THE INTERPLAY BETWEEN THE INCOTERMS & CISG ON THE INTERNATIONAL SALE OF GOODS

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Abstract
This paper aims to briefly lay the conceptual framework for research on the relationship between the passing of risk in the international chamber of commerce terms (INCOTERMS) and the United Nation Convention on Contracts for the International sale of goods (CISG). To stimulate discussion on the issue of passing of risk; it will provide a detailed examination in which the intrinsic aspects of the Incoterms risk allocation will be compared with the Convention, in order to identify areas of similarities or difference when dealing with risk? It will also attempt to clear the air on whether an inclusion of Incoterms rule in a contract is an exclusion of the CISG law (for those insinuating that Incoterms rules are substitutes to the application of the CISG).

Keywords: *Sale of Goods, International, INCOTERMS, CISG, and Commercial.*

Introduction

The concept of risk allocation in international commercial contracts breaches the question of who will bear the ultimate responsibility for goods that are either damaged or lost in transit.[1] This ultimately handles the question of payment and the responsibility of the buyer to support the goods irrespective of loss attributed to third parties. The most important risk-rules are those applying to contracts of sale of goods involving carriage of the goods since this accounts for almost all international sales.[2]

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[1] Neil Gary Oberman, 'Transfer of Risk from Seller to Buyer in International Commercial Contracts: A comparative Analysis of Risk Allocation under the CISG, UCC and Incoterms', (1997) <http://cisgw3.law.pace.edu/cisg/thesis/Oberman.html#fn94> accessed 14th February 2018

[2] J O Honnold and H M Flechtner, *Uniform Law for International Sales*, 516

This paper contains discussions on the issue of passing of risk; it will provide a detailed examination in which the intrinsic aspects of the Incoterms risk allocation will be compared with Convention, in order to identify areas of similarities or difference when dealing with risk? It will also attempt to clear the air on whether an inclusion of Incoterms rule in a contract is an exclusion of the CISG law (for those insinuating that Incoterms rules are substitutes to the application of the CISG), whereas others are of the view that both complement each other and can work together to achieve greater results.We will now begin to discuss these issues to see which of the arguments holds true in reality.

1.1 Comparing Risk Allocation Under the Incoterms Rules and the Convention

1.1.1 Rules for any Mode or Modes of Transport under the Incoterms vis-a-vis the Convention

EXW (Ex Works), FCA (Free Carrier), CPT (Carriage Paid To), CIP (Carriage and Insurance Paid To), DAT (Delivered At Terminal), DAP (Delivered At Place) and DDP (Delivered Duty Paid).

THE EXW INCOTERMS rule can be likened to the provisions of article 69(1)(i) "first sentence" of the Convention but however, differs slightly from article 69(1) first sentence where goods are to be delivered at the seller's place of business.

The Incoterms EXW will let the risk pass the moment the seller places the goods at the buyer's disposal, either at his place of business or at another named place (*i.e.* works, factory, warehouse, etc.) while the Vienna Convention will let the risk pass when the buyer takes over the goods at the seller's premises (or if he commits a breach of contract by failing to take delivery) or when the buyer is aware the goods are placed at his disposal at the place other than the seller's place of business. The Incoterm EXW lets the risk pass as soon as the goods have been made available to the buyer at the delivery point (i.e. the seller's place or another named place), without any requirement such as the buyer's awareness of the goods being placed at his disposal or the buyer's failure to take delivery constituting a breach of contract.[3]

Joanna illustrates this point thus, by providing the following narratives:

[3] ICC, 'INCOTERMS 2010' <https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-2010/> accessed 1 March, 2022.

> let us assume that a Belgian seller and a Norwegian buyer agree on the sale of 5000 boxes of chocolate under the Incoterms 2010 rule EXW. The contract states that the goods are available for the buyer to pick up at the seller's place of business from the 1stof August till the 14thof August. On the 1st of August the buyer is informed that the load of chocolate is ready, but on the 5th of August the chocolate melts by a malfunctioning cooling system, caused by an 'act of god'. Under EXW, the buyer will have to bear the loss of the goods since the risk passes the moments the goods are placed at his disposal, ready to be picked up. The Convention, however, lets the risk pass to the buyer the 14th of August, when the buyer commits a breach of contract by his failure to take delivery of the goods; consequently, the seller will bear the risk of loss under the Convention.

It is worthy of note that in both under the Convention and the Incoterm, The risk only passes when goods are clearly identified to the contract. This is a basic condition present in all ICC Incoterms.

The next to be discussed here is the CPT AND CIP INCOTERMS rule. Like we had pointed out earlier in our discussion, there is really no difference between the CPT and the CIP, other than the fact that under the CIP, the seller is obliged to include and contract for insurance on behalf of the buyer. This is why the writer resolves to discuss both together.

The relevant point of transfer of risk under CPT will be where the goods are handed over to the carrier or another person nominated by the seller at an agreed place. The seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.[4] This is different from the regime in the 'maritime' C-terms CFR and CIF where risk will pass the moment the seller delivers the goods on board the vessel.

The CPT and CIP can be likened to Article 67 (1) (ii) "second sentence". According to art. 67(1)(ii) when the seller has to hand over the goods at a particular place, the risk does not pass to the buyer until the goods are handed over to the carrier at this particular place (Incoterms especially regulate particular places). The seller is not bound to hand over the goods himself. Art. 67(1)(ii) applies without taking into account whether the

[4]Incoterms 2010, Berlin, ICC Publication no. 715

seller himself (or his employees) transports the goods for the first part of the way or uses an independent carrier. It suffices that the goods are placed at the disposal - by whomsoever - of the carrier at the particular place or are already in the carrier's control (in case of a previous handing over of the goods). The goods must be placed in the carrier's care or control.

The main application of Article 67(1)(ii) CISG will be the carriage of goods overseas, whereby the seller, with his place of business inland, agrees upon delivery from seaport X. The first-carrier rule of Article 67(1)(i) does not apply; according to Article 67(1)(ii) the risk does not pass until the goods are handed over to the carrier at seaport X. The carriage over land takes place at the seller's risk, the carriage overseas at the buyer's risk.[5]

Next are, **DAT (Delivered At Terminal), DAP (Delivered At Place) and DDP (Delivered Duty Paid). (D-TERMS).** The Incoterms 2010 rules provide us with three **D-terms** that should be used in situations where the seller has the obligation to carry the goods at his own cost and risk to the named destination. All D-terms require the seller to deliver the goods at the named point, to pay for them to get there and to assume all risks concerning the goods in transit

All of then D-terms, which fall under the category of "any mode of transport", are destination trade terms (also called arrival contracts) where the seller fulfills his obligations by delivering the goods at the destination. These D-terms can best be compared with the rules expressed in Article 69(2) of the Convention, which stipulates that "if the buyer is bound to take over the goods at a place other than a place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place".

In a dispute between an Austrian seller and a Bulgarian buyer, the seller had to deliver by placing the goods at the Austrian-Hungarian border according to Incoterm DAF (Delivery At Frontier, today subsumed by Incoterm DAP).[6] The tribunal referred to Article 69 of the Convention to conclude that the seller had neither delivered the goods nor placed the goods at the buyer's disposal thus not leading to the risk passing. Because of this the buyer was not held liable for injury to the goods due to prolonged deposit in the warehouse.

[5] Supra

[6] Court of Arbitration of the ICC 1992, Case No 7197/1993, Clout Case No 104, http://cisgw3.law.pace.edu/cases/927197i1.html

According to the wording of the Incoterms, the mere fact that the seller places the goods at the buyer's disposal is enough to let the risk pass from seller to buyer. Article 69(2) of the Convention requires the buyer to be aware that the goods are placed at that place. The considerations that led to determining the appropriate time of passing of risk are different when the goods are at a place other than the seller's place of business.

If the parties elect to use the DAP term, the seller has a duty to have the goods carried up to a point from where the buyer has to take over the onward carriage. The Convention's Rule IV would appear to apply as contained in Article 69 (2), which states "risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place." In other words, when the buyer is informed by notice and the goods are made available to him.

1.1.2 Rules for Sea and Inland Waterway Transport

FAS (Free Alongside Ship) FOB (Free On Board) CFR (Cost and Freight) CIF (Cost, Insurance and Freight)

Here we begin with the 'maritime' C-terms CFR and CIF where risk will pass the moment the seller delivers the goods on board of the ship. The CFR and CIF terms, allocates risk in a precise manner that differs in substance from the Convention's approach. How then does the Convention view the passage of risk? According to Rule II contained in Article 67(1) sentence one of the Convention "If the contract of sale involves carriage of the goods and the seller is not bound to hand them over at a particular place, the risk passes to the buyer when the goods are handed over to the first carrier." We should note that Article 67 states the rules in the situation where the seller hands over the goods to a carrier. Under this term the seller selects the vessel and contracts for the carriage of the goods. Thus, when the seller is not bound to hand over the goods at a particular place, the Convention considers there to be a transfer of risk when the goods are handed over to the first carrier.

However, it is important to note that Article 67(1) of the Convention is still subject to Article 66, where risk will not automatically pass to the buyer if the loss or damage is due to an act or omission of the seller, even though ordinarily the risk should have passed to the buyer.

This was the situation in the 1992 case[7] between a Californian buyer and a Chinese seller that agreed on the sale of 10,000 kg of jasmine aldehyde (jasminal), CIF New York. After signing the contract, the buyer warned the seller by fax that the goods were subject to deterioration at high temperatures. The buyer explicitly asked the seller to inform the carrier accordingly and to make sure that the jasminal would be stored in a relatively cool place during transport. The buyer also asked to have the jasminal transported as far as possible on a direct line. The seller raised no objections but replied that the temperature at the port was appropriate and could not endanger the goods. When the jasminal, after passing through Hong Kong, was unloaded in New York, a large part had melted and leaked due to excessive heat during the voyage. A few days later the jasminal was shipped on to the end user who refused to accept it. The buyer at that moment informed the seller about the damage and caused the goods to be examined on the same day. The parties then reached a settlement agreement under which the seller was to pay US$ 60,000 as damages, of which US$ 20,000 had to be paid in cash within a fixed date, whilst the remainder was to be compensated in further transactions between the parties by the seller's renouncement of commissions and profits. The seller, however, did not pay US $ 20,000 nor could any further transactions between the parties be concluded. The buyer brought an action before an Arbitration Commission claiming payment of US $ 60,000 plus interest as well as damages for the economic loss caused by the seller's failure to pay the agreed sum. The Arbitrators held that the seller was responsible for the damage to the goods according to Article 66 of the Convention. Notwithstanding the CIF clause, which means that risk passes to the buyer with the goods crossing the railing of the ship, in this case the parties had entered into a separate special contractual agreement with regard to the temperature problem during transport. As the seller had not given appropriate directives to the carrier and had sent the jasminal via Hong Kong instead of assigning a direct ship, it had not complied with its separately determined contractual duties. The damage therefore was caused by an act or omission of the seller, as required by Article 66 of the Convention. Since it had become apparent that the seller did not intend to transact any further business with the buyer in order to compensate part of the damage, the Court held that the buyer was entitled

[7]UNILEX Database, 1995- CIETAC (China International Economic and Trade Arbitration Commission) <http://www.unilex.info/case.cfm?id=210> accessed 19th of February 2018

to the payment of US$ 60,000. In addition, the Court awarded the buyer an annual interest of 5% on US$ 20,000 as from the date payment was due.

FOB, CIF and CFR are the most frequently used in contracts of sale of goods afloat. Under these terms the risk passes when the goods are placed on board of the vessel.

The FAS (Free Alongside Ship) Term can be likened to Article 67(1) of the Conventions' second sentence, which provides that where the parties have agreed on delivery of the goods to a certain place, risk passes when the seller hands the goods over to the carrier at that place. The buyer is the one who should take over the goods and load them on board the vessel; the procedure of loading is at the buyer's risk. If the goods suffer any damage while they are being loaded, the seller is absolved from any liability. The responsibility of placing the goods alongside the vessel resembles the act of handing over the goods at a "particular place. It is generally accepted that risk passes at the end of the handing over process. Nevertheless, the Convention's rule differs from that of the FAS term in that, whereas under the latter the risk passes when the goods have just been placed alongside the vessel, without being necessary that the buyer takes delivery, under the Convention's provision, the risk passes when the goods are delivered to the carrier at the particular place, and not when they are merely placed at his disposal.

The same Convention's rule seems to apply to FOB (Free on Board) contracts as well. Under the latter the seller should deliver the goods on board the vessel and risk passes when the goods are on board the vessel (previously "the ship's rail"). The ship's rail was seen in the old days as the border line between the seller's and buyer's territory as well as between the shipper's and carrier's or the customs agent's and captain's. Nonetheless, the ship's rail is a rather controversial criterion, which may be susceptible to different interpretations. Article 67(1) of the Conventions' second sentence would apply once more in that case, since delivery on board the vessel, at the agreed port under the FOB term, equates to delivery at a "particular place".

Finally it should be stressed that INCOTERMS 2010 deal only with "accidental" loss or damage to the goods; therefore, they do not regulate situations that involve loss or damage due to acts or omissions of the seller. In that case article 66 CISG applies. Furthermore, INCOTERMS 2010 do not contain any similar provisions to that of Article 70 CISG either, thus, leaving it up to the Convention to regulate cases of simultaneous "accidental" loss or damage and fundamental breach on the

part of the seller.[8]

1.2 Shortfalls of The Incoterms Rules

Although Incoterms are sometimes more detailed than the CISG as to where delivery takes place and risk passes, there are aspects, which are not regulated by the standardized Incoterms rules at all but are covered by the CISG. Incoterms do not regulate the situation where the loss or damage that occurred after the risk had passed was caused by the act or omission on the part of the seller. Where, during the voyage at sea, the goods deteriorate due to the seller's failure to instruct the carrier to keep the goods at a specific temperature, Incoterms will not cover the situation as they only deal with the risk of incidental loss or damage. Consequently, the buyer will still be obliged to pay the purchase price. Article 66 of the Convention, on the other hand, states that the buyer will be discharged from his obligation to pay the price when the damage is due to the act or omission of the seller. This is an example where Article 66 of the CISG can supplement an inadequate Incoterms rule.

Incoterms provide no detailed rules on the time of delivery apart from prescribing that delivery should take place as per the agreement of the parties, that is at an "agreed date" or within an "agreed period," or that the buyer should take delivery when the goods have been delivered "as envisaged in A4.[9]

The FAS (INCOTERMS2010) rule is the only rule, which provides that, if the parties have agreed for delivery to take place within an agreed period, the buyer would have the option to choose the date within that period. In the case of the other ten Incoterms 2010 rules, it is assumed that delivery can be made at any time within that period, naturally with notice to the other party. Where no time or period for delivery is agreed, Article 33(c) CISG can supplement the Incoterms rules as it provides that delivery is to take place "within a reasonable time after the conclusion of the contract."

1.3 Interaction Between The CISG and Incoterms

Honnold best describes the interaction between the Convention and Incoterms as a workable relationship.[10] The main areas for interaction

[8]Incoterms 2010.
[9]Incoterms 2010.
[10] John O Honnold, 'Uniform Law for International Sales under the 1980 United Nations Convention', (3rdedn, Kluwer Law Int'l 1999) 472-495; Michael J Dennis, 'Modernizing And

between the CISG and Incoterms are delivery and the passing of risk. However, as the discussion has shown, there is the potential for interaction in a far wider context.[11]

The risk rules of the Convention and Incoterms contain several similarities that facilitate the interaction between the two instruments. Under both, risk means any accidental loss or damage to the goods caused by neither an act nor an omission of any of the parties. Strong similarities exist between articles 67 and 69 CISG and the "modern" Incoterms It seems that the drafters of the Convention borrowed the basic notion that risk transfers on handing over the goods to a carrier from the modernized INCOTERMS rules, FCA, CPT, and CIP.

Despite their different roles, they can support each other by being employed jointly in contract formation. For example, when the drafter of an international contract properly invokes the Incoterms and incorporates them into a contract that has a governing law based on the Convention, they can be very useful to precisely enumerate the key steps that the parties should take for risk allocation. On the other hand, using the Convention provides answers to questions that the parties have not answered by contract provisions or by using the Incoterms. Further, answers to questions not settled by the Convention or Incoterms, may be found by verifying the gap filling law. Finally, the Convention provides a legal method to avoid or to resolve disputes among the parties in a wide range of situations, not covered in Incoterms, when a party fails to perform his duties under the contract.

1.4 **Summary**

Incoterms will supersede the Convention's provisions on delivery and the passing of risk. The question is whether Incoterms replace the CISG's default rules on delivery and risk in toto or whether they only derogate from the rules. Is it possible to still resort to the CISG's provisions when an Incoterms rule is uncertain or inadequate? In other words, is there any case for parallel application and co-existence between the two?

Article 6 of the Convention provides for the opportunity to "derogate from or vary the effect" of any of the Convention's provisions. This means that agreement on the application of a trade usage, such as an Incoterms rule, does not have to exclude the CISG delivery and risk rules in their entirety, but that it can merely modify or supplement a particular rule in so far as the

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Harmonizing International Contract Law: the CISG and the UNIDROIT Principles Continue to Provide the Best Way Forward' (2014) 19 [1], *Uniform Law Review*, 114–151.

[11]Winship P, 'Changing Contract Practices in the Light of the United Nations Sales Convention: A Guide for Practitioners' (1995) 29 *IL* 545.

usage embodied in the Incoterms rule may be inconsistent with the CISG's provision. For the rest, they complement and support each other.[12]

Conclusion and Recommendation

2.1 Conclusion

Employing internationally accepted trade terms with regards to risk allocation is a great commodity and allows persons from across the globe to ascribe the same definition to terms regardless of their cultural and legal backgrounds. Overall, it can be said that generally, risk allocation under the Convention makes room for a reasonable compromise between the seller and buyer's interests.[13]

However, despite its weaknesses though, it should not be forgotten that the CISG is a document, which resulted from the cooperation of countries with different legal backgrounds, economic status, social culture and political history and it is more than anticipated and excused for containing compromises and unsettled issues. What is of significance is that the Vienna Convention is a document of vast magnitude and it undeniably provides an environment that promotes and strengthens international trade.

On the other hand, the use of Incoterms is a cost saving technique that alleviates undue and tedious descriptive work for the drafter of an international contract. Therefore, using the two voices together can be a positive force in international trade, by allowing uniform law to flourish in its use. In conclusion, it can be said that the two voices can harmoniously co-exist and offer their own perspective towards the much debated issue of risk allocation in international sales. The wish expressed by the author is, for the parties in an international sales contract to pay additional attention to the passing of risk issues, since they can be of extreme importance to the outcome of their transaction, and for the legislator to act prudently and effectively in order to settle satisfactorily the intrinsic problems of risk allocation and to sort out its related vague and intricate aspects.

However, subjects not settled by the Incoterms will still be settled by the

[12]Michael J Dennis, 'Modernizing And Harmonizing International Contract Law: the CISG and the UNIDROIT Principles Continue to Provide the Best Way Forward', (March 2014) 19 (1) Uniform Law Review, 114–151

[13] K Pantelidou, 'Issues from the allocation of risk under the Vienna Convention for the international sale of goods' (2002) 97 *Private Law Chronicle*, 102.

rules of the CISG. As we have seen, the use of one regime does not exclude the use of the other. Courts and tribunals around the world use Incoterms and the CISG as complementary sources to solve disputes arising out of contracts for the sale of goods.

2.2 Recommendations

It is now obvious as illustrated during this work that the Vienna Convention's rules on risk allocation, even though quite practical, lack clarity and comprehensiveness sometimes. This can be seen in its inability to define important terms such as "risk", "delivery", "first Carrier", etc., thereby leaving it to different and divergent interpretations.[14] This leads to confusion and often times, disputes, thus distorting the goal of harmonization. Furthermore, some of its provisions are rather ambiguous and vague. For example, Article 68 of the Convention, the rule dealing with risk allocation on sales of goods in transit and its complicated technique for the attribution of retroactive effect. Moreover, it seems that the Convention fails to take into account modern developments and practices in international trade, since it does not include separate rules on containerization despite the immense growth of use of containers.

Therefore looking forward, there should be an aiming for a revise, up-to-date standard applicable to risk allocation in international transactions thus:

i. **Legislators And Representatives Should Take Stepsso that the CISG will Finally Accomplish the Purpose that it was Drafted for, i.e., Uniformity of the Law of International Sales:** In spite of its wide acceptance, for international law to continue to flourish and meet the demands of this technological age, it requires continued movement. It is with this in mind that the author hopes that a detailed examination and overhauling of the risk allocation provisions will prove to be helpful in this regard.

ii. **There is Need for a Review of the Provision of the Convention Pertaining Sale on Transit and Bulk Sale, i.e., Article 68:** The Convention's provisions of risk allocation of bulk sales is horribly lacking and is more detrimental than constructive. This is illustrated by article 68's allocation of risk prior to goods being

[14] (n 12).

apportioned. Parties to a contract may wish to employ specific provisions with regards to goods sold in transit and undivided share of fungible goods (Parties should note that risk allocation in transit sales of undivided bulk takes place prior to apportionment). However before the said review takes place, parties to bulk sales in transit are advised to go to all lengths to avoid using the provisions contained in article 68, since risk allocation takes place prior to property in the goods being transferred to the buyer. Thus affecting the party at the end of the line.

iii. **There should be an option for the use of out-turn clause:** Also, it is recommend that during such review of the provision of the Convention as pertaining to risk allocation especially under Article 68, there should be included an option for the use of out-turn clause. An "out-turn" clause in bulk sales during transit is the best method of dealing with unknown perils during transit sales. This approach allows the party at the end of the line to pay for only the goods he receives. For example, the last party who purchases two tons of grain will only pay for what he receives at the end of the line. Furthermore, When employing an out-turn clause, parties should take note that the CIF term should be considered incompatible as it would otherwise transfer the risk to the buyer. Under a CIF 2010 term, risk is allocated to the buyer when the goods are on board the vessel. Clearly, in a transit sale, this would be incompatible. It is recommended that employing terms that allocate risk to the buyer in similar terms be avoided when using an out-turn clause.