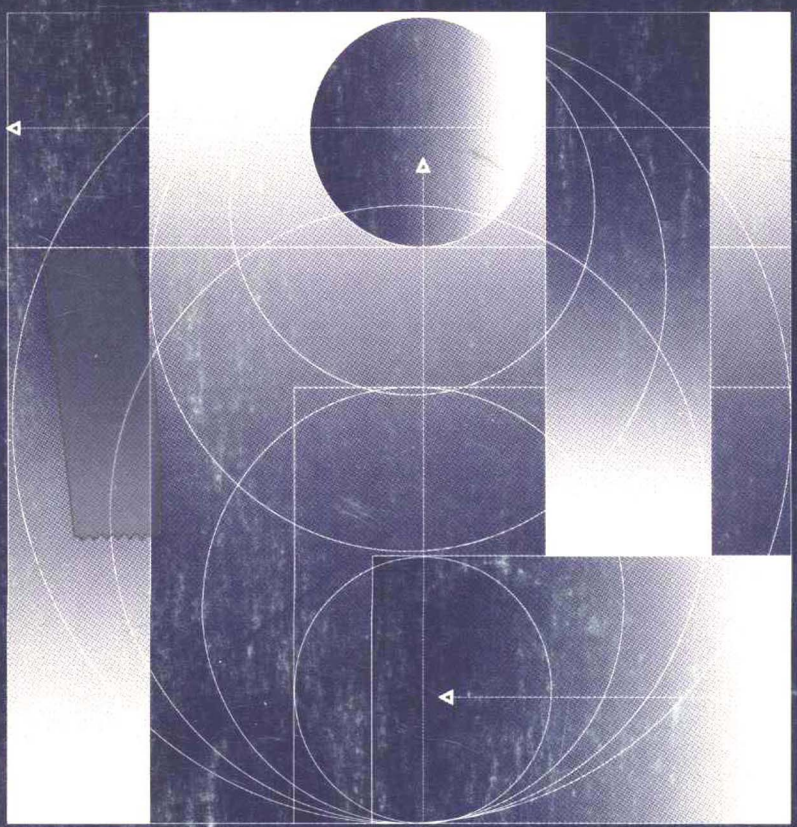
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

LEGAL ASPECTS OF INTERNATIONAL TRADE



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Legal aspects of international trade

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EXECUTIVE SUMMARY

This report focuses on the legal framework underlying export-import transactions and examines the risks inherent in international trade and the means by which they can be contained. It reviews the most frequent legal problems that arise from the sale of goods when the seller and the buyer are based in different countries.

After the provisions governing the international sales of goods have been introduced, the nature and functions of international commercial terms, or "Incoterms", are discussed. These are internationally standardized definitions setting out the rights and responsibilities of the exporter and the importer regarding the arrangements and payment for the delivery of goods in international transactions. The report then describes the different ways of ensuring that the main contractual obligations under the sale transaction are respected and, in particular, that the promised goods and services are delivered by the seller and the agreed payment is made by the buyer. The principal instruments to secure payment (documentary credits and documentary collections) and performance of the contract (bank guarantees) are therefore described.

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INTRODUCTION

1. A typical trade transaction starts with a contract of sale. A seller and a buyer agree a price for a specified quantity and type of goods to be purchased under specified terms and conditions. From the buyer's point of view the legal objective of such a contract is to obtain ownership of the goods, and from the seller's to receive the price. Thus the essence of the contract is the transfer of property in goods for financial consideration.[1]

2. Like any other contract, a contract of sale depends on an agreement—between the seller and the buyer—which is usually shown by the acceptance of an offer.[2] The contract of sale of goods is characterized in a majority of countries by the principle of "freedom of contract": the parties are free to fix the terms and conditions of the contract of sale—what prices will be charged, how payment will be handled, who will bear which costs of delivery, who will support which risks—subject to the general principles of law and to domestic legislation governing unfair contract terms.

3. The contract of sale has been characterized as the "master" contract[3] since the series of contractual arrangements which follow—as regards transport, insurance and payment—should accord with its provisions. Thus to avoid unwanted disputes and litigation it is essential that the contract of sale is carefully drafted and that specific reference is made to existing trade terms, like the current Incoterms (see chapter II), when stipulating the delivery point and the allocation of rights and responsibilities between the buyer and the seller. Moreover, if payment is to be by letter of credit (see chapter III), the requirements under the credit need to be clearly spelt out.

4. International sales of goods differ from domestic sales in a number of ways: they generally involve long distances—during which the goods are in the custody of the carrier—the risks involved in such transit are greater, and the transaction is normally irreversible, in that the physical return of the goods to the seller is in practice unlikely to be a realistic option. Furthermore, because of its nature, the transaction might be subject to a number of different jurisdictions with diverse legal systems. To cope with these problems, the business community has developed a number of standard contracts[4] and rules which cater for the peculiar needs of international commerce.[5]

5. It is the purpose of this report to familiarize readers with some of the most important tools used in international trade to:

(*a*) Allocate the rights and responsibilities of exporters and importers regarding the arrangements and payment for the delivery of the goods (chapter II);

(*b*) Secure the payment by the buyer of the merchandises contracted (chapter III);

(*c*) Protect the buyer against the non-performance of the contractual obligations by the seller (chapter IV).

6. The information provided in this report is not easily accessible to many developing countries and countries with economies in transition. It is believed that awareness of the legal aspects involved in international transactions will assist these countries in conducting international trade more efficiently. Other important issues such as transport and insurance will be dealt with in the second part of this report by the UNCTAD secretariat.

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[1] An exchange of goods is not therefore a contract for the sale of goods but a barter. Likewise a gift for no consideration is not a contract of sale. See P. Sellman, *Law of International Trade*, 7th ed., HLT Publications, 1996, p. 2, London.

[2] The rules as regards the making and communication of offer and acceptance and the revocation and termination of offers are common to all contracts, and may be found in general works on the law of contracts. See, for example, Benjamin, *The Sale of Goods*, Sweet and Maxwell, 1981, p. 22, London.

[3] G. Jiménez, *ICC guide to export-import basics*, Paris, ICC Publication No. 543, 1997, p. 34.

[4] One of the most recent standard contracts is the ICC Model International Sale Contract (1997 edition) for the sale of manufactured goods intended for resale.

[5] C. Debattista, *Sale of Goods Carried by Sea*, Butterworths, 1990, p. 1, London.

Chapter I

INTERNATIONAL SALE OF GOODS

7. Contracts of sale are governed by either national law—the law of the domicile of the seller or the buyer—or by an international treaty, the United Nations Convention on Contracts for the International Sale of Goods (CCISG—described below). Since the CCISG and most national laws are based on the customs of the business community (the *lex mercatoria*[6]) it is not surprising that they exhibit a great degree of similarity. It is precisely for this reason that we will briefly review the main provisions of the Convention.[7]

A. International regulation of the sale of goods

8. Preparation of a uniform law for the international sale of goods began in 1930 at the International Institute for the Unification of Private Law (UNIDROIT) in Rome. It was felt at the time that it would be of great value to the international business community to unify the law relating to international sales, to avoid providing different answers to questions such as when an offer or acceptance becomes effective, when possession, property or risk in the goods sold passes, what the rights of a buyer are when goods not conforming to the contract are tendered, and similar questions.[8] After a long interruption in the work as a result of the Second World War, a draft was finally submitted to a diplomatic conference in The Hague in 1964, which adopted two conventions, the Convention relating to a Uniform Law on the International Sale of Goods and the Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods.

9. Almost immediately upon the adoption of the two conventions, there was widespread criticism of their provisions as reflecting primarily the legal traditions of continental western Europe. One of the first tasks undertaken by the United Nations Commission on International Trade Law (UNCITRAL) upon its establishment in 1968 was to study the two conventions to ascertain which modifications might render them capable of wider acceptance by countries of different legal, social and economic systems. The result of this study was the adoption by diplomatic conference on 11 April 1980 of the United Nations Convention on Contracts for the International Sale of Goods,[9] which combines the subject matter of the two prior conventions.[10]

B. Application of the United Nations Convention on Contracts for the International Sale of Goods

10. Six forms of sale are excluded from the Convention according to article 2, the so-called "consumer contract" (goods bought for personal, family or household use), unless the seller at any time before, or at the time of, the conclusion of the contact neither knew, nor ought to have known, that the contract was a consumer contract. Also excluded are sales by auction and on execution or otherwise by authority of law. The nature of the goods is the basis for three further exclusions: the sale of securities, the sale of ships and aircraft, and the sale of electricity.[11]

11. Article 1 (1) provides for the Convention to apply to contracts of sales of goods between parties whose places of business are in different States when either both of those States are contracting States or the rules of private international law lead to the law of a contracting State. Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be

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[6] Among the most authoritative definitions of the *lex mercatoria* are the following: "A set of general principles, and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular system of law" (B. Goldman, *Contemporary Problems in International Arbitration*, 1983, p. 116); "A single autonomous body of law created by the international business community", (B. M. Cremades and S. L. Plehn, "The New Lex Mercatoria and the Harmonization of the Laws of International Commercial Transactions", *1984, Boston University, International Law Journal*, p. 324). See also Lord Justice Mustill, *The New Lex Mercatoria: The First Twenty-five Years*, Liber Amicorum for the Rt. Hon. Lord Wilberforce, edited by M. Bos and I. Brownlie, Oxford, Clarendon Press, 1987, pp. 149-183.

[7] Cf. footnote 4 above. Failing contrary agreement between the parties, the ICC Model International Sale Contract subjects the transaction to the CCISG, which, for ease of reference, is appended to the model contract as annex 1. By means of this incorporation of the CCISG into the model contract, the Convention will apply whether or not the countries of the seller and buyer have ratified the Convention.

[8] C. M. Schmitthoff, *The Law and Practice of International Trade* (9th ed.), Stevens and Sons, 1990, p. 240, London.

[9] The CCISG came into force on 1 January 1988. As at 1 January 1998 the Convention applied in 51 States in different parts of the world and with different economic and legal systems. According to the "Shipping, Transport, Marine Insurance and International Trade Newsletter" of Dibb Lupton Alsop, (March 1998), the States which have adopted the Convention to date are responsible for more than 60 per cent of the total volume of worldwide trade.

[10] See explanatory note by the UNCITRAL secretariat on the United Nations Convention on Contracts for the International Sale of Goods (http://www.un.org@UNCITRAL).

[11] H. van Houtte, *The Law of International Trade*, London, Sweet and Maxwell, 1995, p. 126.

taken into consideration in determining the application of the Convention.

12. According to article 6, the parties may exclude the application of the CCISG or derogate or vary its effect. Parties may also negotiate different clauses in their contract. Moreover, usages which are customary between the parties and any practices which have developed in their relationship take precedence over the rules of the CCISG.[12] Even usages which reasonable people would normally consider to be part of their contract take precedence over the provisions of the Convention.[13]

13. Parties may furthermore agree that the CCISG shall only apply in part and that they will derogate from some other CCISG provisions or alter their legal effect. The basic principle of the Convention is that, subject to one exception, the parties should be free to exclude its terms in whole or in part (article 6). The exception relates to the requirement of writing. The Convention provides that a contract does not have to be concluded, evidenced or varied in writing (article 12).[14] Article 96, however, allows a State whose laws do have such a requirement to make a declaration that this rule is not to apply when any party to the contract has his place of business in that State. In that case, the requirement of writing cannot be excluded.[15]

14. Finally, the CCISG is not applicable to the capacity of the parties, the formal validity of the contract, the transfer of ownership and the legal effects of the contract in respect of third parties.[16]

15. Pursuant to article 92, contracting States may exclude the application of part II (formation of an international contract of sale) or part III (substantive rules).[17]

C. Formation of the contract

16. Part II of the CCISG defines how and when an international contract of sale comes into existence. Thus, in accordance with article 23: "A contract is concluded at the moment when an acceptance of an offer becomes effective in accordance with the provisions of this Convention".

1. *Offer*

17. An "offer" is a statement intended to result in a binding contract if duly accepted by the offeree. It is defined in the Convention as: "a proposal for concluding a contract addressed to one or more specific persons . . . if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance. A proposal is sufficiently definite if it indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and the price." (article 14 (1)) Thus the seller should make certain that the essential elements of the contract are clearly stated in the communications exchanged by the parties. The sending of price lists, catalogues and so on are in principle not offers.

18. The offer is effective as soon as it reaches the offeree (article 15 (2)). The offeror may still withdraw his offer if the withdrawal reaches the offeree before or at the same time as the offer (article 15.2). After the offer has reached the offeree, but before the acceptance has been dispatched, the offer may still be revoked, unless it was irrevocable, or could be considered by the offeree to be irrevocable (article 16).

19. An offer, even if it is irrevocable, is terminated when a rejection reaches the offeror (article 17).

2. *Acceptance*

20. An "acceptance" is defined as a statement made by, or other conduct of, the offeree that indicates assent to an offer. Actions of the acceptor, such as dispatch of goods or payment of the price, may indicate an implied acceptance. Silence or inactivity does not in itself amount to acceptance (article 18). Article 19 deals with the so-called "battle of forms" between the offeror and offeree, when there is a discrepancy between the conditions offered and those accepted. The article reads as follows:

> (1) A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.
>
> (2) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects orally to the discrepancy or dispatches a notice to that effect. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.
>
> (3) Additional or different terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.

D. Obligations and remedies of seller and buyer

21. Part III of the CCISG regulates the respective rights and obligations of buyers and sellers. A fundamental breach of contract is defined in the Convention (article 25) as a breach that results in such a detriment to the other

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[12] When the seller and the buyer have agreed on a trade term, such as free on board (FOB) or cost, insurance and freight (CIF), the regulation intended by that term takes precedence over the provisions of the Convention. Further, the Convention does not prevent the parties from agreeing on a uniform interpretation of the trade terms by embodying into their contract Incoterms or a similar text. See C. Schmitthoff, op. cit., pp. 245-246.

[13] The standard contracts of the Federation of Oils, Seeds and Fats Associations (FOSFA) and the Grain and Feed Trade Association (GAFTA) include the following clause: "The following shall not apply to this contract: (*a*) the uniform law on sales (. . .); (*b*) the United Nations Convention on Contracts for the International Sale of Goods (. . .)". (Van Houtte, op. cit., p. 127.)

[14] To warn traders of the dangers of contracts based on a "handshake" or a "gentlemen's agreement" the following humorous definition is provided of a gentlemen's agreement: "An unwritten agreement, not a contract, between two parties—neither of which may be a gentleman—under which each party believes the other side is fully bound, while its own performance is strictly optional" (Jiménez, op. cit., p. 33).

[15] Clifford Chance, "The UN Convention on Contracts for the International Sale of Goods", *Maritime Review*, October 1991, No. 8, p. 18.

[16] Van Houtte, op. cit., pp. 127-128.

[17] Ibid., p. 128.

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.

1. *Obligations of the seller*

22. The basic obligation of the seller, as set out in article 30, is "to deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and this convention". In general, the seller must deliver goods that are of the quantity, quality and description required by the contract and that are contained or packaged in the manner agreed.

23. The Convention provides supplementary rules (in the absence of contractual agreement) as to when, where and how the seller must perform its obligations. One set of rules of particular importance involves the seller's obligation to deliver goods that are free from any right or claim of a third party, including rights based on industrial property or other intellectual property.

24. In connection with the seller's obligations in regard to the quality of the goods, the Convention contains provisions on the buyer's obligation to inspect the goods. He must give notice of any lack of their conformity with the contract within a reasonable time after he has discovered it or ought to have discovered it, and at the latest two years from the date on which the goods were actually handed over to the buyer, unless this time-limit is inconsistent with a contractual period of guarantee (article 39).[18]

2. *Remedies available to the buyer*

25. If the seller fails to perform any of his obligations the buyer may, depending on the circumstances, resort to the following remedies:[19]

(a) *Request for specific performance*: as provided for in article 46, the buyer may require performance by the seller of his obligations or, if the goods do not conform with the contract, the buyer may require delivery of substitute goods (but only if the lack of conformity constitutes a fundamental breach of contract);

(b) *Time extension and right to cure*: the buyer may fix an additional period of time of reasonable length for performance by the seller of his obligations. The buyer may not, during that period, resort to any remedy for breach of contract. However, the buyer is not deprived thereby of any right he may have to claim damages for delay in performance (article 47);

(c) *Avoidance of the contract*: as provided for in article 49, the buyer may declare the contract avoided: (*a*) if the failure by the seller to perform any of his obligations under the contract amounts to a fundamental breach of contract, or (*b*) in case of non-delivery of the goods;

(d) *Reduction of the price*: as provided for in article 50, if the goods do not conform with the contract and whether or not the price has already been paid, the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time.[20]

3. *Obligations of the buyer*

26. The basic obligation of the buyer is (*a*) to pay the price for the goods and (*b*) take delivery of them as required by the contract (article 53).

(*a*) The obligation to pay covers three elements:[21]

(i) *The determination of the price*: although in principle the price is determined in the contract, in the absence of the same, the parties are considered to have made an implied reference to the price generally charged at the time of conclusion of the contract for such goods sold under comparable circumstances in the trade concerned (article 55);

(ii) *The place of payment*: the price must be paid at the seller's place of business or if the payment is to be made against the handing over of the goods or of documents, at the place where the handing over takes place (article 57);

(iii) *The moment of payment*: in the absence of an agreed time for payment the buyer must pay the price at the moment the seller places either the goods or documents controlling their disposition at the buyer's disposal (article 58 (1)). If the contract involves the carriage of goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer except against payment of the price (article 58 (2)) unless the contract states otherwise the buyer is not bound to pay the price until he has had the opportunity to examine the goods (article 58 (3)).

(*b*) *Taking delivery*: article 60, specifically provides that the buyer's obligation to take delivery consists in (*a*) doing all the acts which could reasonably be expected of him in order to enable the seller to make delivery, and (*b*) taking over the goods. If the buyer does not take delivery he breaches the contract, which may make him liable for any damage to the goods.

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[18] See explanatory note by the UNCITRAL secretariat on the United Nations Convention on Contracts for the International Sale of Goods, op. cit., p. 57.

[19] By exercising his right to other remedies, the buyer is not deprived of any right he may have to claim damages (article 45 (2)). *The whole thrust of the Convention is on preserving the contract, and not permitting one party or the other to set the contract aside for a relatively minor breach.* This is achieved by disregarding the common law distinction between conditions and warranties. The right of one party or the other to avoid the contract depends particularly upon there having been a fundamental breach. See Clifford Chance, op. cit., p. 20.

[20] This remedy is new to common law. Its advantage is said to be that it enables the buyer to resolve his problem without the need to resort to a court. In many cases, however, this will not be practicable. If payment is made against an irrevocable letter of credit, it will be impossible to reduce the price before payment. Payment will have to be made under protest and reclaimed later (ibid., p. 21).

[21] See Van Houtte, op. cit., pp. 141-142.

4. *Remedies available to the seller*

27. The general pattern of remedies is the same as those available to the buyer: he may require the performance of an obligation, declare the contract avoided and claim damages.[22]

(a) *Request for specific performance*: pursuant to article 62, the seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with this requirement. The seller may allow the buyer an additional period of time of reasonable length for performance by the buyer of his obligations (article 63 (1)).

(b) *Avoidance of the contract*: the seller may declare the contract avoided (article 64) (*a*) if the failure by the buyer to perform any of his obligations amounts to a fundamental breach of contract, or (*b*) if the buyer does not, within the additional period of time fixed by the seller perform his obligation to pay the price or take delivery of the goods, or if he declares that he will not do so within the period so fixed.

E. Passing of risk

28. A question of risk will arise when the goods which have been agreed to be sold are lost, damaged, destroyed or deteriorated and it is necessary to decide whether the seller or the buyer shall bear the loss.[23]

29. Pursuant to article 66 of the Convention:

> 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.

30. Parties may stipulate a specific clause for the passing of risk in the contract or they may include it implicitly by referring to an Incoterm. If nothing has been agreed, the supplementary rules of the Convention will apply.[24]

31. The general rule under the Convention is that except for contracts of sales involving carriage the risk passes to the buyer upon delivery 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 the 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 (article 69 (2)). 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 (article 69 (3)). For a contract of sale involving carriage the following rules apply (articles 67 and 68):

> (1) 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. 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. The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of the risk.
>
> (2) Nevertheless, the risk does not pass to the buyer until the goods are clearly identified to the contract, whether by markings on the goods, by shipping documents, by notice given to the buyer or otherwise.
>
> The 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 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.

F. Common provisions for seller and buyer

1. *Anticipatory breach*

32. If, after concluding the contract of sale, it appears that a party will be unable to perform a substantial part of his obligations, the other party may:

(a) *Suspend the performance*: a party may suspend the performance of his obligations if, after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of (i) a serious deficiency in his ability to perform or in his creditworthiness, or (ii) his conduct in preparing to perform or in performing the contract (article 71). A party suspending performance, whether before or after dispatch of the goods, must immediately give notice of the suspension to the other party and must continue with performance if the other party provides adequate assurance of his performance.

(b) *Avoid the contract*: if prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided. If time allows, the party intending to declare the contract avoided must give reasonable notice to the other party in order to permit him to provide adequate assurance of his performance (articles 72 and 73).

2. *Damages*

33. Damages are due when there is:

(*a*) a breach of contract;

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[22] Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. See articles 74 to 77 of the CCISG and footnote 19, above.

[23] As a general rule the risk of the loss is, prima facie, in the person in whom the property is "res peri domino". (See Benjamin, op. cit., p. 402).

[24] Van Houtte, op. cit., p. 144.

(*b*) a loss suffered by the other party; and

(*c*) a causal link between the breach of the contract and the loss.[25]

34. Damages for breach of contract include the loss of profit. Such damages may not exceed the loss which the party in breach foresaw, or should have foreseen, at the time of the conclusion of the contract (article 74). The party claiming damages must take all reasonable measures to mitigate the loss (article 77).

3. *The exemption of* force majeure

35. A party is not liable for failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control. The impediment should be unforeseeable at the time of the conclusion of the contract (article 79 (1)). The exemption is only temporary: it only applies during the time the impediment exists (article 79 (3)).

[25] Van Houtte, op. cit., p. 146.

4. *Preservation of goods*

36. The Convention imposes on both parties the duty to preserve any goods in their possession belonging to the other party. Such a duty is of great importance in an international sale of goods where the other party is from a foreign country and may not have agents in the country where the goods are located. Under certain circumstances the party in possession of the goods may sell them. A party selling the goods has the right to retain out of the proceeds of sale an amount equal to the reasonable expenses of preserving the goods and of selling them and must account to the other party for the balance.[26]

[26] See explanatory note by the UNCITRAL secretariat of the United Nations Convention on Contracts for the International Sale of Goods, op. cit., p. 60.

Chapter II

INCOTERMS

37. Those engaged in international trade and commerce prefer standardization of their contract provisions. By doing so, costs and risks can be calculated more accurately and easily, and the number of disputes inherent in any business transaction reduced to a minimum. The techniques and methods adopted to achieve this have varied and have ranged from the formulation of standard contracts affecting only a particular industry or trade,[27] sometimes categorized as "vertical standardization", to standardization of terms that affect the entire business irrespective of the commodity traded, or "horizontal standardization".[28] The latter type of standardization has primarily taken place in the area of trade terms.

38. Trade terms are primarily designed to define the method of delivery of the goods sold and to delimit the rights and duties of seller and buyer with regard to the following:

(*a*) Who will arrange and pay for the carriage of the goods from one point to another?

(*b*) Who will bear the risk if these operations cannot be carried out?

(*c*) Who will bear the risk of loss of or damage to the goods in transit?

All of these questions are concerned with actually getting the goods from the seller to the buyer.

39. Although universally recognized, trade terms might be interpreted differently in various countries and their meaning may be modified by agreement of the parties, the custom of a particular trade or the usage prevailing in a particular port.

40. Incoterms (international commercial terms) are among the most important and universally recognized international trade terms. Incoterms are internationally standardized definitions that have been prepared by the International Chamber of Commerce (ICC), setting out the rights and responsibilities of exporters and importers regarding the arrangements and payment for the delivery of the goods in international sales.

41. Incoterms do not cover all possible legal or transport issues arising out of an international sale, but are a sort of contractual shorthand which allows the parties to easily specify their undertaking as to:

(*a*) The transport costs which the seller will cover;

(*b*) The point at which risk of loss will be transferred from seller to buyer;

(*c*) Who must handle customs formalities and pay duties;

(*d*) Insurance coverage, if any.

42. The purpose of Incoterms is therefore to provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade. Thus the uncertainties of different interpretations of such terms in different countries can be avoided or at least reduced to a considerable degree.[29]

A. Development of Incoterms

43. The history of Incoterms[30] dates all the way back to the 1920s, when the ICC noticed with concern that FOB in one country did not mean the same thing in another country. The ICC began to research these different interpretations and discovered that despite the differences, there was a great deal of agreement. Common trade terms were standardized in 1936 with the first edition of *Incoterms*, which was subsequently revised in 1953, 1967, 1976, 1980 and 1990.

44. It was not until 1980 that the ICC changed its approach of merely revising the existing terms and practices to seek the common denominator in the interpretation of the terms. Since 1980, new terms as well as amendments to existing terms have been included in *Incoterms* to suit changing circumstances in different trades, such as the trend towards an increase of cargo unitization compared with traditional cargo handling at the ship's side.[31] It was precisely this trend that made certain traditional practices obsolete. Thus, the ship's rail—once the traditional "critical point" under the FOB, CFR (cost and freight) and CIF terms—was no longer suitable as the point for the division

[27] C. Schmitthoff, "The unification or harmonization of law by means of standard contracts and general conditions", *International and Comparative Law Quarterly*, vol. 17, July 1968, pp. 551-570.

[28] This classification was first suggested by Eisemann. See F. Eisemann, "Incoterms and the British export trade", *Journal of Business Law*, 1965, pp. 114-116, and D. M. Sassoon "Trade terms and the container revolution", *Journal of Maritime Law and Commerce*, October 1969, vol. 1, No. 1, p. 73.

[29] ICC, *Incoterms 1990*, Paris, ICC Publication No. 460, p. 6.

[30] See F. Eisemann and Y. Derains, *La pratique des Incoterms: objet et histoire des Incoterms*, ICC Publication No. 453, 1988, pp. 3-9.

[31] The 1980 edition of *Incoterms* contained two new terms: "Free carrier" [named point] and "Freight or Carriage and Insurance paid to" (ICC, "Revision of Incoterms", ICC Document No. 460/234, 1978).

of functions, costs and risks between sellers and buyers.[32] Costs relating to the time after the receipt by the carrier and before the loading of the cargo will normally be included in the freight and, therefore, it becomes more or less impossible to identify precise cost distribution at the ship's rail. In addition since a key function of the transport document is to evidence the "good order and condition" of the goods, it should be issued at a point where the carrier has reasonable means of conducting a check. In modern transport operations this point has shifted from the ship's rail to seaport or inland terminals, where the goods are frequently stowed in containers or trailers, or on flats or pallets. As a result, a "received for shipment" type of document was developed as an alternative to the traditional on-board bill of lading. The new transportation techniques and the changed documentary practices received special attention in the 1980 revision of *Incoterms*.[33]

45. In order to bring the rules in line with current international trade practice, *Incoterms* was last revised in 1990. The main reason for this revision was the desire to adapt terms to the increasing use of electronic data interchange (EDI) and changed transportation techniques, particularly the unitization of cargo in containers, multimodal transport and roll-on/roll-off traffic with road vehicles and railway wagons in short sea maritime transport. In connection with the substantive changes made, the terms have been grouped in four basically different categories for easier reading and understanding.[34]

B. The legal nature of Incoterms

46. Incoterms are contractual trade usages,[35] universally accepted by all trading countries and derived from the *lex mercatoria*.[36] They are not statutory trade usages which have force of law by virtue of a national enactment or a measure of delegated legislation. That is the reason by which merchants wishing to use them should specify that their contracts be governed by *Incoterms 1990* or by the latest Incoterms version. Furthermore, it should be kept in mind that Incoterms do not exist in a vacuum; although they provide a skeleton of terms, these terms can only survive within the body of a contract of sale.

47. Incoterms are not the only example of standardized trade terms. In fact, rules of interpretation similar to those contained in Incoterms have been established in different countries and regions of the world. The most relevant ones are the following:

(a) *The American Foreign Trade Definitions* that appeared in the United States in 1919 and which were last revised in 1941. The definitions do not have the status of law but sellers and buyers may adopt them as part of their contracts of sale. These trade definitions have apparently not been used by the trade organizations of the United States since 1980.

(b) *The Rules of Warsaw and Oxford* that were proposed by the International Law Association in 1932.

(c) *The General Conditions for Delivery of Merchandise* which were developed in 1968 in the Council for Mutual Economic Assistance (for the former Soviet Union and some countries in Eastern Europe) and revised on 1 January 1976.

(d) *Combiterms*,[37] which were proposed in 1969 to simplify the division of costs and risks between the parties, by introducing code numbers for the cost units contained in the trade terms. Under each trade term it is then resolved which of the seller and the buyer shall bear each cost unit. This was deemed to be particularly important for the traffic of consignments insufficient to make up a full load for a wagon, truck or container and which therefore had to be grouped together with other consignments belonging to different shippers or consignees (cargo consolidation). The advantages of this system are obvious, since the placing of the cost units on either the seller or the buyer is determined in advance and there is no room for a subsequent dispute between the seller and the buyer provided, of course, that all costs arising are correctly included in the cost units.[38]

C. The current Incoterms

48. The 1990 version of the Incoterms has introduced a very clear and easy to understand presentation called the "mirror-method". This means that every responsibility of the buyer is placed next to the corresponding responsibility of the seller. These responsibilities or obligations are grouped under 10 numbered articles, divided into two parallel series, one for the seller's responsibilities, and one for the buyer's responsibilities (see table 1).

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[32] According to Lord Devlin, "Only the most enthusiastic lawyer could watch with satisfaction the spectacle of liabilities shifting uneasily as the cargo sways at the end of a derrick across a notional perpendicular projecting from the ship's rail" (*Pyrene Co. Ltd.* v. *Scindia Navigation Co. Ltd.* (1954) 2QB 402, p. 419).

[33] ICC, *Guide to Incoterms: The Impact of Modern Transport* (1980 edition) ICC Publication No. 354, pp. 8-9.

[34] ICC, *Incoterms 1990: why new Incoterms?* ICC Publication No. 460, p. 6.

[35] Although there is not a single definition of "trade usage", research carried out in 1980 by the ICC Institute of International Business Law and Practice on the interpretation and application of international trade usages, revealed a considerable degree of unanimity in the understanding of this term. Thus it is thought that the uniformly accepted features of a trade usage are as follows: "A trade usage is a method of dealing or a way of conduct generally observed in a particular line of business with such regularity that it is accepted as binding by those engaged in that line of business". For a comprehensive classification of international trade usages see C. M. Schmitthoff, "International trade usages", *Newsletter of the Institute of International Business Law and Practice*, September 1987, ICC Publication No. 440/4, pp. 26-30.

[36] The *lex mercatoria* has been defined as "a set of general principles, and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular national system of law" and "a single autonomous body of law created by the international business community" (Lord Justice Mustill, op. cit., p. 151). See also B. Goldman, "The applicable law: general principles of law—the lex mercatoria", *Contemporary Problems in International Arbitration*, Dordrecht, Martinus Nijhoff, 1987, pp. 113-125.

[37] See ICC, *Guide to Incoterms*, ICC Publication No. 354, p. 9.

[38] A chart of combiterms is included in annex III.

TABLE 1: Seller's and buyer's responsibilities

	A—Seller's responsibilities		*B—Buyer's responsibilities*
A1	Providing the goods in conformity with the contract	**B1**	Payment of the price
A2	Licences and other certificates	**B2**	Licences, authorizations and formalities
A3	Contracts of carriage and insurance	**B3**	Contract of carriage
A4	Delivery of the goods	**B4**	Taking delivery
A5	Transfer of risk of loss or damage	**B5**	Transfer of risks
A6	Division of costs and taxes	**B6**	Division of costs
A7	Notice to the buyer	**B7**	Notice to the seller
A8	Proof of delivery, transport documents or equivalent electronic message	**B8**	Proof of delivery, transport documents
A9	Checking, packing and marking	**B9**	Inspection of goods
A10	Providing additional assistance and information	**B10**	Other obligations

49. Each of the 13 Incoterms has a precise definition, but they can be grouped into the following four basic categories (for explanation of abbreviations and for definitions, see annex I):

(a) *E-term* (EXW): where goods are made available to the buyer at the seller's premise;

(b) *F-terms* (FCA, FAS, FOB): where the seller is required to deliver the goods to a carrier appointed by the buyer;

(c) *C-terms* (CFR, CIF, CPT, CIP): where the seller has to contract for carriage, but without assuming the risk of loss or of damage to the goods or additional costs due to events occurring after shipment or dispatch;

(d) *D-terms* (DAF, DES, DEQ, DDU, DDP): where the seller has to bear all costs and risks needed to bring the goods to the country of destination.

D. Particular considerations

1. *Shipment contracts and arrival contracts*

50. With the exception of the EXW term, all the other terms can be divided into what are known as "shipment contracts" and "arrival contracts". There is an important difference between these types of contracts.

51. Under the arrival contracts, the seller is responsible for the goods all the way to their arrival in the country of destination. Only the so-called D-terms (DAF, DES, DEQ, DDU and DPP) will turn a contract into an arrival contract. With all the other terms (the shipment contracts, such as FOB and CIF), the seller fulfils his delivery obligation at the point of shipment, irrespective of the fact that the cost of transport and insurance might have been paid by the seller. This is the key distinction between the C-terms, like CIF and CIP, and the D-terms. Thus the C-terms provide not only for one critical point but for two critical points: the point of division of risks (e.g. the ship's rail) and the point for division of costs, which is the destination point. In the case of the D-terms (arrival contracts), both of these crucial points coincide in the destination point. The distinction between the two types of contracts is essential, since the solution given in the case of goods lost or damaged in transit will be completely different, depending upon whether the contract is a shipment contract or an arrival contract. If it is a shipment contract, the responsibility for recovering the cargo loss or damage will lie with the buyer, since the risk has already been transferred to him, whilst in the case of an arrival contract the seller may be liable for breach of contract, since he has not fulfilled his delivery obligation under the contract.

52. A buyer will be better protected by a D-term, whereby the seller has to bear all the costs and risks needed to bring the goods to the buyer's country of destination, than by a CIF Incoterm, since in the latter case the only recourse available to the buyer is the insurance coverage, as the seller does not assume the risk of loss or damage to the goods after shipment. It follows that, in the case of shipment contracts, if the goods are shipped and lost during ocean transit the seller is still entitled to tender the proper shipping documents to the buyer and to claim the purchase price. That is the reason why terms like DDU or DPP mean greater risk for the seller and involve higher prices.[39]

[39] Delivered terms have become more popular in international trade over the past decades. In addition to the advantage of optimizing transport economy, D-terms allow for greater control by the seller of the quality of transport. In the case of high-value manufactured goods, it may be very important for the seller to be in a position to assure that the goods arrive in time and in good condition. Control of the entire transport chain is facilitated for a seller under D-terms (see Jiménez, op. cit., p. 89).