Chapter 5 RISK ALLOCATION

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§5.01 INTRODUCTION

This chapter discusses the allocation of risk between the parties. This issue is often overlooked by the parties during contractual negotiations, resulting in potential future disputes as to which party is responsible and/or liable for lost or damaged goods. Contractual terms setting forth the obligations of each party coupled with the use of Incoterms may assist in resolving these issues. However, in their absence, courts will look to the obligations set forth in the CISG and the rules of risk allocation set forth in Articles 66 through 70 to settle these issues.

Practical Application: Counsel should consult Table 4—Commercial Transactions Comparative Chart in Appendix A.

§5.02 PASSING OF RISK

The issue of passing of risk with regard to damaged or lost goods is often given last consideration in contract negotiations or used as a secondary concern to close the deal. Although insurance coverage will cover most claims, allocation of the risk of loss becomes most relevant for primary insurance, including subrogation actions,1 salvage and business issues,2 and particularly when one party has no insurance coverage. Pursuant to the freedom of contract as set forth in Article 6, courts will enforce the contract agreed to by the parties with regard to risk allocation.3 In doing such, courts will look not only to the language of the contract but also to the specific trade terms commonly used in international commercial transactions, such as Incoterms.4 Because the CISG is essentially a “gap filler,” parties are able in principle to introduce in their contracts clauses that derogate from the CISG pursuant to Article 6. If the parties include Incoterms in their contract, these terms of course have an obligatory power; they prevail over the

clauses of the CISG. 5

In the absence of an agreement, the CISG provides for the passing of risk from the seller to the buyer with reference to “price risk” or payment of the goods due to loss or damage of goods, as is set forth in Part III, Chapter IV: Passing of Risk, Articles 66-70. 6

Article 66 provides the following:

Loss of or damage to the goods after the risk has passed to the buyer does not discharge him from his obligation to pay the price, unless the loss or damage is due to an act or omission of the seller.

In general, a theory of risk allocation is based on time of delivery of the goods with an exception being made for the sale of goods during transit under the CISG. 7 In particular, Article 66, when reflected upon Articles 31-36, provides that the risk passes from the seller to the buyer when the seller has fulfilled his or her obligations to deliver or any obligation imposed therein. As such, the seller is liable for any lack of conformity which exists at the time prior to delivery of the goods to the buyer. Upon delivery, the buyer bears the risk of “[l]oss of or damage to the goods after the risk has passed to the buyer ... unless the damage is due to an act or omission of the seller.” 8

Consequently, it follows that a seller must first prove that the goods were delivered prior to imposing an obligation on the buyer to pay for the goods. 9 Upon proof of delivery, the buyer will have to pay for the goods and assume all damages thereafter absent proof that damages or loss were the result of the seller. Hence, the buyer has to prove that the damage to the goods arose prior to the passing of the risk. One U.S. court noted that “just as a buyer-defendant bears the burden of proving breach of the implied warranty of fitness for ordinary purposes under the U.C.C. under the CISG the buyer-defendant bears the burden of proving non-conformity at the time of transfer.” 10 Loss or damage also covers physical loss, deterioration, or damage of the goods. 11 Proof that the seller is liable for the loss or damage can be provided by

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obligations imposed on the seller in an agreement, Incoterms, or conduct of the parties by application of Article 8 as a means to define terms within the agreement. If the buyer cannot prove that the seller was at fault, then the buyer is still obliged to pay or is limited in its remedies. See generally Chapter 8.

§5.03 INCOTERMS

Incoterms, which is an abbreviation of International and Commercial with the added word Terms, is published by the International Chamber of Commerce ("ICC"), "who has been a catalyst for the unification of terms used in contracts of foreign trade."14 The purpose behind Incoterms is to "provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade," thereby reducing uncertainties deriving from the multiple interpretations given to commercial transactions by countries with different legislation, usages, and customs. Incoterms are the most common set of international trade rules that define the positions where the risks of the shipper, carrier, and shippers' agents begin and finish. Initially published in 1936 by the ICC, they are revised every ten years to ensure compatibility with modern developments. Incoterms constitute a common and universal international trade language which results from international commercial practice, is easily understandable for the parties involved, and is voluntarily accepted by them, and which determines the scope of the clauses of international contract of sales by means of acronyms and abbreviations that indicate their content.19

Practical Application: Because Incoterms are revised every ten years, a practitioner should be aware of the correct year of application. For example, if a
contract is formed prior to 2000, then Incoterms are presumably governed by INCOTERMS 1990. Contracts formulated after 2000 incorporating Incoterms should make explicit reference to INCOTERMS 2000. This is especially true for the buyer due to the change of FAS terms, which make it the seller’s responsibility to clear the goods for export as per FAS term. This is a reversal from previous Incoterms’ versions that required the buyer to arrange for export clearance. This is true for the seller as well as under DEQ term of Incoterms 2000; it is the buyer’s responsibility to clear the goods for import and to pay for all formalities, duties, taxes, and other charges upon import. This is a reversal from previous Incoterms versions that required the seller to arrange for import clearance.

In 1990, the ICC grouped the 13 Incoterms into four different categories, commencing with the terms whereby the seller makes the goods available to the buyer only at the seller’s own premises—<<Exw>> term (EXW); the second group provides that the seller must deliver the goods to a carrier appointed by the buyer—<<F>> terms (FCA, FOB, FAS). The <<C>> terms (CFR, CIF, CPT, CIP) provide that the seller has to contract for carriage without assuming the risk of loss of or damage to the goods or additional costs due to events occurring after shipment and dispatch, and the <<D>> terms (DAF, DES, DEX, DDU, and DDP) provide that the seller has to bear all costs and risks needed to transport the goods to the place of destination. See Appendix A-6, Table 4—Roadmap to Incoterms (2000).

Incorporation of Incoterms further defines the obligations of the parties, including allocation of risks of loss. Notably, Incoterms, similar to the CISG, do not address the transfer of title. Although the CISG does not define trade terms, which generally enumerate when risk is passed from seller to buyer, courts have recognized Incoterms either individually or through incorporation through Article 9. "Even if the usage of Incoterms is not global, the fact that they are well known in international trade means that they are


26CLOUT case No. 247 [SPAIN Audiencia Provincial [Appellate Court] Córdoba 31 October 1997, available at http://ciscw3.law.pace.edu/cases/971031s4.html (“CFPO” allocates cost of shipment to the destination, but has no relevance to passing of risk); Argentina 31 October 1995 Appellate Court (Bedial v. Müggenburg), available at http://ciscw3.law.pace.edu/cases/951031a1.html (C & F clause does not affect the passing of the risk); Germany 9 July 1997 Appellate Court Köln, available at http://ciscw3.law.pace.edu/cases/970709g3.html (“ex works” only served as a means to govern the share of the transport costs and not the passing of risk).
contract and do not require the basis of a certain sales law that diverges from the CISG.27

§5.04 GOODS DELIVERED BY CARRIER

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 for transmission to the buyer in accordance with the contract of sale.28 If the seller is bound to hand the goods over to a carrier at a particular place, the risk does not pass to the buyer until the goods are handed over to the carrier at that place.29 Once the seller has fulfilled these obligations, the risk passes to the buyer.30 The seller again must still prove delivery to the carrier31 as conformity is linked to the time when the risk passes.32 Courts have held that a mere suspicion of a nonconformity as a result of a public regulation will remain with the seller even though the nonconformity has not yet been discovered by the buyer since the nonconformity existed at the time the risk passed to the buyer.33 However, a seller is not responsible for depreciation of the goods once the goods are handed over to the carrier for transmission to the buyer unless the seller was responsible; if, for example, the buyer had given a mandate as to form and type of transportation34 or for a carrier's delay in delivery.35 Notably, a carrier can be found liable if its obligations extended to transporting the merchandise "from door to door." The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of the risk according to article 67(1).36 Therefore, it has been held that retention of a title clause in a contract does not modify a CIF term relating to the passage of risk of loss as the risk passes without taking into account who owns the goods pursuant to Article 4(b).37 Similarly, Incoterms only address passage of risk, not transfer of title.38 Under the CISG, the passage of risk is likewise independent of the transfer of title. Moreover, the risk does

28 Article 67(1).
34 Germany 22 August 2002 Appellate Court Schleswig, available at http://cisgw3.law.pace.edu/cases/020822g2.html (finding seller would be liable for contributory negligence only if it had ordered the carrier to overload the transport).
38 See Debbattista, supra, note 21.
not pass to the buyer until the goods are clearly identified to the contract, whether by markings on the goods, by shipping documents, or by notice given to the buyer or otherwise.  

§5.05 GOODS SOLD IN TRANSIT

An illustration of the impact of inclusion of developing countries in drafting the CISG is set forth in Article 68. See, e.g., Chapter 1 with reference to the adoption of the 1964 Hague Conventions. This proviso can be divided into two parts. The first sentence establishes that “[t]he risk in respect of goods sold in transit passes to the buyer from the time of the conclusion of the contract.” The second sentence provides “[h]owever, if the circumstances so indicate, the risk is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents embodying the contract of carriage.” Hence, the first sentence of Article 68, which was promoted by developing countries, establishes the primary rule that the risk passes “from the time of the conclusion of the contract,” but is qualified by the second sentence, which makes the risk pass retroactively from the moment the goods are handed over to the carrier “if the circumstances so indicate thereby precluding recourse to domestic law.” Nevertheless, if at the time of the conclusion of the contract of sale the seller knew or ought to have known that the goods had been lost or damaged and did not disclose this to the buyer, the loss or damage is at the risk of the seller.

§5.06 NON-CARRIER CASES

Article 69 covers all instances not established in Articles 67 and 68. Therefore, if the contract of sale does not involve goods sold in transit or by carrier then the risk passes to the buyer when he takes over the goods or, if he does not do so in due time, from the time when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery. However, 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. Hence, damages to goods held in deposit will not pass to a buyer if the seller neither delivered the goods nor placed the goods at the disposal of the buyer. If the contract relates to goods not then identified, the goods are considered not to

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40 Article 68 (emphasis added).

41 Wu Dong, CIEETC’s Practice on the CISG, Nordic Journal of Commercial Law, at nn.33, 109, 158, FN 230 (2/2005), also available at http://cisgw3.law.pace.edu/cases/970401c1.html (finding evidence the tribunal established that the seller had performed his obligations and the buyer should claim for relevant damages against the carrier).


44 Article 68.


47 Article 69(2) (Emphasis added); Denmark 8 July 2004 Randers County Court, available at http://cisgw3.law.pace.edu/cases/040708d1.html.

be placed at the disposal of the buyer until they are clearly identified to the contract.\textsuperscript{49}

\section*{§5.07 PRESERVATION OF BUYER'S RIGHTS}

If the seller has committed a fundamental breach of contract, then the transfer of risk set forth in Articles 67, 68, and 69 will not impair the remedies available to the buyer on account of the breach.\textsuperscript{50} Therefore, if the seller commits a fundamental breach, although the risk has passed, a buyer may elect to insist on the delivery of substitute goods pursuant to Article 46(2), or to avoid the contract pursuant to Article 49. Moreover, the effects of avoidance as set forth in "Articles 81 through 84 CISG on the allocation of the risk in the context of avoidance of the contract supersede where applicable the general risk allocation rules of Articles 66 to 70."\textsuperscript{51}

\textsuperscript{49}Article 69(3).
\textsuperscript{50}Article 70.
\textsuperscript{51}Austria 29 June 1999 Supreme Court, available at http://cissw3.law.pace.edu/cases/990629a3.html.