

Dissertation

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CISG - what risks does it involve to seller and how does he secure against them?
- a practical guide

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Chapter I: Purpose of the dissertation

The United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG) governs more than 70 % of all international sales transactions. Sellers and buyers involved in international sales of goods will therefore likely become acquainted with the Convention sooner or later.

The purpose of this dissertation is to identify what risks the CISG involves for seller and to describe how he can allocate, reduce or eliminate these risks.

For this purpose I will make use of cases – judgments as well as arbitration awards – as they will hopefully give a better picture of what risks seller is exposed to in “the real life” than the wording of the CISG itself does. The internet provides *numerous* cases involving the Convention. I will only concentrate on the leading cases.

Entering into an international sales contract will, in many cases, involve negotiations between seller and buyer.¹ Often seller’s interest in minimising his risks will conflict with buyer’s interest in minimising his own risks. Thus seller cannot be sure that buyer will accept all conditions, including conditions on allocation of risks etc., set out by him. Depending on the relative strength between seller and buyer, the contract will more likely be a compromise between them. This dissertation hopefully gives seller some ideas on what he should *try* to agree on to minimize his risks as much as possible.

¹ Notwithstanding the increased use of standard contracts, it is still possible for the parties to amend or supply it by negotiation.

Chapter II: Background to the CISG

II.1: The international *lex mercatoria*

As a principal rule, seller and buyer in an international sales contract are free to choose the proper law, i.e. the law governing their contract. They can choose the legal system of a country or they can choose a system of rules unrelated to any country – often referred to as the international *lex mercatoria*. The international *lex mercatoria* has been defined as:²

“The international *lex mercatoria* embodies the legal norms governing the activities of persons in international trade” and “the international *lex mercatoria* is the body of law governing the activities of the international merchant.”

Legal writers distinguish between the old and the new *lex mercatoria*.³ Generally, while the old *lex mercatoria* is based on practices and usages, the new *lex mercatoria* is embodied in codes/conventions resulting from compromises in international organisations.⁴

For the merchants it is, of course, of importance to ascertain whether the rules embodied in the international *lex mercatoria* have legal force, i.e. whether they imply enforceable legal rights and obligations. Clive M. Schmitthoff states that the international *lex mercatoria* is legally justified by existing by leave and license of sovereign national states.⁵ Furthermore, the international *lex mercatoria* is, to a great extent, an expression of customary law.⁶

The fact that the international *lex mercatoria* is regularly referred to by judges and arbitrators seems to me to be the strongest indication that the international *lex mercatoria* is recognised as having legal force. In *Deutsche Schachtbau- und Tiefbohrergesellschaft v Ras al Khaimah National Oil Co*⁷ the parties in the contract had not agreed on the proper law, but the arbitrator and later the Court of Appeal found that there was an implied choice of “in-

² Hercules Booyesen *International transactions and the international law merchant* 1st ed. (Pretoria: Interlegal, 1995) p. 3-4. There is, however, no unambiguous definition.

³ John Felemegas ‘The United Nations Convention on Contracts for the International Sale of Goods: article 7 and uniform interpretation’ in *Review of the Convention on Contracts for the International Sale of Goods (CISG) 2000-2001* (Kluwer Law International) p. 139. See also Aleksandar Goldstajn ‘*Lex Mercatoria* and the CISG: the global law merchant’ in Petar Sarcevic & Paul Volken *The international sale of goods revisited* (The Hague: Kluwer Law International, 2001) p. 241.

⁴ Felemegas *ibid* p. 139.

⁵ Clive M. Schmitthoff ‘The unification of the law of international trade’ in Schmitthoff’s *Select Essays on international trade law* (Dordrecht, 1998) 170 at p. 172 quoted in Booyesen *supra* p. 10-11.

⁶ Booyesen *supra* p. 11.

⁷ [1987] 2 All ER 769 (CA) p. 778-779.

ternationally accepted principles of law governing contractual relations” within the field of oil drilling.

By providing substantive legal rules unrelated to any country, the international *lex mercatoria* is neutral in relation to each party in an international sales contract. It is therefore appropriate to choose as the proper law in a situation where each part is unwilling to be subjected to the legal system in the other party’s country.

II.2: The CISG as international *lex mercatoria*

Booyesen states that the CISG is one of the most important legal sources of the international *lex mercatoria*⁸ but also international commercial customs and general principles of law form part thereof.⁹ Furthermore the UNIDROIT Principles of International Commercial Contracts can be regarded as international *lex mercatoria*.

If the parties in an international sales contract choose the international *lex mercatoria* as the proper law, it is argued that this automatically implies a choice of the CISG, unless the parties have expressly excluded the use of the Convention.¹⁰ The argument seems right where both parties live in countries where the CISG forms part of the domestic law (“contracting states”). It is, however, arguable whether the argument also applies where none of the states are contracting states. Therefore, if the parties want the CISG to be the proper law, it is recommended that they mention this expressly in their contract.¹¹

If, on the other hand, the parties have chosen the CISG as the proper law, it cannot be concluded that they have thereby chosen the international *lex mercatoria* as proper law where the CISG does not apply. The proper law must here be found through the rules of private international law (PIL).

⁸ Hercules Booyesen *Principles of international trade law as a monistic system* 1st ed. (Pretoria: Interlegal, 2003) p. 594.

⁹ Booyesen *International transactions and the international law merchant* supra p. 2.

¹⁰ Booyesen *Principles of international trade law as a monistic system* supra p. 576.

¹¹ In a judgment of 11 January 2005 an Italian District Court (Tribunale di Padova Sez. Este) held that reference to rules of supranational character, e.g. the international *lex mercatoria*, the UNIDROIT Principles or the CISG when the Convention is not per se applicable is not a regular choice of law clause. It is merely an incorporation of the rules into the contract to the effect that they will bind the parties only to the extent that they do not conflict with the mandatory rules of the proper domestic law. The judgment seems to pay too little attention to the parties’ autonomy in choosing the proper law. *Ostroznik Savo v. La Faraona soc. coop. a r.l.* available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=1005&step=Abstract> (accessed 27 April 2005).

II.3: History of the CISG

The history of the CISG goes back to the time after the First World War when the League of Nations founded UNIDROIT (the International Institute for the Unification of Private Law).

UNIDROIT started working on a uniform code for international sales and produced drafts in 1935, 1939, 1956 and 1958. The drafts led to the two Hague Conventions of 1964: The Hague Convention on the formation of contracts (Uniform Law on Formation – “ULF”) and the Hague Convention on the international sales of goods (Uniform Law on International Sales – “ULIS”). The Hague Conventions of 1964 had limited support: only 8 countries – all European – signed the Conventions. The intent of a uniform code for international sales on a bigger scale was therefore not achieved and that led to the foundation of UNCITRAL (United Nations Commission on International Trade Law).

The drafting process for a new uniform code for international sales was long because it was difficult to persuade the different countries to sign on to it. Each country had their own rules and was not pleased to agree on other countries’ rules, but a lot of diplomatic cooperation resulted in 1980 in the CISG, which came into force the 1st January 1988.

Unlike the Hague Conventions of 1964, the CISG has become a success. Thus far 65 countries¹² have signed on to it and 70 % or more of world trade is now governed by the Convention, mainly because the United States has joined it.

Chapter III: Application of the CISG

III.1: Applicable to individuals?

The CISG is a convention. Conventions are binding for states, not for individuals. The effect of conventions on individuals depends on the state bound by the conventions. Some states make conventions directly applicable to individuals, i.e. without incorporation in national law, while for individuals from other states, the application is conditional on the Convention’s incorporation in national law.

The CISG contains provisions directly applicable to contracts concluded by individuals. The Convention is “self-executing and capable of direct application to individual rela-

¹² Information available at www.cisg.law.pace.edu/cisg/countries/cntries.html .

tions.”¹³ Whether the Convention is directly applicable to individuals through national law still depends on national law, i.e. whether conventions have to be incorporated in national law or not to be directly applicable to individuals. The parties are, however, still free to make the CISG a direct part of their contract or to make it the proper law.

III.2: Scope of the CISG

III.2.a: When does the CISG come into play?

According to CISG art 1(a) and (b), the Convention applies to international contracts on sale of goods between parties whose places of business are in different states when the states are contracting states, or when PIL rules lead to the application of the law of a contracting state.

The CISG does not define a place of business. Charl Hugo quotes John O. Honnold’s suggestion that it is “a permanent and regular place for the transacting of general business.”¹⁴ It does not have to be the main office, but there must be a real connection between the party and the place of business.¹⁵

It is decisive whether the parties have their places of business in different states. Consequently, it is irrelevant whether the parties have same nationality or whether the conclusion and/or performance of the sales contract takes place in a non-contracting state.

It is easy to determine whether states are contracting states. Several websites provide information on this, e.g. www.cisg.law.pace.edu/cisg/countries/cntries.html.

It is more difficult when it comes to the use of PIL. To find the proper law, it must first be decided which state’s PIL to apply; and if the PIL in a non-contracting state is to be applied and it leads to the law of a contracting state, then a court in the first state is not bound to use the CISG.¹⁶

¹³ Booyesen *Principles of international trade law as a monistic system* supra p. 595.

¹⁴ Charl Hugo ‘The United Nations Convention on the International Sale of Goods: its scope of application from a South African perspective’ (1999) 11 SA Merc IJ p. 8.

¹⁵ CISG art 10 deals with the situation where seller and/or buyer have more places of business. The relevant place of business in terms of CISG art 1 is the place of business with the closest relation to the contract and its performance.

¹⁶ Booyesen *Principles of international trade law as a monistic system* supra p. 574.

PIL only applies in the absence of a choice of law clause. To avoid the mentioned difficulties, it is therefore advisable to agree on a choice of law clause in the sales contract.

The CISG also applies when the parties have chosen the CISG as the proper law. This is simply a consequence of the parties' autonomy to contract. If the parties choose to incorporate a choice of law clause in their sales contract, making the CISG the proper law, and if the Convention is not applicable according to its art 1(1), they should have in mind *Ostrozniak Savo v. La Faraona soc. soop. a r.l.*¹⁷ and be aware of the risk that the clause may not be considered a veritable choice of law clause.

As part of their autonomy, the parties may exclude the application of the CISG or, subject to certain limitations, derogate from or vary the effects of it.¹⁸

III.2.b: Positive and negative delimitation

What contracts?

CISG art 1(1) provides that the Convention applies to contracts on "sale of goods". It does not positively define "sale of goods", but only gives a single example on what should be considered a sale.¹⁹ A more precise idea of the scope of the CISG can be achieved from the negative delimitation in art 2. From this provision it follows that the Convention applies to sales of *moveable, tangible and corporeal things*.²⁰

What content?

CISG art 4 provides a positive and a negative delimitation of what content in the sales contract the Convention governs. It governs the formation of the contract and the rights and obligations of seller and buyer arising from the contract. It does not govern the validity of the contract, its provisions or any usage. Neither is it concerned with the contract's effect on property in the goods.

Finally, CISG art 5 states that the Convention does not apply to seller's liability for death or personal injury caused by the goods.

¹⁷ Referred in fn. 11.

¹⁸ CISG art 6 read with art 12.

¹⁹ In terms of CISG article 3(1) contracts for the supply of goods to be manufactured or produced are deemed as sales unless the party who has ordered the goods undertakes to supply a substantial part of the materials necessary for the manufacture/production.

²⁰ Booyesen *Principles of international trade law as a monistic system* supra p. 577.

III.3: Law complementing the CISG

Even though the CISG (in terms of its art 1(1) or by express choice of the parties) is the proper law in a sales contract, the Convention cannot stand alone as proper law. The aspects of the contract that are not governed by the CISG,²¹ are governed either by usages or practices in terms of CISG art 9 or by national law found through a choice of law clause or PIL.

According to CISG art 9(2),²² the “parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage 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 in the particular trade concerned.”. A usage as described prevails over the CISG as the proper law.²³

The wording of CISG art 9(2) (“...and which in international trade is widely known to...”) primarily points towards *international* usages, but also *national* and even *local* usages are encompassed if they fulfil the conditions set out in the provision.²⁴

It is acknowledged in theory²⁵ as well as in practice²⁶ that ICC’s Incoterms constitute usages as described in CISG art 9(2). Also the UNIDROIT Principles can be usages in terms of CISG art 9(2).²⁷

²¹ Cf. CISG art 4 and art 5.

²² By CISG art 9(1) the parties are bound by any agreed usage and by any practices established between them.

²³ Eric E. Bergsten ‘Basic concepts of the UN Convention on the International Sale of Goods’ in P. Doralt, ed, *Das UNCITRAL-Kaufrecht zum Vergleich zum Österreichischen Recht* (Vienna: Manzsche Verlags und Universitätsbuchhandlung, 1985) p. 20-21 quoted in Secretariat Commentary at note 6 available at <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-09.html> (accessed 23 August 2005). See also Joseph Lookofsky ‘The 1980 United Nations Convention on Contracts for the International Sale of Goods’ in J. Herbots & R. Blanpain, ed, *International Encyclopaedia of laws – contracts* (The Hague: Kluwer Law International, 2000) p. 57 available at <http://www.cisg.law.pace.edu/cisg/biblio/loo9.html> (accessed 23 August 2005).

²⁴ John O. Honnold *Uniform law for international sales under the 1980 United Nations Convention* 3rd ed. (The Hague: Kluwer Law International, 1999) p. 128 available at <http://www.cisg.law.pace.edu/cisg/biblio/ho9.html> (accessed 23 August 2005). In a judgment of 21 March 2000, the Austrian Supreme Court (Oberster Gerichtshof) held that “usages are widely known and regularly observed in the sense Art. 9(2) CISG demands, when recognized by the majority of persons doing business in the same field” and acknowledged a local usage. Case No. 10 Ob 344/99g available at <http://cisgw3.law.pace.edu/cases/000321a3.html#cx> (accessed 23 August 2005).

²⁵ Booyesen *International Transactions and the international law merchant* supra p 221. In contrary Indira Carr who states that Incoterms have to be specifically incorporated in the contract by the parties, Carr *Principles of international trade* 2nd ed. (London: Cavendish Publishing Limited, 1999) p 1. This book is, however, from 1999 and there are later decisions stating that the Incoterms are encompassed by CISG art 9(2).

²⁶ *St. Paul Guardian Insurance company and Travelers Insurance Company v. Neuromed Medical Systems & Support, GmbH* No. 00 CIV. 9344 (SHS) of 26 March 2002.

²⁷ In an arbitration award of October 1998, the ICC Court of Arbitration held that usages “are echoed by, among others, the United Nations Convention on Contracts for the International Sale of Goods (CISG) and

Chapter IV: Risks from outside sources/securing against them

IV.1: General comments

In all contracts – national as well as international – the principal rule is that the parties in the contract must carry out their obligations arising from the contract (“pacta sunt servanda”). This rule applies even though the circumstances on which the parties agreed subsequently change, becoming more burdensome for one or both of the parties to carry out the obligations.

All legal systems take into account situations of changed circumstances where the changes are not caused by the contract parties but by outside sources,²⁸ but the conditions under which a party is excused from performance of his obligations vary from country to country.²⁹ These variations can cause problems in international sales, e.g. if changed circumstances excuse seller from performance in his own country but not in buyer’s country.

CISG art 79 is an attempt to tackle the problems associated with changed circumstances in international sales contracts.³⁰ The provision does not refer to similar domestic systems as “acts of God”, “force majeure”, “frustration” etc.³¹ and with the requirement of an “impediment”, it constitutes a system of its own with no connection to any national law.³² CISG art 79 thereby creates predictability in contracts governed by the Convention. In a judgment of 14 May 1993, a German District Court (Landgericht Aachen) held that either the parties or courts/arbitrators dealing with CISG art 79 should look at domestic systems when interpreting the provision.³³

also the UNIDROIT Principles of International Commercial Contracts, ...”. Case No 9333 available at <http://cisgw3.law.pace.edu/cases/989333i1.html#cx> (accessed 9 August 2005).

²⁸ Joern 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 *Review of the Convention on Contracts for the International Sale of Goods (CISG) 1999 – 2000* (The Hague: Kluwer Law International) p. 198.

²⁹ Jennifer M. Bund ‘Force majeure clauses: drafting advice for the CISG practitioner’ in *17 Journal of Law and Commerce* (1998) p. 381 available at <http://www.cisg.law.pace.edu/cisg/biblio/bund.html> (accessed 30 June 2005).

³⁰ Joern Rimke supra p. 198.

³¹ Chengwei Liu ‘Force majeure – perspectives from the CISG, UNIDROIT Principles, PECL and case law [2nd edition: case annotated update (April 2005)]’ available at www.cisg.law.pace.edu/cisg/biblio/liu6.html (accessed 04.07.05).

³² Liu supra.

³³ No. 43 O 136/92 available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=23&step=Abstract> (accessed 30 June 2005).

CISG art 79 has not solved the problems regarding changed circumstances entirely and the parties therefore often agree on changed circumstances in their own terms.³⁴

IV.2: CISG art 79

CISG art 79 constitutes an exemption from the principal rule that a party in breach of his contractual obligations is liable to the other party.

Art 79(1) requires four conditions to be fulfilled before a party who has failed to perform his obligations is excused from liability:

- the failure to perform any of his obligations is due to an impediment *and*
- the impediment is beyond his control *and*
- he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract *and*
- he could not reasonably have been expected to have avoided or overcome the impediment or its consequences

The failure to perform any of the party's obligations must be due to an impediment. The "failure to perform" must be broadly interpreted.³⁵ The non-performance can be total or partial, temporary or final.³⁶

Notwithstanding the clear wording, "*any* (my emphasising) of his obligations", it has been discussed whether "failure to perform" encompasses failure to deliver goods *in conformity with the contract*, cf. CISG art 30 and 35. In a judgment of 24 March 1999, the German Federal Supreme Court (Bundesgerichtshof) said:³⁷

"...that it may remain undecided whether CISG Art. 79 encompasses all conceivable cases and forms of non-performance of contractual obligations creating a liability and is not limited to certain types of contractual violations and, therefore, includes the delivery of goods not in conformity with the contract defectiveness...".

³⁴ Joern Rimke supra p. 198.

³⁵ Rimke supra p. 214. See also Liu, supra.

³⁶ Ulrich Magnus 'Force majeure and the CISG' in Petar Sarcevic and Paul Volken, ed., *The international sale of goods revisited* (The Hague: Kluwer Law International, 2001) p. 14.

³⁷ BGH VIII ZR 121/98 available at <http://cisgw3.law.pace.edu/cases/990324g1.html#ettc> (accessed 30 June 2005).

But later on the Court stated:

“In this respect (*seller’s liability for his suppliers*, my emphasising), the [CISG] does not distinguish between an untimely delivery and a delivery of goods not in conformity with the contract. For both breaches of contract the same standard of liability applies.”.

This statement supports that the delivery of non-conforming goods is encompassed by CISG art 79 and in his commentary on the judgment, Peter Schlechtriem says that the “prevailing view, not only in Germany, is that “a failure to perform any obligation” within the meaning of Art. 79(1) CISG includes the delivery of non-conforming goods.”.³⁸

To avoid uncertainty, seller should incorporate in the sales contract a provision stating that “any of his obligations” in terms of CISG art 79 encompasses delivery of non-conforming goods.

“Any of his obligations” also encompasses obligations not described in the CISG, but in the contract.³⁹

The CISG does not define an “impediment”. Whether an event constitutes an “impediment”, depends on the facts in every case.⁴⁰ Anja Carlsen states that “impediment” covers both economic and physical difficulties and refers to the UNCITRAL discussions on the CISG.⁴¹ There are, however, different views on whether economic difficulties can be impediments excusing a party from performance.⁴²

To avoid uncertainty, seller should incorporate in the sales contract a provision stating that “impediment” in terms of CISG art 79 includes economic impediments. The provision should specify what economic difficulties can be impediments (e.g. price fluctuations), when economic difficulties amount to impediments (e.g. suppliers’ price increase on a cer-

³⁸ Peter Schlechtriem ‘Commentary on CISG issues by the BGH’ in *50 years of the Bundesgerichtshof [Federal Supreme Court of Germany]: a celebration anthology from the academic community* quoted in the editorial remarks to the judgment available at <http://cisgw3.law.pace.edu/cases/990324g1.html#ce> (accessed 30 June 2005).

³⁹ Liu supra.

⁴⁰ Liu supra.

⁴¹ Anja Carlsen ‘Can the hardship provisions in the UNIDROTI Principles be applied when the CISG is the governing law?’ available at <http://www.cisg.law.pace.edu/cisg/biblio/carlsen.html> (accessed 22 June 2005)

⁴² Magnus supra p. 16 with references to different views.

tain per cent) and the consequences of the economic impediment (e.g. that seller will be relieved from his obligations).

Impediments occurring before as well as after the conclusion of the sales contract can excuse the parties from performance.⁴³ In a number of cases however, it has been held that an impediment existing at the time of the conclusion of the contract was foreseeable for seller and thus did not excuse him from performance.⁴⁴

The failure to perform must “be due” to an impediment, i.e. the failure to perform must be a consequence of the impediment. In an arbitration award of 24 April 1996, the Bulgarian Chamber of Commerce and Industry held that a seller was not excused from his obligation to deliver coal because of a strike, since he was already in default at the time of the strike.⁴⁵

The impediment must be beyond the party’s control, i.e. it must be beyond the party’s normal sphere of responsibility.⁴⁶ Seller cannot escape the risks allocated to him in the sales contract by invoking CISG art 79.

In the judgment of 24 March 1999⁴⁷, the German Federal Supreme Court stated:

“The possibility of exemption under CISG Art.79 does not change the allocation of the contractual risk.

...

Because the seller has the risk of acquisition (as shown), he can only be exempted under CISG Art. 79 (1) and (2) (...) if the defectiveness is due to circumstances out of his own control or out of each of his suppliers’ control.”

Seller is deemed to be in control over his business.⁴⁸ Factors connected with this business are not impediments “beyond his control”.

⁴³ Magnus supra p. 14.

⁴⁴ See e.g. case referred to in fn. 45.

⁴⁵ Case No. 56/1995 available at <http://cisgw3.law.pace.edu/cases/960424bu.html#cx> (accessed 30 June 2005).

⁴⁶ Magnus supra p. 14.

⁴⁷ Reference in fn. 37.

⁴⁸ Liu supra.

It is seller's responsibility to deliver the goods he has sold. He "generally guarantees his financial capability to procure and produce the promised goods."⁴⁹ Thus, increased costs by procuring or manufacturing the goods will not exempt seller from his obligation to deliver the goods. Ulrich Magnus argues that seller is only exempted if the goods are no longer available at the market or if the costs of manufacturing them will ruin him.⁵⁰

In few other incidents, however, seller may also be excused from his performance under CISG art 79. Chengwei Liu states that "where governmental regulations or the actions of governmental officials prevented a party's performance, it may be deemed an impediment beyond the control" of that party.⁵¹

Seller's obligation to deliver the goods implies that he normally bears the risk for his suppliers. In an ICC arbitration of 1995, the arbitrator thus held:⁵²

"The [Seller] who has chosen the supplier to perform his contract with the [Buyer] must be held responsible for the behaviour of the latter. This follows from Article 79(2) of the Vienna Convention 1980 because the seller's responsibility for his supplier is an integral part of the general risk of supply of goods."

Seller is not liable for his suppliers if they are beyond his control and their failure to perform could "neither be contemplated nor cured"⁵³. This will only occur in very few cases "when the seller could neither choose nor control his auxiliary suppliers and it was not possible to procure, produce or repair the goods in any other manner."⁵⁴

Seller can limit his liability for defaults from his suppliers in the sales contract with buyer.

It is seller's responsibility to possess the financial capability to procure and produce the goods he has contracted for. In an arbitration award of 21 March 1996, the German Schiedsgericht der Handelskammer stated that difficulties in delivery due to seller's or

⁴⁹ Liu supra.

⁵⁰ Magnus supra p. 15-16.

⁵¹ In an arbitration award of 22 January 1997 the Russian arbitrator held that buyer was exempted from his obligation of taking delivery in a case where the goods could not be imported because officials would not certify the safety of the goods. Case No. 155/1996 available at <http://cisgw3.law.pace.edu/cases/970122r1.html#cx> (accessed 23 August 2005).

⁵² Case No. 8128 available at <http://cisgw3.law.pace.edu/cases/958128i1.html#cx> (accessed 23 August 2005).

⁵³ Liu supra.

⁵⁴ Liu supra.

seller's suppliers' financial problems do not constitute impediments "beyond...control" but belong to seller's area of risk.⁵⁵

The third condition for exemption from liability is that the party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the sales contract. The impediment must have been *unforeseeable* at that time.⁵⁶

The requirement that the impediment must be unforeseeable at the time of the conclusion of the sales contract, relates not only to the impediment itself but also to the date or period of its occurrence.⁵⁷

The impediment must be *reasonably* unforeseeable. "The reference is thus the reasonable person,..., i.e., halfway between the inveterate pessimist who foresees all sorts of disasters and the resolute optimist who never anticipates the least misfortune".⁵⁸

If seller at the time of the conclusion of the sales contract has foreseen the possibility of a potential impediment, he must incorporate in the contract a provision describing the consequences of the impediment if it occurs. If the contract does not (expressly or implicitly) show that the parties have foreseen the impediment at the time of the conclusion of the contract, it is for the courts and arbitrators to decide this and case law on CISG art 79 is numerous:

Weather:

If seller's country at the same time every year experiences same kind of violent weather, e.g. typhoons, earthquakes etc., constituting an impediment for seller's performance, this impediment is normally not regarded as unforeseeable. It can, however, be different if the weather condition occurs at abnormal times of the year. In a memorandum of 6 July 2004 the U.S. District Court gave an opinion on a situation where a Russian seller was hindered

⁵⁵ Available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=1958step=Abstract> (accessed 30 June 2005).

⁵⁶ In the Secretariat Commentary, it is mentioned that all impediments are foreseeable in one degree or another because they have occurred in the past and can be expected to occur again in the future, see at n. 5 available at <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-79.html> (accessed 22 June 2005). See also Bernhard Gomard & Hardy Rechnagel, ed., *De Forenede Nationers Konvention om internationale køb* (København: Jurist- og Økonomiforbundets Forlag, 1999) p. 222.

⁵⁷ Liu *supra*.

⁵⁸ Dennis Tallon in Cesare Massimo Bianca & Michael Joachim Bonell, ed., *Commentary on the International Sales Law: The 1980 Vienna Sale Convention* (Milan, 1987) p. 579 available at <http://www.cisg.law.pace.edu/cisg/biblio/tallon-bb79.html> (accessed 23 August 2005).

in delivering the goods to a German buyer due to heavy frost that prevented the ship from leaving the St. Petersburg Port.⁵⁹ The Court stated that seller “presented evidence that the severity of the winter in 2002 and the early onset of the freezing of the port and its consequences were far from ordinary occurrences.” It continued:

“ Whether it was foreseeable that such severe weather would occur and would stop even the icebreakers from working is a question of fact for the jury. In so holding, the Court notes that the freezing over of the upper Mississippi River has been the basis of a successful force majeure clause” and Defendants “force majeure affirmative defence may be viable...”

Negative development in the market:

Case law shows that courts and arbitrators are reluctant to excuse the parties from performance due to negative development in the market.

In an arbitration award of 12 February 1998, the Bulgarian Chamber of Commerce and Industry examined buyer’s allegation that a negative development in the market situation and revaluation of the currency for payment constituted an impediment under CISG art 79.⁶⁰ The arbitrator held that these events were not impediments under CISG art 79 but buyer’s normal commercial risk. He stated that:

“The listed circumstances that caused the [buyer’s] desire to have delivery suspended do not correspond the requirements outlined in Article 79 of the CISG. [...] Such consequences are not unexpected”.

In a judgment of 2 May 1995, a Belgian District Court (Rechtbank van Koophandel) held that fluctuations of prices are foreseeable events in international trade and do not render the performance impossible. It is to be regarded as a normal risk in commercial activities.⁶¹

Ulrich Magnus states that if prices or currencies vary excessively there is a tendency that the party facing difficulties due to the variation can be excused from performance. “The

⁵⁹ *Raw Materials Inc. v. Manfred Forberich GmbH & Co, KG*, Case No. 03 C 1154 available at www.unilex.info/case.cfm?pid=1&do=case&id=987&step=Fulltext (accessed 30 June 2005).

⁶⁰ Case No. 11/96 available at <http://cisgw3.law.pace.edu/cases/980212bu.html#cx> (accessed 23 August 2005).

⁶¹ *Vital Berry Marketing NV v. Dira-Frost NV*, Case No. AR 1849/94 available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=263&step=Abstract> (accessed 30 June 2005).

fluctuation, however, must be so radical that, in fact, it creates an economic barrier to performance. An increase or decrease up to 50 per cent in the price or value of currency will normally not suffice.”⁶²

Acts of public authorities:

If the act consists at the time of the conclusion of the sales contract, the parties are generally not excused from performance. In a judgment of 2 October 1998, from the Dutch Rechtbank’s-Hertogenbosch, a seller was not excused, notwithstanding Singaporean regulations made it impossible for him to perform. Seller was aware of the regulations before conclusion of the sales contract and it was his own risk to contract with buyer.⁶³

In the Bulgarian arbitration award of 24 April 1996,⁶⁴ a public authority prohibition on exports in seller’s country did not excuse him from his obligation to deliver part of the goods as the prohibition was already in force at the time of the conclusion of the sales contract and thus foreseeable.

Strikes and non-delivery from suppliers are normally foreseeable.⁶⁵

The fourth and last condition for exemption from liability is that the party could not reasonably have avoided or overcome the impediment or its consequences. The condition emphasises the principal rule of “pacta sunt servanda”. Even though seller is met with impediment(s) he has an obligation to avoid or overcome the impediment(s) in a way that can reasonably be expected from him, i.e. what is customary, or what similar individuals would do in a similar situation.⁶⁶ Seller must find a “commercially reasonable substitute for the performance which was required under the contract”.⁶⁷

⁶² Ulrich Magnus supra p. 16. In a judgment of 14 January 1993, an Italian District Court (Tribunale Civile di Monza) held that a price increase at 30 per cent was not sufficient to invoke CISG art 79. *Nuova Fucinati S.p.A. v. Fondmetal International A.B* available at <http://cisgw3.law.pace.edu/cases/930114i3.html#ta> (accessed 30 June 2005). The judgment has been criticized as the judges applied the Italian standard of force majeure and not CISG’s standard of impediment, see Anja Carlsen supra.

⁶³ *Malaysia Dairy Industries Pte. Ltd. v. Dairex Holland BV* Rolnr. 9981/HA ZA 95-2299 available at www.unilex.info/case.cfm?pid=1&do=case&id=443&step=Abstract (accessed 30 June 2005).

⁶⁴ Reference in fn. 45.

⁶⁵ Joseph Lookofsky *Internationale køb* (København, Jurist- og Økonomiforbundets Forlag, 1985) p. 86.

⁶⁶ Rimke supra p. 216.

⁶⁷ Secretariat Commentary supra at n. 7.

CISG art 79(2) provides that if the party's failure to perform is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if:

- he is exempt under art 79(1) and
- the third person would be so exempt if art 79(1) were applied to him

This has been called a kind of "double force majeure"⁶⁸

CISG art 79(2) does not define a "third person". According to the Secretariat Commentary, "The third person must be someone who has been engaged to perform the whole or a part of the contract. It does not include suppliers of the goods or of raw materials to the seller."

⁶⁹ The supply is only a preliminary step in the process of manufacturing the goods and does not amount to "perform the whole or a part of the contract."⁷⁰

In the judgment of 24 March 1999,⁷¹ the German Federal Supreme Court held that the failure of seller's suppliers to deliver conforming goods to buyer did not excuse seller from performance:

"If the supplier's (or suppliers') breach of the contract is a general impediment within the meaning of CISG art 79 at all, it is generally an impediment that the seller must avoid or overcome according to the content of the contract of sale".

Neither does CISG art 79(2) encompass seller's employers. Ulrich Magnus refers to the prevailing view that only 'subcontractors "who are involved in the performance of the contract by means of an "organic connection"' are encompassed by art 79(2).⁷²

In an arbitration award of 21 March 1996, the German Chamber of Commerce (Schiedsgericht der Handelskammer) held that a sub-contractor was encompassed by CISG art 79(2) but not a manufacturer or sub-supplier.⁷³

⁶⁸ Liu supra.

⁶⁹ Secretariat Commentary supra at n. 12.

⁷⁰ Bund supra p. 387.

⁷¹ Reference in fn. 37.

⁷² Ulrich Magnus supra. p. 20.

⁷³ Available at <http://cisgw3.law.pace.edu/cases/960321g1.html#ct> (accessed 23 August 2005).

In a judgment of 10 February 1999, a Swiss Commercial Court held that a carrier of the goods is not encompassed by CISG art 79 (2) if seller does not have an obligation to arrange for the carriage. If seller and buyer have agreed to ship the goods under the Incoterms CIF or CIP and seller therefore has the responsibility for sending the goods to buyer, the carrier of the goods would normally fall within the scope of art 79(2).

The cases show that courts and arbitrators are very strict when they interpret “third persons” in terms of CISG art 79(2). To avoid uncertainty seller should incorporate in the sales contract a provision stating what third persons should be encompassed by the provision.

CISG art 79 only relieves the non-performing party from liability to pay *damages* to the other party.⁷⁴ Thus, in a situation where seller is excused under art 79, buyer can claim specific performance, avoid the contract or claim price reduction or interest if the conditions for these remedies are fulfilled.

The CISG does not deal with liquidated damages. In the Secretariat Commentary it is mentioned that “It is a matter of domestic law not governed by this Convention as to whether the failure to perform exempts the non-performing party from paying a sum stipulated in the contract for liquid damages or as a penalty for non performance”⁷⁵

If seller and buyer have agreed on a liquidated damages clause,⁷⁶ seller can limit his liability by incorporating in the sales contract a provision stating that he is exempted from paying liquidated damages if CISG art 79 applies.

As described the CISG leaves more issues open for interpretation. In the sections below different boilerplates, whereby seller can limit his liability further, will be described.

Among these, force majeure and hardship clauses are the most common and therefore will be discussed in more detail.

⁷⁴ Ole Lando argues that this cannot be the intent with CISG art. 79, Lando ‘The CISG and the UNIDROIT Principles in a global commerce code, Remedies for non-performance’ in *Mélanges offerts à Marcel Fontaine* (Belgium: Larier, 2003) p. 471.

⁷⁵ Secretariat Commentary supra at n. 9.

⁷⁶ See chapter V.4.b.

IV.3: Different ways of securing

IV.3.a: Force majeure clause

Generally, force majeure occurs “when the performance of a contract is impossible due to unforeseeable events beyond the control of the parties”.⁷⁷

Almost every international business contract has a force majeure clause irrespective of what law governs the contract.⁷⁸ According to Jennifer M. Bund a well-drafted force majeure clause that describes the extraordinary circumstances under which a party is excused from performance, increases predictability and provides more appropriate protection of the parties than CISG art 79.⁷⁹

Before drafting a force majeure clause, seller and buyer should consider whether CISG art 79 provides sufficient protection. This might be the case where the sale involves a single uncomplicated item, easy and quick to procure or manufacture for seller. If so, it is not necessary for a specific force majeure clause in the sales contract.

If seller and buyer agree to incorporate a force majeure clause in their sales contract, they should avoid the use of terms and wording from their respective national legal systems. Seller and buyer are very likely from different countries and different legal systems may have different interpretations of the same terms/wording.

When seller and buyer negotiate a force majeure clause, they can have resource to ICC’s document no. 421. The document is a standard force majeure clause that describes under which conditions the parties are excused from performance. The parties should not uncritically quote the ICC force majeure clause, but should take into account their specific needs and adapt the clause accordingly.⁸⁰

Generally, force majeure clauses must contain the following:⁸¹

⁷⁷ Rimke supra p. 199.

⁷⁸ Rimke supra p. 229-230.

⁷⁹ Bund supra p. 404

⁸⁰ James M. Klotz *International sales agreements – an annotated drafting and negotiating guide* (The Hague: Kluwer Law International, 1998) p. 242.

⁸¹ Rimke supra p. 230-232. See also Bund supra p. 407.

Definition of force majeure:

A well-drafted contract includes an introductory list of definitions. The force majeure clause should include a catch-all definition. A classic definition of force majeure is given above. In international contracts there is a tendency to make the definition a little less strict than the classic definition.⁸² Thus in some definitions it is not required that the force majeure event makes it *impossible* to perform an obligation. It is sufficient that the event hinders the *normal* performance. Furthermore, it is not always required that the event was unforeseeable at the time of the conclusion of the contract.⁸³ In this way a force majeure clause is close to a hardship clause.

Jennifer M. Bund states that courts more likely give effect to force majeure clauses with a list of specific force majeure events than a clause merely containing a catch-all provision.⁸⁴ It is therefore recommended (and usual practise) to add a subsequent non-exhaustive list of events agreed by the parties to constitute force majeure. Examples of traditional force majeure events are tornadoes, lightning, floods, fires, earthquakes and unusually severe weather conditions.

Force majeure events have been extended in international contracts to include e.g. turmoil of a social nature.⁸⁵ A good example of this is the FIDIC Silverbook on Conditions of Contract for EPC/Turnkey Projects where the non-exhaustive list of examples includes war, hostilities, invasion, act of foreign enemies, rebellion, terrorism, revolution, insurrection, military or usurped power, civil war, riot, commotion, disorder and strike or lockout by persons other than the contractor's personnel.⁸⁶ To emphasise the non-exhaustive nature of the listed examples the parties can use the following wording: "including, but not limited to...".

In continuation of the non-exhaustive list of examples of force majeure events the parties can agree on a list with events excluded from being force majeure events.⁸⁷ From seller's point of view it is appropriate to agree on exclusions for subsequent foreign exchange controls and buyer's inability to obtain necessary financing, making it impossible for buyer to

⁸² Rimke supra p. 230.

⁸³ Bund supra p. 405

⁸⁴ Bund supra p. 407.

⁸⁵ Rimke supra p. 231.

⁸⁶ Even though this non-exhaustive list relates to engineering projects, it is obvious that a similar clause is applicable in international contracts on sales of goods.

⁸⁷ Klotz supra p. 248-249 with example.

pay seller. This is buyer's risk in a normal sales contract and therefore normally excluded from being an impediment in terms of CISG art 79(1), but an express exclusion will remove any doubt.

Interpretation:

Warranties will often coincide with a force majeure clause. If seller has warranted certain qualities of his goods, he will often be bound by this warranty even though a force majeure event makes it impossible for him to deliver the warranted goods. To limit his liability, seller should incorporate in the sales contract a provision stating that "This warranty is subject to the force majeure clause."⁸⁸

Duty of the non-performing party to notify the other party:

The force majeure clause must describe what a party must do in order to invoke the clause. In most force majeure clauses it is required that the party who wants to invoke the clause must give notice to the other party that a force majeure event has occurred and what impact it has on his ability to perform.

The force majeure clause should expressly mention:⁸⁹

- the time limit for notice
- whether the notice should be written or it is sufficient with an oral notice
- whether the notice comes into effect at the party's dispatch of it or at the other party's receipt thereof.
- the consequences of failure to give notice
- when the duty to give notice arises

Legal effect of a force majeure event:

The traditional effect of a force majeure event is the termination of the contract and the non-performing party's exemption from paying damages to the other party. In international sales contracts the consequence of a force majeure event is not always termination of the contract. To promote the continuation of the sales contract, the legal effect can be:⁹⁰

⁸⁸ Bund supra p. 409.

⁸⁹ Bund supra p. 406.

⁹⁰ Rimke supra p 232.

- **Suspension of performance during the force majeure event or extension of performance for a specific period:**

If performance is suspended during the force majeure event the clause must define exactly when both parties' obligations revive. If performance is extended for a specific period this period should not be fixed with subjective phrases such as "reasonable time after..."⁹¹ This can give rise to disputes on what is "reasonable" time. If the force majeure event is permanent or continues after the extended period for performance, the parties should be free to terminate the contract.

- **Renegotiation of the contract:**

Instead of terminating the contract, the force majeure clause can impose an obligation to renegotiate the contract. If the renegotiation should fail, the parties can agree that the further process should be before an arbitrator or be another kind of alternative dispute resolution.

Interest:

From seller's point of view it is appropriate with a provision on buyer's continued payment of interest if seller has delivered the goods but buyer is prevented from paying for the goods.⁹² The time when interest starts to accrue and the interest rate should be mentioned.

IV.3.b: Hardship clause

Hardship clauses relate to "events that make contractual performance not impossible, but only more burdensome for one party, creating an "undue hardship" for this party. They deal with unforeseen circumstances that fundamentally change the contractual equilibrium."⁹³

Hardship is also defined in UNIDROIT Principles art 6.2.2: "There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished..."

⁹¹ Klotz supra p. 251.

⁹² Klotz supra p. 250.

⁹³ Joachim G. Frick *Arbitration and Complex International Contracts* (The Hague: Kluwer Law International) p. 178.

The CISG does not contain provisions on hardship. Especially in long term contracts the parties are therefore recommended to agree on a hardship clause.⁹⁴ This is not an unusual clause. In fact, hardship clauses are among the most common contract adaptation clauses.⁹⁵ A hardship clause aims at an adaptation of the contract to the changed circumstances - often after a renegotiation of the contract. Thereby a hardship clause is more flexible and less far reaching than a traditional force majeure clause that terminates the contract in case of a force majeure event. Often a contract contains both a force majeure and a hardship clause.⁹⁶

It is difficult to foresee the exact consequences of a hardship event. The hardship clause should therefore not describe an obligation to reach an agreement of a well-defined content. The clause should more appropriately give the party facing a hardship event the right to a renegotiation of the contract – either a renegotiation with the parties alone, or with help from a third party. If the parties do not reach an agreement, the clause should describe the consequences thereof, e.g. termination, arbitration etc.⁹⁷

A hardship clause must describe the procedure to be followed when a hardship event requires adaptation of the contract.

If the adaptation involves increased costs, the hardship clause should allocate these costs.

If the parties have not agreed on a hardship clause, the question arises whether the CISG has an implied hardship clause.

It is acknowledged in theory⁹⁸ as well as in practice⁹⁹ that the UNIDROIT Principles serve as means of interpreting the CISG. Anja Carlsen argues, however, that the hardship provisions in the UNIDROIT Principles should not be applied in a gap-filling manner when the

⁹⁴ In a judgment of 12 June 2001 a French Court of Appeal (Cour d'Appel de Colmar) held that it was up to the buyer, "who was aware of entering into a long-term business relationship, to provide for mechanisms of renegotiation for the case of changes of circumstances (i.e. by including a hardship clause in the contract)", available at www.unilex.info/case.cfm?pid=1&do=case&id=814&step=Abstract (accessed 30 June 2005).

⁹⁵ Frick supra p. 177.

⁹⁶ Frick supra p. 178.

⁹⁷ Frick supra p. 180.

⁹⁸ Ulrich Magnus 'Die Allgemeinen Grundsätze im UN-Kaufrecht' 59 (1995) *Rebels Zeitschrift* at p. 492-493 available at <http://www.cisg.law.pace.edu/cisg/text/matchup/general-observations.html#un6> (accessed 22 June 2005). See also Carlsen supra.

⁹⁹ Judgment of 23 October 1996 from the French Court of Appeals of Grenoble available at <http://cisgw3.law.pace.edu/cisg/wais/db/cases2/961023f1.html> (accessed 9 August 2005).

CISG is the proper law.¹⁰⁰ She refers to the preparation for the CISG in UNCITRAL and the Diplomatic Conference where it was suggested that the CISG should contain a provision on hardship. The proposal was rejected because the draftsmen felt it would have too big an impact on the parties' obligations arising from the contract. Anja Carlsen concludes that "The rejection of a hardship provision indicates the CISG never intended that hardship should exist side by side with Article 79."¹⁰¹

Joern Rimke also concludes that the drafting process of CISG art 79 excludes the existence of an implied hardship provision in the Convention. He further argues that CISG art 79 is exhaustive in its setting limits of the seller's and buyer's responsibility for non-performance.¹⁰²

In *Nuova Fucinati S.p.A. v. Fondmetall Int*¹⁰³ the Court held:

"...even if CISG applied, the seller could not rely on hardship as a ground for avoidance since CISG did not contemplate such a remedy in Art. 79 or elsewhere."

If the parties agree on a hardship clause in their sales contract, they can choose to incorporate the UNIDROIT Principles on hardship in their contract. Art 6.2.2 provides a definition of hardship and art 6.2.3 describes the effect of hardship. In terms of art 6.2.3(1), the disadvantaged party is entitled to request renegotiations. The request, however, does not in itself entitle him to withhold performance.¹⁰⁴ If the parties cannot agree on an adaptation of the contract, either of the parties may ask the court to terminate the contract or adapt the contract with a view of "restoring its equilibrium".¹⁰⁵

The parties can also choose to draft their own hardship clause in their contract.¹⁰⁶ A hardship clause consists of two main parts.¹⁰⁷

¹⁰⁰ Carlsen supra.

¹⁰¹ Carlsen supra.

¹⁰² Rimke supra p. 220.

¹⁰³ Reference in fn. 62.

¹⁰⁴ UNIDROIT Principles art. 6.2.3(2)

¹⁰⁵ UNIDROIT Principles art 6.2.3(4).

¹⁰⁶ Drafting guidelines can be found in the section on force majeure clauses, IV.3.a.

¹⁰⁷ Rimke supra p. 228.

Definition of “hardship”:

Important elements of “hardship” are that the circumstances at the time of the conclusion of the sales contract have changed in a serious and substantial way beyond the control of either party. Furthermore the changes must be entirely unforeseeable by the parties.

The definition must describe the consequences of the changed circumstances. It is recommended that the changed circumstances have made it “much more burdensome” for the party to fulfil its obligations under the contract. Subjective wording such as that the contract has become “unfair” to the party etc. should be avoided, as it may give rise to disputes on the interpreting of the standard.¹⁰⁸

As in a force majeure clause, it is recommended “to use broad wording, give a list of specific circumstances as examples, and insert the excluded circumstances.”¹⁰⁹

Legal effect of a hardship event:

As opposed to the traditional force majeure clauses, hardship clauses do not provide for the termination of the contract, but for the adaptation of the contract to the changed circumstances.

The parties can set out the criteria for the adaptation of the contract, e.g. “to restore the equilibrium between the parties as it was at the time of the conclusion of the contract.”¹¹⁰

The hardship clause should describe the consequences if seller and buyer cannot agree on the adaptation of the contract, e.g. termination of the contract or adaptation of the contract decided by a neutral third party.

In international sales contracts where the traditional force majeure definition is “softened” a little, Joern Rimke suggests that the parties only agree on one clause covering the situation of changed circumstances.¹¹¹

I cannot see the advantage of only one clause compared to a sales contract including a force majeure clause *and* a hardship clause. A good draftsman should be able to provide

¹⁰⁸ Rimke supra p. 229.

¹⁰⁹ Rimke supra p. 229

¹¹⁰ Rimke supra p. 229

¹¹¹ Rimke supra p. 243.

specific wording in both clauses and to emphasise the difference between force majeure and hardship.

The following clauses will only be described briefly. The aim is to give seller an idea of the broad spectrum of different boilerplates that can be used in international sales contracts.¹¹²

IV.3.c: Variation and Change Order

A Variation and Change Order gives one party the right to unilaterally adapt the contract to changed circumstances. The clause must describe what circumstances will give the right to adapt the contract and should be accompanied by a clause allocating additional costs caused by the adaptations.

IV.3.d: Automatic Adaptation clause

The clause relates to an objective standard and provides for adaptation of the contract when changes in this standard occur.

If seller and buyer agree on a General Review and Renegotiation clause,¹¹³ it is not necessary to agree on an Automatic Adaptation clause too.

Seller should incorporate a clause providing that, if the changes increase the costs for the work to seller, the contract price will be increased with a specified amount. Seller should be prepared that buyer, on the other hand, will claim a clause providing that the contract price be decreased if the changes decrease the costs.

IV.3.e: General review and renegotiation clause

The clause puts the parties under an obligation to negotiate in good faith, should the contract need any adjustment. There is no obligation to achieve a specific result. The clause merely outlines the procedure to be followed when renegotiating.

IV.3.f: Special Risk clause

Contrary to the hardship clause the Special Risk clause describes specific triggering events. The clause allocates the risk of the triggering event to one of the parties in a predetermined

¹¹² The clauses are all found in Frick, *supra*. Even though most of the clauses are described in relation to engineering contracts, there seem to be no obstacles for the use of the clauses in sales contracts.

¹¹³ Chapter IV.3.e.

way. The consequence of a Special Risk event is the continuation of the sales contract and not the termination thereof. The special triggering events, as well as the risk allocation, must be well defined in the contract.

Chapter V: Risks from defaults from seller himself/securing against them

V.1: General comments

When examining the risks from defaults from seller himself, a natural starting point is CISG art 30, summarizing seller's key obligations. It is by failing these obligations that seller faces risks from his own side. According to CISG art 30 "seller must deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and the convention". The obligations are subsequently described in detail in articles 32 – 44. In this chapter I will concentrate on seller's obligation to *deliver goods conforming* to the contract.

V.2: CISG art 31 - delivery

CISG art 31 describes seller's obligation to deliver the goods - *how* to deliver and the *place* of delivery. The *time* of delivery is described in CISG art 33.

The introduction to CISG art 31 emphasises the parties' freedom to contract – their party autonomy:¹¹⁴ the provision only applies if the parties have not agreed otherwise. The place of delivery is a key issue in international sales contracts and the parties will often have agreed on this. Therefore CISG art 31 will not come into play often.¹¹⁵

CISG art 31 distinguishes between sales contracts involving carriage of goods (art 31(a)) and contracts not involving carriage of goods (art 31(b)+(c)). Generally, in contracts involving carriage, seller has an obligation to arrange for the carriage and in contracts not involving carriage, buyer has an obligation to collect the goods.¹¹⁶ In most international sales the contract involves carriage of the goods and I will therefore only examine CISG art 31(a) here.¹¹⁷

¹¹⁴ Chengwei Liu's editorial remarks available at <http://www.cisg.law.pace.edu/cisg/text/peclcomp31.html#er> (accessed 9 July 2005).

¹¹⁵ Herbert Bernstein and Joseph Lookofsky *Understanding the CISG in Europe* 2nd ed. (The Hague: Kluwer Law International, 2003) p. 72.

¹¹⁶ Huber in Peter Schlechtriem, ed., *Commentary on the UN Convention on the International Sale of Goods (CISG)* 2nd ed. (Oxford: University Press, 1998) p. 222.

¹¹⁷ Generally, when a provision in the CISG governs both contracts involving carriage and contracts not involving carriage, I will only examine the provision in relation to contracts involving carriage.

A sales contract involves carriage of the goods if the parties have agreed on this. The CISG itself does not impose on seller a duty to arrange for carriage.¹¹⁸ In international sales, however, the distance between the parties will often indicate that the contract involves carriage.¹¹⁹ If seller does not wish to arrange for the carriage, this must appear in the contract – either by a specific provision or by referring to an appropriate Incoterm that places the obligation on buyer (FCA, FAS, FOB).

If the sales contract involves carriage of the goods, seller's obligation to deliver consists in handing the goods over to the first carrier for transmission to the buyer. Seller only has to take the steps necessary to ensure that buyer is *enabled* to obtain possession of the goods. He does not have to ensure that buyer obtains actual physical possession. Therefore, carriage is “the transportation of the goods which the seller must arrange in order to enable the buyer to take them over”¹²⁰.

If the goods have to be packed in order to be sent by seller, seller's obligation to deliver is extended to an obligation to pack the goods in a sufficient manner.¹²¹ He must ensure “to present its cargo to the carrier for loading, packed and prepared in a manner reasonably suited to surviving the carriage with no more than the most minor damage under normal conditions of care and carriage.”¹²²

Seller's obligation is the “handing...over” of the goods to the first carrier. Seller has handed over the goods when “the carrier obtains physical custody of them for the purposes of carriage.”¹²³ Seller remains responsible for the goods until the carrier has taken possession of them.¹²⁴ Seller's preparing the goods for dispatch does not constitute “handing...over” in terms of CISG art 31(a)¹²⁵

¹¹⁸ Huber supra p. 226.

¹¹⁹ Huber supra p. 226. See also John O. Honnold *Uniform Law for International Sales* 3rd ed. (The Hague: Kluwer Law International 1999) p. [239].

¹²⁰ Huber supra p. 225.

¹²¹ Huber supra p. 232.

¹²² John Hare *Shipping law and admiralty jurisdiction in South Africa* 1st ed. (South Africa: Juta & co, Ltd, 1999) p. 636. The standard is described in relation to the Carriage Of Goods at Sea Act but seems to be applicable irrespective of how the carriage is governed.

¹²³ Huber supra p. 229.

¹²⁴ Secretariat Commentary at n. 9 available at www.cisg.law.pace.edu/cisg/text/secomm/secomm-31.html (accessed 9 July 2005).

¹²⁵ Huber supra p. 229

If seller has undertaken to deliver the goods to buyer himself, he is not a “carrier” and he does not carry out his obligation to “hand...over” in terms of CISG art 31(a) as long the goods are in his control.¹²⁶

The CISG does not have any rules on where seller must hand over the goods to the first carrier and seller should incorporate in the sales contract a provision for the place of handing over the goods.

Seller must hand the goods over to “the first carrier”. Only carriage arranged with a carrier constitutes “carriage” in terms of CISG art 31(a). A carrier must be an “independent contractor entrusted the transportation.”¹²⁷ In a judgment of 19 August 2003, the Swiss Appellate Court (Tribunal cantonal) thus held:¹²⁸:

“The carrier must not be dependent on the seller (i.e., must be independent) for this article to apply (...).”

If seller has undertaken to carry out the carriage himself, delivery first takes place “when he hands the goods over to the buyer at the destination”.¹²⁹ The carrier must also be independent of buyer.¹³⁰

When seller has handed the goods over to the first carrier, delivery has taken place and risk of the goods is transferred to buyer.¹³¹ Seller is therefore relieved of liability from acts and omissions by the carrier and the consequences thereof, e.g. delayed arrival of the goods.¹³²

If seller dispatches the goods to an incorrect destination, he is theoretically in breach of his obligation to deliver the goods according to CISG art 31(a). If buyer never receives the goods, seller has not delivered the goods accordingly. If buyer accepts the goods, notwithstanding the incorrect destination, seller has delivered accordingly but may be liable for damages.¹³³

¹²⁶ Huber supra p. 225.

¹²⁷ Huber supra p. 225.

¹²⁸ No. C1 03 100 available at <http://cisgw3.law.pace.edu/cases/030819s1.html#cx> (accessed 11 July 2005).

¹²⁹ Huber supra p. 227.

¹³⁰ Bernstein and Lookofsky supra p. 73. See also Liu supra.

¹³¹ CISG art 67(1).

¹³² Judgment of 10 February 1999 from the Swiss Comm. Court, Case No. HG 970238.1 available at <http://cisgw3.law.pace.edu/cases/990210s1.html#cx> (accessed 12 September 2005).

¹³³ Huber supra p. 233-234.

If seller delivers non-conforming goods, aliuds (goods other than contracted for) or if the packaging is defective, these breaches of contract are all regarded as non-conforming goods in terms of CISG art 35 and do not affect that delivery has taken place.¹³⁴

CISG art 31(a) is only applicable if the parties have not agreed otherwise. ICC's Incoterms are often used in sales contracts involving carriage of goods. The Incoterms provide a set of international rules on interpretation of the most used trade terms in international trade.¹³⁵ Each of the present 13 Incoterms 2000 gives rules on ten matters in connection with delivery that must be agreed on in sales contracts, e.g. provision of the goods and payment of the price, licenses, authorisations and formalities and contract of carriage and insurance.

Some of the Incoterms correspond to CISG art 31 with regard to place and method of delivery and these Incoterms therefore do not amend art 31, but merely supplement it in describing how delivery takes place.

Other Incoterms are different from CISG art 31 in contemplating another place of delivery, e.g. by providing that delivery takes place when the goods pass the ship's rail. If these Incoterms constitute usages or agreed terms, they prevail over the CISG.

If the parties want Incoterms to be part of their sales contract and the Incoterms do not constitute usages in terms of CISG art 9(2), the parties must make the agreed Incoterm a part of their sales contract. The 3-digit code alone is insufficient to establish any agreement.¹³⁶ The parties must link the code to the applicable Incoterms (2000) and specify place of delivery or destination. This is of special importance because the American Uniform Commercial Code (UCC) also operates with codes similar to Incoterms, but with a slightly different meaning.¹³⁷ This specification should be linked to the price. If the parties want to vary an Incoterm it must be spelled out unambiguously.

¹³⁴ Huber supra pp. 231-232.

¹³⁵ Maria Livanos Cattai in a foreword to ICC's Incoterms 2000.

¹³⁶ Prof. Dr. Burghard Piltz "INCOTERMS and the UN Convention on Contracts for the International Sale of Goods" in *Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998* (The Hague: Kluwer Law International) p. 44.

¹³⁷ Henry Gabriel *Practitioner's guide to the Convention on Contracts for the International Sale of Goods (CISG) and the Uniform Commercial Code (UCC)* 1st ed. (Oceana Publications, Inc., 1994) p. 202.

When the parties refer to Incoterms, it is important to define the time when delivery takes place, as this is the time where risk of accidental loss of or damage to the goods is transferred from seller to buyer, cf. Incoterms A4 read with A5.

CISG art 32(2) supplements art 31(a) by specifying seller's obligations when he is bound to arrange for carriage.

V.3: CISG art 32(2) - contracts necessary for carriage

CISG art 32 provides that seller (if he is bound to arrange for carriage of the goods) must make the necessary contracts for carriage of the goods to the fixed place. If the sales contract includes carriage, cf. CISG art 31(a), seller is bound to arrange for carriage unless the parties have agreed otherwise¹³⁸, e.g. by Incoterms FCA, FAS or FOB or are bound by usage, cf. CISG art 9(2). If seller does not arrange for a contract of carriage, he is in breach of his key obligation to deliver the goods.

The CISG does not have provisions on which party should bear the costs for the carriage. Seller should ensure that the sales contract allocates these costs – either by a specific provision or by referring to an appropriate Incoterm (A3 and B3 allocates these costs). If nothing is agreed the costs will be imposed on the party having the obligation to arrange for carriage.

Neither does the CISG have provisions on which party should bear export licenses and taxes. Seller should ensure that the sales contract allocates these costs – either by a specific provision or by referring to an appropriate Incoterm (A2 and B2 allocates these costs). Honnold states that CISG art 31 can be useful “in allocating responsibility for matters such as export licenses and export taxes” even though the provision is less “clear-cut” than an express provision in the contract”.¹³⁹ According to Honnold, buyer has a responsibility to arrange for the export if buyer has an obligation to collect the goods at seller's place of business.

¹³⁸ Huber supra p. 256.

¹³⁹ Honnold supra p. [243].

The parties must remember to incorporate in their sales contract a provision on the “fixed place” in terms of CISG art 32(2). If the contract is silent, there is an assumption that the fixed place is buyer’s place of business.¹⁴⁰

The parties are free to include in their sales contract provisions on the type of vehicle and transportation route. Where the contract is silent, seller must make the contracts for carriage “by means of transportation appropriate in the circumstances and according to the usual terms for such transportation”, cf. CISG art 32(2).

In a judgment of 20 February 1997 a Swiss District Court (Bezirksgericht) held¹⁴¹:

“Thereby, a seller has to choose such a means of transportation as appears appropriate in the specific circumstances and necessary to the general terms for such transportation.

...

Hence, the choice of the mode of transportation was in the [seller]’s own discretion.”

Appropriate means of transportation relate both to the kind of vehicle and to the route.¹⁴² Seller should, among other things, take into consideration the distance from the place of delivery to the destination and on basis of this decide the appropriate kind of vehicle.¹⁴³

“Usual terms” relate to both price and liability.¹⁴⁴ Seller is bound by fixed transportation rates. If there are no fixed rates, he must find the most reasonable price by comparing prices and carrier’s reliability. A very cheap price may indicate that the carrier has limited his liability to a great extent.

CISG art 32(3) deals with insurance of the goods during the carriage. Chapter VIII examines what types of insurance are relevant to seller.

¹⁴⁰ Huber supra p. 257.

¹⁴¹ Case No. T.171/95 available at <http://cisgw3.law.pace.edu/cases/970220s1.html#cx> (accessed 11 July 2005).

¹⁴² Huber supra p. 257.

¹⁴³ In a judgment of 18 July 2001 a Chinese court found that maritime transportation was obviously not a proper means as seller should have known the distance of transport. Available at <http://cisgw3.law.pace.edu/cases/010718c1.html#cx> (accessed 11 July 2005).

¹⁴⁴ See Huber supra p. 257.

V.4: *Timely delivery*

V.4.a: CISG art 33

In terms of CISG art 33(a) and (b), seller must deliver the goods on the date or within the period fixed or determinable from the contract. If the parties have not agreed on the time of delivery, seller must deliver the goods “within a reasonable time after the conclusion of the contract”, art 33(c). Art 33(c) needs some comments in relation to the requirement “reasonable”.

When determining what is “within a reasonable time” one should look not only at the facts in the individual case, but also at similar cases and fairness.¹⁴⁵ First of all the standard must be determined pursuant to the parties’ statements. In a judgment of 27 April 1999, a German Appellate Court (Oberlandesgericht) held that notwithstanding buyer’s indications on time of delivery had not become a term of the sales contract, they had to be taken into account in determining the reasonable time of delivery.¹⁴⁶

Delivery is “within a reasonable time” if it is within “acceptable commercial conduct” in the case.¹⁴⁷ From seller’s point of view, the standard necessarily varies depending on whether he has the goods in stock or has to manufacture them or procure them from a third party. It is, however, important to emphasise that a look should not only be had at seller’s interest but at the interest of both parties.¹⁴⁸ Delivery “within a reasonable time” can be immediate delivery, e.g. if it is obvious that buyer has an urgent need for the goods.¹⁴⁹ However, a clause requiring delivery “as soon as possible” does not necessarily mean that delivery “within a reasonable time” is immediately after the conclusion of the contract.¹⁵⁰

If seller fails to perform his obligation of timely delivery, buyer may claim damages as provided in CISG art 74 to 77, cf. CISG art 45(b). Buyer’s right to claim damages is not dependent on seller’s fault. Even though a delayed delivery is caused by defaults from seller’s supplier(s) buyer may claim damages.

¹⁴⁵ Huber supra p. 266.

¹⁴⁶ 9 U 146/98 available at <http://cisgw3.law.pace.edu/cases/990427g1.html#cx> (accessed 15 July 2003).

¹⁴⁷ Secretariat Commentary available at <http://www.cisg.law.pace.edu/cisg/text/seccomm/secomm-33.html> (accessed 15 July 2005).

¹⁴⁸ Huber supra p. 266. See also Lookofsky ‘The 1980 United Nations Convention on Contracts for the International Sale of Goods’ supra p. 86 available at <http://www.cisg.law.pace.edu/cisg/biblio/loo33.html> (accessed 15 July 2005).

¹⁴⁹ Huber supra p. 267.

¹⁵⁰ Judgment of 3 October 2001 from the Belgium Commercial Court available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=948&step=Abstract> (accessed 15 July 2005).

To limit his liability, seller can include a liquidated damages clause in the sales contract with buyer. If seller is dependent on procuring the goods from a supplier, seller can also include a liquidated damages clause in his contract with the supplier.

V.4.b: Liquidated damages clause ¹⁵¹

If seller and buyer have agreed on a liquidated damages clause and seller fails to perform his obligation of timely delivery of the goods, seller immediately begins to owe buyer according to the clause, typically an agreed amount per week or per month, until he makes the necessary corrections. Seller's advantage is that the clause reduces his possible loss. Buyer cannot claim other damages as a result of the delay and a well-written clause will also put a ceiling on the damages.

If seller has agreed on a liquidated damages clause in his contract with a supplier, seller's advantage is that he should only prove that his supplier has not delivered at the agreed time. Seller does not have to prove any fault by the supplier. Furthermore, seller does not have to prove an economic loss.

When calculating the liquidated damages, the parties must make a fair and genuine pre-estimate of buyer's loss if seller fails to perform his obligation of timely delivery of the goods. The parties must *agree* that it is a fair and genuine pre-estimate. Hanna Gadsby describes the legal principle of liquidated damages as: "Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss."¹⁵²

Especially where seller deals with suppliers in England or some American states, seller should be careful not to agree to too big liquidated damages. If the liquidated damages do not look like a genuine pre-estimate of the loss, but rather a penalty clause to "terrorize" the supplier to finish, then English law does not allow seller to claim the penalty. Sellers dealing in England should therefore keep documentation for the calculation of liquid damages. The purpose of liquidated damages should be compensatory only.¹⁵³

¹⁵¹ My research on liquidated damages clauses is from engineering contracts but it is difficult to see why the clauses should not have the same effect in international sales contracts.

¹⁵² Available at <http://www.ghlaw.com/html/5publications/articles/liquid.html> (accessed 18 April 2005).

¹⁵³ Hanna Gadsby *supra*. Examples of liquidated damages clauses are found in the FIDIC Silverbook clause 8.7 and in Johan Schiller's unpublished article 'Law in practice: risk exposure in international sales' p. VII.1.

V.5: Delivery of *conforming* goods

V.5.a: CISG art 35

It cannot come as a surprise that seller must deliver goods required by the contract, cf. CISG art 35(1). The provision “really only states the obvious”¹⁵⁴ and clarifies how the goods should conform to the contract.

CISG art 35(1) is concerned with seller’s *express* obligations according to the contract.¹⁵⁵ Seller must deliver the quantity of goods required by the contract. Thus delivery of less *or more* than required by the contract constitutes delivery of non-conforming goods.

Seller must deliver goods of the quality and description required by the contract. Delivery of a different kind of goods (*aliud pro alio*) constitutes non-conforming goods and not late delivery of the goods originally contracted for.¹⁵⁶

Finally, seller must deliver goods, which are contained or packaged in the manner required by the contract.

CISG art 35(2) is concerned with seller’s *implied* obligations and applies if the parties have not agreed otherwise. The provision describes what the parties should normally expressly agree on in their contract.¹⁵⁷

According to CISG art 32(2)(a), seller must deliver goods “fit for the purposes for which goods of the same description would *ordinarily* (my emphasising) be used”. This means that the goods must be fit for commercial purpose, i.e. resale.¹⁵⁸ In a judgment of 2 March 2005, the German Federal Supreme Court (Bundesgerichtshof) decided upon a case where the authorities in Germany (buyer’s country) issued an ordinance in which pork meat from

¹⁵⁴ Jacob S. Ziegel ‘Report to the Uniform Law Conference of Canada on convention on Contracts for the International Sale of Goods’ available at

<http://www.unilex.info/case.cfm?pid=1&do=case&id=948&step=Abstract> (accessed 11 July 2005).

¹⁵⁵ Seller’s *implied* obligations are dealt with in CISG art 35(2). The distinction between express and implied obligations is seen in Bernstein and Lookofsky supra p. 83.

¹⁵⁶ See judgment of 26 June 1999 from the Austrian Supreme Court (Oberster Gerichtshof) (1 Ob 74/99 K) available at <http://cisgw3.law.pace.edu/cases/990629a3.html#cx> (accessed 11 July 2005).

¹⁵⁷ Honnold supra p. [252].

¹⁵⁸ Schwenzer in Peter Schlechtriem *Commentary on the UN Convention on Contracts for International Sales of Goods (CISG)* supra p. 279. See also Bernstein and Lookofsky supra p. 83.

Belgium (seller's country) was declared to be unmarketable, insofar as no certificate was presented declaring the meat free of contaminants. The Court held:¹⁵⁹

“If the parties have not agreed otherwise, the goods only conform with the contract if they are fit for the purpose for which goods of the same description would ordinarily be used (Art. 35(2)(a) CISG). In international wholesale and intermediate trade, an important part of being fit for the purposes of ordinary use is resaleability (tradeability)...”

When international standards apply to the goods, seller must make sure that the goods are in conformity with these standards. Uncertainty arises where standards in seller's country are different from standards in buyer's country. Seller should incorporate in the sales contract a provision stating what standard applies. If the contract is silent on this issue, the situation depends upon the circumstances in each case. However, Schwenzer sets out some *guidelines*:¹⁶⁰

Seller is not supposed to possess knowledge of statutory requirements in buyer's country unless he has knowledge of these requirements, e.g. from previous business relations with buyer or if buyer has made the requirements clear to seller.¹⁶¹ Thus seller has normally fulfilled his obligation to deliver conforming goods if they comply with the requirement in his own country. In the judgment of 2 March 2005¹⁶², the German Federal Supreme Court held:

“Insofar as the compliance with public regulations is relevant here, the circumstances in the Seller's country are generally controlling because the Seller cannot be generally expected to know the relevant provisions in the buyer's country or ... in the country of the ultimate consumer. (...) The situation is only different, how-

¹⁵⁹ VIII ZR 67/04 available at <http://cisgw3.law.pace.edu/cases/050302g1.html#cx> (accessed 11 July 2005). See also judgment of 18 January 2002 from the Belgian Commercial Court where the Court found that although no written agreement was entered into, it was reasonable for buyer to expect that the tomatoes were fit for resale, available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=941&step=Abstract> (accessed 23 August 2005).

¹⁶⁰ Schwenzer supra p. 280-281. Honnold states that “In sum, under the Convention problems of contract interpretation are to be solved on the bases of the *facts of each transaction* and not under a general legal rule specifying that the seller's (or buyer's) region controls the parties' understanding.” supra p. [257].

¹⁶¹ See also Lookofsky supra p. 91-92 available at <http://www.cisg.law.pace.edu/cisg/biblio/loo35.html> (accessed 11 July 2005).

¹⁶² Reference in fn. 159. See also judgment of 8 March 1995 from the German Federal Supreme Court (Bundesgerichtshof) Case No. VIII ZR 159/94 available at <http://cisgw3.law.pace.edu/cases/950308g3.html#ta> (accessed 11 July 2005).

ever, if the provisions in the Seller's and the Buyer's country are essentially the same, or if the Seller is familiar with the regulations in the Buyer's country based on certain circumstances.”.

If the standards are higher in seller's country than in buyer's country, seller normally fulfils his obligation to deliver conforming goods when the goods conform to the requirements in buyer's country. The situation is, however, different if buyer has pointed out to seller that he wants the goods to comply with the standards in seller's country.¹⁶³

In both cases the overall requirement, that the goods “are fit for the purposes for which goods of the same description would ordinarily be used”, must be fulfilled.

To avoid uncertainty, seller can incorporate in the sales contract a provision clarifying what “ordinary” means.

CISG art 35(2)(b) provides that seller must deliver goods “fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract...”. The particular purpose merely has to be “made known” (expressly or implicitly) to seller and not necessarily *agreed* upon.¹⁶⁴

In an arbitration award of 15 October 2002 the Netherlands Arbitration Institute decided upon a case where buyer refused to take delivery of the goods (condensate mixed with crude oil called “Rijn Blend”). Buyer averred that the blend did not conform with buyer's intended use of it. The Arbitral Tribunal held:

“The question then arises whether [buyer], at that time (*i.e.*, 1993 and 1994) expressly or impliedly indicated to the respective [sellers] the use it intended to make of the Rijn Blend. The Arbitral Tribunal is of the opinion that it did not. First, the sale contracts do not contain a product quality specification. Absent such a specification, [buyer] did not indicate expressly the particular purpose it had in mind for the Rijn Blend. Secondly, an implied indication as to a particular purpose made in 1993 and 1994 also has not been proven.”¹⁶⁵

¹⁶³ Schwenger supra p. 280.

¹⁶⁴ Schwenger supra p. 281.

¹⁶⁵ Case No. 2319 available at <http://cisgw3.law.pace.edu/cases/021015n1.html#cx> (accessed 9 September 2005)

To limit his liability, seller can incorporate a provision in the sales contract defining particular purposes for which seller will not undertake liability.

In terms of CISG art 35(2)(c), the goods must “possess the qualities of goods which seller has held out to the buyer as a sample or model;”

To limit his liability, seller can incorporate a provision in the sales contract stating that the goods are sold without liability at all or without liability for some more specified features.

Finally, the goods must be contained or packaged in the usual manner or, if no usages exist, in a preserving and protecting manner, cf. CISG art 35(2)(d). Bianca states: “In contracts of sale involving carriage of the goods it has always been understood that it is the seller’s duty to provide for the proper packaging of the goods...In order to shift the burden of packaging the goods from the seller to the buyer there must be an unmistakable contractual clause to this effect.”¹⁶⁶

If it is usual not to pack the goods, seller does not have an obligation to contain or pack the goods.¹⁶⁷ If no usages exist seller must pack the goods in an *adequate* manner. “What is required is the degree of protection that is usual for goods of comparable fragility”.¹⁶⁸ He must take into consideration factors as the nature of the goods, the length of the travel and the weather conditions.¹⁶⁹ If seller does not carry out this implied obligation, he is liable to buyer even though the risk has passed.¹⁷⁰

According to CISG art 36(1), the relevant time to examine whether the goods conform to the sales contract is the time when the risk for accidental damages to or loss of the goods passes from seller to buyer. The risk passes according to CISG art 66 – 70¹⁷¹ unless the parties have agreed otherwise, e.g. by the Incoterms.

¹⁶⁶ Bianca-Bonell Commentary p. 277 quoted in Secretariat Commentary available at www.cisg.law.pace.edu/cisg/text/secomm/secomm-35.html (accessed 11 July 2005).

¹⁶⁷ Honnold supra p. [259].

¹⁶⁸ Honnold supra p. [259].

¹⁶⁹ Schwenger supra p. 284.

¹⁷⁰ Schwenger supra p. 284.

¹⁷¹ Chapter VIII.

Seller is liable for lack of conformity even after the risk has passed if the lack is caused by breach of one or more of his obligations. This is so even though seller is in no fault, since the CISG is built on a no fault system.¹⁷² Seller is also liable after the risk has passed if he has given a guarantee for durability during a certain period, cf. CISG art 36(2), but seller can limit this liability by providing that the guarantee only applies if buyer has the goods properly contained and uses the goods appropriately.

V.5.b: Disclaimers

CISG art 6 provides that the parties are free to exclude the application of, derogate from or vary the effect of art 35. A disclaimer normally displaces the obligations in art 35.¹⁷³ A disclaimer can exclude or limit seller's liability. The validity of the disclaimer must be determined on the basis of domestic law, cf. CISG art 4.¹⁷⁴

An example of an *exclusion* clause is the non-rejection clause.¹⁷⁵ A non-rejection clause deprives buyer of the right to reject non-conforming goods and limits his right to damages.

Related to the exclusion clause is the conclusive evidence clause that require seller to obtain a certificate from an independent appraiser as definitive proof of the quality of the goods. When seller presents the certificate, buyer cannot claim that the goods are non-conforming even if this turns out to be the situation.¹⁷⁶ To be effective the conclusive evidence clause must be unambiguous and seller must emphasise the importance of checking the statements in the clause and of the consequences of not doing so.¹⁷⁷

Pamela Sellman mentions two kinds of *limitations* of liability clauses. The first is the liquidated damages clause.¹⁷⁸ The second clause either sets a maximum recoverable amount or excludes the right to special kinds of damages.

¹⁷² Lookofsky supra p. 93.

¹⁷³ Lookofsky supra p. 95.

¹⁷⁴ Chapter VII.

¹⁷⁵ Pamela Sellman states that common law countries regard the non-rejection clause an exclusion clause, Sellman *Law of international trade* 4th ed., (Old Bailey Press) p. 14

¹⁷⁶ *Gill & Duffus v Berger* [1981] 2 Lloyd's Rep 233 in Sellman supra p. 15-16.

¹⁷⁷ The Privy Council's decision in *Financial Institutions Services Limited v. Negril Negril Holdings Ltd., Negril Investment Company Ltd.* The Court of Appeal's decision referred in 2004 WL 1476678 [2004] UKPC 40 PC (Jam). Even though this judgment relates to a banks relationship with a client, the decision seems to be an expression of general principles and therefore also applicable in sales contracts.

¹⁷⁸ Chapter V.4.b.

Chapter VI: Risks from defaults from buyer/securing against them

VI.1: General comments

CISG art 53 summarizes buyer's key obligations. According to the provision, buyer "must pay the price for the goods and take delivery of them as required by the contract and this Convention.". The obligations are subsequently described in detail in art 54 – 60. In this Chapter I will only examine the articles most relevant from seller's point of view (art 54, 56, 57 and 58).

VI.2: CISG art 54 – buyer's steps to enable payment

CISG art 54 provides that buyer must take the steps and comply with formalities required under the contract or laws/regulations necessary for making the payment.

Even though CISG art 54 states that these steps etc. are a part of buyer's obligation to pay the price, it is important for seller to know that they are obligations per se. If buyer fails to perform the obligations, seller can rely on the remedies in CISG art 61 – 65. Seller does not need to rely on art 71 on anticipatory breach of buyer's obligations.¹⁷⁹

In the Secretariat Commentary it is stated that the "steps" in CISG art 54 include "applying for a letter of credit or a bank guarantee of payment¹⁸⁰, registering the contract with a government office or with a bank, procuring the necessary foreign exchange or applying for official authorization to remit the currency abroad."¹⁸¹

Since letters of credit play a big role in international sales contracts,¹⁸² seller would often be at risk of not getting payment if it was sufficient for buyer merely to *apply* for the letter of credit, i.e. without an obligation to guarantee that the issuing bank will *open* it. This issue has been under consideration, but the law now seems to be that buyer must succeed in

¹⁷⁹ Secretariat Commentary at n. 5 available at www.cisg.law.pace.edu/cisg/text/secomm/secomm-54.html (accessed 18 July 2005). See also Honnold supra p. [352].

¹⁸⁰ See e.g. arbitration award of 17 November 1995 from the Hungarian Chamber of Commerce and Industry Court of Arbitration, Case No.VB/94124 available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=217&step=Abstract> (accessed 26 July 2005).

¹⁸¹ Secretarial Commentary, supra at n. 2.

¹⁸² Chapter VI.5.c.

obtaining the letter of credit.¹⁸³ In a judgment of 17 November 2000, the Supreme Court of Queensland held that buyer's failure to *establish* a letter of credit was a failure to take the necessary "steps" in terms of CISG art 54 and constituted a fundamental breach of the contract.¹⁸⁴

That buyer must go a step further than just *requesting* his bank to make the payment is also established by a Russian arbitration award of 17 October 1995¹⁸⁵. The Tribunal found that buyer had failed to perform his obligations under CISG art 54 as:

"...[buyer] did not take any definite steps to enable payment to be made except for sending a request to the bank to transfer the price of the goods to the [seller's] account."

If the parties have agreed that buyer must secure the payment of the price by e.g. letters of credit or a bank guarantee, buyer must have established the required security for payment to be made at the agreed time. To avoid uncertainty the parties should agree on a latest date for buyer's security.

Buyer's responsibility for payment seems to be very strict in relation to "steps of a strictly commercial nature"¹⁸⁶ (i.e. steps that buyer, when necessary, must undertake to establish a letter of credit or a bank guarantee), whereas seller should be aware that buyer's responsibility may be less strict if buyer cannot comply with formalities required under any "laws and regulations", cf. CISG art 54. This mainly relates to governmental requirements in relation to payment.¹⁸⁷ Banks' procedures for payment, e.g. the procedure for paying with letters of credit, are often well established and it is relatively simple for buyer to contact his bank to obtain detailed information on these procedures (and to find alternative resources if he cannot comply with the respective bank's procedure). It is different when it comes to governmental requirements. They are not as predictable as banks' procedures and buyer often does not have alternative resources. Therefore courts and arbitrators may be

¹⁸³ Dietrich Maskow in Bianca-Bonell *Commentary on the International Sales Law* (Giuffrè: Milan, 1987) p. 395 available at <http://www.cisg.law.pace.edu/cisg/biblio/maskow-bb54.html> (accessed 18 July 2005). Opposite Secretariat Commentary *supra* at n. 3.

¹⁸⁴ *Downs Investments Pty Ltd v Perjawa Steel SDN BHD*, Civil Jurisdiction No. 10680 of 1996, available at <http://cisgw3.law.pace.edu/cases/001117a2.html#ct> (accessed 18 July 2005).

¹⁸⁵ Case No. 123/1992 available at <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/951017r1.html> (accessed 18 July 2005).

¹⁸⁶ This expression is used several times by Maskow about steps of more a private nature as opposed to steps of governmental nature.

¹⁸⁷ Maskow *supra* p. 395-396.

more reluctant to find a buyer guilty in breach of his obligations in terms of art 54 if the failure to perform the obligations is caused by governmental restrictions.

In buyer's attempt to comply with governmental requirements, buyer and not seller will have contact with the authorities. Maskow concludes that seller therefore has a risk that he will first be aware of a potential breach too late, i.e. when he has already dispatched the goods.¹⁸⁸ Seller should be aware of this problem and keep a tight correspondence with buyer on this issue.

Seller may have an obligation to take steps to enable the payment to be made. If seller is the only party who can comply with laws and regulations in his country enabling the payment to be made, he is under an obligation to take the necessary steps to enable payment.¹⁸⁹

VI.3: CISG art 57 – place of buyer's payment

The provision applies if the parties have not agreed on the place of payment. Since the place of payment plays an important role, the parties should always agree on this in their contract and in most international contracts the parties do agree on this.¹⁹⁰

CISG art 57 governs the place of payment where "payment is to be made against the handing over of the goods or of documents"(art 57(1)(b)) and where this is not the case (art 57(1)(a)), e.g. where the parties have agreed on advance payment of the whole or part of the price.¹⁹¹

CISG art 57(1)(a) reinstates the common principle that the place to perform a monetary obligation is the creditor's place of business. When nothing is agreed, buyer must pay the price at seller's place of business. If buyer has paid too much and claims the overcharge back, then buyer is the creditor and seller must pay the overcharge at buyer's place of business.¹⁹²

¹⁸⁸ Maskow supra p. 398.

¹⁸⁹ Maskow supra p. 397.

¹⁹⁰ Chengwei Liu 'Place of performance' at n. (g) available at <http://www.cisg.law.pace.edu/cisg/text/peclcomp57.html#er> (accessed 18 July 2005).

¹⁹¹ Maskow supra p. 412 available at <http://www.cisg.law.pace.edu/cisg/biblio/maskow-bb57.html> (accessed 18 July 2005).

¹⁹² Honnold supra p. 359 available at <http://www.cisg.law.pace.edu/cisg/biblio/ho57.html> (accessed 18 July 2005).

Seller does not bear the risk of the transfer of the payment. If buyer, however, has paid the price at the time where the goods or documents are handed over, then the further transmission of the payment is at seller's risk.¹⁹³

If payment is to be made against the handing over of the goods or of documents, CISG art 57(1)(b), buyer must pay the price where the goods or documents are to be handed over. Where the parties have agreed on "cash against documents", seller normally hands the documents over to his bank, which thereafter sends the documents to buyer's bank. Seller undertakes that the documents are handed over at buyer's place of business and thus the place of payment is buyer's place of business. Seller bears the risk of the transfer of the payment to his bank.¹⁹⁴

Where the parties have agreed on payment against a letter of credit, the documents are handed over at seller's confirming bank, which becomes the place of payment.¹⁹⁵ As soon as the confirming bank has paid seller an amount corresponding to the price, buyer has fulfilled his obligation to pay the price.¹⁹⁶

If seller changes his place of business after conclusion of the sales contract, he does not bear the risk for the consequences of the change, except from an increase in payment expenses. However, if seller does not inform buyer of the change in due time before payment is to be made, a delayed payment caused by the late information should not be seen as a breach of the contract.¹⁹⁷

The parties should agree on a place of payment. From seller's point of view it is most convenient to agree on payment at his place of business/to an account in his country. He thereby avoids dealing with potential difficulties in buyer's country himself, e.g. exchange controls, prohibitions against export of foreign currency, requirements of a licence to export funds etc.¹⁹⁸ Seller must, however, bear in mind that buyers from countries with weak currencies can have problems with payment and therefore seller should secure himself against such risks in his contract.

¹⁹³ Lief Sevón 'Obligations of the buyer under the Vienna Convention on the International Sale of Goods' (1990) 106 *Juridisk Tidsskrift* p. 333-335, quoted in Secretariat Commentary (fn. 4) available at www.cisg.law.pace.edu/cisg/text/secomm/secomm-57.html (accessed 18 July 05).

¹⁹⁴ Maskow *supra* p. 415.

¹⁹⁵ Chapter VI.5.c.

¹⁹⁶ Maskow *supra* p. 416.

¹⁹⁷ Sevón *supra*. See also Maskow *supra* p. 413.

¹⁹⁸ Honnold *supra* p. 358.

Often seller, in his invoice, states where payment must be made. If this place is not agreed on in the sales contract too, such a statement does not constitute an agreement on the place of payment¹⁹⁹ and buyer is not obliged to pay at the place stated in the invoice. The statement merely indicates that seller accepts that buyer pays at that particular place and that buyer has a right to pay at such a place.

Finally, it should be mentioned that CISG art 57 governs not only buyer's payment of the price, but also other payments such as payment of "damages, liquidated damages, interests and reimbursement of expenses."²⁰⁰

VI.4: CISG art 58 – time for buyer's payment

Seller would obtain the highest possible security if he could agree on advance payment of the entire price; but there are always at least two parties in a international sales contract and it is not likely that buyer will agree on the advance payment of the entire price as this will put him at risk of not receiving the goods after payment has been made. CISG art 58 represents a fair solution to this dilemma: "The basic rule is that the goods should be exchanged for payment of the price".²⁰¹

I will primarily examine art 58(2) dealing with contracts involving carriage, but short comments will also be made on art 58(3).

In terms of CISG art 58(2), seller may dispatch the goods on condition that the goods, or documents controlling their disposition²⁰², will not be handed over to buyer except against payment. The provision itself seems to impose risks on seller: in contracts involving carriage of the goods, seller often finds himself in a situation where he must arrange and pay for the carriage without having received buyer's payment of the price. Furthermore, seller apparently loses control over the goods as soon as they are dispatched but before he has received payment.²⁰³ It should, however, be remembered that seller controls the goods as long as he is in possession of the documents controlling their disposition. Art 58(2) secures

¹⁹⁹ Sévon supra. See also Honnold supra p. 360 and Liu supra at note (s).

²⁰⁰ Liu supra at note (q).

²⁰¹ Sévon supra p. 335 quoted in Secretariat Commentary at note 3 available at www.cisg.law.pace.edu/cisg/text/secomm/secomm-58.html (accessed 18 July 2005).

²⁰² The "documents controlling their disposition" are documents of title. As examples Maskow mentions a bill of lading and a warehouse receipt, supra p. 426 available at www.cisg.law.pace.edu/cisg/biblio/maskow-bb58.html (accessed 18 July 2005).

²⁰³ Maskow supra p. 422

seller in such a way that he can require that the goods or documents not be handed over to buyer, except against payment of the price. In this way, as Honnold states, “Art 58 is designed to minimise risks for both parties – risk to the seller from delivery before payment and risk to the buyer from payment for defective goods.”²⁰⁴

In sales involving carriage, seller must pay the costs connected with the carriage unless otherwise agreed. He must ship the goods before buyer’s payment of the price and he thereby faces the risk that the final exchange of goods and price might not take place for some reason. The jungle warfare that takes place in real life provides several examples of this risk. Seller is in a vulnerable situation if the goods arrive in a non-conforming condition because it is impossible for him to sell the goods to another buyer at the same price as agreed on with the original buyer. Sevón states, “Some buyers may use this fact as a means to force the seller to accept a reduction of the price by refraining from taking delivery of the goods on the alleged ground of non-conformity. The seller can protect himself against such claims by a provision in the contract specifying a procedure for delivery according to which the buyer may not inspect the goods until payment has been made.”²⁰⁵

Another way in which seller can secure delivery of the goods against payment, is by payment by a letter of credit. CISG is not involved with payments by letters of credit, but it is a safe method of payment for both seller and buyer and therefore often used in international sales.

CISG art 58(2) does not protect seller against buyer’s insolvency. A way to secure against buyer’s insolvency is by a guarantee from a third party – often a bank.²⁰⁶

In sales contracts on successive deliveries, every delivery and the corresponding payment must be regarded as separate contracts. Therefore, seller is not entitled to make a next delivery dependent on buyer’s payment of previous arrears or dependent on advance payment of future deliveries. To limit the risk of buyer’s failure to pay, seller should claim security for the payments.²⁰⁷

²⁰⁴ Honnold supra p. 362 available at www.cisg.law.pace.edu/cisg/biblio/ho58.html (accessed 18 July 2005).

²⁰⁵ Sevón supra.

²⁰⁶ Lookofsky supra p. 131 (fn 2) available at <http://www.cisg.law.pace.edu/cisg/biblio/loo58.html> (accessed 18 July 2005). See chapter VI.5.b.

²⁰⁷ Maskow supra p. 423.

If nothing is agreed, CISG art 58(3) provides the general rule that seller must give buyer an opportunity to examine the goods before he requires payment from buyer. It is seller's responsibility to provide appropriate means for this examination.²⁰⁸ Seller can make arrangements with the carrier to allow buyer an appropriate examination of the goods before the goods or documents are handed over to buyer.²⁰⁹ If the parties have agreed on payment by a letter of credit, this procedure of payment is normally inconsistent with buyer's examination of the goods before payment, and buyer cannot make payment dependent on his examination. If seller and buyer have a longstanding business relationship, seller can, however, delay the presentation of documents to a time after the goods have arrived, thereby allowing buyer to examine the goods before final payment.²¹⁰

If buyer, after his examination, rejects the goods as non-conforming and if no valid non-rejection clause has been agreed upon, seller must resell the goods. This can result in additional costs for seller. If the parties have agreed on payment by a letter of credit, seller can avoid this situation if the documents mentioned in the letter of credit include a certificate of quality whereby an independent inspector declares that the goods are of the required quality.

There are several ways whereby seller can protect himself and reduce or eliminate the risk that buyer does not pay the right price at the right time.

VI.5: Different ways to secure payment

If buyer fails to pay the price, seller is often forced to sue buyer or bring the case to arbitration. This is time consuming and involves expenses and other risks for seller. Seller should instead *secure* himself against buyer's failure to pay.

VI.5.a: Liquid document

Seller can take out a liquid document against buyer. A liquid document is buyer's written acknowledgment of the debt. If seller has a liquid document, his proceedings in court or with the arbitrator will be much shorter, because there will most likely not be any dispute that buyer owes seller the amount stated in the liquid document.

²⁰⁸ Secretariat Commentary supra at note 5.

²⁰⁹ Secretariat Commentary supra at note 6.

²¹⁰ Honnold supra p. 365.

In most countries the period of prescription on a liquid document is longer than the period of prescription on ordinary contractual claims. If seller obtains a liquid document in respect of an already existing claim, where prescription is running from the time the debt was incurred, the effect of the liquid document is that it interrupts prescription, and the prescription on the liquid document starts to run.

A liquid document has another spin-off effect. Seller sues on the document – not on the contract. The procedure in most countries is that seller gets a script of the summary judgment, but seller cannot execute on it if buyer has a defence against the liquid document, e.g. that it has been obtained by fraud.

VI.5.b: Bank guarantee

A liquid document merely reduces the risk of buyer's failure to pay the price. It does not protect seller against buyer's insolvency. Seller can eliminate this risk by obtaining a third party guarantee for buyer's payment. In almost every guarantee used in international trades the guarantor is buyer's bank.

A bank guarantee is “the promise of the bank (the “Guarantor”) to pay a certain sum of money to the addressee of the promise (i.e. the “Beneficiary”). The promise is given on instruction of the bank's client (the “Principal”).²¹¹

Two types of guarantees are used in international trades. With a *demand guarantee*, seller only has to write to the bank and *inform* them that buyer has failed to perform the obligations agreed upon in the letter of guarantee. The letter of guarantee contains very specific wording, and should seller fail to use the exact phrases in the letter of the guarantee and in the ICC rules on guarantees,²¹² the bank will refuse to pay him.

With a *conditional* guarantee, seller must *prove* that buyer has failed to perform the obligations agreed upon in the letter of guarantee.

Seller will normally use a bank guarantee if the parties have agreed on payment against an open invoice and seller foresees a risk of buyer's insolvency.²¹³

²¹¹ Schiller supra p. VI.6.

²¹² Most guarantees in international sales are subject to ICC rules on guarantees.

²¹³ Schiller supra p. VI.10.

Bank guarantees often include a validity date and seller should be aware that a potential claim against the guarantor must be raised within the date of expiry of the guarantee.

The validity of a guarantee is completely independent of the validity of the underlying payment claim.²¹⁴ For seller this is an advantage, because the bank will not spend time on examining whether the underlying payment claim is valid or not.

VI.5.c: Documentary credit

The documentary credit is the standard method of payment in international sales contracts where the parties do not know each other sufficiently well. Since 1919 documentary credit has been governed by ICC's UCP (Uniform Customs and Practice of International Banking) and if the parties agreed on payment by a letter of credit the payment should be governed by UCP.²¹⁵ The current UCP version is 500 and 500 e.

The letter of credit is a promise by buyer's bank (the issuing bank – I/B) to pay the price for the goods in exchange for certain specified documents.

When the parties have agreed on payment by a letter of credit and which documents seller must present, buyer instructs the I/B to open the letter. The I/B will often have its own standard forms of instruction, telling them exactly what is to be in the letter of credit.²¹⁶ The I/B can inform seller directly of the opening of the letter of credit but will normally send the letter to seller's bank (the confirming bank – C/B) and ask them to confirm the letter. When the C/B has confirmed the letter of credit, it is sent to seller with the C/B's confirmation.

When the C/B has confirmed the letter of credit, seller has reduced his risk of non-payment: the I/B bears the risk of buyer's payment and the C/B bears the risk of the I/B's payment.

To take this risk, the C/B requires a fee from seller – the higher risk, the higher fee. If the C/B refuses to confirm the letter of credit, seller can regard this as a strong indication that

²¹⁴ Schiller supra p. VI.6.

²¹⁵ It must be stated in the letter of credit that UCP is governing the credit, UCP art 1.

²¹⁶ Klotz suggests that the parties attach a draft of the letter of credit to the sales contract so the letter gets an unambiguous content. This advice seems, however, of less importance when the bank uses a standard form, supra p. 146.

the I/B is not creditworthy.²¹⁷ In such a situation, seller should consider demanding the letter of credit be issued by another bank or require advance payment or a bank guarantee.

When seller gets the letter of credit, he must immediately compare it with the sales contract. If the letter of credit conforms with the sales contract, seller must hand over the agreed documents to the C/B. The main document is usually a bill of lading or a similar transport document proving that seller has dispatched the goods to buyer.

If the letter of credit does not conform with the sales contract, seller should not accept it. The letter should be changed by the I/B on instructions from buyer. Seller can refuse to ship the goods until the letter of credit has been changed.

Seller must present documents that comply with the terms in the letter of credit. This is the doctrine of strict compliance.²¹⁸ Only then will the C/B accept seller's draft. If the documents presented by seller comply with the letter of credit, the C/B must pay.²¹⁹ If it does not pay, it is liable for seller's causal economic loss.

If the documents do not comply with the terms in the letter of credit, the C/B may refuse to acknowledge the documents.²²⁰ If the C/B does and pays, it is at its own risk.²²¹ Either the C/B can ask seller to resubmit correct documents, or the I/B can ask buyer to waive the non-conformity. To avoid the situation where the documents do not conform with the letter of credit, the parties should not describe the goods in detail in the documents.²²²

UCP art 39 allows seller a certain tolerance in quantity of the goods, unless the letter of credit states that the quantity must not be exceeded or reduced. The provision makes it possible to deal in bulk.

²¹⁷ Klotz supra p. 144.

²¹⁸ Pamela Sellmann supra p 149.

²¹⁹ UCP art 14 b.

²²⁰ UCP art 14 b.

²²¹ In *Equitable Trust Company of New York v Dawson Partners, Ltd* (1927) 27 Ll. L. Rep 49 the judge held that "There is no room for documents which are almost the same...". The judgment states that the doctrine of de minimis does not apply in payments by letter of credit. See also *J H Rayner & Co Ltd v Hambro's Bank Ltd* [1943] 1 KB 37 (CA) where the bank was allowed to refuse a document of shipment of "machine shelled groundnut kernels". The letter of credit required proof of shipment of "Coromandel groundnuts".

²²² UCP art 37(c).

If the goods do not conform with the contract, buyer cannot stop payment. Once the letter of credit is put into operation, buyer cannot stop it unless the documents presented by seller are fraudulent.²²³

The parties must agree on the type of credit. If the sales contract prescribes cash payment, seller should agree on *sight credit/sight draft*.²²⁴ As soon as seller presents the documents to the C/B and the C/B accepts them and seller's draft, the C/B makes payment.

More frequently the credit will be a *term credit/term draft*. The C/B promises to pay after a certain term – e.g. 30 or 60 days after presentation of documents. In the meantime, the C/B has accepted seller's draft. As soon as the draft is matured, seller can go to the bank for payment.

If seller is not the manufacturer of the goods, but has bought the goods from a supplier, seller can pay the supplier by assigning the proceeds of the sale to the supplier²²⁵. An alternative is to agree on a *transferable credit*, where the supplier is the new beneficiary instead of seller. A credit is only transferable if it is designated so by the I/B.²²⁶ The transferable credit should be arranged in a way that prevents buyer to identify and contact the supplier. Seller thereby avoids that buyer in future deals directly with the supplier and prevents seller from obtaining the “middleman's profit”.²²⁷ A transferable credit is only transferable once,²²⁸ but the credit can be transferred in parts if seller has contracted with more suppliers.²²⁹

If the sales contract prescribes advance payment, seller should try to agree on a “*Red clause credit*”. This credit secures seller an advance payment against presentation of the required documents before he ships the goods.²³⁰ The credit obviously implies a big advantage for seller whereas buyer bears the risk of not getting the goods. The credit will therefore normally only be used if the parties have trust in each other (or if seller has a very strong position compared to buyer).

²²³ *Phillips v Standard Bank of South Africa Ltd* 1985 (3) SA 301 (W).

²²⁴ Pamela Sellmann supra p. 138.

²²⁵ UCP art 49.

²²⁶ UCP art 48(b).

²²⁷ Sellmann supra p. 139.

²²⁸ UCP art 48(g).

²²⁹ UCP art 48(a).

²³⁰ Sellmann supra p. 143.

The parties should carefully consider the elements of the letter of credit. Johan Schiller has a list of important elements, which should be incorporated in the sales contract.²³¹ Below I will mention the most important elements from the seller's point of view:

Seller should agree on an **irrevocable** letter of credit:

A letter of credit can be revocable or irrevocable. A revocable letter of credit can be altered or cancelled without seller's consent. A revocable letter, therefore, does not protect seller sufficiently against buyer's unilateral alteration or cancellation of the letter of credit. A seller should only agree on a revocable letter of credit if he has trust in buyer.

In an irrevocable letter of credit, the *C/B undertakes* to pay seller against presentation of the required documents. An irrevocable letter of credit cannot be altered or cancelled without seller's consent.²³²

The parties should indicate whether the letter of credit is revocable or irrevocable. If the parties have not indicated this, the letter of credit is deemed irrevocable²³³

Seller should agree on a **confirmed** letter of credit:

When the *C/B* has confirmed the letter of credit, they have undertaken to pay seller against presentation of the required documents²³⁴. The *C/B's* confirmation reinforces the undertaking of the *I/B*.²³⁵ It may have serious consequences if the *C/B's* confirmation is delayed. If the letter of credit has been opened, seller may find himself in a position where he has to ship the goods to avoid delayed delivery before he has received the confirmation. To limit this risk, seller should incorporate in the sales contract a provision stating a date within which the *C/B* must have confirmed the letter of credit. If the *C/B* does not confirm the letter within this date, seller should be entitled to terminate the sales contract.²³⁶

The parties should agree on **which documents** seller must present to the *C/B*:

Seller should try to agree only to such documents as he can procure without assistance from buyer.²³⁷ Beside the bill of lading mentioned above, the parties often agree on a:

²³¹ Schiller supra p. VI:3 – VI:4.

²³² UCP art 9(d).

²³³ UCP art 6(c).

²³⁴ UCP art 9(b).

²³⁵ Sellmann supra p. 137.

²³⁶ Klotz supra p. 148-140 with an example of a clause.

²³⁷ Schiller supra p. VI:5.

- commercial invoice

In accordance with the doctrine of strict compliance, the price stated in the invoice must be exactly the same as stated in the letter of credit; otherwise the C/B can refuse to accept the invoice. If the C/B accepts the invoice, it will not pay more than the amount stated in the letter of credit. If seller dispatches a bigger quantity of goods than originally agreed with buyer²³⁸ and adapts the price in the commercial invoice accordingly, seller must obtain the remaining price direct from buyer.²³⁹

As mentioned above the letter of credit or the required documents should not normally contain a detailed description of the goods. This is, however, not the situation with the commercial invoice. The invoice must describe the goods in detail.²⁴⁰

- insurance documents

Unless otherwise stated in the letter of credit, a broker's cover note is not sufficient if the letter of credit calls for insurance documents.²⁴¹ Likewise will insurance documents issued later than the date of loading on board or dispatching not be accepted by the C/B.²⁴² The insurance documents "should provide at least basic cover in respect of the relevant goods for the relevant carriage."²⁴³

- Certificate of origin/certificate of inspection

Seller should agree on a **sight credit**, see above.

Seller should ensure that the letter of credit takes into account potential **price adjustments**.²⁴⁴

The parties should agree on the **allocation of the costs** for opening the letter of credit.

The parties should agree on the **date of opening** the letter of credit:

²³⁸ But still within the tolerances in UCP art 39.

²³⁹ Sellmann supra p. 153.

²⁴⁰ UCP art 37(c). See also *Glencore International and Another v Bank of China* [1996] 1 Lloyd's Rep. 135.

²⁴¹ UCP art 34 (c).

²⁴² UCP art 34 (e).

²⁴³ Sellmann supra p. 155.

²⁴⁴ Klotz supra p. 145-146 with example.

From seller's point of view, it is important that the letter of credit is opened as early as possible so he has some security of buyer's payment before he dispatches the goods. If the I/B does not open the letter of credit within the agreed date, buyer is in breach of his obligations according to CISG art 54. If the parties have not agreed on a date of opening the letter of credit, buyer must open it at the latest before the first date for shipment of the goods.²⁴⁵ The letter of credit is deemed opened when seller has been notified about its opening.²⁴⁶

The parties should agree on the **date of expiry** of the letter of credit:

The date of expiry must be realistic. Seller must make a genuine estimate of his ability to deliver in time.²⁴⁷

VI.5.d: CISG art 64 – “fundamental breach”

According to CISG art 64, seller may only declare the contract avoided if buyer's failure to pay amounts to a fundamental breach, or if buyer does not pay within the additional time of payment fixed by seller in terms of art 63. CISG art 25 defines a “fundamental breach”, but the wording of the provision is not unambiguous and requires further interpretation.

To avoid disputes about when buyer's failure to make payment amounts to a fundamental breach, seller can incorporate in the sales contract a provision stating that every delayed payment is deemed to be a fundamental breach that entitles seller to avoid the contract (or suspend his own performance).²⁴⁸ This allows seller to avoid the contract without fixing an additional time for buyer's performance as mentioned in CISG art 63. This is of special importance if the goods are perishable and seller needs to dispose of the goods quickly.

If the parties agree that buyer should have time to rectify his failure to pay the price, seller can try to agree on a clause that allows him to determine this period unilaterally.²⁴⁹

²⁴⁵ Sellmann supra p. 133.

²⁴⁶ Sellmann supra p. 133.

²⁴⁷ “Sellers are usually overly optimistic when they can ship, and thus will agree to unrealistic expiration dates in letters of credit.”, Klotz supra p. 149.

²⁴⁸ Klotz supra p. 133 with example.

²⁴⁹ Klotz supra p. 134 with example.

VI.5.e: Transfer of ownership

Before examination of retention of title clauses, some comments have to be made on transfer of ownership.

The CISG is not concerned with “the effect, which the contract may have on the property in the goods sold”.²⁵⁰ The word “property” is the relation to third parties.²⁵¹ Some of the provisions in the CISG²⁵² may have an *impact* on third parties, but the Convention only governs the relationship between seller and buyer. Property in the goods and transfer of ownership are governed by the proper law.

From seller’s point of view, the important question is how long he is protected against buyer’s creditors and can take back his goods.

In *Denmark* there are no statutory rules on transfer of ownership. The rules have been developed by case law. Transfer of ownership does not take place on a specific time or at a specific place, but depends on the kind of sale²⁵³

The slightly different issue when seller is protected against buyer’s creditors is dealt with as “seller’s right of stoppage”²⁵⁴ and is regulated by the Danish Sale of Goods Act. From seller’s point of view, the crucial time is where he hands over the goods to buyer, i.e. the physical delivery to buyer or buyer’s agent. Until this time he has the right to exercise stoppage in transit if buyer goes bankrupt etc.²⁵⁵ According to Danish law, therefore, seller has the right of stoppage in transit even though the contract of sale has been concluded and buyer has obtained the title to the goods.

In *South Africa* ownership is generally transferred at delivery. However, transfer of ownership requires that seller has been legally entitled to dispose of the goods and that buyer has been legally entitled to obtain ownership of the goods.²⁵⁶

²⁵⁰ CISG art 4(b).

²⁵¹ Jan Hellner ‘The law of sales and the law of contract: some remarks on the United Nations Convention on International sales’ in Francis D Rose *Lex Mercatoria* (London: LLP Professional Publishing, 2000) p. 177.

²⁵² E.g. CISG art 71.

²⁵³ Jette H. Ronoe *Transfer of Ownership in international trade* (The Hague: Kluwer Law International, 1999) p. 103.

²⁵⁴ Ronoe supra p. 110.

²⁵⁵ The Danish Sales of Goods Act § 39.

²⁵⁶ Lance Burger in Ronoe supra p. 330.

VI.5.f: Retention of title²⁵⁷

With a retention of title clause seller retains the title of the goods and obtains protection against buyer's creditors until buyer has made the entire payment.

Passing of title is not the same as passing of risk and a pure retention of title clause says nothing about passing of risk. The risk for the goods can be transferred to buyer either before or after transfer of title depending on the domestic law and the parties' individual agreement. It is in seller's interest that the risk is buyer's for as long as possible and seller can incorporate in the sales contract a provision stating that the title to the goods shall remain with him but at buyer's risk.²⁵⁸

As with other boilerplates, a retention of title clause should not just be slapped in at random. *Firstly*, boilerplates affect the purchase price as more risks are allocated to buyer. *Secondly*, seller should consider whether a boilerplate really improves his position. If seller has sold goods that can cause damage to the environment and the goods in fact cause environmental damages after delivery but before passing of title, seller can be held liable for the damages as the owner of the goods.²⁵⁹

The validity of a retention of title clause is not governed by the CISG,²⁶⁰ but by domestic law. Not all countries recognise a retention of title clause. A retention of title clause is only effective if it is valid in seller's country and enforceable in buyer's country.²⁶¹ The ICC has published a guide, "Retention of Title – A practical guide to 19 national legislations", where seller can obtain knowledge on different countries' requirements of retention of title clauses.²⁶²

Because of the different rules in different countries, the retention of title clause must be specific for each of the countries seller is dealing in.²⁶³

²⁵⁷ Also called Romalpa clause.

²⁵⁸ Klotz supra p. 175 with example.

²⁵⁹ Klotz supra p. 176.

²⁶⁰ CISG art 4(a). In *Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd*. 28 April 1995 [1995] 57 Fed Court Rep 216-240 the judge, however, held that the *construction and interpretation* of a retention of title clause fell within the scope of CISG. Available at <http://cisgw3.law.pace.edu/cases/950428a2.html#ta> (accessed 24 August 2005)

²⁶¹ Introductory remarks in the ICC guide "Retention of Title – A practical guide to 19 national legislations".

²⁶² Foreword to the ICC guide.

²⁶³ Ibid.

Denmark recognises a retention of title clause as valid if the clause has been *agreed* on when the goods *are handed over to buyer* at the latest.²⁶⁴ The agreement must be clear and unambiguous. If the parties use seller's standard form, the clause must be emphasised in the text.

The retention of title clause must only relate to the goods sold. The clause does not protect seller in previous or future deliveries.

As a general rule, a retention of title clause is not valid if seller was aware that the intent of buyer's purchase was a resale.

South Africa also recognises retention of title clauses. The clause must be agreed on between seller and buyer. A seller of components to a manufacturer should distinguish between situations where the final product, ready for resale, can or cannot be divided into individual parts. Only in the former situation a retention of title clause is valid.

VI.6: CISG art 60 – buyer's obligation to take delivery

Even though seller's primary interest is receiving the purchase price, buyer's obligation to take delivery is not without importance to seller. If buyer fails to take delivery, seller may be liable to a carrier for extra costs incurred by keeping the goods for a longer period.²⁶⁵

According to CISG art 60, buyer's obligation to take delivery consists of two parts: *Firstly*, he must take the necessary "preliminary acts"²⁶⁶ to "enable the seller to make delivery". Seller can only require that buyer takes "reasonable" acts to enable delivery. If delivery requires extraordinary acts, seller must at least make them known to buyer. Maskow seems to suggest that seller's information hereafter establishes an obligation for buyer to take the required acts.²⁶⁷

Seller should distinguish between acts enabling him to make delivery and acts enabling him to produce the goods.²⁶⁸ Only the former case is encompassed by CISG art 60. As a

²⁶⁴ Ronoe supra p. 116. The following comments on validity of retention of title clauses in Denmark and South Africa are all based on. Ronoe's "Transfer of Ownership in international trade".

²⁶⁵ Honnold supra p. 374 available at www.cisg.law.pace.edu/cisg/biblio/ho60.html (accessed 18 July 2005).

²⁶⁶ Lookofsky supra p. 132 available at www.cisg.law.pace.edu/cisg/biblio/loo60.html (accessed 18 July 2005).

²⁶⁷ Maskow supra p. 436 available at www.cisg.law.pace.edu/cisg/biblio/maskow-bb60.html (accessed 18 July 2005).

²⁶⁸ Maskow supra p. 436.

borderline case Maskow mentions buyer's delivery of packing material.²⁶⁹ If this should be a part of buyer's obligation to take delivery, the parties should incorporate in the sales contract a provision stating this.

If the parties have agreed on an Incoterm, this term will describe buyer's obligations in the delivery process.

Secondly, buyer must take over the goods. In deciding where and when buyer must fulfil this obligation, seller's corresponding obligations to deliver the goods, CISG art 31, have to be taken into consideration.²⁷⁰

Buyer's taking delivery of the goods does not mean that he thereby has accepted them as conforming with the contract. Seller must be prepared for buyer's subsequent rejection of the goods should he find them non-conforming.

VI.7: CISG art 73 – seller's risk in instalment contracts

In instalment contracts buyer's failure to pay one instalment may indicate a risk of future default payments. Seller can avoid the contract in respect of the instalment that has not been paid if buyer's failure to pay amounts to a fundamental breach.²⁷¹ But what about future instalments?

The purpose of CISG art 73 is to "avoid unnecessarily drastic consequences from the failure to perform a separable part of the contract."²⁷² CISG art 73(2) provides that seller can only avoid the sales contract in respect of future instalments if buyer's "failure to perform any of his obligations in respect of any instalment gives [seller] good grounds to conclude that a fundamental breach of contract will occur with respect to future instalments..."

Honnold states that "The test is whether the initial breach gives "the other party *good ground to conclude* that a fundamental breach of contract will occur with respect to future instalments" – a standard that *is less strict and more subjective* (my emphasising) than grounds for suspension under Article 71 or for avoidance under Article 72."²⁷³ (avoidance

²⁶⁹ Maskow supra p. 436.

²⁷⁰ Maskow supra p. 435.

²⁷¹ CISG art 73(1).

²⁷² Honnold supra p. 442 available at www.cisg.law.pace.edu/cisg/biblio/ho73.html (accessed 18 July 2005).

²⁷³ Honnold supra p. 442.

in case of anticipatory breach of contract).’. In an arbitration award of 10 December 1997, an Austrian Arbitral Court held:²⁷⁴

“Honsell (...) is of the opinion, that the term “goods grounds” in Art. 73(2) presupposes the least level of probability for the assumption of a future breach of contract, it suffices when for the reasons ascertained a defect in the performance of the future instalments will occur with “predominant probability”. The court of decision is of the same opinion.”

It is therefore of importance to seller to ascertain whether the sales contract is an instalment contract.

A contract is an instalment contract if it provides for “the successive delivery of goods”.²⁷⁵ Where seller and buyer have entered in *two or more* contracts, these contracts can under certain circumstances be regarded as *one* instalment contract. In the Austrian arbitration award of 10 December 1997,²⁷⁶ the Arbitral Court held:

“...both contracts are to be considered a unitary transaction from an economic point of view insofar, as they provide for the delivery of the absolute same kind of goods in instalments during the period ...under the same legal terms- with slightly differing terms of payment - and they had been concluded the same day.”

The Arbitral Court subjected the contract (the “unitary transaction”) to CISG art 73.

When does buyer’s failure to pay one instalment give seller “good grounds to conclude that a fundamental breach of contract will occur with respect to future instalments”? Liu states, “What is important *is the seriousness of the anticipatory breach as to future instalments that the non-breaching party fears will occur in view of the current breach.*”²⁷⁷

In *Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd*,²⁷⁸ the Australian judge found that the appointment of an administrator by the director in an insolvent

²⁷⁴ Case No. S 2/97 available at <http://cisgw3.law.pace.edu/cases/971210a3.html#cx> (accessed 26 July 2005).

²⁷⁵ Chengwei Liu ‘Avoidance in the case of an instalment contract’ 2nd ed. available at www.cisg.law.pace.edu/cisg/biblio/liu11.html (accessed 18 July 2005).

²⁷⁶ Reference in fn. 273.

²⁷⁷ Liu *supra*.

²⁷⁸ Reference in fn. 259.

company constituted “good grounds” and entitled seller to avoid the contract in future. Buyer’s failure to give seller a valid bank guarantee may also constitute “good grounds” to believe that a future fundamental breach will occur.²⁷⁹

Seller can avoid the uncertainty of whether buyer’s failure to pay one instalment gives seller “good grounds to conclude that a fundamental breach of contract will occur with respect to future instalments” with a provision in the sales contract stating that every failure to perform a payment is deemed a fundamental breach of the contract with respect to future instalments.

Even though seller is entitled to avoid the sales contract in future, CISG art 73 does not enable him to repossess the instalments he has already delivered. A retention of title clause entitles seller to repossess previous deliveries. Seller can also incorporate a provision in the sales contract that entitles him to repossess and resell the goods irrespective of the impact buyer’s failure to pay may have on the future contract.

If the goods are intended for resale seller faces the risk that he cannot avoid the contract with respect to an instalment and take back the goods delivered in that instalment, because buyer has sold the goods before payment of the price. Seller can eliminate this risk with a provision in the sales contract stating that buyer cannot sell the goods received in an instalment until seller has received full payment for that instalment. A less strict limitation on buyer is a provision stating that buyer is obliged to keep proceeds from his sale separate from his other goods. In this way seller is secured that he can take the goods back or at least has security to the value of the goods.

If the sales contract entitles seller to take the goods back if buyer does not pay the price seller should incorporate a provision in the sales contract stating that buyer is required to keep the goods insured and in a good condition.²⁸⁰

²⁷⁹ Arbitration award of 17 November 1995 from the Hungarian Chamber of Commerce and Industry Court of Arbitration, VB/94124 available at www.unilex.info/case.cfm?pid=1&do=case&id=217&step=Abstract (accessed 26 July 2005).

²⁸⁰ Jacob S. Ziegel ‘Comments on Roder Zelt- und Hallenkonstruktionene GmbH v. Rosedown Park Pty Ltd.’ in *Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998* p. 54.

Chapter VII: Restrictions on disclaimers

VII.1: General comments

Even though contract parties should read the contract carefully before signing it, this is not always the reality in the business world. This implies that the parties are not familiar with the terms in the other party's documents. It can be a nasty surprise for buyer to find a disclaimer written in small type in seller's standard forms and from seller's point of view this involves a risk of time consuming litigation or arbitration with excessive subsequent costs.

VII.2: Substantive law on disclaimers

Three conditions must be fulfilled before a disclaimer is regarded as enforceable.²⁸¹

Firstly, the disclaimer (or other boilerplate clauses) must be *incorporated* in the sales contract. This implies that a disclaimer must be emphasised, e.g. by bold letters or in a separate section. In a judgment of 18 January 2002, the Belgium Commercial Court (Rechtbank van Koophandel) held that seller's standard term, according to which buyer had to give notice to seller about non-conformity within 24 hours, was not incorporated in the sales contract because it was written with too small print and in seller's language foreign to buyer.²⁸²

Especially if the disclaimer is part of seller's standard form and thereby not negotiated between the parties, the disclaimer must be emphasised clearly to buyer. Furthermore, the more burdensome the disclaimer is, the more it must be emphasised.

Danish courts examine the "incorporation" question by a "flexible, multi-factor kind of test: Are the standard terms actually enclosed with the contract or merely mentioned by reference (...)? Is the reference to the standard terms conspicuous or, ..., in fine-print? Is the contract language understandable to both parties, or is it (...) in a foreign legal tongue?".²⁸³

²⁸¹ Lookofsky supra p. 95-97 available at www.cisg.law.pace.edu/cisg/biblio/loo35.html (accessed 18 July 2005). See also Lookofsky 'The Limits of commercial contract freedom: under the UNIDROIT "Restatement" and Danish law' *American Journal of Comparative Law* (1998) 46 485 at p. 493-505 available at www.cisg.law.pace.edu/cisg/biblio/lookofsky2.html (accessed 26 July 2005).

²⁸² Available at www.unilex.info/case.cfm?pid=1&do=case&id=941&step=Abstract (accessed 4 May 2005).

²⁸³ Lookofsky 'The Limits of commercial contract freedom: under the UNIDROIT "Restatement" and Danish law' supra p. 504-505. In the case reported in U1995.856H, the Danish Supreme Court (Højesteret) examined the standard terms in a bailment contract. The terms were in fine print and in a language (English) foreign to

Secondly, the disclaimer must be *interpreted* in accordance with both parties' intent. A court dealing with interpretation of a disclaimer in a contract governed by the CISG is therefore required to find the parties' intent. In a judgment of 30 January 2001, the U.S. District Court for the Northern District of California held:²⁸⁴

“...the CISG requires a “mirror-image” approach to contract negotiations that allows the court to inquire into the subjective intent of the parties.”

If the disclaimer is unclear, a Danish court will apply the maxim “*contra proferentem*” and interpret the disclaimer against the draftsman (seller) unless seller can prove that buyer also intended the exclusion or limitation of seller's liability.²⁸⁵

The disclaimer is “interpreted within the total contractual context”²⁸⁶ Seller must be careful how he describes the goods to buyer during negotiations or presentation of the goods. If seller's descriptions are clear enough to constitute guarantees, a court or arbitrator may hold that the disclaimer is inconsistent with the guarantees and disregard the disclaimer.

Thirdly, the disclaimer must be valid according to domestic law.²⁸⁷ Domestic law may differ at this point, but some guidance can be found in the UNIDROIT Principles Chapter 3 “Validity”.

Chapter VIII: Insurance

VIII.1: General comments

CISG Chapter IV governs “Passing of risk”. In the preceding chapters I have described the risk of defaults from seller and buyer, i.e. the risk of *breach* of seller's and buyer's obligations under the CISG or under their contract. The risk in CISG Chapter IV is the risk of *accidental* loss of or damage to the goods, i.e. loss of or damage to the goods not attributed to defaults from seller or buyer.

the bailor. The Court found the terms binding to the bailor because the parties had previously dealt with each other and the bailor had previously received information in English on the standard terms.

²⁸⁴ *Supermicro Computer Inc. v. Digitechnic, S.A. and Carri systems dba Digitechnic* No. C-00-0224-CAL available at <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/010130u1.html#ct> (accessed 11 July 2005).

²⁸⁵ As far as I am concerned this is not the situation in Danish courts only but an expression of general law applicable in most countries.

²⁸⁶ Lookofsky *supra* p. 502.

²⁸⁷ CISG art 4(a).

VIII.2: CISG art 66 – 70

CISG art 66 – 70 govern the consequences of the passing of risk and the moment when the risk passes. It is impossible for a convention as broad as the CISG to decide a moment for the passing of risk appropriate for all variants of contracts found in international sales of goods. The parties will therefore often have agreed on this moment, either with an express provision in the sales contract, or by referring to an appropriate Incoterm.²⁸⁸

I will not go into details with the separate provisions in the CISG, but merely use them as a starting point to a description of how seller can protect himself with insurance as long as he bears the risk for the goods.

CISG art 66 defines the consequences of the passing of risk. When the risk has passed to buyer, he must pay the price even though the goods are subsequently lost or damaged unless this is a result of an act or omission from seller. Unless seller has defaulted, he is in a strong position after the passing of risk since it is difficult for buyer to excuse his failure to pay with reference to CISG art 79.²⁸⁹

CISG art 67 governs the passing of risk in contracts involving carriage.²⁹⁰ If seller is not bound to hand the goods over at a specific place, the risk passes when seller hands the goods over to the first carrier. The moment of the passing of risk therefore coincides with seller's delivery of the goods.²⁹¹ If seller merely delivers the goods to an intermediary, the risk does not pass at delivery. If seller knows that the goods are handed over to an intermediary instead of the first carrier (or agent for the first carrier), he should incorporate a provision in the sales contract stating that risk passes when the goods are handed over to the intermediary or at an earlier stage.²⁹²

²⁸⁸ Honnold *Uniform Law for International Sales* 3rd ed. (The Hague: Kluwer Law International 1999) p. [398].

²⁸⁹ Chapter IV. Honnold, however, expresses himself a little bombastically when he states, "no impediment prevents payment of the price.", supra p. [395].

²⁹⁰ Contracts not involving carriage are governed by CISG art 69. I will not examine the provision in this dissertation.

²⁹¹ Not in all sales governed by the CISG does seller's delivery of the goods coincides with the passing of risk.

²⁹² Honnold supra p. [401].

The parties can agree on an earlier moment for the passing of risk than delivery to the first carrier. According to the Incoterm EXW, the risk already passes when seller places the goods at buyer's disposal at the agreed place of delivery.

If the goods have to be shipped and the parties have agreed on Incoterm FOB, CFR or CIF, the risk first passes when the goods have passed the ship's rail.

CISG art 67 does not encompass the situation where the goods are carried by seller's own means of transport, because the goods are then not handed over to a "carrier".²⁹³

Especially in contracts involving carriage of the goods at sea, it is important for the parties to insure the goods, because the access to claim damages against the carrier for loss of or damage to the goods is limited according to the Hague-Visby Rules Art IV Rule 5(a).²⁹⁴

CISG art 70 provides that buyer – notwithstanding the passing of risk – will still be entitled to the remedies offered by the CISG, if seller has committed a fundamental breach of the contract. Honnold states it in this way: 'But when - ... - the breach is so serious "as to give a right of rejection" (avoidance) the defective delivery to the carrier is not effective to transfer transit risks to the buyer, and his right to reject because of the breach is preserved."²⁹⁵ Therefore, in case of seller's fundamental breach of contract he cannot reject liability by averring that the risk has passed.

VIII.3: Who should take out cargo insurance?

In some types of insurance it is obvious which party should take out the insurance. Product liability insurance e.g. is only for the benefit of seller and it is obviously seller who takes out this insurance.²⁹⁶

With cargo insurance the question of which party should take out the insurance is not so simple as above because both parties benefit from the insurance. Klotz argues that insurance of the goods is an important issue but "usually treated with little or no respect."²⁹⁷ It is therefore peculiar that the CISG does not govern which of the parties should take out cargo insurance. This issue is to be agreed upon by the parties themselves. If their sales

²⁹³ Chapter V.2. See also Honnold supra p. [403].

²⁹⁴ Honnold supra p. [395] fn. 3. See also Klotz supra p. 195.

²⁹⁵ Honnold supra p. [420].

²⁹⁶ Chapter VIII.5.d.

²⁹⁷ Klotz supra p. 173.

contract refers to the Incoterms, the A3 and B3 clauses allocate the obligation to obtain cargo insurance.²⁹⁸ In CIF and CIP sales seller has the obligation to obtain cargo insurance at his own expense.

Honnold mentions some questions the parties should ask themselves when determining who should take out cargo insurance: “Which party is in a better position to evaluate the loss and press a claim against the insurer and to salvage or dispose of damaged goods? Who can insure the good at the least cost? Who is more likely to carry insurance under standard commercial practice? What rules on risk will minimize litigation over negligence in the care and custody of the goods?.”²⁹⁹

VIII.4: General insurance principles

In chapters V-VII I have examined how seller can allocate different kinds of risks to buyer. In most sales contracts, however, there will be risks that seller has to bear. Seller can to a great extent insure himself against these remaining or residual risks.

English courts tended to be pacesetters of insurance law, and the English authorities are still valid almost everywhere in the world. General insurance principles can therefore often be sought in English insurance law.

It is a general principle that the insured must have an insurable interest, i.e. that there exists a risk that will cause him a loss or deprive him of a profit if it occurs.³⁰⁰ As long as seller has property in the goods or bears the risk for them, he has an insurable interest in the goods.³⁰¹

Another general principle is that an insurance contract requires the utmost good faith (*uberrimae fidei*) from both the insurance company (the insurer) and the future insured.³⁰² When the future insured proposes being insured, he must disclose all facts material to the

²⁹⁸ In some Incoterms neither of the parties have an *obligation* to take out cargo insurance. Despite not having an obligation to take out insurance it may be in the interest of both parties to take out insurance in any case.

²⁹⁹ Honnold *supra* p. [393].

³⁰⁰ *Macaura v Northern Assurance Co Ltd* [1925] All ER Rep 51. In marine insurance governed by the English Marine Insurance Act 1906 (“The Act”) the requirement of an insurable interest is governed in section 4-15.

³⁰¹ John Birds & Norma J. Hird *Birds’ modern insurance law* 6th ed. (Thomson, Sweet & Maxwell) p. 56. In *Thomas Cheshire & Co v Vaughan Bros & Co* (1920) 123 LT 487 exporters of nitrate shipped from South Africa were held to have an insurable interest in the goods.

³⁰² For marine insurance governed by the English Marine Insurance Act 1906 this principle is stated in section 17.

risk (also facts known by the future insured's employees or agents, but not himself³⁰³), i.e. facts which may influence an underwriter in assessing the risk and calculating the premium.³⁰⁴ Furthermore, the future insured must disclose every change in risk in the period between the proposal form being sent to the insurer and the policy being issued.

If the future insured does not disclose all material facts, the insurer is not bound by the contract.

The issue of the policy can take a long time. When seller has proposed for insurance he should ask his insurance broker to issue a cover note. A cover note is temporary cover pending the issue of the policy. It covers from the moment it is issued on standard terms, as the insurer will incorporate in the policy.

VIII.5: Different types of insurances relevant to seller

VIII.5.a: General indemnity insurance

If seller is covered by general indemnity insurance, he is entitled to claim the economic loss caused by an insured event. He cannot claim more than the loss, even though he is overinsured or the loss is covered by more than one policy.

If seller is covered by more than one policy and each insurer excludes liability if the risk is covered elsewhere, he is still entitled to indemnity if he suffers an economic loss. If nothing is mentioned in the policies, he can claim his loss from each of the insurers. If seller has obtained indemnity from one insurer only, he cannot claim the paid premium back from the other insurer, as they have been at full risk.³⁰⁵

If seller is underinsured the insurer only pays a proportionate share of the loss, i.e. seller will not recover his full loss.

A general indemnity policy is almost always an all risks policy. Notwithstanding the name "all risk", there may be risks not covered by the policy.

³⁰³ Carr supra p. 229.

³⁰⁴ The principle of "utmost good faith" in relation to disclosure of material facts is not applicable in South Africa in relation to non-marine insurance. It is only applicable in the Anglo-American countries and colonial systems. Scandinavia merely operates with a principle of "good faith" although nothing indicates that this should be a lesser standard than "utmost good faith", Hare supra p. 693.

³⁰⁵ Hare supra p. 680.

VIII.5.b: Marine insurance³⁰⁶

Despite the name *marine* insurance, the general principles on marine insurance are applicable also to other kinds of transport insurance, i.e. transport by air, rail or road.³⁰⁷ In this section I will only examine seller's insurable risks when the goods are transported by ship.

The majority of marine insurance policies are issued at Lloyd's policies. In many countries marine insurance is governed by English law, especially the English Marine Insurance Act 1906, because English law is the only appropriate way to interpret and understand a Lloyd's policy.³⁰⁸

There are different types of marine insurance. Seller can take out a voyage policy covering a specific voyage or he can take out a time policy covering a specific period or he can combine the two types of coverage.³⁰⁹ In international sales the voyage policy is often used.³¹⁰

Seller can take out a valued or an unvalued policy. An unvalued policy does not specify the value of the goods. The value is first determined if the goods are lost or damaged, but cannot exceed the insured sum.³¹¹ The insured sum is maximum the prime costs, i.e. the price paid to buy the goods or the costs by producing them, plus the expenses of transporting them to the ship.³¹² An unvalued policy therefore, does not cover loss of profit.

Loss of profit is covered by a valued policy. A valued policy "specifies the agreed value of the subject-matter insured".³¹³ Seller should disclose to the insurer whether his valuation includes a profit. If he does not, there is a risk that this will be deemed as a non-disclosure of a material fact.³¹⁴

³⁰⁶ Marine insurance is an example of indemnity insurance, Hare supra p. 678.

³⁰⁷ Carr supra p. 223. See also Klotz, supra p. 195.

³⁰⁸ *Amin Rasheed Shipping Corp v Kuwait Insurance Co* [1984] AC 50.

³⁰⁹ The Act art 25(1).

³¹⁰ Carr supra p. 225-226.

³¹¹ The Act art 28.

³¹² The Act art 16(3).

³¹³ The Act art 27(2).

³¹⁴ Carr supra p. 226.

Seller must make a genuine estimate of the value of the goods including his profit. An excessive value can be regarded as fraud. Furthermore, the higher the value of the goods, the higher premium will be charged.³¹⁵

In case of an insured event, the insurer will normally pay the agreed amount as indemnity irrespective of seller's actual loss provided that seller has not overvalued the goods.³¹⁶

Seller can take out a floating policy or an open cover. A floating policy describes the insurance in general terms and leaves particulars to be defined later.³¹⁷ The policy is appropriate in instalment sales where more shipments are involved,³¹⁸ but seller and buyer do not know the particulars in the individual shipments at the time the policy is taken out.

An open cover is not a policy, but an arrangement where the insurer first issues policies when required by seller. As seller does not have to take out separate policies for every shipment, this is a cheaper way of insurance.³¹⁹

Marine insurance based on a Lloyd's policy will often refer to Institute Cargo Clauses (A), (B) or (C).³²⁰ The Institute Cargo Clauses represent different covers where version (A) covers the greatest risk, (B) the medium risk and (C) the lowest risk. The difference in cover is reflected in the composition of the Clauses. Institute Cargo Clauses (A) by and large only lists the exclusions, whereas Institute Cargo Clauses (B) and (C) list both the covered risks and the exclusions.

Only Institute Cargo Clauses (A) is an "all risk" policy. Despite the name it does not have an unlimited cover.³²¹ Clauses 4-7 in the Institute Cargo Clauses (A) contain express exclusions. Furthermore, an "all risk" policy generally only covers "accidental, fortuitous and unexpected (as opposed to inevitable, natural or expected) loss or damage caused by an insured peril..."³²²

³¹⁵ Hare supra p.

³¹⁶ Hare supra p. 679.

³¹⁷ The Act art 29(1).

³¹⁸ Carr supra p. 227.

³¹⁹ Klotz supra p. 196.

³²⁰ Hare supra p. 709. The Clauses were introduced 1st January 1982.

³²¹ Hare therefore calls the name a "misnomer", supra p. 751.

³²² Clare Dillon & J P Van Niekerk *South African maritime law and marine insurance: selected topics* (Durban/Pretoria: Butterworth, 1983) p. 148. See also N. Geoffrey Hudson *The Institute Clauses* 2nd ed. (Lloyd's of London Press Ltd., 1995) p. 10-11. In *Gaunt v. British & Foreign Marine Insurance Co. Ltd* (1921) 26

If seller in the sales contract undertakes to take out insurance of the goods, he must be careful how to draft the undertaking. If seller undertakes to take out “insurance covering the goods against all risks”, this cover is broader than the cover in an “all risks” policy. In the former case the sales contract contemplates insurance against all risks no matter of what nature. In the latter case the policy has a well-defined cover with specific exclusions. The meaning “all risk” has a different meaning between seller and buyer than between insurer and insured.³²³

In addition to the cover of “all risks of loss of or damage to the subject-matter insured except as provided in Clauses 4,5,6 and 7 below”³²⁴ the Institute Cargo Clauses (A) covers general average and salvage charges, if the expenses are incurred to avoid or in connection with avoidance of loss caused by perils not excluded in Clauses 4-7.³²⁵ Furthermore, the insurance covers seller’s proportion of liability under contract of affreightment “Both to Blame Collision” Clause. Institute Cargo Clauses (B) and (C) also have the two mentioned additional covers.

Institute Cargo Clauses (B) and (C) list the covered risks. I will not examine the separate risks in this dissertation but refer to Clause 1-3 in both Institute Cargo Clauses. I will only emphasise that the following risks are covered by version (B) but not by version (C):

- earthquake, volcanic eruption or lightning
- entry of sea, lake, or river water into vessel, craft, hold, conveyance, container, lift-van, or place of storage
- total loss of any package lost overboard or dropped during loading or unloading from vessel or craft.

In English insurance practise it is a general rule that the “subject-matter insured” does not include packing materials, unless the underwriters have stated this in the policy with clear wording. However, there are cases that apparently do not comply with this rule. In *Brown*

Com.Cas. 247 judge Sumner held that the expression “all risks” “...covers a risk, not certainty;” referred in Hudson supra p. 10-11.

³²³ Dillon & Van Niekerk supra p. 147.

³²⁴ Clause 1.

³²⁵ If English law applies to the policy, the terms “general average” and “salvage charges” are defined in art 65 and 66 in The Act.

*v. Fleming*³²⁶ the subject-matter insured was “228 cases whiskey”. The straw, in which the bottles were packed, got wet during transit and damaged the labels on the bottles. The judge held that the straw was part of the subject-matter insured.

The Institute Cargo Clauses (A), (B) and (C) contain the same exclusion clauses: the General Exclusion Clause, the Unseaworthiness and Unfitness Exclusion Clause, the War Exclusion Clause and the Strikes Exclusion Clause. There are, however, differences between the Clauses. The General Exclusion Clause in Institute Cargo Clauses (A) does not exclude deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person(s) as Institute Cargo Clauses (B) and (C) do. Seller insured by Institute Cargo Clauses (B) or (C) can for an additional premium obtain cover for these perils by separate clauses, e.g. by Institute Malicious Damage Clause.

The War Exclusion Clause in Institute Cargo Clauses (A) does not include piracy as Institute Cargo Clause (B) and (C) do. Seller insured by Institute Cargo Clauses (A) is therefore insured against piracy.

For an additional premium seller can obtain insurance against war and strikes risks, e.g. by Institute War Clauses (Cargo)³²⁷ and Institute Strikes Clauses (Cargo).

The duration of cover is determined in the Transit Clause³²⁸ in all three Institute Cargo Clauses. The Transit Clause provides cover for pre- and post shipment risks. The Clauses, however, must be read in conjunction with the Termination of Contract of Carriage Clause³²⁹ and the Change of Voyage Clause³³⁰ to get the full picture of the duration of cover.

If seller and buyer have agreed on the Incoterms CIF or CIP, seller has an obligation to obtain cargo insurance at his own expense for the benefit of buyer. According to A3 in both terms, the insurance must be in accordance with the minimum cover provided by Institute Cargo Clauses (C). If buyer wants additional cover, e.g. cover against war risk, he must inform seller accordingly and seller must then, if possible, provide such insurance at buyer's expense.

³²⁶ (1902) 7 Com.Cas. 245, referred in Hudson *supra* p. 12.

³²⁷ The Institute War Clauses (Cargo) excludes cover of piracy.

³²⁸ Clause 8.1 in Institute Cargo Clauses (A), (B) and (C).

³²⁹ Clause 9

³³⁰ Clause 10

Seller can allocate his expenses by obtaining cargo insurance to buyer by an increased price for the goods. However, if the general market rate on insurance increases *after* the conclusion of the sales contract, the increased premium is seller's risk. To limit the risk of increased market rates seller can incorporate a provision in the sales contract stating that buyer bears the risk of subsequent increases in the market rate

VIII.5.c: Life and accident insurance

Seller's business can suffer serious damage if seller loses a key employee who has played a crucial role in the sale of seller's products. In the business world it is common to take out insurance on the life of a key employee (a "key person policy"). To take out a key person policy, seller must have an insurable interest in the key person's life *at the time the policy is issued*. If the key person dies or is injured after he has left seller's company, seller may still be entitled to indemnity because he had an insurable interest at the time the policy was issued.³³¹ However, life policies are renewable every year and seller cannot renew a key person policy if the key person has left the company, because seller then no longer has an insurable interest in that person.

VIII.5.d: Other specialised types of insurance

In line with the progress in international sales, the insurance market has developed new and more specialised products. A browse through websites from different insurance companies gives a good picture of to what considerable extent seller can insure his interests. Below I will mention some of the more special insurance types that can be relevant for a seller.³³²

Product liability insurance:

A common type of insurance appropriate for sellers of goods is the product liability insurance. The insurance covers seller's legal liability for damage to third parties – death or bodily injury and/or loss of or damage to material property - caused by seller's goods. In most countries product liability is governed by statutes that impose strict liability on seller. In Denmark, for instance, seller is legally liable for damages caused by a defected product regardless of any fault on his side.

³³¹ *Dalby v India and London Life Assurance Co* (1854) 139 ER 465.

³³² Most of the described types of insurances are found on the web site of the South African department of the international insurance company AIG available at <http://www.aig.co.za/commercial/index.htm> (accessed 25 July 2005).

Product liability insurances offer varied covers. Seller should consult an insurance broker specialised in product liability to get advice on what cover is appropriate for seller's business.

Recall insurance:³³³

Seller's delivery of defective products can have serious consequences for seller's business. In addition to excessive costs by recalling the products seller risks that important business relationships lose confidence in seller's products and stop dealing with him.

Product liability insurance seldom covers seller's costs incurred by inspecting the goods, recalling them from buyer or destroying them. These costs are covered by recall insurance. In addition, most recall insurers offer optional cover for e.g. rehabilitation expenses to restore or repair the products for intended sales levels and loss of net or gross profit. Often cover is limited to a specific period after the discovery of the defective product. Furthermore, most insurers offer seller assistance and guidance in how to recall and how to re-establish the market's confidence in seller's product.

Contaminated products insurance:³³⁴

Food, beverages, tobacco, cosmetics and pharmaceuticals etc. intended for use by consumers can be contaminated so they are useless for their intended purpose – they can even become harmful to one's health. Cases of contaminated consumer products often attract the media's interest with serious consequences for seller, because the market may lose confidence in seller's products generally.

Contaminated product insurers normally cover recall costs, costs incurred by business interruption, rehabilitation costs and consultancy costs caused by either accidental or malicious contamination. They normally also provide specialists consultants who help seller with crisis management planning and loss prevention.

Whether an insurer will take out insurance for seller and to what premium depends on an evaluation of seller's place of business, product type and packaging, previous incidents, crisis management/recall plans and quality control.

³³³ Information available at <http://www.aig.co.za/commercial/index.htm> (accessed 25 July 2005).

³³⁴ Information available at <http://www.aig.co.za/commercial/index.htm> (accessed 25 July 2005).

Business interruption:

Business interruption insurance covers seller's loss caused by interruption of or interference with his business in consequence of damage on the premises. The insurance normally covers seller's loss of gross profit due to a reduction in turnover. Moreover, it covers seller's increased costs of working, provided that the costs are necessary and reasonable for avoiding or limiting the reduction in turnover. Furthermore, the insurance can offer cover for fines or penalties for breach of contract.

Fidelity insurance:

A more specialised type of insurance not directly aimed at sellers is the fidelity insurance. In short, fidelity insurance covers seller against direct economic loss caused by fraudulent or dishonest acts committed by seller's employee/employees. A condition for cover is that seller's employee(s) had the intent either to cause seller a financial loss or to obtain financial benefit for himself or other persons.

Most business people do not like to talk about their fidelity insurance because it can be seen as an expression of lack of control of the employees. Moreover, far from all cases are investigated by the police and brought to court. Many employers prefer the employee to confess their guilt so it is unnecessary to take the unpleasant further step and report the case to the police. Therefore, not many cases are published.

Chapter IX: Conclusion

Even though the CISG is meant as gap filler where the parties have not agreed otherwise in their individual sales contract, the Convention leaves much to interpretation. Just the number of cases involving disputes on the CISG shows that the Convention is not altogether clear.

I have tried to describe the most relevant risks to a seller involved in international sales governed by the CISG and how he can reduce or eliminate most of these risks.

It might seem obvious that seller merely eliminates all his risks by exclusion clauses only limited by the rules on validity of disclaimers. The picture is, however, not that simple.

Seller might not be aware of all the risks imposed on him. International sales contracts can be complex and can be entered into under pressure of time constraints. In this dissertation I have tried to draw seller's attention to some of the more common risks.

Furthermore, as a wise businessman once said, "there is no free lunch". The more clauses whereby seller tries to allocate risks to buyer, the more it will affect the price; and the more risks are covered by insurance, the higher premium seller must pay.

Many factors play a role when seller drafts his contract with buyer (if he doesn't use a standard form). In contracts where seller and buyer have known each other through a long business relationship, they will likely show each other more trust and reduce the number of boilerplates compared to contracts where seller and buyer are unknown to each other.

It is difficult to give specific advice on exactly what clauses seller should incorporate in the sales contract, as this depends on the contract and the business relationship with buyer; and seller should remember that he is not the only party in the sales contract: what reduces seller's risks, increases the risks for buyer and buyer will likely want some other clauses than seller. My dissertation is more meant as a guideline to a seller with ideas as to how he can protect himself. The final result of the negotiations is, of course, up to the parties themselves.

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