ANALYZING THE PASSING OF RISK UNDER THE CONTRACTS ON INTERNATIONAL SALE OF GOODS

Apeksha Chauhan*

Abstract

The allocation of risk is an issue which preoccupies equally both the seller and the buyer in an international sale contract, since it can affect the course and outcome of their transaction to a great extent. The rules on passing of risk answer the question of whether the buyer is obliged to pay the price for the goods even if they have been "accidentally" lost or damaged or whether the seller is entitled to claim their price. Because of its harsh and sometimes unfair consequences, the passing of risk forms a subject, which the parties specifically refer to in their contract in an attempt to avoid confusion and possible litigation. Owing to its importance, it could not be left out from the scope of one of the most successful attempts at unification of international sales law, which is the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG). Analogous rules are included in the International Chamber of Commerce's standard trade terms, INCOTERMS, which are widely used by commercial men and companies around the world. The present study will commence with some remarks on the history and scope of the Vienna Convention and some thoughts on trade terms and INCOTERMS. It will also examine the notion of risk and the theories on its transfer, which have been formulated in different legal systems. It will focus on the rules on risk allocation under the Vienna Convention and INCOTERMS 2000. Finally, the present study will conclude with an overall evaluation of the rules pertaining to risk allocation and a wish that soon satisfactory solutions will be found for the problems that trouble this area of law.

Keywords: International sale, INCOTERMS, CISG, International Business, Goods

* *Student-LL.M.* @ National Law University, Odisha; Email: 17llm009@nluo.ac.in; Contact: +91-9871678706

INTRODUCTION

The allocation of risk in a transaction relating to international sale of goods is one of the most significant factors involved between the buyer and the seller as it can bring alteration in the final outcome of their transaction to a huge extent. It is obvious that the goods are not only exposed to the risk of physical destruction or damage but other factors like governmental interference, vandalism, seizure due to export or import bans could also play a relevant role. *"Owing to its importance, it could not be left out from the scope of one of the most successful attempts at unification of international sales law, which is the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG)".*

The general principle is that the CISG requires the identification of the goods for the risk to pass.[1] The theory of passing of risk that applies to the CISG creates a connection with regard to the passing of time and the time at which the goods are to be delivered. It is therefore an established fact that out of the parties, the one that has physical control on the goods would be the bearer of the risk when such type of a circumstance arises. This theory comes across as the most sensible and reasonable theory out of the lot, because the party which has the physical control of the goods is in a more feasible position to take care of them and prevent them from any damage and can also safeguard them.[2]

However, in cases with respect to the contracts dealing with the international sale of goods, the goods are not given to the seller in a direct manner, there is always an involvement of a carriage in between that is responsible for making the goods reach the buyer. This leads to the creation of a very confusing situation and both the seller and buyer are not in the possession of the goods, rather they are under the control of the carrier. Normally, in such circumstances the buyer bears the risk. This may seem to be unfair to the buyer, as he is not in direct control of the goods, and at the very same moment it is not in a position to protect and keep an eye on the carriage. Thus in such situations the bill of lading plays a very diligent role for the buyer.

"*It is worth mentioning that very often the bill of lading is used for the payment of the price when a letter of credit is involved. However, in these cases, the bill of lading has proven to be a useful mechanism, which soothes the buyer's unfavorable position of having to bear the risk for goods. Under a Letter of Credit transaction, the buyer and seller agree previously on*

[1] Piltz, *Internationales Kaufrecht*, para 4-275
[2] The Theory of Risks in the 1980 Vienna Sale of Goods Convention

a sale contract, the buyer would provide instructions to its issuing bank to open a documentary credit in favor of the seller. The issuing bank then asks the bank in the seller's country to advise the seller of opening of credit. The seller is then able to collect payment only after providing all the correct documents referred to in credit, proving that he shipped the goods.[3]"

The provisions with respect to the passing of risk under the CISG Convention are exclusive and to the application of the given provisions in complete sense and Article 66-70 of the CISG provide for the regulatory provisions with respect to the concept of passing of risk. However, the CISG does not define the meaning of "risk" in any of its Articles. But the Convention does provide for consequences for its transfer and also discusses and examines the passing of risk in each individual case.

The rules on passing of risk do not involve risks that are created by the general fluctuations in an economy. For example, if a seller is not able to resell the goods because of the changes in the market environment or if there is fluctuations in the currency, then the deterioration or damage caused in such a situation would not be recovered by applying the rules of passing of risk. The rules of passing of risk merely provide for the point in time at which the goods had to conform to its respective contract.

CONSEQUENCE OF THE PASSING OF RISK- ARTICLE 66 CISG

Article 66 of the CISG Convention briefly mentions the implications of the risk on the parties of a contract by stating that the damage or loss of goods does not give the right to the buyer to not fulfill his obligations of payment. The buyer to whom risk has passed is still obliged to accept damage goods and make the payment for them as long as the loss or damage is accidental the buyer has to fulfill his obligations without having the right to claim that it is seller's non-performance. However, the wording of the Article 66 is not exhaustive. The Convention's notion of risk includes various forms and types of different circumstances of loss of goods like, theft, handing over the goods to the wrong recipient; even loss of weight of the goods also falls under the category of risk. "Article 66 does not require a breach of obligation but an act of omission on behalf of the seller."

[3] *The Convention generally embraces the view that the party which should bear the risk of accidental loss or damage to the goods should be the buyer, since the loss or damage is usually revealed at the end of the day when the goods are in the buyer's hands.*

In the case of Piperonal Aldehyde[4], "there was a contract between a Chinese seller and a buyer from US which contained the trade term CIF (Cost, Insurance, and Freight), under which the risk passes after the goods have passed the ships rail at the Chinese port. The seller was liable for being unable to provide the carrier with proper instructions regarding the temperature that had to be maintained when the goods are stored during carriage. The Chinese arbitral tribunal found the seller guilty for loss of the chemical goods by melting. The final phrase of Article 66 'unless the loss or damage is due to an act or omission of the seller' is not limited to acts or omission of the seller that would breach his obligations under the contract; however such a proposal was rejected by the commission when the draft of the same was being discussed.[5]"

But in certain situations the actions of the seller that cause damage to the goods will not be constituted as a breach of contract. "The second part of Article 66 is of great significance, as even when the risk has been passed, the seller can still interfere with the goods so as to cause damage and the second half of the Article 66 makes it clear that the buyer would not have to pay the price when the damage is caused by an act of seller.[6]"

The CISG thus clearly covers the situations where the seller does not breach his contractual obligations but conducts a breach of legal duty, which might be unlawful under the law of torts but not under the law of contract.[7]

Following the basic concept of passing of risk that is so embodied in this Article, the seller retains the claim for the purchase price after the passing of risk, even if good have been lost or damaged. Where the competent court allowed denying the sellers claim under its own law, it would be allowed to do so also under the CISG. It is thus preferable to use a fair standard of reasonableness with relation to the passing of risk. The last part of this Article provides for the requirement that the loss or the damage of the goods must be coincidental. It is required that the loss or damage is not attributable to the seller.

PASSING OF RISK IN CASES INVOLVING CARRIAGE OF GOODS- ARTICLE 67 CISG

[4] China International Economic and Trade Arbitration Commission (People's Republic of China) 1999, Piperonal Aldehyde case, Clout case no. 683, Available at: http://cisgw3.law.pace.edu/cases/990000c1

[5] B. Nicholas in C. M. Bianca and M. J. Bonell, Commentary, 485

[6] X, UNCITRAL Yearbook VIII, New York, United Nations, 1977, pp. 527-528.

[7] *Supra* note 5; See also, G. Hager and M. Schmidt-Kessel in P. Schlechtriem and I. Schwenzer, Commentary, 925

Mostly all of the international sales contract involve sale by the way of carriage of goods. This Article provides for the very basis of passing of risk under the convention. The very first step that should be taken is to examine what is the exact meaning of sale of goods by the way of carriage. This can be meant to be that it is the liability of the seller to provide for all the facilities with respect to carriage of the goods at the same time it is his responsibility to make sure that the goods are reached safely to the buyer. All the activities between the buyer and the seller should take place in harmonization with the contract of sale. So as to make sure that the risk is passed on to the buyer from the seller, the seller should send the goods by the way of a third party carrier and not through its own personnel. The very simple logic behind this is to lower the chances of disputes and so as to save the cost of litigation.[8]

In case of multi modal transport, wherein goods are carried by way of more than one mode of transportation, the risk would pass at the time goods are handed over to the first carrier. In such cases, the buyer is always at a more meritorious position because he has the advantage of finding defects or any harm if has been exerted on the goods and can also claim for insurance for the same. Second part of Article 67 clearly states the need that the goods should be "clearly identified to the contract" so as to pass the risk from the seller to the buyer.

By the inculcation of this provision under the CISG the buyer is given protection from any false or fraudulent claims of the seller. "It is therefore, necessary that the goods are identified, according to the Article's wording, when the seller marks the goods, when the goods are expressly indicated in the shipping documents, when the seller gives notice to the buyer, or in any other way, since the enumeration in Article 67(2) is not exhaustive. In the case of fungible[9] bulk goods and of collective consignments create a special issue because in these cases are very complex it is very tough to ascertain the exact time of passing of risk."

"*This has been supported by different opinions,[10] Cases of collective consignments (where this is permitted by the contract or a trade usage) include cases where there is one cargo of goods of the same kind (i.e. oil, wheat, natural gas), which is meant to cover several contracts of sale, by distributing parts of the cargo to several buyers. It is true, that the*

[8] *Transfer of Risk in the Contract of Sale involving Carriage of Goods: A Comparative Study* in English, Greek Law and the United Nations Convention on Contracts for the International Sale of Goods

[9] The meaning of 'fungible goods' is provided in Article 415 (Definitions) of the North American Free Trade Agreement (NAFTA) in Chapter Four (Rules of Origin), according to which 'fungible goods or fungible materials means goods or materials that are interchangeable for commercial purposes and whose properties are essentially identical'. NAFTA (1992) 32 ILM 289 (1993)

[10] P.Schlechtriem, op cit, Art 67, para 10a, S.Bollée, op cit, 256 and F.Enderlein and D.Maskow, op cit, 269

problem arising in passing of risk in cases of identifiable bulk goods is a peculiar one, and is still not clearly settled by the Convention."

The sale of collective assignments and bulk goods requires very specialized policies and terms within the contract so as to make sure that the sale of such assignments is done with efficiency, thus all the parties that are involved in such trade are usually recommended to provide for each and every peculiar detail of the consignment.

For example, "let us presume that there is a ship loaded with 5,000 tons of wheat without any identification, that were meant to satisfy several sale contracts for various buyers, and out of which 3,000 tones suffered severe damage because of overheating before the division of the cargo. In such circumstances, one view suggests that 'the identification of the goods to the contract needs to relate only to the collective consignment. The buyers bear the risk collectively. A partial loss is borne by them pro rata; if the whole consignment is lost, each party loses his entire share'. And the second view argues that the identification takes place only when the goods are divided among the various buyers with the taking over of the goods. Thus, if the goods suffer loss or damage before their division, the buyers will not have to pay the price."

GOODS SOLD IN TRANSIT- ARTICLE 68 CISG

Article 68 deals with the sale of goods that are in transit, it is usually the case wherein the seller has already started his journey along with the goods without the full and complete knowledge about the buyer or the recipient. In such a case the contract will be said to have been concluded the moment the journey of the seller has begun, however the goods are still in transit[11]. This is because such goods would be bought and sold many time before they reach their final destination. One of the drawbacks that Article 68 carriers is that it provides for splitting of the risk that is there in transit. In majority of such circumstances, it is very tough to judge whether the loss had taken place before the final conclusion of the contract of sale or before.

In the second half of the Article, the risk passes retroactively from the time the goods were handed over to the carrier who is responsible for issuing the documents embodying the

[11] *By sending to the buyers the relevant documents, for example the bill of lading (when there is carriage of goods by sea), the invoice, the insurance contract, the certification of quality etc.*

contract of carriage. These documents must provide for evidence of the existence of the contract of carriage, since in a contrary situation the rule is inapplicable.

"The third sentence of Article 68 'introduces a proviso'; it provides for that when the seller had known or was supposed to know at the moment when the contract was concluded, that the goods had suffered damage or loss and did not provide information to the buyer regarding the same, then he bears the risk of the loss or damage. In case the seller is punished for his bad faith; the question that arises, is whether this sentence refers to both previous sentences or not. Furthermore, the third sentence of Article 68 involves further problems of interpretation; it states that the seller bears the risk of "the loss or the damage", but does not provide for any further clarification. Another point unclear under Article 68 is whether it is necessary for the passing of risk in sales of transit goods, for the goods to be identified to the contract. The Article does state, the requirement of identification of goods."

However there are a huge number of uncertainties as per the context, meaning and interpretation of Article 68 of the CISG, the practical relevance arises where there is an actual loss of goods.

THE RESIDUAL CASES- ARTICLE 69 CISG

Under the ambit of Article 69(1), "the risk is passed on to the buyer at the instance when the goods are in the control of the buyer. The goods are kept at the disposal of the buyer only when all the requirements are met with so as to gain physical control over the goods. Hence, if the goods are at the buyer's disposal and he is delaying in taking delivery for a long time, so as to commit a breach of contract, then the risk passes to him just at the moment when the goods are placed at his disposal. If the place of delivery is any other place than the seller's place of business then Article 69(2) comes into effect.

The third portion of Article 69 requires, "as a prerequisite for the risk to pass to the buyer, the clear identification of the goods to the contract. A very similar rule was encountered earlier in Article 67(2) and thus the same remarks would apply to both the provisions. The sellers is expected to then send a notice to the buyer to give him the information that the goods have been identified and are at his disposal; he would have then fulfilled his obligation to enable the buyer to take over the goods. In cases with respect to fungible goods there is a need for

required identification so as to make sure that the goods are on an acknowledgement, wherein the warehouse keeper has kept it on buyer's behalf.[12]

This Article deals primarily in situations where the buyer and the seller are at the same place. It requires the sale to happen when there the seller must bring the goods to the buyer at a place agreed upon. The buyer cannot prevent the passing of risk by delaying taking over the goods and thereby burden the seller continuously with the risk of loss or damage. The very central element of this Article is placing the goods at disposal rather than the delay in taking over of the goods. However in real life situations, the requirement of buyer's actual knowledge will in very rare circumstances give rise to difficulties. The notification provided by the seller to make the buyer aware of the fact that the goods have been placed at disposal is very significant.

RISK AND REMEDIES- ARTICLE 70 CISG

The need for this Article is felt when the seller commits a fundamental breach of contract with respect to passing of risk. Therefore, 'the buyer's remedies as per the account of the seller's fundamental breach of contract are taken at priority over the risk rules'. The significantly necessary prerequisite is the commitment of a fundamental breach of contract[13] by the seller.

It is very obvious that the loss or the damage of the goods should not be caused by the reason of the seller's fundamental breach; rather it should be accidental, this is because in the former case we would not be talk about passing of risk, but about a breach of contract because of an act or omission of the seller.

Article 70 is silent on the relationship between the passing of risk and the breaches that are present at the time of passing risk, but which is below the threshold of Article 25. The provisions with respect to fundamental breach should not be misunderstood that in case when the breach so done is not fundamental, but still the remedies are triggered.

[12] *Where unascertained goods are of such a kind that the seller cannot set aside a part of them until the buyer takes delivery, it shall be sufficient for the seller to do all acts necessary to enable the buyer to take delivery.*

[13] *A breach of contract committed by one of the parties is 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.*

"In a case opposite to the above situation, where the breach is not fundamental, the risk is passed normally to the buyer and he has at his own discretion only the remedies of repair, reduction in price and damages for the goods that were defective before the passing of risk. Moreover, he has to bear the risk of any damage or loss of the goods due to an accidental event. He would not have the discretion to declare the contract of sale avoided or ask for substitute goods, since these remedies are only available in cases of fundamental breach of contract."

CONCLUSION

Articles that are provided under the CISG Articles 66-70 provide the rules that are concerned with the passing of risk in the sale of goods in international manner. The parties that had drafted the convention were of the view that the practices that are included in the CISG should be with harmony with the principles of international customary law and as per the lex mercetoria. By providing special focus for the rules on the passing of risk that also includes carriage; they partly succeeded in this mission. If we carefully look into the various provisions of the part relating to the passing of risk, we can find that there are ambiguities that could have been avoided. There is no definition given to concepts such as 'handing over', 'the first carrier' and 'circumstances leading to retroactive risk passing.' The very lack of defining such important terms, leads to different opinions by different scholars, which is not supportive of the goal of the drafters to create a uniform law of sales. Furthermore, the drafting parties should have fixed the contradiction of Article 70, although the practical implications of this contradiction are rare.

The compromise that was reached in Article 68 is understandable taking into consideration the very difficulties encountered while negotiating. The choice of the drafters to add to this dispute-creating regime could have been avoided. The second sentence of the Article will however remedy this in most situations; nevertheless I think that the Convention should have better provided us with the circumstances for when retroactive risk passing occurs, for example the transfer of insurance policy, instead of using the vague wording it contains now.