RISK OF LOSS IN JAPANESE SALES TRANSACTIONS

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I. INTRODUCTION

The problems of risk of loss are defined somewhat more broadly in Japan than in the United States. The American lawyer looks at risk of loss as the problem of determining who shall bear the financial burden when some physical object is damaged or destroyed. While making this determination is also a risk of loss problem in Japan, the Japanese lawyer characterizes additional problems as being within the scope of risk of loss. In Japan risk of loss is an inherent problem in all bilateral contracts, not merely contracts involving the transfer of goods. This is because the common law requirement of consideration is not required for a valid contract in Japan. Thus, where the obligation of one party to a bilateral contract becomes extinguished by impossibility, what effect has the lapse of this obligation on the obligation of the other party? In the context of a sale, when the

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1 Some mention should be made of the importance of distinguishing between "original" and "subsequent" impossibility. If the impossibility existed at the time the contract was formed—original impossibility—the problem would not be treated under the risk of loss provisions; rather, it is treated as a contract formation problem. Where an original impossibility exists, there is no contract. See Haseyama v. Katô, 4 Minshū 497 (Sup. Ct., Oct. 26, 1950); Funeful Suiden K.K. v. Gomi, 12 Minshū 911 (Gr. Ct. Cass., April 21, 1933); Miyashita v. Yoshiida, 25 Minrolu 2172 (Gr. Ct. Cass., Nov. 19, 1919).

2 Determining the dividing line between "original" and "subsequent" impossibility, therefore, is of great importance. Just where this dividing line should be drawn has been a matter of some debate. According to the majority view, that line is drawn at the time when the obligations come into existence. See 3 ISHIZAKA, NIPPON MIMF6 SAIKEN (Obligation law in the Japanese Civil Code) 2117 (rev. ed. 1915); Obo, SAIKEN SORON (General theory of obligation law) 98, in 20 HORITSUGAKU ZENSHU (1959); Suekawa, KEIYAKU SORON (General theory of obligation law) 129-30 (1932); Yamamoto, KIKEN FUTAN (Risk of loss) 254-55, in 1 KEIYAKUHÔ TAIKEI (1962). However, a minority of scholars have presented strong arguments that the dividing line should be drawn at the time when the contract is agreed upon. See HATOKAMI, NIPPON SAIKENHÔ KAKURON (Particulars of Japanese obligation law) 151 (1924); Ishida, SAIKEN KAKURON (Particulars of obligation law) 35; 5(1) WAGATSUMA, MIMF6 KOGI (Lectures on the Civil Code) 81 (1954). The dispute seems to have centered mainly on an impossibility which occurs before a suspensive condition in a bilateral contract is fulfilled. The majority would classify such an impossibility as "original," hence not a risk of loss problem. However, the minority view would classify such an impossibility as "subsequent," so a risk of loss problem would arise. For the purposes of this paper, however, this dispute is irrelevant since the matter is resolved in the sale of goods context by Civil Code article 535. See note 4 infra.
seller's obligation to deliver is excused by impossibility, what effect has this on the buyer's obligation to pay the purchase price? This is a risk of loss problem in Japan, covering also loss of profit in the bargain. In American law the risk of loss of profit in the bargain is generally overlooked, the usual result being that both performances are merely excused. Likewise in Japan contracts for services may raise risk of loss problems. The risk in these contexts is that one party to a bilateral contract may have to perform even though the performance of the other party has been excused. For the purposes of this article, however, risk of loss will relate to the question of who shall bear the burden when goods which are the object of a sales contract are damaged or destroyed.

Somewhat surprising, perhaps, to the American lawyer is the fact that risk of loss in its sale of goods context is not covered in the Japanese Commercial Code. Rather, the Japanese turn to those provisions of their Civil Code which govern contracts in general. This is, of course, a reflection of the breadth of the risk of loss problem in Japan.

The fundamental principle of risk of loss in Japanese sales transactions is that the risk passes to the buyer (obligee) once the goods are specifically identified as the object of the sales contract. Depending upon the provisions of the contract and the nature of the goods which are its subject matter, this identification may occur simultaneously with the formation of the contract, or subsequently upon the performance of some act by the seller.

From the outset it should be understood that in Japanese parlance, risk of loss is not usually said to "pass" or "shift" from the seller to the buyer. Rather, while the risk of loss is borne by the seller, it is said that "the obligor burden rule applies." Conversely, when the risk of loss falls on the buyer, it is said that "the obligee burden rule applies." This article will attempt to present these rules and their interpretations in particular circumstances.

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2 The pertinent articles of the Japanese Civil Code refer to the parties as "obligor" and "obligee." At the risk of belaboring the obvious, it should be noted that the obligor-obligee relationship depends upon the particular obligation under contemplation. Thus, in a contract for the sale of goods, the seller is the obligor and the buyer is the obligee in respect to the obligation to deliver the goods. Conversely, in respect to the obligation to pay the purchase price, the buyer is the obligor and the seller the obligee. However, since this article deals with loss or damage to the subject matter of the sale—the goods—"obligor," where used in this article, is synonymous with "seller" and "obligee" is synonymous with "buyer."
II. THE RULES

A. In General

The so-called obligee burden rule is derived from Japanese Civil Code article 534:

(1) Where the creation or transfer of a real right over a specific thing is made the object of a bilateral contract and the thing is lost or damaged by any cause for which the obligor is not responsible, such loss or damage shall be borne by the obligee.

(2) The provisions of the preceding paragraph shall apply to a contract relating to a non-specific thing as from the time when the thing has become specific in accordance with the provisions of Article 401 paragraph 2.

It can be seen from this language that the obligee burden rule applies to specific goods and to nonspecific goods which are subsequently made specific. What is meant by these terms, and the methods by which nonspecific goods may be made specific, will be discussed below.

The obligor burden rule is derived from Civil Code article 536(1):

"Except in the cases mentioned in the preceding two Articles, if the

5 This English translation, and those of the Japanese Civil Code provisions which follow, are taken from 2 Eibun hōreisha [EHS] Law Bulletin Series No. 2100 (1966).

4 Civil Code article 534 is discussed in the text immediately above. Civil Code article 535 provides:

(1) The provisions of the preceding Article shall not apply in cases where the subject-matter of a bilateral contract subject to a suspensive condition has been lost during the pendency of the condition.

(2) If the thing has been damaged by any cause for which the obligor is not responsible, such damage shall be borne by the obligee.

(3) If the thing has been damaged by any cause for which the obligor is responsible, the obligee may, in the event of the fulfilment of the condition, demand either the performance of the contract or the rescission thereof, at his option; this shall not, however, preclude a demand of compensation for damages.

An obligation conditioned upon a suspensive condition (teisshī jōken) arises upon the fulfilment of the suspensive condition. Civil Code art. 127(1). (A "suspensive" condition is the equivalent of a condition precedent. That is, the obligation is "held in suspension" until the occurrence of the condition, at which time the obligation becomes firm.) In contrast, an obligation conditioned upon a condition subsequent (kaijo jōken) ceases to be effective upon the fulfilment of the condition subsequent. Civil Code art. 127(2).

For example, S, an employee of X Company, is informed that he is to be transferred from X's Tokyo branch to X's Osaka branch. S and B enter a contract for the sale of S's house to B. The contract provides, "This contract will become enforceable if B succeeds in obtaining a bank loan sufficient to cover the purchase price." The obtaining of the loan by B is a suspensive condition (teisshī jōken). Another provision of the contract is, "This contract will be deemed not to have existed if S is transferred back to Tokyo within three months from the date of the contract." S's transfer back to Tokyo within the stated time is a condition subsequent (kaijo jōken). If the house were to burn down after S and B entered into the contract but
performance of an obligation becomes impossible by any cause for which neither of the parties is responsible, the obligor is not entitled to counter-performance." The effect of this article in the sales context is to deprive the seller of his right to demand the purchase price in cases where the goods are lost or damaged before specification.

In the event of total impossibility to perform, article 536(1), when applicable, has the effect of completely extinguishing the seller's right to claim the purchase price. If the buyer in such a case has paid part of the purchase price prior to the impossibility, the seller must refund such payment. If the performance is only partially impossible, then the seller's right to demand the purchase price is completely extinguished only if such partial impossibility renders the balance of performance meaningless; i.e., only if partial impossibility destroys the value of the performance originally anticipated. Otherwise, the seller's right to counter-performance (payment of the purchase price) is merely reduced to the extent that his own performance is impossible. 

It becomes apparent from this general discussion of the rules that the matters of specification of the goods and of the responsibilities of the parties in contributing to loss or damage are critical issues in determining who shall bear the risk of loss.

**B. Specification of Goods**

1. **At Time of Contract.** Goods which have been identified as

before B obtained the bank loan, article 535(1) would apply, and the loss would fall on S. However, if the house was not completely destroyed by the fire, but merely damaged, and if S was not responsible for the fire, then article 535(2) would place the loss on B.

Article 535(2) has been criticized by many Japanese scholars on the grounds that (1) there is no reasonable foundation for thus distinguishing the effects of loss and damages, and (2) its application may fall with unjust results upon the buyer. See Chūshaku minpō (Civil Code annotated) 309 (Taniguchi ed. 1966); Wagatsuma & Arizumi, Saikensō (Law of obligations) 264, in Hōritsu haku taikei kōmentāru (1951).

Only a few reported decisions have involved Civil Code article 536(1): (a) lease of land, Ishikawa v. Kyōanji, 13 Minshū 1588 (Sup. Ct., Dec. 4, 1959), affirming, 7 Kakyō Minshū 463 (Tokyo High Ct., Feb. 28, 1955); Mishita-mura v. Torigaigumi, Hōritsu shim bun (No. 1356) 25 (Osaka Dist. Ct., Dec. 18, 1917); (b) contract for work, Nishitani v. Nakamura, 8 Minroku 100 (Gr. Ct. Cass., Dec. 18, 1902); (c) transfer of a business, Oki v. Tokyo Drug Shōkai, 72 Hōritsu shim bun 23 (Tokyo Dist. Ct., Dec. 8, 1920).

It should be noted that "loss or damage" includes not only physical destruction or damage, such as by air raid (Yamanaka Kōkūki K.K. v. Oizumi, 3 Minshū 226 (Sup. Ct., May 31, 1949)), or by earthquake (Hayakawa v. Zusō Gogyō K.K., Hōritsu shim bun (No. 2622) 5 (Tokyo Dist. Ct., Oct. 14, 1926)), but also loss resulting from the exercise of governmental power, such as a public execution sale (Fujita v. Oi, 6 Minshū 236 (Gr. Ct. Cass., Feb. 25, 1927)).
the subject matter of a sales contract at the time of contract formation are “specific” goods. Goods which are identified in specie only are nonspecific goods. For example, a contract to sell a whole stock of mosquito repellent incense which was obtained by a particular person, or a contract to sell a particular building or its fixtures, would be contracts to sell specific goods. A contract for the sale of “wheat” on the other hand, would be a contract to sell nonspecific goods. It might be noted that to be identified even in specie (so that a sales contract for nonspecific goods exists) the kind of goods identified must be distinguishable from other kinds. It is not necessary, however, that goods identified in specie be fungibles.

The difference between goods being classified as “specific” or “nonspecific” at the time of contract formation is one of degree. The more specifically the goods are identified, the more likely the goods will be found to be specific. No set rule can be stated which will cover all situations. Perhaps there is no reason for a precise rule at the time the contract is formed, since the Civil Code provides the means for making “nonspecific” goods “specific” subsequent to the formation of the contract.

Some scholars argue that a distinction should be drawn between goods in specie—e.g., a fishing net—and goods in restricted specie—e.g., twenty square feet of a particular fishing net. However, there seems to be no need for such a distinction, since in the case of goods described in restricted specie the obligee burden rule does not apply until the goods are specified.
2. Subsequent to Contract Formation. It will be recalled that Civil Code article 534(2) provides that the obligee burden rule applies to nonspecific goods when such goods become specific in accordance with Civil Code article 401 (2). The latter article provides:

If, ... [where the subject-matter of a claim is indicated in specie only], the obligor has performed all acts that are necessary for the delivery of a thing or has with the consent of the obligee designated a thing to be delivered, such a thing shall thenceforth constitute the subject-matter of the claim.

It can be seen from this section that two methods are provided for specifying goods which were unspecified at the time of formation.

a. Designation. Subsequent to the formation of the contract, the seller may specify the goods by designation with the consent of the buyer. With consent, designation in any manner, such as separating goods out of the seller's stock or actually dispatching the goods, suffices for this purpose. Note that a mere mental designation is not alone enough. The designated goods must be identifiable as such, e.g., by segregation or marking. If the seller does not designate the goods with the consent of the buyer, then the goods do not become specified until all acts necessary for delivery of the goods are performed.14

b. Performance of all acts necessary for delivery. Civil Code article 401(2) provides that subsequent to the formation of the contract, goods may become specified when “the obligor has performed all acts that are necessary for the delivery of a thing.”15 This clause means


14 Wagatsuma, op. cit. supra note 1, at 30; 1 Yunoki, Hanrei saiken hō sōron (General theory of obligation law in case law) 54 (1950).

15 This requirement is said to have been patterned after German Civil Code (BGB) article 243(2), which had been adopted in Germany only after long debate. Asai, Shūrui saimu no tokutei (Specification of assorted obligations) 23, in 7 Sōgō hanrei kenkyū sōsho (Mimpo) (1961).

The former Japanese Civil Code had provided, in article 332, that delivery of nonspecific goods or designation in the presence of both parties determined the time when ownership of nonspecific goods passed. The present Civil Code makes special provision for the time that risk of loss shifts. Mimpo shuseien ryūshō (Reasons for the Civil Code amendment draft) (1898), commenting on the first part of paragraph 2 of article 401, states:

The old Code does not provide for specification of the subject matter through performance of all acts that are necessary for the delivery of the goods by the obligor. Without such provision, however, there is the possibility of injustice; for even if the obligor had performed all the acts required of him by contract, he would still bear the risk of loss. For this reason, this draft provides that after the obligor has performed all acts that are necessary for the delivery of the goods, such goods become the subject matter of the obligation.
that the obligor must completely perform all acts which are to be
done by himself in order for the goods to be specified. There is no
general standard applicable to all situations which defines just what
these acts are.\textsuperscript{16} Rather, the acts necessary for delivery depend upon
the nature of the delivery contemplated and trade custom. The follow-
ing standards are applicable, however, when the place of performance
has been determined.

(1) Delivery at buyer's residence or place of business. When the
obligation requires delivery of the subject-matter at the obligee's resi-
dence or place of business, "all acts that are necessary for the delivery
of a thing" are performed by actually tendering the goods at that
place. Unless determined otherwise by agreement or trade usage, this
requirement is not met by the obligor's merely separating the goods
out of his stock and dispatching them by railway or other transpor-
tation facilities.\textsuperscript{17}

(2) Delivery at seller's residence or place of business. When the
obligation is delivery of the subject-matter at the residence or place
of business of the obligor, goods become specified when the obligor
segregates them, puts them in condition for immediate delivery to the
obligee, and gives notice thereof to the obligee.\textsuperscript{18}

(3) Delivery at some other place. When the contract calls for
delivery of the subject-matter at some place other than the buyer's
or seller's residence or place of business: (i) if delivery at such place
is a part of the obligation, then the obligor must tender the goods at
that place;\textsuperscript{19} but (ii) if delivery of the goods at such place is not
deemed a part of the obligation, but rather a mere gratuitous courtesy,
the goods become specified when dispatched.\textsuperscript{20}

\textsuperscript{16} 4 Wagatsuma, Mîmîrō Kôgi (Lectures on the Civil Code) 32 (rev. ed. 1964).
\textsuperscript{17} Kagaya v. Odagiri, 25 Minroku 2402 (Gr. Ct. Cass., Dec. 25, 1919); Oô, op. cit.
\textsuperscript{supra} note 1, at 36; 4 Wagatsuma, op. cit. \textsuperscript{supra} note 16, at 32.
\textsuperscript{18} Similarly, if the residence or place of business of the obligee is unknown, the
goods are specified when they are put in a deliverable condition by the obligor, un-
less at the time the contract was made he was aware that the obligee's address was
unknown. Asai, op. cit. \textsuperscript{supra} note 15, at 31; 4 Wagatsuma, op. cit. \textsuperscript{supra} note 16,
at 32.
\textsuperscript{19} The obligor must also notify the obligee that the goods have arrived at that
place. Ishida, op. cit. \textsuperscript{supra} note 1, at 26; Oô, op. cit. \textsuperscript{supra} note 1, at 37; 4
Wagatsuma, op. cit. \textsuperscript{supra} note 16, at 32.
\textsuperscript{20} Oô, op. cit. \textsuperscript{supra} note 1, at 37; 4 Wagatsuma, op. cit. \textsuperscript{supra} note 16, at 32.
If goods are sent with accompanying documents, all acts have been performed when
the goods and documents arrive and notice is given to the buyer. Kojima v. Suzuki,
19 Hôritsu Shûbun (Mîmîrō) 260 (Tokyo Dist. Ct., Aug. 6, 1928). Goods are
also specified through delivery of a warehouse receipt to the buyer. Kimura Tolu-
If goods are to be sent on a specific ship, they are specified by shipment. Fukuchi v.
Kiba, Hôritsu Shûbun (No. 2035) 18 (Yokohama Dist. Ct., July 26, 1922).
It should be noted in connection with these rules that performance of "all acts that are necessary for the delivery of a thing" is not necessarily the same as tender of performance. If the obligation is to deliver goods at the residence or place of business of the buyer, and the seller does tender the goods there, such goods are usually specified by such tender. However, it should be noted that "tender" may be something short of actual performance under Japanese Civil Code article 493:

A tender of performance shall be done actually and in strict accordance with the tenor of the obligation; however, if the obligee had previously refused its acceptance or if an act of the obligee is required for the performance, it shall be sufficient to notify the obligee that all preparations have been made for performance.

Therefore, in some circumstances notice to the buyer will satisfy the general tender requirement of article 493, yet such notice alone cannot be said to be performance of all acts necessary for specifying the goods. This is especially true when the goods are to be picked up by the buyer at some place other than his place of business so that some "act by the obligee is required for the performance." It cannot be said that specification has been made in such a case unless the obligor actually segregated the goods before giving notice to the obligee that all preparations have been made for performance.21

C. Responsibility of the Parties

It will be recalled that the obligee burden rule of Civil Code article 534 operates when the loss or damage results from "any cause for which the obligor is not responsible." It is thus apparent that the obligee need not be responsible for the loss in order for him to bear the loss. Rather, it is the obligor's responsibility which is relevant, once the goods have become specified. In order for the obligor to be responsible, so as to preclude operation of the obligee burden rule, the loss must be causally related to some act or omission by the obligor such that the loss would not have occurred without it.22

While the goods remain unspecified, so that the obligor burden rule

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21 Where tar for fishing nets was to be delivered in buyer's tar tank at a place designated by seller, and the seller made preparations for delivery by providing steam heating and arranging for laborers to deliver the tar, these preparations alone were not sufficient to specify the goods. Tsuneno v. Iwate-ken Gyogyō Kyōdōkumiai Rengōkai, 9 Minshū 1642 (Sup. Ct., Oct. 18, 1955).

22 Miyazaki v. Masunaga, 7 Minrōku 121 (Gr. Ct. Cass., Nov. 28, 1901).
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of article 536(1) would normally apply, the obligee23 may still bear the burden if he is responsible for the loss. This conclusion has its basis in Civil Code article 536(2), which provides in part: “If performance becomes impossible for any cause for which the obligee is responsible, the obligor shall not lose his right to demand counter-performance . . . .” The meaning of the phrase “any cause for which the obligee is responsible” is not entirely clear. The buyer, in principle, has no legal obligation to make the seller’s performance possible. There are only a few reported decisions of any possible relevance on this point, but they do not involve the sale of goods.24 Some illustrations of “any cause for which the obligee is responsible” might be loss or damage resulting from the buyer’s tort, breach of a duty of care by a buyer who also happens to be custodian of the goods, and impossibility resulting from the buyer’s failure to perform some act which was expected of him, such as a late arrival to receive the goods.25 For example, if the buyer delayed in receiving the tendered goods, and such delay was caused by the buyer, then such delay would be considered a “cause for which the obligee is responsible” within the meaning of article 536(2). Therefore, if the goods were lost during the period of delay, the seller would not lose his claim for the purchase price.26 It would probably be safe to conclude generally that the “cause” in Civil Code article 536(2) is such that imposes on the buyer the standard of good faith conduct, as determined by social and commercial common sense.27

Once it is determined that the obligee was responsible for the seller’s impossibility to perform, it will be recalled that article 536(2) allows the seller to claim the purchase price. That article continues: “. . . however, if he [the obligor] has received any benefit through being

23 It should be noted that the term “obligee” includes the holder of an option to purchase. Aomizu v. Fujii, Hōritsu shimbun (No. 2238) 16 (Gr. Ct. Cass., July 23, 1923); Uchino v. Japan, Hōritsu shimbun (No. 2234) 19 (Gr. Ct. Cass., No. 151, 1923).
24 Of the reported cases involving Civil Code article 536(2), most have been concerned with labor contracts. A few have dealt with: (a) contracts for work: Judgment of July 5, 1938, 5 Hankan zuensihi 4 (Gr. Ct. Cass.); Judgment of Oct. 21, 1931, 1 Higaoku 378 (Gr. Ct. Cass.); Oriental Hotel, Ltd. v. Yabe, 16 Minroku 1066 (Gr. Ct. Cass., Dec. 20, 1912); Masuo v. Kajihara, Hōritsu shimbun (No. 1305) 32 (Osaka App. Ch., Aug. 3, 1917); and (b) sales of stock, Hara v. Tsuboi, 5 Minshii 709 (Gr. Ct. Cass., July 20, 1926).
25 Suekawa, op. cit. supra note 1, at 142.
26 Suekawa, op. cit. supra note 1, at 144; 5(1) Wagatsuma, op. cit. supra note 1, at 112.
27 Suekawa, op. cit. supra note 1, at 142; 5(1) Wagatsuma, op. cit. supra note 1, at 112. Broader than negligence, “cause” here corresponds to Vertretung in German law.
relieved of his own obligation, he shall return such benefit to the obligee." Such benefits might be insurance proceeds or the scrap value of a damaged machine. The idea behind this provision is, of course, that such benefit would constitute unjust enrichment in the hands of a seller whose obligation to perform has been excused. It should be noted that the seller’s obligation to return the benefit is independent of the buyer’s obligation to pay the price. Therefore, the buyer cannot deduct such an amount from the price he is required to pay unless the legal requirements of an offset are satisfied. Nor is the plea for concurrent performance applicable, since the obligation to pay the price and the obligation to return the benefit are not counter-obligations.

Likewise, where the obligee was not responsible for the loss or damage, but still bears the burden under article 534 because the goods had become specified before they were lost, it is the prevailing opinion that article 536(2) should apply by analogy. The result, of course, is that the seller must refund to the buyer any benefits which the seller realized as a result of the loss.

There are some special situations which sometimes raise risk of loss problems, as when the contract is to sell goods which the seller does not own at the time of the contract. There is no connection, at least theoretically, between the transfer of ownership and the transfer of risk of loss.

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28 Suekawa, op. cit. supra note 1, at 145.
29 Japanese Civil Code art. 335: “One of the parties to a bilateral contract may refuse performance of his own obligation until the other party tenders performance of his obligation; however, this shall not apply where the obligation of the party is not due.”
30 Suekawa, op. cit. supra note 1, at 146.
32 It should be noted that risk of loss problems are sometimes unconsciously considered in relation to the transfer of ownership. Ownership is transferred by a declaration of intention by the parties. Civil Code art. 176. In the absence of such a declaration of the parties, ownership of goods is deemed to be transferred to the buyer when the goods are specified. Sawamura Aen K.K. v. Ichikawa Shōji K.K., 14 Minshū 1528 (Sup. Ct., June 24, 1960). Therefore, unless the parties have otherwise agreed, the time ownership transfers coincides with the time the risk of loss shifts.

It has been argued that if a sales contract provides that ownership is to be transferred at a particular time after specification of the goods, the obligee burden rule does not apply until ownership is actually transferred. See 5(1) Wagatsuma, op. cit. supra note 1, at 102. This argument does not seem persuasive, however, since the Japanese principle of risk of loss is not related to the transfer of ownership. See Hatoyama, op. cit. supra note 13, at 139; Yamamoto, op. cit. supra note 1, at
was entered into, the risk of loss would be placed on the buyer under article 534. However, it is generally understood that the obligee burden rule does not apply.\(^{33}\)

When the same specific goods (or nonspecific goods which are subsequently made specific) are sold to two different buyers, who shall bear the risk of loss? Two opinions prevailed in the past: (1) all buyers should share the risk,\(^{34}\) and (2) the first buyer shall bear the risk.\(^{35}\) The prevailing opinion today, however, is that the obligor burden rule should apply unless one of the buyers is responsible for the loss, in which case he should bear the loss.\(^{36}\)

### III. Special Agreements in Domestic Sales

Nothing prevents the parties from making a special agreement to be bound by a risk of loss rule other than that provided in the Japanese Civil Code. As has been noted above, in the sale of nonspecific goods application of the Civil Code rule alone may leave much room to dispute when the goods become specified as the subject matter of the contract. There is always the possibility of unsound results. It is recommended, therefore, that parties to a sales contract should agree in advance on the precise time when the risk of loss is to be assumed by the buyer. This agreed time should probably be at some particular point in the process of transferring the goods.\(^{37}\)

Japanese domestic sales contracts frequently contain such special agreements. Many such contracts settle upon delivery as the point at which risk of loss shifts. Others fix the point of transfer of risk of loss at the time of “acceptance” or “completion of inspection.”\(^{38}\)

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\(^{32}\) See also the comment on Civil Code article 534 (formerly article 523) in MIMP\(\text{シュ} \text{ス} \text{プ} \text{イ} \text{シ} \text{オ} \text{シ} \text{ン} \text{ス}\) RYUSHI:

When a specific thing is made the subject matter of a contract, the transfer of ownership has no effect. If the thing increases in value or quantity, the obligor cannot demand increased payment; if the thing decreases, the obligee cannot demand a decrease in price. Thus, once a thing has become the subject matter of a contract, any change in its value has no effect on the price. But any such change will affect the profit or loss of the parties. Even if the thing is lost, the obligee is not discharged from his duty to pay.

\(^{33}\) ISHIDA, op. cit. supra note 1, at 33; SUEKAWA, op. cit. supra note 1, at 124-25; \(5(1)\) WAGATSUMA, op. cit. supra note 1, at 103.

\(^{34}\) 3 ISHIZAKA, op. cit supra note 1, at 2112-13; SUEHIRO, op. cit. supra note 13, at 167.

\(^{35}\) YOKOTA, SAIKEN KAKUROI (Particulars of obligation law) 124 (rev. ed. 1927).

\(^{36}\) HAYOYAMA, op. cit. supra note 13, at 145-46; KAINO, op. cit. supra note 31, at 76; 4 MATSUZAKA, MIMP\(\text{テ} \text{イ} \text{ヨ} \text{シ}\) (Civil law summary) 46 (1956); SUEKAWA, op. cit. supra note 1, at 127-28; \(5(1)\) WAGATSUMA, op. cit. supra note 1, at 103.

\(^{37}\) See TANIKAWA, SHOHIN NO BAIBAI (Sales of goods) 94-95 (1964).

\(^{38}\) Ibid.
Generally speaking, it would seem reasonable for the risk of loss to shift from the seller to the buyer at the time of delivery, because as a result of delivery the buyer has possession and control of the goods and the seller has completed his performance. In the sale of nonspecific goods selection of this point for the time risk of loss is to shift will have the same result as if the Civil Code risk of loss provisions had been applied, since in the sale of nonspecific goods there is seldom specification before delivery.39

If the point when the risk shifts to the buyer is fixed by agreement as the time of acceptance, the seller bears the risk of loss until the goods pass inspection and the performance of the seller is completed. In other words, the obligor burden rule would be followed to the end. In this case, “any cause for which the obligee is responsible” in Civil Code article 536(2) should be interpreted more liberally. This is because the goods would have come into the possession of the buyer, who would then have a duty to exercise a good manager’s care over the goods.40

In a new attempt to confine Risk of Loss (kiken-futan) to the narrow area of loss or damage to the goods,41 the risk of loss clause of the Standard Contract Form for Sales of Goods42 makes broad and clear provisions for distributing the loss or damages between the parties:43

Article 3: Any loss of or damages to the goods arising before [delivery, acceptance] is borne by the seller unless due to any cause for which the buyer is responsible, and any loss of or damages to the goods arising after [delivery, acceptance] is borne by the buyer unless due to any cause for which the seller is responsible.

Article 4: . . . [T]he acceptance of goods is completed at the time of the end of inspection by the buyer.

39 See TANIKAWA, op. cit. supra note 37, at 98. See also notes 15-20 supra and accompanying text.
40 See TANIKAWA, op. cit. supra note 37, at 99.
41 See TANIKAWA, op. cit. supra note 37, at 96-98; Hoshino & Tanikawa, Hyojun dosan baibai keiyaku yakkan no kenkyu (3) (Study on the standard contract form for sales of goods (part 3)), 252 SHOJOHOMU KENKYU 19-21 (1962). In criticism of these views, see the opinions of Professors Kawamata and Hayashi in Shimpoihamu: shohin baibai ni okeru mimpo to shohou (Symposium: sales of goods in the Civil Code and Commercial Code), 25 SHIRO 58-59, 60-67 (1963).
42 Hyojun dosan baibai keiyakusho (an).
43 See TANIKAWA, op. cit. supra note 37, at 24-36; Hoshino & Tanikawa, Hyojun dosan baibai keiyaku yakkan no kenkyu (1) (Study on the standard contract form for sales of goods (part 1)), 245 SHOJOHOMU KENKYU 4-8 (1962); Hoshino & Tanikawa, Shimpoihamu: shohin baibai ni okeru mimpo to shohou (Symposium: sales of goods in the Civil Code and Commercial Code), 25 SHIRO 4-14 (1963).
A. In General

Neither the Japanese Civil nor Commercial Codes contain special provisions covering international sales. Moreover, few international sales contract forms prepared by Japanese traders contain special agreement clauses covering risk of loss. It is generally assumed by Japanese traders that such problems will be solved more or less automatically in accordance with the actual form of sale chosen, be it FOB, CIF, C & F, FAS, or Ex-Ship. It should be pointed out, however, that there is no established rule for the exact legal effect of each of these sale forms. For instance, some understand the rights and obligations of the parties in CIF contracts to be in accordance with the Incoterms of 1953. Others believe the Warsaw-Oxford Rules of 1932 are applicable. Still others believe the rules under English law should be generally followed. However, neither Incoterms nor Warsaw Oxford Rules should be applicable unless the parties quoted them expressly or impliedly. The assertion that English law provides the general rules is based on a background in which many sales contracts have chosen the London arbitration clause or English law as the governing law in a conflict of laws situation. However, Japanese law will be held applicable in Japanese courts if the intention of the parties cannot be determined and if the contract was formed in Japan, or if the offer was sent from Japan to another country.
Thus, with all these possible governing laws, how can risk of loss under, say, a CIF contract be determined? Unfortunately, there are no reported Japanese cases involving risk of loss problems in international sales. In all likelihood, a Japanese court would take into account the terms of the whole contract, trade custom, and risk distribution under the Japanese Civil Code in order to finally resolve what the parties to the contract probably intended. The court would also be influenced by the opinions of Japanese scholars. Some of these opinions follow below.

B. Ex-Ship

Where an Ex-Ship contract is used, under either the Japanese Civil Code or Incoterms the risk shifts to the buyer at the time the goods are delivered to the buyer after arrival at the designated port. In the case of an Ex-Ship contract by a particular vessel, if the seller has duly designated the vessel and shipped the goods, any loss or damage occurring after shipment, but before arrival, would give rise to liability for the buyer. The same shall not apply to juristic acts either of creating or disposing of jus in re or other right to be registered.

Article 9:

(1) As regards an expression of intention made to a person residing in a place governed by a different law, the place from which notice of the same is dispatched shall be regarded as the place of the act.

(2) As regards the formation and effect of a contract, the place from which the notice of the offer is dispatched shall be regarded as the place of the act. In case the recipient of the offer is ignorant, at the time of his acceptance, of the place from which the offer has been dispatched, the place of the offeror's domicile shall be regarded as the place of act.

I.C.C., INCOTERMS 1953 at 60, 62:

Ex Ship...(named port of destination)

A. Seller must:

2. Place the goods effectively at the disposal of the buyer, at the time as provided in the contract, on board the vessel by unloading equipment appropriate to the nature of the goods.

3. Bear all risks and expense of the goods until such time as they shall have been effectively placed at the disposal of the buyer in accordance with article A.2, provided, however, that they have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

B. Buyer must:

2. Bear all risks and expense of the goods from the time when they shall have been effectively placed at his disposal in accordance with article A.2, provided always that they have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

"On board the vessel," as used in the above article A.2, is interpreted as the time when the goods are discharged from tackles of the ship. See KOSAI, KOKUSAI ROKKI TICHI KIYOU (Standard of the international trade condition) 121-22 (1955). Under Japanese law, such time is the time of actual delivery. KOMACHIYA, op. cit. supra note 47, at 24.
to a risk of loss problem, because the seller’s performance would thereby be rendered impossible. However, in the case of an Ex-Ship contract by an undesignated vessel the mere loss or damage occurring during the voyage does not give rise to a risk of loss problem, since performance by the seller is still possible. (It will be recalled from the introduction that the risk of loss problem arises when the seller sues the buyer for the price after the seller’s obligation to perform has been extinguished by impossibility.)

C. FOB

In an FOB contract it is said that the risk shifts to the buyer when delivery is made on board by the seller. "On board" refers to the time when the goods are placed in the ship's hold. Under Incoterms the general rule is that the risk transfers to the buyer when the goods have passed the ship's rail at the designated port of shipment. However, if there is any delay in the ship's arrival, or in receipt of the goods by the ship on the fixed date, the risk nevertheless shifts to the buyer on the date previously agreed upon as the arrival or delivery date. Such constructions under Incoterms are popular in Japan.

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51 But see Komachiya, op. cit. supra note 47, at 28-30. Komachiya’s opinion that the arrival of the ship is the event which makes the sales contract effective is open to doubt. In this author’s opinion, the ship’s arrival is connected with problems of risk of loss and impossibility, rather than problems of contract formation.

52 Komachiya, op. cit. supra note 47, at 46-47. The problem of risk of loss does not arise until the objective impossibility of performance is proven. Id. at 46.

53 Komachiya, op. cit. supra note 47, at 147. According to Professor Komachiya, risk of loss does not pass to the buyer until the seller has shipped as the shipper and holds a bill of lading directed to the seller. Id. at 150-51. But this view confuses the transfer of risk of loss with that of ownership.

54 Komachiya, op. cit. supra note 47, at 148.

55 I.C.C., Incoterms 1953 at 24:
FOB (free on board) .......... (named port of shipment)

A. Seller must:

4. Subject to the provisions of article B.3 and B.4 below, bear all costs and risks of the goods until such time as they shall have effectively passed the ship's rail at the named port of shipment, including any taxes, fees or charges.

56 I.C.C., Incoterms 1953 at 26:
FOB ...

B. Buyer must:

2. Bear all costs and risks of the goods from the time when they shall have effectively passed the ship's rail at the named port of shipment, and pay the price as provided in the contract.

3. Bear any additional costs incurred because the vessel named by him shall have failed to arrive on the stipulated date or by the end of the period specified, or shall be unable to take the goods or shall close for cargo earlier than the stipulated date or the end of the period specified and all the risks of the goods from the date of expiration of the period stipulated, provided, however, that the
Japanese law construes CIF contracts as transferring the risk of loss to the buyer at the time of shipment, which is that time when the goods are placed “on board.” However, some Japanese scholars suggest that the risk transfers to the buyer when the shipping documents are tendered to the buyer, and that the shift in risk of loss operates retroactively to the time the goods are placed on board. This opinion seems to rest upon the theory that goods are not specified until the bill of lading is tendered. However, this theory seems to be untenable. Once the goods have been placed “on board,” it cannot be denied that they have been specified, whether or not the bill of lading has been tendered. This theory seems to confuse the problem of risk of loss with the problem of the right to be paid; it is the right to payment which is conditioned upon tender of the bill of lading to the buyer.

A special agreement added to the usual CIF contract may sometimes change the character of the CIF condition itself. Under Incoterms the risk of loss shifts to the buyer when the goods have effectively passed the ship’s rail at the port of shipment. The risk may also pass to the buyer upon the expiration of a period for which he has reserved the right to give shipping instructions, if he fails to exercise this power. Under the Warsaw-Oxford Rules risk of loss
shifts to the buyer when the goods are loaded on board the vessel or, under certain conditions, delivered to the carrier.\(^1\)

It will thus be seen that the time of transfer of the risk of loss may differ according to the rule adopted by the parties. However, in none of these cases, unless English law is followed,\(^2\) is the transfer of the risk necessarily related to the time ownership is transferred.\(^3\)

V. RISK OF LOSS AND INSURANCE

Cargo insurance usually covers loss or damage to goods in international sales. Ordinarily, however, the period of coverage is not necessarily consistent with the time risk of loss is transferred. Nor as has been previously discussed, is the time the risk transfers necessarily consistent with the time ownership transfers to the buyer. As a result, some difficult problems are raised.\(^4\)

B. Buyer must:

3. Bear all risks of the goods from the time when they shall have effectively passed the ship's rail at the port of shipment.

4. In case he may have reserved to himself a period within which to have the goods shipped and/or the right to choose the port of destination, and he fails to give instructions in time, bear the additional costs thereby incurred and all risks of the goods from the date of the expiration of the period fixed for shipment, provided always that the goods shall have been duly appropriated to the contract.\(\ldots\)

As a practical matter the bill of lading is made out only after the goods are on board. Therefore, under the Incoterms CIF term if the goods are damaged during the time when the goods have passed the rail but are not yet on board, then the seller will have lost his right because he cannot tender a proper bill of lading. See Tanikawa, *Funacumi niage zengo no hōritsu kankei* (Legal relations before and after shipment and discharge), 139 Jūshūro 24-25 (1957).

\(^1\) Warsaw-Oxford Rule 5 (Risk):

The risk shall be transferred to the buyer from the moment the goods are loaded on board the vessel in accordance with the provisions of Rule 2 or, should the seller be entitled in accordance with the provisions of Rule 7 (III) and (IV) in lieu of loading the goods on board the vessel to deliver the goods into the custody of the carrier, from the time such delivery has effectively taken place.

\(^2\) Sale of Goods Act, 1893, 56 & 57 Vict. c. 71, § 20:

Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not:

Provided that where delivery has been delayed through the fault of either buyer or seller the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault;

Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as a bailee or custodian of the goods of the other party. Note also id. at § 16: "Where there is a contract for the sale of unascertained goods no property in the goods is transferred to the buyer unless and until the goods are ascertained."

\(^3\) See, e.g., Warsaw-Oxford Rule 6 (Property): "Subject to the provisions of Rule 20 (II), the time of the passing of the property in the goods shall be the moment when the seller delivers the documents into the possession of the buyer."

\(^4\) See Tanikawa, *supra* note 60, at 22, for a discussion of the delicate legal rela-
The Japanese Commercial Code provides that the liability of the insurer commences at the time when the cargo has left the land and terminates at the time when its unloading has been completed at the port of unloading. The phrase "cargo has left the land" refers to the time when the cargo has been detached from the surface of the earth for shipment at the port of loading; hence, the risks incident to lighterage are covered in the policy. The usual marine insurance policy written in English states: "Beginning the adventure upon the said goods and merchandises from the loading thereof on board the said ship, and so to continue and endure until the said goods and merchandises shall have arrived at ———, and until the same be there discharged and safely landed." The time when the goods are placed "on board" is considered to be the time when the goods are actually placed on the deck of the ship or in its hold. "Safely landed" means that the goods are "safely delivered on shore" at a landing place, such as a wharf at the port of discharge. "Safely" means that the goods are "deposited in a safe place on shore." Even under insurance policies written in Japanese, coverage begins when the goods are loaded, and terminates when they are landed.

If a buyer under an FOB contract purchases insurance, there is little likelihood of any problem arising. However, there could be a

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65 Japanese Commercial Code art. 822(1):

In cases where the cargo has been insured or in cases where prospective profit or remuneration to be earned upon the arrival of the cargo have been insured, the liability of the insurer shall commence at the time when cargo has left the land and terminate at the time when its unloading has been completed at the port of unloading.

[English translation from 2 EHS No. 2200 (1963).]

66 See Imamura, Kajii Hoken Keiyaku Ron (Marine insurance contracts) (chū) 299 (1942); Katō, Kajii Kiken Ron (Marine risks) 266 (1932); Komachiya, Kajii Hokenhō Kaku Ron (Particulars of marine insurance law) (jō) 373 (1961); Nozu, Hoken Keiyaku Ron (Insurance contract law) 358 (1942); Ōmori, Hokenhō (Insurance law) 232, in 31 Hōritsugaku Zenshū (1957).

67 Imamura, op. cit. supra note 66, at 299, 303; Komachiya, op. cit. supra note 66, at 373.

68 Katsuragi, Eibun Tsumin Hoken Shōken Ron (Marine cargo insurance policies written in English) 50 (1959); Yokō, Eibun Kanotsu Kajii Hoken Yakkam (Marine cargo insurance clauses written in English), 5 Shin Sōgai Hokenhō Köza 254 (1964). The ground for this argument is the provision in "Rules for Construction of Policies" in England that "Where goods or other movables are insured 'from the loading thereof,' the risk does not attach until such goods or movables are actually on board...."

69 Katsuragi, op. cit. supra note 68, at 51-52; Yokō, supra note 68, at 254. See Rule 5 of the "Rules for Construction of Policies."

70 Including shipment to the lighter. Komachiya, op. cit. supra note 66, at 373.

71 Cargo should be discharged at a safe landing place. Imamura, op. cit. supra note 66, at 380; Komachiya, op. cit. supra note 66, at 379.
gap in coverage if the sales contract were drawn under Incoterms provisions and the insurance policy were written in English. The gap in coverage would be that time during which the goods have passed the ship's rail but have yet to be placed on board.\textsuperscript{72} In such a case the buyer would be wise to purchase insurance with a lighterage clause in order to be completely covered.

The seller in Ex-Ship contracts is always covered because all policies extend coverage until landing. The buyer, on the other hand would not be protected against loss or damage occurring after delivery "alongside ship" or "on board," but before the goods are actually landed on shore.

In CIF contracts an insurance policy issued to the seller could be construed to have been purchased on behalf of the buyer, so that the insurable interest would be deemed transferred to the buyer when the ownership of the property passed.\textsuperscript{73} Even here problems may result because of the possible difference between the time of transfer of ownership and the time of transfer of the risk of loss; it is construed under Japanese law that one must own cargo if one is to have an insurable interest in it.\textsuperscript{74} Thus, if loss or damage to the goods were to occur during the period of the seller's risk, but after ownership had transferred to the buyer, the seller would no longer have an insurable interest and his loss would not be covered by the policy. In practice, however, the court might protect the seller by regarding him as having retained ownership of the lost or damaged goods. After the risk of loss and ownership have passed to the buyer, he is entitled to insurance coverage after receipt of the insurance policy from the seller. But if ownership of the goods remained in the seller, the seller would be free to claim either payment of the purchase price from the buyer or the insurance money from the insurer, because he would still have an insurable interest.\textsuperscript{75}

If the buyer were obligated to pay for the goods in this situation, he would still not be entitled to the insurance money, at least theoretically, because he would have no right to demand the transfer of such

\textsuperscript{72} If the loss occurs during this gap in coverage, the seller who is under an obligation to acquire and tender bills of lading may possibly be unable to acquire them and, consequently, to demand payment.

\textsuperscript{73} See Japanese Commercial Code art. 650(1): "When the insured has assigned the subject-matter of the insurance he shall be presumed to have assigned at the same time the rights arising from the contract of the insurance."

\textsuperscript{74} \textit{Omori, op. cit. supra} note 66, at 228.

\textsuperscript{75} \textit{Katô, Katjô hihoken rieki ron} (Insurable marine interests) 59 (1942).
a right of insurance. In practice, however, the insurer's obligation to pay the buyer could be based upon the fictional assumption that ownership had been transferred before the loss or damage. In CIF contracts containing a clause quoting Incoterms, the seller might lose the right to claim the price because of the obligation to tender a bill of lading.

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76 Hatoyama, Nippon saikenho kakuron 137 (rev. ed. 1924); Katô, op. cit. supra note 75, at 61.

77 Katsuragi, op. cit. supra note 68, at 37-38, sets forth this reasoning. However, this explains only the transferability of the insurance policy; it does not satisfactorily explain how risks are covered under such policies.

78 See note 60 supra.