

THE PASSING OF LEGAL RISK UNDER THE VIENNA SALES  
CONVENTION: DOES ARTICLE 66 CISG COVER ACTS OF STATE?

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**1 INTRODUCTION**

The rules on the passing of risk contained in Arts. 66–70 of the 1980 *United Nations Convention on Contracts for the International Sale of Goods*<sup>1</sup> (CISG) determine which party bears the financial risk of accidental loss or damage to goods between contract conclusion and complete performance.<sup>2</sup> This article analyses the concept of risk outlined by Art. 66 CISG, and in particular whether it covers Acts of State. Article 66 CISG provides:

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<sup>1</sup> *United Nations Convention on Contracts for the International Sale of Goods* (1980), United Nations Document A/Conf.97/18 Annex I, available at: <<http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf>>.

<sup>2</sup> Hager, G. and Schmidt-Kessel, M.: “Commentary on Article 66” in Schlechtriem, P. and Schwenzer, I. (eds), *Commentary on the UN Convention on the International Sale of Goods*, 2010, Oxford University Press, Oxford, at pp. 921–6; Brunner, C., *UN-Kaufrecht – CISG*, 2004, St  mpfli, Bern, at Art. 66 para. 1. For a systematic overview of Arts. 66–70 CISG, see Erauw, J., “Observations on passing of risk” in Ferrari, F., Flechtner, H. and Brand, R. (eds), *The Draft UNCITRAL Digest and Beyond*, 2004, Sellier, Munich, at pp. 292–318.

*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.*

Article 66 CISG outlines the main legal consequence of the risk passing to the buyer and needs to be read in the following context: Articles 67–69 CISG deal with the time at which the risk passes. Article 36(1) CISG specifies that a lack of conformity in the goods must have arisen by the time when the risk passes in order for the seller to be liable.

The time when the risk passes determines the point from which the buyer must pay for the goods even though it has not received them or received them only with reduced value and even though neither party to the sales contract is responsible for the loss or damage. By contrast, if the seller still has to perform, the buyer's obligation to pay the price is not 'risk' in the sense of Art. 66 CISG, but a contractual obligation in exchange for the seller's performance. Accordingly, the seller's risk of having to perform its obligations passes together with the buyer's risk of having to pay the purchase price.<sup>3</sup> Therefore, Art. 66 CISG deals with situations where the buyer must pay and has no recourse to the remedies set out in Art. 45 CISG with regard to the lost or damaged goods.<sup>4</sup>

As the English scholar Clive M. Schmitthoff emphasised: 'From Justinian to Rabel the passing of risk has been a controversial problem in the contract of sale.'<sup>5</sup> In uniform sales law, concepts of risk have been the object of debate, study and legal practice

<sup>3</sup> Nicholas, B., "Commentary on Article 66 CISG" in Bianca, C. M. and Bonell, M. J. (eds), *Commentary on the International Sales Law*, 1987, Giuffrè, Milan, at pp. 483–4; Vulliétý, J.-P., *Le transfert des risques dans la vente internationale*, 1998, Helbing & Lichtenhahn, Basel, at para. 2.156.

<sup>4</sup> See, e.g., Herber, R. and Czerwenka, B., *Internationales Kaufrecht*, 1991, C. H. Beck, Munich, at Art. 66 para. 2. Admittedly, Art. 79(5) CISG states that in case of an impediment beyond his control, the buyer maintains a right to claim damages. However, after the risk has passed to the buyer, the specific rule of Art. 66 CISG overrides any general rule on excuse. See Honnold, J. O. and Flechtner, H. M., *Uniform Law for International Sales under the 1980 United Nations Convention*, 2009, Kluwer Law International, The Hague, at Art. 66 para. 361; see also Bridge, M., "The Transfer of Risk under the UN Sales Convention 1980 (CISG)" in Andersen, C. B. and Schroeter, U. G. (eds), *Sharing International Commercial Law Across National Boundaries: Festschrift for Albert H. Kritzer on the Occasion of his Eightieth Birthday*, 2008, Wildy, Simmonds & Hill Publishing, London, at p. 83, also available at: <<http://www.cisg.law.pace.edu/cisg/biblio/bridge4.html>>.

<sup>5</sup> Schmitthoff, C. M., "The Risk of Loss in Transit in International Sales (1965)" in Cheng, C.-J. (ed), *Clive M. Schmitthoff's Select Essays on International Trade Law*, 1988, Martinus Nijhoff Publishers, Dordrecht, at pp. 277–305; compare Rabel, E., "Der Entwurf eines einheitlichen Kaufgesetzes" (1935) 9 *Rabels Zeitschrift* 1, at p. 357 ("This question is of such importance for long distance sales contracts, especially when overseas, that the firms and clauses always address it. It also does not become redundant through transport insurance, not even if the anticipated profit is covered, since it remains questionable who has to pay the insurance costs." (authors' translation)) See also Magnus, U., "Vorbemerkungen zu Art. 66" in J. von Staudinger, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen, Wiener UN-Kaufrecht (CISG)*, 2005, Sellier, Berlin, at Vorbemerkungen zu Art. 66, para. 1.

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since 1930.<sup>6</sup> In particular, as Rabel pointed out in the commentary to his draft uniform sales law in 1935, there is no globally established view on the qualification of Acts of State as matters of risk.<sup>7</sup> Acts of State can take different forms. A public authority may, for example, confiscate, forbid the possession, intended use or further commercial exploitation of goods, or pass import or export bans.<sup>8</sup> For the purpose of this article, this risk of public intervention shall be referred to as 'legal risk'.<sup>9</sup> In the CISG, neither the wording of Art. 66 nor its drafting history expressly deals with the issue of legal risk, and so the question arises: Does Art. 66 CISG cover Acts of State?

In order to address this question, this article proceeds as follows. Part 2 provides a brief overview of Art. 66 CISG in cases of physical risk. Part 3 deals with legal risk, discussing different approaches with respect to whether Acts of State are matters of risk. Part 4 sets out the conclusion.

## 2 PHYSICAL RISK: AN OVERVIEW

During the diplomatic drafting conference of the CISG in April 1980, neither national representatives nor the different commissions discussed in detail which events should fall within the concept of risk.<sup>10</sup> Article 66 CISG is based on Art. 96 of the *Uniform Law on the International Sale of Goods*,<sup>11</sup> which provided:

*Where the risk has passed to the buyer, he shall pay the price notwithstanding the loss or deterioration of the goods, unless this is due to the act of the seller or of some other person for whose conduct the seller is responsible.*

<sup>6</sup> Erauw, J., "Observations on passing of risk," *supra* fn 2, at p. 292.

<sup>7</sup> Rabel, E., "Der Entwurf eines einheitlichen Kaufgesetzes," *supra* fn 5, at p. 357.

<sup>8</sup> Compare Erauw, J., "Observations on passing of risk," *supra* fn 2, at p. 296.

<sup>9</sup> It should be noted that this risk is not identical to 'political risk'. Political risk usually comprises all events having a political background, including civil unrest, terrorism and other events that are not necessarily Acts of State. See Valiotti, Z., "Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000," (2003) *Thesis for the LL.M. in International Commercial Law at the University of Kent at Canterbury*, at fn 52, available at: <<http://www.cisg.law.pace.edu/cisg/biblio/valiotti1.html#i>>. Furthermore, it should be clarified that the definition of 'legal risk' used in this article does not comprise the chance that the buyer is insolvent (credit risk), uncertainties as to the applicable law and its meaning, or any other issues that are sometimes described as issues of risk in the general context of sales law. See Dalhuisen, J. H., *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law: Volume 2 Contract and Moveable Property*, 2010, Hart Publishing, Portland, at p. 155; Sheaffer, C., "The Failure of the United Nations Convention on Contracts for the International Sale of Goods and a Proposal for a New Uniform Global Code in International Sales Law" (2007) 15 *Cardozo Journal of International & Comparative Law* 461, at p. 470.

<sup>10</sup> See, e.g., Hager, G. and Schmidt-Kessel, M., "Commentary on Article 66," *supra* fn 2, at pp. 921-6.

<sup>11</sup> *Uniform Law on the International Sale of Goods* (1964), available at: <<http://www.cisg.law.pace.edu/cisg/text/ulis.html>>.

The word 'deterioration' was replaced by 'damage' in the CISG because 'deterioration' might be taken to refer only to natural spoilage or evaporation, whereas the provision is concerned with all casualties to the goods.<sup>12</sup> Accordingly, Art. 66 CISG mentions 'loss of or damage to the goods'. This may naturally comprise physical impairment of the goods, which will be analysed in two parts: loss of the goods (**Part 2.1**) and damage to the goods (**Part 2.2**).<sup>13</sup>

## 2.1 LOSS OF THE GOODS

Loss of the goods generally means loss by accident, Acts of God, and impact of third parties, for which neither party to the sales contract is responsible.<sup>14</sup> First, this concept covers the physical loss of goods due to their complete destruction.<sup>15</sup>

Example 1: A contract called for the seller to send 100 bales of cotton to the buyer. Article 67(1) CISG provides that the risk passes to the buyer when the goods are handed over to the first carrier. The seller loaded the bales on the ship. During carriage, a fire broke out, burning the freight. Nevertheless, the buyer had to pay the purchase price for the burnt cotton bales.

Second, loss comprises disappearance of goods. This includes, for example, cases where the goods cannot be found, have been stolen, or have been transferred to another person.<sup>16</sup>

Example 2: Seller and buyer contracted for the sale of furniture manufactured and stored in a warehouse. Article 69(2) CISG provides 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. The warehouse firm declared bankruptcy and the furniture disappeared from the warehouse before delivery was due. Subsequently, the seller sued the buyer for the purchase price. The buyer was not obliged to pay because the risk had not passed under Art. 69(2) CISG.<sup>17</sup>

<sup>12</sup> See, e.g., Nicholas, B., "Commentary on Article 66," *supra* fn 3, at pp. 483–4; United Nations Commission on International Trade Law, *Yearbook Volume VI*, 1975, United Nations, New York, at p. 109.

<sup>13</sup> For the risk of increased transport costs see Schönle, H. and Koller, T., "Commentary on Article 66" in Honsell, H. (ed), *Kommentar zum UN-Kaufrecht*, 2009, Springer, Berlin, at Art. 66 para. 23 (the buyer bears the price risk after the passing of risk even though the seller carries the normal transport costs).

<sup>14</sup> Enderlein, F. and Maskow, D., *International Sales Law*, 1992, Oceana Publications, New York, at Art. 66 para. 2; Schönle, H. and Koller, T., "Commentary on Article 66," *supra* fn. 13, at Art. 66 para. 17.

<sup>15</sup> Heuzé, V., *La vente internationale de marchandises*, 2000, E.J.A., Paris, at para. 371; Honnold, J. O. and Flechtner, H. M., *Uniform Law for International Sales*, *supra* fn 4, at Art. 66 para. 361.

<sup>16</sup> See, e.g., Erauw, J. "Observations on passing of risk," *supra* fn 2, at p. 294.

<sup>17</sup> See Oberlandesgericht Hamm 19 U 127/97 (1998) 1999 *Recht der Internationalen Wirtschaft* 786.

## 2.2 DAMAGE TO THE GOODS

Goods may be damaged during transport, storage or handling. Damage includes every physical alteration of the goods leading to a decline in quality in terms of Art. 35 CISG.<sup>18</sup> Damage usually results from lack of care, such as inappropriate packaging or insufficient cooling of the goods, or damage caused by others (the carrier, vandalism, etc.).

Example 1: An Argentinean buyer and a German seller concluded a contract for the sale of dried mushrooms to be shipped to the buyer. In accordance with Art. 67 CISG, the risk passed to the buyer when the goods were handed over to the first carrier for transmission to the buyer. In the course of their transport to Buenos Aires, the mushrooms were contaminated by insects. Yet, the buyer had to pay the purchase price.<sup>19</sup>

Example 2: A German company sold a mobile magnetic resonance imaging system to a United States company. According to the Ex-Works Incoterm contained in the contract, the risk passed to the buyer when the seller made the goods available at its premises. Due to improper handling by the carrier, fragile parts of the machine broke during transit. Still, the buyer had to pay the price for the broken machine.<sup>20</sup>

## 3 LEGAL RISK

While there is consensus about the concept of physical risk, the concept of legal risk,<sup>21</sup> *i.e.*, the risk that a public authority may confiscate, forbid the possession, intended use or further commercial exploitation of the goods, pass import or export bans, etc., remains controversial. The debate has resulted in a broad spectrum of approaches, which can be categorised as follows: According to one view, Acts of State are generally covered by the concept of risk in Art. 66 CISG (Part 3.1). Another view rejects this approach and, in general, does not qualify Acts of State as matters of risk (Part 3.2). Yet another view holds that Acts of State are not covered by the concept of risk except where the respective Act has an effect that is equivalent to loss of or damage to the goods (Part 3.3). This part analyses and evaluates the arguments and criteria put forth by the respective opinions.

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<sup>18</sup> See, e.g., Witz, W., „Commentary on Article 66“ in Witz, W., Salger, H. and Lorenz, M., *International Einheitliches Kaufrecht: Praktiker-Kommentar und Vertragsgestaltung zum CISG*, 2000, Verlag Recht und Wirtschaft, Heidelberg, at Art. 66 para. 3.

<sup>19</sup> See *Bedial, S.A. v Paul Muggenburg and Co. GmbH* (1995) 21 October 1996 *El Derecho* 4.

<sup>20</sup> See *St. Paul Guardian Ins. Co. v Neuromed Medical Sys. & Support* (2002) 2002 WL 465312.

<sup>21</sup> See *supra* fn 9.

### 3.1 ACTS OF STATE ARE GENERALLY COVERED BY THE CONCEPT OF RISK

One view generally classifies Acts of State as matters of risk.<sup>22</sup> Yet, among authors who advocate this view, there are considerable differences as to whether exceptions should be made and, if so, what kind of exceptions.

Some authors simply state that Acts of State are matters of risk under Art. 66 CISG and do not reserve any exceptions.<sup>23</sup> They partly argue that Art. 66 CISG should be understood as a general principle under Art. 7(2) CISG and therefore extended to similar cases, such as Acts of State.<sup>24</sup>

Other authors have developed systems of exceptions. Schönle and Koller,<sup>25</sup> for example, advocate three main categories of exceptions. First, they consider confiscation in the context of war, political embargos against the country of destination, expropriation and 'similar' Acts of State to be covered by the concept of risk, but emphasise that the last half-sentence of Art. 66 CISG (Art. 66 CISG *in fine*) always needs to be observed. Article 66 CISG *in fine* states that the risk passes to the buyer '[...] unless the loss or damage is due to an act or omission of the seller'. The authors mention an example where a German seller chose to transport lead through France shortly before the outbreak of the First World War and the goods were confiscated as enemy property. In such a case, the risk might not pass to the buyer.

Notwithstanding the discussion below<sup>26</sup>, it can already be said here that the *in fine* criterion does not solve the problem of when to classify an Act of State as a matter of risk. Article 66 CISG *in fine* does not attempt to define the concept of risk, but has a different function: It determines in which situations the risk should remain with the seller. Thus, in the example given above, one would first have to determine whether

<sup>22</sup> Achilles, W.-A., *Kommentar zum UN-Kaufrechtsübereinkommen (CISG)*, 2000, Luchterhand, Berlin, at Art. 66 para. 2; Brunner, C., *UN-Kaufrecht – CISG*, *supra* fn 2, at Art. 66 para. 12; Enderlein, F. and Maskow, D., *International Sales Law*, *supra* fn 14, at Art. 66 para. 2; Erauw, J., "Observations on passing of risk," *supra* fn 2, at p. 296; Huber, P., "Commentary on Art. 66" in Schmidt, K. (ed), *Münchener Kommentar zum Bürgerlichen Gesetzbuch (CISG)*, 2008, C.H. Beck, Munich, at Art. 66 para. 7; Magnus, U., "Commentary on Article 66," *supra* fn 5, at Art. 66 para. 6; Neumayer, K. and Ming, C., *Convention de Vienne sur les contrats de vente internationale de marchandises*, 1993, CEDIDAC, Lausanne, at Art. 66 para. 1; Schönle, H. and Koller, T., "Commentary on Article 66," *supra* fn 14, at Art. 66 paras. 19–21.

<sup>23</sup> Achilles, W.-A., *Kommentar*, *supra* fn 22, at Art. 66 para. 2; Enderlein, F. and Maskow, D., *International Sales Law*, *supra* fn 14, at Art. 66 para. 2; Erauw, J., "Observations on passing of risk," *supra* fn 2, at p. 296; Huber, P., *supra* fn 22, at Art. 66 para. 7; Magnus, U., "Commentary on Article 66," *supra* fn 5, at Art. 66 para. 6; Neumayer, K. and Ming, C., *Convention de Vienne*, *supra* fn 22, at Art. 66 para. 1.

<sup>24</sup> See, e.g., Huber, P., *supra* fn 22, at Art. 66 para. 4; Witz, W., "Commentary on Article 66," *supra* fn 18, at Art. 66 para. 4.

<sup>25</sup> Schönle, H. and Koller, "Commentary on Article 66," *supra* fn 14, at Art. 66 paras. 19–21.

<sup>27</sup> Erauw, J., "Observation on passing of risk," *supra* fn 2, at p. 316.

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the confiscation constitutes a matter of risk before evaluating whether it should remain with the seller because the seller knowingly or negligently chose a dangerous route. Consequently, this exception can only be relevant after the notion of risk has been otherwise clarified. In any case, recourse to Art. 66 CISG *in fine* should, if possible, be avoided since it is highly disputed in itself. It has been called a 'disturbing exception'<sup>27</sup> and an 'unfortunate rule' which may produce 'undesirable or even foolish results'.<sup>28</sup>

Secondly, concerning import and export bans, Schönle and Koller do not consider it appropriate to apply the rules on the passing of risk and prefer to resort to contract interpretation, for example, interpretation of Incoterms.<sup>29</sup>

Thirdly, with regard to public law requirements and restrictions in the buyer's country or the country of destination, Schönle and Koller believe that those Acts are not matters of risk, but of contract interpretation, which are to be resolved in accordance with Art. 35 CISG.<sup>30</sup>

Brunner,<sup>31</sup> also by way of contract interpretation, suggests reserving a different exception to the rule that Acts of State would be covered by Art. 66 CISG. He notes that the buyer might be entitled to avoid or adjust the contract if the purpose of the contract was known to the seller and if that purpose was unforeseeably frustrated. The legal basis for this approach is Art. 7(1) CISG (good faith) or Art. 79 CISG in conjunction with Art. 7(2) CISG and Art. 6.2.3(4) UNIDROIT Principles,<sup>32</sup> according to which 'hardship' allows a court to terminate a contract. Regarding public law requirements and restrictions in the buyer's country or the country of destination, Brunner agrees that those cases should be resolved in accordance with Art. 35 CISG.

The general presumption that Acts of State are covered by the concept of risk may be supported by the wording of Art. 66 CISG. Indeed, Art. 66 CISG does not contain an exhaustive definition of events.<sup>33</sup> However, this cannot mean that its scope can be extended to all sorts of legal risk via Art. 7(2) CISG, as some authors suggest.<sup>34</sup> An

<sup>27</sup> Erauw, J., "Observation on passing of risk," *supra* fn 2, at p. 316.

<sup>28</sup> Enderlein, F. and Maskow, D., *International Sales Law*, *supra* fn 14, at Art. 66 para. 3.

<sup>29</sup> Incoterms are standardized trade terms for use in international trade. See International Chamber of Commerce, *Incoterms 2000: ICC Official Rules for the Interpretation of Trade Terms*, 2000, ICC, Paris.

<sup>30</sup> For an overview of public law regulations under Art. 35 CISG, see Flechtner, H., "Funky Mussels, a Stolen Car, and Decrepit Used Shoes: Non-Conforming Goods and Notice Thereof under the United Nations Sales Convention (CISG)" (2008) 26 Boston University International Law Journal 1. Contra, see Schlechtriem, P., "Compliance with local law; seller's obligations and liability: Annotation to German Supreme Court decision of 2 March 2005 [VIII ZR 67/04]," (2005) available at: <<http://www.cisg.law.pace.edu/cisg/biblio/slechchtriem7.html>>.

<sup>31</sup> Brunner, C., *UN-Kaufrecht – CISG*, *supra* fn 2, at Art. 66 para. 12.

<sup>32</sup> See International Institute for the Unification of Private Law, *UNIDROIT Principles of International Commercial Contracts*, 2010, UNIDROIT, Rome, also available at: <http://www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf>,

<sup>33</sup> Compare Huber, P., "Commentary on Article 66," *supra* fn 22, at Art. 66 para. 6.

<sup>34</sup> See *supra* fn 24.

analogy would require, first, a gap in Art. 66 CISG, and second, that the cases expressly regulated by it and the situation at hand are so analogous that it would be inherently unjust not to adopt the same solution for the non-regulated situation.<sup>35</sup> In our view, there is no gap, since a simple interpretation of Art. 66 CISG already leads to reasonable solutions.<sup>36</sup> In any case, legal risk situations can have many different forms<sup>37</sup> and consequences, so that it does not seem convincing to assume that they are analogous to physical impairment of the goods in general. Such an undifferentiated approach may be easy to apply, but it produces results that are incompatible with the purpose of the CISG's risk passing rules.<sup>38</sup> If, for example, the country of destination passes a regulation that limits the recommended cadmium concentration in mussels<sup>39</sup> it is common ground that this is a question of contract interpretation under Art. 35 CISG and not a matter of passing of risk in the sense of Art. 66 CISG.<sup>40</sup>

The authors that have developed systems of exceptions, namely Schönle/Koller and Brunner, still hold fast to this undeveloped 'general analogy', but try to limit the strict application of Art. 66 CISG to legal risk by distinguishing different categories of Acts of State. This approach can certainly lead to reasonable results on a case-by-case basis. At the same time, it has the disadvantage of not providing uniform and clear criteria to determine the scope of Art. 66 CISG with regard to legal risk. But such criteria are desirable, since Art. 7(1) CISG requires the promotion of uniformity in the application of the Convention. To reach this goal, courts should take into account arguments contained in foreign CISG decisions and doctrine on the issue.<sup>41</sup> In the event one finds that there is a gap that needs to be filled pursuant to Art. 7(2) CISG, it is particularly important for courts to be able to fill such a gap in a uniform manner.<sup>42</sup> However, in the absence of uniform criteria, it is not always clear whether the rules on the passing of risk apply.

Example: A seller and a buyer contracted for water pumps for use in a third country, to be delivered to the buyer's country. The pumps contained beryllium, a hazardous element. The contract contained a warranty for public law regulations

<sup>35</sup> Bonell, M. J., "Commentary on Article 7 CISG," *supra* fn 3, at pp. 77–9.

<sup>36</sup> See *infra* Part 3.3.

<sup>37</sup> Erauw, J., "Observations on passing of risk," *supra* fn 2, at p. 296; Dalhuisen, J. H., *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, *supra* fn 9, at pp. 155, 157.

<sup>38</sup> For a purpose-oriented interpretation see *infra* Part 3.3.

<sup>39</sup> See Bundesgerichtshof VIII ZR 159/94 (1995) 129 Entscheidungen des Bundesgerichtshofs in Zivilsachen 75.

<sup>40</sup> See, e.g., Flechtner, H., "Funky Mussels," *supra* fn 30.

<sup>41</sup> Ferrari, F., "Interpretation of the Convention and gap filling: Art.7" in Ferrari, F., Flechtner, H. and Brand, R. (eds), *The Draft UNCITRAL Digest and Beyond*, *supra* fn 2, at p. 144; Honnold, J. O. and Flechtner, H. M., *Uniform Law for International Sales*, *supra* fn 4, at Art. 6 para. 92; Schlechtriem, P., "Commentary on Article 7" in Schlechtriem, P. and Schwenzer, I. (eds), *Commentary on the UN Convention on the International Sale of Goods*, 2010, Oxford University Press, Oxford, at Art. 7 para. 10; Winship, P., "Changing Contract Practices in the Light of the United Nations Sales Convention: A Guide For Practitioners" (1995) 29 *International Lawyer* 528.

<sup>42</sup> Magnus, U., "Commentary on Article 66," *supra* fn 5, at Art. 66 para. 9.



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and an Incoterm allocating the risk for import licenses to the buyer. The military regime in the country of destination passed a decree that prohibited the import or manufacture of products containing any amounts of a number of chemical elements, including beryllium.<sup>43</sup> Is the decree covered by Art. 66 CISG?

The categories of exceptions put forward by Schönle/Koller and Brunner are difficult to identify since their definition and comprehensiveness vary significantly: Schönle/Koller do not consider import bans and public law restrictions as matters of risk, but of contract interpretation, while Brunner would ask if the seller knew that the goods were meant to be imported into the third country and whether the military decree was foreseeable. Moreover, it seems impossible to exhaustively define categories, as can be seen from Schönle and Koller, who, despite a comprehensive systematisation, have to add 'similar' Acts to their categories.<sup>44</sup> Even if one is able to identify common categories, it must still be decided whether the Act of State in question falls under any of those categories. It is true that this problem always occurs when applying categories. But in our view it is preferable, especially in factually complex legal risk scenarios such as the abovementioned example, to interpret Art. 66 CISG in order to ensure that the results are consistent with the CISG's concept of risk passing. This significantly reduces the risk of diverging or even contradictory decisions that can result from an unreflecting application of the rather opaque exceptions to the rule that Acts of State would be covered by Art. 66 CISG.

### 3.2 ACTS OF STATE ARE GENERALLY NOT COVERED BY THE CONCEPT OF RISK

Pursuant to a different view, the CISG's rules on the passing of risk generally do not cover Acts of State.<sup>45</sup> According to this view, Acts of State are not matters of risk. The question of who bears the risk for such Acts should rather be resolved by contract interpretation. Hager reserves one exception for confiscation by an enemy country in the case of war. Here, the provisions of the passing of risk should apply since this kind of confiscation is equivalent to physical loss of the goods and since the buyer can insure against this risk. Finally, the risk of import and export bans is to be borne, in the absence of a contractual agreement, by the party who would be best able to do so. Thus, the seller would normally have to obtain an export license and the buyer would have to obtain an import license.

<sup>43</sup> This example was taken from the problem of the 17th Annual Willem C. Vis International Commercial Arbitration Moot, available at: <<http://www.cisg.law.pace.edu/cisg/moot/moot17.pdf>>.

<sup>44</sup> See Schönle, H. and Koller, T., "Commentary on Article 66," *supra* fn 14, at Art. 66 para. 2.1 (listing as Acts of State '[w]ar events, political embargos against the country of destination, expropriation and similar Acts of State').

<sup>45</sup> Benicke, C., "Commentary on Article 66" in *Münchener Kommentar zum Handelsgesetzbuch (CISG)*, 2007, C.H. Beck, Munich, at Art. 66 para. 4; Hager, G., "Commentary on Article 66," *supra* fn 2, at pp. 921-6; Romein, A., "The Passing of Risk: A comparison between the passing of risk under the CISG and German law," at Chapter I A.I.2, available at: <<http://www.cisg.law.pace.edu/cisg/biblio/romein.html#passing>>.

Hager<sup>46</sup> proposes two arguments in favour of this view. First, he suggests that the wording of Art. 66 CISG ‘loss of or damage to the goods’ shows that the passing of risk deals with the alteration of the substance of the goods themselves. By contrast, governmental measures are meant to affect the owner of the goods since governmental acts are acts in law, against which the affected owner can defend himself. They are not concerned with the goods as objects, but with the rights related to the goods, which have nothing to do with the passing of risk. Hager therefore argues that as a rule of thumb, the risk of confiscation should also be borne by the owner. The question of ownership, however, only refers to access to justice, namely which party will have standing to challenge an Act of State. Therefore, it does not influence the notion of risk.<sup>47</sup>

The second argument is that of insurability: The CISG’s rules on the passing of risk generally allocate the risk of loss or damage to the party who insures against that risk or at least can obtain such insurance. But according to Hager, it is practically impossible to obtain insurance protection against Acts of State. Consequently, if insurance coverage is not available, the Act is not a matter of risk. It is true that the goods will usually be covered by insurance during the respective time of bearing the risk.<sup>48</sup> But it would go too far to make the application of Art. 66 CISG dependent on the availability of insurance coverage for three reasons. First, Art. 66 CISG does not mention this additional criterion. In fact, the Australian Delegation at the Vienna Conference requested ‘to recognize the close relationship between the passage of risk in the goods and the need to insure those goods’ by providing that the risk should not pass to the buyer under Art. 67 CISG until it had an opportunity to insure. The Australian delegate drew attention to Art. 30(3) of the draft Convention (Art. 32(3) of the final text of the CISG), which provides that the buyer should be able to request information necessary for him to effect insurance of the goods. The request was, however, rejected.<sup>49</sup> Therefore, a criterion based on insurability would be contrary to the CISG’s legislative history.

And, risk and insurance coverage are not inextricably linked. There are various situations in which a party is not sufficiently protected by insurance – for example, when the insurer or carrier has become insolvent, or the limit of insurance coverage

<sup>46</sup> Hager, G., “Commentary on Article 66,” *supra* fn 2, at pp. 921–6; see also Bollée, S., “The Theory of Risks in the 1980 Vienna Sale of Goods Convention,” 1999–2000 Pace Review of the Convention on Contracts for the International Sale of Goods 245, at p. 273; Romein, A., “The Passing of Risk,” *supra* fn 44, at Chapter 1 A.I.2.; Valioti, Z., “Passing of Risk,” *supra* fn 9, at Chapter I.C.i.

<sup>47</sup> See Hager, G. and Schmidt-Kessel, M., “Commentary on Article 66,” *supra* fn 2, at pp. 921–6.

<sup>48</sup> See, e.g., Honnold, J. O. and Flechtner, H. M., *Uniform Law for International Sales*, *supra* fn 4, at Art. 66 para. 358.

<sup>49</sup> 1980 Vienna Diplomatic Conference, “Summary Records of Meetings of the First Committee: 3, 31st Meeting” in United Nations Conference on Contracts for the International Sale of Goods, *Official Records: Documents of the Conference and Summary Records of the Plenary Meetings and of the Meetings of the Main Committees*, A/CONF.97/19, 1991, United Nations, New York, at Art. 79 of the draft Convention [Art. 67 of the final text of the CISG], (A/CONF.97/C.1/L.227) pp. 402–3 paras. 58–

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has been reached, or the carrier is exonerated.<sup>50</sup> Yet, Art. 66 CISG applies, with an even sharper consequence: The risk of having to press a claim against the insurer becomes the definitive risk to pay.<sup>51</sup> The rules on the passing of risk are not confined to situations where the loss or damage can in fact be absorbed by insurance.

Finally, the insurability criterion would entail the strange result that the buyer would have to prove that in fact, no insurance coverage was available. As stated by Hager, it may be 'practically' impossible to insure against certain Acts of State. If 'practically' means 'with reasonable economic consequences', the question is whether insurance coverage could have been obtained without sacrificing the transaction profit. Proof would depend on extremely delicate, difficult to prove questions of fact. Therefore, an insurability criterion would also simply be impractical.

While neither ownership nor insurability are suitable to determine whether an Act of State falls within the concept of risk, the starting point of this approach – namely that Art. 66 CISG deals with the alteration of the substance of the goods themselves – is the key to the issue of legal risk and shall now be elaborated.

**3.3 ACTS OF STATE ARE NOT COVERED BY THE CONCEPT OF RISK UNLESS THEY HAVE EQUIVALENT EFFECTS TO LOSS OR DAMAGE**

According to a third approach, Acts of State are not covered by the concept of risk, except where the respective Act has an effect that is equivalent to loss of or damage to the goods.<sup>52</sup> If so, for example if the goods are permanently blocked, confiscated, destroyed or damaged by intervention of the State, the Act is covered by the concept of risk. If not, for example if an Act of State restricts or forbids the sale of the goods or refuses an authorisation necessary to conduct the transaction while leaving the goods in the possession of the seller, the Act in question is not governed by the concept of risk. In these cases, the effect of the public intervention is not equivalent to physical loss of or damage to the goods. Therefore, Art. 66 CISG does not apply and the consequences of the Act of State depend on the interpretation of the parties' obligations under the sales contract and the Convention. In the authors' view, the wording, purpose, and context of the CISG speak in favour of this approach.

The wording of Art. 66 CISG undoubtedly states the main consequence of the passing of risk, namely, that once the risk has passed to the buyer, the buyer is under an

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<sup>50</sup> Schönle, H. and Koller, T., "Vorbemerkungen zu Art. 66–70," *supra* fn 14, at Vorbemerkungen zu Art. 66 para. 3.

<sup>51</sup> U.N. Secretariat, "Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat" in United Nations Conference on Contracts for the International Sale of Goods, *Official Records*, at pp. 63–4.

<sup>52</sup> Piltz, B., *Internationales Kaufrecht*, 2008, C.H. Beck, Munich, at para. 4–270; Vulliétty, J.-P., *Le transfert des risques*, *supra* fn 3, at para. 2.171.

obligation to pay for the goods notwithstanding their subsequent loss or damage.<sup>53</sup> It is true that the text of Art. 66 CISG does not list the events that might lead to damage or loss of the goods. The wording does, however, suggest what factual circumstances may trigger the application of Art. 66 CISG – ‘loss of or damage to the goods’. Whenever reference is made to the extensive and non-exhaustive wording of Art. 66 CISG,<sup>54</sup> covering theft, emergency unloading, etc., the result is always loss of or damage to the goods. Therefore, in the authors’ view, the factual consequences of the Act of State and not the type of Act of State should be the starting point to determine whether Art. 66 CISG applies. Consequently, if an Act of State results in loss of or damage to the goods, the rules on the passing of risk should apply.

This approach accords with the context of the CISG. The provisions of the CISG need to be interpreted in the context of Art. 7 CISG.<sup>55</sup> Pursuant to Art. 7(1), in the interpretation of the CISG, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade. Promoting uniformity of application means that courts should take into account arguments contained in foreign CISG decisions and doctrine on the issue.<sup>56</sup> Relevant case law on legal risk is rare. In fact, the only case known to the authors that expressly deals with the qualification of an Act of State as ‘risk’ within the meaning of Art. 66 CISG is the so-called *Caviar Case*.<sup>57</sup>

In the *Caviar Case*, a Yugoslav company sold and delivered caviar to a Hungarian company. According to their contract, ‘the buyer [had] to pick up the fish eggs at the seller’s address and take the goods to his facilities in Hungary’. The eggs entered Hungarian customs, but one day later a UN embargo against Yugoslavia took effect in Hungary. As a result, the Hungarian authorities moved the eggs outside the bonded warehouse area and the buyer could not take delivery, clear the caviar through customs or return it to the seller, so that the caviar finally had to be thrown away as its expiry date had passed. The court held that this loss, caused by an Act of State, had to be borne by the buyer, since pursuant to the FOB Incoterm chosen by the parties, the risk had already passed to it when the embargo occurred. It is already questionable whether this case should have been solved based on the rules on the passing of risk, since the seller had already fully performed its obligations.<sup>58</sup>

<sup>53</sup> See U.N. Secretariat, “Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat,” *supra* fn 51, at pp. 63–4.

<sup>54</sup> See, e.g., Nicholas, B., “Commentary on Article 66,” *supra* fn 3, at pp. 483–4; United Nations Commission on International Trade Law, *Yearbook Volume VI*, *supra* fn 12, at p. 109.

<sup>55</sup> Huber, P. and Mullis, A., *The CISG*, 2007, Sellier, Munich, at p. 7; Schwenger, I. and Hachem, P., “Commentary on Article 7,” *supra* fn 2, at Art. 7 para. 6.

<sup>56</sup> Honnold, J. O. and Flechtner, H. M., *Uniform Law for International Sales*, *supra* fn 4, at Art. 6 para. 92; Ferrari, F., “Interpretation of the Convention and gap filling: Article 7,” *supra* fn 41, at p. 144; Schlechtriem, P., “Commentary on Article 7,” *supra* fn 2, at Art. 7 para. 10; Winship, P., “Changing Contract Practices,” *supra* fn 41.

<sup>57</sup> Arbitral award in case No. VB/96074 of the Arbitration Court of the Chamber of Commerce and Industry of Budapest (1996), available at: <<http://cisgw3.law.pace.edu/cases/961210h1.html>>.

<sup>58</sup> Benicke, C., “Commentary on Article 66,” *supra* fn 45, at Art. 66 para. 4 fn 7.

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In any event, the *Caviar Case*, although often cited as a decision in favour of a broader legal risk concept,<sup>59</sup> only provides limited guidance for future legal risk cases. It only deals with one specific legal risk situation and does not contain general guidelines as to the qualification of Acts of State as matters of risk. In the absence of comprehensive case-law, a judge will necessarily turn to doctrine on this point.<sup>60</sup> As discussed above, the view that generally considers Acts of State to be covered by Art. 66 CISG but reserves exceptions for certain categories of Acts of State entails a high risk of divergent or even contradictory decisions.<sup>61</sup> Uniform solutions to legal risk situations are more likely to be found by using a simple criterion that derives from the interpretation of Art. 66 CISG. Indeed, applying the test of equivalent effects enables any legal risk situation to be decided based on one question: Does the Act have an effect on the goods which is equivalent to their loss or damage?

The simplicity in the application of this test shall be demonstrated on the basis of two cases, namely the *Caviar Case* and the aforementioned *Moot Case*. In the *Caviar Case*, the UN embargo caused the eggs to be definitely blocked in Hungarian customs, which, in turn, meant that the eggs had to be thrown away as their expiry date had passed. Therefore, the Act of State (embargo) had an effect equal to loss of the goods, so that the rules on the passing of risk apply.

In the *Vis Moot* case mentioned above, seller and buyer contracted for water pumps for use in a third country to be delivered to the buyer's country. The pumps contained beryllium, a hazardous element. The contract contained a warranty for public law regulations and an Incoterm allocating the risk for import licenses to the buyer. The military regime in the country of destination passed a decree that prohibited the import or manufacture of products containing any amount of a number of chemical elements, including beryllium. The buyer could, however, place the goods in its warehouse. In this situation, the buyer remains in possession of technically flawless pumps. The Act of State (military decree) does not have an effect equal to loss of or damage to the goods. Consequently, not the rules on the passing of risk, but the interpretation of the seller's contractual warranty and the buyer's remedies that may result therefrom determine who bears the 'risk' of this intervention.

How and when a seizure of durable goods amounts to a loss of the goods is a different question. One could imagine, for example, that the military regime in the *Vis Moot* scenario had confiscated and safely stored the pumps. In this scenario, according to the approach of equivalent effects, the risk passing rules will apply in case the pumps are definitely blocked. After having thereby determined when the risk passing rules should apply, the question whether the pumps were in fact definitely blocked remains a question of fact. One can imagine a situation in which the military regime decided it

<sup>59</sup> See Hager, G. and Schmidt-Kessel, M., "Commentary on Article 66," *supra* fn 2, at pp. 921–6; Huber, P., "Commentary on Article 66," *supra* fn 22, at Art. 66 para. 7 fn 9.

<sup>60</sup> See Ferrari, F., "Interpretation of the Convention and gap filling: Article 7," *supra* fn 41, at p. 144; Oberster Gerichtshof 2 Ob 100/00w (2000) 2000 Recht der Wirtschaft 506.

<sup>61</sup> See *supra* Part 3.1.

would not under any circumstance release the goods. In this case, the goods are indeed definitely blocked, thus amounting to a loss. But one may also imagine that the regime was willing to release the goods under certain conditions. In this case, the question whether the seller omitted to take the necessary steps to have the goods released becomes decisive; it has to be dealt with under Art. 66 CISG *in fine*. The same considerations apply to the question of whether an embargo is permanent or how long one has to search for missing goods before they can be considered definitely lost.

To sum up, the approach of equivalent effects to loss of or damage to the goods avoids unnecessary categorisations and criteria and provides comfort of justice even in complex legal risk situations.

Finally, this approach is also consistent with the purpose of Art. 66 CISG. This means enquiring as to when it is appropriate to allocate the parties' risk through the rules on the passing of risk, and when it makes sense to allocate risk through contractual remedies. A law-and-economics analysis may serve to enhance our understanding of the function of Art. 66 CISG.<sup>62</sup>

The arguments on the application of Art. 66 CISG put forth by the different authors more or less expressly take into account economic considerations, including most directly Hager's 'insurability argument'. In assessing legal provisions, an economic analysis takes into consideration the efficiency of a provision.<sup>63</sup> Concerning the CISG, it aims at determining whether its rules maximise contractual value for parties engaged in international trade.<sup>64</sup> The theories of economic efficiency are all encompassed by the idea that nothing more can be achieved given the resources available.<sup>65</sup> These considerations shall now be applied to legal risk situations.

On the one hand, if the goods are indeed accidentally lost, the parties' resources will not be available at all. If the goods are accidentally damaged after the risk has passed to the buyer, none of the parties to the sales contract can be held responsible. This follows from Art. 36(1) CISG, which states that the seller is only liable for a lack of conformity that exists at the time when the risk of loss of the goods passes to the buyer. Conversely, if the lack of conformity came into existence after the passing of risk, the seller is not liable for the obligation to deliver conforming goods pursuant to Art. 35 CISG. Thus, if the goods are accidentally lost or damaged, contractual provisions cannot provide incentives to influence the seller's behaviour.<sup>66</sup> Accordingly, the rules on the passing of risk do not serve the function of efficiency,

<sup>62</sup> See Cenini, M. and Parisi, F., "An Economic Analysis of the CISG" in Janssen, A. and Meyer, O. (eds), *CISG Methodology*, 2009, Sellier, Munich, at pp. 151–70.

<sup>63</sup> Posner, R. A., *Economic Analysis of Law*, 1986, Little, Brown and Company, Boston, at p. 21; Schäfer, H.-B. and Ott, C., *Lehrbuch der ökonomischen Analyse des Zivilrechts*, 1995, Springer, Berlin, at p. 1.

<sup>64</sup> Di Matteo, L. A. and Ostas, D. T., "Comparative Efficiency in International Sales Law" (2011) 26 *American University International Law Review* 371; Katz, A. W., "Remedies for breach of contract under the CISG" (2006) 25 *International Review of Law and Economics* 378, at p. 379.

<sup>65</sup> See, e.g., Posner, R. A., *Economic Analysis of Law*, *supra* fn 63, at p. 12.

<sup>66</sup> See Schäfer, H.-B. and Ott, C., *Lehrbuch der ökonomischen Analyse*, *supra* fn 63, at p. 372.

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but only that of risk distribution.<sup>67</sup> The risk distribution often determines which party will have to press a claim against the insurer.<sup>68</sup> Where insurance coverage is absent or inadequate – which might be the case for certain legal risk situations – the distribution of the risk has an even sharper impact.<sup>69</sup> It is then that the seller's risk of having to perform again or the buyer's definitive risk to pay arise. In all these situations, Art. 66 CISG provides clear-cut and sometimes seemingly harsh results by strictly allocating the risk to one of the parties.

On the other hand, if the parties still have access to the goods and one party is responsible for their legal impairment, value can be maximised. The parties' contract can promote efficiency by setting up a comprehensive system of incentives. For instance, the seller might have given a special warranty for public law regulations in the country of destination. The warranty may in turn entitle the buyer to a price reduction (Art. 48 CISG), contract avoidance (Art. 49 CISG) or other remedies enumerated in Art. 45(1) CISG. Where export of the goods is possible but costly, the parties may have agreed for the seller to bear the export costs by using an Incoterm.<sup>70</sup> In those situations, the default risk distribution<sup>71</sup> envisaged by Art. 66 CISG is inappropriate.

The criterion of equivalent effects reflects the foregoing considerations since it only applies Art. 66 CISG when risk distribution instead of efficiency is appropriate – solely when the respective Act of State has an effect that is equivalent to loss of or damage to the goods. Therefore, this criterion is decisive to limit the application of Art. 66 CISG to situations that correspond with the purpose of the CISG's rules on the passing of risk.

#### 4 CONCLUSION

After more than seventy-five years of debate on the concepts of risk in uniform sales law, it is undisputed that Art. 66 CISG ('loss of or damage to the goods') covers physical impairment of the goods. As regards Acts of State, three different approaches can be distinguished, namely that Acts of State are generally covered by the concept of risk; that they are generally not covered by the concept of risk; and finally, that they are not covered except where the respective Act has an effect which is equivalent to loss of or damage to the goods. In the authors' view, the approach of equivalent effects to loss of or damage to the goods is preferable since it provides a simple

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<sup>67</sup> Schönle, H. and Koller, T., "Vorbemerkungen zu Art. 66–70," *supra* fn 14, at Vorbemerkungen zu Art. 66 para. 3; Schlechtriem, P., *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods*, 1986, Manz, Vienna, at p. 85.

<sup>68</sup> Piltz, B., *Internationales Kaufrecht*, *supra* fn 52, at para. 4–270.

<sup>69</sup> U.N. Secretariat, "Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat," *supra* fn 51, at pp. 63–4.

<sup>70</sup> One example of such a clause is the Incoterms A2 clause. See International Chamber of Commerce, *Incoterms 2000*, *supra* fn 29.

<sup>71</sup> For a cost of contracting analysis of default rules, see Korobkin, R., "The Status Quo Bias and Contract Default Rules" (1998) 83 *Cornell Law Review* 608.

criterion that conforms with the wording and purpose of Art. 66 CISG and thereby provides uniform and reasonable solutions to the qualification of Acts of State as matters of risk in the future. Therefore, the authors suggest that Art. 66 CISG does not cover Acts of State, except where the respective Act results in loss of or damage to the goods.