

UNCTAD training course on implications of the COVID-19 pandemic for commercial contracts

The sale of goods on shipment terms and Covid-19

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1. Sale of goods on shipment terms

Contracts for the international commercial sale of goods may be divided into three main groups depending on the mode and place of delivery of the consignment sold:

- *E terms* (or *ex works* contracts);
- *D terms* (destination/arrival or delivered contracts); and
- *Shipment terms*.

Broadly speaking, the delivery of the goods is made at the seller's premises in *EX terms*, at the buyer's premises in *D terms* and generally on board a vessel at the loading port, in *shipment terms* such as c.i.f. (cost insurance and freight) and f.o.b. (free on board) terms. More importantly, delivery and risk of transit loss are intimately connected the latter passing from the seller to the buyer immediately after the former.² So, E terms see the risk of transit loss passing on lifting the cargo at the point of origin and D terms see the risk of loss resting with the seller across the entire logistical chain.³ More complex is rule of passing of risk in CIF and FOB sales where the seller is never responsible for the safe arrival of goods but only for shipping them in accordance with the terms and conditions of the contract.⁴ As a result, the risk of loss or damage of the goods in transit is on the buyer.⁵ The net consequence of this rule is that if the goods (shipped in accordance with the contract) do not arrive at their final destination or are damaged or short-delivered, the buyer still needs to pay the full contract price⁶ and his remedies lie against the carrier and/or the cargo underwriters.

This is because performance of this type of contract is 'dual', i.e., both physical (*goods* must be delivered in accordance with the terms of the contract) *and* documentary (*documents* must be tendered as provided for in the contract).⁷ Once physical performance has been accomplished and the goods have been shipped the seller must tender the agreed documents to the buyer and, if the *documents* are in order, the buyer must pay the agreed sale price, even if goods are lost or damaged in transit. Under English law, both physical delivery and documentary tender are essential for the

¹ The views expressed are those of the author and do not necessarily reflect the view of the United Nations. For a fuller account of the effects of Covid-19 in sale contracts see the UNCTAD briefing note at: ([COVID-19 implications for commercial contracts: International sale of goods on CIF and FOB terms \(UNCTAD/DTL/TLB/INF/2021/2\)](#))

² F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 2-003; M. Bridge (Ed), *Benjamin's Sale of Goods*, 10th edn (London, 2017), at 18-294 and 14-119.

³ F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 2-005.

⁴ F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 2-018.

⁵ *The Julia* [1949] AC 293; *Scottish & Newcastle Int Ltd v Othon Galanos* [2006] EWCA Civ 1750; [2007] 2 Lloyd's Rep 341; aff'd at [2008] UKHL 11; [2008] 1 Lloyd's Rep 462.

⁶ Unless the contract provides for price adjustment clauses or is concluded on "landed quantity/quality at contract price" clauses.

⁷ *Scottish & Newcastle Int Ltd v Othon Galanos* [2006] EWCA Civ 1750; [2007] 2 Lloyd's Rep 341; aff'd at [2008] UKHL 11; [2008] 1 Lloyd's Rep 462, at [48]. F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 5-002.

correct performance of the contract. Performance is meticulously scrutinized by the buyer, particularly on a falling market, and both physical and documentary breaches typically allow rejection of the goods and/or the documents and immediate termination, on top of the usual action in damages for breach of contract. Importantly, the market relies heavily on the information contained in, and the timing of, shipping documents and English law regards the duty to comply meticulously with documentary obligations as strict.⁸

While the performance of contracts agreed on D and E terms may have also been badly affected by the pandemic, the allocation of the responsibility for non-performance and/or delay is generally straightforward and the liabilities that follow fall squarely on one or the other party.

Sale agreed on shipment terms however come in such an array of varieties that it may be difficult for the parties and their liability underwriters to allocate responsibility without recourse to mediation or – in the last resort – arbitration or litigation. For this reason, this briefing note is dedicated to the identification of the main features of this latter type of commercial sale, where the link between the sale contract, the shipping arrangements and the circulation of documents becomes more complex⁹ and where the impact of Covid-19 may prove less predictable in the medium and long term. This type of international contracts are often subject to English law and deferred to international arbitration or the jurisdiction of the Commercial Court in London. For this reason, this briefing note will focus mainly on English law, although references will be made to other jurisdictions where necessary.

Payment is extremely important in every sale contract and particularly so in international transactions in which the physical distance between the parties and the delay between delivery and reception of the goods increases the risks of non-payment, intervening insolvency and quality/quantity disputes.

In international trade payments are usually agreed on a 'cash against documents' (CAD) basis or through banking instruments such as commercial 'documentary letters of credit'. The choice of one or other of these payment methods has a significant impact on the parties' documentary duties and a delay or failure to procure one or more of the documents required will have a different consequence on the buyer's duty to pay the price.

Whichever the method of payment chosen by the parties, documents are to be regarded as the essential key to access payment and must be exactly as specified in the sale contract or in the letter of credit.¹⁰ Each and every document agreed upon must be prepared in accordance with any relevant contractual provision or match the very rigid banking standards,¹¹ duly filled and signed and tendered within the agreed timeframe¹² in order to be accepted and paid against. When banks are involved, the Uniform Customs and Practice for Documentary Credits (UCP 600)¹³ contain a large

⁸ The consequence of this is that even slight formal documentary defects do generally allow the buyer to reject the documentary tender, refuse payment, terminate the contract and claim damages for breach; see *Cehave NV v Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1976] QB 44; and *SIAT di Dal Ferro v Tradax Overseas SA* [1980] 1 Lloyd's Rep. 53. For a fuller discussion see F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 7-005 – 7-016; and C. Debattista, *Bills of Lading in Export Trade*, 3rd edn (London, 2008), para 9.16.

⁹ See F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 2-003.

¹⁰ F. Lorenzon, *Sassoon on CIF and FOB Contracts*, 7th edn (London, 2020), at 8-006. Letters of credit, governed by the UCP 600, are usually confirmed and irrevocable; documentary requirements mirror/are aligned with the sale contract. Both the issuing and the advising/confirming bank are required to pay against conforming documents, but will reject non-conforming documents; in case of rejection, the seller will also be in breach of the sale contract and, if the buyer has suffered a loss, may be exposed to a claim by the buyer for damages.

¹¹ International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits (2007 Revision) UCP 600*, ICC Publication n. 600E, Article 14. See www.iccwbo.org.

¹² UCP 600, Article 6.

¹³ UCP 600, Article 1.

number of very detailed formal requirements for all documents to be presented under a letter of credit and gives the bank the right and duty to reject any presentation which does not strictly meet these standards.¹⁴

2. Basic principles on the transfer of risk in shipment sales

In c.i.f., c.& f. and f.o.b. contracts, risk is separated from property,

- Risk passing ***on or as from shipment***;
- and property passing ***when the contract says it is to pass***.

Shipping before selling: The rule that the risk in goods passes on **or as from** shipment also responds to the commercial reality that a seller might have shipped his goods under a contract of carriage before he has concluded negotiations on the trading contract. Thus, if the goods are damaged in transit prior to the contract of sale, the buyer still bears the risk and must still pay the seller against conforming documents, safe in the knowledge that (in most cases) the documents give him adequate remedies against the carrier and insurer.

The rule that risk passes on or as from shipment has a number of statutory and Common law exceptions:

1. Losses caused by delayed delivery [s.20(2)];
Gatoil v. Tradax [1985] 1 Lloyd's Rep. 350
2. Losses caused by breach of the duty to take reasonable care of warehoused goods [s.20(3)];
3. Risk does not pass where the seller has failed to make a reasonable contract of carriage [32(2)].
4. Losses caused where the seller has failed to pass on insurance information [s.32(3)];
5. losses caused by a breach of the seller's duty to ship goods likely to withstand normal sea transit
Please read *Mash & Murrell v. Emanuel* [1961] 2 Lloyd's Rep. 326.

The rule can of course be amended by contract: e.g.

"Out-turn" quantity clauses

The purpose here is for the buyer to pay only for goods which he has received.

See, for example, **FOSFA 54, lines 171-174**

Landed quality clauses

The purpose here is to allow for a reduction in the price for deterioration in transit.

Etc.

¹⁴ UCP 600, Article 14(a).

3. Physical and documentary duties: the English model

Shipment sales require the seller to perform its delivery obligation in two ways:

- a. physical; and
- b. documentary.

Under English law both modes of performance are primary duties and they both must be complied with.

a. On the physical front

Section 13 of the Sale of Goods Act 1979 states:

13(1) Where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description.

13(1A) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition.

The practical question the parties will be asking is:

What sort of non-conformity exposes *the seller* to possible rejection?

What sort of non-conformity entitles *the buyer* to reject?

- First of all, see ***the contract***.

- Where ***the contract fails to make it clear***, either explicitly or implicitly, whether a particular type of non-conformity was intended to be fatal to the seller, the court will look to evidence from the market as to whether the description of the goods in the contract went to the identity of the commodity sold.

Tradax Internacional S.A. v. Goldschmidt S.A. [1977] 2 Lloyd's Rep. 604

Of particular relevance is the fact that time and place of shipment are conditions of the contract and all the goods sold must be shipped from the agreed place within the period agreed in the sale contract.

Bowes v. Shand (1877) 2 App. Cas. 455.

This may be very harsh on the seller who may well have little contractual control over the vessel (particularly in every case where he is not the charterer).

b. On the documentary front

Not only do documents provide evidence of physical performance, but they are an essential component of the delivery.

Moreover, all documentary breaches are breaches of conditions entitling the buyer to terminate the contract and claim damages (if any).

So the fact that time and place of shipment are conditions of the contract translates into their documentary equivalent that the bill of lading tendered must evidence shipment made from the agreed place within the shipment window.

If a bank is involved through a letter of credit, the bill of lading must be dated within the shipment window stated in the credit and indicate that the goods have been shipped on board a named vessel at the port of loading stated in the credit.

See UCP 600, Article 20(ii).

4. Covid-19 and its impact on shipment sales

Covid-19 has been declared a Pandemic by the World Health Organization on 11 March 2020 but by that time it had already generated a lot of issues in international trade and shipping.

A Pandemic generates variations and distortion to business life even without the legal restrictions which may accompany it, but as soon governments worldwide take preventive measures to contain the spread of the disease the effects on the ordinary course of business become significant and long standing.

The key effect of a total or partial lockdown is that services cannot be provided with the speed and efficiency with which we expect them to be and this causes delays and – most significantly – compound delays.

- Delay at the producing plant may lead to a partial or total failure to deliver;
- Delays at the loading port may also translate in a failure to ship by the agreed time and extensions may be hard to negotiate at difficult times;
- Delay in the preparation and/or transmission of the documents can prove fatal to both a 'cash against documents' and a letter of credit transaction.

As time in general and proper timing in particular are key ingredients of international trade, any disruption affecting it may have severe consequences for both sellers and buyers.

In the commodity market, it is not uncommon for cargo to be shipped by the original seller and then sold on a string of consecutive spot deals. None of the traders involved with the intermediate sales gets involved with the physical handling of the cargo which is and remains idle on board the ship. All they deal with, and rely upon, is the quick and reliable flow of the shipping documents: any disruption in that flow due to slow or intermittent postal or banking services will affect this type of trade too.

A Pandemic should be treated as a specific 'event' and evaluated in its contractual context on a case-by-case basis. The 'event' itself may be the root cause of a contractual default but it is more often the case that the true reason of a failure or delay in performance is the consequence of the 'event' rather than the event itself.

It would appear that the most common events of default connected with Covid-19 so far have been:

- a. Delayed shipment/delivery;
- b. Delayed discharge;
- c. Delay in the availability of documents.

On this last point, can the parties use electronic documents instead of paper ones?

Electronic trading systems were developed to provide traders a secure and user friendly platform through which operate their business safely and quickly.

The International Group of P&I Clubs (IG) approved the following systems:

- Bolero;¹⁵
- EssDOCS;¹⁶
- E-titleTM;¹⁷
- Global Share S.A. edoxOnline;¹⁸
- WAVE-BL;¹⁹
- CargoX;²⁰
- TradeLens²¹

These systems were approved by the International Group as it was reassured that bills issued under them would be capable of performing the three functions of a bill of lading namely (a) a receipt, (b) a document of title at common law and (c) evidence of a contract of carriage which – of paramount importance in the eye of a liability underwriter – incorporates the Hague or Hague-Visby Rules.

However, as we shall see, their purported ‘equivalence’ to a paper document does not go far enough, yet.

The Law Commission has recently made a proposal for a new piece of English legislation allowing documents of title to be issued in electronic format. The very authoritative Law Commission Report can be found at:

<https://www.lawcom.gov.uk/project/electronic-trade-documents/>

The text of the bill itself is set out at the end after p. 242.

¹⁵ <https://www.bolero.net/rulebook-and-title-registry/>, last accessed 13/05/2022.

¹⁶ <https://www.essdocs.com/company/users-agreement-dsua>, last accessed 13/05/2022.

¹⁷ https://www.e-title.net/sol_overview.php, last accessed 13/05/2022.

¹⁸ <https://web.edoxonline.com/index.php/global-share/>, last accessed 13/05/2022.

¹⁹ <https://wavebl.com>, last accessed 13/05/2022.

²⁰ <https://cargox.io>, last accessed 13/05/2022.

²¹ <https://www.tradelens.com>, last accessed 13/05/22.