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Passing of Risk in Convention on the International Sale of Goods

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Passing of risk is an indispensable issue of contract of sale transactions. It determines which party bears the loss or damage of goods. This issue is more important in international commercial transactions than in national contract of sale transactions. Therefore, CISG lays down rules on passing of risk. CISG Articles 66–70 regulate passing of risk provisions. The purpose of this paper is to analyse CISG Articles 66–70.
Keywords: Passing of Risk, CISG, Vienna Convention, Contract of Sale.

Introduction

The definition of risk is very significant in understanding the concept of passing of risk. However, CISG does not define the term of risk. Moreover, it is not generally defined in national legislations, but it is defined in doctrine. Chinese legal scholar Feng Datong defines risk as "[i]n the international sale of goods, risk denotes the various accidental losses the goods may suffer, such as theft, fire, sinking, breakage, leakage and other abnormal deterioration" (Zhao, 1999, p. 10). In the field of international commercial contract law, some scholars state regarding risk: "All international commercial contracts, and especially mid and long-term ones, are to be found in the area of risk. The omnipresence of risk in international commercial relationships makes it to be a factor of delay of commercial expansion. There is a permanent impact between the force of expansion of exports and the force of risk. It is an impact which must not get out of control, as if it remains unchecked it negatively influences the decisional process of the participants to international commerce and it determines a noticeable limitation of the volume of business. The participants must feel protected against the negative consequences which may rise from decisions taken in the context of the uncertainty of the occurrence of a risk and especially in conditions which render uncertain the possibility of avoiding the risk" (Costin, 1996, p. 153–154; Oglinda, Olariu, 2018, p. 104). It is a negative concept (Asghari, Yahyazaden, Lavafpour, Kardjazi, 2012, p. 102). For example, force majeure, an act of god, collision, firing etc. are classical examples of risk. The common character of these examples is that they are accidental and not caused by the buyer or seller (Adisommongkon, 2017, p. 103). However, it should be noted that the fluctuation of

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the currency exchange rate of the goods sold is not considered as risk, because fluctuations do not give rise to the loss or damage of the goods; they cause an advantage to either the buyer or the seller (Buydaert, 2013, p. 16).

The legal issue of passing of risk arises in the period between the formation and the performance of the contract of sale (Demir, 2014, p. 223). It determines the bearer of the risk of movable goods in the contract of sale if goods are damaged or lost. The consequences of this term hold a significant place between buyer and seller (Srivastava, 2018, p. 1248). Therefore, it can be defined as the determination of the bearer party as a result of the deterioration, perishing, loss, or damages of goods which are subject to an international sales contract from the formation of the contract to its performance between the buyer and seller (Demir, 2014, p. 223). For instance, if the risk passes from the seller to the buyer and the goods are damaged or lost, and this is not due to an omission or act of the seller, the buyer must pay the price (Buydaert, 2013, p. 14).

1. The Passing of Risk Systems

1.1. The Conclusion of Contract

According to the conclusion of a contract system, the risk passes to the buyer at the conclusion of a contract, although the buyer could not have possession of goods, or the transfer of title of goods could not occur from the seller to the buyer. The principle of this system traces back to Roman law and is known as *periculum est emptoris* (Doğan, 2016, p. 53). The Institute of Justinian describes this principle in the following words:

"As soon as the sale is contracted, that is, in the case of a sale made without writing, when the parties have agreed on the price, all risk attaching to the thing sold falls upon the purchaser, although the thing has not yet been delivered to him. Therefore, if the slave sold dies or receives an injury in any part of his body, or the whole or a portion of the house is burnt, or the whole or a portion of the land is carried away by the force of a flood or is diminished or deteriorated by an inundation, or by a tempest making havoc with the trees, the loss falls on the purchaser, and although he does not receive the thing, he is obliged to pay the price, for the seller does not suffer for anything which happens without any fraud or fault of his" (Zhao, 1999, p. 25).

This principle could not meet the standards of modern times and especially in international sale of goods. According to Schwarz, this principle was accepted in older times when sales occurred in cash and the transfer of ownership occurred suddenly from seller to buyer (Schwarz, s. 164; Doğan, 2016, p. 56), and as such, it functions well in conditions reminiscent of older historical epochs (Doğan, 2016, p. 57).

1.2. The Transfer of Property from Seller to Buyer

According to the system of the transfer of property from Seller to Buyer, risk passes the buyer at the transfer of ownership. The general rule is that the loss or damage of the goods falls on the person who holds ownership. This principle is called *res perit domino* – "risk follows ownership" (Zhao, 1999, p. 27–28). Based on this principle, ownership and damage are interconnected with each other. In a relevant case *Tarling v. Baxter*, a stack of hay was burned before the delivery and payment were made. Justice Bayley J. expressed his opinion in this case to describe *res perit domino* as follows (Zhao, 1999, p. 30):

"It is quite clear that the loss must fall upon him in whom the property was vested at the time when it was destroyed by fire. The rule of law is, that where there is an immediate sale, and nothing remains to be done by the vendor as between him and the vendee, the property in thing sold vested

in the vendee and then all the consequences resulting from the vesting of the property follow, one of which is, that if it be destroyed, the loss falls upon the vendee."

This principle is considered as impractical, since the buyer bears the loss or damage of goods with the conclusion of the contract although the goods are under control of the seller (Doğan, 2016, p. 57). Under this situation, the seller may be careless about the goods when the goods are under their control, since the risk passes to the buyer before the buyer take.

1.3. Taking Physical Possession

According to the system of Taking Physical Possession, risk passes from seller to buyer at the conclusion of taking physical possession. The buyer starts to bear damage or loss of goods after the possession of goods is transferred from seller to buyer. This principle is based on who is the possessor. The principle meets with international trade practice since the possessor must protect the goods, take the necessary security measures, and consider the risk due to their control over the goods (Doğan, 2016, p. 58). Namely, "deliverance of goods and risk goes hand in hand" (Patil, 2016, p. 24). In cases involving the carriage of goods, the seller cannot deliver goods to the buyer directly, but the buyer will get them from the carrier. If the seller sends the goods to the buyer through the carrier in maritime commercial law, the carrier issues the bill of lading, which serves as a receipt for the goods shipped and a document of title under a contract of affreightment. The bill of lading is proof of the possession of the goods covered by the scope of it, and its holder may conclude the delivery of the goods at the destination seaport or sell the goods while in transit by endorsement. As a result, although the buyer does not have possession on goods during transportation, the risk belongs to the buyer during transportation (Adisommongkon, 2017, p. 107).

2. Passing of Risk in CISG

CISG 66–70 Articles govern the passing of risk rules. Pursuant to CISG Article 6, parties may make the choice of a law contract. Where CISG becomes applicable law in the absence of any choice of law agreement, CISG 66–70 articles becomes applicable law rules for passing of risk (Huber, Mullis, 2007, p. 314).

2.1. Consequences of Passing of Risk in CISG: Article 66

CISG Article 66 lays down consequences of passing of risk. CISG Article 66 states as follows: "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."

Pursuant to CISG Article 66, the most important result of the passing of risk is that the buyer will be responsible for paying the price if the commodities are damaged or lost after risk passes from the seller to the buyer. In a broad sense, this provision should be interpreted as a basic principle of CISG Article 7(2). By way of illustration, after risk passes to the buyer, the buyer party shall bear the consequences of shrinkage of the goods, of emergency unloading, of the carrier's negligence, or general average (Huber, Mullis, 2007, p. 316). The time at which the risk of goods passes from the seller to the buyer is often determined by the contract (Huber, Mullis, 2007, p. 314). Each party is responsible for the period in which they bear the contractual risk (Oglinda, Olariu, 2018, p. 106). The CIETAC (China International Economic and Trade Arbitration Commission) issued a judgment supporting this principle. In 1992 there was a contract between a Californian buyer and a Chinese seller for the sale

of 10.000kg of jasmine aldehyde (jasminal), CIF New York. The buyer warned the seller regarding the sensitivity of the cargo to high temperatures and asked them to make sure that it can be stored in a cool place. Further, the buyer asked the seller to transport jasmine aldehyde on a direct line. The seller approved that the temperature was appropriate at the seaport, but when the cargo arrived in New York, after passing by the seaport of Hong Kong, a substantial part of it had melted and leaked due to high heat during voyage. The cargo reached the final user, who did not accept it. It was then that the buyer informed the seller of the damages and he had the commodities examined on that day. After the parties concluded a settlement agreement, the seller was obliged to pay 60.000 US dollars in damages, of which 20.000 US dollars should be paid in cash and the rest compensated in further transactions between parties. The seller did not pay the cash amount and the further transactions could not be reached as a consensus. Upon an Arbitration Commission, the buyer requested 60.000US dollars plus interest and damages. The Arbitral Tribunal decided that the seller was liable for the damage pursuant to CISG Article 66. Although, according to the CIF Clause, the risk passes from the seller to the buyer when the goods pass the ship railway; in the present case, there had been a special contractual clause regarding the temperature in the course of transportation time. The seller could not perform his obligations under the special contractual clause, since they neglected the correct and sufficient directions to the carrier and, instead of instructing a direct route, conversely sent the cargo via Hong Kong, which had caused its deterioration. Therefore, the damage was brought about by "an act or omission of the seller" and thus the risk had not passed from the seller to the buyer (Valioti, 2004, p. 12).

2.2. Passing of Risk in Cases Involving Carriage of Goods: Article 67

CISG Article 67 governs passing of risk rules in the contract of sale involving a carriage of goods. CISG Article 67(1) sets two situations in its first two sentences where transportation is carried out by third persons (Adisommongkon, 2017, p. 109):

a) If parties do not agree on a particular place for handing over goods in contract of sale, the risk passes from the seller to the buyer when the goods are delivered to the first carrier.

b) If parties agree on the place of deliverance of goods in a particular place, the risk passes from the seller to the buyer when the goods are delivered to the carrier at that particular place.

To understand these two conditions, the legal terms of *first carrier* and *handing over* should be analysed respectively; neither of them are defined in CISG. Firstly, the first carrier is an independent third entity who takes control of the goods which are subject to a contract of sale as a freight forwarder. It is a reasonable condition that the risk passes from the seller to the buyer when goods are handed over to the first carrier, since the seller loses their control and possession over the goods. Therefore, they should not bear risk or loss of goods (Adisommongkon, 2017, p. 110). Secondly, handing over is defined by HAGER as "transferring the goods into the carrier's custody." The handing over of the goods is completed when the goods are taken into the physical custody of the carrier. In a case between a German buyer and an Italian seller of plants, the court ruled that "handing over requires that the carrier takes custody of the goods, which implies an actual surrender of the goods to the carrier. It is no doubt necessary for the seller to load the goods onto or into the respective means of transport. Thus, the risk only passes when loading is completed" (Landgericht Bamberg (Germany) 23 October 2006, Plants Case; Buydaert, 2013, p. 35–36).

Both conditions have one common point. Third sentence of CISG Article 61(1) states that "[t] he seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of the risk." In international trade, it is an accepted practice that the seller may retain the shipping documents of the goods as a form of security until the buyer makes the payment to the seller.

It is a very important and useful rule for avoiding the basic rule of passing of risk losing its effect (Buydaert, 2013, p. 37–38).

CISG Article 67(2) sets an important exception. The risk does not pass from the seller to the buyer until the goods are explicitly described or identified in the contract of sale, whether by the shipping document, by marking on the cargo, or by a notice given to the buyer. Identifying the goods is a very crucial criterion for determining the risk holder. The purpose of this provision is to determine the seller, in case the goods are partially lost or damaged, or the buyer, to whom the risk of goods bears by reflecting the term of public risk (Şamlı, 2007, p. 328–329). Identification is the duty of the seller. A Russian arbitral tribunal ruled that a seller could explicitly identify the goods for the purpose of the contract through shipping documents. Namely, if there is no identification of goods, the risk belongs to the seller until the moment the goods become identifiable[1].

As a result, from a factual point of view, the legal issue of the passing of risk to the buyer is more complex in the circumstances when an independent third entity acts as a carrier than in a relationship between the buyer and the seller that does not include a carrier (Oglinda, Olariu, 2018, p. 107). However, it should be emphasized that parties of contract of sale set the CIF or FOB clause based on party autonomy and the choice of law rules in CISG provisions in practice; therefore, the provision of CISG Article 67 is not practically important (Hansu, 2016, p. 206).

2.3. Passing of Risk with Goods Sold in Transit: Article 68

CISG Article 68 governs the passing of risk with goods sold in transit. CISG Article 68 states that "[t]he risk in respect of goods sold in transit passes to the buyer from the time of the conclusion of the contract. However, 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. Nevertheless, if at the time of the conclusion of the contract of sale the seller knew or ought to have 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."

There is no definition of goods sold in transit in this provision. It should be defined as goods which are sold while they are kept in truck, train or ship. Goods are resold during the voyage, while the goods are brought by the seller. The contract of sale is concluded in the course of voyage of goods. As a rule, risk passes regarding goods sold in transit from the seller to the buyer at the time of concluding a contract according to the first sentence of CISG Article 68. It may cause serious problems in practice, since it is very difficult to determine the exact time in which the loss or damage of goods occurred, and it presents difficulties in proving the time of loss of damage of the goods. Therefore, the second sentence of CISG Article 68 states a retroactive passing of risk. This means if there is a sale of goods sold in transit on a "special circumstance," the risk passes from the seller to the buyer retroactively at the moment of loading goods (Adisommongkon, 2017, p. 110–111). This sentence is criticised by scholars, since it is not clear which type of special circumstance it refers to (Berman, Ladd, 1988, p. 430). Since this sentence is a vague rule, the provision is available to be interpreted uniformly by national courts. The third sentence of CISG Article 68 provides that if the seller knew at the moment when the contract was made that the goods had suffered loss or damage and did not give this information to the buyer, they bear the risk of the damage or loss. In that case, the seller is considered to be in bad faith (Valioti, 2004, p. 16). This sentence is criticized, however. There is a problem in the application of this

[1] Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry (Russian Federation) 30 December 1998, Arbitral Award no. 62/1998; Buydaert, 2013, p. 38.

rule to damages occurred before or after the contract is concluded. It is not a very clear reference to the damage or loss of which the seller knew or ought to have known when the contract was concluded, or it also includes damages which occurred after the contract was concluded but which are connected to the current damages at the conclusion of the contract (Nicolas in Bianca, Bonell, Commentary, p. 499; Buydaert, 2013, p. 46). These issues are not certain. This uncertainty creates problems in practice. Many scholars are of the opinion that CISG Article 68 is seldom used in practice and, thus, INCOTERMS rules are applied instead of the CISG Article 68 provision (Adisommongkon, 2017, p. 112–113).

2.4. Passing of Risk in Residual Cases: Article 69

CISG Article 69 governs passing of risk in residual cases. It states as follows:

"(1) In cases not within articles 67 and 68, 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.

(2) 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 this disposal at that place.

(3) If the contract relates to goods not then identified, the goods are considered not to be placed at the disposal of the buyer until they are clearly identified to the contract."

CISG Article 69 governs cases not within the scope of Articles 67 and 68. It supplements the CISG Article 66 provision regarding the contract of sale (Berman, Ladd, 1988, p. 430). In another words, CISG Article 69 is applied for all contracts of sale which do not deal with an independent carrier (Çakırca, 2012, p. 102). Pursuant to CISG Article 69, there are three different scenarios, as follows (Erauw, 2005, p. 215):

First scenario: if the goods are handed over to the buyer at the seller's place of business, but the buyer delays in taking over the goods, risk passes from the seller to the buyer, since the buyer is in breach for not taking over the goods pursuant to Article 69(1). This provision does not explicitly oblige the seller to notify the buyer that the goods are available. However, as CISG Article 67(2) requires, the identification of the goods frequently requires a notice or some form of communication. Furthermore, the contract of sale between the buyer and the seller may require such a notice.

Second scenario: if the goods are handed over to the buyer at a place other than the seller's place of business (e.g., if the seller transports the goods to the buyer's place of business or plant), risk passes from the seller to the buyer when "delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place" pursuant to Article 69(2). The risk changes more readily when a place of business of the seller is not the place of delivery. There are several legal grounds for this. First of all, this place is known by the buyer. Secondly, the buyer turned to be aware of the availability of the goods or was notified. Therefore, Pursuant to Article 67(2), risk passes from the seller to the buyer independently of whether the buyer has breached his obligation to accept the delivery of the goods.

Third scenario: If the parties do not agree on a particular place other than the seller's place of business for delivery, the seller has an obligation to send them at the disposal of the buyer to the seller's place of business in accordance with CISG Article 31(c), as it existed when the contract was concluded[2].

[2] CISG Article 31(c) states: "If the seller is not bound to deliver the goods at any other particular place, his obligation to deliver consists:

(c) in other cases – in placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of conclusion of the contract".

Under CISG Article 69, Erauw summarizes the chronology of the passing of risk as follows (Erauw, 2005, p. 214–215):

"(a) When the goods are taken over by the buyer at the seller's place of business (Article 69(1), first part), risk passes even if this occurs before the date by which delivery is due.

(b) In other cases, the key element for passing of risk is the goods being at the disposal of buyer (Article 69(2), and the second part of Article 69(1)."

2.5. Passing of Risk in Non-Accidental Cases: Article 70

CISG Article 70 governs the passing of risk rules in non-accidental cases as follows: "If the seller has committed a fundamental breach of contract, articles 67, 68 and 69 do not impair the remedies available to the buyer on account of the breach."

It governs the relationship between the buyer's remedies and the passing of risk if the seller commits a fundamental breach of contract of sale (Valioti, 2004, p. 19). A breach of contract is defined in CISG Articles 25 and 45. A breach of contract is defined as a failure to perform any of the obligations under the CISG or the contract of sale in CISG Article 45. Pursuant to CISG Article 25, a breach of contract is deemed as fundamental "if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result." Definitions of breach of a contract of sale are subjective and unclear in both articles. The border of the breach of contracts can be determined based on interpretations of national courts and arbitral tribunals (Aydin, 2013, p. 222–223). If the seller breaches the contract of sale, the buyer has optional remedies, such as the reduction of the price of goods or compensation. If the seller commits a fundamental breach of contract of sale, the seller has two more optional remedies, such as avoidance of contract and changes of defective goods with goods without defection (Basedow, 2005, s. 490; Aydin, 2013, p. 222–223). These articles shall be applied under two conditions. The first condition is the passing of risk from the seller to the buyer. The second condition is the fundamental breach of contract of sale by the seller. Even if the risk passes to the buyer under these conditions, the buyer does not pay the amount of goods and enjoys one of four optional remedies (Aydin, 2013, p. 223).

Conclusion

Since passing of risk is a very crucial matter that determines risk holders in international sale transactions, CISG lays down rules on passing of risk.

First, CISG accepts taking physical possession as a passing of risk system when considered in light of CISG Articles 67–68 and 69. Under these articles, the risk passes from the seller to the buyer at the conclusion of taking physical possession from the seller to the buyer or the independent carrier, although there are some exceptional situations in these provisions.

Secondly, CISG Articles of 66 and 70 regulate the consequences of passing of risk. Although CISG Article 66 regulates consequences of passing of risk plainly, CISG Article 70 focuses mainly on the buyer's remedies and damaged goods than the basic consequences of passing of risk. Under CISG Article 66, after the risk passes from the seller to the buyer, any occurring damage or loss of goods belongs to the buyer. It is the fundamental principle of passing of risk. Under CISG Article 70, the buyer has four remedies against a fundamental contractual breach of the seller: restitution, right to substituted goods, right to claim damages, and avoidance of contract.

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Passing of Risk in Convention on International Sale of Goods

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S u m m a r y

Passing of risk is subject to many disputes. It has three systems: the conclusion of contract, the transfer of property from the seller to the buyer, and taking physical possession. In considering these systems, taking physical possession is accepted as the most logical passing of risk system. Therefore, CISG accepts it as a passing of risk system.

Yunus Emre AY was born in Antalya in 1992. After completing his LLB studies in İzmir in 2014, he commenced compulsory internship to be an admitted lawyer in Antalya. He completed his LLM studies in 2017 in English at Charles University in the Prague Faculty of Law. He practices law at his law office since the beginning of 2020. Besides practicing law in Turkey, he publishes papers in the field of private international law and international business law in peer-reviewed law journals. His research areas are private international law (mainly international business law), intellectual property law, and immigration law.