

Energy, Trade & Commodities Alert

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INCOTERMS 2010 – What you need to know (Part 2)

Our previous client alert, “INCOTERMS 2010 – What you need to know (part 1)” gave a brief overview of the main changes to INCOTERMS 2010, which comes into effect on 1 January 2011. We mentioned in that alert that, in addition to various amendments to the terms, the new INCOTERMS do not contain the DAF, DES, DEQ and DDU terms, these having been replaced with two new terms, DAP (Delivered At Place) and DAT (Delivered At Terminal).

So, which terms should you now contract on? What are the differences from INCOTERMS 2000? And how might the new Terms be used in international trade contracts?

This client alert (part 2 of a series) will focus on the amendments to the FOB and CIF Terms and how these affect the obligations of the buyer and seller. We will also briefly address FAS and CFR.

FOB and CIF – Key Terms/Changes

FOB and CIF are, historically, the rules most often incorporated in international sale of goods contracts. It is important, therefore, to understand the subtle changes INCOTERMS 2010 makes to these terms.

The new terms reiterate that both FOB and CIF are for use only when goods are transported by sea or inland waterway. The terms should not be used where there is any form of road/rail/air transport involved, or where goods are handed over to the carrier before they are on board the vessel, for example goods in containers which may well be delivered at a terminal.

As with all of the terms in the new version, there are diagrams at the start of the FOB and CIF sections, which helpfully indicate where “delivery” occurs (e.g. on board the vessel) and what to put after the term (i.e. named port of shipment or named port of destination).

Similarly as with all of the terms, any of the documents which the seller and buyer are required to provide may be supplied electronically “if agreed between the parties or customary”. While this may be a good idea in practice, to ensure speed and consistency, a party who wishes to insist on paper documentation should make that clear in the sale contract.

FOB

Contracts of Carriage and Insurance (A3/B3)

The seller owes no obligation to the buyer to make a contract of carriage, as this is normally the responsibility of the buyer. However, the new INCOTERMS provide that if requested by the buyer or if it is commercial practice and the buyer does not give a timely instruction to the contrary, the seller “may” contract for carriage on usual terms at the buyer’s risk and expense. Equally, the seller may decline to do so but “shall promptly notify” the buyer.

Therefore the new FOB INCOTERM requires a notice from the seller in trades where it may be “commercial practice” for the seller to arrange carriage. Logically, we think that it is preferable for the seller to exclude this unless the seller wishes to have an option to ship e.g. “buyer to arrange carriage in all circumstances”. The alternative that you see in many contracts is, if the buyer does not tender a vessel, the seller has a right to store at loadport and be paid against warehouse receipts – this requires express wording in the sale contract.

As with INCOTERMS 2000, neither party is obliged to the other to arrange insurance for the benefit of the other party. The new terms however place an express obligation on the seller to provide any information that the buyer needs to obtain insurance.

Delivery (A4)/Taking Delivery (B4)

The delivery provisions are similar to INCOTERMS 2000, however, the seller’s obligation is now to place the goods “on board the vessel,” rather than over the ship’s rail at the loading port indicated by the buyer. The “ship’s rail” as the point of delivery has been omitted in preference for the goods

being delivered on board the vessel in order to more closely reflect modern commercial reality and to avoid costly disputes over when exactly the goods pass the “ship’s rail”.

If no specific loading point has been indicated by the buyer, the new Terms make it clear that the seller may select the point that best suits the seller’s purpose. In practice, it would be sensible to include an express provision enabling the seller to choose the loading point if that is what is agreed.

Finally the new Terms clarify that the seller may now perform its delivery obligation by procuring delivered goods as opposed to deliver goods itself. This simply reflects the current accepted practice in string sales.

Risk (A5/B5)

The transfer of risk provision remains the same, aside from the clarification that risk passes when the goods are on board the vessel, not when they pass over the ship’s rail.

Checking/Packaging/Marking (A9)

INCOTERMS 2010 provide that the seller must actually pack the goods; under the previous Terms the obligation was only to provide packaging. In relation to the costs of “checking operations”, the new Terms now provide that the cost of any pre-shipment inspection required by the authority of the export country is part of the costs that the seller must bear. Express terms should be used if the parties wish to allocate costs differently. The corollary of this in B9 is that the buyer is to bear the costs of any other mandatory pre-shipment inspection. Again additional terms would still be useful to avoid arguments as to the nature of any pre-shipment inspection.

CIF

Contracts of Carriage/Insurance (A3/B3)

The seller is required to obtain cargo insurance complying at least with the minimum cover provided by Clauses (C) of the Institute Cargo Clauses. Note, however, that this is the minimum level of insurance and covers only major casualties, such as total loss of cargo. The buyer also has the option of requiring that the seller provides, at the buyer’s expense and where procurable, any additional cover, for example, cover provided by Clauses (A) or (B) of the Institute Cargo Clauses or any similar clauses and/or cover complying with the Institute War Clauses and/or Institute Strikes Clauses or any similar set of clauses. This acts as a sort insurance “bolt-on”, but the buyer will be required to pay more for this. If the buyer wishes for the seller to arrange for this “bolt-on” insurance, it is recommended that this is included in the sale contract.

In INCOTERMS 2000, there were no specific references to Institute Cargo Clauses (A), (B) and (C), as well as the references to the Institute War Clauses and Institute Strikes Clauses.

The buyer must now provide the seller (upon request), with any information necessary for the seller to procure any additional insurance as requested by the buyer and the seller must provide the buyer with the insurance policy or other evidence of insurance cover, as well as any information that the buyer needs to procure any additional insurance.

Delivery (A4/B4)

The seller may now deliver (in lieu of placing the goods onboard the vessel) by procuring the goods so delivered, provided that the goods are delivered on the agreed date or within the agreed period and in the manner customary at the port.

Risk (A5/B5)

The seller has to bear all risks of loss of or damage to the goods until they have been delivered on board the vessel. The concept of the “ship’s rail” has been abandoned, given the uncertainty of when goods actually pass the ship’s rail.

Allocation of Costs (B6)

In addition to those costs for which the buyer was responsible as detailed in INCOTERMS 2000, the buyer is now also responsible for the costs of any “bolt-on” insurance that it has requested. This is a formalisation of the previous arrangements made between parties.

Checking/Packaging/Marking (A9)

The seller is obliged to package the goods (as opposed to simply providing packaging), unless it is usual for the particular trade to transport the type of goods sold unpackaged.

Inspection (B9)

The buyer is to bear the costs of any mandatory pre-shipment inspection, except when such inspection is mandated by the country of export.

FOB/CIF Variants

INCOTERMS 2010 has not made any provision for “refined” FOB/CIF terms, for example CIFFO, CIF Liner Terms or FOB stowed/trimmed. If a party wishes to contract on these terms, it must explicitly provide for this in the sale contract.

FAS

The provisions of FAS are largely identical to FOB, with the exception that goods are delivered, and risk passes, once the goods are placed alongside the vessel, as opposed to when they are placed on-board the vessel. You may wish to expressly provide for what exactly constitutes the goods being “alongside” the vessel.

CFR

Similarly, the provisions of CFR are largely identical to CIF, with the exception that the seller is not obliged to procure insurance.

Conclusion

INCOTERMS 2010 does not represent a major departure from INCOTERMS 2000 in respect of FOB, FAS, CIF and CFR terms, rather they have been refined and clarified for ease of understanding and use. Parties should still include express terms where they are of particular importance or where INCOTERMS does not cover the issue.

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