

## Aantekeninge/Notes

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### Incoterms<sup>®</sup> variants: greater precision or more uncertainty?

#### 1 Introduction

The International Chamber of Commerce introduced Incoterms<sup>®</sup> to achieve some form of international standardisation pertaining to the delivery of goods, passage of risk, allocation of costs and customs formalities under an international contract of sale. These rules “explain a set of three-letter trade terms reflecting business-to-business practice in contracts for the sale of goods” (ICC *Incoterms*<sup>®</sup> 2010 (2010) 5). They are formulated with reference to the most consistent business practices and customs at a given point in time and are regularly updated to keep up with developments in international commercial practice (Foreword to *Incoterms*<sup>®</sup> 2010). By standardising trade term content Incoterms<sup>®</sup> achieve legal certainty, which means a reduction in disputes and, hence, also in transaction costs.

The latest revision, Incoterms<sup>®</sup> 2010, came into operation on 1 January 2011. It introduced a new classification of trade term rules by making a distinction between rules appropriate for all modes of transportation (the EXW, FCA, CPT, CIP, DAT, DAP and DDP rules), and rules aimed exclusively at maritime and waterway transport (FAS, FOB, CFR and CIF). The distinction facilitates the general use of the rules. In addition, the Guidance Note preceding each rule contains advice on the appropriateness of such rule in a particular trade context.

The standardised definitions may, however, be overridden by customs applicable at the place or port where the rule is used (*Incoterms*<sup>®</sup> 2010 5 par 2). Furthermore, they can be adapted by using Incoterms<sup>®</sup> variants. Additions to or variations of the basic term can either add to or derogate from the parties’ obligations (Raty “Variants on Incoterms (Part 2)” in *Incoterms in Practice* (ed Debattista) (1995) 152-153). For example, an added obligation for the seller to load the goods on the buyer’s collecting vehicle in the case of the EXW term, or to pay for costs of discharge in the case of the CIF term. Variants such as “free on board stowed” (FOBS) and “free on board stowed and trimmed” (FOBST) are also regularly used in international trade to extend the seller’s delivery obligations.

Whilst Incoterms<sup>®</sup> merely reflect the commercial practice most commonly used, trade term variants are primarily aimed at obtaining greater precision (ICC *Incoterms* 2000 (1999) Introduction par 11; Ramberg *Guide to Incoterms*<sup>®</sup> 2010 (2010) 41; Raty 152-153). Incoterms<sup>®</sup> recognise the principle of party autonomy and therefore do not prohibit

variations of the standard definitions (*Incoterms*<sup>®</sup> 2010 Introduction 10). However, since there are no consistent practices in regard to the obligations contained under these variants, their content is not standardised and, hence, they create uncertainties. A lack of clarity on the extent of the parties' respective obligations and how far they deviate from the standard rule can create disputes and increase transaction costs. In the case of "EXW loaded" or "FOB stowed", for example, there is no general world-wide consensus that the addition extend the seller's obligations to include both the cost of actually loading the goods and the risk of fortuitous loss of or damage to the goods during the process of loading or stowage. Additions to the C-terms also present many problems. These terms constitute shipment contracts where the seller fulfils his delivery obligations on shipment of the goods. The addition of obligations referring to the destination could suggest that an arrival or destination term was intended. (Ramberg 42-43). In the result, the seller could be at risk until the goods actually arrive at the destination. Divergent opinions are held on whether *Incoterms*<sup>®</sup> variants postpone the passage of risk until the additional obligations are performed.

The official rules provide no guidance on how to deal with these variants, except to warn users against the dangers in contracting on this basis (*Incoterms*<sup>®</sup> 2010 Introduction 10). The question that this note addresses is whether *Incoterms*<sup>®</sup> variants succeed in providing greater clarity as regards the obligations of the seller and buyer, or whether they actually contribute to more uncertainty. For purposes of this analysis the discussion will be restricted to FOB and CIF variants.

## 2 Analysis

### 2.1 FOB Variants

The rationale for the FOB variants has its roots firmly in tradition. International mercantile custom determined that the seller's obligation to deliver the goods on board the vessel nominated by the buyer is fulfilled the moment that the goods cross the ship's rail. Although the ship's rail as a dividing point for risks and costs seems to be a fairly simple solution, it was never appropriate in practice. It is difficult to separate the loading costs for work performed before the point of passing the ship's rail from that performed thereafter, especially if the whole loading operation is conducted by the same company. Moreover, it is also impracticable to divide the functions and risks between the parties while the goods are swinging across the ship's rail. As Devlin J (as he then was) remarked in *Pyrene v Scindia Navigation* (1954 2 QB 402 419):

Only the most enthusiastic lawyer could watch with satisfaction the spectacle of liabilities shifting uneasily as the cargo sways at the end of a derrick across a notional perpendicular projecting from the ship's rail.

The question of the passing of risk can become especially difficult in the context of accidents during loading operations, for example if the ropes break when the cargo is lifted from the shore onto the ship. One suggestion has been that where the goods are damaged during the

loading process, the risk will be on the seller if they fall on the wharf or in the water, whereas it will be on the buyer if they fall on deck (Valiotti *Passing of Risk in international sale contracts: A comparative examination of the rules on risk under the United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980) and Incoterms 2000* (LLM thesis 2003 University of Kent) text accompanying nn 207-212, 266-268). However, because it is purely fortuitous on which side of the rail the cargo drops, this suggestion does not produce a legally satisfying result. In principle, such an accident affects both the contract of sale and the contract of maritime carriage by sea. In the contract of carriage by sea, the loading operation is considered as an indivisible whole and the carrier's liability for negligence extends to all stages of that operation, irrespective of whether they occurred before or after crossing of the ship's rail (Devlin J in *Pyrene v Scindia Navigation supra* 419). However, when it comes to the contract of sale, the situation has never been clear, especially if the parties failed to stipulate this point in their contract.

Generally, there are two views. One view suggests that under an FOB contract the goods are at the buyer's risk when they pass the ship's rail so that it is irrelevant whether they reach the ship safely on completion of the loading operation. The other view suggests that the seller has fulfilled his obligations under an FOB contract only if the goods are deposited safely on board the vessel and the loading operation is completed (Murray et al *Schmitthoff's Export Trade: The Law and Practice of International Trade* (2007) par 2-013).

In practice, merchants developed trade usage variants to deal with the uncertainties that come with the ship's rail criterion in regard to the division of risks and costs. The seller's obligation to place the goods on board may be extended by a phrase added to the FOB term, for example "FOB stowed" (FOBS), "FOB trimmed" (FOBT) or "FOB stowed and trimmed" (FOBST). These variants of the FOB term are aimed at safety, stress and stability of the goods. "Stowing" means ensuring that the cargo is positioned on board the vessel in such a manner as to be safe during the proposed transit, for example to position the cargo so that it is distanced from parts of the ship that generate heat and to ensure the stability or balance of the ship. "Trimming" involves the levelling of the cargo during or shortly after loading so that it is evenly distributed in each hold and throughout the ship as a whole. This process applies to dry bulk cargoes to ensure the stability and structural strength of the vessel. In the case of some cargoes it also ensures that the holds are more efficiently filled or in others, such as in the case of coal, it can reduce the spontaneous heating of the cargo. (Reynolds "Stowing, trimming and their effects on delivery, risk and property in sales 'fobs', 'fobt' and 'fobst'" 1994 (1) *Lloyd's Maritime and Commercial LQ* 119 119-120; Klotz & Barrett *International Sales Agreements: An Annotated Drafting and Negotiating Guide* (1998) 71-72 nn 22, 23). In practice, these duties are performed by stevedores and the costs are included in the freight that is to be paid by the buyer. However, expenses for stowing and trimming can be shifted between buyer and seller. FOBS, FOBT or FOBST indicate

that such costs are shifted to the seller (Reynolds 1994 *Lloyd's Maritime and Commercial LQ* 121; Griffin Day & Griffin *The Law of International Trade* (2003) 58).

Apart from allocating costs, the question is whether these variations have any effect on what constitutes delivery under the contract of sale or on the moment that risk passes from the seller to the buyer. There is no clarity as to whether a seller will only effect delivery once loading, stowing and/or trimming, as the case may be, have been completed, and whether the passage of risk is postponed until these additional obligations are performed.

One opinion is that a resort to trade term variants does not change the point of delivery or the point where risk transfers to the buyer. It only serves to specify the costs for securing and trimming the goods at the port of loading (Raty 155, 161). In the case of an FOB sale where the buyer contracts for carriage, or the seller contracts on behalf of the buyer, the seller is unable to control stowage and trimming as there is no contract between him and those responsible for these obligations. One of the principles on which trade terms are based is that the obligations are kept together, namely that whoever has the custody of the cargo also bears the risk. Deviations of this basic rule distort the obligations and should only take place for special reasons. Moreover, policy considerations of international trade also dictate that risk should follow control (Mikkola "Variants on Incoterms (Part 1)" in *Incoterms in Practice* (ed Debattista) (1995) 144 147-148). Once the goods have crossed the ship's rail and are placed on board the vessel, control is relinquished to the buyer, who will then be protected by marine insurance or the contract of carriage. On strength of these considerations, the stowing and trimming obligations should merely entail an additional financial obligation on the part of the seller and not influence the point of delivery or the passing of risk.

The other view is that the seller's delivery obligation is not met until the stowing and trimming obligations have been completed. According to this view, the law should recognise that parties who insert such clauses into their sale contracts intend to provide for both a physical and a financial obligation, and that their intentions would be frustrated if the term was merely regarded as allocating a financial obligation. Delivery and the passing of risk should therefore be delayed until the stowing and trimming have been completed (Reynolds 1994 *Lloyd's Maritime and Commercial LQ* 121-123, 124-127). (For similar, but qualified, opinions see Klotz & Barrett 72; Treitel "Overseas Sales" in *Benjamin's Sale of Goods* (ed Guest) (2006) par 20-090.) Support for this view is found in an American case, *Minex Shipping v International Trading Company of Virginia and SS Eirini* (1969 303 F Supp 205). In this case, the sales contract provided that bags of cement would be shipped "FOB stowed Polish port". The cement became contaminated during the voyage as a result of soy beans falling on the cement bags. The buyer maintained that the contract term required the seller to sweep, clean and dry the holds of

the vessel. However, the court held that the “stowed” term did not impose these duties upon the seller. The seller was merely obligated to place the cement in the holds “in an orderly, compact manner” and “in such a manner as to protect the goods from friction, bruising, or damage from leakage”. The court held that once the cargo was properly stowed, the risk of damage passed to the buyer.

But what is the position after the latest revision of Incoterms<sup>®</sup>? In pursuance of modern commercial practice, the ICC’s standardised FOB rule now omits all references to the ship’s rail and states that delivery takes place when the goods are placed “on board the vessel nominated by the buyer at the named port of shipment or by procuring the goods so delivered” (FOB *Incoterms*<sup>®</sup> 2010 article A4; *Incoterms*<sup>®</sup> 2010 Introduction 7). Ambiguities and arbitrary results that have accompanied the notion of the ship’s rail are now removed. Because Incoterms<sup>®</sup> link the passing of risk to the point of delivery, this means that the goods are delivered and the risk passes when they are placed on board the vessel nominated by the buyer (FOB *Incoterms*<sup>®</sup> 2010 article A5). But when are the goods considered to be delivered on board the vessel? The ICC advises that in the absence of port customs and practices between the parties, the default position would be when the goods are “first at rest on deck” in an undamaged condition (see answer to Question 17 “Incoterms Rules Q&A September 2011: ICC general guidance on selected questions on the Incoterms<sup>®</sup> 2010 rules” available online at <http://www.iccwbo.org/Products-and-Services/Trade-facilitation/Incoterms-2010/Q-A-September-2011> (accessed 2012-08-30)). Would that then mean that under FOBS and FOBST delivery takes place and risk passes only when the goods are safely stowed and trimmed? The ICC seems to support this view. In reply to a question on when risk transfers under “stowed and secured/trimmed” variants, the ICC states that the costs for the buyer would “most likely be understood to begin only when the goods were safely stowed/secured/trimmed as set out in the contract and passage of risk would likewise be delayed” (see answer to Question 18 “Incoterms Rules Q&A September 2011 ICC” supra). Port customs should, however, also be taken into consideration when interpreting these variants.

However, this is not necessarily the final word on this issue. The ICC points out that their views “are intended as general interpretive guidance only, and not as authoritative opinion” (Introduction to “Incoterms Rules Q&A September 2011” supra). Furthermore, they choose to state their answer to this particular question in a cautious and general manner. The phrase “most likely to be understood”, which introduces the reply, leaves room for other interpretations. This means that there is still no certainty on the legal position concerning delivery and risk under FOB variants. For these reasons, it is important that parties clarify whether the seller is to undertake the responsibilities for loading and stowage operations at his cost or whether this also entails an assumption of risk until the loading and stowage obligations are completed, for example, by adding a phrase such as “FOB stowed, costs and risks in connection with loading on the seller”. (See also the second part of the reply to Question 18

“Incoterms Rules Q&A September 2011” supra where the ICC strongly encourages parties to clarify their intentions.)

## 2.2 CIF Variants

Because the CIF rule may not be suitable for all situations, merchants have sought to tailor the standard-form CIF term to fit specific commercial conditions. For example, if the goods are sold “CIF landed”, the unloading costs including lighterage and wharfage charges are borne by the seller or are included into the sea freight which he has to pay. Another example is “CIF undischarged” or “CIF free out” where the intention is that the seller’s obligations are limited to those that are to be effected inside the ship’s hold in the port of discharge. Costs for unloading should be borne by the buyer (Raty 156; Ramberg 43).

Deviations from the standard-form CIF contract are common where oil is transported by sea. A common modification is the “out-turn” or “landed weight” clause which relieves the buyer from having to pay on the basis of the quantities shown on the bill of lading as is normally the case under CIF. These practices evolved because of the potential for losses during the transportation of oil. A distinction must be made between transportation loss and marine loss. Transportation loss refers to loss in the volume of oil during transit due to evaporation, sludge, accumulation, spillage or measurement error, whilst marine loss covers loss caused by fortuitous events such as vessel destruction, bad weather or war (Lightburn & Nienaber “Out-turn clauses in cif contracts in the oil trade” 1987 *Lloyd’s Maritime and Commercial LQ* 177 178).

There is agreement that unavoidable transportation loss is shifted to the seller. However, when it comes to other types of risks, there are conflicting views on their apportionment. According to one view, other types of risk pass on shipment as is the case under the normal CIF rule. The out-turn clause is therefore only a price adjustment mechanism with regard to unavoidable transit losses, leaving the risk of marine loss on the buyer. A more far-reaching approach is that an out-turn clause moves the time at which the risk of loss, whether marine or transportation loss, transfers to the buyer from the point of shipment to the port of destination. This view eliminates the need to distinguish between marine loss and transportation loss (Lightburn & Nienaber 178-179).

Scholars such as Lightburn and Nienaber (179) prefer to deal with the issue as under any normal CIF contract. It is their argument that by choosing CIF as the applicable contract basis, a range of obligations is made part of the contract without the use of express words to that effect. No compelling reasons exist for justifying an exception to the normal CIF rules in the case of an out-turn clause. Traditionally out-turn clauses are a short-hand way of dealing with unavoidable transportation loss as opposed to marine loss. A party seeking to overcome the accepted meaning of an out-turn clause in a particular case should therefore carry the burden of showing that the parties intended to disregard the legal

consequences that would normally flow from its use. If parties wish to deviate from the standard meaning, they should provide for that through express contractual terms (Lightburn & Nienaber 179).

Before the 2004 revision of article 2 of the American Uniform Commercial Code (UCC), section 2-321 UCC reflected a policy decision that the out-turn variant should be construed so as to involve the least possible deviation from the CIF basis, while at the same time taking into account the inevitability of transportation losses. This section dealt with CIF or C&F “Net Landed Weights”, “Payment on Arrival”, and “Warranty of Condition on Arrival” terms. The Official Comment to the section stated that they are:

[v]ariations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C.&F. term as to the passing of marine risks to the buyer at the point of shipment.

The UCC drew a clear distinction between “CIF out-turn” contracts and “CIF no arrival-no sale” contracts. Section 2-234 UCC left the risk of loss in “no arrival-no sale” contracts explicitly on the seller. In the case of “CIF out-turn” contracts, section 2-321 split the risk, by placing the risk of necessary loss (“the risk of quality and weight deterioration during shipment”) on the seller, and the risk of extraordinary loss (“marine risks”) on the buyer. The case law shows that this position correlates with mercantile expectations (Lightburn & Nienaber 180-181). It is therefore likely that the legal position will remain the same even after the provisions have been repealed from the official Code.

There is no statutory provision in the English Sale of Goods Act on CIF out-turn clauses. Although CIF variants may create the impression that the contract becomes a destination or arrival contract, the case law indicates that that they do not affect the character of the contract as a true CIF contract (Murray *et al* par 2-037). In a number of cases where the amount payable was made dependable on the quantity of goods which actually arrive, the courts have held that clauses which shift the risk of loss from the buyer to the seller do not necessarily change the essence of a CIF contract and that it merely entails that the seller should allow a price adjustment after the goods have landed (*Denbigh Cowan & Co v Atcherley* 1921 90 LJKB 836; *The Gabbiano* 1940 P 166 174; *Oleificio Zucchi SpA v Northern Sale Ltd* 1965 2 Lloyd’s Rep 496 518; *Oricon Waren & Handels GmbH v Intergraan NV* 1967 2 Lloyd’s Rep 83 94).

In *Soon Hua Heng Co Ltd v Glencore* (1996 1 Lloyd’s Rep 398), the court held that out-turn or similar clauses are normally intended to relate only to the determination of the price. If the goods are lost and the buyer has already paid an estimated price on tender of the documents, he is not entitled to an adjustment, unless he can prove that the shipped goods

were less in quantity or quality than he has paid for. The out-turn clause should therefore only apply to cases where the weight difference arises from ordinary circumstances. Such a clause does not entail that the whole of the risk is to remain on the seller until actual delivery, since such an interpretation would mean that the contract would no longer be a CIF contract (Treitel par 19-006).

These opinions should be supported inasmuch as they underline the need to preserve the basic character of the CIF term. Variations of the CIF term should not affect the character of CIF as a shipping term where delivery and the passing of risk take place on shipment. An additional obligation does not necessarily, nor automatically, change the risk distribution under Incoterms<sup>®</sup> (Lightburn & Nienaber 184-185). Risks do not follow from functions and costs. That is evidenced by the C-terms where the seller has to pay for the freight to the indicated destination but does not have to assume the risk of loss of or damage to the goods after dispatch from the country of export (Ramberg 41). CIF variations should therefore merely affect the financial obligations of the parties. If the parties intend to shift the point of delivery or the passing of risk for accidental disasters, they should conclude their contract on the basis of an arrival term.

The out-turn variant, in particular, is intended to cover a range of limited events which would otherwise have fallen under the ambit of the risk rule and should not be used to move the point of delivery or the general point where risk transfers from the seller to the buyer. Moreover, in the case of an out-turn clause, the variation is primarily aimed at a specific type of trade, namely the oil trade, where it reflects the commercial practice of dealing with unavoidable transportation losses. These types of risk have been extensively analysed by industry specialists and are clearly recognised in the oil trade (Lightburn & Nienaber 179). If the parties want to broaden the scope of the out-turn clause they should choose another term or they should state their intention clearly.

### **3 Conclusion**

The discussion and analysis of the FOB and CIF variants have shown that, even though they originate from a need to simplify matters, Incoterms<sup>®</sup> variants create more uncertainty than clarity (Mikkola 145). Because there is no consistent practice as regards trade term variants, the ICC could not yet standardise their meaning, and thus the organisation cautions against their use (*Incoterms<sup>®</sup> 2010* Introduction 10).

The ICC has endeavoured to formulate guidelines for interpreting the “stowed” and “stowed and trimmed” variants. However, these formulations do not function as an authoritative opinion and are only intended as general interpretive guidelines. Moreover, because they are expressed in uncertain terms, they leave room for differing interpretations. For these reasons, parties should clarify whether the

seller intends to merely undertake the responsibilities for loading and stowage operations at his cost or whether this also entails an assumption of risk until the loading and stowage obligations are completed.

An additional obligation does not necessarily, nor automatically, change the point that risk passes under Incoterms<sup>®</sup>. The analysis showed that expressions such as “CIF landed” or “CIF out-turn weights” are normally not interpreted as changing the nature of the CIF term. The word “landed” usually refers to the costs of discharge, and “out-turn weights” merely signifies that the buyer should pay according to the weight ascertained after discharge so that condensation of the goods during their transport should, for instance, be taken into account when fixing the price. However, this does not mean that the seller bears the risk of fortuitous loss of or damage to the goods during their carriage.

Because Incoterms<sup>®</sup> do not standardise commonly used trade term variants, parties who use them contract at their own peril. Incoterms<sup>®</sup> leave it either to trade usage in a particular trade sector, to port customs or to the parties themselves to clarify the content of such deviations. If parties wish to deviate from the standard meaning of Incoterms<sup>®</sup> they should avoid misunderstandings by using express contractual terms which explain their intention clearly (*Incoterms<sup>®</sup> 2010* Introduction 10). If, for example, the parties merely intend to clarify the extent to which the seller should pay for certain costs without moving the point where risk passes, this should be said explicitly by adding the phrase “discharging costs until placing the goods on the quay for seller’s account”, or “stowed and trimmed but at the buyer’s risk after the goods have been placed on board” to their contract (Ramberg 42-43).

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### **Postscript**

This note is based on research conducted towards the author’s unpublished doctoral dissertation Coetzee *INCOTERMS as a form of standardisation in international sales law: the interplay between mercantile custom and substantive sales law with specific reference to the passing of risk* (LLD dissertation 2010 US).