



CHAPTER 5

The Documentary Sale and Terms of Trade

Imagine that your firm is a manufacturer of specialty cotton yarn, which it sells to domestic knitting and weaving mills. You receive an inquiry from a potential foreign customer expressing an interest in your yarn and requesting a price quote or *pro forma* invoice showing the price for the goods and two different shipping and cargo insurance options: one if the customer takes delivery of the yarn at a named seaport in your country and arranges ocean transport and insurance himself, and another if you arrange for all insurance on the goods and their transportation to a seaport near the buyer. This will let the customer determine if it is more cost-effective for you to arrange and pay the cost of ocean shipping or for the customer to do it.

The customer also requests your “most favorable payment terms” and supplies you with banking and credit information and trade references. Typically, your shipments to established domestic customers are on “open account” terms, and you offer a 30-day credit period for payment. However, you are uncertain about granting the same terms to a new foreign customer because there it is possible that you may never see your money. If the customer fails to pay, it may be difficult for you to find a substitute buyer in that part of the world. Moreover, you would like your money as quickly as possible. On the other hand, if you demand cash in advance, the customer may take his business elsewhere. After all, you realize that the customer probably has no more reason to trust you to ship as promised than you have reason to trust the customer to pay. Being new to exporting, you begin to do some research and consult several international trade specialists from government, freight forwarding, and banking. You would like to know if there are payment options other than open account or cash in advance.

Evaluating your customer’s creditworthiness and deciding on payment terms is not your only concern. The customer wants you to quote a price for the yarn using two shipping alternatives. The first requires you to make the goods available to the buyer at a seaport in your country. This means that you must determine

the costs of packing, crating, and ground transportation to the port named by your customer. The second alternative requires you to calculate the costs of ocean transport and marine cargo insurance to a foreign port in your customer’s country. You calculate the weight and number of pallets of yarn to be shipped and estimate that it will fill one ocean container. On that basis, you request your freight forwarder to provide land and ocean transportation costs, container fees, dock fees, forwarder’s fees, insurance coverage, and other costs.

You need the answer to one remaining question before you can produce your *pro forma* invoice: What is your liability for damage to the yarn during shipment? You know the perils of the sea are great. What if the ship goes down in a storm or the yarn is stolen or damaged by saltwater condensation? Which party, buyer or seller, will bear the risk of loss? Even if the insurance covers the loss, and even if the law permits a claim against the carrier (the topics of Chapter 7), as between buyer and seller, which party must try to recover it? At what moment or at what place does the risk of loss shift from the seller to the buyer? Are you free from responsibility when the goods leave your hands, when the goods reach the buyer’s mill, or at some point in between? Does it matter which party, buyer or seller, owns the goods at the time they are lost or damaged? You want to know if you can “negotiate away” the responsibility for damage to the goods as quickly as possible after they leave your hands. Is there any way to put language in the contract that assigns the risks of the ocean voyage to the buyer? We will try to answer these questions in this chapter in our coverage of several basic subjects:

1. A brief description of the transaction risks facing the buyer and seller
2. The legal nature of documents of title, such as ocean bills of lading, and the significance of their negotiability to international commerce
3. The documentary sale and collection process used in exchanging goods for money



4. The role of ocean carriers and international banks in facilitating the documentary sale
5. An explanation of the difference between “shipment contracts” and “destination contracts”
6. The use of shipping terms and trade terms in sales contracts to assign the shipping responsibilities and the risk of loss between buyer and seller

TRANSACTION RISK

For purposes of this book, the term **transaction risk** refers to the risks facing the buyer and seller when they move money and goods in an international sales transaction. Transaction risks arise from barriers that separate buyer and seller, including distance, oceans, the time that the cargo is out of possession of the parties, communication and language difficulties, cultural differences, national boundaries, interference by local customs authorities, and legal systems.

Delivery Risk

Two of the most obvious forms of transaction risk are delivery risk and payment risk. **Delivery risk** is the risk to the buyer that the seller will fail to ship the goods as called for in the contract. For instance, the seller might fail to ship the goods at all, or on time, properly packaged, adequately insured, and using the agreed mode of transportation. There is much greater delivery risk in an international sale than in a domestic sale because the buyer may not know the seller very well. The seller may fail to ship due to any number of business reasons. In addition, the seller may not have the same commitment to its foreign customers as it does to its domestic customers. The seller may even be a cheat and fill the containers with worthless rubbish or ship less than the quantity billed. Indeed, international business can be fraught with peril.

Distance and the use of ocean transport also increase delivery risk. Despite the importance of air transport today, most cargo is still carried by sea. Although all forms of transportation put cargo at risk, ocean cargo can be imperiled by time, moisture, storms, shipwreck, pilferage of ocean containers, and, even today, piracy. In addition, *multimodal transport* (the use of more than one mode of transportation, such as truck plus ocean vessel) places the goods at risk during transfers and at times when they are temporarily warehoused.

Payment Risk

Payment risk (also called credit risk) is the risk to the seller that the buyer will fail to pay as promised. Payment risk is compounded by the difficulty the seller may have getting a credit history on a foreign customer or obtaining banking and trade information. The buyer’s distance, and location in a foreign country with an unfamiliar legal system, means that any attempt to collect payment can be costly and time consuming. If the buyer fails or refuses to pay, the seller might have to resort to litigation in the buyer’s country to recover the money owed. Even then, recovery might become impossible, if the buyer becomes insolvent or bankrupt. If a foreign buyer refuses delivery, it may not be cost-effective to ship the goods home, and the seller may have difficulty locating a substitute buyer that far away.

Ideally, if sellers could have their way, they would have *cash in advance* from new foreign buyers before the goods leave their hands. That is certainly the most secure form of payment. On the other hand, few buyers would part with their money merely in the hope that the goods they order will ever arrive. An unscrupulous seller who already has the cash may be tempted to walk away without shipping or to ship goods other than those that were ordered. The seller may have no long-term interest in exporting to a foreign market or may be dishonest. Cultural and language barriers might make it especially hard to gauge a seller’s honesty or intentions. So, cash in advance as a payment option usually will not serve to bring buyer and seller together.

On the other hand, all buyers would like to buy on open credit terms, or on **open account**. With open account terms, the seller grants an extended credit period for the buyer to pay, typically 30 days. In domestic sales, for the seller who has had an opportunity to learn the creditworthiness of the buyer, sales are often made on open account terms. However, few sellers would risk shipping their goods, perhaps halfway around the world, giving up possession, control, and even ownership of the goods to a foreign buyer, without some adequate assurance of payment. Perhaps after a long relationship has developed between them, they may agree to do business this way, but an open account sale is usually not secure enough for most large international transactions. In addition, a seller who agrees to sell on open account in a foreign currency bears the risk that the currency will fall in value during the open credit period. Thus, if cash in advance



or open account terms were the only payment options, buyer and seller would be at an impasse. Bringing them together requires some other form of payment. One method that provides assurances to both parties is the documentary sale.

THE DOCUMENTARY SALE

The **documentary sale** is a type of contract for the sale of goods in which possession and ownership of the goods are transferred from seller to buyer through negotiation and delivery of a negotiable document of title issued by an ocean carrier. The seller's obligation is to place the goods in the hands of an ocean carrier within the time called for in the contract, in exchange for a negotiable document of title and to negotiate the document of title to the buyer in return either for immediate payment or, if an extension of credit is anticipated by the contract, for the buyer's promise to pay at a future date. The buyer's obligation is to "purchase" the document in a timely fashion and to take delivery of the goods. Correspondent banks in the buyer's and seller's countries handle the process of exchanging a document of title in return for money. It reduces the transaction risks between a buyer and a seller who are great distances apart by ensuring that if one releases the title to the goods, the other will release the money. The documentary sale is a unique method of exchange devised by early traders when their sailing vessels traveled medieval trade routes. The method spread by custom and practice and eventually became recognized in early English law, in the modern common law countries, and in the civil law countries of Europe. Today, the documentary sale is a common type of contract for the sale of goods.

The Document of Title

The first step to understanding the documentary sale is to understand the nature of a negotiable document of title. A negotiable **document of title** is a document that evidences the ownership of goods it represents. It entitles the person who possesses the document to possess the goods. Documents of title are created out of a special "bailment" relationship between the owner of personal property, the **bailor**, and the one to whom its possession is entrusted, the **bailee**. A **bailment** is a relationship involving the separation of ownership and possession of personal property. The bailee receives

the property on the condition that it will care for and return the property in the condition in which it was given or will transfer or dispose of it in accordance with the terms of the bailee's agreement with the bailor. Bailments are common in everyday life and are treated in more depth in other law classes. One example of a commercial bailment occurs when a bailor places goods in a warehouse for storage. The warehouse operator (the bailee) issues a document of title known as a *warehouse receipt*. The document serves as a receipt for goods taken into its possession, and also as a document of title. For example, a farmer may place leaf tobacco in a warehouse, receive a warehouse receipt, and either reclaim the tobacco or sell it at auction by delivering the warehouse receipt to the buyer. In international trade, the most commonly used documents of title are bills of lading and multimodal transport documents.

Negotiability of Documents of Title. Documents of title may either be negotiable or be nonnegotiable. A negotiable document of title is one stating that the goods will be delivered "to the order of a named person or assigns" or "to the bearer." Negotiable documents can be transferred by negotiation from one party to another in return for value or payment. **Negotiation** is the transfer of a document of title by its owner to another in a manner that passes title to the document, title to the goods, and the right to claim the goods from the issuer of the document. Order documents are negotiated by delivery. Bearer documents are negotiated by a signed indorsement and delivery. Documents of title are used to transfer ownership of goods from one party to another without the necessity of transferring physical possession of the goods themselves. When a negotiable document of title is sold in the ordinary course of trade, the seller is said to have made a **constructive delivery** of the goods to the seller. The property can stay in the possession of the bailee while the owner or subsequent owners sell or resell it or pledge it as collateral for a loan. In this chapter, we will discuss just one type of document of title used for moving goods by ocean—the ocean or maritime bill of lading. In a later chapter, we will cover air cargo and the use of air waybills in some detail.

The Bill of Lading

A negotiable ocean **bill of lading** is a document of title that an ocean carrier issues to a shipper upon receiving goods for transport (see Exhibit 5.1). Having first been

Exhibit 5.1

Ocean Bill of Lading

OCEAN BILL OF LADING

Shipper/Exporter Shipper's name Address		Export References Invoice or order number (Not negotiable unless consigned to order)	
Consignee (Complete Name and Address) To the order of: Shipper		Forwarding Agent - References Shippers Freight Forwarder	
Notify Party (Complete Name and Address) Buyer or buyer's import agent		Forwarding Agent - References U.S.A.	Forwarding Agent - References
Per		Domestic Routing/Export Instructions Pre-carriage These commodities licensed by U.S. for ultimate destination Japan and for resale to any destination except North Korea, Iraq, Cambodia, or Cuba.	
Ocean Vessel	Flag	Port of Loading	Place of delivery
Port of Discharge	For Transshipment To		

Carrier's Receipt		Particulars Furnished By Shipper		
Marks and Numbers	No. of Cont. or Other Pkgs.	Description of Goods	Gross Weight	Measurement
Container No. UP 362459 Seal # 2398112	95	1 x 40' container said to contain down pillows on invoices to be as per proforma invoices nos. 2368714, 2368715 dated April 15, 2008.		
Shipping Marks: Down Bedding		*Shipper Load, Stuff & Count Clean Shipped on board 5/10/2008 *Freight Prepaid House to port basis Signed <u><i>huang</i></u> Title of Company Official	1,550 Kg (Net)	

Received in apparent good order and condition except as otherwise noted herein the goods, containers, or units mentioned above for transportation from the place of receipt (if named above or (if not named) the port of loading to the port of discharge or place of delivery (as the case may be) subject to exceptions, limitations, conditions and liberties hereof and there to be delivered to the consignee or his or their assigns.

(TERMS OF THIS BILL OF LADING CONTINUED ON REVERSE SIDE HEREOF)

Freight Charges	Prepaid	Collect
Land Charges		
Port Charges		
Ocean Charges		
Container Rental		
Total	4850.00	

B/L No. _____

IN WITNESS WHEREOF, The Master or Agent of said vessel has affirmed to THREE (3) _____ Bills of Lading, all of the tenor and date, one of which being accomplished, the others stand void.

Carrier TAMPA BAY STEAMSHIP
JACKSONVILLE, FLA.

By *Shuy*
Agent for the Master/RS

Dated at Port of Shipment Mo. 5 Day 10 Yr. 08



used in the sixteenth century, the bill of lading plays a vital role in international trade. It has three roles.

1. It is a receipt for the goods from the carrier, indicating any damage to the goods that was visible or apparent at the time of loading.
2. It is the contract of carriage between the shipper and the carrier (i.e., a *transport document*).
3. It is the document of title to the goods described in it.

For the purposes of this chapter, unless otherwise noted, we refer only to negotiable ocean bills of lading. Later in this chapter, we describe different types of ocean bills, including nonnegotiable bills, as well negotiable multimodal transport documents. In the United States, the laws governing the negotiability of bills of lading are the *Federal Bills of Lading Act* (for bills originating in the United States for export shipments) and the *Uniform Commercial Code*.

Rights of Purchasers of Documents of Title

Although some readers may be familiar with the rights of parties that purchase **negotiable instruments**, such as checks and promissory notes, the law regarding the transfer and sale of **negotiable documents** is somewhat different because the functions of the two are different. Negotiable instruments serve as a substitute for money, whereas negotiable documents are used to move goods and to transfer their ownership and possession.

Good-Faith Purchasers of Documents of Title. The legal rights of the purchaser of a document of title in the United States depend on whether the case is governed by Article 7 of the *Uniform Commercial Code* or by the *Federal Bills of Lading Act*. The *Federal Bills of Lading Act* (enacted in 1916) is probably the more important of these, because it applies to all bills of lading issued by any common carrier for the shipment of goods in interstate or international commerce. This discussion generally applies to both laws. In order for negotiable documents of title to be freely accepted in commerce and trade, the law gives special protection to those who purchase negotiable documents under such circumstances as to become holders by due negotiation.

A **holder by due negotiation** (otherwise referred to as a good-faith purchaser) is one who purchases a negotiable document (1) for value (and not in settlement of a past debt), (2) in good faith and without any notice of any adverse claim against it, and (3) in the ordinary course of business or financing. If it is an

order instrument, then the good-faith purchaser must take it by indorsement.

When a buyer, bank, or other party takes a document as a good-faith purchaser, it not only takes title to the document and to the goods it represents, but it acquires even greater rights in the document and to the goods than were had by the party who negotiated it to the purchaser. The rule states as follows: A good-faith purchaser takes a negotiable document of title free from the adverse claims that third parties might have against the goods represented in the document (excluding claims of the carrier for unpaid shipping charges or the claims of government customs authorities). Thus, a good-faith purchaser of a negotiable document of title, as a general rule, will get clear title to the goods described therein, and must not be concerned that someone else may have a greater right to claim the goods. For example, assume that a firm is having financial difficulties. It delivers goods to a carrier for shipment to a foreign buyer, obtains a bill of lading, and negotiates the document to the buyer. In the meantime, a creditor of the seller attempts to put a lien on the goods to satisfy its debt. If the buyer is a good-faith purchaser, then his or her rights to the goods will prevail over the creditor's lien.

Now consider a slightly different case: A entrusts goods to B for storage. B delivers the goods to a carrier, obtains a bill of lading, negotiates the document to C, and absconds with the money. C, who is a good-faith purchaser, takes title to both the document and the goods. A may not reclaim them because C takes **paramount title**. This means that C's rights are superior, even against the original owner, because B was entrusted with the goods and then wrongfully sold them.

There are many cases where the good-faith purchaser takes greater rights than the transferor of the document had. But in certain other instances, a good-faith purchaser might not enjoy greater rights. For instance, if a thief steals goods and obtains a bill of lading, a purchaser of the document does not obtain paramount title over the original owner. In the following case, *Banque de Depots v. Ferroligas*, the court addresses the rights of a party who takes a bill of lading by "due negotiation." Notice how the court attempts to protect the rights of these purchasers of negotiable documents.

Different rules apply to transferees of nonnegotiable bills of lading and to transferees of negotiable bills of lading who did not take them by due negotiation or in good faith. In these cases, the holder receives only those rights that the transferor had or that the transferor had the actual authority to convey. Recall the



example in which A entrusted goods to B for storage. Now assume that B transfers a nonnegotiable bill of lading to C and absconds with the money. A can reclaim the goods from C.

Carrier's Liability for Misdelivery. The carrier may deliver the goods only to the holder of an original bill of lading. Assume that A entrusts a shipment of goods to an ocean carrier and obtains a bill of lading. The carrier delivers the goods to B without asking B to produce the

document. Without knowledge of what has occurred, A sells the bill to C, who takes it for value and in good faith. C is the good-faith purchaser and the owner of the goods and may bring an action to reclaim the goods from B. C also has a cause of action against the carrier for misdelivery of the goods because the carrier violated the terms of the contract of carriage. A further example of a carrier's liability for misdelivery may be found in the following case of *Ample Bright Development, Ltd. v. Comis International*.



Banque de Depots v. Ferroligas

569 So. 2d 40 (1990) (Court of Appeals of Louisiana)

BACKGROUND AND FACTS

Banque de Depots, a Swiss bank, brought an action against Bozel, a Brazilian exporter, seeking a money judgment because Bozel had allegedly misapplied the bank's funds. The bank obtained an order seizing 1,300 metric tons of calcium silicon located in a Louisiana port. The calcium silicon was shipped under ocean bills of lading by Bozel from Rio de Janeiro to New Orleans for transit to three purchasers, none of whom were domiciled in Louisiana. The documents were still in the hands of the collecting banks and had not yet been negotiated to the buyers. Bozel asked the court to free the goods because he was not the owner of the bills of lading.

LOBRANO, JUDGE

Bozel asserts that . . . title to the cargo follows the bills of lading, and once those were transferred to the collecting banks, they [Bozel] were no longer the owner of the cargo.

The Bank asserts that . . . only bills of lading which are "duly negotiated" transfer ownership of goods . . . They contend that the bills of lading may have been transferred to the collecting banks, but they were not "duly negotiated" . . . since there was no value given prior to the attachment . . .

We agree that Louisiana law governs the ownership of the cargo when it reached Chalmette, La. Article 2 of the UCC has not been adopted in Louisiana, hence the courts must look to the Louisiana Civil Code in determining the ownership of movables . . .

The holder of a duly negotiated bill of lading acquires title to the document and title to the goods described therein. It is clear that once a carrier has issued a negotiable bill of lading for goods being placed in commerce, the intent of the law is to protect those who subsequently become holders through "due negotiation." Part and parcel of that intent is the

protection afforded the [carrier] in relinquishing possession of the goods to the holder of the document. Thus, although goods in the possession of a [carrier] may have been seized, if the document's negotiation has not been enjoined or the document is not in its possession, [Louisiana law] permits the [carrier] to surrender the goods to the duly negotiated holder. The law protects that holder from acquiring goods that are subject to a seizure. Any other conclusion would lead to the absurd result of requiring the holder, prior to his purchase of the bill of lading, to check every jurisdiction through which the goods passed to determine if it has been seized by judicial process. This would defeat the purpose of our commercial laws.

The record is clear that on May 14, 1990, the date of the seizure, the negotiable bills of lading were outstanding. They were not in the hands of the carrier and their negotiation had not been enjoined. As discussed, the validity of the attachment must be determined as of the date it was issued. The Bank cannot cure this defect by seeking to impound the bills of lading after it obtained the seizure. To hold otherwise would create an impossible contradiction in our commercial laws since the "seized" goods would still be subject to the legal effects of the unimpaired "due negotiation" of the corresponding bills of lading. The legal "capture" of the bills of lading is a prerequisite to the seizure of the goods.

We order that the writ of attachment be dissolved.

Decision. A court-ordered seizure of goods in transit cannot stand when the title to the goods is represented by a bill of lading and the bill of lading itself was not seized by the court order.

Comment. The Swiss bank was attempting to assert jurisdiction over Bozel by seizing its cargo in the United States. Although this attempt failed, the court stated

continues

continued

that the bank was free to continue to find other ways to get jurisdiction over Bozel.

Case Questions

1. Why did the court not permit Banque de Depots to seize the cargo Bozel shipped?
2. What are the policy reasons for not allowing a creditor, such as Banque de Depots, to seize cargo that is being shipped to a buyer under a bill of lading?
3. What are the expectations of a good faith purchaser of a bill of lading?



Ample Bright Development, Ltd. v. Comis International

913 F.Supp.2d 925 (2012) (United States District Court for the Central District of California)

BACKGROUND AND FACTS

Ample Bright Development Ltd. is a Chinese trading company that receives inquiries from overseas companies regarding handbag accessories and finds suitable Chinese factories to produce those accessories. Ample Bright received a series of purchase orders from Pacific Worldwide, Inc. Ample Bright subsequently selected Alice Leathers, a Chinese company, to fill the order. Ample Bright placed the orders for handbags, wallets, iPhone cases, iPhone clutches, and similar items with Alice Leathers in its own name, and was responsible for paying the factory itself. Pacific directed Ample Bright to use Comis International to transport the goods. Ample Bright had not previously used Comis as a freight forwarder or shipping agent. The six bills of lading representing the transaction with Pacific specifically provided that: "The surrender of the original order bill of lading properly endorsed shall be required before the delivery of the property."

Ample Bright neither surrendered the original bills of lading nor authorized release of the goods to Pacific. Despite this language and without Ample Bright's knowledge, Comis released the goods to Pacific. Pacific subsequently failed to pay for the goods, and Ample Bright in turn did not pay Alice Leathers. Alice Leathers sued Ample Bright to recover the amounts it was owed for the goods received by Pacific. Ample Bright filed a lawsuit against Comis for wrongful release of the goods in contravention of the terms of the bills of lading.

MORROW, DISTRICT COURT JUDGE

Ample Bright first asserts a conversion claim. "Conversion is the wrongful exercise of dominion over the property of another. The elements of a conversion are the plaintiff's ownership or right to possession of the property at the time of the conversion; the defendant's conversion by a wrongful act or disposition of property rights; and damages." *Farmers Ins. Exchange v. Zerin*, 53 Cal.App.4th 445, 451, 61 Cal.Rptr.2d 707 (1997) (quoting *Oakdale Village Group v. Fong*, 43 Cal.App.4th 539,

543–44, 50 Cal.Rptr.2d 810 (1996)). "Delivery to a person who is not the holder [of the bill of lading], without the holder's authorization, constitutes a conversion of the [shipped] goods and a breach of contract." *Bil Finance Co. v. U–States Forwarding Services Corp.*, 95 Cal. App.4th 111, 124, 115 Cal.Rptr.2d 312 (2002).

As the purchaser of the goods, Ample Bright had a right to possess the property that comprised the shipments at issue in this case.

Each of the bills of lading for the shipments expressly provided: "The surrender of the original order bill of lading properly endorsed shall be required before the delivery of the property." Ample Bright did not surrender the original bills of lading, nor did it authorize release of the goods by telex, as it had done in the past. Nonetheless, Comis released the goods to Pacific in violation of the agreement between Comis and Ample Bright. In doing so, Comis wrongfully deprived Ample Bright of its property.

Defendants argue that the parties had a course of dealing that permitted Comis to release the goods to Pacific. A party can waive its right to require delivery by presentation of the original bill of lading if it knowingly permits cargo to be cleared by other means. [citation omitted]. The California Commercial Code provides that "a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance." CAL. COM.CODE § 1303(f). A "waiver is the intentional relinquishment or abandonment of a known right or privilege." *Smith v. Selma Community Hosp.*, 164 Cal.App.4th 1478, 1506, 80 Cal.Rptr.3d 745 (2008). Under California law, moreover, delivery of goods to a person who is not the holder of a bill of lading constitutes a conversion only if the delivery is made without the authorization of the holder of the bill of lading. [citation omitted].

Ample Bright did not knowingly permit the shipments at issue to be released to Pacific. It was not aware that Comis was releasing the goods to Pacific without its authorization, either through release of the original bills

continues



continued

of lading or by telex. . . . Comis had no course of dealing with Ample Bright that permitted the conduct in which defendants engaged. . . . Because the evidence does not support defendants' assertion that Ample Bright and Comis had a common course of dealing pursuant to which Comis, with Ample Bright's knowledge, released shipped goods without requiring surrender of the original bill of lading or a telex release of the goods, the court cannot find that Ample Bright waived its right to require either surrender of the bill of lading or telex release.

In sum, it is undisputed that, despite receiving the goods, Pacific did not pay Ample Bright for the shipments at issue in this case. For the reasons stated, the court concludes that Ample Bright is entitled to recover from defendants on its conversion claim.

Ample Bright seeks compensatory damages of \$264,635.10, the amount Pacific was to pay for the goods at issue in this case. This is the amount of detriment proximately caused by defendants' release of the goods without Ample Bright's authorization, which

allowed Pacific to receive the goods without paying the money it owed. . . . For the reasons stated, the court concludes that Ample Bright is entitled to \$264,635.10. The court will enter judgment in that amount.

Decision. The disregard of the limitations contained within the bills of lading received from the shipper subjected the freight forwarder to liability in an amount equal to the value of the property wrongfully received by the ultimate purchaser.

Case Questions

1. Why did the court not permit Comis to diverge from the terms of the bill of lading?
2. What are the policy reasons for not allowing a carrier, such as Comis, to disregard the terms of a bill of lading?
3. When combined with the opinion in *Banque de Depots v. Ferroligas*, what does this case tell you about the legal nature and effect of the bill of lading to trade?

Importance of Negotiability to Trade. The negotiability of the bill of lading is what makes it so important to trade. As the document is bought and sold, so too are the goods it represents. Negotiability permits merchants to trade in cargo while it is still afloat. With a bill of lading, goods can be bought and sold, time and again, while they are still on the high seas, with the bill of lading circling the globe from one buyer to the next. This practice is, in fact, quite common. Persian Gulf oil can change hands 20 or 30 times in the 6 weeks that it takes a tanker to reach U.S. waters.

The negotiability of bills of lading was recognized in most European trading centers at least as early as the sixteenth century. Early records of them have been found in many languages. In 1883, Lord Justice Bowen described the bill of lading in *Sanders Brothers v. Maclean & Co.*, (1883) 11 Q.B.D. 327 at 341.

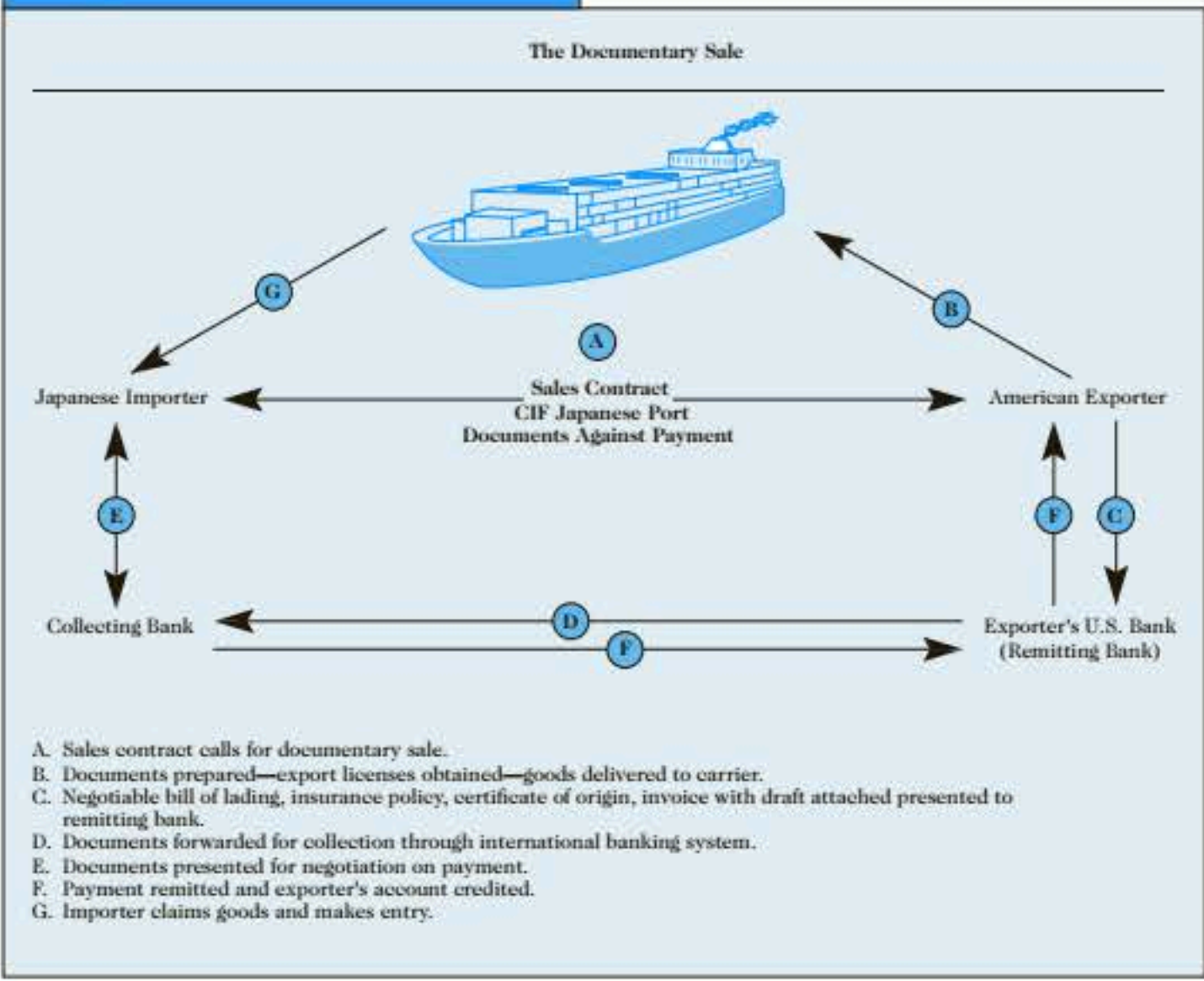
The law as to the indorsement of bills of lading is as clear as in my opinion the practice of all European merchants is thoroughly understood. A cargo at sea while in the hands of the carrier is necessarily incapable of physical delivery. During this period of transit and voyage, the bill of lading by the law merchant is universally recognized as its symbol, and the indorsement and delivery of the bill of lading operates as a symbolical delivery of the cargo. Property in the goods passes by such indorsement and delivery of the bill of lading, whenever it is the intention of the parties that the property should pass, just as under similar

circumstances the property would pass by an actual delivery of the goods. And for the purpose of passing such property in the goods and completing the title of the indorsee to full possession thereof, the bill of lading, until complete delivery of the cargo has been made on shore to someone rightfully claiming under it, remains in force as a symbol, and carries with it not only the full ownership of the goods, but also all rights created by the contract of carriage between the shipper and the shipowner. It is a key which in the hands of a rightful owner is intended to unlock the door of the warehouse, floating or fixed, in which the goods may chance to be.

As the vessel bearing the goods proceeds out of the harbor and onto the open ocean, the seller safely retains the title to the merchandise, literally held in hand. The seller can sell the goods as planned by sending the bill of lading ahead to the buyer, divert the shipment to another buyer around the globe, pledge it for a loan, or bring it home. This unique flexibility has made the documentary sale essential to world trade and the international economy.

Documentary Collection. The **documentary collection** is the process by which banking institutions serve as intermediaries between seller and buyer to handle the exchange of the bill of lading for payment (see Exhibit 5.2). The documentary collection is an integral part of the documentary sale. It provides a safer

Exhibit 5.2



alternative for payment than either cash in advance or sale on open account. The parties might indicate their desire for a documentary collection by specifying in the contract that payment terms are “cash against documents” or “documents against payment” (sometimes abbreviated CAD or D/P). Such an indication is not always essential because the collection process is implied in most documentary sales contracts.

Here is a simplified description of how the documentary collection process works: Seller places the goods in the hands of a carrier and in return receives a negotiable bill of lading or multimodal **transport document** made to its order or assigns. Seller indorses the bill of lading and presents it to the bank for collection. Along with

the bill of lading, the seller includes other essential documents that the contract requires it to submit, such as a **marine insurance** policy on the goods covering the risks of the ocean voyage. The customs regulations in the buyer’s country may require a **certificate of origin**. The seller’s **commercial invoice** describing the goods and showing the price to be paid is always required. Finally, a **documentary draft** is necessary to expedite the exchange of money. The draft is a negotiable instrument for making payment for the invoice and for the bill of lading. In a later chapter we describe the draft as a negotiable “order to pay” made out by the seller, drawn on the buyer for collection, and payable to the order of the seller. Its purpose is to tell the parties how much to



pay when purchasing the bill of lading. The bank also needs the draft if financing is to be provided for the sale. Other documents may be required, as well, depending on the needs of the parties or the export–import regulations of their countries.

The seller's bank forwards the draft and documents to a **collecting bank** in the buyer's country, with instructions to release the documents to the buyer only on payment of the draft. A collecting bank is any bank authorized to collect on an instrument. When the buyer pays the draft, the collecting bank remits the money back to the seller's bank.

If the documents are presented in good order, the collection process should work smoothly, with buyer and seller each getting what they bargained for in the contract. The process may not be so smooth, however, if the documents tendered contain one or more obvious defects. If they appear forged, or if they show that the goods were shipped later than the date called for in the contract, or on an improper vessel, or if the goods are inadequately insured, or if the documents on their face appear fraudulent (e.g., a nonexistent shipping line), the buyer may refuse them. The buyer's refusal could come as quite a surprise to the seller, who in good faith shipped and tendered documents to the buyer only to find that they have been rejected and the draft unpaid due to some "technicality." Of course, the point of contention may be more than just a technicality to the buyer, who may feel the rejection was based on good cause. Either way, the seller is left with a good deal of exposure while the goods remain in a distant foreign port.

CIF Contracts and the English Common Law. There are many variations on the documentary sale. However, under one of the oldest and most typical variations, the seller must not only tender a bill of lading to the buyer for payment but also provide marine insurance on the goods and prepay the freight charges to the foreign port. These contracts are called **CIF contracts**. The acronym CIF is a trade term that stands for "cost, insurance, and freight." Trade terms are shorthand abbreviations drafted into a contract that assign the risk of loss, freight charges, and other responsibilities to either buyer or seller. Later in the chapter we discuss CIF and other trade terms, including some not used in documentary sales, are discussed later in the chapter.

In the following English case, the seller in San Francisco tendered documents covering a shipment

of hops to the buyer in London. The buyer wanted to inspect the merchandise first and refused to pay until delivery was made. The seller claimed that payment was due immediately upon presentation of the documents, even though the hops were still somewhere aboard ship on the ocean. The Kennedy dissent in *Biddell Brothers* represents a virtually universal view of CIF and other documentary sales contracts today. This rule has been adopted by the UCC, is incorporated into statutes in other countries, and has long been recognized by courts in the United States and throughout the world.

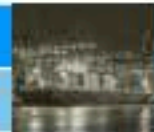
Certificates of Inspection or Analysis

The documentary sales transaction serves to protect the buyer as well as the seller. The bill of lading ensures that the goods have been loaded aboard ship for transport on the date shown, and the insurance policy protects against covered marine losses. However, the buyer must take the description of the goods in the bill of lading, and in the invoice that usually accompanies it, at face value. If the goods are nonconforming or defective, or if a lesser quantity was shipped, the buyer's only remedy may be an action for breach of contract. In many industries, buyers will require that an inspection report of a reputable, independent testing laboratory or inspection service, usually located in the seller's country, accompany a bill of lading. These might certify the quantity, quality, or other characteristic of the goods being purchased. Examples include **certificates of inspection**, **certificates of weight**, or **certificates of analysis**. Inspections are common in the chemical, extraction, and commodities businesses, as well as throughout other types of international trade. For instance, major apparel retailers in the United States typically arrange for preshipment inspection of garments for defects in the country of assembly.

In the *Basse and Selve v. Bank of Australasia* case, the buyer claimed that its bank should have been more diligent in accepting an inspection certificate that the seller had obtained from a chemist by fraud and trickery.

How Secure Are Documentary Payment Terms?

No reader should be left with the impression that documentary payment terms are appropriate for all parties or for all transactions. They are appropriate for shipments



Biddell Brothers v. E. Clemens Horst Co.

1 King's Bench 934 (1911) (Court of Appeal)

BACKGROUND AND FACTS

The defendant entered into a contract to sell hops to the plaintiff in London, as follows:

... one hundred bales, equal to or better than choice brewing Pacific Coast hops of each of the crops of the years 1905 to 1912 inclusive. The said hops to be shipped to Sunderland. The [buyer] shall pay for the said hops at the rate of ninety shillings sterling per 112 lbs. CIF to London, Liverpool, or Hull. Terms net cash.

The seller wrote to the buyer stating that they were ready to ship and that they expected payment upon presentation of a negotiable bill of lading. The buyer replied that it was prepared to take delivery but insisted that the seller either submit samples for prior inspection or that it be permitted to inspect each bale prior to payment. The buyer was unwilling to accept a certificate of inspection from the San Francisco Merchant's Exchange as assurance of quality. The seller refused to ship, and the buyer brought this action. The seller counterclaimed for the buyer's refusal to pay on the documents. The lower court ruled in for the defendant buyer. The Court of Appeals affirmed, with Kennedy, L.J., dissenting. On appeal to the House of Lords, the judgment was reversed.

LORD JUSTICE KENNEDY, DISSENTING

The plaintiffs' case is that the price was not to be paid until they had been given an opportunity of inspecting the shipment, which could not be given until after its arrival in this country. The defendants contend that the plaintiffs' obligation was to pay for the hops, whether they arrived or not, against tender of the shipping documents. The Court, therefore, has in the present case to decide what are the true conditions of the right of the seller to payment under a CIF contract, if that commercial contract is to be performed strictly according to its tenor.

Let us see, step by step, how according to those principles and rules the transactions as in such a CIF contract as that before us is and, I think, must be carried out in order to fulfill its terms.

At the port of shipment—in this case San Francisco—the vendor ships the goods intended for the purchaser under the contract. Under the Sale of Goods Act, 1893, [section] 18, by such shipment the goods are appropriated by the vendor to the fulfillment of the contract, and by virtue of [section] 32 the delivery of the goods to the carrier—whether named by the purchaser or not—for the purpose of transmission to the purchaser is *prima facie* to be deemed to be a delivery of the goods to the purchaser. Two further legal results arise out of the shipment. The goods

are at risk of the purchaser, against which he has protected himself by the stipulation in his CIF contract that the vendor shall, at his own cost, provide him with a proper policy of marine insurance intended to protect the buyer's interest, and available for his use, if the goods should be lost in transit. How is such a tender to be made of goods afloat under a CIF contract? By tender of the bill of lading, accompanied in case the goods have been lost in transit by the policy of insurance. The bill of lading in law and in fact represents the goods. Possession of the bill of lading places the goods at the disposal of the purchaser. .

... But then I understand it to be objected on behalf of the plaintiffs: "Granted that the purchaser might, if he pleased, take this constructive delivery and pay against it the price of the goods; what is there in the 'cost freight and insurance' contract which compels him to do so? Why may he not insist on an option of waiting for a tender of delivery of the goods themselves after having had an opportunity of examining them after their arrival?"

There are, I think, several sufficient answers to such a proposition. In the first place, an option of a time of payment is not a term which can be inferred, where the contract itself is silent. So far as I am aware, there is no authority for the inference of an option as to times of payment to be found either in the law books or in the Sale of Goods Act. Secondly, if there is a duty on the vendor to tender the bill of lading, there must, it seems to me, be a corresponding duty on the part of the purchaser to pay when such tender is made. For thereunder, as the bill of lading with its accompanying documents comes forward by mail, the purchaser obtains the privilege and absolute power of profitably dealing with the goods days or weeks, or, perhaps, in the case of shipments from a distant port, months, before the arrival of the goods themselves. This is, indeed, the essential and peculiar advantage which the buyer of imported goods intends to gain under the CIF contract according to the construction which I put upon it.

Finally, let me test the soundness of the plaintiffs' contention that according to the true meaning of this contract their obligation to pay arises only when delivery of the goods has been tendered to them after they have an opportunity of examination, in this way. Suppose the goods to have been shipped, the bill of lading taken, and the insurance for the benefit of the buyer duly effected by the seller, as expressly stipulated in the contract. Suppose the goods then during the ocean transit to have been lost by the perils of the sea. The vendor tenders the bill of lading, with the insurance policy and the other shipping documents (if any) to

continues



continued

the purchaser, to whom from the moment of shipment the property has passed, and at whose risk, covered by the insurance, the goods were at the time of loss. Is it, I ask myself, arguable that the purchaser could be heard to say, "I will not pay because I cannot have delivery of and an examination of the goods?" But it is just this which is necessarily involved in the contention of these plaintiffs. The seller's answer, and I think conclusive answer, is, "You have the bill of lading and the policy of insurance."

In my judgment, the judgment of Hamilton, J., was right, and this appeal, so far as relates to the plaintiffs' claim, should be dismissed.

Decision. Under a CIF sales contract, the buyer has no right to inspect the goods but is obligated to pay upon the presentation of the proper documents.

Case Questions

1. Why did the court rule that the buyer was not entitled to inspect the goods prior to paying for them?
2. What assurance did the buyer have that conforming goods were actually shipped?
3. What terms could the buyer have negotiated in the contract to assure that the goods shipped would be as ordered?
4. Assume that the documents arrive well ahead of the ocean cargo and that they are purchased by the buyer. A day later, the ship and cargo go down at sea. Assuming that the carrier was not at fault, what is the buyer's recourse?
5. In a CIF contract, which party assumes the risk of changes in the cost of ocean freight after the signing of the contract but before shipment?

that are of low to moderate value, shipments to repeat customers, and shipments of goods that may cost-effectively be returned home or resold to a substitute buyer if the original buyer rejects the documents. Traders that buy and sell commodities, natural resource materials, or other goods while they are still in transit also use documentary sales.

By establishing a regular course of business on documentary terms, the seller may become more comfortable in advancing to open credit account terms later. However, a documentary sale is not the most secure method of doing business because it offers no guarantee that the buyer will actually purchase the documents when presented. There is always the possibility that the buyer may become insolvent, find the goods more cheaply from another source, or change his or her mind.

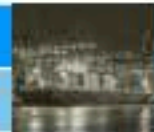
Even though the seller can maintain possession, ownership, and control of the goods through the bill of lading and can attempt to resell them to a substitute customer, that may not be so easy when the goods are in a foreign country or if they have a custom design and are not readily saleable. Therefore, the seller may want to require some additional security where the goods are of a very high value, specially manufactured, for first-time orders to new customers, or where a seller is uncertain as to the creditworthiness or integrity of a prospective foreign customer. In this case it may be wise to require full or partial payment in advance of shipment. The seller may also want to consider another

advance payment alternative that we will study in a later chapter: the use of a "letter of credit" from the buyer's bank wherein the bank irrevocably promises to become primarily responsible for purchasing the documents in lieu of the buyer. This added layer of security substitutes the credit worthiness and integrity of a bank for that of the buyer.

Measuring Damages for Breach of the Documentary Sale

In Chapter 4 we discussed the remedies available to a buyer and seller for breach of contract. In the case of the documentary sale, if the buyer sues the seller for non-delivery or other breach of contract, you can measure the buyer's damages by the difference between the contract price for the goods and the cost or fair market value of replacement goods. How do you determine the market value in a documentary sale? Is it the market value at the time that the goods ship, the time of delivery of the goods, or the time of payment?

Under the English view, damages are based on the market value as of the date when the buyer would have paid for the goods had the seller not breached. In *Sharpe & Co., Ltd. v. Nosawa & Co.*, (1917) 2 K.B. 814, a Japanese seller entered into a contract to ship peas to an English buyer under a documentary sale, CIF London. Neither the goods nor the documents were ever sent, and the buyer sued for damages. The question was whether the buyer's damages should have been



Basse and Selve v. Bank of Australasia

90 Law Times 618 (1904) (King's Bench)

BACKGROUND AND FACTS

The plaintiff had purchased ore from Oppenheimer. The plaintiff requested that the defendant bank negotiate documents on its behalf from Oppenheimer covering a shipment of "cobalt ore analysis not less than 5 per cent peroxide." The plaintiff specified that the bill of lading must be accompanied by a policy of insurance and a certificate of analysis from Dr. Helms, a Sydney chemist. Oppenheimer submitted for analysis phony samples of ore to the chemist, who, on the basis of this small sample, issued his certificate indicating the quality to be as described in the bill of lading. In fact, the ore contained in the actual shipment was worthless. The plaintiff brought this action in order to recover amounts paid by the bank against the documents.

JUSTICE BIGHAM

It was no part of their duty to verify the genuineness of the documents; the duty was not cast upon them of making inquiries at the office of the ship's agent as to whether the goods had, in truth, been received on board; nor were they to examine the contents of the packages to see whether they were right; nor were they to communicate with Dr. Helms in order to ascertain whether he had properly made the analysis mentioned in the certificate. The plaintiffs' mandate amounted in business to a representation to the defendants that upon all such matters they might rely on Oppenheimer, and the legal effect of such a representation is now to preclude the plaintiffs from questioning the validity of any apparently regular documents which Oppenheimer might tender. If this is so, then the only question left on this part of the case is whether the documents were apparently regular. It is admitted by the plaintiffs that the bill of lading and the policy of insurance were apparently regular, but an objection is made on this score to Helms's certificate. It is said that it professes to show

merely the test of the contents of a sample packet with a mark upon it, and does not purport to show a test of the bill of lading of 100 tons of ore. This, I think, is a fanciful objection. Large quantities of produce are necessarily tested by means of samples. Such samples are drawn either by the servants of the owner of the goods or (as it seems) by the servants of the analyst, and if the samples are carefully and skillfully drawn they generally fairly represent the bulk. But in this case it would be no part of the bank's duty to see to the sampling or to ascertain that it was fairly done. The bank was entitled to assume that it was so just as they were entitled to assume that the analyst had acted skillfully in making the analysis. The certificate is, in my opinion, regular on its face, and comes within the meaning of the mandate under which the bank was acting, and the bank in taking it acted carefully and properly.

Judgment for defendants.

Decision. The court ruled that because the certificate on its face was regular, the bank had acted properly in paying the seller. The bank had no duty to inspect the ore itself.

Case Questions

1. Why do buyers in international transactions often use inspection firms?
2. If the seller fails to provide an inspection certificate as required in the contract, can the buyer refuse to accept the documents?
3. Give examples of industries or products that would benefit from the following: health certificate, ingredients certificate, fumigation certificate, inspection certificate, certificate of chemical analysis, certificate of quantity or weight, and social compliance audit certificate.

calculated on the basis of the difference between the contract price (£10.15 sterling per ton) and the market price of peas at the time of the anticipated August delivery (£17.10 sterling per ton), or the difference between the contract price and the market price of peas on July 21, when the documents would have been tendered in London (£12.00 sterling per ton). The court held that the seller's responsibility under this contract would have been incomplete until he delivered the shipping documents to the buyer in London, at which time he would have been paid, and that the damages should therefore be measured by the price of peas on that date, July 21.

In a market with rapidly fluctuating prices, this question becomes especially important. *Seaver v. Lindsay Light Co.*, 135 N.E. 329 (N.Y. 1922) illustrates how American courts have diverged from the English rule. The seller and buyer entered a CIF contract for the shipment of thorium from Chicago to London. After the seller refused to ship, the buyer brought an action for breach of contract. Contrary to the English rule, the New York court looked at the nature of a shipment contract and stated:

Where was the delivery of the thorium in the present case to be made? Was it at Chicago or at the London



dock? When the correspondence and cablegrams are all construed together, as they must be, then it seems to me they clearly indicate an intention on the part of both parties that the delivery was to be made at Chicago, and when the defendant delivered to a carrier at that point, paid the freight to point of destination, and forwarded the other necessary documents, he had fully completed his part of the contract.

The court then concluded that damages for breach of a shipment contract should be measured by the market price of the goods *at the port of shipment on that date*.

Types of Ocean Bills of Lading

Bills of lading can take a variety of forms with different functions and usages in trade. The legal significance of each is important to all parties to the document.

Clean Bills of Lading. In addition to being a document of title, the bill of lading is also a receipt for the goods. A **clean bill of lading** is one that contains no notations by the carrier that indicate any visible damage to the goods, packages, drums, or other containers being loaded. Buyers should insist that all contracts call for the seller to provide a clean bill.

A bill of lading that is not clean is *foul*. Normally, this description applies only to the external appearance of the goods. For instance, the bill of lading must note leaking containers, rust on metal products, and external evidence of infestation by insects. As a generally accepted practice, the bill of lading must state the condition of the goods themselves, even if they are not externally observable, if the carrier knows or should have known that the goods are damaged. This type of inspection serves to protect the carrier from responsibility for preshipment damage.

A buyer who receives a clean bill still has no assurance that the goods will arrive in good condition. A clean bill of lading means only that the carrier noted no obvious or visible damage to the goods when they were loaded aboard ship. A clean bill of lading is no guarantee as to the quality of the goods or their conformance to the description in the sales contract. Moreover, it is no guarantee that the goods will not be damaged during the voyage.

On-Board Bills of Lading. An **on-board bill of lading**, signed by the ship's master or other agent of the carrier, states that the goods have actually been loaded aboard a certain vessel. In most documentary sales, the buyer would want to specify that payment is

conditioned upon receipt of a negotiable, clean onboard bill of lading. This document gives some assurance that the goods described in the bill of lading have actually been loaded on board and are under way to the buyer. It also insulates the exporter from loss of the goods before loading. An importer who buys an on-board bill also has an approximate idea of when the goods will arrive.

Received-for-Shipment Bills of Lading. A **received-for-shipment bill of lading**, on the other hand, is issued by a carrier only upon having received goods for transport. It has limited use in cases of a delay between the delivery of the goods to the carrier and their being loaded aboard ship. Imagine a buyer who is asked to pay for a received-for-shipment bill of lading for bananas being shipped from Honduras to the United States. The buyer has no guarantee that they will not spoil on the sun-parched dock weeks before they are loaded. Most documentary sales contracts will require that sellers tender on-board (and clean) bills of lading. A received-for-shipment bill of lading can be converted into an on-board bill of lading if the carrier notes the vessel name and date of loading on the face of the bill.

Straight Bills of Lading. The bill of lading used in a documentary sale is negotiable. In nondocumentary sales, a nonnegotiable or **straight bill of lading** will suffice. A straight bill of lading should not be confused with a sea waybill which is used in some countries and is a nonnegotiable receipt for goods received by the carrier containing the contract of carriage and identifying the party to whom the goods may be released. Sea waybills are used less frequently than bills of lading.

Ocean carriers use a straight bill of lading only if the seller intends that the goods be delivered directly to a **consignee**, a specific person, named in the bill. The consignee may be the foreign buyer, as in the case of a sale on open account terms. It may also be the buyer's bank or customs agent. There is no requirement for the consignee to produce the actual straight bill of lading to the carrier in order to take delivery in the United States; generally the only requirement is proof of identification. However, courts in Canada, the United Kingdom, and some other countries require consignees to produce a straight bill of lading when claiming their goods from the carrier.

Straight bills of lading are also used when the exporter is shipping to its own agent (or subsidiary company) in the foreign country, with the expectation that the agent will make direct arrangements with the



buyer for payment before turning over the goods. As in the case of negotiable documents, the carrier may deliver only to the party named in the bill. If the carrier delivers the goods to anyone else, it will be liable for misdelivery. Straight bills do not represent transferable title to the goods and cannot be used as the sole collateral for a loan. Thus, the typical use of straight bills of lading is when there is no financing involved.

Other Types of Transport Documents

Many specialized types of transport documents are in use today. The ocean bills of lading just described are only a few of the most common types. Transport documents have specific uses, depending on the type of carrier and the function the document is to perform. Many new types of transport documents have been developed because of modern shipping techniques. The following summary describes the different types of transport documents.

Air Waybills. Most air transport is handled through nonnegotiable **air waybills** issued by air cargo carriers. The carrier will make delivery only to the consignee named in the bill. The importance of negotiability in air transport is not as important as in ocean freight because the goods are not out of the control of the parties for long periods. The air waybill contains a mechanism by which the seller can guarantee payment, even though the sale is not a documentary sale. The air waybill can name a foreign bank as consignee and specify that the goods be held at the point of destination until the bank guarantees payment or until the bank approves release to the buyer. COD services are also available.

Forwarder's Bills of Lading. **Freight forwarders** (who usually also act as customs brokers for importers) are federally licensed individuals who act as agents for sellers. They handle their foreign shipments, book transportation, prepare documents and customs forms, and perform other functions. They are excellent sources of information on packing and transporting cargo, evaluating alternative shipping options, and obtaining freight rates. Freight forwarders can issue either straight or order bills of lading. Only certain forms of forwarder's bills are acceptable in a documentary sale. Forwarder's bills allow claims only against the forwarder itself, not the carrier. The carrier is liable only to the forwarder who holds the carrier's bill of lading.

Forwarder's bills must be distinguished from forwarder's receipts, which are mere acknowledgments

that the forwarder has received goods for shipment. Such receipts are nonnegotiable and usually will not be accepted for payment under a draft unless specifically allowed.

Multimodal Transport Documents. When goods are transported by only one mode of transportation, the transport is referred to as *unimodal*. If the transport is executed using more than one mode of transportation, the transport is **multimodal**. **Multimodal transport operators**, sometimes called **combined transport operators**, are firms that arrange for cargo to be sent via several different carriers in one journey—truck, rail, barge, and/or ship. Multimodal transport was made possible by new methods of containerizing freight that replaced “break bulk” cargo for all but the smallest shipments. The **multimodal transport document**, or **combined transport document**, is a single contract between the shipper and the operator, who, in turn, contracts with each of the carriers involved. They are sometimes referred to as “through bills of lading.” The operators become responsible for the shipment of goods throughout the time of their transport.

Electronic Data Interchange

Paper transport documents are increasingly being replaced by **electronic data interchange (EDI)**, whereby shipping data are transmitted over the Internet using one of several standards. Under this practice, trade documents such as bills of lading, letters of credit, and certificates of origin may be filed electronically at a central database.

The electronic transfer of documents has several advantages over paper-based transfers. First, it lets buyers and sellers track goods that are in transit and lets the parties make necessary adjustments when the goods are delayed. Second, the faster transmission of bills of lading and other documents lets the seller get faster payment for goods, which in turn translates into an improved cash flow for the seller. Third, it eliminates the need to prepare multiple copies of documents manually, which reduces redundant paperwork and improves efficiency and accuracy.

The use of EDI raises several issues. A principal concern is security. Traditionally, the buyer has had to present an original signed bill of lading to receive the goods. Although a “digital signature” may replace the written signature requirement, such documents may not be protected against unauthorized access. Infrastructure is



another issue. Not all geographic regions have reliable telecommunication networks.

Another obstacle to the global paperless system of trade is the lack of standardization. A particular trade document, such as a bill of lading, may have several different formats depending on the country and practices it uses. For a global system to work, there must be a standard format of trade documents.

ALLOCATING SHIPPING RESPONSIBILITIES AND THE RISK OF LOSS

Earlier in this chapter, and in the *Biddell Brothers* case, we saw that in certain documentary sales the seller is responsible for arranging and paying for ocean transportation and that risk of loss shifts to the buyer when the goods are properly delivered to the carrier at the port of shipment.

In the following sections, we look at how shipping responsibilities and risk of loss are allocated in general. The material in the following sections applies to all contracts for the sale of goods, not just those with documentary payment terms.

Freight and Transportation Charges

Shipping terms are integral to the price term itself. Because of the high cost of air and ocean freight, a buyer and seller must do more than merely agree on a price for the goods; they must also agree on who is going to pay the transportation and cargo insurance charges. For the price quoted, will the seller deliver the goods to the buyer, put them aboard a ship, or just make them available to a common carrier at the factory door? For instance, a seller might say, "This is the price if you come to my factory and pick up the goods. If you want me to pay to get them to the seaport in my country, or even across the ocean to your country, I will, but this is what the price of the goods will be then."

A seller will frequently present a proposal to a buyer offering a choice of shipping terms. For instance, one proposal may show a price with ocean freight, another without. These choices provide the buyer with a breakdown of the costs and responsibility for those costs within the transaction. Buyers who have an itemized breakdown of the various transportation, handling, and insurance charges from the seller can compare

those with the costs of making the shipping arrangements themselves. Furthermore, transportation costs are needed if the buyer is comparing prices from two different foreign suppliers located in different parts of the world.

A buyer who requests all suppliers to quote prices with the same shipping terms can compare "apples to apples." A buyer might also request certain shipping terms because of the nature of their business. A buyer who imports regularly may have buying agents in the seller's country who can handle the details of moving the goods. Similarly, a buyer may take full responsibility for chartering its own ships, as in the case of a developing country making a large purchase of grain. They may want the grain made available to them alongside their ship, and they will pay all expenses and bear all risks from that point. In many cases, a seller who maintains a warehouse in the buyer's country will price the goods for pickup there.

Unless a seller is in such a dominant position in the market that it can dictate terms, it may want to offer more flexible shipping terms to make the sale. Even if a competitor offers a lower price, a firm with better shipping terms may get the order. The buyer may lack experience in moving cargo or may just not want to deal with arranging transportation in the seller's country.

For instance, imagine a Japanese buyer who attends a trade fair in New York and concludes a contract with a company from Boone, North Carolina. The buyer may not want to bother with getting the goods from "the Boonedocks" to a U.S. seaport and then on to Japan. Rather, the buyer just wants the best price for the goods delivered and unloaded from a ship at a Japanese seaport nearest the buyer's factory.

Allocating the Risk of Loss

The parties to a contract must know when they are responsible for damage or loss to goods and when they are not. Clearly, the seller is responsible if fire destroys the goods during production at the seller's plant. Likewise, if the goods are destroyed after they have been moved into the buyer's warehouse, then the buyer is responsible. But when does the risk pass from one party to the other? In some countries, in the absence of a provision in the contract, the risk of loss is on the party who has "title" to the goods—the party who owns them, or the bill of lading, at that moment. However, because the bill of lading does not move physically with the goods, a determination of who owned the goods at the



time of their destruction is often difficult. For example, the bill of lading may have been negotiated to the buyer at 2:12 in the afternoon, but we have no evidence as to what time the ship actually sank. Here, there is no way of determining who actually “owned” the goods at the exact moment of loss. This “title” method has not been employed in the United States for many decades.

Ideally, the seller wants to be free of the risk of loss as soon as the goods leave its premises. The buyer would like to delay it for as long as possible. The ability to negotiate, of course, stems from the relative bargaining position of the parties. If the seller’s products contain superior technology or if they are commodities in short supply or patented products that the buyer needs, then the seller may be in a stronger position to shift the risk to the buyer. Similarly, if the buyer is in a dominant economic position, such as by being able to order in large quantities, the buyer may be able to dictate the terms of the contract. For example, the owner of a rare 1927 Rolls-Royce in London may say to a U.S. buyer, “You may purchase my Rolls in London and drive it away, but if you want it shipped to you, you must bear all the risks of the journey from the moment it leaves my door.”

Buyer and seller are always free to decide in their contract when the risk of loss will pass from one to the other. However, if the parties fail to do so and a dispute arises, the courts will be forced to decide on the basis of whether the contract is of the shipment type or of the destination type.

Destination Contracts. How the responsibilities of the parties are defined determines whether a contract is a shipment or a destination contract: Who has responsibility for shipping or transporting the goods? Who is paying the freight charges? By what means will the buyer remit payment? If the contract calls for the seller to deliver the goods to a particular destination, such as the buyer’s city or place of business, the contract is a **destination contract** (also known as an “arrival” contract). Under the UCC, the risk of loss in a destination contract passes to the buyer when the goods are tendered to the buyer at the point of destination.

Shipment Contracts. If the contract calls for the seller to ship the goods by carrier but does not require the seller to deliver the goods to a named place, then it is a shipment contract (also known as a “departure” contract). In a **shipment contract**, the risk of loss or damage to the goods passes to the buyer when the goods are given to the first carrier—be it truck, airline, or ocean

carrier. Shipment contracts are more common in international trade because sellers usually prefer not to be responsible for the goods at sea.

The Risk of Loss in International Sales under the CISG

The Convention on Contracts for the International Sale of Goods contains provisions that assign the risk of loss in Articles 66–70. The basic rule of Article 66 is that, unless the parties agree otherwise, any loss or damage to the goods occurring after the risk of loss has passed from seller to buyer does not relieve the buyer of his or her obligation to pay for the goods, unless the loss or damage is the fault of the seller. According to Article 67, if the contract calls for the goods to be handed over to a carrier at a particular place, then the risk passes to the buyer at that place. However, if the seller is simply expected to ship and no particular place is mentioned, the risk passes to the buyer when the goods are handed over to the first carrier for shipment to the buyer. For instance, assume that a company located in Boone, North Carolina, confirms an order for the export of its product to a foreign customer. The contract reads simply “Seller will handle all transportation charges and arrangements.” The seller arranges for a trucking company to pick up the goods and deliver them to the air carrier’s terminal at the airport in Charlotte, 100 miles away. The risk of loss will pass from seller to buyer when the goods are first handed over to the trucking company at the seller’s factory or warehouse in Boone. If the goods are damaged from that point forth, on land or in the air (or at sea, in the case of ocean shipment), the loss falls on the buyer. Of course, the seller is responsible for properly packaging and preparing the merchandise for shipment. The buyer would be relieved from any obligation to pay for the goods if the loss was due to an act or omission of the seller (Article 66).

Trade Terms

While it is possible to draft a detailed agreement for allocating shipping and transportation charges between buyer and seller and to specify when the risk of loss shall pass, in most routine cases this is done by using **trade terms**, sometimes called *shipping terms*. Trade terms are usually expressed in the form of abbreviated symbols, such as FOB or CIF. They are a shorthand method that permits the parties to express their agreement quickly, with little confusion, and with few language problems. If the parties use a trade term in their

contract, they must define it. If it is not defined in the contract, a court would have to look to the applicable law for its interpretation. The most common method of defining trade terms, however, is to incorporate them into the contract by reference to some independent source or publication.

International Rules for the Interpretation of Trade Terms

The most important set of trade-term definitions are the *International Rules for the Interpretation of Trade Terms*, or *Incoterms 2010*, published by the Paris-based *International Chamber of Commerce*. These definitions have the support of important business groups, including manufacturing, shipping, and banking industries worldwide. Courts and legal scholars in many countries cite them as having the effect of customary law. First published in 1936, the current revision was released in January 2011.

Incoterms include 11 trade terms classified into four groups—E, F, C, and D—according to the relative responsibilities of each party and to the point at which the risk of loss passes from seller to buyer. Exhibit 5.3 arranges the terms with the minimum responsibility of the seller and the maximum responsibility of the buyer appearing at the top; the minimum responsibility of the buyer and maximum responsibility of the seller appear at the bottom. International salespeople, export managers, and world traders benefit from a working knowledge of these terms. Because *Incoterms* are not automatically part of a contract for the sale of goods, parties should include a clause, such as “This contract is to be interpreted in accordance with *Incoterms*.”

The following case, *Cedar Petrochemicals, Inc. v. Dongbu Hannong Chemical Co.*, illustrates the wide acceptance of *Incoterms* and its interaction with the Convention on Contracts for the International Sale of Goods discussed in Chapter 4.

The following section looks at some hypothetical illustrations to see how these terms are used. Keep in mind that the terms were drafted by their authors to reflect how companies actually do business. Selecting a term for incorporation in a contract is more than just bargaining over who will pay freight costs or bear the risk of loss. Certain terms may fit better with the needs of the parties. Some are suited for ocean carriage, some for air transport, and others for **multimodal transport**. Some terms are suited for a documentary form of payment, while others are suited to open account payment

terms. Also, keep in mind that the terms are for maritime and inland waterway transport only: FAS, FOB, CFR, and CIF. Others are for any mode of transport.

E Terms

E terms place the lowest amount of responsibility on the seller. In the following hypothetical situation, assume a buyer in the Netherlands is placing an order with a supplier in Albany, New York. The buyer states that its U.S. subsidiary will pick up the goods at the Albany plant and arrange export. Therefore, the seller will probably quote its price in terms *EXW Albany factory*. Under this term, the seller need only make the goods available at its factory (or mill, farm, warehouse, or other place of business) and present the buyer with an invoice for payment. The buyer must arrange all transportation and bear all risks and expenses of the journey from that point. The buyer must also clear the goods for export by obtaining export licenses from the U.S. government.

This term is most often used when the buyer will pick up the goods by truck or rail. Therefore, for international shipments, EXW terms are common in Europe where goods frequently move across national boundaries by ground transportation. But unless the buyer requests this term, use of it may show that the seller is not really interested in exporting and is unwilling to accommodate a foreign buyer.

F Terms

The **F terms** are shipment contracts similar to those studied earlier. Under F terms, the seller must deliver the goods to the designated point of departure “free” of expense or risk to the buyer. At that point, the risk of loss passes from seller to buyer. The buyer arranges the transportation and pays all freight costs. However, if it is convenient and the parties agree, the seller may pay the freight and add that amount to the invoice price already quoted. F terms are often used when the buyer contracts for a complete shipload of materials or commodities and thus has reason to assume the responsibility for arranging carriage. F terms may also be used because the buyer feels that it can obtain better freight rates than the seller. Some F terms are for ocean shipment only. Others can be used for all modes of transport.

Assume that the buyer in the Netherlands wants to arrange its own ocean transportation. The seller in Albany wants to deliver the goods to a carrier near it, for transportation to the Port of New York, making it

Exhibit 5.3

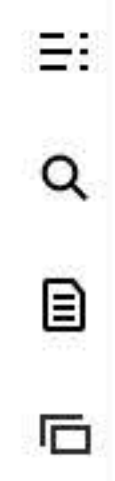
Explanation of Incoterms 2010 ICC Official Rules for the Interpretation of Trade Terms

Group and Type	Term Abbreviation/ In Full	Mode of Transportation	Seller's Responsibilities	Buyer's Responsibilities	Passage of Risk
E Group	EXW Ex Works	All modes	Have the goods ready for pickup at the location specified in the contract, usually seller's place of business.	Provide vehicle or rail car and load goods. Obtain export licenses. Enter goods through customs.	When the goods are made available by seller at named location.
	FCA Free Carrier	All modes	Place the goods in the hands of a carrier named by the buyer at the place specified. Provide export license.	Choose carrier, arrange transport, and pay freight charges. On arrival, enter goods through customs.	When the goods are delivered to the carrier or terminal operator at the named place of shipment.
F Group	FAS Free Alongside Ship	Sea and inland waterway only	Place the goods alongside the ship specified by the buyer (on the dock or barge) within the time required by the contract, ready for loading. Obtain export license.	Choose ocean carrier, arrange transport, and pay freight. Enter goods through customs.	When the goods are delivered alongside the ship specified by buyer.
	FOB Free on Board	Sea and inland waterway only	Load the goods on board the ship specified by the buyer within the time required by the contract. Pay costs of loading. Obtain export license.	Choose ocean carrier and pay freight charges. Enter goods through customs.	When the goods are on board at port of shipment.
	CFR Cost and Freight	Sea and inland waterway only	Contract for transport and pay freight charges to the named port of destination. Arrange for loading of goods on board ship, usually of seller's choice, and pay costs of loading. Obtain export license. Notify buyer of shipment. Documentary sale is assumed. Tender document is to buyer.	Purchase document of title and take delivery from ocean carrier. No date of delivery at buyer's port is implied. Pay import duties. Enter goods through customs.	When the goods are on board at port of shipment. Buyer must procure own insurance or else use CIF term.
C Group	CIF Cost, Insurance, and Freight	Sea and inland waterway only	Same as CFR, with added requirement that seller purchase marine insurance. Insurance policy is assigned to buyer. Documentary sale is assumed.	Same as CFR, except seller supplies insurance. Buyer may request additional insurance coverage at own expense.	When the goods are on board at port of shipment. If damage or loss, buyer files a claim with insurer.

continued

CPT Carriage Paid To	All modes	Similar to CFR, but for all modes of transport. Deliver goods to truck, rail, or multimodal carrier, or to ship, and arrange for transport to destination. Freight charges prepaid. Obtain export license. Notify buyer of shipment. Seller need not insure goods. Documentary sale is assumed.	Similar to CFR. Purchase document of title and take delivery of goods from carrier. Enter goods through customs. Pay import duties.	When the goods are delivered by the seller to the first carrier. Buyer must procure own insurance or use CIP term.
CIP Carriage and Insurance Paid To	All modes	Same as CPT, with added requirement that seller purchase insurance. Insurance policy assigned to buyer.	Same as CPT. Purchase document of title and take delivery of goods from carrier. Enter goods through customs. Pay import duties.	When the goods are delivered by the seller to the first carrier. If damage or loss, buyer files a claim with insurer.
D Group				
DAT Delivered at Terminal	All modes	Seller clears the goods for export and bears all costs associated with delivering the goods and unloading them at the terminal at the named port or destination.	Take delivery of goods at specified location. Buyer is responsible for all costs after delivery and unloading of the goods including clearing the goods for import in the named country of destination.	When the goods are unloaded and delivered to buyer at specified location.
DAP Delivered at Place	All modes	Seller clears the goods for export and bears all costs associated with delivering the goods at the named place of destination not unloaded.	Take delivery of goods at specified location. Buyer is responsible for all costs after delivery including unloading of the goods and clearing the goods for import in the named country of destination.	When the goods are delivered to buyer at specified destination.
DDP Delivered Duty Paid	All modes	Same as DAT, except that seller obtains import licenses, pays import duties, and clears goods through customs. Place of destination specified is usually buyer's place of business.	Take delivery of goods at specified location.	When the goods are unloaded and delivered to buyer at specified location. Seller should insure for own protection.

Source: export.gov, Incoterms 2010, located at http://export.gov/faq/eg_main_043740.asp.



necessary for different forms of transportation. For instance, the seller might deliver the goods to a barge hauler for a trip down the Hudson, or to a railroad or trucking company. The seller may want to hand over the goods to a multimodal terminal operator nearby and let it handle the goods from there. This inland carrier will then transport the goods to the Port of New York for shipment to the foreign destination. If this inland carrier is in Albany, then the seller should

quote prices *FCA Albany*. Here, for the contract price, the seller bears the costs and assumes all risks of getting the goods from its factory to the carrier or terminal in Albany. The seller then has the responsibility to obtain any necessary government export licenses. This term can also be used for air transport. A term *FCA JFK Airport* means that the seller has agreed, for the contract price, to deliver the goods from Albany to the airline in New York for shipment.



Cedar Petrochemicals, Inc. v. Dongbu Hannong Chemical Co.

2011 WL 4494602 (2011) (United States District Court for the Southern District of New York)

BACKGROUND AND FACTS

In May 2005, Cedar Petrochemicals, Inc., a New York-based petrochemicals trader, entered into a contract with Dongbu Hannong Chemical Co., Ltd., a South Korean corporation, whereby the latter agreed to deliver a certain quantity of liquid phenol to a ship called the *Bow Flora* in the port of Ulsan, South Korea, at which point Cedar would take possession. The terms and conditions of the contract provided that “Incoterms 2000 as amended to date” would govern and contained the delivery term “FOB Ulsan Anchorage, Korea.” The contract also provided that the phenol meet certain specifications with respect to color.

The phenol was subsequently loaded onto the *Green Pioneer*, a ship chartered by Dongbu, in the port of Yosu, South Korea for shipment to Ulsan where it was transferred to Cedar’s vessel, the *Bow Flora*. Inspections in Ulsan determined that the phenol complied with contract specifications and, as a result, Cedar tendered payment to Dongbu. However, subsequent tests performed when the *Bow Flora* arrived in Rotterdam, the Netherlands, in July 2005 revealed that the phenol no longer conformed to contract specifications. Retesting in South Korea discovered the presence of particulate matter in the *Green Pioneer* which may have tainted a portion of the phenol when it was transferred to the *Bow Flora*.

In May 2006, Cedar filed a lawsuit against Dongbu alleging breach of two provisions of the CISG, specifically, Article 35 (requiring goods be fit for ordinary usage or any particular purpose that is “expressly or impliedly made known to the seller”) and Article 36 (providing that a seller is liable for defects present before risk transfers to the buyer “even though the lack of conformity becomes apparent only after that time”). Dongbu claimed that the contractual term “F.O.B. Ulsan, Anchorage” displaced the provisions of the Convention on Contracts for the International Sale of Goods (“CISG”) on which Cedar relied and that it was only

obligated to provide phenol that conformed to the specifications at the time of delivery in Korea.

TAYLOR SWAIN, DISTRICT COURT JUDGE

The CISG is an international convention that governs the formation of international sales contracts, as well as the rights and obligations of the parties. The Convention “automatically applies to international sales contracts between parties from different contracting states unless the parties agree to exclude [its] application.” *Zhejiang Shaoxing Yongli Printing & Dyeing Co., Ltd. v. Microflock Textile Group Corp.*, No. 06–CV–22608(JJO), 2008 WL 2098062, at *2 (S.D.Fla. May 19, 2008); CISG Art. 6. Where parties wish to exercise their right to derogate from the CISG, they must do so explicitly. *See BP Oil Int’l, Ltd., v. Empresa Estatal Petroleos de Ecuador*, 332 F.3d 333, 337 (5th Cir.2003) (holding that “if the parties decide to exclude the [CISG], it should be expressly excluded by language which states that it does not apply”); *Asante Techs., Inc. v. PMC-Sierra, Inc.*, 164 F.Supp.2d 1142, 1150 (N.D.Cal.2001) (holding that a choice of law provision selecting British Columbia law did not “envince a clear intent to opt out of the CISG”). None of the terms Dongbu cites explicitly exclude or otherwise express a clear intent to displace the CISG.

Dongbu’s contention that the “F.O.B.” term displaces Article 36 liability for hidden defects that only manifest after delivery is plainly incorrect. As provided in the contract, the definition of “F.O.B.” is furnished by Incoterms (International Commercial Terms) 2000, a widely used glossary of trade terms published by the International Chamber of Commerce. According to Incoterms 2000:

“Free on Board” means that the seller delivers when the goods pass the ship’s rail at the named port of shipment. This means that the buyer has to bear all costs and risks of loss or damage to the goods from that point.



continued

It is worth noting at the outset that the entire body of Incoterms—“F.O.B” included—is incorporated into the CISG through Article 9(2) thereof. [citation omitted]. Dongbu makes no attempt to explain how a term that is made part of the CISG could also derogate from it. More to the point, because the contract does not explicitly displace any provision of the CISG, Dongbu’s argument depends on the errant assumption that Free on Board is so fundamentally incompatible with Article 36 that the choice of the former necessarily implies a decision to exclude the latter. Free on Board means that, if the goods are injured before risk has passed to the buyer, the seller is liable; if the injury occurs afterward, the buyer is liable. Article 36 is wholly compatible with that division of risk; it merely affirms that the decisive question when assigning liability is who bore the risk of loss at the time the injury occurred, not when the injury manifested. [citation omitted]. If Cedar succeeds in showing that the phenol was damaged prior to delivery

to the Bow Flora, the FOB term will not shield Dongbu from liability.

For the foregoing reasons, Defendant’s motion for summary judgment dismissing Plaintiff’s complaint is denied in its entirety.

Decision. The court held that Incoterms are incorporated into the body of the CISG, and there was no incompatibility between the CISG and the Incoterm “F.O.B.” The parties’ contract failed to displace any provision of the CISG, and consequently, the application of *Incoterms* as well.

CASE QUESTIONS

1. What provisions could Dongbu have included in the contract with Cedar if it intended to avoid the application of the CISG?
2. What *Incoterm* would you have recommended to Dongbu in order to avoid the result in this case?

Assume now that the Dutch buyer is purchasing a bulk cargo, such as agricultural commodities, and will charter a full ship for the overseas voyage—a *voyage charter*—departing from New York to Rotterdam. The buyer may find the voyage charter more convenient and cheaper to arrange than leaving the shipping up to the seller. The buyer wants the seller to place the goods on barges or on the pier alongside the ship, *Queen Anna E*, docked at the Port of New York. The appropriate contract terms are *FAS Queen Anna E*. (If the name of the vessel is not yet known, the parties can contract on terms *FAS New York*.) The risk of loss passes from seller to buyer once the goods are alongside the ship. The buyer, having arranged the ocean transport, will pay the separate costs of loading the vessel. The seller must obtain an export license and clear the goods for export. An *FAS* buyer should also provide the seller with notice of the ship’s departure date and loading times. The seller’s obligation is to place the goods alongside the vessel within the time called for in the contract.

Under *FOB* (free on board) contracts, the seller bears slightly more responsibility. In addition to obtaining export clearance, the seller must place the goods aboard the ship. Risk of loss passes to the buyer once the goods are on board. Therefore, if the contract is on terms *FOB New York* or *FOB Queen Anna E*, the seller must secure export licenses, pay all costs of loading, and deliver the goods over the ship’s rail. Notice that under

Incoterms, the seller’s responsibility does not end until the goods are actually on board the vessel. Exporters should always use the *FOB* term as a shipment contract as it was intended. Using it in conjunction with a destination location (e.g., *FOB foreign port*) contradicts the *Incoterms* definition and shifts the risk of the voyage to the exporter.

C Terms

C terms are also shipment contracts. The letter C indicates that the seller is responsible for certain costs after the delivery of goods to the carrier. Like the *FOB* term, however, risk of loss passes to the buyer when the goods are on board the vessel or carrier. Assume that our Dutch buyer requests pricing information from Albany. As an experienced exporter, the seller might understand that the buyer has little interest in arranging transportation, let alone coming to pick up the goods. The buyer simply wants the goods delivered to the port of entry in its country closest to its company. If this requires ocean shipment, the seller will prepare a price quotation *CFR Port of Rotterdam* (formerly called *C & F*) or *CIF Port of Rotterdam*. For the price quoted, the seller will deliver the goods to an ocean carrier, arrange shipment, prepay the freight charges to the agreed-on port of destination, obtain a clean on-board bill of lading marked *freight prepaid*, and forward it along with the invoice to the buyer for payment.



The only difference between CFR and CIF terms is that under CIF terms the seller must also procure and forward to the buyer a policy of marine insurance to cover the risk of loss once it passes to the buyer. (This amount is the minimum coverage; the buyer may want to request the purchase of additional insurance for its own protection.) By providing both carriage and insurance coverage, the seller is able to earn additional profit yet retain its rights in the goods until payment is made against documents. Upon presentation of the bill of lading, the Dutch buyer must make payment, but once it receives the bill of lading, it can resell the goods, or if the goods are lost, it is entitled to collect the insurance money. However, both *Incoterms* and maritime practice seem to indicate that, if the seller desires, it may forgo its right to collect on the documents, negotiate the bill of lading directly to the buyer, and make other arrangements for payment or credit.

If the seller intends to arrange ocean transportation but will deliver the goods to a road or rail carrier, inland waterway, or to a multimodal terminal operator for transit to the seaport, the seller may wish to quote *CPT, Port of Rotterdam*. Here, the risk of loss shifts to the buyer when the goods are delivered to the first carrier. CIP terms are the same as under CPT, with the added requirement that the seller procure insurance to cover the buyer's risk of loss.

D Terms

Contracts with **D terms** of sale are destination (or "arrival") contracts. If the seller in Albany is willing to enter into a destination contract, then it must be willing to accept far greater responsibility than under any other terms. For the price stated in the contract, the seller must deliver the goods at the port of destination and bear the risk of loss throughout the journey. Thus, if the goods are lost in transit, the Dutch buyer would not be entitled to claim the insurance money, although the buyer may have lost profits it was hoping to make on the goods.

The *D terms* may be used for any mode or modes of transport. If the contract terms are *DAT Rotterdam*, the seller must clear the goods for export and bears all costs and risks associated with their delivery and unloading at the terminal in Rotterdam. The Dutch buyer is responsible for all costs and risks going forward including clearing the goods for import in the Netherlands. The parties' responsibilities are identical if the contract terms are *DAP Rotterdam* with the exception that the seller is responsible for delivery to the named destination not unloaded, and the buyer is responsible for the

costs and risks associated with unloading in addition to clearing the goods through customs. Finally, the seller's responsibilities are at their maximum if the contract terms are *DDP Rotterdam* in which the seller bears all risks and costs associated with delivery of the goods ready for unloading and cleared for import. Clearly, the seller will not want to take on the responsibility and risks of a DDP shipment unless it is experienced in importing into the Netherlands and familiar with customs regulations and tariff laws there.

Today, destination contracts are actually becoming more popular due to an increasingly competitive and globalized marketplace. Many manufacturers and other shippers find they must do more and more to win and keep customers. In other words, shippers often have to provide credit terms to their customers by shipping on open account and giving the customer time to pay. Shippers are also being forced to take greater responsibility for getting the goods into the customer's hands. For these reasons, more and more shippers are quoting prices on D terms than ever before. Still others are quoting prices on C terms to shift the risk of the voyage but voluntarily forgoing the documentary collection and sending the bill of lading directly to the customer for payment on open account.

Modification of Trade Terms

On occasion, the parties may be tempted to alter the meaning of a trade term in their contract to meet their own business requirements. The International Chamber of Commerce and many experienced lawyers usually recommend that buyer and seller do not attempt to add to, explain, or change the meaning of any trade term without legal advice. This "customizing" only causes needless confusion. The problem usually arises in CIF contract cases. The general rule is that if the additional shipping terms added by the parties to a CIF contract do not contradict the usual terms of a CIF contract, then the contract will still be considered a CIF contract.

On the other hand, by inserting additional terms that are contrary to the usual meaning of CIF, they can destroy the CIF terms. For instance, assume that the parties enter into a contract labeled "CIF." They then add that "payment is not due until the goods are sold by the buyer." A court must then decide, looking at all the evidence, whether the contract was on CIF terms. The court in *Kumar Corp. v. Nopal Lines, Ltd.* discusses this issue. As you read, notice that the court decides the case on the basis of the seller's failure to obtain insurance on the cargo as required under CIF terms.



Kumar Corp. v. Nopal Lines, Ltd.

462 So. 2d 1178 (1985) (District Court of Appeals of Florida)

BACKGROUND AND FACTS

Kumar sold 700 television sets to one of its largest customers, Nava, in Venezuela. The contract was on CIF terms, Maracaibo. However, they agreed that Nava would not pay Kumar until Nava actually sold the merchandise. Kumar obtained the televisions from its supplier, received them in its Miami warehouse, loaded them on a trailer, delivered the trailer to its freight forwarder, Maduro, in Florida, and obtained the shipping documents. The trailer was stolen from the Maduro lot and found abandoned and empty. Kumar had failed to obtain marine insurance on the cargo. Kumar sued Maduro and the carrier. The defendants argued that, because the risk of loss had passed from Kumar to Nava, Kumar did not have standing to sue. The trial court agreed with the defendants and dismissed Kumar's case. Kumar appealed.

DANIEL S. PEARSON, JUDGE

Kumar's argument that it is the real party in interest proceeds . . . from the premise that its agreement to postpone Nava's obligation to pay for the goods modified the ordinary consequence of the CIF contract that the risk of loss shifts to the buyer. A CIF contract is a recognized and established form of contract, the incidents of which are well known. Thus, if a buyer and seller adopt such a contract, "they will be presumed, in the absence of any express term to the contrary, to have adopted all the normal incidents of that type of contract," D. M. Day, *The Law of International Trade*, 4 (1981), one of which is that the buyer, not the seller, bears the risk of loss when the goods are delivered to the carrier and the seller's other contractual obligations are fulfilled. A CIF contract is not a contract "that goods shall arrive, but a contract to ship goods complying with the contract of sale, to obtain, unless the contract otherwise provides, the ordinary contract of carriage to the place of destination, and the ordinary contract of insurance of the goods on that voyage, and to tender these documents against payment of the contract price." C. Schmitthoff, *The Law and Practice of International Trade*, 26-27 (7th ed. 1980).

It is clear, however, that parties may vary the terms of a CIF contract to meet their own requirements. But where the agreed-upon variation is such that it removes a vital ingredient of a CIF contract, then the contract ceases to be a CIF contract. Thus, "if according to the intention of the parties the actual delivery of the goods [to the buyer] is an essential condition of performance, the contract is not a CIF contract." C. Schmitthoff, *supra*.

In the present case, Kumar and Nava agreed to payment upon Nava's sale of the goods in Venezuela . . . [thereby negating an essential ingredient of the CIF contract]. . . . [T]he use of the term CIF does not ipso facto make the contract a CIF contract if the contract has been altered in a manner that is repugnant to the very nature of a CIF contract. Therefore, because the record before us does not . . . conclusively show that the contract remained a true CIF contract despite the agreement between Kumar and Nava concerning the payment for the goods, it was improper for the trial court to conclude as a matter of law that the risk of loss passed to Nava when Kumar delivered the goods to the shipper.

But even assuming, *arguendo*, that we were to conclude, as did the trial court, that the risk of loss passed to Nava merely by virtue of the label CIF on the contract, Kumar must still prevail. Under the CIF contract, Kumar was obliged to procure insurance, and by not doing so, acted, intentionally or unintentionally, as the insurer of the shipment. As the insurer of the shipment, Kumar was obliged to pay Nava, the risk bearer, for the loss when the goods were stolen. Being legally obliged to pay Nava's loss, Kumar would thus be subrogated to Nava's claims against the appellees. Since a subrogee is the real party in interest and may sue in its own name, Kumar would have standing to sue under this theory.

Reversed and remanded for further proceedings.

Decision. The court held that where, under a CIF contract, the seller fails to obtain marine cargo insurance on behalf of the buyer, the risk of loss remains with the seller, who becomes a self-insurer of the property. As such, the seller has standing to sue the carrier for the cargo loss.

Case Questions

1. In what way did the wording of the contract contradict the CIF term?
2. If the court said that the parties may vary the terms of their contract to meet their own requirements, why did the court not recognize the contradictory wording?
3. Assume that a seller fails to procure insurance on a shipment as required by contract and that the shipment is lost at sea. As between buyer and seller, which party will bear the loss?



CONCLUSION

Transaction risks can threaten significant costs to doing international business. Contract negotiations represent a good opportunity to address transaction risks in advance. In an international contract for the sale of goods, the terms of sale are as essential to the contract as the quality of the goods themselves. Moving goods around the world is expensive and risky. If a contract does not specify the terms of sale and who bears the risk of loss, the parties may be in for a tremendous surprise. Moreover, because of the risks of nonpayment and non-delivery, the parties may not wish to do business on cash or open account terms until a business relationship is established. Thus, an understanding of the documentary sale, as well as of the most common trade terms, is necessary for any international sales specialist or export manager.

Despite the continued and widespread use of the documentary sale, its use has declined somewhat in the recent years due to a number of factors. First, the greater reliability of international credit reporting makes open account transactions between foreign parties much

safer than in previous years. Second, increasing globalization means closer, long-term relationships between vendors in a global supply chain. Third, it is possible to purchase many of the same products on other terms from domestic sources, such as domestic subsidiaries of foreign manufacturers or through local distributors. Nevertheless, the documentary sale is often used when the credit risk is significant. It is also used when the goods will be resold while in transit. Common examples are agricultural commodities, oil, and fungible goods. The bill of lading, which serves as a document of title, permits the goods to be bought and sold, time and again, even though they remain aboard ship on the high seas or are sitting in a foreign port.

No reader should be left with the impression that the documentary sale eliminates the risk of foreign shipments. The buyer might refuse the documents when they are presented by its bank or it may be unable to pay. Similarly, the buyer might purchase documents that appear to be in order only to find defective merchandise in the containers—or no merchandise at all. The solution to some of these problems is the subject of the next chapter.

Chapter Summary

1. *Transaction risks* are those risks to buyer and seller resulting from moving money and goods under an international sales contract. They arise from barriers that separate buyer and seller, including distance, oceans, the time that the cargo is out of possession of the parties, communication and language difficulties, cultural differences, national boundaries, interference by local customs authorities, and differences in legal systems.
2. The *documentary sale* is one type of contract for the international sale of goods, using ocean transport, in which the buyer must pay upon the presentation of a negotiable document of title by the seller. The parties might indicate their desire for a documentary sale by specifying in the contract that payment terms are “cash against documents” or “documents against payment.”
3. A *bill of lading* is a document of title that an *ocean carrier* issues to a shipper upon receiving goods for transport. Bills of lading can be negotiable or nonnegotiable. Nonnegotiable bills are contracts of carriage and receipts for depositing goods with a carrier for shipment. Additionally, negotiable bills of lading serve as a document of title. Only negotiable bills of lading can be used in the documentary sale.
4. The documentary sale is critical to world trade because it allows the holder of the document of title to trade in the goods while they are still at sea. The documents may be bought and sold many times before they reach a final destination.
5. The *documentary collection* is the process by which international banks serve as intermediaries between seller and buyer to handle the exchange of the bill of lading in return for payment.
6. In a documentary sale, the buyer is given no opportunity to inspect the goods. In essence, the buyer is not buying goods, but is buying documents that represent ownership of the goods. The seller’s basic obligation is to ship the good in accordance with the contract and to tender a clean bill of lading to the buyer. The buyer’s obligation is to purchase the bill of lading when presented by a bank in the buyer’s

- country. A “clean” bill is one with no notations from the carrier or carrier’s agent indicating that damage to the goods was observable at the time of loading. Cargo insurance is a key component of most documentary sales.
- Due to the expense of ocean shipment, and the perils of the sea, it is important for the parties to know that they have the freedom to negotiate which of them, buyer or seller, will pay for transportation expenses and insurance, and which of them will bear the risk of loss or damage during transit. This is often done using a shorthand *trade term* in the contract. The most commonly used definitions for trade terms are *Incoterms*, published by the International Chamber of Commerce. If used in a contract, they will be recognized and enforced by courts.
 - Incoterms* include 11 trade terms, classified into four groups—E, F, C, and D—according to the relative responsibilities of each party and to the point at which the risk of loss passes from seller to buyer. As Exhibit 5.4 shows, Incoterms are arranged in order ranking the responsibility of buyer and seller. The E term EXW, or Ex Works, represents the maximum responsibility of the buyer and minimum responsibility of the seller. The D term DDP, or delivery duty paid, represents the maximum responsibility of the seller and the minimum responsibility of the buyer. The C terms are shipment contracts. The D terms are destination contracts.
 - Some trade terms are appropriate for documentary sales; others can be used for contracts that call for open account or other payment terms.
 - While the documentary sale is still widely used as a safe payment mechanism, experienced parties attempt to forge long-term business relationships with flexible payment terms.

Key Terms

transaction risk 121	transport document 128	freight forwarders 134
delivery risk 121	marine insurance 128	multimodal 134
payment risk (credit risk) 121	certificate of origin 128	multimodal transport operators 134
open account 121	commercial invoice 128	combined transport operators 134
documentary sale 122	documentary draft 128	multimodal transport
document of title 122	collecting bank 129	document 134
bailor 122	CIF contracts 129	combined transport document 134
bailee 122	certificates of inspection 129	electronic data interchange (EDI) 134
bailment 122	certificates of weight 129	destination contract 136
negotiation 122	certificates of analysis 129	shipment contract 136
constructive delivery 122	clean bill of lading 133	trade terms 136
bill of lading 122	on-board bill of lading 133	<i>Incoterms</i> 2010 137
negotiable instrument 124	received-for-shipment bill	multimodal transport 137
negotiable document 124	of lading 133	E terms 137
holder by due negotiation 124	straight bill of lading 133	F terms 137
paramount title 124	consignee 133	C terms 141
documentary collection 127	air waybills 134	D terms 142

Questions and Case Problems

- Bruitrix held a bill of lading covering a shipment of washing machines that it had purchased. The washing machines were placed into a bonded warehouse operated by the British Transport Commission. Bruitrix pledged the bill of lading to its creditor, Barclay’s Bank, as security for an outstanding debt. Two months later, the defendant,

the Commissioners of Customs, obtained a judgment against Bruitrix for a delinquent tax. The bank attempted to take possession of the goods in order to satisfy Bruitrix's outstanding debt. On the same day, the Commissioners attempted to take possession of the goods to satisfy their judgment. The bank brought this action claiming that the pledge had transferred title to the goods to it and that as the holder of the bill of lading it was entitled to the goods. Who has a greater right in the property, Barclays Bank or the Commissioners? Why? How does the bill of lading serve as a financing device? The bill of lading is a contract of carriage. When does the carrier discharge its performance under the contract? *Barclay's Bank, Ltd. v. Commissioners of Customs and Excise*, (1963) 1 Lloyd's 81, Queen's Bench.

2. In March 1999, China North Chemical Industries Corporation and Beston Chemical Corporation entered into a contract under which Nocinco agreed to sell to Beston 718 pallets of explosive boosters deliverable "CIF" to Berwick, Louisiana, for which Beston agreed to pay \$2,477,691.00. The cargo was ultimately entrusted to Guangzhou Ocean Shipping Company, which booked a ship specially licensed to carry explosives cargo. The contract did not specify how the cargo would be stowed on board the transporting ship. However, Beston sent Nocinco a detailed list of stowage requirements, receipt of which Nocinco acknowledged. The ship proved too small to accommodate all of the cargo if the captain followed Beston's instructions. The captain agreed to guarantee safe passage and issued to Nocinco a clean bill of lading covering the cargo. Unfortunately, the ship encountered storm conditions during which the cargo was damaged. Experts who examined the cargo when it arrived in Louisiana concluded that the damage was the result of improper stowage, inadequate securing, and the heavy weather encountered during the voyage. Beston subsequently paid 15% of the contract price but refused to pay the remaining balance. Nocinco filed a lawsuit against Beston to recover the remaining \$2,077,464.60 due under the contract. Nocinco argued that it performed its obligations under the contract when it delivered the cargo to the ship in good condition as evidenced by the clean bill of lading. Nocinco conceded that the cargo was improperly loaded and stowed but that, under the contract's CIF term, the risk of loss passed to Beston when the cargo passed the ship's rail. The fact that the cargo arrived in Louisiana in damaged condition did not discharge Beston's obligation to pay the contract price. Beston argued that Nocinco's receipt, acknowledgement, and ultimate disregard of Beston's shipping requirements excused it from paying the full contract price. Should Beston's additional shipping requirements modify the CIF term which Nocinco otherwise met under the 1990 version of *Incoterms* in force and effect at the time of the contract? What *Incoterms* might Beston have employed to ensure compliance

with its shipping requirements and transfer the risk of loss to Nocinco pending delivery in Louisiana? *China North Chemical Industries Corp. v. Beston Chemical Corp.*, 2006 WL 295395 (S.D. Tex. 2006).

3. Lite-On Peripherals, Inc. was a California-based corporation engaged in the computer hardware business. Lite-On's parent company was Silitek Corporation, a Taiwan-based corporation. On January 22, 1996, Burlington Air Express, Inc. received 1,000 cartons comprised of 5,000 computer keyboards from Silitek in Keelung, Taiwan, for transportation to Los Angeles, California. Burlington issued a bill of lading in the form of its own negotiable combined transport bill of lading. The bill provided that the goods were "consigned to order of" Reveal Computer Products, Inc. in California and were to be delivered to Reveal only upon surrender of a duly endorsed copy of said bill. The price of all 5,000 keyboards contained in the 1,000 cartons was \$202,800. Despite the presence of such a provision on the face of its bill, Burlington delivered the computer keyboards to Reveal without obtaining a copy of the bill. In fact, the bill was in the hands of Lite-On, Silitek's assignee, at the time the goods were delivered to Reveal. Furthermore, type-written portions of the bill of lading provided that Lite-On was to be notified before delivery to Reveal was attempted. Burlington made no efforts to notify Lite-On. Finally, Lite-On, prior to delivery, notified Burlington by telephone and faxed letter that no delivery was to be made to Reveal as its creditworthiness was in question and the original bill of lading was in Lite-On's possession. Notwithstanding such a warning from Lite-On or the terms of the bill of lading, Burlington delivered the entire shipment to Reveal on or about February 6, 1996. Lite-On was eventually able to recover 2,495 of the 5,000 keyboards from Reveal. However, 2,505 of the items were never recovered. Reveal failed to pay Silitek or Lite-On for the computer keyboards and subsequently filed bankruptcy. The value of the 2,505 keyboards improperly delivered to Reveal and unrecoverable by Lite-On was \$101,602.80. Lite-On sued Burlington for misdelivery, conversion, negligence, and breach of contract. The district court held in favor of Lite-On, and Burlington appealed. What should be the outcome on appeal? *Lite-On Peripherals, Inc. v. Burlington Air Express, Inc.*, 255 F.3d 1189 (9th Cir. 2001).
4. Phillips contracted to buy naphtha from Tradax for shipment from Algeria to Puerto Rico on C&F terms. Shipment was to be made between September 20 and 28, 1981. The agreement incorporated the ICC *Incoterms*. It also contained a *force majeure* clause that stated, "In the event of any delay in shipment or delivery of the goods by the seller, the unaffected party may cancel the unfulfilled balance of the contract." On September 16, Tradax shipped on the *Oxy Trader*. While en route, the *Oxy Trader* was detained by maritime authorities at Gibraltar, deemed unsafe, and not allowed to proceed. Tradax informed



- Phillips, which telexed back on October 1 that October 15 was the last acceptable delivery date. On October 7, its cargo had to be offloaded in Portugal for shipment on another vessel. On October 13, Phillips refused payment of the documents due to the delay. In November, Tradax sold the cargo to a third party at a loss. Phillips brought this action in the United States. Tradax claimed that it had ceased to bear responsibility for the goods when it transferred the goods to the carrier for shipment. Phillips maintained that it was excused from performance because the ship's delay constituted *force majeure*. Judgment for whom, and why? *Phillips Puerto Rico Core, Inc. v. Tradax Petroleum Ltd.*, 782 F.2d 314 (2d Cir. 1985).
5. Shared Imaging, a U.S. company, agreed to purchase an MRI machine from Neuromed, a German seller. The one-page contract of sale stated that the delivery terms were "CIF New York Seaport, the buyer will arrange and pay for customs clearance as well as transport to Calumet City." In addition, under "Disclaimer," it stated, "system including all accessories and options remain the property of Neuromed till complete payment has been received." Payment was to be made when the machine was received in Calumet City. The contract also stated that it was to be governed by the laws of Germany. The MRI was loaded aboard the vessel *Atlantic Carrier* undamaged and in good working order. When it reached its destination of Calumet City, Illinois, it had been damaged and was in need of extensive repair, which led plaintiff to conclude that the MRI had been damaged in transit. Shared Imaging filed its claim for insurance with St. Paul Guardian, who brought an action against Neuromed for damages. Neuromed argued that the case should be dismissed because it was not liable under German law. What law should the court apply in this case? How should the court define the term *CIF*? *St. Paul Guardian Ins. Co. v. Neuromed Medical Systems & Support, GmbH*, 2002 U.S. Dist. LEXIS 5096 (S.D.N.Y. 2002).
6. The defendant agreed to sell watches to the buyer in Mexico. A notation was printed at the bottom of the contract that, translated into English, reads as follows: "Please send the merchandise in cardboard boxes duly strapped with metal bands via air parcel post to Chetumal. Documents to Banco de Comercio De Quintana Roo S.A." There were no provisions in the contract that specifically allocated the risk of loss on the goods sold while in the possession of the carrier. When the goods were lost in transit, the buyer sued for a refund of his purchase price. Judgment was entered for the defendant, and the buyer appealed. Judgment for whom, and why? Was this a shipment or destination contract? When or where did the risk of loss pass? *Pestana v. Karinol Corp.*, 367 So. 2d 1096 (Fla. Dist. Ct. App. 1979).
7. C-ART, Ltd. was an exporter of goods based in Hong Kong. C-ART entered into a contract with the New York Merchandising Company, a New York importing company, for the purchase of goods from manufacturers in Hong Kong. The goods were shipped by Hong Kong Islands Line America, S.A., an ocean carrier, from Hong Kong to California. In 1986, C-ART purchased goods from various Hong Kong manufacturers and arranged for their shipment to NYMCO in California. Upon delivery of each shipment of goods to HKIL in Hong Kong, HKIL issued to C-ART a bill of lading which C-ART would in turn present to a bank to exchange for payment from NYMCO. NYMCO would ultimately receive the original bills of lading in exchange for its proper payment for the goods. NYMCO would then present the bills of lading to HKIL upon the arrival of its ship in California in order to take possession of the goods. However, HKIL released the shipments to NYMCO upon the presentment of a NYMCO "corporate guarantee" that payment would be forthcoming. Shortly after HKIL's release of the goods to NYMCO but before C-ART had been paid, NYMCO filed for bankruptcy. After unsuccessfully attempting to recover payment for the goods from NYMCO, C-ART filed a lawsuit against HKIL for misdelivery of the goods without a properly endorsed bill of lading. The district court ruled in favor of C-ART and entered judgment for \$185,997.65, and HKIL appealed. What is the legal effect of the bill of lading in this case? How should the shipper's liability be construed with respect to the provisions of the bill of lading? Does it make any difference that the goods were shipped F.O.B. Hong Kong, thus transferring the risk of loss to NYMCO prior to the ship's arrival in California? *C-ART, Ltd. v. Hong Kong Islands Line America, S.A.*, 940 F.2d 530 (9th Cir. 1991).
8. Empresa Estatal Petroleos de Ecuador (PetroEcuador) contracted with BP Oil International, Ltd. for the purchase of 140,000 barrels of gasoline to be delivered CFR from Texas to Ecuador. The contract separately provided that the terms were governed by Ecuadorian law. The contract also required that the gasoline have a gum content of less than three milligrams per one hundred milliliters to be determined at the port of departure in Texas. The gasoline was tested for gum content upon departure and was deemed satisfactory. However, the gum content exceeded the contractual limit upon retesting in Ecuador, and PetroEcuador refused to accept delivery. BP resold the gasoline at a loss of \$2 million and sued PetroEcuador for breach of contract. BP claimed that the Convention on Contracts for the International Sale of Goods was applicable to the transaction. As such, BP contended that the risk of loss passed to PetroEcuador upon the loading of the goods in Texas. However, PetroEcuador claimed that local law required the delivery of conforming goods to the agreed destination despite the ratification of the CISG by Ecuador. Which party is correct? When did the risk of loss pass in this case? *BP Oil International, Ltd. v. Empresa Estatal Petroleos de Ecuador*, 332 F.3d 333 (5th Cir. 2003).

Managerial Implications

You receive a fax transmittal from Japanese buyers you met in New York. They indicate that they want to order 5,000 down bed pillows. The pillows must contain no less than 85 percent cluster prime white goose down. To make the transportation as cost-effective as possible, they want pricing for a full ocean container. Before placing the order, they want to discuss the details of the sale.

Their fax indicates that although the buyers prefer to pay for the pillows on open account terms, they will consider your suggestions for payment options. Also they are unwilling to purchase against the documents unless they can first inspect the pillows on their arrival in Japan. They want this right of inspection to find out if the quality is what they ordered and to look for possible freight damage. They feel strongly about this issue and insist on these conditions, unless you can provide them with adequate protection. In addition, they want to consider the cost of alternative shipping arrangements before deciding whether to handle these themselves.

1. Prepare a *pro forma* invoice giving your buyer several options for shipping the pillows. Consider how to pack

and transport them to the closest or best seaport. What facilities are available for handling containerized cargo or for multimodal transport in your region? Using *Inco-terms*, present a breakdown of the shipping alternatives and costs involved in the transaction. Contact a freight forwarder and inquire as to what services it can provide. Can the freight forwarder assist you in obtaining the information you need to prepare your *pro forma* invoice?

2. In determining your export price, what other factors must you consider in addition to freight costs? Do you consider additional communication expenses, port fees, trade show expense, forwarder fees, sales agents, and clerical expenses? Discuss your export pricing with your marketing team and decide on your pricing strategy.
3. Prepare a letter to accompany the *pro forma* invoice explaining why payment by "cash against documents" is fair to both parties. What can you propose to address the buyers' concerns that the goods shipped will conform to their quality specifications? How will the goods be protected from marine risks?

Ethical Considerations

Your company is expecting a shipment of 10,000 T-shirts from a company in Pakistan. You recently received a call from a nearby bank that it was in possession of a negotiable bill of lading aboard the ship *Jhelum* and documents from Pakistan covering a shipment of T-shirts, and that they were awaiting your payment. However, you are concerned.

The Pakistani company made the initial contact with your firm via the Internet, locating you through one of several trade directories in which you are listed. The prices quoted for shirts are considerably less than what you currently pay or are able to pay for a comparable quality. You begin to do some research. You find the company's site on the Internet, with pictures of its mill and textile products. Several days after you make enquiries through the U.S. Commercial Service, you receive an e-mail from its office in Karachi indicating that one of its staff officers was unable to locate the mill, but thought that the company "was currently exporting from Pakistan."

Recently you have been hearing of many international business scams. You are worried about what might really be in the ocean container and wonder if you should purchase the documents from the bank or refuse them just in case. You look at the documents and see that the bill of lading is dated one day later than the date for shipment called for in the contract. You are getting cold feet, and think you might want out. (1) Do you think, under the circumstances, that it is ethical to refuse the documents based on a minor technicality? Why or why not? Do you believe you have enough information to make a fair decision? What are your options? (2) Now assume that you contacted the ocean carrier and they said that they do not have a ship named *Jhelum* currently in the fleet. Does this change your decision? (3) If this is a fraudulent scheme, how could it be perpetrated on an unsuspecting buyer?



The convention limited what damages were recoverable by a plaintiff and under what circumstances, and it placed caps on the amount that could be recovered. By the late 1990s, a passenger could recover no more than \$75,000 in proven damages for death or bodily injury and only more than that if the plaintiff could prove the airline's "willful misconduct" (which was often difficult to prove). Liability for loss or damage to baggage or cargo was also limited. As the air industry grew out of its infancy, these limits became unreasonably low. After all, damages awarded in a wrongful death action in an automobile crash might amount to many, many times more than what could be lawfully recovered in an airline disaster. Yet both are based on economic and other measures of the value of a human life. Another problem with the *Warsaw Convention* was that it was never modernized or adapted to electronic commerce and modern air transportation methods. By the end of the twentieth century, it was clear that a new treaty was needed.

The Montreal Convention of 1999

The most important change to air transportation law in 70 years occurred with the adoption of the *Montreal Convention for the Unification of Certain Rules for International Carriage by Air* (1999), referred to in this chapter as the *Montreal Convention*. It now replaces the outdated *Warsaw Convention* in those countries where ratified (the *Warsaw Convention* remains in effect in about 50 others). As of 2016, the *Montreal Convention* was in force in 123 countries, including the United States, Canada, Mexico, Japan, China, and the European Union, to name a few. The *Montreal Convention* eases restrictions and raises the limits on recovery from air carriers above those of the *Warsaw Convention*, and accommodates the use of electronic tickets and other documents. It also requires that airlines maintain adequate insurance for losses or damages and include provisions for compensating passengers for flight or baggage delays.

The language of the *Montreal Convention* is patterned after the older *Warsaw Convention*. This was intended by the drafters, so that there could be continuity in its interpretation by courts. The legislative history of the U.S. Senate in considering the ratification of the *Montreal Convention* makes it clear that Congress had intended that much of the case law decided by U.S. courts under the earlier convention was to apply to the new convention.

International Carriage by Aircraft. The *Montreal Convention* applies "to all international carriage of persons, baggage and cargo by aircraft" in which the *place of departure* and the *place of destination* are in two countries that are party to the convention. The place of departure and place of destination is that destination listed in the ticket and not where the passenger intended to fly. If the aircraft is diverted to some other country due to weather or accident, or even returns to the departing airport, the place of destination is still that is listed in the ticket for purposes of determining if the flight is an international one. The convention does not apply to a passenger who is ticketed for travel between two countries that are not party to the convention or for domestic travel solely within one country.

The convention also applies where the place of departure and place of destination are within a single country that is party to the convention if there is an *agreed stopping place* in another country, even if that other country is not party to the convention. This includes round-trip tickets. Assume a passenger has a round-trip ticket from the United States for travel to a foreign country and returning to the United States. The flight is covered by the convention regardless of whether or not that foreign country is party to the convention.

Next, consider a passenger who is traveling internationally, but whose journey includes a domestic leg. Assume that a U.S. passenger is ticketed for round-trip travel from Chicago to Los Angeles, connecting on another flight with a different airline from Los Angeles to Tokyo. Is the flight from Chicago to Los Angeles considered part of the "international carriage" and governed by the convention? Here, the determining factor is how the passenger was ticketed and whether he or she was engaged in a *continuous international journey*. The answer for that passenger is "yes" if the flight from Chicago to Los Angeles is deemed to be *one undivided carriage* that is part of a *single operation*. If all legs of a journey, international and domestic, are booked on the same ticket, then they are presumed to be one undivided carriage. Even where the separate flights are purchased and booked on different tickets, or even on different airlines, they may still be considered one undivided journey if the domestic and international legs may be considered a "single operation."

The *Montreal Convention* provides the exclusive remedy to a plaintiff to the extent that the convention covers the plaintiff's claim. If a passenger files suit in state



CHAPTER 6

Legal Issues in International Transportation



This chapter is about international aviation and maritime law. Our discussion is limited to a few crucial areas of international business law that concern almost everyone doing business internationally: the legal aspects of moving goods and people by air and sea. We will not cover domestic transportation or those narrow regulatory issues that directly concern only firms operating in the transportation industry. Our focus is on the liability of air carriers for death or bodily injury to passengers traveling internationally and for loss or damage to baggage or air cargo, the liability of marine carriers for damage or loss to cargo, the liability of freight forwarders and other transport intermediaries, and selected issues in maritime and marine cargo insurance law.

You will see many common solutions to common problems, because there is probably more uniformity in aviation and maritime law around the world than there is with other laws. There are likely two reasons. First, both modern aviation and maritime law rely heavily on international conventions. This has had a harmonizing effect on national legislation. This does not mean that all national aviation or maritime laws are completely alike, or that courts in all countries render the same decisions. Of course, they do not. But they each have common objectives and take similar approaches to handling legal issues. We will see this throughout the chapter. Second, in the maritime area, the law grew out of customary law, based on the traditions of ancient and medieval mariners, ship owners, and merchants. The customs were enforced by early maritime courts in port cities whose judgments were put into medieval maritime codes that spread westward from the eastern Mediterranean around the coastline of Europe to the Baltic. After all, those who go to sea share similar problems and common dangers. It is no wonder then that so much of our modern maritime law concepts are so similar around the world.

THE LIABILITY OF INTERNATIONAL AIR CARRIERS

Commercial air transportation developed rapidly in the first few years after the Wright Brothers' famous flight at Kitty Hawk in 1903. In 1911 the first airmail service began in the United States, and the first scheduled passenger service, albeit very rudimentary, was only a few years after that. By the 1920s the race was on to develop regular commercial air service, and by the 1930s newly started companies were vying for the first transatlantic cargo and passenger services. The pace was accelerated by innovations in engineering, the bravery of young pilots, the backing of the military and government, and savvy business investors, and by the demand for faster, safer air transportation. The pace of aviation development was indeed rapid, almost too rapid for legal change to keep up. But soon after World War I, governments around the world recognized the need for international cooperation in regulating air transportation, including uniformity in the laws relating to the use of airspace, the nationality of aircraft, and rules for navigation. Of importance to this chapter, governments realized that one of their most important goals was to protect the fledgling air industry from financial disaster by placing limits on the liability of air carriers for damages. After all, investors feared that their fortunes could be wiped out in one air disaster, and insurance companies feared insuring air carriers. Out of the early work of the League of Nations and several international air conferences came several air treaties, including the *Warsaw Convention of 1929*.

For more than 70 years, the *Warsaw Convention of 1929* was the most important law governing the liability of air carriers for loss or damage to cargo or baggage during international shipping, and for death or bodily injury to passengers engaging in international travel.



court against an airline, alleging damage to checked baggage (or a shipper for damage to cargo), the airline may “remove” the case to federal court because the convention specifically addresses damage to baggage (and cargo) and provides a remedy. In other words, if both a state law and the convention address the same

issue, and there is a conflict between them, the convention will prevail. In the following case, *El Al Israel Airlines, Ltd. v. Tseng*, the U.S. Supreme Court ruled that the *Warsaw Convention* provided the exclusive cause of action against an air carrier for injuries incurred during international travel.



El Al Israel Airlines, Ltd. v. Tseng

525 U.S. 155 (1999) United States Supreme Court

BACKGROUND AND FACTS

Tseng purchased a ticket on an El Al flight from New York to Tel Aviv. Prior to boarding, an El Al security guard questioned her about her travel plans. The guard considered her response “illogical” and ranked her as a security risk. Tseng was taken to a private security room and told to remove her shoes and to lower her blue jeans to mid-hip. A female guard then searched her body outside her clothing by hand. Nothing was found, and she was allowed to board. She did not suffer any bodily injury. Tseng sued El Al in New York state court for assault and false imprisonment under New York law. El Al removed the case to a federal district court. The district court dismissed, concluding that Tseng’s only remedy was under the Warsaw Convention, and that the Convention precluded recovery unless there was bodily injury. On appeal, the U.S. Court of Appeals held that a plaintiff who did not qualify for relief under the Convention could seek relief under local law for an injury sustained in the course of international air travel. El Al then appealed to the U.S. Supreme Court.

JUSTICE GINSBURG

[Tseng’s] case presents a question of the Convention’s exclusivity: When the Convention allows no recovery for the episode-in-suit, does it correspondingly preclude the passenger from maintaining an action for damages under another source of law, in this case, New York tort law? * * * We . . . hold that recovery for a personal injury suffered “on board [an] aircraft or in the course of any of the operations of embarking or disembarking,” if not allowed under the Convention, is not available at all. Recourse to local law, we are persuaded, would undermine the uniform regulation of international air carrier liability that the Warsaw Convention was designed to foster, [citations omitted] * * *

The Warsaw Convention . . . declares . . . that the “[C]onvention shall apply to all international transportation of persons, baggage, or goods performed by aircraft for hire.” * * * Article 17 establishes the conditions of liability for personal injury to passengers: “The carrier shall be liable for damage sustained in the event of

the death or . . . bodily injury suffered by a passenger, if the accident which caused the damage so sustained took place on board the aircraft or in the course of any of the operations of embarking or disembarking.” * * * We accept it as given that El Al’s search of Tseng was not an “accident” within the meaning of Article 17, for the parties do not place that Court of Appeals conclusion at issue . . . The parties do not dispute that the episode-in-suit occurred in international transportation in the course of embarking. * * *

The cardinal purpose of the Warsaw Convention, we have observed, is to “achiev[e] uniformity of rules governing claims arising from international air transportation.” *Eastern Airlines, Inc. v. Floyd*, 499 U.S. 530, 111 S.Ct. 1489 (1991). The Convention signatories, in the treaty’s preamble, specifically “recognized the advantage of regulating in a uniform manner the conditions of . . . the liability of the carrier.” To provide the desired uniformity, the Convention sets out an array of liability rules, which the treaty declares, “apply to all international transportation of persons, baggage, or goods performed by aircraft.” * * * Given the Convention’s comprehensive scheme of liability rules and its textual emphasis on uniformity, we would be hard put to conclude that the delegates at Warsaw meant to subject air carriers to the distinct, non-uniform liability rules of the individual signatory nations. * * *

Construing the Convention, as did the Court of Appeals, to allow passengers to pursue claims under local law when the Convention does not permit recovery could produce several anomalies. Carriers might be exposed to unlimited liability under diverse legal regimes, but would be prevented, under the treaty, from contracting out of such liability. Passengers injured physically in an emergency landing might be subject to the liability caps of the Convention, while those merely traumatized in the same mishap would be free to sue outside of the Convention for potentially unlimited damages. The Court of Appeals’ construction of the Convention would encourage artful pleading by plaintiffs seeking to opt out of the Convention’s liability scheme when local law promised

continues



continued

recovery in excess of that prescribed by the treaty. Such a reading would scarcely advance the predictability that adherence to the treaty has achieved worldwide. * * *

Decision. The decision of the Court of Appeals was reversed. Under the Warsaw Convention, a passenger may not bring an action for personal injury damages under state law when his or her claim does not satisfy the conditions for liability under the convention.

Case Questions

1. Why was Tseng not able to pursue a remedy under New York state law?
2. What policy reasons does the Court give for holding that the air liability convention should preclude remedies under local or state law?
3. Why would Tseng not be successful in an action against the airline in federal court under the convention?

Jurisdiction. In summary, lawsuits governed by the *Montreal Convention*, whether for death, bodily injury, cargo damage, or baggage claims, can be brought only in a country that is party to the convention and, at the option of the plaintiff, in one of the following locations: (1) the country where the passenger's tickets were purchased or the air waybill for cargo issued, (2) the country of final destination, (3) the country where the carrier is incorporated or domiciled, (4) the country where the carrier has its principal place of business, or (5) in addition to the first four locations, in the case of claims for bodily injury or death, in the country of the passenger's "principal and permanent residence," if the carrier provides air service there. This "fifth jurisdiction" prevents many passengers or their families from having to litigate cases in far-off countries.

Air Carrier's Liability for Death or Bodily Injury

The plaintiff in an air accident is usually the injured passenger or the estate or heirs of a deceased passenger. Article 17 of the convention states,

The carrier is liable for damage sustained in case of death or bodily injury of a passenger upon condition only that the accident which caused the death or injury took place on board the aircraft or in the course of any of the operations of embarking or disembarking. [emphasis added]

The sections in italics show the three basic requirements for liability: (1) death or bodily injury of a passenger, (2) resulting from an accident, (3) on board the aircraft or while embarking or disembarking. Thousands of litigated cases exist on these issues.

Accident. There are many court decisions discussing the meaning of "accident." It generally requires that the cause of injury be an event that presents a risk peculiar

to air travel and "external" to the passenger. This might include injuries resulting from a fall while boarding, the spilling of hot coffee on a passenger, air turbulence, or a crash landing. In *Air France v. Saks*, 470 U.S. 392 (1985), the Supreme Court attempts to explain the meaning of the term "accident." The plaintiff was on a 12-hour flight from Paris to Los Angeles when she felt a severe pressure and pain in her ear during descent. The flight was routine and the plane landed normally. She disembarked without informing the airline of her ailment. Five days later, she consulted a doctor who concluded that she had become permanently deaf in her left ear. The trial court said it was not an accident. The U.S. Court of Appeals reversed, believing that the *Warsaw Convention* imposed absolute liability on airlines for injuries caused by the risks inherent in air travel. The U.S. Supreme Court disagreed and reversed, stating that,

Liability under Article 17 of the *Warsaw Convention* arises only if a passenger's injury is caused by an *unexpected or unusual event or happening that is external to the passenger*. This definition should be flexibly applied after assessment of all the circumstances surrounding a passenger's injuries . . . But when the injury indisputably results from *the passenger's own internal reaction to the usual, normal, and expected operation of the aircraft*, it has not been caused by an accident, and Article 17 of the *Warsaw Convention* cannot apply." [emphasis added]

The Court went on to give some examples of accidents from prior cases. These included torts committed by terrorists, a drunken passenger who fell and injured a fellow passenger, and a "sudden dive" that led to pressure change, which caused hearing loss. The general rule of *Air France v. Saks* was accepted by the British House of Lords in 2005 in litigation involving cases of deep vein thrombosis (formation of blood clots in the legs from sitting for long periods during flight). American and British cases have held that blood clots result from a passenger's internal reaction to the usual,



normal, and expected operation of an aircraft and thus are not accidents. However, in the following case, *Olympic Airways v. Husain*, 540 U.S. 644 (2004) the U.S. Supreme Court arrived at a different conclusion in the

case of an asthmatic passenger aboard a passenger aircraft who died from an allergic reaction to secondhand smoke resulting from the flight attendant's refusal to move his seat further from the smoking section.



Olympic Airways v. Husain

540 U.S. 644 (2004) United States Supreme Court

BACKGROUND AND FACTS

Dr. Abid Hanson was traveling with his wife and family aboard an Olympic Airways flight from Athens to New York. He suffered from asthma and was affected by secondhand smoke. They were seated in a nonsmoking section, three rows from the smoking section. As Dr. Hanson was struggling to breathe, his wife, Rubina Husain, made three urgent requests that he be moved away from the smoke. Her requests were refused. The flight attendant claimed that the flight was "totally full" (which was not correct) and that she was "too busy." Dr. Hanson walked to the front of the plane for air. He died shortly later, despite attempts to revive him. At trial, the court awarded Mrs. Husain a \$1.4 million judgment due to the willful conduct of the flight attendant. The U.S. Court of Appeals affirmed. Olympic Airways appealed to the Supreme Court, arguing that Dr. Hanson's death was the result of his internal reaction to the usual and expected operation of the airplane and thus not the result of an accident.

JUSTICE THOMAS

* * * Petitioner [Olympic] argues that the "accident" inquiry should focus on the "injury producing event," which, according to petitioner, was the presence of ambient cigarette smoke in the aircraft's cabin. Because the petitioner's policies permitted smoking on international flights, the petitioner contends that Dr. Hanson's death resulted from his own internal reaction—namely, an asthma attack—to the normal operation of the aircraft. The petitioner also argues that the flight attendant's failure to move Dr. Hanson was inaction, whereas Article 17 requires an action that causes the injury. We disagree. * * *

The petitioner's focus on the ambient cigarette smoke as the injury-producing event is misplaced. We do not doubt that the presence of ambient cigarette smoke in the aircraft's cabin during an international flight might have been "normal" at the time of the flight in question. But the petitioner's "injury producing event" inquiry—which looks to "the precise factual 'event' that caused the injury"—neglects the reality that there are often multiple interrelated factual events that combine to cause any given injury. In [*Air France v. Saks*, 470 U.S. 392 (1985)], the Court recognized that any one of these factual events or happenings may be a

link in the chain of causes and—so long as it is unusual or unexpected—could constitute an "accident" under Article 17. Indeed, the very fact that multiple events will necessarily combine and interrelate to cause any particular injury makes it difficult to define, in any coherent or non-question-begging way, any single event as the "injury producing event."

The petitioner's only claim to the contrary here is to say: "Looking to the purely factual description of relevant events, the aggravating event was Dr. Hanson remaining in his assigned non-smoking seat and being exposed to ambient smoke, which allegedly aggravated his pre-existing asthmatic condition leading to his death," and that the "injury producing event" was "not the flight attendant's failure to act or violation of industry standards." [Brief for Petitioner] Petitioner ignores the fact that the flight attendant's refusal on three separate occasions to move Dr. Hanson was also a "factual 'event,' " that the District Court correctly found to be a " 'link in the chain' " of causes that led to Dr. Hanson's death. Petitioner's statement that the flight attendant's failure to reseat Dr. Hanson was not the "injury producing event" is nothing more than a bald assertion, unsupported by any law or argument. * * * The exposure to the smoke and the refusal to assist the passenger are happenings that both contributed to the passenger's death.

And the petitioner's argument that the flight attendant's failure to act cannot constitute an "accident" because only affirmative acts are "events or happenings" under *Saks* is unavailing. . . . The relevant "accident" inquiry under *Saks* is whether there is "an unexpected or unusual event or happening." The rejection of an explicit request for assistance would be an "event" or "happening" under the ordinary and usual definitions of these terms. See *American Heritage Dictionary* 635 (3rd ed. 1992) ("event": "something that takes place; an occurrence"); *Black's Law Dictionary* 554-555 (6th ed. 1990) ("event": "Something that happens").

Decision. The flight attendant's "unexpected or unusual" refusal to move the passenger to another seat, contrary to airline policy and industry standards, was an "accident" that was "external to the passenger" within the meaning of Article 17 of the *Montreal Convention*. It was a link in a chain of causation that

continues



continued

resulted in the aggravation of a passenger's pre-existing medical condition by exposure to a normal condition (smoking, which was permitted at the time) in the aircraft cabin.

Case Questions

1. Why were the events in this case deemed "unexpected or unusual"?
2. Why did the Court reject Olympic's argument that the term "accident" refers only to affirmative acts?
3. What is the significance of the attendant's failure to move the asthmatic passenger away from the smoke when that was contrary to airline industry procedures?
4. How does this case differ from *Air France v. Saks* and the British "deep vein thrombosis" cases, cited in the text?

Embarking or Disembarking. A carrier is only liable for damages occurring "on board the aircraft or in the course of any of the operations of embarking or disembarking." Whether a passenger is embarking or disembarking often turns on their proximity to the security or boarding gate, the *imminence of boarding*, whether their movements were under the control of the airline or security officials, and the activity of the passenger at the time. If they were actually in the process of boarding or exiting the aircraft, then the airline is responsible. However, the airline would generally not be responsible where the passenger is outside of the control of airline employees and moving about the terminal. In one case, an airline was held not responsible where the passenger was injured approximately one-half hour before the flight and several hundred feet from the departure gate, and the passengers had not yet been called to board the flight. Other cases have held the airlines not liable for injuries in corridors and on moving stairs or sidewalks that are under the control of the terminal, not the airline.

In most cases, there is no liability for injuries sustained while a passenger is dining or shopping, or at the baggage claim. However, many cases are more complicated. In *Singh v. North American Airlines*, 426 F.Supp.2d 38 (E.D.N.Y. 2006), the passenger was arrested and imprisoned for several months when illegal drugs were discovered in his baggage on arrival in New York on a flight from Guyana. It was later discovered that airline employees had placed Singh's name and identification tags on the bags to illegally transport drugs. Singh sued the airline. The District Court ruled that this was "an accident" covered by the convention because the process of checking baggage in Guyana and obtaining baggage claim tags was a necessary part of the embarkation process there. The court added that it did not matter in this case that the damage arose later, when Singh was

imprisoned. It was sufficient, the court believed, that the "accident itself took place on board the aircraft or in the course of any of the operations of embarking or disembarking."

Limitations on Liability for Death or Bodily Injuries. The monetary limit of an air carrier's liability is set not in the currency of any one country, but in **special drawing rights** (SDRs). SDRs represent an amount equal to a mix of currency values (the euro, Japanese yen, British pound sterling, U.S. dollar, and, as of 2016, the Chinese yuan) developed by the International Monetary Fund (IMF). This facilitates an easy conversion from the limits expressed in the convention into any currency. SDR values are listed daily on the IMF website. For example, on January 10, 2017, one SDR was worth approximately \$1.35 (rounded). The convention calls for the regular review of the limits so they can be adjusted for inflation. The review is done by the International Civil Aviation Organization, a specialized agency of the United Nations, charged with assisting nations in developing international policies and standards for air safety, security, and operations.

The *Montreal Convention* sets up a two-tiered liability system. First, the carrier is strictly, or absolutely, liable for all damages from death or bodily injury that can be proven by the passenger or the representative of their estate, in an amount not exceeding 113,100 SDRs per passenger (about \$152,384 on January 10, 2017), arising out of an accident. Strict or absolute liability means that the carrier is liable without regard to fault. In addition, the carrier is presumed to be liable for all proven damages above 113,100 SDRs, with no limit on the amount, unless the carrier can show that the damages were not due to its negligence, willfulness, or other wrongful act or omission or to that of its employees or agents.

Compensable Damages. The convention does not specify the types of compensatory damages (medical, loss of earnings, etc.) that a plaintiff can recover. Local law determines that an air carrier is exonerated to the extent that the passenger's own negligence contributed to his or her injuries or death. Thus, if a passenger is scalded by hot coffee on the seat-back table in front of him because he was not careful while removing his coat, he is most likely unable to recover anything from the carrier. Punitive damages are never allowed under the *Montreal Convention*. Where damages for mental anguish or emotional distress are permitted by state or federal law, or by national law in another country, they may only be awarded to a plaintiff under the *Montreal Convention* if they are actually caused by bodily injury. In *Ehrlich v. American Airlines, Inc.*, 360 F.3d 366 (2004), the U.S. Court of Appeals sitting in New York considered a claim by passengers for mental anguish resulting from an emergency evacuation of the aircraft. The passengers testified that they suffered from nightmares and anxiety from the evacuation. In the course of the evacuation, they also sustained knee injuries. The court did not allow recovery for the mental anguish because it was not "caused by" the bodily injury to the knee, but merely accompanied it.

In a case with a nearly tragic ending, *Eastern Airlines, Inc. v. Floyd*, 499 U.S. 530 (1991), the U.S. Supreme Court considered a passenger's suit for emotional distress resulting from the pilot's announcement that three engines had failed, and that the aircraft was losing altitude and would ditch in the Atlantic Ocean. After a period of descending flight without power, the crew was able to restart an engine and land the plane safely in Miami. The court concluded that "an air carrier cannot be held liable under Article 17 when an accident has not caused a passenger to suffer death, physical injury, or physical manifestation of injury." In other cases, it has been held that passengers could not recover damages for emotional distress merely because of stolen baggage or because their seat had been downgraded from first class to economy.

Third-Party Suits. The *Montreal Convention* applies only to claims against air carriers. It does not prohibit or govern claims brought against third parties, such as the manufacturer of a defectively designed or built airplane, the company that serviced or maintained it, the owners or operators of the airport, private security firms, retailers or vendors operating within airport facilities, or other passengers. These cases are primarily governed by ordinary tort law of the state or jurisdiction in which the case is heard.

Air Waybills and Air Cargo Losses

Unlike passengers who are "ticketed" for travel, cargo moves pursuant to a transport document called an air waybill. It serves as a contract between the **consignor** (shipper) and carrier that states the freight charges and other conditions of transport. It is also a receipt from the carrier for having received the goods in good condition, and instructions for delivery to a named **consignee**. Unlike typical marine bills of lading, air waybills are nonnegotiable, and are not documents of title. An example appears in Exhibit 6.1. A **master air waybill** is one issued directly to a shipper by an air carrier. A **house air waybill** is one issued by a freight forwarder to the shipper (thus representing a contract between them) and is also used where the shipments of several shippers are being consolidated by the forwarder to one destination. There is a movement toward the use of electronic air waybills, just as there has been with passenger tickets. In 2012 the United States began accepting electronic air waybills for shipments crossing U.S. borders. The International Air Transport Association (IATA), a trade association of airlines, expects that most air waybills will be electronic in the near future.

An air carrier is only liable for loss or damage to cargo under its control up to 19 SDRs per kilogram, unless the shipper has declared a higher actual value on the air waybill and paid an additional fee if required. The carrier is not responsible for damages resulting from an inherent defect or quality of the cargo, defective packing by the shipper, an act of war or armed conflict, or an act of public authority, such as customs authorities.

Baggage Losses. The liability of the carrier in the case of loss, damage, or delay to baggage on board an aircraft or under their control is limited to 1,131 SDRs per passenger, unless the passenger has declared a higher actual value and paid any additional fees required.

Delay. Travelers will appreciate the new provisions of the *Montreal Convention*, which make airlines liable for delays in transporting passengers, baggage, or cargo. However, the carrier is not liable if it proves that it and its servants and agents took reasonable measures to avoid the damage or that it was impossible for it or them to take such measures. Liability for delays is limited to 4,694 SDRs per passenger.



Exhibit 6.1

International Air Waybill

037- 0226 0123		INTERNATIONAL AIR WAYBILL		037- 0226 0123		
SHIPPER'S NAME AND ADDRESS ABC Company 123 Elm St. Anytown, NC 12345		SHIPPER'S ACCOUNT NUMBER		NOT NEGOTIABLE AIR WAYBILL (AIR CONSIGNMENT NOTE) USAIR US Air, Inc. NATIONAL AIRPORT, WASHINGTON, D.C. 20001 Copies 1, 2 and 3 of this Air Waybill are originals and have the same validity. It is agreed that the goods described herein are accepted in apparent good order and condition (except as noted) for carriage SUBJECT TO THE CONDITIONS OF CONTRACT ON THE REVERSE HEREOF. THE SHIPPER'S ATTENTION IS DRAWN TO THE NOTICE CONCERNING CARRIERS' LIMITATION OF LIABILITY. Shipper may increase such limitation of liability by declaring a higher value for carriage and paying a supplemental charge if required. TO EXPEDITE MOVEMENT, SHIPMENT MAY BE DIVERTED TO MOTOR OR OTHER CARRIER AS PER TARIFF RULE UNLESS SHIPPER GIVES OTHER INSTRUCTIONS HEREON.		
CONSIGNEE'S NAME AND ADDRESS XYZ Corporation 456 Wind St. Anycity, France		CONSIGNEE'S ACCOUNT NUMBER		ISSUING CARRIER'S AGENT NAME AND CITY Foreign Custom Broker 1001 Maple St. Anycity, France		
AGENTS DATA CODE 1-5678		ACCOUNT NUMBER		ALSO NOTIFY NAME AND ADDRESS (OPTIONAL ACCOUNTING INFORMATION)		
AIRPORT OF DEPARTURE (NAME OF FIRST CARRIER AND REQUESTED ROUTING) Charlotte		ACCOUNTING INFORMATION		SHIPPER CHECK ONE		
FLIGHT AND DESTINATION BY FIRST CARRIER CDG LRS		CURRENCY USD		☒ AIR ☐ SEA ☐ COMAT		
AIRPORT OF DESTINATION PARIS		DECLARED VALUE FOR CARRIAGE NVD		DECLARED VALUE FOR CARRIAGE 5000		
FLIGHT DATE 08/15/08		AMOUNT OF INSURANCE NIL		POLYMERASE- If shipper requests insurance in accordance with conditions on reverse hereof, indicate amount to be insured in figures in box marked amount of insurance.		
HANDLING INFORMATION MKD: AS Addr. PO# 0001		NOTIFICATION PERSON NOTIFIED BY		DATE/TIME DISPATCH		
NO. OF PIECES B/L	WEIGHT 109	RATE CLASS 109	WEIGHT 109	RATE 2.10	TOTAL 228.90	NATURE AND QUANTITY OF GOODS (INCL. DIMENSIONS OR VOLUME) Leather aprons
PREPAID WEIGHT CHARGE COLLECT A 228.90		PICK-UP CHARGE B 25.00		ORIGIN ADVANCE CHARGE E		ITEMS PREPAID
VALUATION CHARGE D		DEL. ZONE C		DEST. ADVANCE CHARGE F		ITEMS COLLECT
TAX I		SHIPPER'S R.F.C. AMOUNT TO BE ENTERED BY SHIPPER		OTHER CHARGES AND DESCRIPTION J		
TOTAL OTHER CHARGES DUE AGENT 58.00		SHIPPER CERTIFIES THAT THE PARTICULARS ON THE FACE HEREOF ARE CORRECT AND THAT INSORAE AS ANY PART OF THE CONSIGNMENT CONTAINS RESTRICTED ARTICLES, SUCH PART IS PROPERLY DESCRIBED BY NAME AND IN PROPER CONDITION FOR CARRIAGE BY AIR ACCORDING TO APPLICABLE NATIONAL GOVERNMENT REGULATIONS, AND FOR INTERNATIONAL SHIPMENTS THE CURRENT INTERNATIONAL AIR TRANSPORT ASSOCIATION'S RESTRICTED ARTICLES REGULATIONS.				
TOTAL OTHER CHARGES DUE CARRIER 10.00		TOTAL COLLECT CHARGES 296.00				
COD CURRICY		SIGNATURE OF ISSUING CARRIER OR ITS AGENT				
TOTAL PREPAID 296.00		FOR CARRIERS USE ONLY AT DESTINATION				



Time Limitations. All legal actions against air carriers for damages must be brought within two years of the date of arrival at the destination, or from the date on which the aircraft ought to have arrived, or from the date on which the carriage stopped. Where baggage or cargo are damaged, the carrier must be notified immediately and no later than seven days from the date of receipt in the case of checked baggage and 14 days from the date of receipt in the case of cargo. Claims for damages for delayed baggage or cargo must be made in writing and at the latest within 21 days from the date on which the baggage or cargo was actually delivered.

MARITIME LAW AND THE CARRIAGE OF GOODS BY SEA

An understanding of maritime law and the jurisdiction of admiralty courts is crucial to anyone shipping goods by ocean carrier. The overwhelming volume of goods shipped overseas moves by water, as compared to air, road, or rail. Estimates are that between 80 and 90 percent of overseas shipments, measured by weight or volume, moves by water, and about 35 percent by volume moves by air (IATA).

Maritime law, as it is used in this book, refers to that body of law within the admiralty jurisdiction of a court that governs private rights and obligations arising out of the operation of vessels on navigable waters or in maritime commerce. It covers activities on the water and can also cover certain related activities on land. Examples are maritime torts and contracts, bills of lading, ship owner's liability for cargo, the law of collision, maritime liens, **salvage** (the rescue or recovery of a ship or cargo that is lost or damaged in navigable waters), **jettison** (throwing cargo or property overboard to save the ship), marine insurance, and the relationship between a ship's crew, master, and ship owner, and other areas. Maritime law also applies to claims for death or injury to mariners or **seamen** (persons employed on vessels regardless of their jobs), or to **longshoremen** (those employed to load and unload ships), and to harbor workers. In the United States, these claims are governed by both federal and state statutes. Maritime law is also referred to as admiralty law, although the latter term is often used when referring to a court's **admiralty jurisdiction**. Admiralty jurisdiction refers to the power of a court to hear and decide admiralty or maritime cases.

There are three main sources of modern maritime law. These are international conventions, national legislation, and the **general maritime law**. The general maritime law in the United States is made up of the decisions of U.S. courts of "admiralty" jurisdiction, as it was handed down from the English admiralty courts when the United States was founded. That precedent was based on customary maritime law—the customs and practices of early mariners and merchants and the early codes of marine courts dating to ancient and medieval times.

History of the General Maritime Law. Maritime law has its roots in the antiquity of the eastern Mediterranean. Although the Phoenicians were great sea traders, the earliest maritime law of which we have much understanding comes from (the Greek island of) Rhodes, dating as early as 1000 B.C. to 800 B.C. during the time of the Byzantine Empire. Rhodes had great harbors and was the center of the sea-trade in the Mediterranean for centuries. **Rhodian law** came from the customs and practices of the mariners and sea-trade. Although there is no known written record of Rhodian law, it has been referred to in the written writings of other maritime codes that it influenced. It was so important in its time that some of its concepts were incorporated into Roman code law.

Rhodian law greatly influenced the westward expansion of maritime law. Principles of Rhodian law were found inscribed on tablets in the (now Italian) port city of Amalfi, and influenced maritime laws to Barcelona, and northward to the Baltic. Local **maritime courts**, which were private courts, developed in the port cities far from the dictates of distant kings and rulers. These courts dealt with problems unknown on land—"jettison," "salvage," "perils of the sea," and so on. They rendered judgments based on the custom and practice of mariners, ship owners, and merchants who often traveled on the very ships that carried their cargos. Those judgments soon became the basis for **maritime codes**—written laws that dealt with uniquely marine problems, including shared responsibility for the ship and cargo at sea, ship owners' responsibility for caring for mariners who fell ill in foreign ports, hiring local pilots to steer through unknown harbors, diversions to save life and property at sea, and enforcing liens on ships for supplies or repairs made in a foreign port. The maritime insurance industry today still relies on the early principles set out in Rhodian law and the later maritime codes.



It was during the twelfth century that perhaps the most influential and detailed medieval maritime code appeared—the **Rolls of Oleron** (*Rôles d'Oléron*) or “Judgments of the Sea.” They were judgments in actual cases heard in local maritime courts in the seaport towns of Normandy and Britain. They were originally in French, but translated later to English, Dutch, and other languages. Here are three actual judgments (that you will be asked about later):

- 3. If a ship is lost in any land or in any place whatever, the mariners are bound to save the most that they can; and if they assist, the master is bound, if he have not money, to pledge some of the goods which they have saved, and to convey them back to their country. And if they do not assist, he is not bound to furnish them with anything or to provide them with anything, on the contrary, they shall lose their wages, when the ship is lost. And this is the judgment in this case.
- 8. A ship loads at Bordeaux, or elsewhere, and it happens that a storm overtakes her at sea, and that they cannot escape without casting over some of the goods on board, the master is bound to say to the merchants: “Sirs, we cannot escape without casting overboard some of these wines or goods” . . . Those goods which are cast overboard, ought to be appraised at the market price of those which have arrived in safety, and shall be sold and shared pound by pound amongst the merchants; and the master ought to share [in the loss] reckoning his ship or his freight at his choice, to reimburse the losses. And this is the judgment in this case.
- 9. It happens that the master of a ship cuts his mast from stress of weather [or cables or anchors]; he ought to call the merchants, and show them that it is expedient to cut the mast, to save the ship and the goods; they ought to be reckoned pound by pound as jettison; and the merchants shall share and pay without any delay, before their goods are landed from the ship. And this is the judgment in this case. [Studer, ed., *The Oak Book of Southampton*, Vol. 2. (1911). Available at OpenLibrary.org]

During the first few hundred years of its development, maritime law (as with the law merchant on land) applied only to the commercial classes, and not to the “common” people. The maritime law of England was separate and distinct from the “common law,” and continued to be heard by local merchant and maritime courts. By at least the seventeenth century, the demands of international commerce, diplomacy, and even war caused English monarchs to demand greater control over foreign trade and maritime issues. Maritime law became more national in character, no longer just the law of a local port.

In England, the king’s courts began to subsume jurisdiction of maritime and commercial cases. It was **Lord Mansfield**, one of the England’s most renowned

common law judges and commonly called the “founder of English commercial law,” who said from the King’s Bench court, “The maritime law is not the law of a particular country, but the general law of nations,” *Luke v. Lyde* [1759] 2 Burr. 882, 887. The days of local courts deciding maritime cases on the basis of custom were over; they had become the province of formal English common law and special admiralty courts. By the mid-eighteenth century, maritime law was received into the common law of England, and common law courts became willing to hear maritime and commercial law cases. Yet the customs and traditions lived on. Lord Mansfield and other judges of the king’s realm continued to cite and rely on the *Rolls of Oleron*, and even the older Rhodian law, to guide their decisions from that day forward.

By the seventeenth century, maritime law in continental Europe also began to take on a national character in the form of new maritime codes. The most important of these was the *Marine Ordinance of France of 1681*, the creation of **Jean Baptiste Colbert**, who is considered by some historians as the greatest lawmaker in French history. The ordinance turned the customary maritime law of local courts into national law enforced by royal courts. It was a model for a new generation of national maritime law in Europe.

The first maritime law in the American colonies came from the English vice-admiralty courts that sat in American port cities. Those courts did not survive. After 1789, U.S. courts with admiralty jurisdiction cited English cases, as well as the medieval maritime codes, although American judges were not hesitant to break from English precedent when justified.

Admiralty Jurisdiction in the United States

When any case arises out of events on or near the water, the most immediate question is whether or not there is admiralty jurisdiction. Cases heard in admiralty are subject to different procedural and substantive rules than would apply in an ordinary law court. Admiralty cases are heard without a jury, and the judge serves as the trier of fact. In addition, admiralty courts apply different laws and defenses, and the time limitations for bringing lawsuits are different. One example is a U.S. maritime statute that limits a ship owner’s liability, under certain circumstances, for damages caused by its ship to little more than the value of the ship itself (46 U.S.C. Sec. 30505). Admiralty law is a specialized area and the province of admiralty lawyers.



Admiralty jurisdiction in the United States stems from Article III, Section 2, of the *U.S. Constitution*, that states, “The judicial power shall extend . . . to all cases of admiralty and maritime jurisdiction.” U.S. statutes grant jurisdiction to the federal district courts “of any civil case of admiralty or maritime jurisdiction.” (28 U.S.C. 1333). Admiralty jurisdiction is primarily federal, although state courts have concurrent jurisdiction in some areas. To maintain uniformity, federal admiralty law preempts state law whenever there is a conflict.

Navigable Waters. Admiralty jurisdiction applies to cases occurring on navigable waters. The term **navigable waters** includes not only the oceans and seas, but also large lakes (such as the Great Lakes), rivers, and waterways, regardless of size, that are *used or capable of being used for commercial activity*. For example, in one case salvors were attempting to recover and obtain ownership of cut logs that had been lost and submerged for over a hundred years in a Georgia river. It is likely that no commerce had been done on that river since that time. The court held that admiralty jurisdiction applied because the waterways were *capable* of commercial activity.

Vessels in Navigation. Admiralty jurisdiction applies to the operation and management of vessels during navigation on navigable waters. U.S. statutes define **vessel** as “every description of watercraft or other artificial contrivance used, or *capable of being used*, as a means of transportation on water.” (1 U.S.C. §3). A vessel does not have to be a ship or boat. A dredge, used to scoop up silt and deepen harbors and channels, has been considered a vessel despite its very limited means of self-propulsion. Even an oil-drilling rig is a vessel if it is mobile and not permanently affixed to the ocean floor. Anything permanently moored to the shore or permanently anchored is not a vessel.

Maritime Torts. When is a tort case heard in admiralty court? According to U.S. court decisions, admiralty jurisdiction applies to a tort that (1) occurs on navigable water, or if the injury or damage is suffered on land, then it was caused by a vessel in navigable water; and (2) has a substantial relationship to traditional maritime activity; and also when (3) the incident has the potential to disrupt maritime commerce.

Historically, jurisdiction over **maritime torts** applied only if the tort occurred *and the injury was sustained* on navigable waters. If the injury was

sustained on land it was not a maritime tort. That changed in 1948 when Congress passed the *Extension of Admiralty Jurisdiction Act* (46 U.S.C. 30101). It extends admiralty jurisdiction of the United States to injuries or property damage “caused by a vessel on navigable waters, even though the injury or damage is done or consummated on land.” Thus, jurisdiction in admiralty now includes damage to a bridge that has been struck by a vessel in navigable waters, to buildings burned as a result of sparks thrown from a vessel, or to environmental damage done to the coastline resulting from a discharge of oil, chemicals, or other pollutants by a vessel in navigable waters. Maritime law regulates recreational activity as well as commercial activity, such as the collision of pleasure boats on navigable waters.

Maritime torts must have a connection to a traditional maritime activity. In *Executive Jet Aviation, Inc. v. Cleveland*, 409 U.S. 249 (1972), the Supreme Court held that the crash of a commercial airliner into Lake Erie was not an admiralty case because it did not have a connection to a “traditional maritime activity,” even though it went down in a navigable water.

Maritime Contracts. Admiralty jurisdiction applies to maritime contracts, such as those that relate to a vessel, to commerce or navigation on navigable waters, or to maritime employment. It does not matter if a contract is made on land or at sea. Marine insurance contracts fall within admiralty jurisdiction even though they are made on land, because they “relate to the navigation, business or commerce of the sea.” Joseph Story in *Delovio v. Boit*, 2 Gall. 398 (1815). **Maritime contracts** include ocean bills of lading, marine insurance contracts, contracts for towing or **wharfage** (a charge for the use of a wharf or dock), contracts for fuel, supplies for or repairs to vessels, contracts to pilot or guide vessels through harbors or canals, and contracts with longshoremen or **stevedores** (companies that employ longshoremen).

Cargo Losses and the Carriage of Goods by Sea

In this section, we switch to a specialized area of maritime law; the liability of ocean carriers for the “carriage of goods by sea.” Before we begin, some definitions will be helpful. **Cargo** is the term for goods carried aboard ships. **Freight** is the price charged to transport cargo. **Ships** are large vessels intended to carry cargo or passengers.



The different types of vessels used in the ocean or seaborne trade are **break-bulk** or general cargo ships (where goods are stowed in individual containers or on pallets in the ship's hold), **dry bulk ships** (for carrying coal, ore, and other minerals, grains and cereals, steel, forest products, fertilizers, etc.), **tankers** (for oils, chemicals, and other liquids), roll-on-roll-off or "Ro-Ro" ships (for carrying vehicles, aircraft, boats, and heavy equipment), specialized vessels such as refrigerated units (called **reefer ships**), and others. Container ships are often used to transport merchandise inside sealed ocean containers. **Containerized ocean cargo** is the fastest growing mode of ocean transport. Today's modern containers were developed in the 1950s to eliminate excessive handling of bulk cargo and to reduce pilferage and damage. They are packed and sealed by the shipper at its place of business, and opened only for customs inspection until they reach their destination. The containers revolutionized ocean shipping by allowing above-deck storage on container vessels, and by permitting efficient intermodal transportation. According to U.S. Customs and Border Protection, some seven million ocean containers enter U.S. ports annually.

Ocean-going cargo is constantly at risk, from the time it leaves the shipper's door until it reaches its destination. Typical examples of cargo damage from reported legal cases include the wrecks, storm damage from rain and seawater, the jettison of cargo, containers washing overboard, infestation from insects or molds, flooding of tankers, contamination from chemicals carried in previous shipments, rust and other moisture damage from saltwater condensation inside the hold, damage from broken refrigeration units and other equipment, losses from fire, damage done to cargo while rescuing the ship from peril, damage resulting from cargo being improperly stowed above deck, losses from theft and modern-day piracy on the seas, damage from acts of war, and many others.

Historically, carriers attempted to limit their liability for cargo damage through exculpatory clauses in bills of lading. With the growth of trade and the advent of large steamship companies in the nineteenth century, ocean carriers became more economically powerful and were able to do this. The exculpatory clauses attempted to free the carrier from all responsibility, including negligence or even for providing an unfit vessel. The small shippers were at the mercy of the steamship companies.

The result was a period of great uncertainty over the liability of ocean carriers.

The Hague Rules. At the end of World War I, there was a worldwide effort to develop uniform rules governing ocean bills of lading. The result was the 1924 *International Convention for the Unification of Certain Rules of Law relating to Bills of Lading*, known as the *Hague Rules*. You could say that the *Hague Rules* were a trade-off. Although carriers could no longer use "fine print" provisions in bills of lading to limit their liability, COGSA defined their responsibilities to the cargo and cargo owners, and limited the carrier's liability for loss or damage to cargo by law. The *Hague Rules* were essentially adopted in the national legislation of many countries, including the United States. After 1968 some countries adopted the *Visby Amendments* to the *Hague Rules* which made some changes to the *Hague Rules*. The *Visby Amendments* have been adopted in Canada, the United Kingdom and most of Europe, Japan, Hong Kong, India, and Singapore. They have not been adopted in the United States.

The Carriage of Goods by Sea Act. The *Hague Rules* were codified in the U.S. *Carriage of Goods by Sea Act* or COGSA (1936). COGSA applies to every bill of lading for the carriage of goods by sea between a U.S. port and a foreign port. It does not apply to shipments between two U.S. ports. COGSA governs the liability of a carrier from the time goods are loaded onto the ship until the time the cargo is unloaded. COGSA does not apply to losses that occur prior to loading or after discharge from the vessel. Thus, it is commonly said that COGSA applies from "tackle to tackle." Another federal law, the *Harter Act* (1893), applies to goods damaged during all ocean shipments not covered by COGSA, including shipments between two U.S. ports and while goods are warehoused prior to loading aboard ship or after discharge.

The protections in COGSA that limit a carrier's liability for damage to goods usually apply to stevedoring companies and to subcontractors that transport or handle goods—not just to the ocean carrier. This is because many bills of lading issued by ocean carriers contain written provisions extending these protections "downstream" to other parties involved in the transport. Such a provision is known as a **Himalaya clause** (for a ship of that name). In *Norfolk Southern Railway Co. v. James N. Kirby, Ltd.*, 543 U.S. 14 (2004),



a multimodal shipment of machinery going from Australia to Savannah by sea, and then to Alabama by rail under a through bill of lading, was damaged when the train derailed in Georgia. The railroad claimed the protections of COGSA. The Supreme Court considered whether COGSA, a maritime statute, should apply to the inland portion of a multimodal shipment. Writing for the Court, Justice Sandra Day O'Connor's opening sentence foretold how the case would be decided, "This is a maritime case about a train wreck." She explained,

Conceptually, so long as a bill of lading requires substantial carriage of goods by sea, its purpose is to effectuate maritime commerce—and thus it is a maritime contract. Its character as a maritime contract is not defeated simply because it also provides for some land carriage. Geography, then, is useful in a conceptual inquiry only in a limited sense: If a bill's sea components are insubstantial, then the bill is not a maritime contract. (543 U.S. at 27)

In a similar case several years later, *Kisen Kaisha Ltd. v. Regal-Beloit Corp.*, 130 S.Ct. 2433 (2010), the Court held that COGSA (and not *Carmack*, a federal railroad statute) applied to the rail portion of a multimodal ocean shipment. Justice Kennedy explained the practical problems that would result if two different laws applied to one multimodal shipment.

Applying two different bill of lading regimes to the same through shipment would undermine COGSA and international, container-based multimodal transport. As *Kirby* explained, "[t]he international transportation industry 'clearly has moved into a new era—the age of multimodalism, door-to-door transport based on efficient use of all available modes of transportation by air, water, and land.'" 543 U.S. at 25. If *Carmack* applied to an inland segment of a shipment from overseas under a through bill, then one set of liability and venue rules would apply when cargo is damaged at sea (COGSA) and another almost always would apply when the damage occurs on land (*Carmack*). Rather than making claims by cargo owners easier to resolve, a court would have to decide where the damage occurred to determine which law applied. As a practical matter, this requirement often could not be met; for damage to the content of containers can occur when the contents are damaged by rough handling, seepage, or theft, at some unknown point. Indeed, adopting the Court of Appeals' approach would seem to require rail carriers to open containers at the port to check if damage

has been done during the sea voyage. This disruption would undermine international container-based transport. (130 S.Ct. at 2447.)

Liability of the Carrier

When cargo damage is visible at the time of delivery, written notice must be given by the consignee to the carrier before the goods are taken from the carrier's custody. If the loss is not visible or apparent, written notice must be given to the carrier within three days of delivery. Failure to do so does not prevent the plaintiff's claim, but does make it procedurally more difficult. The statute of limitations for filing claims under COGSA is one year.

In the event of a cargo dispute, the claims are generally brought by the "cargo interest," typically the holder of the bill of lading, such as a shipper, consignee, or the insurer. If unresolved, and the case proceeds to court, the plaintiff must show that the goods were lost or damaged while in the carrier's custody. One way of doing this is to prove that the damage was of the type that could only have occurred while the goods were at sea, such as having been soaked with sea water. The burden then shifts to the carrier to prove that it cared for the goods appropriately or that the loss occurred in a manner for which the carrier is not legally responsible under COGSA.

To determine if the loss or damage occurred while the carrier had custody of the goods, we begin by looking at the bill of lading. If goods are not sealed and locked in an ocean container but are visible and open to inspection by the carrier, then the issuance of a **clean bill of lading** to the shipper is proof that the goods were shipped in good condition and not damaged. (Recall a clean bill is one with no notations by the carrier or its agent showing visible or apparent damage to the goods on loading). However, if the goods are enclosed and sealed in a package or container of any type and the carrier is unable to inspect them, then a clean bill is not evidence of the condition or even the quantity of the goods inside. Carriers do not open sealed containers to routinely count packages as that would only open them to liability. *Asoma Corp. v. M/V Land*, 46 Fed. Appx. 34 (2d Cir.2002) involved coils of water-sensitive steel that had rusted. The coils had been oiled, covered in laminated paper, and enclosed in galvanized steel cans sealed with strapping bands. The court held that a clean bill of lading does not prove that the cargo was in good



condition when received from the shipper because the carrier could not inspect the cargo. Moreover, the shipper did not produce any other evidence that the goods were in good condition when handing them over to the carrier.

Carrier's Responsibilities for Cargo Shortages.

A dispute over whether goods were stolen or lost overboard at sea may depend on whether there is a difference in the weight of the goods on loading and on unloading. A statement of the weight of the cargo in a bill of lading issued by a carrier is binding on the carrier, even where it is the shipper that provides the weight. This is true even where the shipper provides the weight of cargo that had been sealed in an ocean container at their inland factory. The carrier can simply weigh the full container at the port and subtract the weight of the metal box. In the case of cargo missing from sealed containers, it is easier to prove a discrepancy in weight than in the number of cartons.

Carrier's Responsibilities for Stowing Cargo.

COGSA strictly defines the liability of a carrier for damage to oceangoing cargo. To understand the carrier's liability under COGSA we must distinguish between damages resulting from improperly loading and caring for the cargo itself, and damage to cargo resulting from improperly navigating, handling, or caring for the ship. With regard to the cargo, it is the responsibility of the carrier and its crew to "properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried" throughout the voyage. For example, the carrier may not stow cargo above deck (other than in a sealed ocean container) because of exposure to the rain and seas, unless the bill of lading specifically allows it, or unless the shipper knows that it is the common practice with that type of cargo. A carrier should not stow cargo in a manner that causes it to shift and be crushed.

Carrier's Responsibilities for a Seaworthy Ship. The rules are different if the cargo is lost or damaged due to a problem with the ship itself. Here the carrier must use *due diligence before and at the beginning of the voyage* to (1) provide a seaworthy ship; (2) properly man, equip, and supply the ship; and (3) make the refrigerated units and all areas where cargo is

carried "fit and safe" for the cargo. For example, the cargo holds must not become contaminated by oil or fuel, and tankers must not be contaminated by chemicals carried on a previous shipment. A ship is **seaworthy** if it is the proper type of ship to carry the type of cargo at issue, is reasonably fit for the intended journey, is prepared for the weather and seas expected, and complies with Coast Guard regulations and relevant shipping industry standards. The requirement that the ship be made seaworthy only "before and at the beginning of the voyage" is due to the fact that a ship could be rendered unseaworthy by events that are unavoidable and beyond the control of the carrier while on the ocean.

Specific Exceptions to Liability. COGSA not only sets out what the carrier must do in preparing the ship for voyage and in handling cargo, but it also lists 16 specific exceptions, or events, for which the carrier is not liable (see Exhibit 6.2). The most striking of these exceptions is that the carrier is not liable for **errors in navigation** or in managing the ship, even if the crew's negligence causes the ship to collide or run aground. However, distinguish that from the carrier's corporate management that fails to use due diligence in hiring an unseaworthy or incompetent crew; here, the ship owner is liable. Similarly, the carrier is not liable if the crew's negligence starts a fire aboard ship, but the carrier is liable if its corporate management fails to use due diligence in providing appropriate firefighting equipment and training prior to the voyage. The last exception for discussion here are the "perils of the sea," our next subject.

Perils of the Sea. Ships encounter tremendous forces of water and weather on the high seas. COGSA exempts carriers from liability for damage resulting from these "perils, dangers, and accidents of the sea." A **peril of the sea** is a fortuitous action of the sea or weather of sufficient force to overcome the strength of a seaworthy ship or the diligence and skill of a seaworthy crew. If the ship is seaworthy when it leaves port and is prepared for expected weather and conditions, the carrier is not liable for cargo damage from a storm so strong that it represents a peril of the sea. The following case, *J. Gerber & Co. v. S.S. Sabine Howaldt*, illustrates damage resulting from a peril of the sea.



Exhibit 6.2

Carriage of Goods by Sea Act Specific Exceptions to Liability

Carriers are not liable for losses resulting from a number of specific causes listed in the statute. These exceptions include the following:

- | | |
|--|--|
| 1. Errors in the navigation or in the management of the ship | 9. An act or omission of the shipper or owner of the goods |
| 2. Fire, unless caused by the actual fault of the carrier (the ship owner) | 10. Labor strikes or lockouts |
| 3. Perils, dangers, and accidents of the sea | 11. Riots and civil commotions |
| 4. An act of God (an unpreventable loss from natural causes or disaster) | 12. Saving life or property at sea |
| 5. An act of war | 13. An inherent defect, quality, or vice of the goods that causes wastage in bulk or weight or other damage or loss |
| 6. An act of public enemies | 14. Insufficiency of packing (by shipper) |
| 7. Legal seizure of the ship | 15. Inadequate marking of goods or containers (by shipper) |
| 8. Quarantine restrictions | 16. Latent defects in ship or equipment (that might render the ship unseaworthy) that were not discoverable by due diligence |



J. Gerber & Co. v. S.S. Sabine Howaldt

437 F.2d 580 (1971) United States Court of Appeals (2d Cir.)

BACKGROUND AND FACTS

S.S. Sabine Howaldt, a small cargo vessel, was chartered for a voyage from Antwerp, Belgium, to Wilmington, Delaware. The ship was carrying steel products consigned to the plaintiff. The cargo was in good condition when loaded at Antwerp. On arrival at the port of destination in the United States, however, the steel showed extensive saltwater damage from rust and pitting. *The Sabine Howaldt* encountered extremely heavy weather on the Atlantic. Water penetrated the ventilators and damaged the cargo. The carrier argued that the damage was caused solely by a peril of the sea and that the ship was seaworthy. The trial court found that the ship was unseaworthy due to the negligence of the defendant and that the winds and seas that the vessel encountered did not constitute a peril of the sea. The carrier appealed.

ANDERSON, CIRCUIT JUDGE

***The ship's log records that . . . the ship was badly strained in her seams and sea water was breaking over forecastle deck, hatches, and upper works. It was necessary for the vessel to heave to and she so remained for 12 hours. [Winds reached 63 knots]. The hull of the

Sabine Howaldt was twisted and strained in the turbulent cross seas; she rolled from 25 degrees–30 degrees; waves constantly broke over her; and she shuddered and vibrated as she was pounded and wrenched by the heavy seas . . . Subsequently it was discovered that during this period of hurricane . . . a port hole in the galley was smashed; the catwalk or gangway from the amidships housing aft over the hatches and the well-deck to the poop was destroyed when it was torn loose and landed against a ventilator, which it dented. ***

On arrival at Wilmington, Delaware . . . the chief officer examined the hatches and found no damage to the hatches, the hatch covers, or their rubber gaskets—all were in good condition. There was no evidence in the case that at any relevant time anything was wrong with the hatches or their MacGregor covers, or that they were at any time damaged or defective. No alterations, changes or repairs were made to the hatches or covers after arrival and before the ship's next voyage from Santo Domingo to Norway in which she encountered heavy seas and shipped green water over decks and hatches but no leaks occurred. All the evidence showed they were in good condition both before and after the voyage. ***

continues



continued

The standard of seaworthiness must remain uncertain because of the imponderables of the forces exerted upon a ship by the winds and seas. Ship design and construction over many centuries of experience have evolved to meet the dangers inherent in violent winds and tempestuous seas. But for the purpose of deciding whether or not they constitute perils of the sea for a particular vessel for the purpose of the statutory exception there is the question of how violent and how tempestuous. These are matters of degree and not amenable to precise definition . . . Other indicia are, assuming a seaworthy ship, the nature and extent of the damage to the ship itself, whether or not the ship was buffeted by cross-seas which wrenched and wracked the hull and set up unusual stresses in it and like factors. While the seaworthiness of a ship presupposes that she is designed, built, and equipped to stand up under reasonable expectable conditions, this means no more than the usual bad weather, which is normal for a particular sea area at a particular time. It does not, however, include an unusual combination of the destructive forces of wind and sea which a skilled and experienced ship's master would not expect and which the ship encountered as a stroke of bad luck. Hurricane-force winds and turbulent cross-seas generating unpredictable strains and pressures on a ship's hull are an example.

We are satisfied that the Sabine Howaldt was a seaworthy vessel when she left Antwerp . . . Throughout the voyage she was operated in a good and seamanlike manner. There was no negligence on the part of the carrier. The damage to the cargo was caused by violence of the wind and sea and particularly by the resulting cross-seas which, through wrenching and twisting the vessel, set up torsions within the hull which forced up the hatch covers and admitted sea water to the holds.

Decision. The decision of the trial court is reversed. The defendant carrier met its burden of proof that the vessel was seaworthy when it left port and that the damage to the cargo resulted solely from a peril of the sea.

Case Questions

1. What is a "peril of the sea"? Why do you think maritime law relieves a carrier from liability for damages resulting from a peril of the sea?
2. Describe the sea and weather conditions here and explain whether they amounted to an exculpatory peril of the sea.
3. If an insurance company pays a claimant for goods damaged during ocean transit, may the insurance company bring the action against the carrier under COGSA?

The Per-Package Limitation

Imagine that you travel to England in search of antiques for sale in your antique store in the United States. You find many pieces from the late eighteenth century. You purchase regency tables, writing desks, chairs, settees, decorative objects, and other smaller pieces from the George II period. You arrange with a reputable freight forwarder to package everything and ship it to you in the United States. The forwarder packages everything individually in cardboard and then places them with other items on wooden pallets for wrapping with heavier cardboard and fastening with steel bands. There are 200 pieces of furniture and decorative objects on 26 pallets. The forwarder arranges for an ocean carrier to deliver a steel container to your warehousing agent for loading. On delivering the container to the carrier, the forwarder receives an ocean bill of lading showing the receipt of "2 × 40 ft. container STC [said to contain] 26 pallets antique furniture." The bill of lading contains no value for the goods, and the forwarder does not object, because the value appears on other customs documentation. You return to the United States and await delivery. Unfortunately, as your

container was being unloaded, it was dropped from the crane and the contents were completely destroyed. You request reimbursement from the carrier in the amount of \$250,000, based on the actual value of the antiques. The carrier says that it is only responsible for \$13,000 and no more. What do you think?

COGSA's Per-Package Liability Limitation. All countries have some limitation on the carrier's liability for loss or damage to goods, expressed either as a monetary limit per package (or shipping unit) or per unit of weight. The limits can be found in the domestic law of each country. In the United States, the limit of a carrier's liability under COGSA is \$500 per package or customary freight unit, provided the shipper gets a "fair opportunity" to declare the "nature and value" of the goods and to state the quantity and description on the bill of lading. The shipper is free to declare any value up to the actual value of the goods, but a higher value may mean a higher freight rate. If no value is stated, the limit applies. A package can be a box of merchandise, a bale of cotton, a coil of wire, a barrel of oil, or something much larger, as in the following case, *Z.K. Marine, Inc. v. M/V Archigetis*.



Z.K. Marine, Inc. v. Archigedis

776 F. Supp. 1549 (1991) United States District Court (S.D.Fla.)

BACKGROUND AND FACTS

The plaintiff, Z.K. Marine, is an importer of yachts for sale in the United States. In 1987, five yachts were shipped from Taiwan to the United States aboard the MV *Archigedis*. Each yacht was shipped under a clean negotiable bill of lading. Each of the five bills of lading provided on its face that one unit only was being shipped, that the yacht was being shipped on deck at the shipper's risk, and that the value of the goods could be declared with prior notice. On the back of each bill of lading, the liability for danger or loss was limited to \$500 per package or customary freight unit. During transit, one yacht was lost and the other four were damaged. The bills of lading were purchased by the plaintiffs while the yachts were in transit. The defendant claims that it is liable only in the amount of \$500 per yacht.

HOEVELER, DISTRICT JUDGE

Defendants argue that pursuant to the *Carriage of Goods by Sea Act*, and the explicit provisions of the bills of lading, damages are limited to \$500 per package. Because the bills of lading are clearly stamped "one unit," defendants contend that their liability is limited to \$500 per yacht. Alternatively, defendants argue that if the yachts are not one package, they are each a customary freight unit—since the freight charges were based upon a customary freight unit and yacht was used as the basis of a single freight charge—and consequently subject to the \$500 limitation.

First, [plaintiffs] argue that there is no opportunity to declare a higher value because the bills of lading themselves provide no space to do so. Although there is no specific slot for the shipper to write in its higher value, there appears plenty of space on the face of the bills for it to do so, if desired. The bills plainly afford space and, by their terms, opportunity for the shipper to declare a higher value.

Plaintiffs argue in the alternative that even if the bills of lading offer the shipper opportunity to declare a higher value, the plaintiffs, as purchasers of the negotiable bills, had no such opportunity. Therefore, they argue that the limitation provisions should not be enforced. Purchasers of a negotiable bill of lading, however, purchase only those rights which the shipper had. The right to declare a higher value and pay higher

freight ended when the goods were delivered on board the ship. Therefore, the purchasers of the bills cannot now complain if a higher value was not declared.

Plaintiffs' next contention is that each yacht is not a package so that the limitation to \$500 per package does not apply. Plaintiffs contend that the cradles attached to the yachts for ease in transporting them do not suffice as packaging because the cradles do not enclose the yachts. Plaintiffs are mistaken in this regard. A package is some class of cargo, irrespective of size or weight, which has been prepared for transportation by the addition of some packaging that facilitates handling, but which does not necessarily enclose the goods In the instant case, the yachts were all transported on cradles, analogous, for purposes of the package analysis, to skids. Accordingly, this court finds that each yacht constituted a package within the purview of COGSA's liability limitation provisions. Therefore the limitation of \$500 per package on the bills of lading applies to limit liability of the carrier to \$500 per yacht

Decision. The court held that each yacht constituted one customary freight unit or "package," that the shipper had been given a fair opportunity to declare a higher value, and that the carrier's liability was limited to \$500 per package. The purchasers of the bills of lading were bound by the terms of the bills of lading, including the limitation provisions.

Comment. COGSA generally does not apply to goods carried above deck unless specifically permitted in the bill of lading, or unless the bill of lading states that COGSA govern, as was the case here. This is known as a clause paramount. Thus, the court held that the COGSA package limitation applied to these yachts.

Case Questions

1. Why might an unknowing or unadvised shipper fail to value marine cargo properly?
2. What is the proper role of the shipper's freight forwarder in giving advice and in arranging transport for ocean cargo?
3. How could the shipper have avoided the result in this case?

The meaning of the term "package" became more complicated after the introduction of containerized freight in the 1960s. Carriers have occasionally argued that the ocean shipping container is itself the "package," which makes them liable for only \$500 for the entire shipment. Steel containers are 8' wide by 20' or 40' long and

are usually stowed one on top of the other, above deck. Carriers usually provide the containers and shippers pack and transport them by road or rail to the ports for loading. Sometimes they are used to consolidate goods from several different shippers, perhaps containing thousands of different items valued at up to millions of dollars.



The question of whether or not a container is a “package” under COGSA has resulted in many conflicting court opinions over the past 30 years. Courts have held that a container is not a “package,” unless the bill of lading (accidentally?) describes the quantity as “one container.”

The purpose of disclosing the number of packages in the bill of lading is to give the carrier a better idea of its total liability if a container is damaged. If the number of packages are not given, but only the total number of items or pieces within a container, then the carrier’s liability may be limited to only \$500 per container. *Binladen BSB Landscaping v. The Nedlloyd Rotterdam*, 759 F.2d 1006 (2d Cir. 1985) involved a shipment of potted plants to Saudi Arabia that were stuffed into a container individually, without any prior packing. The bill of lading stated, “1 × 40 ft. reefer container, said to contain 7,790 live plants.” The court noted that stating the number of plants was not the same thing as stating the number of packages (or customary freight units) and the carrier was liable for only \$500 in the destruction of the cargo.

Another common problem in defining the term “package” involves shipments of cartons strapped to wooden pallets or skids by steel bands, cardboard, or shrink-wrapping. Different courts have resolved this differently, even in the United States. Many courts hold that the number of “packages” is the number of pallets. *Tokio Marine & Fire Ins. Co., Ltd. v. Nippon Express U.S.A.*, 155 F. Supp. 2d 1167 (C.D. Cal. 2000) involved a shipment of car radio components shipped in 177 cardboard cartons on 33 wooden pallets. Each pallet was wrapped in heavy cardboard and strapped with plastic bands, so that the cartons inside were not visible. The bill of lading showed the quantity as “1 container STC 33 skids.” The goods were then described as “177 pieces, car radio components.” The court held that each of the 33 skids, and not each of the 177 cartons, was a \$500 “package.” There seemed to be two reasons: The quantity section of the bill of lading clearly specified “33 skids” and the smaller cartons could not be seen through the heavy outer cardboard wrapping. The court distinguished this from other cases where the pallets were shrink-wrapped in transparent polyethylene, noting that with shrink-wrapping the carrier could plainly see the number of smaller cartons on each skid and read the markings on each.

These cases give due warning that an export sales manager or freight forwarder should follow good shipping practices and get expert advice when needed. Goods should always be prepared and packaged for shipment in a customary and safe manner. The shipper should always be certain that the goods are correctly described, weighed, and counted and that their value

is correctly stated on the bill of lading. The number of COGSA packages being shipped, based on the smallest unit of packaging, should be declared in the quantity section of the bill of lading (e.g., “1 × 40 ft. container STC 1,000 cases red table wine”). A shipper should also use caution when declaring a quantity of goods based on individual unpacked units or pieces. Of course, a shipper must never knowingly or fraudulently misstate the identity of cargo or its value on the bill of lading, or the carrier cannot be held liable for any damage to the goods.

THE LIABILITY OF OCEAN TRANSPORTATION INTERMEDIARIES

Many companies that ship or receive goods internationally often use the services of intermediaries—service companies that handle the cargo, arrange transportation with air or ocean carriers, assist shippers in clearing legal hurdles in moving freight internationally, and provide many other services. The ocean transportation intermediaries discussed here include *freight forwarders* and *non-vessel operating common carriers*.

Freight Forwarders

Transporting goods over great distances and across national borders is often costly, complex, and highly susceptible to error and unexpected delays. Most exporters (as well as importers) rely on the services of professional **freight forwarders** for assistance. Forwarders act as agents for shippers in contracting with air, land, or sea carriers for the transportation of goods to a place of destination. These are some of the functions that forwarders provide to shippers:

- Advice on shipping alternatives and cost information
- Contracting with carriers for transportation of cargo by air, land, and sea
- Obtaining cargo insurance
- Assisting in packing, crating, and containerizing cargo
- Advice on marking of packages, cartons, and pallets
- Assisting in consolidating smaller shipments of several different shippers into one container
- Arranging warehousing of goods pending shipment or delivery
- Preparing shipping and customs documents
- Assisting in moving goods through customs and across national borders

Many forwarders specialize in moving complex or dangerous cargo, such as explosives. Some have foreign



offices and are familiar with foreign import regulations. When forwarders receive cargo for shipment, they issue **forwarder's receipts** or house bills of lading (called consignment notes in some countries). These do not have the same legal effects as ocean bills of lading and are not negotiable.

Non-Vessel Operating Common Carriers

Shippers who can fill an entire ocean container with goods can receive more favorable shipping rates than those shippers who must move small amounts of break-bulk cargo without a container. **Non-vessel operating common carriers** (commonly referred to as NVOCCs) act as freight consolidators for small shipments, permitting them to take advantage of lower freight rates. A NVOCC is a common carrier that functions like an ocean carrier but does not operate the vessels by which transportation is provided. It issues bills of lading and assumes liability

for goods due to loss or damage during transport. It also performs many of the same services as a freight forwarder. The *Federal Maritime Commission* licenses and regulates ocean transportation intermediaries that operate in the United States. Ocean carriers, freight forwarders, and NVOCCs in the United States are governed by the *Shipping Act of 1984* and the *Ocean Shipping Reform Act of 1998*. The latter represents an attempt by the U.S. Congress to reform ocean shipping regulation by allowing carriers greater flexibility in contracting with shippers and establishing shipping rates. Because these agreements are considered private contracts (with no bill of lading), they are not subject to COGSA. States and municipalities in the United States are prohibited from regulating freight forwarders.

The following case, *Prima U.S. Inc. v. Panalpina, Inc.*, compares the liability of a freight forwarder with that of an NVOCC.



Prima U.S. Inc. v. Panalpina, Inc.

223 F.3d 126 (2000) United States Court of Appeals (2d Cir.)

BACKGROUND AND FACTS

Westinghouse contracted with Panalpina, a freight forwarder, to arrange for the transportation of an electric transformer from Italy to Iowa. Panalpina stated to Westinghouse, "[R]est assured your shipment will receive door to door our close care and supervision . . ." Westinghouse paid Panalpina over \$20,000 for its services. As was the industry custom, Panalpina did not issue a bill of lading for the shipment.

Panalpina hired an Italian company to coordinate the movement of the transformer through Italy, who then hired a local stevedoring company, to load the transformer aboard the ship for the voyage to the United States. Panalpina never inquired of the stevedore how the transformer was lashed for the ocean voyage, nor did it supervise the endeavor. During the ocean voyage, the ship encountered heavy seas and the transformer broke loose, crushing a laser-cutting machine owned by Prima. Prima sued the owner of the ship, Westinghouse, and Panalpina for damages to the laser. The district court held Panalpina liable, and Panalpina appealed.

MCLAUGHLIN, CIRCUIT JUDGE

The job of a non-vessel operating common carrier ("NVOCC") is to consolidate cargo from numerous shippers into larger groups for shipment by an ocean

carrier. An NVOCC—as opposed to the actual ocean carrier transporting the cargo—issues a bill of lading to each shipper. If anything happens to the goods during the voyage the NVOCC is liable to the shipper because of the bill of lading that it issued.

A freight forwarder like Panalpina, on the other hand, simply facilitates the movement of cargo to the ocean vessel. The freight forwarder secures cargo space with a steamship company, gives advice on governmental licensing requirements, proper port of exit and letter of credit intricacies, and arranges to have the cargo reach the seaboard in time to meet the designated vessel. Freight forwarders generally make arrangements for the movement of cargo at the request of clients and are vitally different from carriers, such as vessels, truckers, stevedores or warehouses, which are directly involved in transporting the cargo . . . As long as the freight forwarder limits its role to arranging for transportation, it will not be held liable to the shipper. Panalpina did not issue a bill of lading and it did not consolidate cargo. It was hired by Westinghouse simply as a freight forwarder to arrange for the transportation of a transformer from Italy to Iowa. By analogy, Panalpina was hired to act as a "travel agent" for the transformer: it set things up and made reservations, but did not engage in any hands-on heavy lifting. Admittedly, Panalpina did state that Westinghouse's "shipment [would] receive door to door our close care and

continues



continued

supervision” However, because of the well settled legal distinction between forwarders and carriers, that statement—mere puffing—cannot transform Panalpina into a carrier, and bestow liability upon it.

Decision. Judgment reversed for Panalpina. Panalpina was a freight forwarder hired by Westinghouse to arrange for transportation and other services. It was not a carrier and was not liable for the cargo during shipment. Freight forwarders must use due diligence and reasonable care in performing their functions. Panalpina was reasonable in its selection of its stevedore to load the ship.

Case Questions

1. Explain the difference between a carrier, a freight forwarder, and a NVOCC.
2. How does the liability of each of the above differ for damage or loss to goods?
3. Why did Panalpina’s assurance that the shipment would “receive door to door our close care and supervision” not subject the freight forwarder to liability?

MARINE CARGO INSURANCE

Cargo insurance is an essential element of international trade. The potential for damage and loss to goods, particularly during ocean shipments, which are lengthier and more hazardous than air shipments, is tremendous. Sellers, buyers, and even banks that finance international sales want to be certain that their interest in the goods is fully insured. If not, the property risks will be unacceptably high.

Marine Insurance Policies

Although policies of insurance cover individual shipments, many shippers who do large volumes of business overseas maintain **open cargo policies**. An open policy offers the convenience and protection of covering all shipments by the shipper of certain types of goods to certain destinations and over specified routes. With an open policy in effect, insurance company authorizes the exporter to issue a certificate of insurance on a form the company provides. Exporters shipping on CIF terms often use open cargo policies. These certificates are negotiable and are transferred along with the bill of lading to the party who purchases and takes title to the goods. The type or form of the certificate is determined by the contract between the parties or by the requirements of the bank that is providing financing for the sale. The insurance company must be notified as soon as possible after shipment under an open policy.

Marine insurance policies cover several different types of losses, including (1) total losses of all or part of a shipment, (2) general averages or general average losses, and (3) partial or particular average losses.

General Average

The concept of general average is derived from ancient mariners, ship owners, and merchants who understood that ocean voyages were a shared venture. After all, lives and commercial interests of all three groups depended on one another while at sea. So early maritime principles developed to assure that each could rely on the other, by seeing that they all shared in the gain and loss of the voyage. By now you should have realized that the three judgments of the *Rolls of Oleron* that appeared earlier in this chapter illustrate this important principle of shared responsibility.

The word “average” in marine insurance law means loss. A **general average** is a loss that results when extraordinary expenses or losses are incurred in saving the vessel or its cargo from danger at sea. It spreads the risk of a disaster at sea by making all parties to the voyage contribute to any loss incurred. Under this rule, if A’s cargo is damaged or “sacrificed” in the process of saving the ship, and B’s cargo is saved as a result, B or its insurer must contribute to A for the loss. A’s claim is a general average. In other words, the owner of the cargo that was sacrificed would have a general average claim for contribution against the owner of the cargo that was saved. For example, when fire threatens an entire ship and certain cargo is damaged by water in putting the fire out, the owners of all of the cargo must contribute to the loss of the cargo that was damaged by the water. The owners of cargo that is thrown overboard to save a sinking ship may have a claim against those whose cargo was thereby saved. General average claims are typically covered by marine insurance.

Modern cases hold that, to prove a general average claim, the claimant must show that (1) the ship, cargo,

and crew were threatened by a *common danger*; (2) the danger was *real and substantial* (the older cases required that the danger be imminent); and (3) either the cargo or ship was voluntarily sacrificed for the benefit of both or extraordinary expenses were incurred to avert a common danger.

General Average Claims by the Carrier. Under general average, ship owners can also bring general average claims against the owners of cargo. The principles of general average apply when a carrier incurs extraordinary expenses in rescuing, saving, or repairing an endangered ship that is in a real and substantial danger. In *Eagle Terminal Tankers, Inc. v. Insurance Co. of USSR*, 637 F.2d 890 (2d Cir. 1981), the ship had traveled for more than a day with a damaged propeller. It dry-docked, unloaded the cargo, had the damage repaired at a cost of \$127,000 (which included the crew's expenses during that time), reloaded, and completed its voyage to Leningrad. The court awarded the carrier the general average claim. It noted that "a ship's master should not be discouraged from taking timely action to avert a disaster," and need not wait until the peril is imminent to claim general average.

The results of general average law must have been quite surprising to the plaintiff in *Amerada Hess Corp. v. S/T Mobil Apex*, 602 F.2d 1095 (2d Cir. 1979). Plaintiff shipped gasoline and naphtha. When the cargo was destroyed by an explosion and fire that had been started by sparks from machinery in the engine room, the plaintiff sued the carrier for damages. The carrier counterclaimed for general average losses. The court denied recovery to the cargo owner under COGSA, holding that the carrier was not liable for the fuel because the ship was not unseaworthy. The court then held, much to the chagrin of the plaintiff, that it was actually liable to the carrier for towing and salvage expenses incurred in arresting the fire and saving the ship.

The York-Antwerp Rules. The *York-Antwerp Rules* are a set of standardized rules on general average. An effort to develop commonly accepted principles of general average began in England as early as 1860, with work on the rules being completed in 1890. Following World War II, an international effort to achieve universally accepted general average rules resulted in the revised *York-Antwerp Rules* of 1950. The rules have achieved widespread acceptance by the maritime industry; the latest version was agreed to in 1994. The rules are not the subject of treaty or convention and

have not been enacted into national laws. They traditionally have become a part of the contract of carriage because their provisions are generally incorporated into all modern bills of lading.

Particular Average Claims

Although total and general average losses are ordinarily covered up to the policy amount, special problems result from partial or particular average losses. A **particular average** is a partial loss to the insured's cargo. Many insurance policies limit the insurer's liability for particular average losses. Because many losses only partially damage the cargo, a shipper must understand the particular average terms of the policy. A policy that is *free of particular average* (or said to be on "FPA terms") will not cover any partial losses. A policy FPA, followed by certain specified losses, will not pay for any partial or particular average losses of that nature. As such, an "FPA fire" policy will not pay for partial losses to the cargo due to fire.

Types of Coverage

Marine cargo insurance is available for virtually any type of risk, for any cargo, destined for almost any port (see Exhibit 6.3). The only limitations are the willingness of the insurer to undertake the risk and the price. The perils clause of the policy describes the types of risk it covers.

The Perils Clause. The **perils clause** covers the basic risks of an ocean voyage. It generally covers extraordinary and unusual perils that are not expected during a voyage. Examples of perils that are included are bad weather sufficient to overcome a seaworthy vessel, shipwreck, stranding, collision, and hitting rocks or floating objects. (An example of a perils clause follows in the next case.) However, this clause does not cover every event that can damage goods. The perils clause does not include damage due to the unseaworthiness of the vessel or loss from explosion or pilferage. The clause only covers losses while at sea. Moreover, it only covers **fortuitous losses**. "Fortuitous" is a concept that runs throughout insurance law. It means that the loss occurred by chance or accident and could not have reasonably have been predicted. For example, damage due to predictable winds or waves are generally not considered fortuitous. Courts have held that damage from seawater due to improper stowage of goods is not fortuitous. Losses due to the "inherent vice" or nature of the goods are not fortuitous, such as steel that rusts

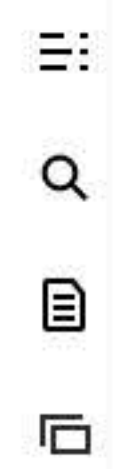


Exhibit 6.3

Marine Cargo Insurance Policy



CHUBB GROUP
of Insurance Companies
CHUBB 100 William Street, New York, N.Y. 10038

CARGO POLICY OF INSURANCE

\$	Number	Issued by the stock insurance company shown below
Open Policy No.		FEDERAL INSURANCE COMPANY
In consideration of a premium as agreed, the Company		Incorporated under the Laws of New Jersey
Does insure (lost or not lost)		
to the amount of		Dollars,
on		
valued at	to be shipped on board of the	B/L Date
at and from		
to		
and it is hereby understood and agreed, that in case of loss, such loss is payable to the order of		
on surrender of this Policy.		

(continued)

Touching the Adventures and Perils which said Assurers are contented to bear, and take upon themselves, in this Voyage, they are of the Seas, Fires, Assailing Thieves, Jettisons, Barratry of the Master and Mariners, and all other like Perils, Losses and Misfortunes that have or shall come to the Hurt, Detriment or Damage of the said Goods and Merchandise, or any part thereof except as may be otherwise provided for herein or endorsed hereon. AND in case of any Loss or Misfortune, it shall be lawful and necessary to and for the Assured, his or their Factors, Servants and Assigns, to sue, labor and travel for, in and about the Defense, Safeguard and Recovery of the said Goods and Merchandise, or any part thereof, without Prejudice to this Insurance; nor shall the acts of the Assured or Assurers, in recovering, saving and preserving the property insured, in case of disaster, be considered a waiver or an acceptance of an abandonment; to the charges whereof, the said Assurers will contribute according to the rate and quantity of the sum hereby insured.

In case of loss, such loss to be paid in thirty days after proof of loss and proof of interest in the property hereby insured.

In case the interest hereby insured is covered by other insurance (except as hereinafter provided) the loss shall be collected from the several policies in the order of the date of their attachment, insurance attaching on the same date to be deemed simultaneous and to contribute pro rata; provided, however, that where any fire insurance, or any insurance (including fire) taken out by any carrier or bailee is available to the beneficiary of this policy, or would be so available if this insurance did not exist, then this insurance shall be void to the extent that such other insurance is or would have been available. It is agreed, nevertheless, that where these Assurers are thus relieved of liability because of the existence of other insurance, these Assurers shall receive and retain the premium payable under this policy and, in consideration thereof, shall guarantee the solvency of the companies and/or underwriters this clause, but not exceeding, in any case, the amount which would have been collectible under this policy if such other insurance did not exist.

In all cases of damage caused by perils insured against, the loss shall, as far as practicable, be ascertained by a separation and a sale or appraisal of a damaged portion only of the contents if the packages so damaged and not otherwise.

Losses arising from breakage and/or leakage and/or loss of weight and/or loss of contents are excluded from this insurance unless caused by stranding or collision with another vessel, or unless this insurance has been expressly extended to include such losses.

Warranted free from Particular Average unless the vessel or craft be stranded, sunk or burnt, but notwithstanding this warranty these Assurers are to pay any loss of or damage to the interest insured which may reasonably be attributed to fire, collision or contact of the vessel and/or conveyance with any external substance (ice included) other than water, or to discharge of cargo at port of distress. The foregoing warranty, however, shall not apply where broader terms of average are provided for herein or by endorsement hereon.

If the voyage aforesaid shall have been terminated before the date of this policy, then there shall be no return of premium on account of such termination of the voyage.

Wherever the words "ship", "vessel", "seaworthiness", "ship or vessel owner" appear in this Policy, they are deemed to include also the words "aircraft", "airworthiness", "aircraft owner".

THIS INSURANCE IS SUBJECT TO THE AMERICAN INSTITUTE CARGO CLAUSES (FEB. 1949) (INCLUDING THE WAREHOUSE TO WAREHOUSE CLAUSE), SOUTH AMERICAN 60 DAY CLAUSE WHEN APPLICABLE. ALSO SUBJECT TO THE AMENDED F. C. & S. AND S. R. & C. C. WARRANTIES (OCT. 1959) (SEE REVERSE)

(continued)



continued

Original and Duplicative issued, one of which being accomplished the other to stand null and void		
SPECIAL CONDITIONS		Marks and Numbers
ON DECK—Merchandise and/or goods shipped on deck to an On Deck Bill of Lading which must be so specified in this policy are insured.—Free of particular average unless caused by the vessel being stranded, sunk, burnt, on fire, or in collision, but including jettison and/or washing overboard, irrespective of percentage.		
Where the words "including M. E. C." are typed in the space below at the time the policy is issued, this insurance is subject to the American Institute Marine Extension Clauses.	Where the words "including Strike Risks" are typed in the space below at the time the policy is issued, this insurance is subject to the Current American Institute S. R. & C. C. Clauses.	Where the words "including War Risk" are typed in the space below at the time the policy is issued, this insurance is subject to the Current War Risk Clauses.
In Witness Whereof, the Company issuing this policy has caused this policy to be signed by its authorized officers, but this policy shall not be valid unless signed by a duly authorized representative of the Company.		
FEDERAL INSURANCE COMPANY		
Date:	Henry G. Gabel Secretary	Henry L. Hudson President Authorized Representative
The following Warranties shall be paramount and shall not be modified or superseded by any other provision included herein or stamped or endorsed hereon unless such other provision refers specifically to the risks excluded by these warranties and expressly assumes the said risks. (A) "Notwithstanding anything herein contained to the contrary, this insurance is warranted free from capture, seizure, arrest, restraint, detainment, confiscation, preemption, requisition or nationalization, and the consequences thereof or any attempt thereat, whether in time of peace or war and whether lawful or otherwise; also warranted free, whether in time of peace or war, from all loss, damage or expense caused by any weapon of war employing atomic or nuclear fission and/or fusion or other reaction or radioactive force or matter or by any mine or torpedo, also warranted free from all consequences of hostilities or warlike operations (whether there be a declaration of war or not), but this warranty shall not exclude collision or contact with aircraft, rockets or similar missiles or with any fixed or floating object (other than a mine or torpedo), stranding heavy weather, fire or explosion unless caused directly (and independently of the nature of the voyage or service which the vessel concerned or, in the case of a collision, any other vessel involved therein, is performing) by a hostile act by or against a belligerent power; and for the purposes of this warranty 'power' includes any authority maintaining naval, military or air forces in association with a power. Further warranted free from the consequences of civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or piracy." (B) Warranted free of loss or damage caused by or resulting from strikes, lockouts, labor disturbances, riots, civil commotions or the acts of any person or persons taking part in any such occurrence or disorder. NOTE: It is necessary for the assured to give prompt notice to these Assurers when they become aware of an event for which they are "held covered" under this policy and the right to such cover is dependent on compliance with this obligation. Source: Sample policy provided courtesy of Chubb Group of Insurance Companies.		



or materials that absorb water from humidity in the air. A loss from improper packaging is not fortuitous.

A shipper who desires additional or special coverage can purchase it from the insurer at an added charge, sometimes called a "specially to cover clause." For instance, a standard perils clause does not generally cover damage resulting from explosion, but a shipper can obtain insurance to cover it in the form of an explosion clause. Similarly, a shipper can purchase additional coverage to protect against the risks

of freshwater damage, moisture damage, and rust or contamination of the cargo from chemicals, oil, or fuel. Many insurers offer specially designed import-export insurance packages for shippers of perishable foodstuffs, tobacco, steel, and other products and commodities.

The *Shaver* case discusses a standard perils clause and several additional types of coverage purchased by the insured. Unfortunately, none of them covered the loss that the plaintiffs had incurred.



Shaver Transportation Co. v. The Travelers Indemnity Co.

481 F.Supp. 892 (1979) United States District Court (D. Or.)

BACKGROUND AND FACTS

Shaver, a barge company, contracted with Weyerhaeuser, the shipper, to transport caustic soda to a buyer. Shaver arranged for marine cargo insurance with Travelers. Several different types of coverage were discussed. Shaver decided on "free from particular average" and "standard perils" provisions, supplemented with "specially to cover" clauses. Shaver loaded the first shipment of caustic soda on one of its barges and transported it to the buyer. The buyer refused delivery because it had been contaminated with tallow. The contamination occurred as Shaver was loading the caustic soda aboard the barge. The barge had previously carried a load of tallow, and Shaver had not thoroughly cleaned the barge input lines. The barge was returned to Shaver's dock. Shaver and Weyerhaeuser filed a claim with Travelers. Travelers argued that the contamination did not represent a recoverable loss under the policy. Shaver and Weyerhaeuser brought this action against Travelers.

SKOPIL, CIRCUIT JUDGE, SITTING BY DESIGNATION

Although the plaintiffs request recovery under several theories, there is only one major issue in the case: Are the losses incurred by the plaintiffs the consequences of an insured event under the marine cargo insurance policy? If the losses are not insured against, no recovery is possible.

[RECOVERY UNDER THE PERILS CLAUSE AND FREE FROM PARTICULAR AVERAGE CLAUSE]

The perils clause, almost identical to ancient perils provisions dating back several hundred years, defines the risks protected by the policy. In addition to a long list of "perils of the sea," the clause concludes with "and all other perils, losses, and misfortunes, that have, or shall, come to the hurt, detriment, or damage to the said goods and merchandise." Plaintiff argues that the "forced" disposition of the caustic soda was like jettison (an enumerated peril) and is covered by the

concluding language of the clause. That language has been interpreted to include only perils that are similar to the enumerated perils.

Whether or not I conclude the forced disposition was a type of jettison, plaintiffs are unable to show an insurable loss due to jettison. The loss contamination of the cargo occurred at the time of loading . . . [P]laintiffs cannot recover under the perils clause of the policy. The term "jettison" also appears in the Free from Particular Average clause. If jettison did occur, this clause affords coverage regardless of the amount of cargo damage. However, I find that a jettison did not occur in this instance. Jettison is the act of throwing overboard from a vessel a part of the cargo, in case of extreme danger, to lighten the ship. The orderly unloading and sale of the cargo to a chemical salvage company is not "jettison." Plaintiff cannot recover under the Free from Particular Average clause.

[RECOVERY UNDER THE . . . SHORE COVERAGE CLAUSE]

The shore coverage clause provides coverage for enumerated risks occurring on shore. Plaintiffs argue that contamination while loading is a shore accident. However, since the contamination occurred within the barge's intake lines, the incident arose "on board." Therefore shore coverage does not apply. Even if it were to apply, contamination of cargo is not within the enumerated risks covered by the shore coverage clause

[RECOVERY UNDER THE INCHMAREE CLAUSE]

The purpose of the Inchmaree clause is to expand the coverage of the policy beyond the perils provision. Federal law allows a vessel owner to become exempt from liability for fault or error in navigation or management of the ship. In contrast, the ship owner must retain liability for negligence in the care and custody of the cargo. The Inchmaree clause is intended to provide

continues



continued

coverage to a cargo owner when a loss is due to error in navigation or management of the vessel since the carrier is exempt from liability. Plaintiffs argue the contamination was the result of an error in management and therefore covered under the Inchmaree clause. Defendant naturally urges the court to find the loss caused by fault in the care and custody of the cargo.

The United States Supreme Court has addressed the distinction between error in management and error in care of cargo but has not articulated a clear test. The Ninth Circuit, noting that no precise definitions exist, advocates a case-by-case determination using the following test: "If the act in question has the primary purpose of affecting the ship, it is 'in navigation or in management'; but if the primary purpose is to affect the cargo, it is not 'in navigation or in management.'" *Grace Line, Inc. v. Todd Shipyards Corporation*, 500 F.2d 361, 374 (9th Cir. 1974).

Using this test, I find that the contamination of the cargo in this case was caused by fault in the care, custody, and control of the cargo. The Inchmaree clause will not provide coverage for plaintiffs' losses under the facts of this case.

[RECOVERY UNDER NEGLIGENCE CLAUSE]

The Negligence clause provides coverage against losses due to enumerated perils caused by the unseaworthiness of the vessel . . . This unseaworthiness must then cause a loss through one of the enumerated perils: "sinking, stranding, fire, explosion, contact with seawater, or by any other cause of the nature of any of the risks assumed in the policy" . . .

Since contamination is not an enumerated peril, plaintiff urges coverage . . . by suggesting the barge was in imminent danger of sinking. Although there is evidence that the caustic soda would have eventually corroded through the barge and caused it to sink, the process would have taken three to five years. This possibility is too far removed to find coverage under a provision providing for loss due to sinking. No recovery is possible under the Negligence clause of this policy . . .

Plaintiffs suggest a number of theories of recovery under the marine cargo insurance policy. None is suited to this case. I am aided in my construction of this policy by one additional fact. Shaver rejected insurance coverage costing more but did not believe contamination was covered under the policy. Plaintiffs' present attempt to include this type of loss within the coverage of the policy is an afterthought.

Judgment shall be entered for the defendant.

Decision. The plaintiffs' loss due to contamination was not covered under any of the clauses of the insurance policy.

Comment. The following clauses were at issue in this case.

[THE PERILS CLAUSE]

"Touching the adventures and perils which the said Assurers are contended to bear, and take upon themselves, they are of the seas and inland waters, man of war, fires, enemies, pirates, rovers, assailing thieves, jettisons, letters of mart and countermart, reprisals, taking at sea, arrests, restraints and detainments of all kings, princes of people of what nation, condition or quality soever, barratry of the master and mariners, and all other perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage to the said goods and merchandise, or any part thereof."

[THE SHORE CLAUSE]

"Including while on docks, wharves, or elsewhere on shore and/or during land transportation, risks of collision, derailment, fire, lightning, sprinkler leakage, cyclones, hurricanes, earthquakes, floods, the rising of navigable waters, or any accident to the conveyance and/or collapse and/or subsidence of docks and/or structures, and to pay loss or damage caused thereby, even though the insurance be otherwise FPA."

[THE INCHMAREE CLAUSE (NAMED AFTER A FAMOUS BRITISH CASE)]

"This insurance is also specially to cover any loss of or damage to the interest insured hereunder, through the bursting of boilers, breakage of shafts, or through any latent defect in the machinery, hull, or appurtenances, or from faults or errors in the navigation and/or management of the vessel by the Master, Mariners, Mates, Engineers, or Pilots; provided, however, that this clause shall not be construed as covering loss arising out of delay, deterioration, or loss of market, unless otherwise provided elsewhere herein."

[THE NEGLIGENCE CLAUSE]

" . . . [T]he Assurers agree that in the event unseaworthiness or a wrongful act or misconduct of shipowner, character, their agents or servants, shall, directly or indirectly, cause loss or damage to the cargo insured by sinking, stranding, fire, explosion, contact with seawater, or by any other cause of the nature of any of the risks assumed in the policy, the Assurers will [subject to the terms of average and other conditions of the policy] pay to an innocent Assured the resulting loss."

Case Questions

1. Tell whether coverage was awarded or denied under each of the following insurance provisions, and why or why not: the perils clause, the shore clause, the "Inchmaree" clause, and the negligence clause.
2. How could the shipper have avoided this problem?



All Risks Coverage. An all risks policy covers all risks except those specifically excluded in the policy. Today, virtually all marine policies are issued with all risks coverage (although as we have already learned, that does not mean that all “losses” are covered, but only fortuitous losses). These policies usually exclude damage from certain specific causes, such as acts of war, damage or loss from delay in reaching the destination, and damage resulting from strikes and civil commotion. Coverage for strikes is available, but usually at additional cost.

War Risk. Typically, marine insurance policies do not cover the risks of war. War risk insurance is available for ocean shipments. If the shipper desires war risk insurance, it must purchase it separately from the insurer. If the buyer wants war risk coverage, it must agree on the price separately from the marine insurance provisions. The rates for war risk insurance are relatively stable in peacetime, but fluctuate almost daily in times of war.

CONCLUSION

This chapter began by discussing the liability of air carriers for the death or injury of passengers, for damage to baggage or cargo, and for flight delays affecting international travel and shipments. Airline-related litigation is very common. Some cases involve individual claims for single incidents. Others involve highly publicized major air disasters. Critics of the American legal system are quick to point out that airline litigation is a big business with American law firms and that much of it is frivolous and unnecessary. On the other hand, it would be nearly impossible for victims of air disasters to seek

recovery without the benefit of experienced aviation lawyers because of the complexity of aviation law and the technical and engineering knowledge required to handle these cases. To put this in perspective, according to the IATA, some three billion passengers were carried by air in 2012, on 37.5 million flights worldwide. Yet there were only 414 fatalities in 15 fatal accidents; the safest year on record for air travel.

Air freight, both domestic and international, is the fastest growing method of cargo transportation. Although only a small fraction of goods by weight moves by air, it accounts for much higher percentage when measured by value. This is due to shipments of higher-value goods and perishables and increased package delivery services.

It has been over 50 years since the beginning of the modern era of containerized ocean cargo. In 1956 the first containers were loaded atop a converted tanker, the *Ideal X*, at the Port of Newark, bound for Houston. They were no more than truck trailer bodies, with the wheels and running gear removed. There were 56 trailers on the *Ideal X*. In 2013, the shipping firm Maersk announced a new container ship capable of carrying 16,000 containers. There are several million ocean containers in transit at any given time. No one knows for sure the number of containers lost at sea each year, or their value. Although it is a relatively small percentage of total ocean freight, by all estimates, it runs into the tens of thousands of containers and billions of dollars annually. There is perhaps no other single area of international business that has engendered as much litigation as ocean cargo losses. It is incumbent on anyone shipping goods to understand the risks involved and what can be done in advance to protect against them.

Chapter Summary

1. The *Montreal Convention* (MC) makes the carrier strictly liable for the death or injury of a passenger ticketed for international travel, or for damages to baggage or cargo, up to an amount equal to 113,100 special drawing rights. In addition, the carrier is liable for all proven damages above that unless the carrier can show that it or its employees were not at fault.
2. The MC applies only to passengers ticketed for “international carriage.” Travel on a domestic flight is included, if it is a part of one continuous international journey.
3. If the MC applies, then it provides the exclusive cause of action against air carriers, preempting state or local law. Lawsuits may be brought against

- third-party defendants, other than the carrier, who were at fault in causing an injury or damage.
4. An air carrier is liable for damage sustained in case of death or bodily injury of a passenger only if the accident that caused the death or injury took place on board the aircraft or in the course of any of the operations of embarking or disembarking. An "accident" is an unexpected or unusual event or happening that is external to the passenger. It is not an accident if death or injury is caused by the passenger's own internal reaction to the usual, normal, and expected operation of the aircraft.
 5. The carrier is not liable to the extent that the passenger's own negligence contributed to the accident or to his or her loss. Injuries for mental harm or emotional distress are only permitted if they were caused by a bodily injury. Punitive damages are not permitted under the MC.
 6. Our maritime law developed out of the customs of ancient medieval ship owners, mariners, and merchants of the Mediterranean, and was adopted into maritime codes used in local courts in port cities. The most famous code is the *Rolls of Oleron*. Important principles of jettison, general average, salvage, maritime liens, the treatment of the ship's crew, all came from these early codes.
 7. In the United States, maritime cases are heard in the admiralty jurisdiction of the federal district courts. Some admiralty cases are also heard in the state courts.
 8. In most nations of the world, the *Hague Rules*, adopted in the United States as the *Carriage of Goods by Sea Act (COGSA)*, govern the liability of a carrier for damage or loss to oceangoing goods.
 9. COGSA provides many limitations on the liability of ship owners. The carrier's primary obligation is to use due diligence to provide a seaworthy ship at the beginning of the voyage. A vessel is seaworthy if it is reasonably fit to carry the cargo it has undertaken to carry on the intended journey. Carriers are generally not liable for damage to cargo resulting from errors in navigation, mismanagement of the ship, acts of god, acts of war or public enemies, labor strikes, damage resulting from saving lives at sea, inherent defects in the goods, or perils of the sea. Liability for damage due to fire aboard the ship is limited to fires caused by the actual fault of the ship's owner.
 10. In the United States, COGSA also provides that carriers are not liable for amounts in excess of \$500 "per package" or "customary freight unit" unless the shipper has indicated a higher amount on the bill of lading.
 11. Maritime and marine insurance law is a complicated and specialized area of the law, with concepts dating back to the days of the ancient mariners. Under the law of general average, a carrier can assert a general average claim against the owners of cargo demanding that they (or their insurers) contribute to expenses incurred in saving a vessel from a common peril on the seas.

Key Terms

international carriage by aircraft 150	longshoremen 157	vessel 159
special drawing rights 154	admiralty jurisdiction 157	maritime tort 159
consignee 155	general maritime law 157	maritime contract 159
consignor 155	Rhodian law 157	wharfage 159
master air waybill 155	maritime courts 157	stevedore 159
house air waybill 155	maritime codes 157	cargo 159
maritime law 157	Rolls of Oleron 158	freight 159
salvage 157	Lord Mansfield 158	ship 159
jettison 157	Jean Baptiste Colbert 158	break-bulk 160
seamen 157	navigable waters 159	dry bulk ships 160



tanker 160	errors in navigation 162	open cargo policy 168
reefer ship 160	peril of the sea 162	general average 168
containerized ocean cargo 160	freight forwarder 166	particular average 169
Himalaya clause 160	forwarder's receipt 167	perils clause 169
clean bill of lading 161	non-vessel operating common	fortuitous losses 169
seaworthy 162	carrier (NVOCC) 167	

Questions and Case Problems

1. The plaintiff was traveling by air from Rome to Philadelphia. Being highly allergic to gluten, she had requested a gluten-free meal at the time she booked the flight. She again informed the flight attendant that she required a gluten-free meal. She was served a vegetarian meal, but it was not gluten-free. After taking a few bites she suffered an allergic reaction, developed hives, and had difficulty breathing. Was this a compensable accident under the *Montreal Convention*? The plaintiff contends she suffered posttraumatic stress disorder. May she recover damages for mental injury? *Schaefer-Condulmari v. U.S. Airways Group, LLC*, WL 4729882 (E.D.P.A. 2009).

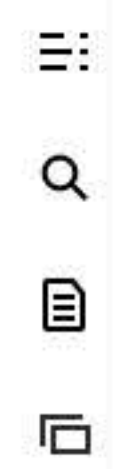
2. The Plaintiff purchased a round-trip ticket on British Airways between London and Denver. Three days later she purchased a round-trip ticket on American Airlines between Denver and Washington, DC. During the flight between Denver and Washington, she was burned by dry ice accidentally given to her by a flight attendant. When booking her flights, the plaintiff had scheduled her connection in Denver so that her flight to Washington would depart within about three hours of her arrival from London, with as short a layover as possible. She had no reason to be in Denver on that day other than to make the plane connection. Plaintiff brought this action for damages more than two years after the flight. Should her case be dismissed? Does the *Montreal Convention's* two-year statute of limitations apply? *Robertson v. American Airlines, Inc.*, 401 F.3d 499 (D.C. Cir. 2005).

3. In 2004, Ellen Kruger was boarding a flight from San Francisco to Seattle, on her way home from Australia, when she was struck on the head with a backpack swung by another passenger. During the flight she became ill, vomited, and remained unconscious for much of the flight. She sued the airline for pain and suffering, emotional distress, and punitive damages. Her husband also sued for loss of consortium and companionship of his wife. United Airlines argued that these were not compensable damages under the
- Montreal Convention*. Does the *Montreal Convention* specify what types of damages are recoverable or whether the husband may bring an action? How is this decided? *Kruger v. United Airlines, Inc.*, 481 F. Supp. 2d 1005 (N.D. Cal. 2007.) How would this case be decided if the injuries were the result of the aircraft plunging into the middle of the Pacific Ocean?

4. Fishman shipped a container of boys' pants on a ship owned by Tropical. The container was lost at sea due to improper storage. The pants were packed into bundles of 12 each and placed into what is known in the industry as a "big pack." A "big pack" is similar to a 4' × 4' pallet, partially enclosed in corrugated cardboard, with a base and cover made of plastic. The bill of lading stated, "1 × 40 ft. [container] STC [said to contain] 39 Big Pack Containing 27,908 units boy's pants." Fishman maintains that Tropical is liable for an amount up to \$500 for each of the 2,325 bundles. If the carrier is liable for up to \$500 per "package," what is the limit of the carrier's liability? *Fishman & Tobin, Inc. v. Tropical Shipping & Const. Co., Ltd.*, 240 F.3d 956 (11th Cir. 2001).

5. Assume a passenger dies aboard an international flight, and that there was no defibrillator aboard the aircraft that might have been used to revive him. Do you think the failure to have a defibrillator is an event "external to the passenger?" Do you think it is an "unexpected or unusual" event? Would it make a difference if there was a legal requirement to have a defibrillator aboard, or that it was or was not industry practice to do so?

6. Sony Corp. packed a shipment of videocassette tapes into a 40-foot ocean container for transport to England. Sony put the tapes into 1,320 cardboard cartons, then strapped the cartons onto 52 wooden pallets. The pallets were put into one shipment container. The bill of lading stated "1 × 40 ft. container: 1,320 ctns. magnetic tape." The value of the tapes shown on the export certificate was \$400,000. On loading, the ship's deck crane dropped the container 60 feet to a concrete deck. Sony claims it can recover the value of the tapes. The ship maintains that under COGSA its liability is limited to 52 pallets.



- How many “packages” were involved here and what do you think should be the outcome? *Sony Magnetic Products Inc. of America v. Merivienti O/Y*, 863 F.2d 1537 (11th Cir. 1989).
7. A shipper of fruits and vegetables delivered a refrigerated van of produce to the S.S. *Bayamon* at the port of Elizabeth, New Jersey, on September 22 for shipment to San Juan, Puerto Rico. The ship was supposed to sail that day but was unable to do so because of repairs needed to correct a boiler problem. The ship sailed on September 25 and arrived in Puerto Rico on September 27. A clause paramount incorporated COGSA into the bill of lading. Upon arrival in Puerto Rico, part of the produce was found to be rotten. The shipper claims that the carrier is liable because the ship was not “seaworthy.” COGSA states that the carrier shall not be liable unless it shows a failure to make the ship seaworthy before and at the beginning of the voyage. Does COGSA apply here, considering that the port is domestic rather than foreign? Is the carrier liable for an unseaworthy vessel? What is the outcome? *Squillante & Zimmerman Sales, Inc. v. Puerto Rico Marine Management, Inc.*, 516 F. Supp. 1049 (D.Puerto Rico 1981).
8. Three judgments of the *Rolls of Oleron* appear in this chapter. Early ship owners, mariners, and merchants found it necessary for all parties aboard ship to share in the risks of the voyage. Explain how these judgments accomplished that.

Managerial Implications

1. Reconsider the hypothetical case presented earlier in this chapter involving the shipment of English antiques to the United States. Do you think that the \$500 per package limitation applies to the container, to each wooden skid, or to each of the individually wrapped pieces of furniture or objects fastened onto the skid? What could have been done differently, if anything, to avoid the confusion and problems in this case? Discuss the ramifications of this case.
2. You are CEO of a firm that regularly imports consumer electronic devices from plants in Thailand, Malaysia, Indonesia, and the Philippines. The devices are shipped to you by ocean carrier through the South China Sea and then are sold in the United States and exported to ports in Europe and the Middle East. What kind of information do you need to assess the potential risk to your cargo passing through the dangerous waters of the South China Sea? From what sources will you receive your information? What sources are available in your library? Which are commercially available? If part of your job is to keep abreast of developments on a daily basis, where will you obtain that information? What types of information might be available from freight forwarders, steamship companies, local port authorities, and insurers?

Ethical Considerations

This one is for fun, so watch for clues! O. L. Salt had a long career in the merchant trade of the western hemisphere, running voyage charters in old tramp freighters and hauling whatever cargo came his way. He had since retired, living on a houseboat south of Miami when he decided to return to the sea. He acquired an old rust-bucket tanker, the *Q. Anne's Revenge II*, from an acquaintance in Panama who found the old ship no longer worth the upkeep. But she would do for hauling small cargos of crude oil. O. L. Salt contracted with an oil trader in Venezuela to haul 40,000 tons of crude oil, worth \$28 million, to a buyer in Houston. All went well, until a few days out from port when the ship's engines apparently gave in under the strain. Sailors on a passing container ship reported seeing fire on the *Q. Anne's Revenge II*, as they watched her disappear into thousands of feet of water near the Cayman Trench in the Caribbean Sea. Those observing reported that the ship had been setting low in the water, appropriate for a tanker with a full load of cargo. Fortunately, Salt and his Jamaican crew were found dry and safe, suitcases in hand, in a Jamaican hotel. They had lost all else, even the ship's log. Luckily for the environment, hardly a trace of an oil spill could be found. The owner of the cargo filed a cargo insurance claim. Salt filed a hull and machinery claim with his insurer for the loss of the *Q. Anne's Revenge II*, a loss that would surely end his long career. O. L. Salt had had enough of old ships and the sea, so he left Miami, and retired to a Greek island.



A few days later, a marine publication reported that an old tramp vessel, sailing under the name *Corfu Sunset*, and flying a Liberian flag of convenience, had been seen entering a Cuban harbor near a refinery there. The reporter who covers maritime news noted that the owner of the cargo likely received a sum well in excess of the market price of oil from Cuba's communist government. After all, Cuba is under a U.S. embargo, its attempts at deep sea oil drilling have failed, and the Russians no longer send them oil.

What happened? Can you speculate on some of the details? Bonus points: What hidden clues are given in

the case? While this is not a true story, it is based on many true stories that are not all that uncommon in the maritime trade. If you are still not clear as to what happened, consider the case of the supertanker, *Salem*, lost at sea in 1980. Conduct some research on the issues presented here. Find out what sources of information are available. Identify the extent of the problems as they exist in the maritime trade, and find out what is being done to deal with them. Consider beginning your research with the *International Maritime Bureau* of the International Chamber of Commerce.