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Transport Law: Preparation of a draft instrument on the carriage of goods [wholly or partly] [by sea]

Comments from the UNCTAD Secretariat on Freedom of Contract

Note by the Secretariat

On 17 February 2005, the Secretariat received comments regarding the issue of freedom of contract from the United Nations Conference on Trade and Development. Those comments, which have been circulated informally during previous sessions of the Working Group, are reproduced in Annex I in the form in which they were received by the Secretariat.

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Annex I

Comments from the UNCTAD Secretariat on Freedom of Contract under the draft instrument

Introductory remarks

1. The draft instrument focuses to a considerable extent on matters of liability, i.e. on the regulation of liability arising in connection with the carriage of goods. Clearly, the draft instrument is intended to provide a modern successor to existing international liability regimes in the field of carriage of goods by sea (i.e. the Hague, Hague-Visby and Hamburg Rules). Moreover, the working assumption is that the draft instrument would also apply to multimodal contracts that include a sea-leg. Against this background, it appears appropriate to recall some of the common elements, which, despite their differences, all existing unimodal liability regimes for the carriage of goods by sea, land and air (i.e. The Hague, Hague-Visby and Hamburg Rules, the CMR, COTIF/CIM, Warsaw Convention (as amended), Montreal Convention) share namely:

> First, **all existing international regimes establish minimum levels of carrier liability, which apply mandatorily**, that is to say the relevant substantive rules on liability of the carrier may not be contractually modified to the detriment of the shipper or consignee.
>
> Secondly, **the mandatory scope of application of the relevant regimes extends to contracts of carriage which are not individually negotiated between the parties**, but are conducted on the carrier's standard terms of contract as typically contained in or evidenced by a transport document issued by the carrier.

2. The main purpose of this approach, common to all existing international liability regimes, is to reduce the potential for abuse in the context of contracts of adhesion, used where parties with unequal bargaining power contract with one another. By establishing minimum levels of liability, which apply mandatorily and may not be contractually modified, existing liability regimes seek to ensure the protection of cargo interests with little bargaining power, i.e. small shippers and third party consignees, against unfair contract terms unilaterally introduced by the carrier in its standard terms of contract.

3. Thus, a central feature of existing international liability regimes is a restriction of freedom of contract with the legislative intent to ensure the protection of small parties against unfair standard contract terms.

4. A central question which arises for consideration of the Working Group is whether and to which extent the draft instrument should follow the same approach as existing international liability regimes.

5. In this context, the treatment in the draft instrument of so-called service contracts or "Ocean Liner Service Agreements" (as described in UNCITRAL A/CN.9/WG.III/WP.34, paras. 19-22) may be of particular and considerable significance. It has been reported that in some trades, 80-90 per cent of liner carriage is conducted under this type of contract and that with the increasing trend

towards concentration in the liner shipping industry and the emergence of alliances in the global freight-forwarding industry, the use of this type of contract is likely to become more prevalent at the global level. Any decision on the treatment of such contracts may, in consequence, also affect the deliberations on substantive liability provisions.

6. Against this background, the following comments are offered to facilitate the discussion.

I. Non-mandatory application of the draft instrument to service contracts/OLSAs

7. It has been suggested that OLSAs, as described (in WP.34), should not be excluded altogether from the scope of application of the draft instrument, but should be exempt from its mandatory application. This would mean that when cargo is carried under a service contract, **the draft instrument liability regime would apply by default, but all or only some of its provisions could be contracted out of or be contractually modified**. When assessing the potential consequences of such an approach, consideration should be given to the following situations.

(a) Service contracts involving large shippers

8. Clearly, in relation to contracts of carriage concluded between parties of broadly equal bargaining power, this approach would not give rise to public policy concerns. Large shippers are just as able to effectively safeguard their interests in contractual negotiations, as are large carriers. Often, the big shippers are themselves carriers, namely freight forwarders, who do not operate any vessels, but have contracted with smaller shippers to transport the cargo from door-to-door. Freight forwarders may thus be both carrier (vis-à-vis the smaller shipper) and shipper (vis-à-vis a unimodal carrier, such as a sea carrier).

9. Nevertheless, it should be noted that if the draft instrument were to apply by default, albeit not mandatorily, a contracting party with more detailed knowledge of all the terms of the complete set of rules may find itself at an advantage. This in particular if, as proposed, the parties may selectively exclude or modify individual provisions, rather than the entire framework. Unless both contracting parties pay due attention to all of the potentially applicable provisions of the draft instrument, as modified, excluded or supplemented contractually, one or other of the contracting parties may find itself "by default" to have agreed to potentially disadvantageous terms. More generally, the potential benefits associated by commercial parties with a predictable internationally uniform liability regime may, in the longer run, fail to materialize.

10. In any event, however, there is no need to protect parties with equal bargaining power by way of mandatory legislation, provided always that third parties who acquire rights and obligations under these contracts would be protected by the mandatory application of the liability regime.

(b) Service contracts involving small shippers

11. The situation is markedly different if parties with clearly unequal bargaining power contract with one another. It is in this context that **concerns arise about the potential use of service contracts as devices to circumvent otherwise applicable mandatory liability rules**.

12. Current practice suggests that service contracts, which account for more than 80 per cent of liner carriage in some trades, may be used not only as between large shippers and carriers, but also for the carriage of very small quantities, such as 10-20 TEUs or even 1 TEU. It is clear that in this context, the contracting parties are not of equal bargaining power. A contract concluded between the shipper of 2 containers—or of 25 containers—and one of the world's top 25 liner companies—in control of almost 80 per cent of global TEU carrying capacity (*Source*: Dyna Liners 06/2004, 6.2.2004)—is not likely to be conducted on the basis of individually negotiated terms. Rather, the carrier's standard terms of contract, as also contained in or referred to in transport documents, such as a bill of lading or sea waybill, will be incorporated into the service contract.

13. In this context it should be recalled that current practice only serves to indicate certain trends, but that future developments at the global level may actually depend on the degree to which the draft instrument does or does not safeguard against abuse of "freedom of contract" by parties with stronger bargaining power.

14. If, in the draft instrument, service contracts are exempt from the mandatory scope of application of the liability regime without any safeguards to ensure that small shippers are effectively protected against unfair contract terms, it is possible that in future most international liner carriage could be conducted on the carrier's standard terms as incorporated into service contracts and thus not subject to mandatory minimum standards of liability.

15. The provisional definition of the characteristics of OLSAs, as set out in WP.34, does not at present ensure that notional agreement of an OLSA may not be used as a contractual device to circumvent otherwise applicable mandatory liability rules to the detriment of the small shipper.

II. The relationship between scope of application and substantive liability regime

16. As has been pointed out at the outset, by establishing mandatory minimum levels of liability, existing liability regimes seek to ensure the protection of cargo interests with little bargaining power, i.e. small shippers and third party consignees, against unfair contract terms unilaterally introduced by the carrier in its standard terms of contract. There appears to be general agreement that this approach remains appropriate in relation to so-called contracts of adhesion, i.e. contracts concluded on the carrier's standard terms as contained in or evidenced by a transport document (or electronic equivalent).

17. At the same time, it is apparent that in relation to the drafting of the substantive content of the liability regime, these considerations are less prevalent than is the case with existing regimes. Rather than being primarily geared to protecting shippers and third-party consignees, the draft instrument, based on the

assumption that market conditions have changed somewhat over the years, appears to aim for a substantive liability regime to regulate the relationship between shippers and carriers as equal negotiating partners. Under the present draft, the parties may, for instance, agree that the shipper is responsible for some of the carrier's functions (art. 11(2)) and/or that the carrier acts in respect of some parts of a transport as freight forwarding agent only (art. 9). Similarly, it has been proposed that the obligations of the shipper, which are much more extensive and detailed than under existing maritime liability regimes, shall be mandatory.

18. However, it is important to note that while the substantive content of the draft instrument is to a considerable degree geared towards contracting partners of equal bargaining power, individually negotiated contracts by such parties may, depending on the outcome of discussions on freedom of contract and scope of application, not be governed by the draft instrument.

19. Questions of scope and substance are linked and should therefore be considered more in context. If individually negotiated contracts are excluded from the draft instrument or are not covered by its mandatory scope, then the substantive liability regime applies mandatorily only to what may be called contracts of adhesion. In relation to these contracts, however, there is no room for adopting an approach less protective of shippers and third-party consignees than existing maritime liability regimes.

20. Thus, in the light of discussions on the mandatory scope of application of the draft instrument, the substantive content of liability provisions may need to be reconsidered.