable.

However, it should be noted that a sales contract for goods sold in transit will often contain a trade term allocating the risk of loss, which will replace the default rule of article 68 CISG.[139] Since no counterpart for the rule in article 68 is to be found in any trade term, such terms are to be interpreted with reference to international trade usage. The CIF and CFR terms are normally associated with sales in transit.

Article 68 does not require that the goods must be clearly ascertained or identified to the contract, as is the case in articles 67(2) and 69(3) CISG. However, it is submitted that, by analogy,[140] such a requirement should be extended to article 68.[141] As with the sale of goods by carriage, the identification of the goods to the contract often takes place by declarations in the shipping documents (usually a bill of lading) or by sending a notice of consignment with which the risk passes *ex nunc*.

Some opinions hold that one has to differentiate between two applications of article 68 CISG.[142] When the seller is allowed to provide a load of unascertained goods according to the contract or trade usages, the risk passes to the buyer at the moment stipulated in article 68 CISG. The buyers bear an eventual loss proportionately to their shares in the bulk consignment.[143] On the other hand, when a cargo of unascertained goods is not allowed, the risk does not pass to the buyer until the goods have been clearly identified to the contract. Because of this uncertainty,

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[139] Lookofsky *Understanding the CISG* 103.
[140] Art 7(2) CISG provides that matters governed but not settled by the Convention can be determined with reference to the general principles on which the Convention is based. Where a so-called "gap" exists, the method of analogy is often used to apply a general principle reflected in one provision to another provision.
[141] Bollée *The Theory of Risks* 264-265 suggests that the general policy underlying the risk provisions of arts 67(2) and 69(3) requires identification of the goods. See also Hager "Article 68" in *Schlechtriem-Schwenzer Commentary* para 6; Valioti *Passing of Risk* text accompanying nn 154, 274; Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 310.
[142] Hager "Article 68" in *Schlechtriem-Schwenzer Commentary* para 6.
[143] Goodfriend 1984 (22) *Colum J Trans L* 589; Grewal "Risk of Loss in Goods Sold during Transit: a Comparative Study of the UN Convention on Contracts for the International Sale of Goods, the UCC, and the British Sale of Goods Act 1991 (14) *Loy LA Int'l Comp LJ* 93 102.

parties to such a contract is advised to specifically agree on the exact point where risk is to pass in order to protect themselves from misunderstandings.[144]

### 6 4 5 Breach of contract by the buyer or seller

The second part of article 69(1) provides that risk will pass to the buyer when the goods are placed at his disposal and he fails to take delivery in due time. This requires that the seller should have taken all the steps necessary to enable the buyer to take control of them, especially by identifying the goods to the contract and informing the buyer of their availability. The buyer must be in the position to transport the goods without further ado. He commits a breach of contract by failing to take delivery when the time for delivery fixed in the contract is due or, when nothing is stipulated in the contract, a reasonable time has passed since the notification that the goods are placed at the buyer's disposal has reached the buyer.[145]

Whether other breaches of contract resulting in a failure to take delivery will also shift the risk, is contentious. Some scholars argue that the buyer also commits breach of contract if, though prepared to take over the goods, he does not pay the price that has become due, so that the seller retains the goods. Because the buyer is in breach, the transfer of risk is dissociated from the concept of custody and the buyer is saddled with the risk even though the goods are under the seller's control.[146] Other examples are, when the buyer does not open a documentary credit as stipulated in the contract; or when the buyer does not give the necessary forwarding instructions; or where he fails to obtain an import licence in time.[147] Those that support the extensive opinion prefer not to limit the passing of risk to a failure to take delivery, but

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[144] Valioti *Passing of Risk* text accompanying n 279; Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 6. Grewal 1991 (14) *Loy LA Int'l Comp LJ* 103 suggests that buyers should use a out-turn clause similar to those used in the oil trade, where the buyer is only liable for the goods actually received. It is his argument that out-turn clauses change the moment of risk to the point of destination. See also Oberman *Transfer of risk from seller to buyer in international commercial contracts: A comparative analysis of risk allocation under the CISG, UCC and INCOTERMS* LL M thesis Laval (1997) http://www.cisg.law.pace.edu/cisg/thesis/Oberman.html (accessed 25-02-2009) Conclusion, for a similar suggestion. However, the discussion on out-turn clauses 5 5 2 *supra* concluded that these clauses have a limited application inasmuch as they do not affect the place of delivery or the point where risk is to pass from the seller to the buyer.

[145] Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 4; Nicholas "Article 69" in *Bianca-Bonell Commentary* para 2 2; Bollée *The Theory of Risks* 267; Roemein *The Passing of Risk* ch 1 D II 1. When the parties have agreed on the time for taking delivery, a notice should not be necessary. See the discussion 6 4 3 *supra*.

[146] Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 4; Bollée *The Theory of Risks* 267; Valioti *Passing of Risk* text accompanying nn 163 & 164. Article 85 provides that in such an event the seller is under the obligation to preserve the goods. *Contra* Nicholas "Article 69" in *Bianca-Bonell Commentary* para 3 4.

[147] Schlechtriem *Uniform Sales Law* 91.

to extend it to include a breach of the buyer's co-operative obligations, such as for example, where the buyer fails to nominate the vessel for an FOB sale.[148] Romein[149] asserts that from this moment, the seller cannot influence the sale of the goods any longer and it would therefore be unfair to put the risk on the seller when the buyer is in default. Although it is agreed that the risk should pass to the buyer in these circumstances, since it is the buyer that prevents the seller from handing the goods over, Romein's *ratio* cannot be fully supported. The main issue is not whether the seller is in a position to "influence" the sale or not. It is against public policy to saddle the seller with the risk in the event where the buyer's failure precludes him from handing over the goods and transferring control to the buyer. Schlechtriem[150] bases his support for the extended interpretation on the general principle underlying both articles 67 and 69, namely that the seller no longer bears the risk once he has relinquished control over the goods in accordance with the contract or when he has been prevented from doing so by the buyer's act or omission which is not in accordance with the contract. This view is to be supported.

Article 68 last sentence provides that, if at the time of the conclusion of the contract the seller knew or ought to have known that the goods have been lost or damaged as a result of his breach, such as concluding a sale for goods that are non-conforming at the time the contract is concluded because of his failure to package the goods properly, the seller retains the risk for any loss or damage that results from such breach.[151]

Article 70 regulates the relation between the passing of risk and the buyer's remedies when the seller has committed a fundamental breach of contract.[152] Under article 70, the risk of loss provisions do not impair the remedies available to the buyer if the seller has breached any obligations under the contract in a significant way. The necessary prerequisite is a fundamental breach of contract by the seller. However, art 70 does not mean that the buyer's remedies for non-fundamental breach are

[148] A strict reading of art 69 may lead to the conclusion that the situation is not covered under art 69 and that the risk remains on the seller in terms of art 67 CISG. Nicholas "Article 69" in *Bianca-Bonell Commentary* 3 3, on the other hand, argues that this case should fall under art 69(2). See n 103 *supra* for his argument.
[149] *The Passing of Risk* ch 1 D II 1.
[150] *Uniform Sales Law* 91 n 374.
[151] See 6 4 4 *supra*.
[152] There are no reported cases in the UNCITRAL Digest on this particular provision. For a discussion on the effect of fundamental breach on the passing of risk, see Dong "The Effect of Fundamental Breach on Passage of Risk in the International Sale of Goods under the United Nations Convention on Contracts for the International Sale of Goods: Comparative analysis with the Contract Law of the People's Republic of China" 2003 (7) *VJ* 233.

impaired.[153] Article 36, furthermore, provides that the seller remains liable for non-conformity which existed when the risk passed to the buyer, even though the lack of conformity only becomes apparent after that time.[154]

## 6 5 Evaluation

This study has established that international sales pose special problems that distinguish them from domestic sales.[155] When it comes to regulating the passing of risk, a unified rule that facilitates international trade should be able to combat the difficulties experienced in applying the rules of private international law as well as the problems resulting from domestic passing of risk rules in the context of international sales. However, it should be borne in mind that unification is not simply "a synthetic exercise, drawing on the different legal systems to develop concepts acceptable to all," but that it should involve innovation as well.[156]

The so-called "autonomous approach" to the passing of risk followed by the CISG has been highly praised. According to Von Hoffmann,[157] "[t]he UN Sales Convention made a fresh start on the passing of risk problem with an original approach differing remarkably from conventional wisdom, yet trying to be close to practical needs."[158] He states that the Convention does not offer one general criterion for the transfer of risk but rather "a typology covering different situations."[159] The draftsmen of the Convention did not rely on precedents in national legislation or on the traditional models[160] in choosing a risk regime. It based its concept on the notion of handing over control over the goods. Because of inherent problems connected with the legal

[153] According to Bollée *The Theory of Risks* 288-289, art 70 has merely a limited explanatory function. She contends that the main reason for including art 70 into the scheme of the Convention is because the buyer's remedies for fundamental breach result in the risk being transferred back to the seller, and that the rules on risk could then provide confusion. If the parties terminate the contract after the risk has passed to the buyer, the provisions of arts 81-84 supersede the risk provisions of Chapter IV. See the decision by the Supreme Court of Austria 29 June 1999 (*dividing wall panels* case) http:/cisgw3.law.pace/edu/cases/990629a3.html (accessed 12-05-2009).
[154] *Cf* 6 3 *supra* for a discussion on the interplay between arts 36 and 66.
[155] See ch 1 *supra*.
[156] Roth 1979 (27) *Am J Comp L* 292-293
[157] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 297-298.
[158] However, considering the underlying similarity between the CISG risk regime and trade term patterns reflected by shipment and destination contracts, it is an exaggeration to consider the CISG regime as "a fresh start" based on "an original approach". See the discussion 6 5 3 *infra.*
[159] Von Hoffmann "Passing of Risk" in *International Sale of Goods* 278, 297.
[160] See 3 1 *supra.*

concept of delivery, the drafters chose to base the rules on different transport situations and to have the risk pass according to each of the stages of dispatch.[161]

To establish whether this approach provides an efficient international rule on the passing of risk, it is necessary to evaluate the rule against the needs of international sales law. These needs have been identified in an earlier part of this study,[162] and will subsequently be used to evaluate the CISG risk rules.

### 6 5 1 Flexible default rules that entrench the principle of party autonomy

The CISG's rules on risk are default rules that can be excluded by means of party agreement as provided for in article 6 CISG. The CISG, therefore, subscribes to the principle of party autonomy. At the same time, the Convention provides that trade usages enjoy preference before its own provisions if the parties have agreed on a usage.[163] In most cases, parties to an international contract of sale conclude their contract on the basis of a trade term. Passing of risk will then be regulated in terms of the specific trade term. The degree to which the CISG's risk rule is ousted by a trade term and the possibility of some form of interplay between the trade term and the CISG risk rules will be analysed in greater detail in the next chapter.

### 6 5 2 Certainty, clarity and predictability

Lack of clarity was a major criticism directed at the Convention's predecessor ULIS, and should therefore be an important criterion in judging the CISG. It is necessary to determine whether the Convention's provisions are drafted in a way that eliminates ambiguity. Furthermore, because a uniform law is aimed at unifying the law of international sales and has to be applied by parties from widely varying legal systems, clear and unambiguous language is a necessity for legal certainty and the effective and efficient application of the risk rule.[164]

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[161] According to Ziegel *Report* "Comment to Art 67", the rules on transfer of risk as envisaged by art 67 is based on a so-called "control" theory. Schlechtriem *Uniform Sales Law* 86 notes that risk is "no longer determined by the legal concept of 'delivery' but rather by a description of the prerequisites for the passing of risk." *Cf* also Audit *The Vienna Sales Convention and the Lex Mercatoria* in Carbonneau (ed) *Lex Mercatoria and Arbitration* re-printed ed (1998) 173 183-184.

[162] Chs 1 & 3 *supra*.

[163] Art 9(1) CISG.

[164] A unified rule has to be translated into different languages; hence, it requires the minimum of ambiguity in its terms to facilitate the translation.

The analysis of the CISG's risk provisions[165] revealed that they are susceptible to potentially conflicting interpretations, which could be a serious threat, not only for the unification goals of the Convention, but also for the economic efficiency of the transaction. The discussion showed that the Convention fails to define important notions under articles 67 and 68, such as "contract of sale involving carriage of the goods;" "handing over of the goods;" "first carrier" or the indicative "circumstances"[166] that will lead to retroactive passing of risk, leaving them open to different and often divergent interpretations. This leads to confusion and misunderstanding, which may jeopardise the important pillars of efficiency, namely certainty, clarity and predictability.

Although it is understandable that the Convention would not be able to generate a "one-size-fits-all" risk rule because of the practical needs of different types of international contracts involving carriage, the manner in which such distinction is made results in the rules being complex and difficult to apply.[167] Transaction costs can only be minimised when the appropriate risk rule is easily identifiable, based on the type of commercial situation involved and the manner in which the goods are to be transported from the seller to the buyer.[168] Uncertainty regarding which of the parties is responsible for the goods, can lead to losses that would otherwise have been avoided.

The risk provisions are primarily stated in exclusionary and qualifying terms. For example, article 67 differentiates between situations where the goods are to be handed to the first carrier and situations where the goods are to be handed to a carrier at a specific place. Article 67(1) introduces this distinction by means of a rule and an exception to the rule, both contained in the same paragraph. Moreover, both the rule and the exception are made subject to the requirement of identification to the contract as stated in paragraph 2.

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[165] See 6 4 *supra*.
[166] Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 95-96 and Nicholas "Article 68" in *Bianca-Bonell Commentary* para 2 3 comment that, if the "circumstances" indicative of the retrospective allocation of risk were to refer to a contrary intention of the parties, the result could just as well have been achieved by means of party agreement or trade usages pursuant to articles 6 and 9 CISG. This requirement of art 68 does little to provide clarity on the issue, except in the case of a CIF sale, where risk is to pass "as from shipment" and the damage to or loss of the goods is covered by insurance.
[167] Erauw 2005-06 (25) *JL & Com* 211; Stocks "Risk of Loss under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods: A Comparative Analysis and Proposed Revision of UCC Sections 2-509 and 2-510" 1993 (87) *Nw UL Rev* 1415 1451.
[168] Stocks 1993 (87) *Nw UL Rev* 1448.

Article 69 also functions on the basis of an exclusion. Article 69(1) is the residual rule that applies to situations that do not fall under articles 69(2) and 67.[169] Paragraph 1, furthermore, applies to cases where the goods are to be taken over from the place of business of the seller. However, this requirement only becomes clear once one has read paragraph 2, which applies to cases where the goods are to be handed at a location other than the seller's place of business. Where the goods are placed at the disposal of the buyer at the seller's place of business, paragraph 1 distinguishes between situations where the buyer takes over the goods in due time and those where he fails to do so. Even if the buyer takes over the goods in due time, it is not clear precisely when during the process of handing over, the risk will pass. Does it happen at the start of the loading process or only after the goods have been loaded onto the buyer's vehicle? This is an important distinction, especially when damage occurs to the goods during the loading process. If the policy consideration underlying article 69, namely that risk follows control, is adhered to, the preferred view would be that risk passes when the goods are taken over by the buyer in the sense that he has taken control of the goods.[170] A lack of clarity can result in a gap, in that one of the parties can be uninsured for a period of time during which they are uncertain of who is to carry the risk.[171]

Article 68 consists of a basic rule and a qualification providing for the retroactive passing of risk. Apart from the uncertainty surrounding the interpretation of the "circumstances" required for the retrospective passing of risk, article 68 presents another difficulty which is not clearly addressed by the provision. This problem pertains to bulk shipments of non-identified fungible goods in which damage is only partial and there is more than one buyer. It is unclear on which party liability will rest in cases in which identification of the goods to the contract has not or cannot be made. In the first place, article 68 does not require identification. However, the general principles on which the risk rules are based show that identification of the goods to the contract is a general requirement for the risk to pass and should therefore apply to article 68 as well. The problem with this requirement, even where it is expressly stated in articles 67(2) and 69(3), is that it does not discuss how to divide liability between multiple buyers, especially when only part of a bulk consignment has been damaged.

[169] At the same time, it also applies in situations where articles 67 and 68 do not apply.
[170] Goodfriend 1984 (22) *Colum J Trans L* 585 supports such an interpretation.
[171] Stocks 1993 (87) *Nw UL Rev* 1451. See also Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 99-100 for a similar argument.

The rule in article 67(2) is the only one dealing with identification of the goods and it is generally accepted that the rule should be applied to article 68. However, the rule is also not clear on what happens in the case of bulk goods where the individual goods have not yet been identified to the contracts of the various buyers. If the buyers have insurance, commercially it will not make much sense to leave the risk on the seller who has no insurance simply because the strict test for identification has not been met.[172] The best solution would be for the buyers to carry the risk proportionally. This result seems to be supported by the CIF term as used in the commodity trade where the seller enters into a number of similar forward delivery contracts. This type of contract entails that the seller does not have the goods at the time of contracting, but that he has already concluded the same number of purchases for similar goods which he will then sell whilst afloat. In these situations it is impossible for the seller to identify the goods to a particular contract, even if he is the shipper, as the goods may be used for any of a number of these contracts. At some point the seller serves the buyer with a notice of appropriation, which means that the risk is allocated to the buyer retroactively to the moment the goods have passed the ship's rail.[173]

However, the CISG provision that deals with the effect of the seller's breach on the passing of risk has been praised as "simple and easy to apply".[174] In the case of a breach by the seller, article 70 preserves the buyer's normal remedies in the event of fundamental breach and does not reallocate risk. The risk will still pass to the buyer irrespective of a breach by the seller. This rule does not shift the risk, but leaves it to the court to determine whether breach has occurred and to assess the appropriate remedy. A resort to the normal remedies for breach conforms to the common assumptions of commercial parties concerning the actions they should take in the event of breach of contract.

Although the policy considerations underlying article 70, which allocate risk to the party in control of the goods, are to be supported, the rule is not always "simple" and "easy to apply". Article 70 is restricted to cases of fundamental breach, which immediately leaves a question mark as to the effect of non-fundamental breach on the buyer's remedies. The discussion of article 70 addressed this question and

[172] Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 92-93.
[173] 93-94.
[174] Stocks 1993 (87) *Nw UL Rev* 1452.

concluded that these remedies are still available. The intention of the provision was mainly to provide for instances of avoidance which would result in the risk passing back to the seller when the contract is cancelled. However, this is not easily determinable from the wording of article 70 and requires some interpretational background to fully grasp the scope of the provision. Moreover, article 70 is based on the notion of fundamental breach, which in itself is a complicated concept to understand and apply in the context of the Convention.

It is concluded that the CISG's risk rules are not completely clear and predictable in all aspects. Vague and ambiguous language resulting in divergent interpretations lead to differing results which may hamper the efficiency of the CISG risk rule as a unified international rule on the allocation of risk.

### 6 5 3 Adherence to policy considerations of international trade and mercantile customs

This study has established that the party who is in the best position to keep the goods safe, to have control over them and is the most cost-effective insurer is also in the best position to carry the risk.[175] This rationale is carried through by articles 67, 69 and 70.

Article 67(1) CISG causes risk to pass when the goods are delivered to the first carrier or to the carrier at an agreed upon place. The buyer is usually in the better position to check the goods and handle their possible loss or damage. Because it is reasonable to assume that the buyer will arrange insurance on the goods from the moment that the seller completes performance and the buyer is empowered to take possession of the goods, it will also be equitable for the buyer to be the one that suffers the loss in this situation. Article 69(2) provides that risk passes when the goods have been placed at the buyer's disposal. Once again, it is reasonable to assume that the buyer will arrange insurance from the time when the seller has completed his performance. To keep the risk on the seller until the buyer has actually taken over the goods, would be unfair and against commercial policy as the goods are no longer under his control.

[175] See 3 2 1 *supra*.

When the buyer is to pick up the goods at the seller's place of business, the seller retains possession of the goods until received by the buyer. Because the seller is in possession of the goods, he is also in the best position to care for them and to insure them against loss. Risk will, therefore, only pass on receipt. The risk of loss provisions of article 69(1) CISG adhere to this underlying assumption. However, article 69(1) states that the seller's responsibility for the goods in his possession does not continue indefinitely. If the buyer does not take delivery in due time, risk is considered to have passed to the buyer as from the moment when the goods were placed at his disposal. Stocks[176] argues that, by relieving the party in control of the goods of his responsibility after the lapse of time, this provision could reduce the incentive of the non-breaching party, in this case the seller, to care for the goods until the dispute can be resolved. However, this should not be a major concern. Such an effect is countered by articles 85-88 CISG, which create an elaborate scheme to encourage the preservation of the goods by the party in control, even in cases of breach. The possibility of having to pay damages or to provide substitute goods provides an adequate incentive for the seller to reduce avoidable losses with no need to reallocate the risk of loss and upset the normal assumptions of insurance and control. Once again the emphasis is placed on the party who is in control of the goods or has them in safekeeping, which is an important policy consideration underlying international sales. Non-breaching parties are required to "take steps as are reasonable in the circumstances" to preserve goods in their possession. Parties who are required to preserve goods may deposit them in a warehouse at the other party's expense, or sell them after an unreasonable delay or when they are susceptible to rapid deterioration. Parties selling the goods may be compensated for reasonable preservation and sales costs.[177]

Stocks,[178] furthermore, submits that, if the scope of article 70 were expanded to preserve the normal remedies for breach for both the buyer and seller, the preservation provisions would be unnecessary, since the innocent party would retain the risk of loss until the goods were properly disposed of and would, therefore, have adequate incentives to care for them. This argument seems to be based on a fallacious assumption as article 70 does not "retain" the risk of loss on the innocent party in the case of the seller's breach of contract. The rationale of article 70 is that the seller's breach does not influence the passing of risk *per se*, but that despite the

[176] 1993 (87) *Nw UL Rev* 1443.
[177] Arts 87-88 CISG.
[178] 1993 (87) *Nw UL Rev* 1444-1445.

risk having passed to him, the buyer retains his remedies for fundamental breach. If the contract is avoided or substitute goods are ordered, the risk will revert to the seller. The prerequisite for avoidance, however, is that the buyer should be able to make restitution of the goods "substantially in the condition in which he received them";[179] hence, the obligation to preserve the goods. Alternatively, he can be relieved from restitution if the goods have perished due to an event outside his control.[180] In the event of the buyer failing to take delivery of goods placed at his disposal at the seller's place of business in due time, article 69(1) second part determines that the risk passes to the buyer and the seller will be entitled to his remedies for breach due to the buyer's failure to take delivery in due time. An expanded article 70 would not retain the risk in these circumstances on the seller. It would still allow the risk to pass to the buyer even though the goods were in the physical possession of the seller, and the seller would still have to exercise his remedies for breach. Even if the Convention did not provide for any obligation to preserve the goods, the seller would, from an economic point of view, preserve the goods under his control until he is able to resell them to another buyer or to mitigate his claim for damages. An adaptation of article 70 would therefore not change the situation at all.

The rationale for placing the risk on the buyer when the goods are placed at his disposal at a place other than the seller's place of business is that the goods are no longer under the physical control of the seller, obviating the need for the seller to take out insurance on the goods. Bridge,[181] however, argues that article 69(2) might cause the buyer to be at risk for a period of time without actually being in breach of contract. This argument is difficult to follow, especially as article 69(2) requires that the buyer must be aware of the fact that the goods are placed at his disposal. His argument seems to turn thereon that article 69(2) does not require the seller to give the buyer efficient time for arranging insurance before having to carry the burden of risk. He contends that the general principles on which the Convention's rules on delivery are based, presuppose the cooperation of the seller to enable the buyer to take out insurance[182] and that this duty should be read into article 69(2) as well. Although this may be true, it still does not excuse the buyer from taking over the goods and then addressing the seller's breach of an ancillary duty by means of the normal remedies for breach of contract.

[179] Art 82(1) CISG.
[180] Art 82(2)(a) CISG.
[181] "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 101.
[182] Art 32(3) CISG.

Policy considerations also require that risk should not be split during transportation of the goods and that, ideally, the buyer should not be held responsible for loss or damage that occurred back in the transport chain to a time when the goods were not effectively under the control of him or his agent. Although article 67 transfers the risk at the moment when the goods are handed over to the first carrier[183] and most commentators agree that this is the most equitable situation because it does not result in the splitting of risk during transit, it could result in the buyer carrying the risk for containerised goods even to a time when the goods were not yet handed to him. If the damage was not caused by a distinguishable or reported event, it will never be possible to establish whether the damage occurred before the goods were handed to the carrier or thereafter, resulting in the buyer being saddled with the burden of risk for the entire journey and even to a time when they had not been under his control.[184]

The splitting of risk during transit may occur where the seller is to hand over the goods to a carrier at a specific place[185] or even where the seller transports the goods in his own vehicles for a part of the journey.[186] The same applies to situations where the goods are not identified to the contract at the time when the goods are handed to the carrier or made available to the buyer.[187] Where the goods are to be handed to a carrier at a specific place, the splitting of risk may be warranted by the fact that risk follows control and that risk should pass when the buyer takes over control over the goods. Splitting of the risk, hence, would operate to protect the buyer. However, when the goods are containerised, any rule that specifies a point in time when risk will pass between the time the goods are placed into the container by the seller and the time they are unloaded by the buyer, may ultimately leave the risk on the buyer for the entire period of carriage if the time and the cause of damage is undeterminable.

A similar situation arises in respect of the sale of goods in transit. The general rule of article 68 splits the risk of loss during transit between the seller and the buyer, namely at the moment when the contract for the sale in transit is concluded. In many instances it may not be possible to determine the condition of the goods at the time

[183] See the discussion on the interpretation of "carrier " 6 4 1 *supra.*
[184] Goodfriend 1984 (22) *Colum J Trans L* 593-594. Neither the parties nor the carrier know the condition of containerised goods at the time the container is handed over to the carrier, especially not if it was stored in a container terminal for some time prior to shipment of the goods. A clean bill of lading is only evidence of the apparent good condition of the goods, which will be issued if the container as such is not damaged.
[185] Art 67(1) second sentence.
[186] In light of the predominant opinion that "carrier" refers to an independent carrier.
[187] Arts 67(2) and 69(3) CISG.

the contract is concluded as the goods are already in the process of being transported. Especially in cases where goods are forwarded in containers, it can cause serious practical problems due to the near impossibility of determining the moment when the damage occurred, unless the container itself was damaged. If damage or loss occurs as a result of an identifiable event such as fire, storm or shipwreck, splitting the risk will not cause any problems as it will be clear when the damage or loss took place. However, damage to the goods due to water seepage, overheating, variations in temperature or unreported accidents during shipment will mean that a general rule which splits risk may work to the detriment of the buyer as he will in effect carry the risk for the entire journey. The exception to the general rule, placing the risk on the buyer retroactively to the time when the goods were first handed over to the carrier, avoids the splitting of transit risk and is justified by the difficulty of pinpointing when damage occurred and also by the fact that insurance policies are generally transferred to the buyer. However, the buyer is still saddled with the risk of the goods to a time when the goods were not under his control, and even to a time before he concluded the contract of sale, which deviates from the assumption of control.

Given the considerations of efficiency and insurance costs reduction, it can be argued that a rule of law that places the burden on the buyer for the entire journey is counterproductive and does not lower transaction costs. It may be true that the risk is not split, but it is now placed on the buyer who cannot insure as efficiently as the seller for the period when the goods are not under his control. Goodfriend[188] argues that it makes more sense for the seller to maintain blanket insurance policies than for the buyer to purchase individual policies for each shipment. It is his argument that the Convention's rules are primarily based on the assumption that the buyer is in the better position to assert insurance claims, but that this consideration is not properly weighed up against the seller's ability to insure the goods more efficiently. In the case of a CIF contract, the seller typically purchases blanket insurance coverage on behalf of the buyer. This is an indication that commercial practice is in favour of the seller taking out insurance despite the fact that the risk is transferred to the buyer.[189]

[188] 1984 (22) *Colum J Trans L* 575 nn 35, 56.
[189] See, however, 3 2 1 *supra* for criticism against the idea of placing the transit risk on the seller. This is contrary to commercial practice, even in cases where the seller is to take out insurance.

To protect the buyer in circumstances involving trans-shipment coupled with inland carriage, Goodfriend[190] concludes that a separate provision is needed which covers containerised cargo by means of a special rule. Although a separate provision for containerised goods may provide a viable solution, it will not provide the most efficient solution in the context of a unified risk rule. It should be borne in mind that the risk rule should be clear, simple and not unnecessarily complex.[191] To extend the definition for "first carrier" to include the seller's own vehicles might present a further step towards preventing the splitting of transit risk. However, it will still not provide a solution to all the problems connected to containerised goods. In the circumstances it will be best for international traders who ship cargo in containers to provide special contractual provisions that avoid the splitting of transit risks in cases where the goods are handed over by the seller's trucks to the independent carrier at an intermediate point or at a specific place as indicated by the contract.[192] It is, therefore, in the buyer's best interest to make an explicit contractual arrangement for the risk to pass on receipt of the goods at the port of destination and not at an earlier point in time,[193] unless the goods can be effectively insured for the course of the journey and the insurance policy transferred to the end buyer.

From a policy perspective it is important that the Convention's rules should be consistent with current trade practices. One criticism of ULIS was that, in resolving the differences between national laws, too little attention was paid to commercial practices.[194] A crucial test for the Convention's risk rules, therefore, is to establish whether they allocate the risk of damage and loss in accordance with contemporary international trade practices. An evaluation on the basis of commercial practice should take note of the fact that when it comes to allocating the risk of accidental disaster to the goods, merchants have for centuries relied on trade terms to address the needs of commercial practice. Despite the unified risk rules of the CISG, trade terms still seem to dominate the legal position regarding the allocation of risk. The question is why do merchants prefer to make use of trade terms? Could that perhaps

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[190] 1984 (22) *Colum J Trans L* 594, 605.
[191] Honnold "Risk of Loss" in *International Sales* para 8 02 (1)(b) & (c) rejects an exception for high-technology goods on the same grounds. See also 3 2 1 *supra.*
[192] Goodfriend 1984 (22) *Colum J Trans L* 594. On 596 he advises parties to specify through standard trade terms which carrier will be considered the first carrier under the contract. INCOTERMS do not split risk and will avoid the problems that could occur in the context of article 67(1). However, this statement must be qualified. The discussion that follows will indicate that the traditional trade terms, such as FOB and CIF, may still cause the risk to split when they are used for containerised goods. See 5 6 *supra*. The most effective regulation of risk will therefore depend on the choice of the correct INCOTERM.
[193] Goodfriend 1984 (22) *Colum J Trans L* 588.
[194] Roth 1979 (27) *Am J Comp L* 293.

be an indication that the CISG's risk rules do not reflect the practices of international commercial practice adequately or effectively?

Scholars have attempted to compare or reconcile the CISG's risk provisions with that of INCOTERMS on a number of occasions.[195] The results of such comparative studies may be useful in evaluating the efficiency of the CISG risk rules at the hand of international trade usage. The point of departure of this study is that trade terms represent mercantile customs and usages and that INCOTERMS standardise these customs and usages to ensure certainty, clarity and predictability.[196] Because INCOTERMS reflect the most common commercial practice in regard to delivery and its associated obligations, such as the passing of risk, they can be used as a yardstick for determining whether the Convention has succeeded in taking commercial practices into account when formulating its rules on risk.[197] If the CISG is to meet the needs of international trade, its risk rules should reflect commercial practices as represented by INCOTERMS.

The risk rules of the Convention and INCOTERMS contain several similarities.[198] The first one is their understanding of the notion of "risk". Under both, "risk" means any accidental loss or damage to the goods, caused by neither an act nor an omission of any of the parties. Furthermore, both refer to price risk, leaving out of the ambit of regulation the risk of non-performance. Both envisage different arrangements for different transport situations. To that extent the CISG risk rules "mirror" the INCOTERMS risk rules. Both sets of rules are modelled on the same underlying patterns of contracting, namely the division between shipment and delivery contracts. Because INCOTERMS had been in existence long before the time the deliberations on the content of the CISG took place, it is possible to conclude that the CISG risk rules were modelled on the basic structure of INCOTERMS. Moreover, with the

[195] De Vries 1982 (17) *Eur Trans L* 495, Oberman *Transfer of risk*; Ramberg "To What Extent do INCOTERMS 2000 Vary Articles 67(2), 68 and 69?" 2005-06 (25) *JL & Com* 219.
[196] See chs 1 & 5.
[197] De Vries 1982 (17) *Eur Trans L* 515.
[198] Gabriel "International Chamber of Commerce INCOTERMS 2000: A Guide to their Terms and Usages" 2001 *VJ* 44 states that "in some instances, absent express terms to the contrary, the equivalent of shipping terms could be gleaned from the default risk of loss provisions in the Convention." Reynolds *INCOTERMS for Americans: Fully Revised for Incoterms 2000* (1999) 13 mentions that "INCOTERMS 2000 closely tracks the UN CISG". However, Booysen *Principles of International Trade Law as a Monistic System* (2003) 601-602 is of the opinion that there is room for conflict between the provisions of the CISG and INCOTERMS, especially in so far as risk of loss of goods in transit is concerned. See also the discussion later on in this section for differences between the CISG risk rules and the traditional maritime trade terms.

exception of article 68 CISG, where risk passes from the time of conclusion of the contract, both instruments link the passing of risk to the transfer of physical control.[199]

Strong similarities exist between articles 67 and 69 CISG and the so-called "modern" INCOTERMS. It seems that the drafters of the Convention borrowed the basic notion of risk transferring on handing over the goods to a carrier from the modernised INCOTERMS. Under the modern trade terms, FCA, CPT and CIP, risk passes on delivery to "a carrier", which can be equated to the "first carrier" of article 67(1) CISG.[200] Finally, both instruments require previous identification of the goods to the contract[201] in order for the risk to pass to the buyer. Although this may lead to the splitting of risk when the goods are identified only after their transportation has started, it is said that it would hardly produce any problems in practice, since it is the dispatch of the notice identifying the goods that should be decisive and not the time when it reaches the buyer.[202] The CIF term, which is used for sales in transit, provides for the risk to pass as from shipment, which is largely similar to the retrospective passing of risk as envisaged by article 68.

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[199] Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 304-305 observes that there is a link between the passing of risk and the handing over of control in the risk rules of both the CISG and INCOTERMS. However, neither of them links the passing of risk to the *de facto* handing over of control. Under many of the INCOTERMS, the place of delivery is the same as the place where the goods are handed over in terms of art 67(1) CISG. However, in the case of some INCOTERMS delivery does not occur at the same place where the seller must perform his delivery obligation under the CISG. In the case of the FOB and CIF terms, delivery takes place when the goods are physically placed on board the vehicle or vessel at a named place and not merely where they are handed to the first carrier. The EXW term is also an exception, since risk passes when the goods are put at the disposal of the buyer and not when they are physically taken over by the buyer. However, it could be argued that the act of placing the goods at the disposal of the buyer entails that the buyer is for all practical purposes placed in a position to take physical possession of the goods. He should therefore make sure that the goods are insured against risks if he is unable to take them over immediately. Whether INCOTERMS determine the place of performance of the seller's delivery obligations or whether they merely allocate risks and costs is a matter over which there is little agreement. Some judicial decisions have struggled with this aspect and held that contracts concluded on F- or C-terms are still regulated by art 31(a) CISG in so far as the delivery obligations are concerned. *Cf* CLOUT Case No 247 *supra*. This study, however, holds that INCOTERMS regulate both delivery and the passing of risk. Erauw is of the view that "delivery", as used in the context of the Convention, implies the delivery of conforming goods. Although this was the case under ULIS, this is not the case under the CISG. Delivery is regulated by art 31 and non-conformity as a separate obligation under art 35. Under the CISG, a seller performs his obligation to deliver even if he delivers non-conforming goods.

[200] Honnold "Risk of Loss" in *International Sales* para 8 02 (2)(a); Honnold *Uniform Law* para 368 1.

[201] Clause B5 INCOTERMS requires that the goods should be appropriated to the contract inasmuch as they should be "clearly set aside or otherwise identified as the contract goods." According to Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 305, INCOTERMS do not always require "the strict identification as mandated under CISG Article 67(2)."

[202] Art 37 CISG; Hager "Article 69" in *Schlechtriem-Schwenzer Commentary* para 10. This would be true if the notice is dispatched before shipment; in other cases, the risk could still be split, unless the risk passes with retrospective effect as from shipment. Moreover, there is little clarity on the situation regarding bulk sales, especially when only part of the bulk is lost or damaged. Ramberg 2005-06 (25) *JL & Com* 20 states that in the case of bulk sales, appropriation takes place by means of a bill of lading if the bulk is identified. Risk could, therefore, pass proportionally to each buyer before breaking bulk at the point of destination.

INCOTERMS define "carrier" as "any person who, in a contract of carriage, undertakes to perform or to procure the performance of transport by rail, road, sea, air, inland waterway or by a combination of such modes."[203] This definition is consistent with the understanding of "carrier" under the CISG.[204] The definition prevents the splitting of risk during transit in cases of containerised goods which are delivered to a container yard or inland terminal before being loaded onto the vessel at the port of shipment. If the goods are destroyed or damaged whilst in the terminal, the risk will be on the buyer. Policy considerations dictate that risk should be with the party that has the control or safekeeping of the goods, whether personal or through an agent.

There are nevertheless instances, such as the traditional maritime trade terms FOB, CIF and CFR, where it is far from clear which one of the CISG risk rules would regulate the situation. Under these INCOTERMS, risk passes when the goods pass the ship's rail at the place of loading; whilst under the CISG, in the absence of any specific place for delivery, risk may pass when the goods are handed over to the first carrier, which is not always the vessel but can also be an inland carrier. The moment that risk passes under the CISG is therefore "less well defined" as in the case of the FOB term.[205] "Crossing the ship's rail" as envisaged by the FOB term requires that the goods are to be loaded onto the vessel, whilst the obligation to "hand over" to a carrier could also be satisfied when the goods are handed to a warehouse or storage terminal operated by the carrier. Handling or stowage which is done within the confines of a carrier's facilities will therefore also be at the risk of the buyer, unless these operations are contracted out to a harbour authority. This is contrary to the mercantile customs on which the FOB term is based. [206]

Because the FOB term refers to a port of shipment, it is generally accepted that the term is in line with the second sentence of article 67(1). Under the second sentence

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[203] See the preamble to the FCA term. See also Van de Veire "Problems Related to the FCA Term" in Debattista (ed) *INCOTERMS in Practice* (1995) 119. This definition suggests that "carrier" not only refers to a person or enterprise actually performing the carriage, but also to a person or enterprise undertaking to perform or to procure the performance of carriage, such as a freight forwarder or a warehouse operator. See 6 4 1 *supra* for the debate on whether a freight forwarder should be included as a "carrier" in art 67.

[204] Honnold "Uniform Law and Uniform Trade Terms – Two Approaches to a Common Goal" in Horn & Schmitthoff (eds) *The Transnational Law of International Commercial Transactions II* 161 167.

[205] Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 305, 307. See also Bridge 2007 (37) *Hong Kong LJ* 38. By choosing an INCOTERM, the parties exclude the CISG's provisions on risk and thereby alter the point of "handing over". See 7 3 infra for a discussion on the extent that the INCOTERM displaces the CISG risk rules.

[206] However, this does not mean that the FOB term is without uncertainties of its own. The discussion of the term 5 5 1 *supra* showed that it is not clear precisely when risk passes during the loading process, more so in the case of an FOB variant such as FOBST.

of article 67, risk will only pass when the goods are handed over to the carrier at the agreed upon port of shipment. Delivery on board the vessel at the agreed port, as required by the FOB term, will equate to handing over the goods at a particular place.[207] Some commentators, however, suggest that paragraph 2 is not to be equated to the FOB term, at least not in the case of a so-called "strict" FOB term,[208] since article 67 only provides for the passing of risk where the seller arranges the transportation of the goods.[209] Such an interpretation would, however, be applicable in the case of the "classic" or "additional services" variants of the FOB term where the seller arranges the carriage on behalf of the buyer. However, where the buyer is to nominate the ship and fails to do so, it is generally accepted that the risk remains on the seller.[210] It has been suggested that article 69(2) may be relied on when the buyer fails to nominate the ship and that the risk is to transfer to the buyer.[211] INCOTERMS present a similar solution in clause B5 of the FOB term. Where the buyer fails to give notice of the vessel name, loading point and required delivery time, the buyer must bear all risks of loss and damage to the goods from the expiry of the agreed period for delivery.

Further problems may occur where a range of ports is agreed upon. This is done when earliest shipment is wanted but the carrier has not yet decided at which ports the next vessel is to call. In these cases, identification of the "particular place" is dependent on the volume of the cargo tendered at the various ports within the relative range. The choice of port can also be left to the seller who may decide on a port which is the most convenient to him or his inland carrier. This could, therefore, be interpreted that no "particular" place was indicated at the conclusion of the contract[212] and that the risk passes when the goods are handed to the first carrier

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[207] Valioti *Passing of Risk* text following n 256; De Vries 1982 (17) *Eur Trans L* 503, 519-520; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 288. For a detailed comparative analysis, see Feltham "CIF and FOB Contracts and the Vienna Convention on Contracts for the International Sale of Goods" 1991 *JBL* 413 422-425. Enderlein & Maskow *International Sales Law* 266-267, 277 para 6 do not agree with this interpretation. Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 6 is of the opinion that this interpretation is not the result of art 67(1) sentence 2, but because of the agreed term itself by virtue of arts 6 and 9 CISG.

[208] Under the strict FOB term, carriage is to be arranged by the buyer. See 2 2 1 1 (i) *supra.*

[209] The discussion of the phrase "if the contract of sale involves carriage" 6 4 1 *supra* indicated that art 67 should only apply where the seller is authorised to arrange and conclude the contract of carriage. This is, however, a controversial issue.

[210] Roth 1979 (27) *Am J Comp L* 308; Sevón *Passing of Risk* 200-201. Where the buyer is to give instructions to the seller on the port of shipment and provides that information subsequent to the conclusion of the contract, Von Hoffmann "Passing of Risk" in *International Sale of Goods* 288 asserts that risk will pass when the goods are handed to the first carrier, and not to the carrier at a specific place, as such place was not provided for at the conclusion of the contract. See also De Vries 1982 (17) *Eur Trans L* 503.

[211] See n 103 *supra.*

[212] The phrase "in accordance with the contract of sale" envisages that the contract would indicate the means of transport and the route for transmission of the goods to the buyer. In UNCITRAL Case No 176

and not at the particular place.[213] This interpretation does not accord with the mercantile customs on which the FOB term is based, namely that risk passes when the goods pass the ship's rail in the port of shipment. Sellers under FOB terms may also deliver the goods at inland collecting points of dispatch where the carrier collects them as a service to the shipper and not at the "agreed port of shipment". In these instances, a strict construction based on article 67(1) would mean that the risk would never pass to the buyer since the goods were never handed over at the agreed port.[214]

Problems of equation with the Convention's risk provisions also occur in the context of the FAS ("free alongside ship … named port of shipment") term. At first glance it seems that article 67(1) second sentence would reflect FAS contracts, where risk passes when the seller places the goods alongside the ship nominated by the buyer on the wharf or in the lighters "in the manner customary at the port".[215] The buyer is the one who should take over the goods and load them on board the vessel.[216] The responsibility of placing the goods alongside the vessel resembles the act of handing over the goods at a "particular place". However, Article 67(1) second sentence differs slightly from that of the mercantile custom reflected by the FAS term. The FAS term provides that the risk passes when the goods have been placed alongside the vessel in the manner that is customary in that particular port.[217] Article 67, on the other hand, causes the risk to pass when the goods are handed to the carrier at the particular place, and not when they are merely placed at his disposal. The Convention presumes that delivery is only valid if the goods are taken over by the

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(Supreme Court Austria 6 February 1996 – *propane* case) http://cisgw3.law.pace.edu/cases/960206a3.html (accessed 12-05-2009), the seller failed to name the port of shipment in an FOB contract, resulting in the buyer never opening a letter of credit. The court held that, as a result of the seller's failure, the goods were never delivered.

[213] De Vries 1982 (17) *Eur Trans L* 506-507 ; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 288-289.

[214] De Vries 1982 (17) *Eur Trans L* 520. However, it should be borne in mind that this "problem" is not caused by the CISG's risk rule but by the parties' ignorance of the correct trade term. If the goods are to be delivered to an inland point and not to the ship as such, the FCA term should be used instead of the FOB term. See 5 6 *supra*.

[215] Clauses A4 and A5 INCOTERMS 2000.

[216] FAS differs from the traditional FOB term inasmuch as delivery takes place when the goods are placed alongside the vessel at the named port of shipment and not when they cross the ship's rail. The advantage of this term is that the parties are not confronted with the problems connected to passing the rail. This term can be used as an alternative to FOB, especially where goods are not loaded directly onto or into the ship. Under FAS, the loading procedure is for the buyer's risk so that the seller is absolved from any liability if the goods suffer any damage while loaded.

[217] What is meant by "delivered alongside the ship" most often depends on the custom of the port. If the custom is that the goods should be so near the ship as to be capable of being lifted onto the ship by the ship's own tackle, it could mean that the seller has not fulfilled his A4 obligation to deliver if that is not the case, and then risk will also not pass. See Rapatout "Transport procedures and techniques" in Ramberg et al (eds) *INCOTERMS 2000: A forum of experts* (2000) 40-41.

other party, which presupposes that delivery is always a bilateral act.[218] Whether the FAS term can be equated to article 67(1) second sentence will ultimately depend on the customs of the port. If such customs do not envisage the buyer taking control immediately, as in the case where the goods are handed to the carrier, it could be that the term may at times be closer to article 69(2), where the risk passes when the goods are placed at the buyer's disposal and he is aware of that. Another argument in favour of such a construction is that article 67 requires carriage to be arranged by the seller. Under the FAS term, there is no obligation on the seller to arrange for carriage of the goods. Additional aspects that have been pointed out as problematic in the context of article 67(1) and the FOB term, provide problems in the context of the FAS term as well, and will not be repeated here.

In the case of a CIF contract, the situation seems to be even more complicated as the acronym relates to the destination port rather than the port of shipment. For example, if one is to interpret "CIF buyer's city"[219] by means of article 67(1) second sentence, it would suggest that risk should not pass to the buyer until the goods are handed over at the buyer's city. Such an interpretation would be totally in conflict with the universal understanding of the CIF term, namely that risk passes at the place of shipment.[220] Irrespective of the fact that the CIF term refers to a "named place of destination," such as the buyer's city, the term remains a shipment term and the risk, therefore, passes when the goods cross the ship's rail.[221] The rationale for this lies in the fact that the price paid by the buyer includes the cost of insurance, which shows that the parties intended to place the transit risk on the buyer. The reference to the buyer's city, therefore does not denote a place of delivery for purposes of the passing of risk, but is an indication that the costs for insurance and freight is to be carried by the seller up to that point.

Under a CIF contract the seller is obliged to contract for the carriage of the goods and to deliver the goods on board the vessel selected by him. Where the contract

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[218] De Vries 1982 (17) *Eur Trans L* 518-519; Valioti *Passing of Risk* text accompanying n 254. Oberman *Transfer of risk* text accompanying n 287 suggests that under article 67, risk will only pass at the end of the "handing over" process.

[219] Under INCOTERMS 2000, the CIF term should indicate the named place of destination and not the place of shipment.

[220] Farnsworth "Review of Standard Forms or Terms Under the Vienna Convention 1988 (21) *Cornell Int'l LJ* 439 445.

[221] Ramberg "Why revise INCOTERMS?" in Ramberg et al (eds) *INCOTERMS 2000: A forum of experts* (2000) 22. Also see Berman & Ladd "Risk of Loss or Damage in Documentary Transactions under the Convention on the International Sale of Goods" 1988 (21) *Cornell Int LJ* 423 428, who point out that the legislative history of art 67(1) shows that this term does not refer to a place of destination but to an intermediate point in the shipment of the goods to its final destination.

indicates the place of shipment,[222] it would render the second sentence applicable. The problem, however, comes in when the contract does not refer to the place of shipment. Because the CIF term does not mention a place of delivery, the seller is not required to hand the goods over at a "particular place"; thus, making the Convention's article 67(1) first sentence the most compatible provision for the passing of risk.[223] However, this interpretation does not accord with commercial practice which determines that risk passes when the goods cross the ship's rail at the port of shipment.[224]

Bridge[225] argues that article 67(1) is "wholly inappropriate" for purposes of the CIF term. Since the seller is responsible for the contract of carriage, delivery of the goods to the carrier merely constitutes delivery in terms of the contract of carriage and does not constitute delivery of the goods to the buyer. The seller is only required to deliver the shipping documents relating to the goods and not the goods themselves. On that basis, he concludes that "it is hard to see why this event should trigger the transfer of any risk relating to the goods themselves." Bridge's conclusion needs some qualification. Although article 67(1) might be inappropriate for defining the CIF term, the basis for his conclusion is flawed. It is agreed that the CIF term is mostly used in the context of documentary sales where goods are sold in transit and, hence, cannot be handed to the buyer physically. However, mercantile custom still holds that risk passes as from shipment. Bridge himself states that, in the case of a CIF sale, risk is to pass when the goods are handed across the ship's rail. It would thus be more appropriate to conclude that article 67(1) is not to be equated to a CIF contract

[222] De Vries 1982 (17) *Eur Trans L* 505 n 15, however, holds that the drafters of the Convention did not realise that, as a rule, CIF terms do not include an agreement on the port of shipment. See also Roth 1979 (27) *Am J Comp L* 296-297; *Secretariat Commentary on Draft article 79* paras 6 -7.

[223] De Vries 1982 (17) *Eur Trans L* 521; Valioti *Passing of Risk* text following n 252; Oberman *Transfer of risk* text following n 321. In CLOUT case No 253 *supra*, a Swiss Appellate Court held that where the parties agreed on a CIF clause, the transfer of risk to the buyer occurred with the delivery of the identified goods to the carrier. The ambiguities relating to the notion of "first carrier" may also have an influence here. See 6 4 1 *supra* for the discussion on what may constitute a first carrier. Feltham 1991 *JBL* 417 argues that in the context of the CIF term, "first carrier" may include an independent land carrier, and that delivery to such a carrier may therefore constitute delivery for purposes of the CIF term. See also Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 90; De Vries 1982 (17) *Eur Trans L* 503-505. Bridge 2007 (37) *Hong Kong LJ* 38 points out that a CIF contract does not necessarily require the seller to ship from a particular port. He may even have a choice between a range of ports.

[224] Hellner "The Vienna Convention and Standard Form Contracts" in *International Sale of Goods* 343-344 holds that, according to international usage, goods sold on a CIF term are only delivered when they are loaded onto the ship. This view goes somewhat further than handing the goods over the ship's rail. See 2 2 1 1 (i) & (ii) *supra* for a discussion on the uncertainties surrounding the precise point where delivery is to take place under FOB and CIF contracts.

[225] "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 91. See also Berman & Ladd 1988 (21) *Cornell Int'l LJ* 424, 427-431, who are of the opinion that the Convention reaches solutions that are essentially opposed to those reached under trade terms commonly used in documentary sales.

inasmuch as the notion of handing over to a carrier is less defined than the notion of crossing the ship's rail.

The CFR (cost and freight … named port of destination) term is applicable to the same situations as those that apply to the CIF term, namely transportation by sea or by inland waterways. As with the CIF term, risk also passes when the goods pass the ship's rail. The only difference is that the CFR term does not provide for insurance, while CIF does. The seller is responsible to contract for carriage and to pay for the loading and unloading of the goods. Article 67(1) first sentence is said to be the closest to this INCOTERM.[226] However, as is the case with the CIF term, this interpretation does not accord with commercial practice. The seller has to deliver the goods on board the vessel at the agreed port of shipment and not merely to the first independent carrier.

In practice, CFR or CIF are frequently used in documentary sales,[227] which means that the basic CISG rule for sales in transit is superseded by commercial practice which determines that the risk passes when the goods pass the ship's rail in the port of shipment.[228] Although the effect of these trade terms is the closest to the retrospective passing of risk as envisaged by the exception to article 68,[229] they still do not coincide in all respects. The exception to article 68 provides that risk passes when the goods are "handed over" to the carrier, which is not the same as "passing the ship's rail".[230]

Although the EXW term presents significant similarities to article 69(1),[231] there are some differences. Both provisions deal with cases where the seller is not obliged to have the goods transported to the buyer but the latter is bound to take over the

[226] Valioti *Passing of Risk* text accompanying n 251; Oberman *Transfer of risk* text accompanying nn 313-315.
[227] Especially in the international sale of commodities.
[228] Ramberg *Guide to INCOTERMS 2000* (1999) 23 suggests that the word "afloat" should be added to the trade term to describe the transaction accurately.
[229] Ramberg 2005-06 (25) *JL & Com* 221. Further problems arise from the requirement that the goods have to be identified, especially in the context of bulk sales of commodities.
[230] Bridge 2007 (37) *Hong Kong LJ* 39.
[231] See, however, CLOUT Case No 283 *supra*, where the German Appellate Court interpreted the clause "list price ex works" and found no inconsistency between the term and art 67(1) CISG. Due to the fact that only the CLOUT abstract is available, it is difficult to analyse the decision. This decision, however, is not to be supported, since the EXW term does not "involve" the carriage of goods. In this case, the seller was from Spain but the goods were produced in Japan. The court held that the risk passed to the buyer when the goods were taken over by a third-party carrier. The court separated the cost and risk obligations and ruled that the EXW term was to regulate the costs, whilst the passing of risk was to be regulated by art 67 CISG. Trade terms regulate both the division of costs and the passing of risk; hence this decision is not in line with the normal understanding and function of trade terms. This ruling shows that courts and tribunals are inconsistent in their regulation of aspects concerning the passing of risk.

goods at the seller's premises. The EXW term differs slightly from article 69(1). Under the EXW term, risk passes when the goods are placed at the disposal of the buyer. The Convention, however, provides that risk passes from a later point; that is when the buyer actually takes over the goods, and only when he commits a breach by not taking delivery in due time, the risk passes from the moment when they are placed at his disposal.[232] However, it should be noted that the Introduction to INCOTERMS 2000[233] states that where they use the expression "placing the goods at the disposal of the buyer", it is to have the same meaning as the phrase "handing over the goods" in the CISG. This could mean that risk is only to pass under the EXW INCOTERM when the goods are handed over to the buyer, as is envisaged by article 69(1) CISG.

Further problems might arise from article 67's failure to indicate when the seller's instructions or authorisation to hand the goods to a carrier should be given. Delivery instructions may be given subsequent to the conclusion of the contract. If a buyer in the case of an EXW sale subsequently instructs or authorises a seller to deliver to a carrier, and the seller agrees to that or simply acts on it, it could mean that the seller is in the language of the Convention now bound to hand the goods to the carrier and that article 67(1) and not article 69(1) applies. That would mean that risk passes when the goods are handed to the carrier and not when the goods are put at the disposal of the buyer for him to collect as is the commercial practice under EXW. This would not only extend the seller's obligations in respect of delivery, but it will also mean that the risk remains on the seller for longer than is envisaged by the commercial practice of EXW. Moreover, if the buyer is able to change the point that risk passes simply by means of his delivery instructions, the seller might end up without insurance cover for a period of time as he was unable to make appropriate insurance arrangements. The possibility of changing the point of risk by merely changing the modalities of taking the goods over conflicts with the policy considerations underlying international trade and violates commercial practices underlying trade terms. Once a trade term is agreed on, it is customary that the risk rule cannot be varied simply through the intervention of an independent carrier on the instruction of the buyer.[234]

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[232] Oberman *Transfer of risk* text accompanying nn 256-257; Valioti *Passing of Risk* text accompanying n 261; De Vries 1982 (17) *Eur Trans L* 516-517. The rationale is that a merchant seller is more likely to have insurance covering the goods still in its possession than a buyer is to have insurance covering incoming undelivered goods. Honnold "Uniform Law and Uniform Trade Terms in *Transnational Law II* 169 is of the opinion that the Convention's rule is preferable.

[233] The official rules 10.

[234] De Vries 1982 (17) *Eur Trans L* 503-504.

It is has also been said that the application of the so-called "modernised INCOTERMS," such as FCA ("free carrier … named place"), are consistent with article 67(1) second sentence.[235] Although this may be so in some cases, INCOTERMS 2000 regulate specific moments when delivery is completed in accordance with the named place of delivery. To that extent, the FCA INCOTERM is more nuanced than article 67 as it distinguishes between different transportation situations to reflect the customs in regard to the loading and unloading of goods. If the named place is the seller's premises, delivery is completed when the goods have been loaded on the means of transport provided by the carrier nominated by the buyer or another person acting on his behalf. This situation is closer to article 69(1) than article 67. If the named place is anywhere other than the seller's premises, delivery takes place when the goods are placed at the disposal of the carrier or another person nominated by the buyer or chosen by the seller on the seller's means of transport not unloaded. This situation, in turn, is closer to that envisaged by article 69(2). Clause A3 places no obligation on the seller to arrange for the carriage of the goods, which is an additional reason why the application of article 67 may not be consistent with the FCA INCOTERM. However, as is the case with the "classic" or "FOB additional services" terms, there is a possibility that the seller may contract for carriage on the buyer's behalf, in which instance the seller would be authorised to arrange for carriage as envisaged by art 67. However, article 67 will only be consistent with the FCA term in limited cases which do not fall under the situations described above. Once again, if no specific point was agreed within the named place and the seller is to choose the point, a "particular place" as required by the second sentence may be absent, and the first sentence would be more consistent with the understanding of the term.[236]

Although the content of the D-terms is more nuanced[237] than that of the CISG rule, they are generally consistent with article 69(2) inasmuch as risk passes when the goods are placed at the disposal of the buyer at a named place of destination.[238]

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[235] Oberman *Transfer of risk* text accompanying nn 238, 271; Honnold *Uniform Law* para 369 2 n 9; De Vries 1982 (17) *Eur Trans L* 525. These terms provide for situations where the seller is to hand over the goods to a carrier and the carriage is conducted by means of a multimodal transport carrier. According to De Vries, the FCA term does not reflect international usage as it has been designed by the ICC to address the problems connected to multi-modal transportation methods. The CPT and CIP terms are also consistent with the first sentence of art 67(1) CISG.

[236] INCOTERMS 2000 provide that, in instances where the buyer fails to provide any instructions on the delivery of the goods for carriage, the seller may deliver the goods "in such a manner as the transport mode and/or the quantity and/or nature of the goods may require."

[237] The main problem connected to delivery terms of this kind is whether it is the seller's or the buyer's responsibility to unload the goods from the carrier. The D-terms endeavour to regulate different scenarios in this regard.

### 6 5 4 Conclusion

The CISG risk rules are default rules that do not always accommodate mercantile customs and practices in such a way that they are clear and easily understood. The analysis has shown that the rules are drafted on the basis of different transportation situations and use exclusionary terms to differentiate between these situations. That makes the rules often complex and difficult to apply. Moreover, the rules entail uncertain and ambiguous terms which present a challenge for the uniform implementation of its content. A lack of clarity can also affect the efficiency of the rules. This can give rise to disputes and it might even result in the goods not being insured for a period of time during their transit whilst the parties are uncertain of who is to have the control over the goods.

An efficient international default risk rule should minimise transaction costs and reduce individual bargaining by placing the risk on the party who is in the best position to prevent avoidable losses.[239] For the most part, the CISG's risk rules link the burden of risk with control of the goods, which is consistent with the policy considerations underlying an efficient international risk rule. However, the analysis has indicated that in some instances, especially where containerised goods are concerned, the CISG risk rule results in the splitting of transit risk, which is inconsistent with the identified policy considerations.

A comparative analysis of trade terms commonly used in international sales and the CISG rules, found that the CISG risk rules are not in all respects consistent with international commercial practices. The traditional maritime trade terms (FOB, FAS, CIF and CFR) are more specific on the moment that risk transfers than article 67(1) CISG. Although the modernised INCOTERMS (FCA, CIP and CPT) are more consistent with the notion of "handing over" to a carrier, the CISG risk rule is less sophisticated than the FCA INCOTERM, which provides for different loading and unloading scenarios. It is, therefore, fair to conclude that in the majority of cases, the CISG rules are detached from commercial practice and fail to accommodate trade usages.[240]

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[238] Ramberg 2005-06 (25) *JL & Com* 221-222.
[239] 1993 (87) *Nw UL Rev* 1446.
[240] "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 105.

Because trade terms function as gap-fillers that accommodate mercantile custom, they are capable of regulating the allocation of risk in accordance with the practical needs of international sales. This result was foreseen by the drafters of the Convention and to that extent the CISG provides for party autonomy and mercantile custom to precede its provisions.[241] The next chapter will deal with the intricate interplay between trade terms and the CISG and the extent to which they can complement and supplement each other.

Although the CISG does not eliminate the need for the parties to solve questions relating to the passing of risk by reference to mercantile custom in the form of a trade term, it must be borne in mind that the Convention was the result of a diplomatic compromise. At the conference various solutions were tested; many of them without success, whilst others were never tested, and it is therefore uncertain whether they would have been favourably received if ever put onto the table.[242] If the Convention were clearer on some issues, many problems would have been resolved. However, the drafters of the Convention worked under pressure and were forced to reach a compromise solution, which was not always the best, but the most acceptable solution to most of the delegates. In the end, the main advantage of the CISG risk rule is not necessarily an improvement on other legal systems, but the elimination of the problems encountered in dealing with various foreign systems in the context of international sales.

[241] See Bridge 2007 (37) *Hong Kong LJ* 38-39, who indicates that standard form contracts in the commodity trade routinely exclude the CISG, especially when it comes to the rules on fundamental breach, cure and the passing of risk. He concludes that the CISG is not suitable for contracts dealing with commodities, but can be applied successfully in the context of manufactured goods. See also Bridge 2003 (15) *Pace Int'l L Rev* 51. For a critique on this view, see Singh & Leisinger 2008 (20) *Pace Int'l L Rev* 161.
[242] Sevón *Passing of Risk* 205-206.

# CHAPTER SEVEN
# THE INTERPLAY BETWEEN INCOTERMS AND THE CISG

## 7 1 Introduction

The analysis of the CISG risk rules in the previous chapter indicates that the Convention does not always address the needs of international sales effectively. Its provisions are formulated in uncertain terms which prevent a clear understanding of the rules and may give rise to divergent interpretations. Moreover, they do not always reflect the customs and usages of international trade in respect of the transfer of risk. Parties, therefore, supplement the Convention's rules with trade terms which take practical aspects into consideration. An analysis of the UNCITRAL Digest of Case Law[1] reveals that in twelve out of the twenty cases on articles 66-69 CISG, the parties agreed on a trade term. Scholars are of the view that the majority of international contracts of sale are concluded on the basis of a trade term.[2] It would, therefore, also be fair to assume that in the majority of contracts governed by the CISG, the parties have agreed on a trade term. This suggests some form of interaction between trade terms and the provisions of the CISG that regulate delivery[3] and the passing of risk.

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[1] *The UNCITRAL Case Digest of Case Law on the United Nations Convention on the International Sale of Goods* 2nd ed (2008) Ch IV Passing of Risk http://www.uncitral.org/pdf/english/clout/08-51939_Ebook.pdf (accessed 18-07-2009). Case law is also available through other databases, such as eg CLOUT, compiled by UNCITRAL (http://www.uncitral.org/uncitral/en/case_law; UNILEX, compiled by UNIDROIT (http://www.unilex.info); Pace Law compiled by the Pace University Law School (http://cisgw3.law.pace.edu) or CISG-online.ch (http://www.globalsaleslaw.orgcisg-online.ch). Generally, research on the case law of the CISG is hampered by language constraints. In most instances, one has to rely on case abstracts, case translations or case comments which do not always give a full and detailed account of the ruling, and more than often, fail to provide the full or the correct facts of a case.

[2] *The Secretariat Commentary to the 1978 Draft Convention Art 78* (draft counterpart of Art 66 CISG) http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-66.html (accessed 29-10-2009) para 3; Enderlein & Maskow *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods* (1992) 257; Lookofsky *Understanding the CISG: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods* 3rd ed (2008) 100-101; *Understanding the CISG in the USA: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods* (1995) 58. Bernstein & Lookofsky *Understanding the CISG in Europe: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods* (1997) 74; Hager "Article 67" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) para 2; Perales Viscassillas "Comments on the draft Digest relating to Articles 14-24 and 66-70" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 259 285; Goodfriend "After the Damage is Done: Risk of Loss Under the United Nations Convention on Contracts for the International Sale of Goods" 1984 (22) *Colum J Trans L* 575 578; Erauw "CISG Articles 66-70: The Risk of Loss and Passing It" 2005-06 (25) *JL & Com* 203 212; Erauw "Observations on passing of risk" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 292 301. On 292 he notes that contractual parties' preference for trade terms may explain the scarcity of case law on the passing of risk.

[3] Although this study focuses on the passing of risk, it is important to note that trade terms define the place of delivery and will supersede the Convention's rules on delivery as set out in art 31 CISG. See in

The purpose of this chapter is to investigate the interplay between INCOTERMS and the CISG's risk rules. A resort to the INCOTERMS definition of a trade term means that the issue of risk will be governed by it and not the risk provisions of the CISG.[4] But what happens where the parties did not explicitly agree on the use of INCOTERMS? In these instances the terms of the contract are to be interpreted.[5] Judges and arbitrators seem to be inconsistent in their approaches towards the interpretation of trade terms. Some fall back on the domestic law applicable to the contract and the understanding of the particular trade term in that context,[6] some purport to define trade terms by reconciling them to the CISG's provisions,[7] whilst others argue that trade terms constitute international trade usage under articles 9(1)[8] and 9(2) CISG[9] and should therefore be interpreted accordingly. Since INCOTERMS represent a codification of international trade usages and practices they may conceivably apply even in the absence of any express reference to them.

However, the interaction between INCOTERMS and the CISG reaches further than the question of applicability in the absence of agreement on the codification. Once it is concluded that INCOTERMS apply to a particular contract, it is still not clear to what extent they displace or derogate from the Convention's risk regime. The Convention provides supplementary gap-filling rules designed for cases where the

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general, the 2008 *UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods* Art 31 http://www.cisg.law.pace.edu/cisg/text/digest-art-31.htm (accessed 24-08-2009), especially paras 3 & 11 and the cases referred to there; Ramberg "To What Extent do INCOTERMS 2000 Vary Articles 67(2), 68 and 69?" 2005-06 (25) *JL & Com* 219. *Cf* also Gabriel "General provisions, obligations of the seller, and remedies for breach of contract by the seller" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 336 346-348; Garro "Cases, analyses and unresolved issues in Articles 25-34, 45-52" in Ferrari et al (eds) *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the UN Sales Convention* (2004) 362 372.

[4] Art 6 CISG provides that the parties can, by agreement, exclude or derogate from any of the provisions of the Convention. The extent to which INCOTERMS replace the CISG risk rule will be discussed in more detail later on. See 7 3 *infra*.

[5] Art 8 CISG provides rules for the interpretation of the parties' intent.

[6] Eg CLOUT Case No 317 (*Oberlandesgericht Karlsruhe* Appellate Court Germany 20 November 1992 – *frozen chicken* case) http://cisgw3.law.pace.edu/cases/921120g1.html (accessed 12-05-2009). See 7 2 2 *infra* for a discussion of the case.

[7] Eg CLOUT Case No 247 (*Audienca Provincial de Córdoba* [Appellate Court] Spain 31 October 1997 – steel profiles case) http://cisgw3.law.pace.edu/cases/971031s4.html (accessed 11-05-2009) and http://www.unilex.info/case.cfm?pid=1&do=case&id=315&step=Abstract (accessed 31-07-2009). See 7 2 2 *infra* for a discussion of this case.

[8] Eg *Xiamen Trade v Lian Zhong* (Xiamen Intermediate People's Court China 5 September 1994) http://cisgw3.law.pace.edu/cases/940905c1.html (accessed 23-07-2009) and http://www.unilex.info/case.cfm?pid=1&do=case&id=211&step=Abstract (accessed 31-07-2009). See 7 2 2 *infra*.

[9] Eg CLOUT Case No 447 (*St Paul Guardian Insurance Co et al v Neuromed Medical Systems & Support et al* 2002 WL 465312 (SD NY 2002), judgment aff'd, 53 Fed Appx 173 (2d Cir 2002), 2002 US Dist LEXIS 5096 (SDNY March 26 2002), United States Federal District Court New York 26 March 2002) http:/cisgw3.law.pace.edu/cases/020326u1.html (accessed 20-08-2009). See 7 2 2 *infra* for a discussion of the case.

contract itself does not provide otherwise.[10] By subjecting the contract to INCOTERMS, the parties derogate from the Convention's provisions on delivery and risk by means of agreement[11] or through trade usage.[12] But does this amount to an exclusion *in toto* or merely to a partial derogation? Moreover, in situations where the INCOTERMS are inadequate, in the sense that they do not provide for particular aspects, could they be supplemented by the CISG's rules and *vice versa*?[13] The investigation will determine whether the CISG can function in conjunction with INCOTERMS to the extent that they mutually complement and support one another.

## 7 2 Applicability of INCOTERMS to a contract governed by the CISG

### 7 2 1 General

This study has established that trade terms consist of usages which range from local usages in particular localities or trades to international customs and usages.[14] INCOTERMS, which endeavour to standardise these customs and usages are formulated by the International Chamber of Commerce, a body which has no legislative status. Unless incorporated into the municipal legislation of a country, INCOTERMS do not enjoy the status of a statutory instrument.[15] Their use depends on the voluntary acceptance by parties within relevant business circles[16] and automatic application seems to be out of the question.

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[10] Goodfriend 1984 (22) *Colum J Trans L* 578. All the provisions of the Convention are non-mandatory and can be replaced by party agreement The Convention allows the parties to derogate from any or to completely exclude the application of its provisions. See Art 6 CISG read together with Art 12 CISG.
[11] Art 6 CISG.
[12] Art 9 CISG.
[13] This study has already established that, due to their limited scope of regulation, INCOTERMS should function within and together with a legal regime that provides for instances beyond those they do not regulate. See 5 7 *supra*.
[14] See 1 3 4 & 5 1 *supra.*
[15] As is the case in Spain and Iraq. See Schmitthoff *International Trade Usages* Report published by the Institute of International Business Law and Practice ICC Publication No 440/4 (1987) para 39; Schmitthoff "The Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 224; Gabriel "International Chamber of Commerce INCOTERMS 2000: A Guide to Their Terms and Usages" 2001 (5) *VJ* 41 n 6. Dasser *INCOTERMS and the Lex Mercatoria: Applicability of INCOTERMS in the Absence of Express Party Consent* LL M thesis Harvard (1995) 51 adds Italy as an example.
[16] To enjoy success, their provisions must be responsive to a practical need in international trade, and be broadly acceptable to all parties concerned. See Rowe "The Contribution of the ICC to the Development of International Trade Law" in Horn & Schmitthoff (eds) *The Transnational Law of International Commercial Transactions II* 51 52.

The Introduction to INCOTERMS 2000[17] accordingly states that they have to be incorporated into the contract of sale by means of express reference in order that they may function as contract terms.[18] However, where there is no express agreement and a national jurisdiction only attributes a contractual character to a trade usage, the issue has to be addressed through contract interpretation.

If the parties have a longstanding business relationship and routinely made use of INCOTERMS to define the trade term used in their contract in the past, INCOTERMS could be inferred as part of the tacit consensus of the parties even if not expressly mentioned in a later transaction. Rules regarding the implication of unexpressed contract terms have over the years expanded to include policy considerations such as *bona fides*, *Treu und Glauben*, business efficacy, trade usage and customs of trade in determining the intentions of the parties to a contract.[19] Being a form of

[17] *ICC official rules for the interpretation of trade terms* Introduction para 4.

[18] Eg CLOUT Case No 104 (ICC international Court of Arbitration Case No 7197 of 1992 – *failure to open letter of credit and penalty clause* case) http://cisgw3.law.pace.edu/cases/937197i1.html (accessed 18-07-2009) and http://www.unilex.info/case.cfm?pid=1&do=case&id=37&step=Abstract (accessed 18-07-2009), where the parties agreed on "DAF (INCOTERMS 1980)"; High Arbitration Court (or Presidium of Supreme Arbitration Court) of the Russian Federation 25 December 1996: Information Letter 10 http://cisgw3.law.pace.edu/cases/961225r1.html (accessed 02-06-2009) - agreement on "CIF INCOTERMS 1990"; Russian Arbitration proceedings 220/1996 of 11 April 1997 http://cisgw3.law.pace.edu/cases/970411r1.html (accessed 02-06-2009) - agreement on "CPT INCOTERMS 1990"; Russian Arbitration proceedings 27/2001 of 24 January 2002 http://cisgw3.law.pace.edu/cisg/cases/020124r1.html (accessed 02-06-2009) - agreement on "CIP INCOTERMS 1990"; ICC Arbitration Case No 7645 of March 1995 - *crude metal* case http://cisgw3.law.pace.edu/cases/957645i1.html (accessed 23-07-2009) - agreement on "CNF FO (INCOTERMS 1990)". See also *Puerto Rico Core Inc v Tradex Petroleum Ltd* 782 F 2d 314 (2d Cir 1985), where the American court was willing to let INCOTERMS supersede the domestic law because the parties have expressly made that choice.

[19] The South African courts, for example, have expanded the so-called officious or imaginative bystander test to include an imputed intention. *Dicta* in *Techni-Pak Sales (Pty) Ltd v Hall* 1968 3 SA 231 (W) and *Van den Berg v Tenner* 1975 2 SA 268 (A) 277, as confirmed by the Supreme Court of Appeal in *Amalgamated Beverage Industries Ltd v Rand Vista Wholesalers* 2004 1 SA 538 (SCA) 540H/I-541A/B and *Greenfield Engineering (Pty) Ltd v NKR Construction* 1978 4 SA 901 (N), provide a few examples. Lubbe & Murray *Farlam & Hathaway – Contract: Cases, Materials and Commentary* 3rd ed (1988) 463 suggest that the interpretation of contracts should be approached as an "objective, normative approach, directed towards establishing the legal consequences of a transaction with reference not merely to the intention of the parties, but also in view of relevant considerations of legal policy." The solution does not always lie in "an all-out search for intention" but rather in an approach where the "gaps in the contractual intention be filled in a manner consistent with the terms of the agreement and in accordance with business efficacy and fairness." The *dictum* of Brand JA in *SA Forestry Co Ltd v York Timbers Ltd* 2005 3 SA 323 (SCA) 339I-J held that, since there is no *numerus clausus* of implied terms in South African law, the courts have the inherent power to develop new implied terms. In deciding whether a particular term should be implied, the courts are led by abstract values of justice, reasonableness and good faith that are underlying our law of contract. It is his view that a term can only be implied if it is considered to be good law, and not merely because it is reasonable, fair or just between the parties in a particular case. Once an implied term of general application is recognised, it is incorporated into all contracts; whilst if it is of specific application, it is implied into those specific contracts, unless specifically excluded by the parties. Similarly, German law applies the concept of *ergänzende Vertragsauslegung.* Sections 133, 157 and 242 BGB as well as section 346 HGB require that a contract should be interpreted with reference to *Treu und Glauben* and *Verkehrssitte*n. See Eisemann *INCOTERMS im internationalen Warenkaufsrecht - Wesen und Geldtungsgrund* (1967) 47-56. For a critique on Eisemann's opinion, see Renck *Der Einfluß der INCOTERMS 1990 auf das UN-Kaufrecht: Eine Untersuchung zu den rechtlichen Wirkungen der INCOTERMS 1990 im Recht des internationalen Warenkaufs* LL M thesis Hamburg (1995) 31-32 and

standardisation aimed at business efficacy and representing international trade usages, INCOTERMS can therefore find application as tacit[20] contractual terms which the parties would normally agree upon if they had applied their minds to it.[21]

Courts often use INCOTERMS as an "interpretative aid" which provides information on the possible intention of the parties and they, therefore, function as a subsidiary source of interpretation.[22] In a study conducted in 1987,[23] Schmitthoff found that courts often apply INCOTERMS even where the contract does not expressly refer to the compilation. In 1975, the German *Bundesgerichtshof* held that the FOB term should be interpreted in accordance with clause 4 of INCOTERMS even "*wenn das nicht ausdrücklich vereinbart ist*."[24] As far back as 1957, the Court of Appeal of München came to a similar conclusion.[25] Schmitthoff's investigation found that the same approach has been followed in Italy, Switzerland, (the former) Yugoslavia and Finland.[26] A subsequent, but more limited analysis by Dasser[27] of the case law of Germany and Austria, did not yield any conclusive results on the legal status of

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his own suggestions in respect of *Auslegungsregeln normativen Charakters* on 32 *et seq*. In English law, the courts are bound to look at the transaction as a whole, deriving the intention of the parties objectively from what they have said in the light of any surrounding circumstances and with due regard to commercial reasonableness and practice. The implied terms approach of English law also makes use of trade usages to establish the content of a contract. It seems that the courts will interpret the contract so as to provide business efficacy and will sometimes even imply an imputed intention on grounds of fairness and policy. See Eisemann "INCOTERMS and the British Export Trade" 1965 *JBL* 114 120; Basedow "The State's Private Law and the Economy – Commercial Law as an Amalgam of Public and Private Rule-Making" 2008 (56) *Am J Comp L* 703 706; Goode *Commercial Law* 3rd ed (2004) 13; Baker "Custom and Usage" in Lord Mackey of Clasfern (ed) *Halsbury's Laws of England XII(1)* 4th ed (1998) para 605. Under revised section 1-201 UCC (2001), American law defines "agreement" as "the bargain of the parties in fact as found in their language or inferred by other circumstances, including course of dealing or usage of trade as provided in Section 1-303." See also revised sections 1-103 & 1-303 UCC which sanction the use of courses of dealing, courses of performance and trade usages in the interpretation of contracts.

[20] Common law and civil systems usually refer to terms based on the tacit but unexpressed intention of the parties as "implied" terms.

[21] According to Schmitthoff *International Trade Usages* para 40, INCOTERMS then function as contractual trade usage.

[22] Erauw 2005-06 (25) *JL & Com* 213; Valioti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000* LL M thesis Kent (2003) http://cisg3.law.pace.edu/cisg/biblio/valioti.html (accessed 01-04-2009) text accompanying n 45. Dasser *INCOTERMS and the Lex Mercatoria* 76 points out that scholars who normally do not acknowledge the binding nature of INCOTERMS without their being incorporated into the contract, also recognise this function. Because of their wide acceptance in international trade, courts will resort to these definitions as *prima facie* evidence of what a specific term is supposed to mean.

[23] *International Trade Usages* para 48.

[24] BGH 18 June 1975, VIII ZR 34/74 NW 917. See also Basedow 2008 (56) *Am J Comp L* 709.

[25] OLG Münich, NJW 1957 426, AWD 1958 79. Many German jurists regard INCOTERMS as standard business conditions (*Allgemeine Geschäftsbedingungen*) regulated by the *Gesetz zur Regelung des Rechts der Allgemeine Geschäftsbedingungen* (*AGBG*). Such a construction is also dependent on party agreement. Renck *Der Einfluß der INCOTERMS* 28-31 discusses but, in the end, rejects such a construction. See also Piltz *INCOTERMS and the UN Convention on the International Sale of Goods* published paper contained in Semenov (ed) *CISG online 20 years conference* (24 April 2000) http://www.20jahre.cisg-library.org/piltz_intro.html (accessed 21-08-2009) Part II.

[26] Schmitthoff *International Trade Usages* para 48.

[27] *INCOTERMS and the Lex Mercatoria* 72-91.

INCOTERMS.[28] Other commentators, however, refer to court decisions in France and Germany for instances where INCOTERMS have been held to be trade usages in domestic law.[29]

What has to be established is whether INCOTERMS only apply when the parties to a contract have agreed on their application, or whether they are also capable of autonomous application in the absence of express or tacit agreement. The legal nature of INCOTERMS and the role that trade practices and usages play within the framework of the governing law of the contract provide some insight on this issue. The discussion will address this question in respect of transactions governed by the CISG.

### 7 2 2 Legal status of INCOTERMS in the context of the CISG

Where the parties have agreed on a trade term without reference to INCOTERMS, their intention has to be established by interpretation. Article 8 CISG provides general rules on the interpretation of statements made by the parties to the contract which permit reference to trade practices and usages. According to article 8(3) the intentions and statements of the parties should be interpreted by considering all circumstances, including their negotiations, any practices which the parties have established between themselves, trade usages and any subsequent conduct of the parties.[30] If they have used INCOTERMS in their previous transactions these terms will apply even though they were never expressly referred to subsequently. Application in this context amounts to tacit incorporation and is therefore still based on the will of the parties.

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[28] He refers to the debate amongst scholars on the legal nature of INCOTERMS and the reflection of such debate in judicial decisions and arbitral awards. His investigation, however, is inconclusive because it was difficult to find cases dealing with the "status" of INCOTERMS at that time and these cases did not provide much material for purposes of an analysis.

[29] Gabriel 2001 (5) *VJ* n 6; Spanogle 1997 (31) *Int'l L* 113; Folsom *International Business Transactions I* 114. De Ly *International Business Law and Lex Mercatoria* (1992) 174 refers to 2 ICC arbitral awards where INCOTERMS were also applied irrespective of any reference to them by the parties, eg ICC Case No 2438 Clunet (1976) 986 and ICC Case No 3894 Clunet (1978) 987.

[30] Pamboukis "The Concept and Function of Usages in the United Nations Convention on the International Sale of Goods" 2005-06 (25) *JL & Com* 107 108; Albán *Remarks on the Manner in which the UNIDROIT Principles May be Used to Interpret or Supplement CISG Article 9* (2004) http://cisgw3.law.pace.edu/cisg/text/anno-art-09.html (accessed 07-03-2009) text accompanying n 3; Bainbridge "Trade Usage in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions" 1984 (24) *Va Jnl Int'l L* 619 659; Schmidt-Kessel "Article 9" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) para 26.

Article 7(1) CISG requires that the Convention should be interpreted with regard to "its universal character and to the need to promote uniformity in its application and good faith in international trade." Scholars are not in agreement on whether these requirements merely refer to the interpretation of the Convention's provisions or whether they also extend to the content of the parties' agreement.[31] The Convention itself does not refer to trade terms[32] and the question is whether the CISG concerns itself with the interpretation of trade terms at all. Article 7(2) CISG provides for matters that are so-called "governed but not settled" by the CISG. Trade terms deal with aspects such as delivery and risk allocation that are governed by the provisions of the Convention, but the meaning of trade terms are not settled by its provisions. In these circumstances, a court or arbitral tribunal should be led by the general principles on which the Convention is based to determine the content and effect of a particular trade term.[33] Several courts have, for example, acknowledged the "prevalence of party autonomy"[34] as a general principle. Another important principle expressly enunciated in the Convention is that widely known and observed usages must be taken into account.[35] In relation to the passing of risk, the CISG's rules

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[31] Ferrari "Uniform Interpretation of the 1980 Uniform Sales Law 1994-95 (24) *Ga J Int'l Comp L* 183 209.

[32] Because trade terms are dynamic in nature and in need of regular revision, the drafters of the CISG realised that a Convention was not a suitable instrument for this need and, therefore, left the interpretation of trade terms to international instruments such as INCOTERMS. See Von Hoffmann "Passing of Risk in International Sales of Goods" in Sarcevic & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 265 296; Berman & Ladd "Risk of Loss or Damage in Documentary Transactions under the Convention on the International Sale of Goods" 1988 (21) *Cornell Int'l LJ* 423. ULIS, in art 9(3), provided explicitly for the interpretation of trade terms by their usual meanings. The absence of specific definitions in ULIS deprived the rules on risk of value and rendered the regulation of international sales incomplete, resulting in the very uncertainty that a uniform law was intended to avoid. See Roth "The Passing of Risk" 1979 (27) *Am J Comp L* 291 309-310. Comments by the Secretary-General of UNCITRAL, *Report by Secretary-General of UN Commission on International Trade Law* UN Doc A/7618, suggest that the authors of the Convention had the availability of INCOTERMS in mind when they decided to omit any reference to trade terms in the Convention.

[33] In interpreting a clause "CNF FO … Korea (INCOTERMS 1990)", the arbitral tribunal in ICC Court of Arbitration Case No 7645 (*crude metal* case) *supra* found that neither the contract nor INCOTERMS could provide any answers as INCOTERMS 1990 did not provide for such a trade term. It concluded that "the rules of the CISG and, in a subordinated way, rules of its underlying principles and, even in a more subordinated way, the rules of Austrian Law are determining for defining the mutual obligations of the parties based on their contract".

[34] Eg *NV AR v NV I* (*Hof Beroep* [Belgium Appellate Court] Gent 15 May 2002 (*design of radio phone* case) http://cisgw3.law.pace.edu/cases/020515b1.html (accessed 24-08-2009); *Rechtbank Koophandel* (District Court) Ieper Belgium 29 January 2001 (*cooling installations* case) http://cisgw3.law.pace.edu/cases/010129b1.html (accessed 24-09-2009); CLOUT Case No 432 (*Landgericht* [District Court] Stendal Germany 12 October 2000 - *granite rock* case) http://cisgw3.law.pace.edu/cases/001012g1.html (accessed 24-08-2009); CLOUT Case No 608 (*Al Palazzo Srl v Bernardaud di Limoges SA Tribunale di Rimini* [District Court Rimini] Italy 26 November 2002 http://cisgw3.law.pace.edu/cases/021126i3.html (accessed 24-08-2009). This principle is also reflected in art 6 CISG. Ferrari 1994-95 (24) *Ga J Int'l Comp L* 222-223 states that "some legal writers have inferred from this principle that the Convention plays a subsidiary role as it provides only for those cases which the parties neither contemplated nor foresaw." In cases of conflict between the principle of party autonomy and any other general principles, party autonomy will prevail. In the case of trade terms, party autonomy determines that mercantile custom prevails. If the parties agreed on an INCOTERM, the codification governs the meaning of the trade term.

[35] *Rechtbank Koophandel Ieper supra;* Ferrari 1994-95 (24) *Ga J Int'l Comp L* 223. *Cf* also Art 9 CISG.

generally reflect the principle that risk follows control of the goods.[36] Only in the absence of any general principle, guidance is to be sought in the domestic governing law of the contract as determined by the rules of private international law.[37]

Recent case law on the CISG shows that courts and arbitral tribunals more readily interpret trade terms with reference to INCOTERMS in the absence of any express reference to the compilation.[38] Despite the universal character of the Convention and the need to promote uniform sales law,[39] some courts, however, still reveal a so-called "homeward trend" in applying the interpretation of the domestic legal system.

This trend is displayed by the ruling of a German Court which had to interpret the meaning of the clause "free delivery, (*frei Haus*) duty-paid (*verzollt*), untaxed (*unversteuert*)," contained in a contract between a French seller and a German buyer for the sale of frozen chickens.[40] Despite the fact that the contract was governed by the CISG, the court held that the "free delivery" clause had to be interpreted with reference to German law since the clause was commonly known in German commerce, was drafted in German and the buyer was from Germany.[41] The court argued that the parties' agreement on the *frei Haus* clause meant an implied exclusion of article 31(a) by virtue of article 6 CISG.[42] Furthermore, the Court argued that the seller was prepared to take the risk of the transportation of the goods since he had concluded a contract to have the goods insured during their transportation. As additional evidence of such an intention, the court also considered the fact that on previous occasions in dealings between the same parties, the seller had carried

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[36] See 6 5 3 *supra*.

[37] Art 7(2) CISG; ICC Court of Arbitration Case No 7645 (*crude metal* case) *supra*. Folsom *International Business Transactions I* 2nd ed (2002) para 2 21 and Spanogle "INCOTERMS and UCC Article 2 – Conflicts and Confusions" 1997 (31) *Int'l L* 111 124-127 are of the view that after the terms on payment and inspection, which were contained in previous versions, were deleted from the 1980, 1990 and 2000 versions of INCOTERMS, it left certain gaps which are now to be filled by national law. However, because the general provisions of national law virtually have no provisions for the interpretation of commercial terms, the courts have to consult customs and usages of trade. These customs and usages, in turn, have to be proven by leading expert evidence. This can saddle users with the burden of proving their content, which is what they tried to avoid by incorporating INCOTERMS in the first place.

[38] See the discussion of the case law later on in this section.

[39] See art 7(1) CISG and the Preamble to the Convention.

[40] CLOUT Case No 317 (*frozen chicken* case) *supra.*

[41] The court relied on art 8(2) CISG to interpret the trade term in light of the meaning what a reasonable person of the same kind as the other party to the contract would have given to it.

[42] According to the UNILEX abstract http://www.unilex.info/case.cfm?pid=1&do=case&id=63&step=Abstract (accessed 21-08-2009), a *franco domicile* clause covers both the cost of delivery as well as the passing of risk. By using this term, the parties have implicitly derogated from both arts 31 and 67 CISG. The court interpreted the term with reference to the understanding that a reasonable man would have had in the same circumstances. Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* n 65, however, points out that the CLOUT abstract, referred to in the text above, is closer to the text of the decision in the original German. Therein the court only referred to the implied exclusion of art 31(1)(a) CISG.

certain goods for the buyer by means of its own transportation. However, in this case, the seller could not prove that the goods were delivered to the buyer and, therefore, the risk never passed.

This decision can be criticised on the following grounds.[43] That the seller had the goods insured and took responsibility for transport costs does not automatically mean that he is also in charge of delivery of the goods to the buyer's place of business and therefore also assumes the risk of damage or loss. INCOTERMS 2000 show that there is no natural correlation between contracting and paying for carriage and insurance on the one hand, and the passing of risk on the other. Under the CIF term, for instance, the seller is responsible for arranging the carriage and paying the costs of such carriage to the place of destination together with the costs of insurance. The risk of loss or damage, however, is transferred in the port of shipment when the goods cross the ship's rail.[44] The INCOTERM which most closely corresponds with "free delivery, duty-paid", namely DDP, has the same meaning as was attached to the contractual clause by the German court and would therefore have led to the same results. An interpretation with reference to the DDP INCOTERM, on the basis that it constitutes a usage of trade by virtue of articles 8(3), 9(1) or 9(2) CISG, would have been more correct.[45] Alternatively, seeing that the contract was governed by the

[43] See also Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 284-285.

[44] CLOUT Case No 191 (*Bedial SA v Paul Müggenburg & Co GmbH - Cámara Nacional de Apelaciones en lo Comercial* Argentina 31 October 1995 – *dehydrated mushroom* case) http://cisgw3.law.pace.edu/cases/951031a1.html (accessed 12-05-2009) is not clear on the effect of a C&F clause on risk. The court held that "a C&F clause does not affect the passing of the risk." This statement is open to different interpretations. It can either mean that the term does not regulate the passing of risk, or it can mean that it does not change the point where risk passes as envisaged by art 67(1) CISG. According to the CLOUT abstract, the buyer took out an insurance policy for transportation risks pursuant to the C&F term. Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 287 n 67 points out that the CLOUT abstract does not provide a correct account of the court's ruling. The court said that "the shipment of the goods means the delivery of the goods to the buyer and also the transfer of the property and from then on the risk of loss or damage is on the buyer." However, even if that is what the court said, it is still not clear whether the court linked the transfer of risk to the transfer of property or merely based its decision on trade usage. A translation of a case comment by Rosch (1997*) Dalloz Siry* 225 http://cisgw3.law.pace.edu/cases/951031a1.html (accessed 12.05.2009), however, sheds more light. According to this comment, the court of first instance held that under a C&F clause, the risk passes when the goods pass the ship's rail. The comment also states that INCOTERMS should prevail over the CISG by virtue of art 6. The UNILEX abstract http://www.unilex.info/case.cfm?pid=1&do=case&id=226&step=Abstract (accessed 21-08-2009) is instructive on what the court said. According to this account, risk passes when the goods are delivered to the first carrier by virtue of art 67(1) CISG. The C&F term does not change the CISG position on the passing of risk "which remained the time of loading aboard the ship." The court, furthermore, held that this was confirmed by the fact that the buyer took out insurance on the goods. The buyer was therefore aware that it assumed the risk of their loss during transportation. See also Garro "The UN Sales Convention in the Americas: Recent Developments" 1998 (17) *JL & Com* 219 238-242.

[45] It should be kept in mind that an interpretation of the *frei Haus* term in accordance with INCOTERMS could be problematic since the term does not really correspond with any of the INCOTERMS.

CISG, article 69(2) CISG which is consistent with the understanding of a *frei Haus* (*franco domicile*) clause, could have been applied.

The decision of a Spanish tribunal[46] reflects a better approach inasmuch as it does not rely on domestic law to interpret the meaning of an international trade term. An Italian seller and a Spanish buyer concluded a contract for the sale of cars to be shipped on a CFFO term. Since both parties were from contracting states, the contract was to be governed by the CISG. The steel from which the cars were made oxidised, resulting in the buyer alleging that the risk was on the seller since the damage occurred before the goods were loaded aboard the ship. It is not entirely clear whether the contract referred to INCOTERMS. The UNCITRAL abstract mentions that the contract of sale was agreed "in accordance with the current INCOTERMS", whilst the UNILEX abstract makes no mention of INCOTERMS. In its ruling, the court referred to both the CISG and INCOTERMS. The UNILEX abstract, furthermore, states that "the C.F.F.O. clause obliged the seller to pay all the expenses to be sustained for the shipment of the goods to destination, including the freight, but had no relevance for the matter of the passing of the risk."[47] Both abstracts, however, state that the seller's responsibility in accordance with articles 31 and 67 ended when the goods passed the ship's rail at the port of shipment. From that point onwards the risk was on the buyer, irrespective of whether it contracted for

[46] CLOUT Case No 247 (*steel profiles* case) *supra*.

[47] It can be inferred that the court considered the CFFO clause merely in connection with the regulation of costs. The *2008 UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods Art 66: Overview of Passage of Risk Provisions* 2nd ed (2008) http://cisgw3.law.pace.edu/cisg/text/anno-art-66.html (accessed 24-09-2009) para 6 cites this decision to show that not all trade terms address the issue of risk of loss or damage. The Digest cites other cases where trade terms are only used as price terms regulating the costs and not as terms that regulate the obligations of delivery and the passing of risk. CLOUT Case No 191 (*Bedial SA v Paul Müggenburg & Co GmbH*) *supra* is another example. However, it has been argued that the translation of the judgement could have given rise to such an interpretation. See n 44 *supra* for a discussion on the problems with this judgement. See also CLOUT Case No 283 (*Oberlandesgericht* [Appellate Court] Köln Germany 9 July 1997 – *video camera* case) http://cisgw3.law.pace.edu/cases/070709g3.html (accessed 12-05-2009), dealing with the term "list price ex works". In this case, the court held that "ex works" merely "served as a means to govern the share of the transport costs and not the passing of risk." The court proceeded to argue that art 67(1) CISG should allocate the risk of transportation if it was agreed that the place of performance should be at the place of business of the buyer. The case translation indicates that the court could not find that such an agreement was reached. The CLOUT abstract, on the other hand, states that the seller could not prove that delivery was made to the first carrier. It is submitted that art 69 would have been a more appropriate provision in light of the "ex works" clause. In regard to the "free delivery" or "franco domicile" term, the Danish Supreme Court in *Damstahl A/S v ATTISrl* (Supreme Court Denmark 15 February 2001) http://cisgw3.law.pace.edu/cases/010215d1.html (accessed 23-07-2009) held that, under Italian law, "a free delivered term in international sales contracts is usually interpreted as to apply solely to the allocation of the costs of transporting the goods." The court in ICC Arbitration Case No 7645 of March 1995 (*crude metal* case) *supra* is more correct when they held that the CNF FO" term (which is equivalent to the CFR term) does not merely function as a price term, but that it was the intention of the parties to incorporate all the aspects as embodied in the INCOTERMS.

the insurance of the goods. One commentator casts some light on this confusion.[48] She points out that the original Spanish text of the Appellate Court's judgement shows that the court held that the "CF" term was synonymous with the CFR INCOTERMS 1990, and that the seller therefore had to pay the costs of transportation of the goods to the port of destination, but that the risk had passed when the goods were delivered on board the vessel in the port of shipment. "FO" was held to be a condition for stowing the goods, namely that the carrier is relieved from any damage during the unloading operations. In addition, the court also relied on article 67 of the CISG to determine the moment when risk passed to the buyer. The court's approach is consistent with the Convention's aim of uniform interpretation in accordance with its international character.[49]

In some instances it is not clear whether the parties to the contract agreed on the use of INCOTERMS or whether the court or arbitral tribunal made use of INCOTERMS to define the agreed upon trade term. A German decision,[50] where the court had to interpret a DDP term, provides an example.[51] The German defendant had a longstanding relationship with a Danish company producing smoked salmon which the latter bought from the plaintiff, a Norwegian company. The processing company ran into financial difficulty and defaulted in paying for the salmon, whereafter the Norwegian company suggested that the German buyer placed its orders directly with it. The seller sent the buyer a confirmation order indicating that it would have the salmon delivered to a specified address other than the processing company's place of business. The buyer signed the confirmation order and returned it by fax. For

[48] Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 286 n 66.

[49] According to Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 286-288, the court's approach indicates that the risk provisions of the CISG were drafted in line with modern international commercial practices as embodied in the INCOTERMS. In n 71 she refers to awards by Spanish arbitral tribunals where they made use of INCOTERMS to interpret trade terms. In the case of *Sentencia Audencia Provincial Castellón* (Spain 12 January 2000), the tribunal had to interpret a CIP clause in a contract between a Spanish company and a French company. No mention was made of the CISG, but the trade term was interpreted in the light of INCOTERMS 1990. In an earlier case, another Spanish tribunal, *Audencia Provencial de Barcelona*, Spain 14 September 1994, followed the same line of thought in connection with a sales contract between a Swedish buyer and a Spanish seller, containing a clause "ex works". (The Pace Law, CLOUT, UNILEX or CISG-online databases contain no reference to these cases, which make them difficult to access.)

[50] CLOUT Case No 340 (*Oberlandesgericht* [Appellate court] *Oldenburg* Germany 22 September 1998 – *raw salmon* case) http://www.cisgw3.law.pace.edu/cases/980922g1.html (accessed 12-05-2009).

[51] See Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 300. The ruling of a Russian tribunal in Arbitration proceeding 99/1997 Russia 21 January 1998 http://cisgw3.law.pace.edu/cases/980121r.1.html (accessed 23-07-2009) provides another example of such an inconsistency. It was held that, in the case of a DDU (particular city) term, the seller's duty to clear the goods and to pay customs duty should be performed in accordance with INCOTERMS 1990. The decision is not entirely clear on the aspect of INCOTERMS. The case abstract, which is derived from an article by Saidov 2003 (1) *VJ* 1 27-28, creates the impression that the contract was concluded on the basis of an INCOTERM, whilst the translation of the judgement indicates that the court interpreted the DDU term with reference to INCOTERMS.

purposes of this dispute, the court found that there was a contract of sale between the Norwegian company and the German buyer. The translation of the ruling[52] shows that the court referred to the DDP term twice only. The first reference was in a fax embodying the confirmation order and which indicated the time for and place of delivery as being a cold storage depot in Denmark in accordance with the DDP INCOTERM.[53] The seller nevertheless still delivered the salmon to the processing company and because of the latter's bankruptcy, the salmon was never delivered to the buyer. The second reference was when the court held that although delivery was made to the wrong address, the seller had performed his delivery obligations, "even though the [seller] was obliged under the contract and INCOTERMS 'DDP' to deliver the goods at his cost and risk to the delivery address." The court was of the view that the salmon was ultimately destined for the processing company where it had to be smoked before delivery to the German buyer. The court held that the divergent delivery was firstly, insignificant in light of the aforementioned argument; and secondly, condoned by the buyer who never complained about it. The court concluded that the risk passed to the buyer by virtue of article 69(2) CISG when the seller delivered the salmon to the company.

The court's conclusion is questionable, especially in light of the DDP term's indication of a named place of destination. Delivery is to made to the specified place and that would also constitute the point where risk is to be transferred. A divergent delivery could not merely be "insignificant" as the court chose to argue. However, in an alternative argument, the court held that, even if the incorrect delivery had been a fundamental breach of contract, the buyer would not be entitled to have the contract avoided as he failed to do so within a reasonable time. Although this might be true, it still does not mean that the risk had passed to the buyer and that he was liable for the purchase price. The risk could only pass if the goods were delivered to the specified place, which never happened. The risk would therefore remain on the seller. Alternatively, it could be argued that this is a situation covered by the exception to article 66, namely that the seller failed to give the correct delivery instructions on the invoices and delivery orders and that the buyer is not liable for the purchase price on account of the seller's omission.

[52] Reference is made to the Queen Mary translation.
[53] This part of the ruling reads as follows: "The fax noted the time allowed for delivery (15-25 June), the delivery address, and the terms for delivery (INCOTERMS DDP)." Courts and arbitral tribunals sometimes use the term "INCOTERMS" rather "loosely", without real reference to the codification as such but merely to indicate that the parties have agreed on a trade term. It is, therefore, not entirely clear whether the parties agreed on the use of INCOTERMS or whether the court, or the translator for that matter, referred to the DDP term as an "INCOTERM".

In a case where the buyer failed to take delivery but subsequently came to an agreement with the seller to change the date for delivery, the Higher People's Court of China[54] found that the FOB delivery term should be interpreted with reference to INCOTERMS 2000. In this case, white corundum was sold FOB. Because of a delay in loading the goods, which was caused by the buyer changing the dates of loading on numerous occasions, part of the goods deteriorated due to exposure to sea breeze during their storage at the port. The court of first instance held that, in accordance with clause B5 of INCOTERMS 2000, the buyer should bear the risk of the goods. Conforming goods were delivered to the port, but owing to the buyer's failure to take delivery, they had to be stored. The buyer appealed, arguing that the seller's neglect during the packaging and transportation of the goods caused the deterioration. The Appellate Court agreed that the risk was for the seller's account as the risk would only pass when the goods crossed the ship's rail, which they never did. The seller failed to take proper care of the goods prior to their delivery and should therefore carry the risk of deterioration.

In the absence of any express reference to the codification, courts and arbitral tribunals often refer to INCOTERMS on the basis of them being consistent with and representative of international trade practices and usages. A Chinese court,[55] for example, held that where the parties had agreed on a trade term,[56] the case should be decided with reference to the Foreign Economic Contract Law of China, the CISG and international usage. Where goods were sold CFR Huangpu Port China, the China International Economic and Trade Arbitration Commission (CIETACC)[57] also ruled that INCOTERMS 1990 should be applied as international practices and customs.

A Spanish court[58] interpreted an "ex factory" clause in a contract between a Spanish seller and an American buyer for the sale of 1 500 tons of concentrated grape juice in the light of INCOTERMS 2000. In its judgement, the court referred to INCOTERMS

[54] *Xinsheng Trade Company v Shougang Nihong Metallurgic Products* (Higher People's Court of Ningxia Hui Autonomous Region China 27 November 2002) http://www.cisg.law.pace.edu/cisg/wais/db/cases2/021127c1.html (accessed 23-07-2009).
[55] *Xiamen Trade v Lian Zhong* supra.
[56] Neither a translation nor a CLOUT abstract is available. It is not clear which term was agreed upon. In its "Classification of Issues", the Pace Law reference indicates that the case deals with an FOB term, whilst the UNILEX abstract refers to a C&F FO term. According to Pamboukis 2005-06 (25) *JL & Com* 129, the parties agreed on an FOB term. Notwithstanding this factual discrepancy, the basic principle that the parties are bound by international trade usage remains.
[57] CIETAC Arbitration proceeding (*PVC suspension resin* case) China 7 April 1999 http://cisgw3/law/pace/edu/cases/990407c1.html (accessed 02-06-2009).
[58] CLOUT Case No 549 (*Cherubino Valsangiacomo SA v American Juice Import Inc* Appellate Court Valencia Spain 7 June 2003 http://cisgw3.law.pace.edu/cases/030607s4.html (accessed 02-06-2009).

as “the most common set of international trade rules that define the positions where the risks of the shipper, carrier and shipper’s agents begin and finish” and “a common and universal international trade language which results from international commercial practice”. Reference is also made to UNCITRAL’s recommendation regarding the use of INCOTERMS.[59] In this case, the buyer failed to collect the goods because of difficulties in opening a documentary credit. Being sensitive to the passing of time, the grape juice suffered some loss in colour as a result of the delay. The court held that, in accordance with INCOTERMS, the buyer assumed the risk of deterioration from the moment the goods were placed at his disposal at the seller’s facilities and he therefore had to carry the loss.

References to INCOTERMS as being consistent with international commercial usages and practices are also found outside the context of the passing of risk. In an arbitration award made by the Arbitration Tribunal of the Russian Federation Chamber of Commerce and Industry,[60] the tribunal took into account that the contract was concluded on CIF terms to determine the amount of loss in profit suffered by the buyer. Although the contract did not refer to INCOTERMS *per se*, the tribunal considered it reasonable to rely on INCOTERMS as “guidelines which reflect the practices of international trade.” The tribunal held that under a CIF contract the goods are insured for 110% of the contract price, where the additional 10% covers the expected profit.

In another case, the same arbitral tribunal[61] referred to INCOTERMS as “approaches acknowledged in the practice of international trade”. In this particular case the contract did not contain any instructions as to the basic terms of delivery of the goods. In establishing the content of the delivery obligations, the tribunal made reference to INCOTERMS 1990 and compared them to the contract terms and the conduct of the parties during their performances. It concluded that the performances of the parties were carried out in line with the CIF or CIP term. According to international trade practices the risk of loss of or damage to the goods passes on delivery of the goods to the carrier for transmission to the buyer.

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[59] See *Yearbook of the United Nations Commission on International Trade Law XXXI* (2000) para 434 www.uncitral.org/pdf/english/texts_endorsed/Endorsement_INCOTERMS2000_ISP98_URCB_e.pdf (accessed 08-08-2009) for their official endorsement of INCOTERMS 2000.

[60] Arbitration proceeding 406/1998 Russia 6 June 2000 http://cisgw3.law.pace.edu/cases/000606r1.html (accessed 02-06-2009).

[61] Arbitration proceeding 62/1998 Russia 30 December 1998 http://cisgw3.law.pace/edu/cases/981230r1.html (accessed 02-06-2009).

The CISG acknowledges the importance of international trade usages and practices. By virtue of article 9(1) the agreement of the parties to a contract may be determined with reference to contractual usages that they have agreed to[62] or practices which they have established between themselves as part of a course of dealing.[63] Courts and arbitral tribunals often rely on article 9(1) CISG as the basis for applying INCOTERMS to a contract. Where the parties clearly refer to them, INCOTERMS apply as "codified" trade usage which the parties have agreed to.[64] However, it is also possible that a trade usage, such as represented by a particular INCOTERM, can be relied on when a usage to this effect exists between the parties.[65] Although such a practice does not necessarily have to be widely known, a well established practice of contractual dealings involving more than one contract is required.[66] Even when the parties make no express reference to such usages they nevertheless are "embodied" in any given contract of sale as part of their implied agreement. Contract terms that arise from practices under article 9(1) prevail over the Convention by virtue of articles 6 and 8.[67] An analysis of the case law on the CISG shows that this approach has been followed by a number of courts and arbitral tribunals when dealing with the meaning of trade terms.

Where reference was made in a contract to "CIF INCOTERMS 1990", the High Arbitration Court of Russia[68] held that the parties had agreed to be bound by INCOTERMS, which represent usages of international trade. They, therefore, had to abide by these terms on the basis of art 9(1) CISG.

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[62] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 1. This may be an express or implied agreement. See also Bonell "Article 9" in Bianca-Bonell (eds) *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (1987) para 2 1 2.

[63] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 8; Bonell "Article 9" in *Bianca-Bonell Commentary* para 2 1 1. See also art 8(3) CISG for the interpretative role of trade usage.

[64] Erauw "Observations on the passing of risk" in *The Draft UNCITRAL Digest and Beyond* 304; Pamboukis 2005-06 (25) *JL & Com* 112; Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 6; Bonell "Article 9" in *Bianca-Bonell Commentary* para 2 3; Honnold *Uniform Law for International Sales under the 1980 United Nations Convention* 3rd ed (1999) paras 114 & 118. Honnold is of the view that widely-accepted commercial definitions can be supported "simply as an intelligent approach to interpretation of the contract without invoking the rules on 'usage' in Article 9." Where trade terms are not widely known and regularly applied in a particular trade, such usages become binding either through express or implied incorporation by means of art 9(1) CISG.

[65] Erauw 2005-06 (25) *JL & Com* 212.

[66] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 8. The course of conduct must have created a justified expectation that the parties will proceed accordingly in the future. Bonell "Article 9" in *Bianca-Bonell Commentary* para 2 1 1; Honnold *Uniform Law* para 116; Pamboukis 2005-06 (25) *JL & Com* 116-118.

[67] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 10; Bonell "Article 9" in *Bianca-Bonell Commentary* paras 1 3 1 & 2 1 2.

[68] Presidium of Supreme Arbitration Court of the Russian Federation 25 December 1996: Information Letter 10 *supra*.

Where a contract contained a reference to the term CFR[69] INCOTERMS 1990, the ICC Court of Arbitration[70] held that, in accordance with article 9(1) CISG, the parties are bound by any usage to which they have agreed. The tribunal concluded that the CFR INCOTERM became part of the agreement and should be taken into account in interpreting the wording of the contract.

The Commercial Court of Argentina[71] held that, even where there is no express reference to INCOTERMS but the agreed upon trade term is acknowledged by INCOTERMS, the INCOTERM will govern the contract by virtue of articles 9(1) and (2) CISG if it "does not clash with the rules and customs generally applicable to the corresponding transaction."

An Italian court of appeal[72] held that an FOB trade term is "binding *inter partes* as an international trade usage under Article 9 CISG." This statement should be read as a reference to article 9(1) CISG. In this case, an Italian seller sold oil to a Swiss buyer. During the loading operations the oil became contaminated with water. The contract contained an FOB term as well as an express reference to the National Iranian Oil Commission (NIOC) standard terms. The court held that under the FOB term and the NIOC terms the seller performed its obligation of delivery when the oil entered the ship's tanks. He, therefore, had to bear the risk of any loss of or damage to the oil that occurred before that moment.

Although trade usage takes precedence over dispositive law, most national systems apply trade usage to supplement the intention of the parties to a contract to the extent that they function as implied contractual terms.[73] The question remains whether INCOTERMS as a codification of international trade usages and customs can have application beyond the express or tacit (implied) intent of the parties.

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[69] The contract itself made reference to the term "CNF FO (INCOTERMS 1990). Since the codification did not provide for such a clause, the parties concurred that what they intended to refer to was a CFR term.

[70] ICC Arbitration Case No 7645 of March 1995 (*crude metal* case) *supra*. See 5 8 3 *supra* for a discussion of this case.

[71] *Arbatax SA Reorganization Proceeding* (*Juzgado Comercial Argentina* [Commercial Court] Buenos Aires 2 July 2003) http://cisgw3.law.pace.edu/cases/030702a1.html (accessed 19-05-2009).

[72] *Marc Rich & Co v Iritechna SpA* ([*Corte di Appelo di Genova*] Appellate Court Geneva Italy 24 March 1995) http://cisgw3.law.pace.edu/cases/950324i3.html (accessed 28-08-2009) and http://www.unilex.info/case.cfm?pid=1&do=case&id=198&step=Abstract (accessed 28-09-2009).

[73] See 4 3 1 *supra.* Trade usages act as gap-fillers where the default rules are inadequate or where the parties fail to make alternative arrangements. Because most parties expect trade usage to apply, it can lower transaction costs as it negates the need for contractual agreement. See Bainbridge 1984 (24) *Va Jnl Int'l L* 650-651.

Customs acquire a normative function when they meet certain stringent criteria.[74] The issue, therefore, is whether trade usage can have normative value in that they can be implied by the law independently of the intention of the parties.

By virtue of article 9(2) CISG the parties are considered to have impliedly made applicable to their contract usages which the parties knew[75] or ought to have known[76] and which are widely known in international trade and regularly observed in the particular trade concerned, unless the parties have agreed otherwise. Article 9(2) recognises the superiority of party agreement, but at the same time determines that trade usages will supersede other provisions of the Convention[77] if they meet the stated requirements. Trade usages are "rules of commerce which are regularly observed by those involved in a particular industry or marketplace."[78] A usage must be universally known, at least in the particular trade to which it applies.[79] It must also be known and observed by the majority of those involved in the particular industry or trade.[80] Inasmuch as a usage must be "widely known" and "regularly observed", it can be assumed to be part of the expectations of the parties. To that extent the requirements of article 9(2) are premised on the presumption of the implied intention of the parties.[81] However, where one or both of the parties to the contract had no knowledge of the usage but ought to have known of it, the question has to be asked

[74] Custom usually requires uniformity in substance, behaviour or application; constant repetition as well as public notoriety of the custom. See Albán *Remarks* text accompanying n 5.
[75] This phrase introduces the so-called "subjective" theory whereby usages may only be applicable if the parties have agreed to them. Usages unknown to either of the parties are not applicable.
[76] This phrase introduces the objective theory that accept usages as applicable to the contract even if unknown to one or both of the parties. Instead of the reasonableness criterion required under art 9(2) of ULIS, art 9(2) CISG uses an objective standard of knowledge which protects the expectation of a party on what the other party to that contract knows. This requirement could possibly confer an objective normative function to usage. Pamboukis 2005-06 (25) *JL & Com* 108-109 is of the view that art 9 reconciles the objective and the subjective theories.
[77] The precedence of trade usage is based on art 6 but also follows directly from the purpose of art 9. See Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 13; Pamboukis 2005-06 (25) *JL & Com* 109-113. CLOUT Case No 240 (*Oberstergerichtshof* [Supreme Court] Austria 15 October 1998 – *timber* case) http://cisgw3.law.pace.edu/cases/981015a3.html (accessed 21-08-2009). See also the 2008 *UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods* Art 9 http://www.cisg.law.pace.edu/cisg/text/digest-art-09.htm (accessed 24-08-2009) para 2 n 5 and the cases referred to there.
[78] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 11. Bonell "Article 9" in *Bianca-Bonell Commentary* para 3 2 points out that the Convention has chosen to refer to "usages" in the widest sense of the word and not to distinguish between customs, usages, *Handelsbräuche* and *Gewohnheitsrecht* as national laws tend to do. The aim of the Convention is to promote autonomous uniform law (art 7(1) CISG). See 4 3 1 *supra* for a discussion on the distinctions that apply in national laws.
[79] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* paras 16 & 18. This does not mean that the usage should be an international usage. Domestic usages will suffice if they are universally known and observed. See also Bonell "Article 9" in *Bianca-Bonell Commentary* paras 2 2 2-2 2 3; Honnold *Uniform Law* para 120 1.
[80] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 16.
[81] Pamboukis 2005-06 (25) *JL & Com* 118-119; Goldštaijn "Usages of Trade and Other Autonomous Rules of International According to the UN" in Sarcevic & Volken (eds) *International Sale of Goods: Dubrovnik Lectures (1980)* (1986) 55 97; Honnold *Uniform Law* paras 120 1 & 121.

whether it is not the law itself, rather than the implied agreement of the parties, that confers binding force on the usage.

Whether the CISG attributes a normative function to trade usages is controversial. Some scholars are of the view that article 9(2) grants a normative value to trade usages,[82] whilst others argue that in the scheme of the Convention trade usage can function merely as gap-fillers to supplement the intention of the parties where they failed to make alternative arrangements.[83] The applicable usage then "has the same effect as a contract" between the parties.[84] However, the supporters of the latter view admit that, by virtue of article 9(2) the parties to an international sales contract may be bound by specific trade usages, even in the absence of party agreement. Both requirements, namely the subjective element that the parties knew or ought to have known of the trade usage, as well as the objective element that the usage should be well known and regularly observed in international trade in that specific type of trade, should be satisfied. To that extent, the provision confers legal effect on the objective expectations of the parties.

One court, however, has construed article 9(2) differently by not limiting the applicable usages to the ones that meet the aforementioned requirements. An American court,[85] with reference to article 9, held that "the usages and practices of the parties or the industry are automatically incorporated into any agreement governed by the Convention, unless expressly excluded by the parties." This judgement seems to border on a normative approach.

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[82] Pamboukis 2005-06 (25) *JL & Com* 118-119. He finds support for his view from Bonell "Article 9" in *Bianca-Bonell Commentary* para 2 2 1, who is of the opinion that to explain its application on the basis of an implied agreement of the parties would amount to a legal fiction. This view is supported by the fact that the rule in art 9(2) is made subject to contrary agreement of the parties. If another interpretation is to be followed, this proviso would made little sense. Bout *Trade Usages: Article 9 of the Convention in Contracts for the International Sale of Goods* (1998) http://cisgw3.law/pace.edu/cisg/biblio/bout.html (accessed 12-10-2009) text accompanying n 23 agrees that the implied applicability of usage in the context of art 9(2) would merely boil down to a fictional consent. Albán *Remarks* n 2 acknowledges the controversial nature of normative usages. He is of the view that art 9(2) refers to international customs – " i.e., objective and international usages whose validity has not been made a pact by the parties in an expressed or tacit way" (Discussion accompanying nn 10 & 11). See also Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 290.

[83] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* paras 1 & 12, however, is of the view that art 9(2) merely establishes contract terms implied by usage. According to him art 9(2) envisages contract supplementation on the basis of a hypothetical intent. This intent is not a fictional intent but is in line with the objective approach to the determination of the parties' intent as set out in art 8(2) CISG. See also Bainbridge 1984 (24) *Va Jnl Int'l L* 659.

[84] Honnold *Uniform Law* para 122.

[85] CLOUT Case No 579 (*Geneva Pharmaceuticals Tech Corp v Barr Labs Inc* - United States Federal District Court New York 10 May 2002) http://cisgw3.law.edu/cases/020510u1.html (accessed 21-08-2009).

If a trade term represents a trade usage that the parties to the contract knew or ought to have known of and the usage is widely known in international trade and regularly observed by traders in that particular trade, such usage will prevail over the provisions of the Convention. INCOTERMS as a codification of international trade usages may therefore enjoy automatic application if they constitute "trade usage" as understood by article 9(2) CISG.[86] This view is reinforced by the case law on the CISG.[87] Rulings by the Tribunal of International Commercial Arbitration[88] and an Argentinean court[89] support this view. Courts in the United States, amongst them an important appellate court, have also relied on article 9(2) to imply INCOTERMS into a contract.

In 2002, the District Court of New York held that INCOTERMS constitute "usages" within the meaning of article 9(2) CISG and are incorporated into the CISG on that basis.[90] This case dealt with a CIF sale between a German seller and an American buyer of a mobile magnetic resonance imaging system, which was damaged whilst *en route*. The court observed that "the aim of INCOTERMS, which stand for international commercial terms, is to provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade," and "these terms are used to allocate the costs of freight and insurance in addition to designating the point in time when the risk of loss passes to the purchaser." The court concluded that pursuant to article 9(2) CISG, the CIF term was to be interpreted with reference to INCOTERMS 1990. The result was that the risk passed when the goods crossed the ship's rail in the port of shipment.

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[86] Honnold *Uniform Law* para 119; Perales Viscassillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 290. According to Bout *Trade Usages* para II F, INCOTERMS are so widely known and widespread in international trade, that it may be assumed that they are part of the expectations of the parties.

[87] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 26; Albán *Remarks* text accompanying n 16,

[88] Russian Federation Chamber of Commerce and Industry Arbitration Award No 406/1998 *supra.*

[89] CLOUT Case No 21 (*Juzgado Nacional de Primera Instancia en lo Comercial* No 7 Argentina 20 May 1991) http://www.unilex.info/case/cfm?pid=1&do=case&id=14&step=Abstract (accessed 21-08-2009). In an *obiter dictum*, the court stated that usages of international commerce have long been accepted in commercial jurisprudence. The FOB, C&F and CIF INCOTERMS are cited as examples of such usages. The court, furthermore, held that usages of international commerce are a source of law on the basis of art 9(2) CISG. This statement can be construed as to mean that art 9(2) usages, and for that matter INCOTERMS, have normative character. Note, however, that the court was incorrect in holding that a C&F term is an INCOTERM; though it has a meaning similar to the CFR INCOTERM. See also the ruling of the Commercial Court of Argentinia, *Arbatax SA Reorganization Proceeding supra*, where it was held that trade terms such as FOB, which are regulated by INCOTERMS, should be interpreted with reference to that codification. By virtue of art 9(2) CISG, INCOTERMS are impliedly made applicable to such contract, even in the absence of any agreement on their applicability.

[90] *St Paul Guardian Insurance v Neuromed Medical Systems supra.*

A similar ruling was made by the United States Court of Appeal in 2003.[91] The court held that "the CISG incorporates INCOTERMS through article 9(2)". The court stated that "[e]ven if the usage of INCOTERMS is not global, the fact that they are well known in international trade means that they are incorporated through Art. 9(2)." This case dealt with a CFR sale of unleaded gasoline from Texas to Ecuador. On arrival it transpired that the gum level of the gasoline exceeded the contractually specified limit, whereupon the buyer refused to take delivery and the seller was forced to sell the gasoline at a loss. Tests undertaken before shipment confirmed that the gum content was adequate before departure from Texas. The court held that under the CFR Incoterm, risk of loss and deterioration passed to the buyer once the goods passed the ship's rail at the port of shipment and that the buyer, therefore, had to carry the loss.

A Texas court[92] held that INCOTERMS are "the dominant source of definitions for the commercial delivery terms used by parties to international sales contracts". They are incorporated into the CISG through article 9(2) CISG. In this case, the seller and the buyer had a longstanding business relationship. They entered into a contract where the seller sold explosive boosters deliverable CIF Berwick Louisiana. The goods were later on found to be damaged due to improper stowage of the cargo, inadequate securing and heavy weather. According to INCOTERMS 1990 the risk of loss transfers to the buyer once the goods have passed the ship's rail at the port of shipment. Although the buyer faxed special instructions to the seller on how the goods had to be stowed, the court found that the seller never agreed to any additional obligations in regard to the stowage of the goods. The risk had therefore passed when conforming goods were handed to the carrier at the port of shipment.[93]

Because article 9(2) CISG not only requires a usage of which the parties "knew or ought to have known", but also one which is "regularly observed by parties to contracts of the type involved in the particular trade concerned", the absence of regular observance normally presents a problem for the application of INCOTERMS

[91] CLOUT Case No 575 (*BP Oil International v Empresa Estatal Petroleos De Ecuador* 332 F 3d 333 (5th Cir 2003) 338, 200 ALR Fed 771, Federal Appellate Court [5th Circuit] United States 11 June 2003) http://cisgw3.law.pace.edu/cases/030611u.html (accessed 21-08-2009).
[92] *China North Chemical Industries Corporation v Beston Chemical Corporation* WL 295396 (SD Tex 2006) (US Federal District Court Texas 7 February 2006) http://cisgw3.law.pace.edu/cases/060207u1.html (accessed 02-06-2009).
[93] If the seller had assumed the additional responsibilities of stowage, these facts might have given rise to the exception of art 66. See 6 3 *supra*.

on the basis of article 9(2).[94] Some scholars argue that INCOTERMS *in toto* are not widely known in every kind of trade and therefore cannot satisfy the requirements of article 9(2) CISG.[95] However, it should be pointed out that article 9(2) does not require that a usage should be internationally known and observed across the full spectrum of international trade for it to find automatic application.[96] Therefore, INCOTERMS will apply in those trades where they are indeed known and regularly observed.[97]

The United States Court of Appeal[98] held that, even though the use of INCOTERMS is not universal, they can be incorporated by virtue of article 9(2) CISG because they are well known in international trade. In support of its view, the court relied on the fact that courts in France and Germany have incorporated INCOTERMS into a contract on the basis of international trade usage or custom.[99] Further support is found in the UNCITRAL Secretariat's statement that INCOTERMS are widely-observed usages

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[94] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 26. See, however, *Geneva Pharmaceuticals Tech Corp v Barr Labs Inc* United States of America 10 May 2002 *supra*, where the court applied trade usage automatically without any further requirements.

[95] This is especially true for the less well known INCOTERMS. See Erauw "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 303; Honnold *Uniform Law* para 118. Renck *Der Einfluß der INCOTERMS 1990* 22-27 also doubts whether INCOTERMS as a whole would qualify as *Handelsbrauch* because there is not a longstanding and uniform practice of interpreting the more modern trade terms with reference to INCOTERMS. For an opinion to the contrary, see Said *Das Risiko der Erteilung von Exportgenehmigungen nach den INCOTERMS, verglichen mit dem BGB* LL D dissertation Trier (1993) 36, who concludes that INCOTERMS might qualify as *Handelsbrauch* but not as *Gewohnheitsrecht*.

[96] See the discussion *supra*, especially n 79. Domestic usages can also suffice as long as they are well known and regularly observed in the trade concerned. See CLOUT Case No 175 (*Oberlandesgericht* [Appellate Court] Graz Austria 9 November 1995 – *marble slabs* case) http://cisgw3.law.pace.edu/cases/951109a3.html (accessed 21-08-2009), where it was held that national usage should be taken into consideration by a foreign party who has been doing business in that country on a regular basis for many years and who has concluded several contracts of a similar nature in that country. In CLOUT Case No 240 (*Oberstergerichtshof* [Supreme Court] Austria 15 October 1998 – *timber* case), the court held that Austrian trade usages in the timber trade would prevail over the provisions of the CISG if they are widely known and regularly observed by parties to contracts in that specific branch of trade and in the geographic area where the party has his place of business. In CLOUT Case No 425 (Supreme Court Austria 21 March 2000 - *wood* case) http://cisgw3.law.pace.edu/cases/000321a3.html (accessed 21-08-2009), the court stated that a usage can only bind a party if he has his place of business in the geographical area where the usage is applicable or if he deals in that area on a regular basis. A usage is widely known and regularly observed if the majority of people doing business in the field recognise the usage.

[97] Bridge *The International Sale of Goods: Law and Practice* (1999) 69-70 states that INCOTERMS are often adopted in the oil trade, whilst they are not commonly used in contracts of dry cargo. Because they are well known and regularly observed in that trade, he is of the view that INCOTERMS might, by virtue of art 9(2), apply in the oil trade even in the absence of express agreement. In the case of dry cargo, though, they will only apply if expressly agreed on.

[98] *BP Oil International v Empresa Estatal Petroleos de Ecuador supra* confirms the *dictum* of the New York District Court in *St Paul Guardian* v *Neuromed supra.* This ruling was made by an important American appellate court, the 5th circuit. This court covers the states of Texas and Louisiana, where the important trade centres Houston, Dallas and New Orleans are located.

[99] Folsom *International Business Transactions I* 114 lends support to this statement. See also 7 2 1 *supra*.

for commercial terms which will replace the provisions of the Convention where applicable.[100]

Despite misgivings on whether INCOTERMS should qualify as international trade usage *in toto*,[101] most scholars agree that the older and more established trade terms, such as FOB and CIF, will qualify as article 9(2) trade usages as they represent commercial practice that goes back a long time.[102] They are widely known and respected and so may have acquired the status of autonomous international trade customs.[103] It should also be noted that the cases which have acknowledged INCOTERMS as article 9(2) trade usages only dealt with the best known and frequently-used trade terms. No cases are reported involving less known trade terms such as the D-terms or EXW. The interpretative results for those are accordingly still uncertain.[104] It is therefore impossible to conclude that all of the INCOTERMS satisfy the strict criteria required to qualify as article 9(2) usages.

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[100] *Report by the Secretary-General of the UN Commission on International Trade Law* UN Doc A/7618 paras 48-50, 57. It is also believed that the authors of the Convention had INCOTERMS in mind when they decided to omit any reference to trade terms in the Convention.

[101] Schmidt-Kessel "Article 9" in *Schlechtriem-Schwenzer Commentary* para 26. He concedes, however, that INCOTERMS may function as a "lasting 'dependable source' of international trade usages." Some commentators go so far as to reject the entire idea of INCOTERMS having an autonomous function. According to Gabriel 2001 (5) *VJ* 42-43, INCOTERMS are not considered part of international customary law. The intent of the parties to rely on INCOTERMS should, therefore, expressly be stated in the contract. Bridge "The Transfer of Risk under the UN Sales Conventions 1980 (CISG)" in Andersen & Schroeter (eds) *Sharing International Commercial Law across National Boundaries: Festchrift for Albert H Kritzer on the Occasion of his Eightieth Birthday* (2008) 77 90 believes that INCOTERMS have to be incorporated into the contract to find application, either through express or implied agreement as envisaged by art 6 CISG. It is his opinion that, in the absence of any incorporation, it is not settled whether INCOTERMS amount to an art 9 trade usage.

[102] Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 290; Basedow 2008 (56) *Am J Comp L* 709. Spanogle 1997 (31) *Int'l L* 113, however, seems not to distinguish between the established terms and the more modern INCOTERMS. He merely states that INCOTERMS "could be made an implicit term of the contract as part of international custom", which appears to be a blanket acknowledgement of their status as international trade usage.

[103] Rowe "The Contribution of the ICC" in *Transnational Law II* 53. De Ly *International Business Law* 174-175 is of the view that the more recent terms may not constitute international trade usage. The ICC created some of the more modern trade terms which affects their legal nature, as they would then not constitute international trade usage. He suggests that the territorial scope of INCOTERMS should also be taken into account in light of other trade term definitions which may prevail in the absence of party agreement, such as those in Article 2 UCC. This may change if the 2003 amendments are enacted, although it seems more and more likely that the revision will be withdrawn in the near future and that the statutory definitions will remain in force. However, it is submitted that in the context of international sales, especially where the CISG is the governing law, the American courts have shown that they will apply INCOTERMS even in the absence of party agreement and that this argument is therefore without substance.

[104] Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 291; Renck *Der Einfluß der INCOTERMS 1990* 19-22; Rowe "The Contribution of the ICC" in *Transnational Law II* 53. See also De Vries "The Passing of Risk in International Sales under the Vienna Sales Convention 1980 as compared with Traditional Trade Terms" 1982 (17) *Eur Trans L* 497 n 37, who notes that the CPT term is not known to all types of trade, whilst the content of the DDP term is unclear on duties, taxes and other costs. These terms, therefore, do not constitute international usages.

Although it is true that the cases dealing with INCOTERMS as normative trade usages involved well-known trade terms such as CIF and FOB, they referred to INCOTERMS *in toto* and not merely to a particular INCOTERM. Moreover, if it is customary in a particular trade to refer to INCOTERMS as a whole, the codification as such will be implied by law. Rules which are based on consistent business practice may gradually acquire the force of international custom if they are regularly observed over a long period of time in a certain sphere of trade. Therefore, the more commonly INCOTERMS are used in a specific trade or region, the greater the possibility that they should be followed as trade usage or mercantile custom, which are binding on the parties even if they did not know about them.[105] Basedow[106] is of the opinion that INCOTERMS, which were originally aimed at reconciling divergent international understandings of trade terms by means of a deliberate international compromise, have through their continuous use been gradually transformed into commercial custom over the course of one or two generations. Whether INCOTERMS can enjoy autonomous application independent of party agreement is, therefore, an issue which is largely dependent on the degree to which they are consistently recognised and applied by merchants in a particular trade.

### 7 3 Interaction between INCOTERMS and the CISG's rules on risk

The provisions of the CISG were drafted as default rules, which mean that the Convention places a high premium on the principle of party autonomy. Article 6 CISG grants parties the freedom to "derogate from or vary the effect of any of its

[105] Eisemann 1965 *JBL* 121-122; Dasser *INCOTERMS and the Lex Mercatoria* 71. Schmitthoff "The Law of International Trade" in Cheng (ed) *Clive M Schmitthoff's Select Essays on International Trade Law* (1988) 219 224 considers INCOTERMS one of the sources of the law of international trade. He distinguishes between 2 sources, namely international legislation and international commercial custom. The latter consists of commercial practices, usages or standards which have been formulated by international agencies such as the ICC. It is his view that international commercial custom has no autonomous application independent of the will of the parties and that it only functions as contractual trade usage. See also Schmitthoff *International Trade Usages* paras 40 & 48. In paras 52-57 & 62, however, he seems to express a slightly different view. Here he states that trade usages are capable of functioning as normative usages if they qualify as universal trade usages. INCOTERMS are "positioned on the borderline of normative and contractual trade usages" and may have crossed this border in some jurisdictions. Germany is mentioned as an example where this might have happened. He concludes that INCOTERMS' practical application is far more important than their legal qualification. INCOTERMS are used extensively in international trade by countries such as Germany, Austria, Finland, Sweden Switzerland, (the former) Yugoslavia, Ireland, and at the time of the publication of the report, which was almost twenty years ago, their use was already growing in the UK, USA and the Philippines. The observance of such usages in practice should be the important and decisive factor in determining their true character. Schmitthoff observes that in jurisdictions which only accord contractual character to INCOTERMS, many jurists consider them "an incipient normative usage [which] will assume this character fully in due course." Taking into consideration that this report was published in 1987, the normative character of INCOTERMS might even be fully established by now.

[106] 2008 (56) *Am J Comp L* 709-710.

provisions" or even to exclude the application of the CISG altogether by means of contractual agreement.[107] It is therefore permissible to depart from articles 66-70 CISG to varying degrees. Parties can either deviate from the effect of a particular rule or they can totally exclude a provision and replace it by their own regulation.

Once parties have agreed[108] on an INCOTERM, the entire definition of the term is drawn into the contract by incorporation on the basis of article 6 CISG.[109] However, there are differences in opinion on whether such an incorporation of INCOTERMS constitutes a total exclusion of the CISG risk rules or merely a partial deviation from such rules.

Erauw,[110] for instance, is of the view that by including an INCOTERM into a contract parties "opt out of some aspects of the rules on passing of risk". This implies a partial derogation from the risk provisions of the CISG. He also states that by so doing they "put the application of article 67 in doubt," which "makes the application of article 67 not straightforward at all." This statement casts uncertainty on the extent to which INCOTERMS will apply to a contract of sale. There is therefore a need to investigate the interplay between INCOTERMS and the CISG in more detail.

The majority of commentators on the CISG concur that express agreement on the incorporation of INCOTERMS will result in their definitions prevailing over the Convention's rules on delivery and the passing of risk.[111] However, this still does not establish whether INCOTERMS will displace the Convention's risk regime in its entirety or only in part. Is it still possible to resort to the CISG's risk provisions if the Incoterm is unclear or insufficient on a certain matter? In other words, is there any

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[107] Schlechtriem "Article 6" in Schlechtriem & Schwenzer (eds) *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed (2005) para 12; Bonell "Article 6" in *Bianca-Bonell Commentary* para 2 1; Honnold *Uniform Law* para 74.

[108] See the discussion 7 2 2 *supra* on express and implied incorporation of INCOTERMS in the context of the CISG.

[109] *The UNCITRAL Case Digest of Case Law* Ch IV Passing of Risk para 6; Goodfriend 1984 (22) *Colum J Trans L* 576; Lookofsky *Understanding the CISG in the USA* 58; Bernstein & Lookofsky *Understanding the CISG in Europe* 75; Lookofsky *Understanding the CISG* 100-101; Schlechtriem "Article 6" in *Schlechtriem-Schwenzer Commentary* para 12.

[110] Erauw (2005-06) 25 *JL & Com* 212; Erauw "Observations on Passing of Risk" in *The Draft UNCITRAL Digest and Beyond* 301.

[111] *The Secretariat Commentary to the 1978 Draft Convention Art 78* (draft counterpart of Art 66 CISG) http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-66.html (accessed 29-10-2008) para 3; Berman & Ladd 1988 (21) *Cornell Int'l LJ* 423-424, 430; Honnold *Uniform Law* para 363; Von Hoffmann "Passing of Risk" in *International Sale of Goods* 296; Lookofsky *Understanding the CISG in the USA* 58-59; Bernstein & Lookofsky *Understanding the CISG in Europe* 74-75; Lookofsky *Understanding the CISG* 101; Grewal "Risk of Loss in Goods Sold in Transit: A Comparative Study of the UN Convention on Contracts for the International Sale of Goods, the UCC and the British Sale of Goods Act" 1991 (14) *Loy LA Int'l & Comp LJ* 93 105.

case for parallel application and co-existence between the INCOTERMS and the CISG risk rule? Again, there is a difference in opinion.

The so-called "traditional" view is that the trade term replaces the CISG risk rules *in toto*.[112] The reasoning is that because INCOTERMS are so complete on the point of passing of risk, there is no need to supplement them with provisions from the CISG.[113] Berman and Ladd[114] even go so far as to state that trade terms may exclude the Convention as a whole. They argue that the Convention's risk rules are limited to sales contracts in which the parties have not used a trade term. It is their opinion that the CISG risk rules are so significantly different from the universal understanding of trade terms and documentary sales, that the use of a trade term may be construed as an implied exclusion of articles 66 to 70 of the Convention and possibly, also the entire Convention. After analysing the CISG's risk rules they conclude that article 66 only concerns sales in which the goods have been taken over by the buyer directly from the seller or have been handed by the seller directly to the buyer, whilst in practice most international sales are conducted as documentary sales. It is their argument that article 66 does not concern documentary sales or sales where the seller hands the goods to a carrier for transmission to the buyer. The reason stated for their opinion is that the universally accepted rules concerning the passing of risk under documentary sales do not discharge the buyer from payment of the purchase price against receipt of the documents if the goods are lost or damaged due to the seller's act or omission. In such an event the buyer only has a claim for damages against the seller. They also argue that article 67 is aimed at situations of trans-shipment from one carrier to another at an intermediate point and not where the seller hands the goods over to a carrier at an intermediate point.[115]

Berman and Ladd's arguments are unconvincing for a number of reasons. In the first instance, their interpretation of article 66 is too restrictive. Article 66 operates as the

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[112] Lookofsky *Understanding the CISG in the USA* 57 and Bernstein & Lookofsky *Understanding the CISG in Europe* 73 mention that the risk regime of the Convention is "wholly" displaced by the trade term. The latest world wide edition, Lookofsky *Understanding the CISG* 99, however, states that the effect of expressly incorporated trade terms is "that the Convention's own risk-regulating regime is effectively displaced." Whether this signifies a change in meaning on the extent to which trade terms may displace the CISG rules, is not clear.

[113] Hellner "The Vienna Convention and Standard Form Contracts" in Sarcevic & Volken (eds) *International Sale of Goods: Dubrovnik Lectures* (1986) 343 makes a similar statement in connection with art 31 CISG, dealing with the delivery obligation. In light of the link between delivery and the passing of risk in INCOTERMS, this statement can apply to the regulation of risk as well. See, however, Erauw "Observations on Passing of Risk" in *The Draft UNCITRAL Digest and Beyond* 305, who is of the opinion that such a view is exaggerated.

[114] 1988 (21) *Cornell Int'l LJ* 437.

[115] This aspect was addressed in 6 4 1 & 6 5 3 *supra*, where it was concluded that article 67 can give rise to the splitting of transit risk.

general provision concerning the passing of risk under the CISG. Moreover, an analysis of the interplay between article 66 and INCOTERMS later on in this chapter will conclude that article 66 is capable of supplementing trade terms. Secondly, it is generally accepted that trade terms do not displace the Convention *in toto*.[116] Moreover, as this study has already established, INCOTERMS have a limited scope of regulation.[117] The reference to a specific INCOTERM would be insufficient to determine the full legal relationship between the parties to a contract of sale. If the Convention is to be ousted as a whole in consequence of the incorporation of an INCOTERM, the parties would have to rely on the governing law of the contract to address aspects that are not regulated by INCOTERMS. This study has indicated that it is not always easy to determine the governing law by applying the rules of private international law. Additional problems, such as forum shopping and the inability of domestic laws to address the needs of an international sales transaction, complicate the matter even further.[118] If the incorporation of INCOTERMS was to result in the exclusion of the CISG in contracts where it otherwise would have been the governing law, it will adversely affect the economic efficiency of the contract. It would also not reflect the true intention of the parties to the contract when they decide to make use of a trade term. In these cases it is their intention to regulate aspects concerning delivery, passing of risk and ancillary obligations in accordance with trade usage and not to exclude the Convention as the governing law of the contract for aspects that are not regulated by the compilation. At most, INCOTERMS will only displace the Convention's delivery and risk regimes.

Another opinion, which is more realistic, is that INCOTERMS do not displace the CISG rules on delivery and risk *in toto*, but only to a limited extent.[119] For the rest,

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[116] Schlechtriem "Article 6" in *Schlechtriem-Schwenzer Commentary* para 12; *CE v CD & AR* (Belgium District Court Kortrijk 19 April 2001 - *bread bags* case) http://cisgw3.law.pace.edu.cases/010419b1.html (accessed 01-06-2009) and http://www.law.kuleuven.ac.be/ipr/eng/cases/2001-04-19.html (accessed 02-06-2009); Austria Supreme Court 22 October 2002 [1 Ob 77/01g] (*gasoline and gas oil* case) http://cisgw3.law.pace.edu/cases/011022a3.html (accessed 31-07-2009).

[117] See 5 7 *supra.*

[118] See 1 1 *supra.*

[119] Erauw "Observations on Passing of Risk" in *The Draft UNCITRAL Digest and Beyond* 301 states that trade terms "partly derogate from the CISG" and that they "opt out of some aspects of the rules on the passing of risk." Perales Viscasillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 287 is of the view that "the use of trade terms does nor entirely displace the CISG rules on the passing of risk." See also Bridge "A Law for International Sales" 2007 (37) *Hong Kong LJ* 17 38, for his view that a contractual reference to a trade term does not present a clear enough indication of an intention to exclude the CISG rules. Moreover, because most contracts contain a trade term, such an exclusion would make the "extensive treatment of risk in the CISG in five articles a rather pointless business if the rules in question are to be applied only in a small minority of cases." For a critical analysis of Bridge's view, see Singh & Leisinger "A Law for International Sale of Goods: A Reply to Michael Bridge" 2008 (20) *Pace Int'l L Rev* 161 188. They comment that according to the Secretariat Commentary the drafters were aware of the fact that, in practice, the risk rules would be applicable in very few cases. It is, therefore, their opinion that trade terms replace the Convention's rules on risk.

they supplement and support each other.[120] Where the Convention's risk rules can provide an answer to an aspect which is not addressed by INCOTERMS, the Convention's rules supplement the INCOTERM rule in so far as the latter is insufficient.[121]

Since INCOTERMS are imported into a contract governed by the CISG on the basis of article 6, their effect on the Convention's rules on risk should be seen against this background. Besides exclusion, article 6 also provides the possibility to "derogate from" or "vary the effect" of any of the Convention's provisions. To derogate from or vary the CISG risk rules, it implies differences between INCOTERMS and the CISG risk rules. Furthermore, it entails that the CISG rule is deviated from, modified, altered or supplemented by the INCOTERM.[122] This means that the rule does not have to be excluded in its entirety, but that its effects can be modified or supplemented in so far as the trade usage may be inconsistent with the CISG rule.[123]

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[120] Schlechtriem "Article 6" in *Schlechtriem-Schwenzer Commentary* para 12 makes it clear that "a refrerence to INCOTERMS does not exclude but merely supplements the Convention." According to Honnold *Uniform Law* para 76, the Convention and trade terms have complementary roles; "each performs a function that cannot be well served by the other." See also Perales Viscassillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 288-289, who is of the view that the CISG may operate as "an aid to the interpretation of the agreed term or to fill gaps in the INCOTERMS, particularly where there is no express reference in the parties' agreement to the application of the ICC text." Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 87-88 is also of the opinion that it will be "safer" if the CISG rules were still to apply when a trade term is used "so that they do least damage to established commercial expectations". See, however, Goodfriend 1984 (22) *Colum J Trans L* n 14, who argues that trade terms constitute trade usage, which is to prevail over the CISG's rules. See also 7 2 2 *supra* for a discussion on trade usage and the CISG and 6 5 3 *supra* for the inconsistency between traditional trade terms and the CISG risk rules.

[121] Enderlein & Maskow *Uniform Sales Law* 257 are of the view that the "broader angle of vision" of the CISG rules on risk encourages a supplementary and complementary function for the INCOTERMS. According to Erauw "Observations on Passing of Risk" in *The Draft UNCITRAL Digest and Beyond* 293, the CISG provisions complement and work *in tandem* with the INCOTERMS. Since INCOTERMS do not constitute a code of law, Grewal 1991 (14) *Loy LA Int'l & Comp LJ* 105-106 is of the opinion that the Convention provides "a body of law within the framework of which trade terms can apply." Berman & Ladd 1988 (21) *Cornell Int'l LJ* 434 agree that INCOTERMS do not solve all problems pertaining to the passing of risk. They are contract terms and their meaning therefore depends on interpretation in the light of some body of law. That means that they are to be supplemented by the governing law of the contract. For similar comments, see also, Piltz *INCOTERMS and the UN Convention* Parts 1, IV & V.

[122] Schlechtriem "Article 6" in *Schlechtriem-Schwenzer Commentary* para 12; Honnold *Uniform Law* paras 74-76. See, however, Bonell "Article 6" in *Bianca-Bonell Commentary* para 2 1-2 3 for a more restrictive view. He only refers to total and partial exclusion of the Convention. However, it should be noted that Bonell does not refer to INCOTERMS in his discussion of art 6. The only reference to INCOTERMS is in his discussion of arts 8(2) and 9(1) CISG, where they are referred to in the context of implied terms.

[123] See Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 90, who argues that an implied agreement on INCOTERMS results in an implied modification of art 67(1) CISG "in so far as Article 67(1) CISG is inconsistent with INCOTERMS." This means that to the extent that INCOTERMS are inconsistent with the CISG risk rule, the codification will find application and for the rest, the Convention's rule will still apply.

A comparative analysis of the most well known INCOTERMS and article 67 of the CISG[124] concluded that, despite broad similarities in pattern and structure, the CISG rules are not always capable of accommodating trade usages clearly. Under FOB and CIF, risk passes at the place of loading the goods onto the vessel when they cross the ship's rail. Under article 67 CISG, risk passes at the place of handing the goods over to the carrier, whether that is the first carrier or a carrier at a specified place. When risk is regulated by one of these terms, the CISG risk rule is derogated from in a narrow sense in so far that risk passes at the moment the goods pass the ship's rail in the port of shipment and not merely when they are "handed over" to the carrier.[125]

Despite the fact that INCOTERMS are sometimes more detailed as to when and where risk passes, there are instances which are not provided for by INCOTERMS altogether. Where the loss or damage occurs after the risk has passed but it was caused by the act or omission of the seller, INCOTERMS do not regulate the situation at all. Where the contract is concluded on the basis of an FOB term, INCOTERMS derogate from article 67 CISG by moving the point where risk passes to the ship's rail at the port of shipment. However, if the goods deteriorate during the voyage at sea due to the seller's omission to instruct the carrier to keep the goods at a specific temperature, INCOTERMS do not address the situation. According to INCOTERMS, the risk has passed to the buyer and he has to pay the purchase price. However, when the overheating of the goods is directly attributable to the omission of the seller to give proper instructions to the seller, the loss or damage to the goods is not caused by an accidental disaster. In this event, article 66 CISG provides that the buyer will be discharged from his obligation to pay the price as the damage was due to the act or omission of the seller. INCOTERMS do not provide for a similar provision. Hence, article 66 can provide legal relief for the buyer.

The decision of a Chinese arbitration panel[126] illustrates the interplay between INCOTERMS and the CISG risk rule in such an event. The seller agreed to sell to the buyer 10 000 kg of jasmine aldehyde which was also agreed to be no less than 99% purity at the price of US $21 per kg "CIF New York". On arrival, the cargo was found

[124] 6 5 3 *supra*.
[125] The notion of "handing over to a carrier" is a broader concept than "loading onto the vessel". The former does not necessarily require that the goods should be delivered onboard the vessel; it suffices that the goods be delivered to a container yard which acts as an agent for the carrier. Enderlein & Maskow *Uniform Sales Law* 257 point out that the CISG will often not be able to fulfil a supplementary function as INCOTERMS are generally more detailed.
[126] China International Economic and Trade Arbitration Commission (CIETAC) – *jasmine aldehyde* case China 1995 http://www.cisg.law.pace.edu/cisg/wais/db/cases2/950223c1.html (accessed 12-05-2006).

to be melted and leaking. The damage caused to the goods during transport was due to the omission of the seller, who did not give the carrier appropriate instructions regarding the temperature, even though the buyer warned the seller that the goods could deteriorate at high temperatures. The tribunal found that under a CIF sale, the risk passes when the good pass the ship's rail at the port of loading. However, since the damage to the goods was caused by an act or omission of the seller to give proper instructions to the carrier on temperature control, the tribunal applied article 66 CISG. This meant that the buyer did not have to carry the price risk. This case is an example of the application of the CISG to "fill a gap" in INCOTERMS. INCOTERMS merely cause a derogation from the provisions of article 67 and not from all the CISG's provisions on risk. Article 66 remains operative, unless the parties have contracted out of it explicitly.[127]

INCOTERMS and the CISG risk rules are complementary and can operate in collaboration to supplement gaps. The introduction of INCOTERMS into a contract does not result in the displacement of the CISG risk rules in their entirety. They will only displace the risk rules in part, and for the rest INCOTERMS will function *in tandem* with the CISG rules.

The ability of INCOTERMS and the CISG to supplement each other is not limited to the issue of risk. This study has found that INCOTERMS have a limited scope and are unable to regulate all aspects of a sales contract.[128] INCOTERMS are focused on the primary obligations of the parties in connection to delivery and risk, and do not, for example, provide rules for the formation of contract. They only cover situations where performance takes place in accordance with the contract and do not provide for instances of breach. They also do not address the issue of exceptions to liability. To be effective INCOTERMS should be supplemented, either by party agreement or by the governing law of the contract.[129] In so far as the CISG's provisions regulate aspects that are not covered by INCOTERMS they can supplement the trade term codification.

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[127] Art 66 complements the provisions of INCOTERMS and supplements them in so far as the latter are based on the same underlying principles of modern international trade as the CISG. See Erauw Observations on Passing of Risk" in *The Draft UNCITRAL Digest and Beyond* 293; Perales Viscassillas "Comments on the draft Digest" in *The Draft UNCITRAL Digest and Beyond* 286-287.

[128] See 5 7 *supra.* See also *BVBA ITM v SA Montanier* (Appellate Court Antwerp Belgium 22 January 2007) http://cisgw3.law.pace.edu/cases/070122b2.html (accessed 23-07-2009).

[129] Gabriel 2001 (5) *VJ* n 3; *Texful Textile Ltd v Cotton Express Textile Inc* 891 F Supp 1381 (CD Cal 1985). Piltz *INCOTERMS and the UN Convention* Part I; Dalhuisen *Dalhuisen on International Commercial, Financial and Trade Law* 114.

Although INCOTERMS do not provide for breach of contract,[130] there is an automatic interrelation between the trade term and the rules relating to breach. If delivery does not take place at the time and place envisaged by INCOTERMS, it will constitute breach of contract which, to the extent that the parties have not provided for such an event, is to be remedied by the governing law of the contract.[131] The same applies to the delivery of non-conforming goods. It may happen that the risk passes to the buyer under the trade term but that the seller breached his obligation to deliver conforming goods. In this regard there is an interrelationship between non-conformity and the passing of risk inasmuch as article 36 CISG provides that conformity is to be determined at the moment that the risk passes from the seller to the buyer.[132] However, even though the A1 clause of INCOTERMS requires that the seller should deliver goods that are "in conformity with the contract of sale and any other evidence of conformity which may be required by the contract," no mention is made of relief for the buyer if he does not perform his obligations. Moreover, the A7 clause of INCOTERMS provides that failure by the seller to give the buyer sufficient notice that the goods have been delivered in accordance with clause A4 constitutes breach of contract by the seller. Once again, there is no specific stipulation in INCOTERMS regarding the consequences of such failure. In the absence of any contractual provision on breach by the seller, such breach should be dealt with by virtue of the CISG's remedies for breach, namely articles 45-52 and 74-77 CISG.[133] Article 70, furthermore, provides that in the case of fundamental breach of contract by the seller,[134] the buyer's remedies are not impaired merely because the risk of loss has passed to him. INCOTERMS, however, do not contain any provisions similar to those of article 70 CISG. The Convention will therefore regulate cases of fundamental breach on the part of the seller.[135] However, the Convention does not indicate whether breach of a trade term by the seller constitutes a fundamental breach.[136] It will therefore depend on the interpretation of the requirements of article 25 CISG.

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[130] Ramberg *ICC Guide to INCOTERMS 2000* 12. The B5 clauses of INCOTERMS, however, provide for the premature passing of risk in certain cases of breach.
[131] Honnold "Uniform Law and Uniform Trade Terms" in *Transnational Law II* 171.
[132] See CLOUT Case No 253 (Appellate Court Lugano *Cantone del Ticino* Switzerland 15 January 1998) http://cisgw3.law.pace.edu/cases/980115s1.html (accessed 11-05-2009). In this case, the seller sold cocoa beans, which had to contain a specified amount of fat and a minimum level of acidity, under a CIF contract. Tests conducted after their delivery in Italy revealed that these values were not as certified. The court, however, found that it was impossible to determine whether the goods were already defective when handed over to the carrier, ie when the risk passed to the buyer.
[133] These remedies include avoidance, specific performance, reduction in price and damages.
[134] The buyer's remedies are not limited to fundamental breach. See the discussion on breach of contract and the passing of risk 6 4 5 *supra* for the situation in the case of non-fundamental breach.
[135] Valioti *Passing of Risk* text following upon n 262.
[136] Berman & Ladd 1988 (21) *Cornell Int'l LJ* 431.

In the so-called *Horsebean* case,[137] a French buyer bought horsebeans from a Chinese seller "FOB Tianjin". The buyer informed the seller that it had contracted to resell the horsebeans to the Military of Egypt. However, the Egyptian inspectors were precluded from inspecting the cargo whilst they were stored in a Chinese warehouse, whereafter the buyer refused to take delivery on grounds of breach of contract. The arbitration tribunal found that the buyer failed to notify the seller of the ship's name, loading location and time as required by INCOTERMS 1990; that this failure amounts to a fundamental breach of contract as envisaged by article 25 CISG and that the buyer's claim for damages should therefore be dismissed.

In a dispute between a British seller and a German buyer over the non-delivery of iron molybdenum (CIF Rotterdam),[138] a German appellate court held that in the case of CIF contracts, timely delivery by a fixed date is per definition an essential term of the contract, which can give rise to a claim for fundamental breach if delivery does not take place timeously.

Although INCOTERMS mainly deal with delivery obligations, they provide no detailed rules on the time of delivery,[139] or when the buyer has to take delivery of[140] or pay for the goods.[141] Here the default rules of the CISG can supplement the INCOTERMS.[142]

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[137] CIETAC Arbitration proceedings (*horsebean* case) China 8 March 1996 http://www.cisg.law.pace.edu/cisg/wais/db/cases2/960308c2.html (accessed 02-06-2009).

[138] Appellate Court Hamburg (*iron molybdenum* case) Germany 28 February 1997 http://cisgw3.law.pace.edu/cases/970228g1.html (accessed 02-06-2009). See also ICC Arbitration Case No 7645 of March 1995 (*crude metal* case) *supra* for a similar conclusion where the parties agreed on a CFR INCOTERM. See 5 8 3 *supra* for a discussion of this case. The Appellate Court Hamburg 12 November 2001 (*memory module* case) http://cisgw3.law.pace.edu/cases/011112g1.html (accessed 21-08-2009), however, questioned the existence of a trade usage which determines that in C&F sales for seasonal goods untimely delivery should automatically constitute a fundamental breach.

[139] The A4 clauses of INCOTERMS only refer to the agreement of the parties, the so-called "agreed period" or "period agreed for delivery".

[140] The B4 clauses dealing with the buyer's obligation to take deliver merely require that the buyer should take delivery when the goods have been delivered "in accordance with A4".

[141] The B1 clauses merely provide that the buyer should "pay the price as provided for in the contract of sale."

[142] Art 33(c) CISG provides that, where no time is fixed by or determinable from the contract, delivery is to take place "within a reasonable time after the conclusion of the contract." Art 60 CISG requires that the buyer has to do "all the acts which could reasonably be expected of him in order to enable the seller to make delivery." In regard to the buyer's obligation to pay the price, arts 53-59 provide default rules on payment, which apply in the absence of party agreement. The Convention also regulates instances where the price has not been fixed at the time of the conclusion of the contract (art 55). See Piltz *INCOTERMS and the UN Convention* Part IV, for arguments on the interplay between INCOTERMS and art 58(1) CISG, concerning the buyer's obligation to pay. The CISG provides that the price should be paid when the goods or the documents controlling their disposition are placed at the disposal of the buyer. Piltz points out that this would depend on the INCOTERM involved. In the event of a D-term, payment should take place when the goods are received by the buyer, since the seller's obligation to deliver and the buyer's obligation to take delivery both take place at that place. The position under the F- and C-terms, however, is less clear. Although the seller's obligation to deliver is performed when the goods are handed to the buyer, it does not mean that the buyer's obligation to take delivery coincides with that. Where the buyer concludes the contract of carriage, as in the case of the F-terms, the goods are placed at the disposal of the buyer when they are handed to the carrier who takes delivery on his

The same applies to the B7 clauses of INCOTERMS, which require that the buyer notifies the seller of the aspects that he has to be aware of to make delivery, such as the time for delivery, the vessel's name, the port of shipment or loading point and the port of destination. Although "sufficient notice" is required, nothing is said in regard to the form or type of notice, its promptness or when it is to become effective. The FAS term, for instance, requires that the seller should deliver the goods alongside the vessel and notify the carrier accordingly. The CISG may provide a solution to this problem by virtue of article 27.[143] This is another example of how the provisions of the CISG can supplement the INCOTERMS in the absence of regulation by the latter.

Apart from the CISG supplementing the INCOTERMS, there are instances where INCOTERMS can supplement the CISG risk regime. Under INCOTERMS, risk normally passes on delivery as envisaged by the A4 clauses.[144] The B5 clauses, however, determine that the risk can be transferred from the seller to the buyer even before the seller has performed his delivery obligations.[145] This may happen when the buyer fails to do what is required of him under clause B7 to assist the seller in delivering the goods, or where the buyer fails to take delivery of the goods under clause B5 of INCOTERMS. Under the F-terms, for instance, the buyer should nominate the carrier and accept the delivery from the carrier as agreed.[146] If the buyer fails to meet any of these requirements, clause B5 provides that he must bear all additional risks of loss of or damage to the goods resulting from his failure as from the agreed date or the expiry date of the agreed period for delivery, provided that the goods are identified as the contract goods. In the case of the D-terms, the buyer should clear the goods for import within an agreed time to enable the seller to embark on the carriage of the goods.[147] In the case of the DDU and DDP terms, clause B5 provides that the buyer should carry any additional risks and costs connected to such failure. Apart from the provision in article 69(1) which provides for

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behalf. Payment should therefore be made at this point. In the case of a C-term, however, the carrier does not act on behalf of the buyer and payment should be made when the goods are received at the point of destination when the buyer takes delivery of the goods.

[143] Piltz *INCOTERMS and the UN Convention* Part III, however, points out that art 27 CISG is based on the dispatch principle, whilst INCOTERMS generally require that the notice should be received. He is of the opinion that art 27 can be applied to all the INCOTERMS, except for the D-terms, which presuppose that the seller is responsible that the buyer receives the notice. It is his argument that, by agreeing on a D-term, the seller has taken on the obligation to deliver at the point of destination, whilst in the case of the F- and C-terms, delivery takes place where the main carriage starts. In the case of a D-term, the seller is, therefore, obliged to make sure that the notice of delivery is received by the buyer correctly and punctually.

[144] See *INCOTERMS 2000* (the official rules) Introduction 9 for a discussion on the concept "delivery" as used by INCOTERMS.

[145] Ramberg *Guide to INCOTERMS 2000* (1999) 61.

[146] Under the C-terms, there is a similar obligation on the buyer if he is entitled to determine the date for shipment of the goods or the port of destination.

[147] Clause B2.

the passing of risk in the event of the buyer's failure to take delivery,[148] the Convention treats failures of the buyer's obligations generally as breach of contract,[149] which does not result in the premature passing of risk. The Convention fails to deal with the buyer's default in providing carriage instructions in due time. The premature passing of risk as provided for by INCOTERMS is not only a more effective deterrent than the remedies for breach, but are also much easier to apply.[150] By providing for the premature passing of risk, INCOTERMS can supplement the CISG's risk regime inasmuch as it provides an additional incentive for the buyer to assist the seller in fulfilling his obligation to give proper and timely delivery of the goods.

INCOTERMS could also supplement the Convention's rules in respect of documentary sales.[151] Although the CISG recognises and validates the practice of documentary sales, it does not attempt to define or regulate it. The Convention deals with documentary transactions only incidentally. For example, article 30 states that the seller must deliver the goods, hand over any documents relating to the goods and transfer the property in the goods as required by the contract and the Convention. Similarly, article 34 states that the seller has to hand over the documents relating to the goods at the time, place and in the form required by the contract. The Convention, however, does not state what the term "documents" includes, nor does it indicate the consequences of a violation of the seller's obligations to hand them over. Failure to hand over documents relating to the goods

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[148] See, however, the problems with this rule envisaged by Bridge "The Transfer of Risk" in *Sharing International Commercial Law across National Boundaries* 99-101. His criticism relates to uncertainties surrounding the time within which the buyer has to take delivery after having been notified that the goods are placed at his disposal. He argues that art 69(1) is not very clear on this aspect. Firstly, unlike art 69(2), it does not state explicitly that the buyer should be aware that the goods are placed at his disposal. One has to gather this requirement from the second paragraph. The time within which the buyer must respond is a variable time, depending on the circumstances of the case. It is his argument that any variable time defining breach is bound to create problems, especially if it is connected to a rule on the passing of risk. He is of the view that the rule, as it stands at the moment, only benefits the seller's insurer and is against the policy that risk should follow control. He is, furthermore, of the view that to demand a fundamental breach by the buyer, or to require an art 63 notice which makes time of the essence, would be more effective in this context. Although Bridge's arguments are not totally without merit, it must be remembered that the rule in art 69(1) is consistent with the rule in the B5 clauses of INCOTERMS and, therefore, confirms general trade practice.

[149] As envisaged by art 60 CISG. The seller will be entitled to exercise the rights provided in arts 46-52 and 74-77. Article 66 CISG does not provide any relief either. The exception merely covers the seller's act or omission and not that of the buyer.

[150] De Vries 1982 (17) *Eur Trans L* 527-528. Enderlein & Maskow *International Sales Law* 277 regard it as "useful if the INCOTERMS were supplemented by the Convention" in cases where the buyer fails to nominate the carrier. See also 6 4 1 & 6 4 2 *supra* for a discussion on the effect of the buyer's failure to nominate the ship in the context of the Convention's risk rules.

[151] Documentary sales are a creation of commercial practice. They developed because the parties to an international sale are separated by distance, which makes it impossible to exchange money for goods *pari passu*. See in general, Berman & Ladd 1988 (21) *Cornell Int'l LJ* 425-426; Berman & Kaufmann "The Law of International Commercial Contracts (Lex Mercatoria)" 1978 (19) *Harv Int'l LJ* 221 237-243.

could be interpreted as a failure to perform a contractual obligation, which means that a breach of contract has occurred. In regard to the passing of risk, article 67(1) third sentence notes that risk passes to the buyer even if the seller is authorised "to retain documents controlling the disposition of the goods".

Because documentary sales are closely related to the use of trade terms, the Convention's failure to define or regulate documentary sales is believed to be connected to the decision of the drafters not to define or regulate the use of trade terms.[152] In the context of sales in transit, it is customary to use the CIF or CFR trade terms. Since the Convention does not provide for documentary sales and trade terms *per se*, INCOTERMS could supplement the provisions of the Convention in this regard.[153] However, because INCOTERMS do not explicitly provide for sales in transit, as well as the general problems encountered with the interpretation of article 68,[154] it is advisable that the parties regulate the passing of risk contractually.

Berman and Ladd[155] hold that, in respect of the risk of loss or damage to goods in transit the Convention reaches solutions essentially opposed to those reached under trade terms commonly used in documentary sales. To this extent, trade terms contradict rather than supplement the Convention. Their argument is based on the drafting history of the third sentence of article 67(1), which provides for the risk to pass even if the seller retains the documents controlling the disposition of the goods. They submit that a historic analysis of the provision shows that the real intention with this sentence was that none of the articles on the passage of risk should apply to sales in which a trade term is used.[156] This part of the article was added on account of a proposal by the United States delegation to the 1977 drafting session. The proposal was designed to make it clear that the seller's retention of control of the goods, by retaining the documents as security against payment until after the goods

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[152] Berman & Ladd 1988 (21) *Cornell Int'l LJ* 431.

[153] *INCOTERMS 2000* (the official rules) Introduction 15 points out that the word "afloat" should be added in cases where the goods are sold whilst at sea. Difficulties of interpretation might, however, arise. One possibility would be to maintain the ordinary meaning where risk passes on shipment. In that case, the buyer might assume the consequences of events that occurred before he entered into a contract of sale. The other possibility would be to let risk pass when the contract of sale in transit is concluded. The ICC rules suggest that the meaning would depend on the governing law of the contract. If the Convention is the governing law, this would mean that art 68 CISG will determine the point when risk passes for sales in transit. See 6 5 3 *supra* for criticism of art 68 CISG, which provides for the risk to pass retroactively to the time when the goods are handed over to the carrier that issued the transport documents. Although the INCOTERMS rule is largely similar to the CIF and CFR terms, where risk passes when the goods cross the ship's rail, the INCOTERMS rule is more detailed and not, in all respects, consistent with the concept of "handing over".

[154] See 6 4 4 *supra* for a discussion on art 68 CISG.

[155] 1988 (21) *Cornell Int'l LJ* 421, 428-431.

[156] N 15.

are shipped, will not let the risk pass.[157] However, the amendment does not achieve its intended purpose, since the words "does not affect the passage of risk" is likely to be interpreted to mean that article 67(1) still applies to documentary sales concluded on the basis of trade terms; whilst the intention was that risk will only pass when the documents are handed over and not merely when the goods are handed over.

Berman and Ladd use the example of the trade term "FOB vessel New York".[158] It is their argument that the trade term, and not article 67, will govern the passing of risk. Therefore, the risk does not pass at all until the seller tenders to the buyer a bill of lading, and only then will the risk pass retroactively to the time the goods were loaded on the vessel in New York. Although they are correct in arguing that the passing of risk will be governed by trade usage rather than article 67,[159] the remainder of their argument is fallacious. According to clause A8 of the FOB (INCOTERMS 2000) term, the seller should provide the buyer with proof of delivery, which may be in the form of a transport document such as a bill of lading. However, this does not make delivery of transport documents a prerequisite for the passing of risk. In that sense, article 67(1) CISG third sentence follows the rule under INCOTERMS.[160] The possibility of retaining the documents controlling the disposition of the goods is aimed at securing payment of the purchase price and is not concerned with the passing of risk. Most commentators agree that the third sentence of article 67 confirms that the Convention does not link the passing of property to the passing of risk.[161]

However, there are other issues connected to the passing of risk where neither the CISG nor the INCOTERMS seem to provide an appropriate regulation. This is especially so where goods are sold and transported in bulk. Collective cargo, containing goods of the same kind shipped in one container or on one ship for several recipients, is normally shipped under CPT and CIP terms. INCOTERMS are consistent with the general notion that goods must be clearly identified to the contract. The B5[162] and B6[163] clauses of INCOTERMS require that the goods must

[157] *Report of the UN Commission on International Trade Law on the work of its 10th Session* (Vienna 23 May - 17 June 1977) 528 UN Doc A/32/17.
[158] 1988 (21) *Cornell Int'l LJ* 430.
[159] Goodfriend 1984 (22) *Colum J Trans L* 578 n 14; Lookofsky *Understanding the CISG in the USA* (1995) 59. See also the discussion 7 2 2 *supra.*
[160] Honnold *Uniform Law* para 370 notes that the rule in art 67 is "useful", inasmuch as it does not upset the basic rule on risk and is consistent with commercial practice.
[161] Nicholas "Article 67" in *Bianca & Bonell Commentary* para 2 6; Hager "Article 67" in *Schlechtriem-Schwenzer Commentary* para 8.
[162] Dealing with the premature passing of risk.
[163] Dealing with the division of costs.

be ”duly appropriated to the contract”, which means that they should be “clearly set aside or otherwise identified as the contract goods”. Failure to identify goods clearly to the contract may result in the risk of loss not being transferred.[164] The process of individualising the goods normally takes place prior to transportation. This is accomplished by clearly marking the goods or naming the consignee and destination of the goods. However, in the case of bulk sales of the same kind, such as oil or grain, the ability to clearly identify a portion of the bulk to one buyer or another is sometimes difficult, if not impossible. Identification normally takes place when the goods are appropriated to different buyers, such as for instance where separate bills of lading or orders for parts of the bulk consignment are issued to each of the parties. Ramberg[165] suggests that the words “appropriated to the contract” means that a *pro rata* part of the bulk may be appropriated to the contract by means of a bill of lading as long as the bulk is identified.

Likewise, the CISG provides no clear answer to the problem of identification in the case of bulk shipments of fungibles. Article 67(2) requires that the goods should be clearly identified to the contract by means of markings, shipping documents, notice to the buyer or any other form of identification before risk will pass. A similar requirement is stated in article 69(2). The goods will not be placed at the disposal of the buyer until they are clearly identified to the contract. Strictly speaking the goods will be appropriated or identified to the contract only when they are separated from the bulk. The discussion in the previous chapter referred to different opinions.[166] One view is that identification of the collective cargo suffices. The buyers form an association for the risk and carry it *pro rata*. Another opinion is that this is not sufficient for a clear identification. The identification, and therefore the passing of risk, does not take place until the goods are divided between the buyers at the place of destination. If the goods are lost or damaged on the way, the buyers are released from their obligation to pay the purchase price.[167]

Ramberg[168] points out that there might be a slight difference between INCOTERMS and the Convention in this respect. Article 67(2) CISG requires that the goods should be “identified to the contract”, whilst the B5 clause of INCOTERMS requires that the goods should be “appropriated to the contract”. It is his argument that “appropriation”

[164] Ramberg *Guide to INCOTERMS 2000* 61.
[165] 2005-06 (25) *JL & Com* 220.
[166] See 6 4 1 & 6 4 2 *supra.*
[167] If the latter interpretation is to followed, it would mean that the original seller will be kept at risk until the goods have arrived at their destination.
[168] 2005-06 (25) *JL & Com* 220-221.

invites the conclusion that a *pro rata* part of the bulk might be appropriated to the contract by a bill of lading as long as the bulk is identified, resulting in risk passing proportionally to the buyers before breaking bulk at destination. "Identification", on the other hand, might suggest that the goods should be separated from the bulk at destination. He concludes that in the absence of case law that can provide any guidance, no distinction should be made between the identification requirement of article 67(2) CISG and the appropriation requirement of INCOTERMS. This view is to be supported. However, to avoid uncertainty and facilitate the efficiency of the transaction, the best solution would be if the parties were to provide for the passing of risk contractually.[169]

## 7 4 Conclusion

INCOTERMS are capable of supplementing the rules of the Convention effectively. Trade usage can apply as express or implied (tacit) contract terms and INCOTERMS will find application if an implied intention to that effect is inferred. Being a codification of trade usages they can also supersede the Convention's default rules by virtue of article 9 CISG. Whether INCOTERMS have autonomous application independent of the intention of the parties is, however, a contentious issue. Such an inference depends on whether a normative character can be attributed to article 9(2) CISG. Views in this regard differ. Some commentators believe that despite the "objective" character of article 9(2)'s requirements, namely that a party "ought to have known" of usages which are "widely known and regularly observed", the provision only sanctions the reasonable expectation of a party as to the usages that the other party is supposed to follow, which boils down to an implied intention. Others, again, believe that the article confers normative character on usages that are internationally known and regularly applied, such as the FOB and CIF terms. Whether INCOTERMS *in toto* are to apply as an article 9(2) normative usage is controversial. Some scholars believe that the more recent INCOTERMS are not widely known and regularly observed and that they could therefore not qualify as article 9(2) usages.

One view holds that INCOTERMS cannot be imposed without an express and clear reference by the parties. Art 9(2) CISG does not change the result because INCOTERMS are not fully compatible with the CISG and, therefore, cannot constitute

[169] Unless the domestic governing law is capable of providing more clarity on this "gap". See also 6 5 2 *supra*.

international usages or any other usage that the parties "ought to have known". According to this view it is inappropriate to replace harmonised uniform law for contract-based rules that "are neither complete nor necessarily in harmony with the CISG provisions." [170] This argument, however, does not have any substance. This study has already concluded that INCOTERMS' "incompleteness" in so far as they have a limited scope of regulation is not a limitation that affects the efficiency of INCOTERMS.[171] As for INCOTERMS not being "in harmony" with the CISG, the analysis conducted in the previous chapter has shown that they have much in common and are based on reconcilable assumptions of possession and control.[172] Moreover, the general structure and content of the CISG risk rules follow that of the INCOTERMS to the extent that they mimic the risk rule under INCOTERMS in many respects. This study has indicated that, despite differences between the traditional trade terms and the CISG risk rules, the modernised INCOTERMS are compatible with the CISG risk rules. The discussion in this chapter has also shown that trade usage supersedes the provisions of the CISG. Substitution mostly takes place on the basis of party agreement, express or implied, but terms can also be implied by law if the trade usage meets certain requirements. It is not required that trade usage should be compatible with the CISG default rules for them to find application as terms implied by law.

This study concludes that, in the end, this issue will be decided by the degree to which INCOTERMS are used in practice. A distinction between terms based on implied intentions or terms implied by law is to a large extent an artificial exercise mainly of interest to legal scholars. For merchants who are involved in day-to-day transactions such technicalities are of little importance. INCOTERMS are a codification of current mercantile customs and usages.[173] They represent the most consistent practices of international trade in regard to the delivery of goods and its associated obligations at a given time. If they are used regularly to the extent that they become customary in a particular type of trade, such distinctions will become even less important. Then they will find automatic application, not only because they are widely known and regularly observed, but mainly because they constitute an efficient way of reducing transaction costs by standardising trade term meanings.

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[170] Erauw (2005-06) 25 *JL & Com* 212 and "Observations on passing of risk" in *The Draft UNCITRAL Digest and Beyond* 302-303, who bases his opinion on the Foreword of INCOTERMS 2000.
[171] See 5 7 *supra*.
[172] See 6 5 3 *supra*.
[173] Goodfriend 1984 (22) *Colum J Trans L* n 19. See also 5 8 1 *supra*.

This conclusion is supported by the discussion on the interaction between INCOTERMS and the CISG's risk rules. The analysis has shown that INCOTERMS do not replace the CISG risk rules *in toto*, but can be supplemented by the Convention. As for aspects not covered by INCOTERMS, there is a need for a collaborative application of both INCOTERMS and the CISG rules. The interaction between the Convention and INCOTERMS constitutes a complementary and supplementary relationship.[174] The Convention can provide answers to questions that are not answered by INCOTERMS and *vice versa*. In collaboration, these two instruments of standardisation can provide the parties to an international contract of sale with a legally effective and economically efficient sales law regime.

[174] Honnold *Uniform Law* para 7; Honnold "Uniform Law and Uniform Trade Terms" in *Transnational Law II* 171; Oberman *Transfer of risk from seller to buyer in international commercial contracts: A comparative analysis of risk allocation under the CISG, UCC and INCOTERMS* LL M thesis Laval (1997) http://www.cisg.law.pace.edu/cisg/thesis/Oberman.html (accessed 25-02-2009) ch 3 I A & B.

# CHAPTER EIGHT
# CONCLUSION

## 8 1 The role of unified law and mercantile custom in facilitating cross-border trade

Legal rules have two main functions, namely to regulate and to facilitate. In the context of international sales these functions are often compromised because of the international nature of the transaction. Differences in the sales laws of countries give rise to uncertainty as to the content of legal rights and obligations and reduce the possibility of predicting the outcome of a dispute. Coupled with the problems experienced in the application of the rules of private international law, smaller businesses and traders often shy away from competing in international markets.[1]

This study has taken as its premise that contract parties are rational maximisers of their own economic interest. To increase the efficiency of the transaction, transaction costs should be reduced to the minimum. Ideally, the contract should be regulated by legal rules that seek to achieve this goal. To assure maximum profit, parties negotiate their contracts in the shortest possible time. Moreover, because modern commercial transactions tend to be extremely complex, it often means that parties fail to address every possible problem that might arise in respect of their contract in detail. It is therefore likely that international contracts of sale will contain gaps which are to be filled by the default substantive law. Unified default rules that are clear, certain and predictable, that represent the legal position that most parties would have contracted for if they had the time and money to negotiate all aspects of their contract in full, and at the same time also protect the principle of party autonomy so that a rule can be changed or adapted if needed, are considered economically efficient.[2]

Unified law has additional advantages inasmuch it does away with the need to resort to private international law rules to determine the applicable law. It provides incentives for people to make contract choices based on the price and quality of goods in different jurisdictions, rather than institutional considerations such as the law and courts of the jurisdiction in question. The problems connected to forum shopping and the role that bargaining power plays in determining a choice of law are therefore

[1] See 1 1 *supra.*
[2] See 1 2 1 & 1 2 2 *supra*.

largely overcome.[3] Uniform sales law rules, such as those provided by the CISG, are aimed at addressing these needs and are generally an effective and efficient solution to the problems experienced in international sales.

Unified sales law, however, is not the only factor that can reduce transaction costs. Despite divergent opinions on its applicability, mercantile custom has since the earliest times played a significant role in commercial transactions.[4] Trade usage can aid the interpretation of a contract and fill gaps that the parties failed to provide for.[5] Even in the absence of party agreement, trade usages can be applicable to the extent that they are certain, well-known and regularly applied in a particular type of trade and therefore expected to be followed by everyone in that trade, even across national borders. Since they are widely known and regularly observed, trade usages are capable of reducing transaction costs inasmuch as they require no negotiation and no clarification.[6] They embody homogeneous and harmonised practices that represent the rules most contract parties would apply in similar circumstances.[7]

Trade usages also have certain advantages over statutory default rules. They are tailored to the needs and requirements of a particular trade and are more susceptible to change brought about by commercial needs than rules that have to be revised from time to time through the legislative process or by the courts.[8] Because they supersede the governing law, the parties to the contract are also freed from the constraints of private international law rules.

In the context of import-export transactions, trade terms play an important role to maximise value and increase the efficiency of the contract. Trade terms are based on mercantile customs and were developed by merchants for use by merchants. They represent trade usages in respect of the delivery obligations of the parties and the allocation of risk of loss of or damage to the goods resulting from events outside the

[3] See in general Linarelli "The Economics of Uniform Laws and Uniform Lawmaking" 2003 (48) *Wayne L Rev* 1387. See also the general discussion on the value of harmonised law 4 2 *supra* and the discussion on the unified rules of private international law 4 3 3 *supra*.
[4] See 1 2 3 and 4 3 1 *supra* for a general discussion on the harmonisation function of mercantile custom.
[5] Bainbridge "Trade Usage in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions" 1984 (24) *Va Jnl Int'l L* 619 623-624; Pamboukis "The Concept and Function of Usages in the United Nations Convention on the International Sale of Goods" 2005-06 (25) *JL & Com* 107; Gillette "Harmony and Stasis in Trade Usage for International Sales" 1999 (39) *Va Jnl Int'l L* 707; Gillette "The Law Merchant in the Modern Age: Institutional Design and International Usages under the CISG" 2004 (5) *Chi J Int'l L* 157.
[6] Bainbridge 1984 (24) *Va Jnl Int'l L* 651; Gillette 1999 (39) *Va Jnl Int'l L* 708.
[7] Gillette 2004 (5) *Chi J Int'l L* 160; Gillette 1999 (39) *Va Jnl Int'l L* 713.
[8] Gillette 1999 (39) *Va Jnl Int'l L* 708.

control of the parties.[9] When it comes to the regulation of price risk, the majority of contracts are concluded on the basis of a trade term.[10] Merchants elect to have these aspects regulated by trade terms because they address the passing of risk in accordance with commercial practice. This study has found that the FOB and CIF trade terms have been the first to develop in the context of shipment contracts.[11] Other terms followed as circumstances and needs surrounding the sale of goods developed. To the extent that they replace elaborate contract clauses and are consistent with the customs and usages commonly applied in certain types of trade or in particular ports, trade terms reduce transaction costs and increase the overall efficiency of the contract.

### 8 2 INCOTERMS as a method of standardising divergent mercantile custom

The harmonisation function of mercantile custom is sometimes limited inasmuch as a trade usage may be confined to a specific geographical area or a type of trade. Trade usages need not be universally known and observed. All that is required, is that the practice should be well known and regularly observed in a particular area or trade. When a party regularly does business in a country or region, he is considered to know the usages applicable in that particular place. Where the contract concerns a specific type of trade in which a usage is internationally known and applied by those involved in that trade, a party will also be expected to know that particular trade usage. This still does not mean that it is a universal usage that applies to all types of contracts or to all merchants in all types of trades at all times and in all places. The result is that the understanding of usages often differ from one country to another or from one type of trade to the other; resulting in legal uncertainty on the content and effect of such usage. It is then left to the discretion of the courts to determine what these obligations may be. [12]

As a reflection of mercantile customs and usages, trade terms are subjected to similar problems. This study has shown that even the oldest and most well known trade terms, FOB and CIF, are prone to divergent interpretations depending on the

[9] See 1 3 *supra.*
[10] See 7 1 *supra*.
[11] See 1 3 2 *supra*.
[12] See Gillette 1999 (39) *Va Jnl Int'l L* 711-712 on the dangers involved when courts have to interpret custom.

type of trade or the physical location in which they are applied.[13] To facilitate consistency in the application of trade usage and eliminate misunderstandings and differences in interpretation, there is a need to standardise the meanings of trade terms. This study analysed the role that INCOTERMS play to standardise trade term definitions and the benefits that are derived from them.

Because INCOTERMS represent a set of rules reflecting the current practice of a majority of the businessmen engaged in international trade, they are more effective than other legal rules that regulate the delivery obligations of the seller and buyer.[14] INCOTERMS take into account the latest practices in trade by providing for multi-modal and container transport in the form of the FAS, CPT and CIP terms, but they also respect long-established practices such as the "ship's rail" in the case of the FOB and CIF terms. By providing for modern forms of transportation, INCOTERMS are able to address the needs of modern international trade and the inefficiencies that may arise from an outdated notion such as the ship's rail in the context of the passing of risk.[15]

Uniformity in the application and understanding of trade terms as well as clarity on the content of the parties' obligations reduce transaction costs and increase the overall efficiency of a transaction. The degree to which trade terms may be harmonised or standardised depends on the consistency of commercial practice. INCOTERMS aim to identify consistent commercial practice in so far as it is practically possible to do so and to formulate that practice into clear and concise language that is easy to understand. However, in regard to issues such as delivery and passing of risk, this study has found that it is impossible to identify absolutely consistent practices that apply universally. The optimal rule in standardising trade terms definitions would therefore have to follow a functional approach rather than a strict rule based one.[16] International sales of goods cover a vast range of trade sectors and types of goods which are to be transported across national borders. Different ports have different customs in regard to the loading and unloading of

[13] See 1 3 4 & 5 1 *supra*.
[14] National laws are inadequate because as a rule they do not do much more than "lay down a few general rules". See Eisemann 1965 "INCOTERMS and the British Export Trade" 1965 *JBL* 114 115. The analysis of different risk regimes conducted in ch 2 has indicated that national laws reflect the politics, economics and ideologies of a particular country.
[15] See 5 4 1 & 5 4 2 *supra*.
[16] DiMatteo et al "The Interpretative Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence" 2004 (34) *Nw J Int'l L & Bus* 299 309-310 suggests that for a functional approach, relative rather than strict uniformity is sufficient. Relative uniformity implies the so-called "lessening of legal impediments to international trade".

goods, which may affect the moment that risk passes from the seller to the buyer. In harmonising trade term definitions it would not be practical to require a degree of harmonisation with zero deviation.[17] INCOTERMS standardise the meaning of trade terms at the hand of the most common commercial practice but at the same time accommodate differences in port customs. A valuable lesson can be learnt from the history and development of the FOB term, namely that rigid definitions and inflexible interpretations which do not recognise the surrounding circumstances in which the term operates may eventually lose touch with reality.[18] Moreover, INCOTERMS recognise that parties may have specific needs which can only be addressed through their own arrangement.[19] The principle of party autonomy is therefore recognised and supported. The functional approach followed by INCOTERMS facilitates international trade by providing certainty and eliminating disputes; thus reducing transaction costs, but at the same time leaving some scope for variations and deviating customs.

INCOTERMS, furthermore, enhance their overall efficiency by following a pragmatic model, which provides for regular revisions of the rules to keep them in line with modern commercial practices and transportation techniques. As an organisation concerned with international business, the ICC has the necessary incentive to search for and correct inefficiencies in existing trade usages. The introduction of trade terms aimed at multimodal and containerised transportation provides an example of their ability to keep up with developments in commercial practice. INCOTERMS also acknowledge the use of technology to facilitate communication.[20] By gathering and disseminating information about new practices, the ICC INCOTERMS can overcome so-called "learning effects,"[21] thereby reducing the information costs that tend to entrench the *status quo* of legal rules instead of adapting to changes in commercial practices.[22] Moreover, the wide range of INCOTERMS enable parties to an international sales contract to make a choice that will best suit their individual situation. The choice will be determined by the nature of the goods, whether they are

[17] See 4 4 1 3 *supra* for a discussion on the degree and scope of harmonisation efforts
[18] Sassoon *CIF and FOB Contracts* 4th ed (1995) para 434. Devlin J in *Pyrene v Scindia Navigation* [1954] 2 QB 402 424 *also* described the FOB contract as a "flexible instrument".
[19] See 5 5 *supra* for a discussion on trade term variations.
[20] See the discussion on the development of INCOTERMS 5 2 3 1 *supra*.
[21] See Walt "Novelty and the Risks of Uniform Sales Law" 1999 (39) *Va J Int'l L* 671 692-697 for a discussion on the effect of learning externalities on uniform sales law.
[22] Gillette 1999 (39) *Va Jnl Int'l L* 737. He explains that a centralised entity for collecting and disseminating information compels the participants in a network to make a simultaneous transition to a new practice.

containerised or bulk goods and also by whether they are transported solely by sea or by means of a multimodal transportation method.[23]

The analysis of the risk regimes of a number of national legal systems and the CISG found that party agreement generally enjoys preference over default rules on risk. INCOTERMS would therefore precede the governing law.[24] However, when the parties have agreed on the use of a particular trade term but failed to indicate whether INCOTERMS will govern the interpretation of the chosen trade term, the situation is not always that straightforward. Because the ICC's formulations do not carry the weight of autonomous law, the application of INCOTERMS depends on party agreement, whether express or tacit.[25] Whether INCOTERMS can apply independently of party agreement is a controversial issue. Scholars disagree on whether INCOTERMS have reached the stage that they have acquired the status of normative custom *in toto*. Some argue that only the older and more recognised trade terms, such as FOB and CIF, may have autonomous application, but that the more modern terms are still not that well-known and regularly applied that they will constitute mercantile custom in the normative sense.[26]

The study concluded that this issue depends on whether INCOTERMS as codification have become so widely known and observed that the parties to the contract could be expected to have knowledge of them. The more those engaged in international trade make use of INCOTERMS, the sooner these rules will acquire the force of international custom or trade usage[27] and the more readily will they be incorporated into contracts. The case law indicates that article 9 CISG could provide the basis for the autonomous application of INCOTERMS.[28]

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[23] Bargaining power also plays a role here as the choice of term directly influences the price of the goods. For example, a CIF contract will imply higher costs because of the inclusion of insurance costs and therefore the price will be adapted accordingly. See Gabriel "International Chamber of Commerce INCOTERMS 2000: A Guide to Their Terms and Usage 2001 (5) *VJ* 41 43; Ramberg *ICC Guide to INCOTERMS 2000* (1999) 19-20 for other considerations that could come into play when considering the appropriate trade term.

[24] See 7 3 *supra*.

[25] See 7 2 1 *supra*.

[26] See 7 2 2 *supra*.

[27] Eisemann 1965 *JBL* 122. See also 7 2 2 *supra*.

[28] Eg *St Paul Guardian Insurance Co et al v Neuromed Medical Systems & Support et al* 2002 US Dist LEXIS 5096 (SDNY March 26 2002), United States Federal District Court New York 26 March 2002 http:/cisgw3.law.pace.edu/cases/020326u1.html (accessed 20-08-2009); *BP Oil International v Empresa Estatal Petroleos De Ecuador supra* 332 F 3d 333 (5th Cir 2003) 338, Federal Appellate Court [5th Circuit] United States 11 June 2003 http://cisgw3.law.pace.edu/cases/030611u.html (accessed 21-08-2009).

It is said that in the case of standard contracts, usages and customs are sometimes imposed on commercial parties irrespective of their real intentions. A refusal to adopt a standard contract could mean that a merchant is excluded from the organised sector of the trade or a particular market and, hence, little choice is left than to agree to its terms. It has even been argued that the abolition of trade term definitions from article 2 UCC in favour of the use of INCOTERMS is merely "an effort to keep domestic firms within the network of trading nations."[29] Although this may be true in some cases, this argument should not diminish the value of INCOTERMS as an efficient means of standardising trade term definitions.

### 8 3 Final observations and proposals

INCOTERMS are an effective method of trade term standardisation as they present stability and uniformity to a degree that is functional but still reduces transaction costs. INCOTERMS reduce transaction costs by providing certainty, clarity and predictability, but at the same time they manage to remain flexible by allowing the parties to a contract to deviate from their rules where appropriate. As a codification of international customs and usages, INCOTERMS facilitate international business by addressing the needs of modern international trade. This is a clear advantage that transnational formulations created by international agencies such as the ICC have over national and international legislation, which can only provide a broad general setting within which the contract may operate.

From the perspective of developing countries, INCOTERMS could have special benefits. These countries are more prone to trade risks than developed or industrialised countries. A lack in economic and bargaining power, often coupled with poor infrastructure and political instability, makes it much more difficult for these countries to effectively compete in the international market. Merchants may be uninformed of trading practices that are well-known in developed countries and may hence operate under a clear disadvantage when it comes to trading internationally. The fact that few lawyers in these countries are specialists in the field of international trade exacerbates the problem. Where goods are exported from a developing country or imported into such a country the transaction should be regulated by clear and concise legal rules that are easily understood and certain. In so far as the

[29] Gillette 1999 (39) *Va Jnl Int'l L* 736-737.

understanding of international trade usages pertaining to delivery and the passing of risk is concerned, INCOTERMS can regulate and facilitate the transaction effectively and efficiently.

It has been suggested that developing countries in the Asian Pacific region should adopt INCOTERMS as the default rule for defining trade terms. INCOTERMS will then function, not as a private opt-in provision, but as a statutory opt-out provision.[30] It is argued that by operating as a statutory default INCOTERMS could provide a safety net for small businesses and those unfamiliar with the complexities of international trade.[31]

Could this argument be applied to facilitate cross-border trade in Africa? Cross-border trade has specific benefits in that it increases revenue and stimulates economic growth. A stable economy also facilitates political stability and increases respect for democratic principles and human rights.[32] Since 1994, South Africa has experienced the advantages of international trade as a tool for promoting social and economic development, creating work opportunities, increasing income, reducing poverty and improving the living conditions of its citizens.[33] The commercial development of the African continent is, however, dependent on conditions that are conducive to cross-border trade. Since independence, most African countries have embraced the idea of liberal trade regimes that reduce or eliminate tariff and non-tariff barriers to trade, which are also supported by The African Union (AU) and the New Partnership for African Development (NEPAD). Over the last decades, a number of regional economic communities (RECs) have been created to stimulate trade amongst African countries.[34] Regional trade blocs have been influential on a

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[30] Roth & Roth "INCOTERMS: Facilitating Trade in the Asian Pacific" 1997 (18) *U Pa J Int'l Econ L* 731 737-741 suggest that INCOTERMS should be endorsed by the Asian Pacific Parliamentarians Forum (APPF) and be introduced into the national laws of the countries of this region by means of statute. The authors also provide a Model INCOTERMS Act as an example of how an APPF resolution could be incorporated into national law.

[31] Businesses that are unfamiliar with INCOTERMS tend not to make use of them. In 1995, the ICC sent out two world wide bulletins to warn against this oversight. Although the use of INCOTERMS in developed countries have risen significantly since then, this has not been the case for developing countries. The proposal to promote INCOTERMS as a statutory rule in developing countries is therefore aimed at extending the benefit of INCOTERMS to countries which are not familiar with these rules.

[32] Eiselen "Adoption of the Vienna Convention for the International Sale of Goods (the CISG) in South Africa" 1999 *SALJ* (116) 329 324.

[33] As per SA's representative at the UN General Assembly Legal Committee, Sivuyile Maqungo *Links between Commercial Law Reform and "Culture of Rule of Law"* 63rd GA 5th Committee 20 October 2008 GA/L 3346 http://www.un.org/News/press/docs/2008/gal3346.doc.htm (accessed 30-08-2009).

[34] Most African countries are members of one or more regional trade agreements (RTAs). Of the 53 countries, 27 are members of two regional groupings, 18 belong to 3, and country is a member of 4. Only 7 countries are members in only one trade bloc. See UNCTAD *Strengthening Regional Economic Integration for Africa's Development* Economic Aid in Africa Report 2009 UNCTAD/ALDC/AFRICA 2009 18 http://www.unctad.org/en/docs/aidafrica2009_en.pdf (accessed 29-08-2009) 11.

macro level by regulating the public law aspects of international trade. However, private law related impediments experienced by international trade should be addressed as well. Thus far this has been perceived as an aspect that is to be dealt with on the micro level and therefore to be regulated by private agreement. The proposal that INCOTERMS should act as a statutory opt-out provision could be extended so that RECs or trade blocs with legislative authority can either adopt or endorse INCOTERMS.[35] The adoption of the rules will result in their application to transactions between and with member states independently of party agreement.[36] Because of the endorsement of INCOTERMS by RECs, parties will be more inclined to conclude their contracts on the basis of INCOTERMS, but for those who still do not want to be bound by INCOTERMS, the option of contractual exclusion will be available.

The adoption of INCOTERMS reduces risk in two ways: firstly, parties are more likely to share a common understanding of the meaning of the trade term they use; and secondly, they can consult the INCOTERMS rules as a common point of reference.[37] INCOTERMS can contribute to the creation of a stable uniform trade environment for developing countries in which traders could do business without the risk of uncertainty on matters connected to the delivery obligations of the parties. Small businesses which do not have the means of knowing international trade usages might find the uniform use of INCOTERMS reassuring. Moreover, they will still be allowed to opt out of the rules if they so decide.

Although this may be a viable proposal for developing countries, in practice its value will be limited for African countries unless combined with a unified sales law. This study has shown that although INCOTERMS have much value as an instrument which standardise trade term definitions, they still do not unify all the aspects connected to an international contract of sale. INCOTERMS have a limited scope inasmuch as they only regulate certain aspects of the contract of sale, mainly in connection with the delivery obligations of the parties and the passing of risk. For aspects that are not regulated by the codification, INCOTERMS still have to be

[35] See Roth & Roth 1997 (18) *U Pa J Int'l Econ L* 740-741 for an example of a Model Resolution for Consideration in the context of the APPF.
[36] A so-called "bottom-down" approach.
[37] Roth & Roth 1997 (18) *U Pa J Int'l Econ L* 738.

supplemented by the rules of the substantive law.[38] INCOTERMS will only reach their full potential if they can operate in conjunction with a unified sales law.

In Africa, the need for a uniform sales law is crucial. Although the legal systems of countries in the SADC region are to a large extent based on the Roman Dutch traditions and, therefore, do not differ significantly, the problem of a multiplicity of legal systems still exists when dealing with countries outside the region. In southern Africa, only Lesotho and Zambia have ratified the CISG and in the whole of Africa only eight countries have done so to date.[39] There are no valid reasons for South Africa's failure to ratify or accede to the Convention, and the same applies to the majority of African countries which have not done so either. Even if INCOTERMS were to be promoted to the level of a statutory instrument, their value as a form of standardisation in international trade will only be fully realised once they function in collaboration with a uniform sales law such as the CISG.

Although this study does not reject the statutory opt-out route, the true efficiency of INCOTERMS is dependent on an increased awareness of their value. The more merchants use INCOTERMS, the more they will become known and be applied as international commercial custom. Dissemination of information on INCOTERMS is important as knowledge and awareness will increase their value, not only for developing countries but also in those developed countries where merchants have become used to nation-specific definitions of trade terms.[40]

This study has shown that the CISG is an appropriate international instrument of unification to supplement and complement the INCOTERMS. In the first instance, they are both international instruments aimed at harmonising aspects pertaining to international sales contracts. Secondly, INCOTERMS represent a codification of mercantile customs and usages. The CISG, in turn, places a high premium on the value of trade usage. This study has shown that INCOTERMS can be incorporated into a contract governed by the CISG through agreement or, in the absence of party agreement, by virtue of article 9 CISG.[41] Thirdly, although INCOTERMS and rules of the substantive law, such as the CISG, play different roles, they are supporting roles.

[38] See 5 7 & 7 3 *supra*.
[39] They are Burundi, Egypt, Gabon, Guinea, Lesotho, Mauritania, Uganda and Zambia. See http://www.cisg.law.pace.edu/cisg/countries/cntries.html (accessed 18-07-2009).
[40] Such as the USA, where the UCC definitions have been in force for a long time or Britain where the courts are still reluctant to apply INCOTERMS in the absence of express reference. In a recent case, *Stora Enso Oyi v Port of Dundee* [2006] 1 CLC 453, the interpretation of a contract with reference to INCOTERMS was denied because they were not explicitly incorporated into the contract.
[41] See 7 2 2 *supra.*

There is a strong correlation between the risk rules of the CISG and those of INCOTERMS in so far as they are based on the same underlying premises, namely that risk should follow control. These premises are sufficiently aligned to permit a symbiosis between INCOTERMS and the CISG. This study also concluded that it is an over-simplified view to hold that INCOTERMS exclude the operation of the CISG risk rule altogether. Although INCOTERMS as a codification of mercantile customs and practices will supersede the CISG rules on risk because of the principle of party autonomy and the fact that trade usage trumps the provisions of the Convention, the CISG risk rule is still capable of supplementing the INCOTERMS rule insofar as it addresses issues pertaining to risk which are not covered by the ICC codification. Moreover, the CISG is effective in supplementing the INCOTERMS on issues that are not covered by them, such as contract formation, breach of contract and the effect of impediments on the obligations of the parties. Supplementation is not a one-way street; INCOTERMS can also provide relief where there are gaps in the Convention's rules.[42]

This study has concluded that it is impossible to isolate one single method of direct or indirect harmonisation which is to be regarded as the optimal method to address the needs of international sales.[43] Even though the CISG provides unified default sales law rules, it was never intended that the Convention would standardise trade term definitions. This is not to be considered as an disadvantage since INCOTERMS are capable of fulfilling this role effectively and efficiently. The real challenge is to use the various instruments of harmonisation in collaboration so that together they can enhance the efficiency of the governing law of a contract. The various techniques and instruments of harmonisation should, therefore, not be regarded as being competitive but as mutually supportive of and supplementing one another. Efficient harmonisation of law depends not on a choice of the single best instrument, but on productive collaborative use of various methods. The CISG, supplemented by the UNIDROIT Principles and the INCOTERMS are instruments that are capable of harmonious co-existence.[44] They can support each other by being jointly employed in a contract of sale to increase the efficiency of the transaction.

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[42] See the discussion on the complementary roles of the CISG and INCOTERMS 7 3 *supra*.
[43] See 4 4 3 *supra*.
[44] Eiselen 1999 (116) *SALJ* 323 369 holds that unification will not be successfully introduced if one is to rely on a single instrument. He argues that the UNIDROIT Principles should be added to the list of INCOTERMS, the UCP and the CISG. Similar sentiments are shared by Rosett "UNIDROIT Principles and Harmonization of International Commercial Law: Focus on Chapter Seven" 1998 (46) *Am J Comp L* 347.

Moreover, an international business transaction comprises various components which, in collaboration with each other, promote wealth and economic stability. Given the complexity of the transactions, the diversity of legal systems and the global scale that trading activities assume today, it will be impossible for one single set of rules to govern the transaction in all its respects. Apart from legal rules that apply to the sales law aspects of the transaction, there are a myriad of rules regulating transportation, payment, insurance, distribution, agency, fiscal matters and other aspects. The constant interplay between the rules of various branches of commercial law is by no means an indication of the inefficiency of a specific rule. Since INCOTERMS and the CISG, each on their own, fail to address all the issues connected to an international sales contract, together they bring benefits that otherwise would not have existed. A particular form of harmonisation cannot function in a vacuum but should constantly interact with other harmonisation instruments to facilitate international sales law and make it more effective. The true efficacy and efficiency of INCOTERMS as a form of standardisation in international sales should therefore be judged on what they can achieve in conjunction with other efforts to harmonise the law applying to international business transactions and thereby facilitate international trade.

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