INSTITUTE OF CHARTERED SHIPBROKERS – LINER TRADES

Session 9

Contracts between sellers and buyers – relevance for the liner operator

Hellenic Management Centre – Feb/Mar 2021

TONY MASON

Course Outline

(1) Introduction – Liner Shipping and the Container Revolution
(2) Liner Ships
(3) Ports, Terminals and Cargo Handling
(4) Through transport systems – containers and intermodal transport
(5) Container Lines and their networks – co-operation
(6) Container Lines and their networks – service structures
(7) Types of businesses in the liner sector – structure and organization
(8) Bills of Lading and other contractual documents
(9) Contracts between sellers and buyers
(10) Revenue and Costs in the Liner Business
(11) The Future for Liner/Container shipping

Topics for this session

- Contracts of Sale
  - Main terms
  - Role of INCOTERMS
- Detailed review of INCOTERMS
- Financing international trade
- Letters of Credit
  - UCP600

Contract of Sale

- Sets out the agreement between buyer and seller
- Seller offers goods in return for payment (or other consideration)
- Defines
  - The parties
  - Goods being bought/sold
  - Who is responsible for organising/paying for movement of goods
  - Who is responsible for customs clearance/duty
  - When payment is due/how it is to be paid
  - Time/Place when ownership of the goods passes from seller to buyer
  - At what stage the risk of damage/loss passes from seller to buyer

The Role of INCOTERMS in the Contract of Sale

WHAT ARE INCOTERMS?

- Produced by International Chamber of Commerce (ICC) since 1936
- 2020 is latest version, but 2010 can still be used (as can previous versions)
- Total of 11 different INCOTERMS rules
- Each terms defines
  - Which transport costs are organised and paid by the seller, and which by the buyer
  - At what point in the transport chain the risk passes from seller to buyer
  - Responsibility for customs clearance/duty payment
  - Specific requirements to obtain insurance
- INCOTERMS do not tell you:
  - When title/property ownership passes
  - When and how the goods are to be paid for
  - These points need to be spelled out in the commercial contract
- The chosen INCOTERM must be stated in the contract, as well as the version (e.g. 2010 or 2020)

INCOTERMS 2020 – AN INTRODUCTION

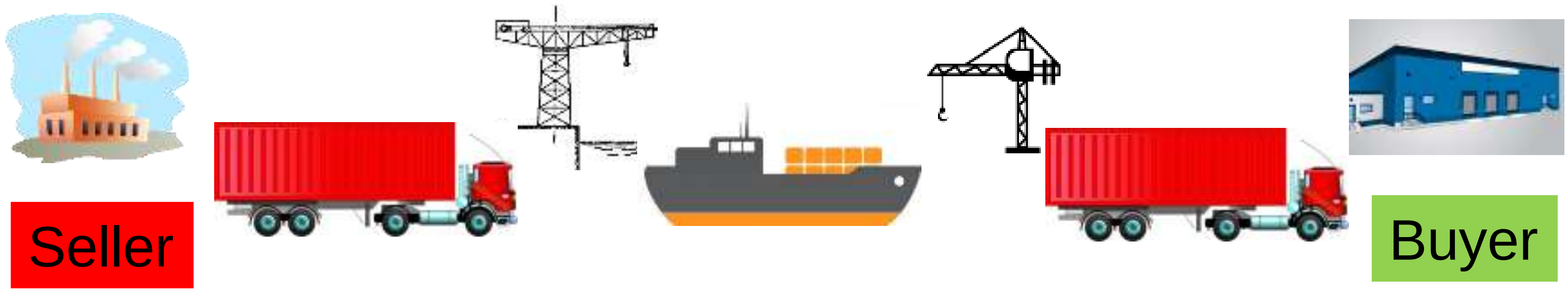
- Incoterms 2020 is effective from 1.1.20, but Incoterms 2010 can still be used as long as specified in the contract
- There are still 11 Incoterms – and just one change of name!
- For May 2021 exam, questions can be answered referring to INCOTERMS 2010 or 2020
- This presentation covers INCOTERMS 2010 in detail, together with the main changes introduced in INCOTERMS 2020

INCOTERMS 2010

11 Different Incoterms

- Four groups of terms
  - E Terms – Buyer responsible for all transport (EXW)
  - F Terms – Buyer responsible for main transport (FAS, FOB, FCA)
  - C Terms – Seller arranges main transport (e.g. sea leg) but risk passes **before** sea leg (CFR,CIF, CPT, CIP)
  - D Terms – Seller arranges main transport – risk passes after main transport (DAT, DAP, DDP)
- Four rules can only be used for sea transport (incl. inland waterways)
  - FAS, FOB, CFR, CIF
- Remaining 7 rules for any mode of transport

EX WORKS - EXW



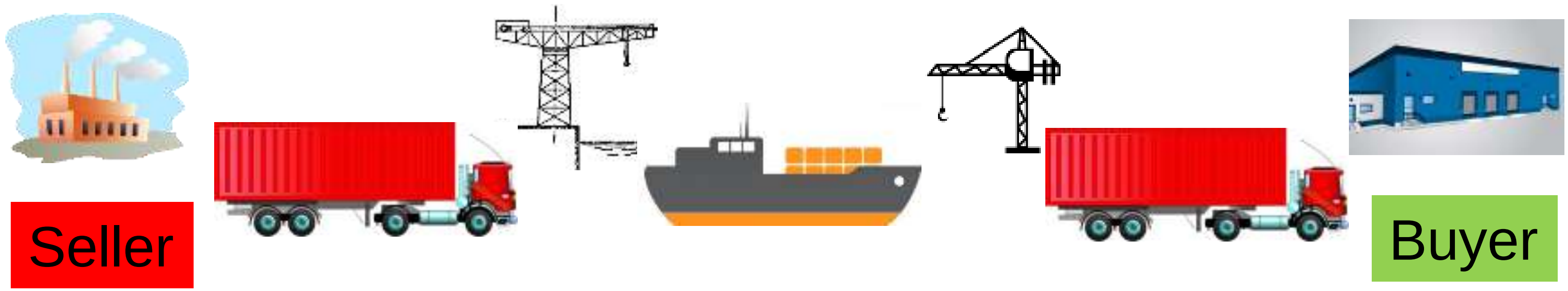
Responsibility/Payment

Passing of Risk

Insurance

- Seller to make goods available suitably packaged
- Buyer is responsible for loading onto vehicle (even though the seller may carry this out)
- Buyer is responsible for export clearance, though seller will need to be involved

FREE CARRIER (named place) - FCA



Responsibility/Payment

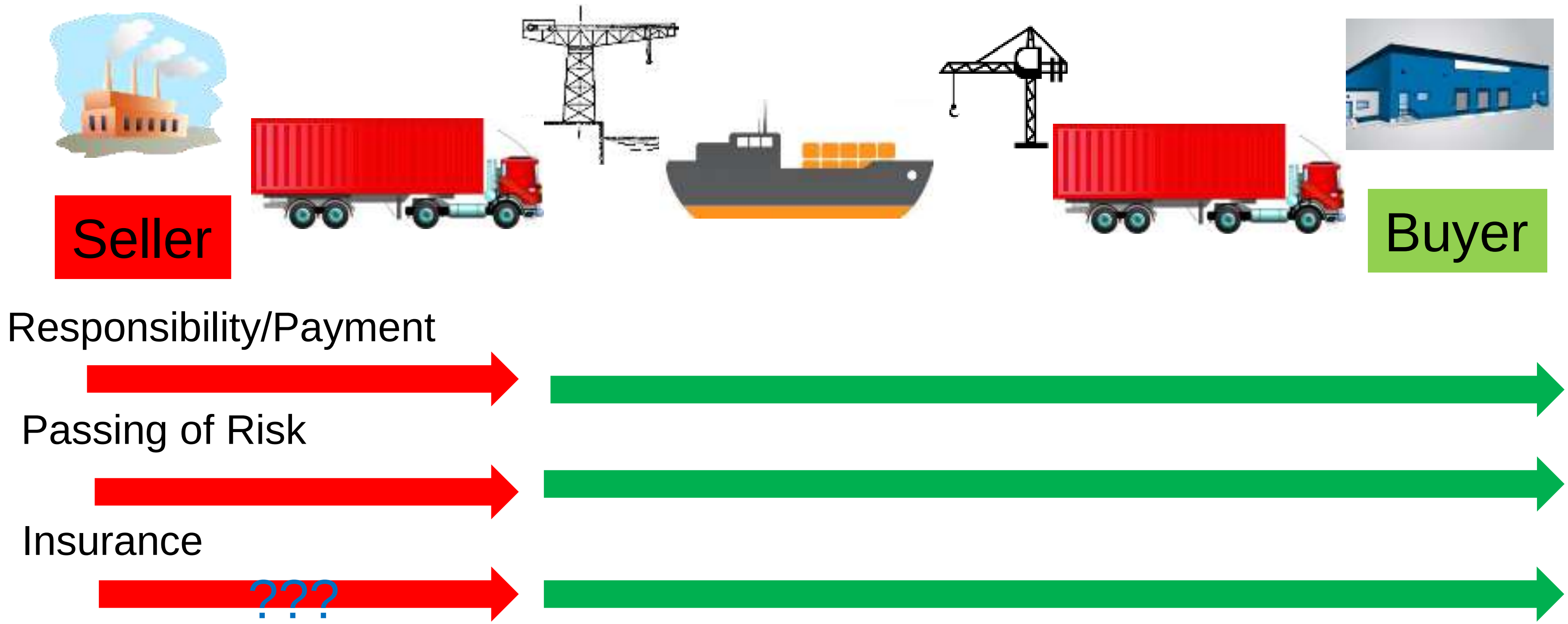
Passing of Risk

Insurance

???

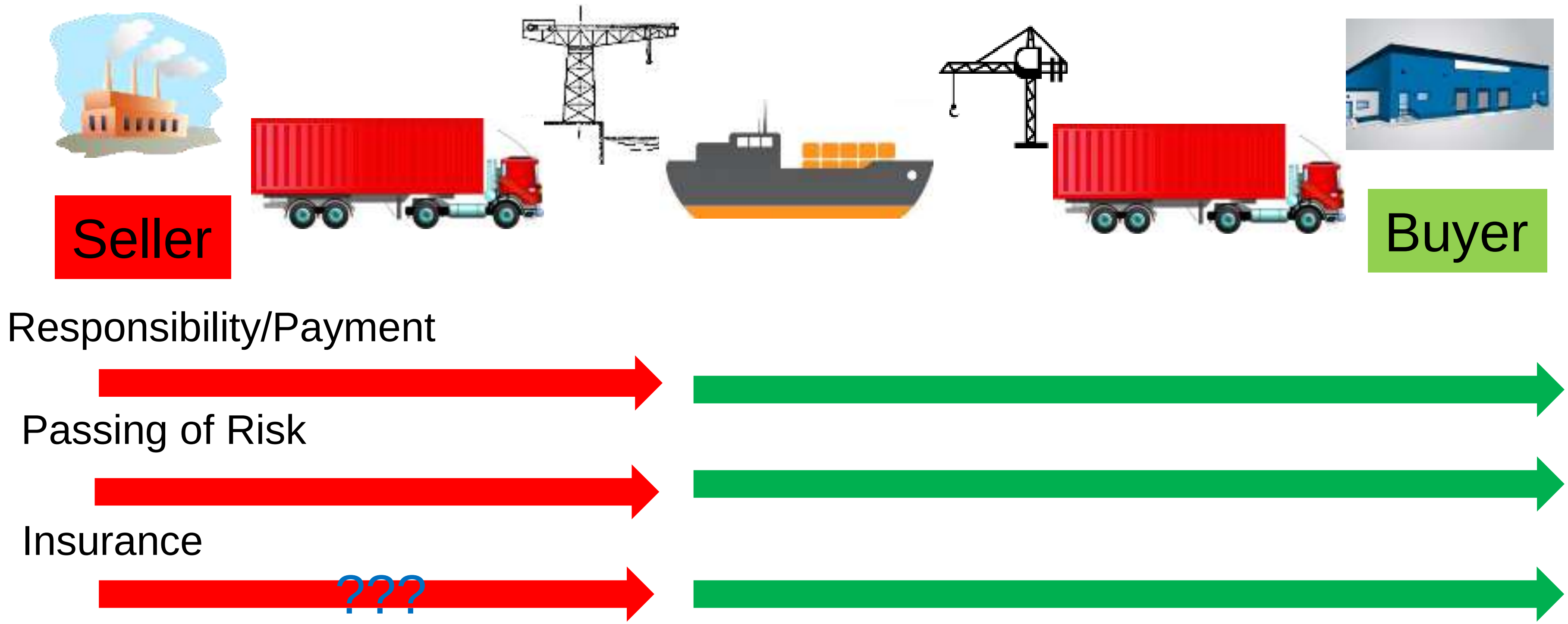
- Seller responsible for delivery to named place
- Seller is responsible for export clearance
- Seller is not obliged to insure goods during pre-carriage
- Buyer is responsible for risk/costs after delivery at named place

FREE ALONGSIDE SHIP - FAS



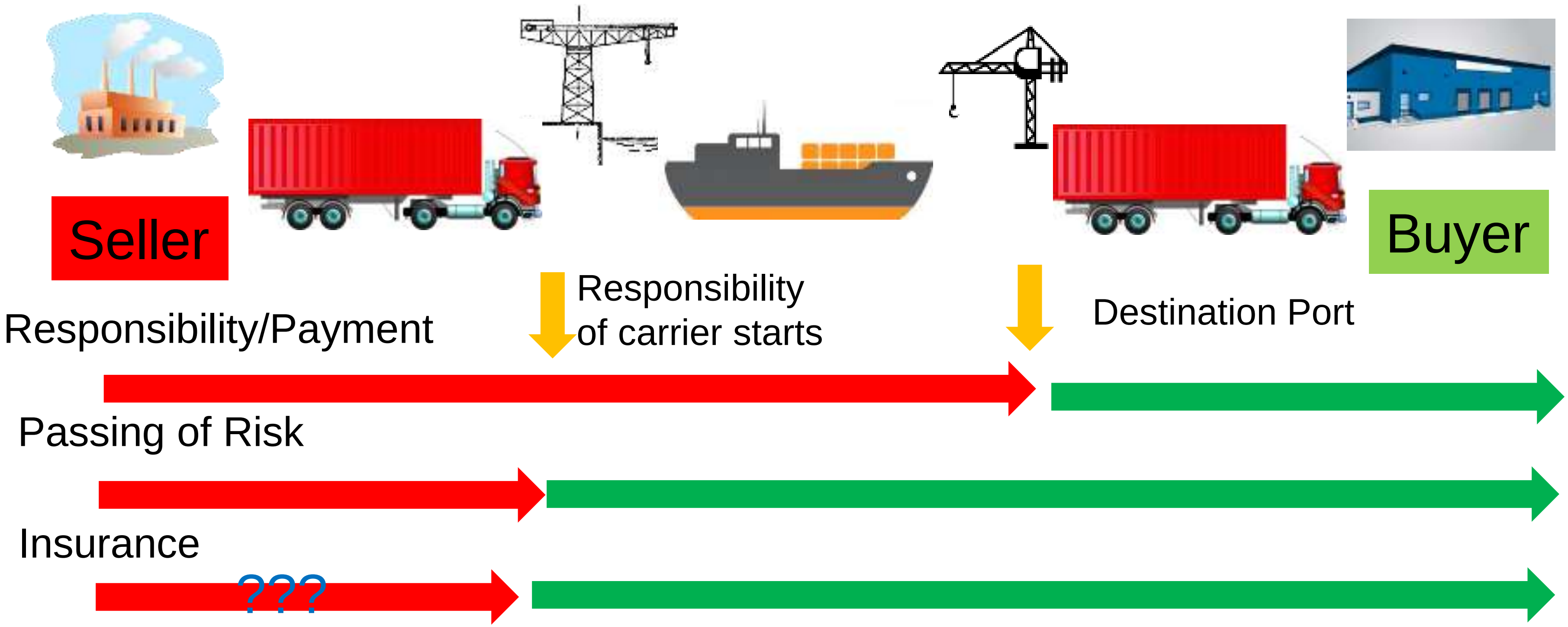
- Seller responsible for delivery of goods cleared for export, alongside the vessel at the named port
- Seller is not obliged to insure goods during pre-carriage
- Buyer is responsible for loading and for all risk/costs thereafter

FREE ON BOARD - FOB



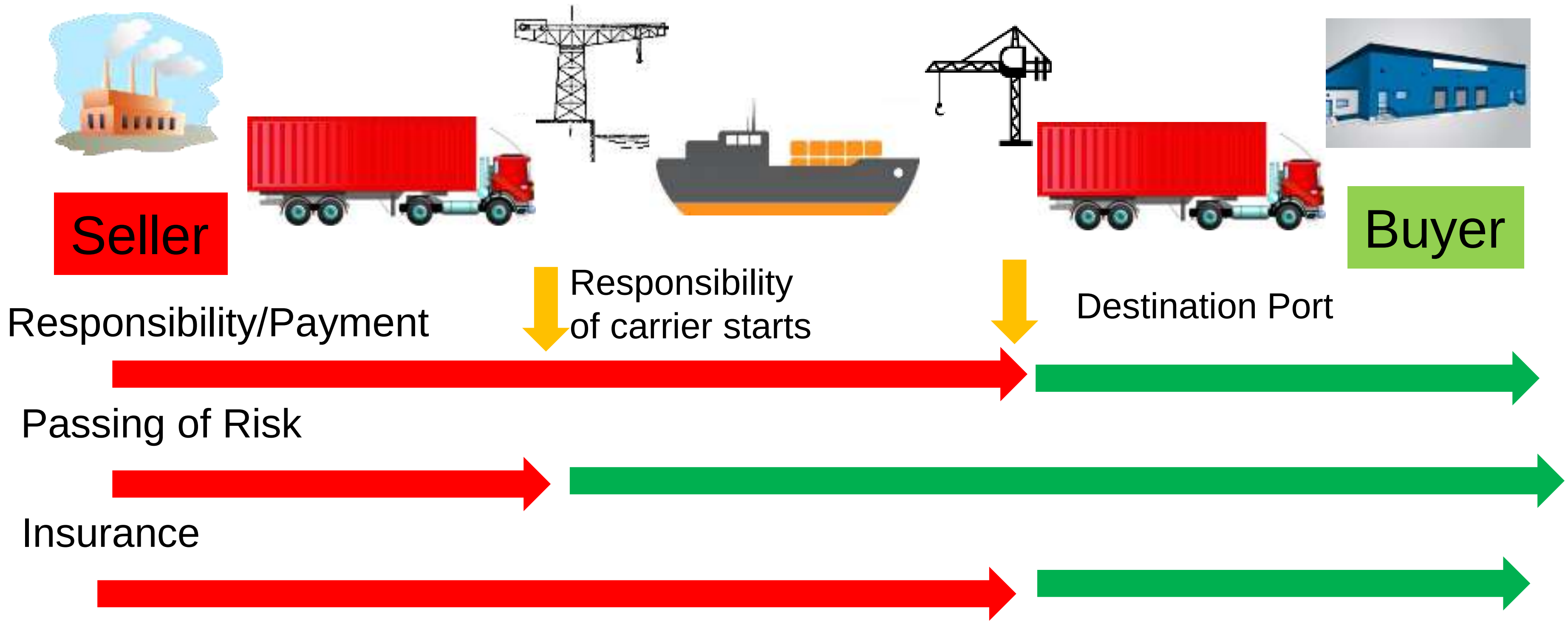
- Seller responsible for delivery of goods cleared for export, and for the loading on the vessel at the named port
- Seller is not obliged to insure goods during pre-carriage
- Buyer is responsible for risk/costs once cargo has been loaded

COST AND FREIGHT (named port) - CFR



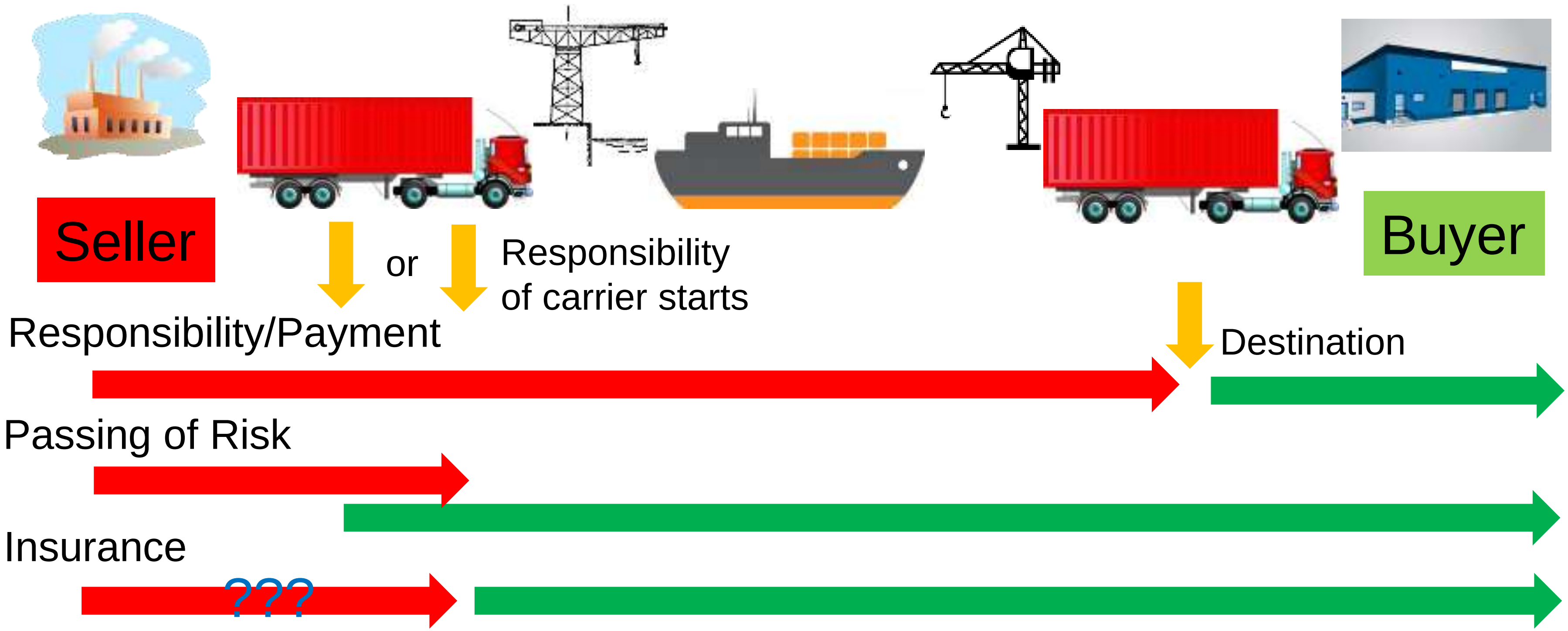
- Seller responsible for arranging/paying for carriage to named port, but not for insurance
- Risk transfers from seller to buyer at loading port – this should be spelled out
- Buyer may therefore wish to take out insurance from this point

COST INSURANCE AND FREIGHT (named port) - CIF



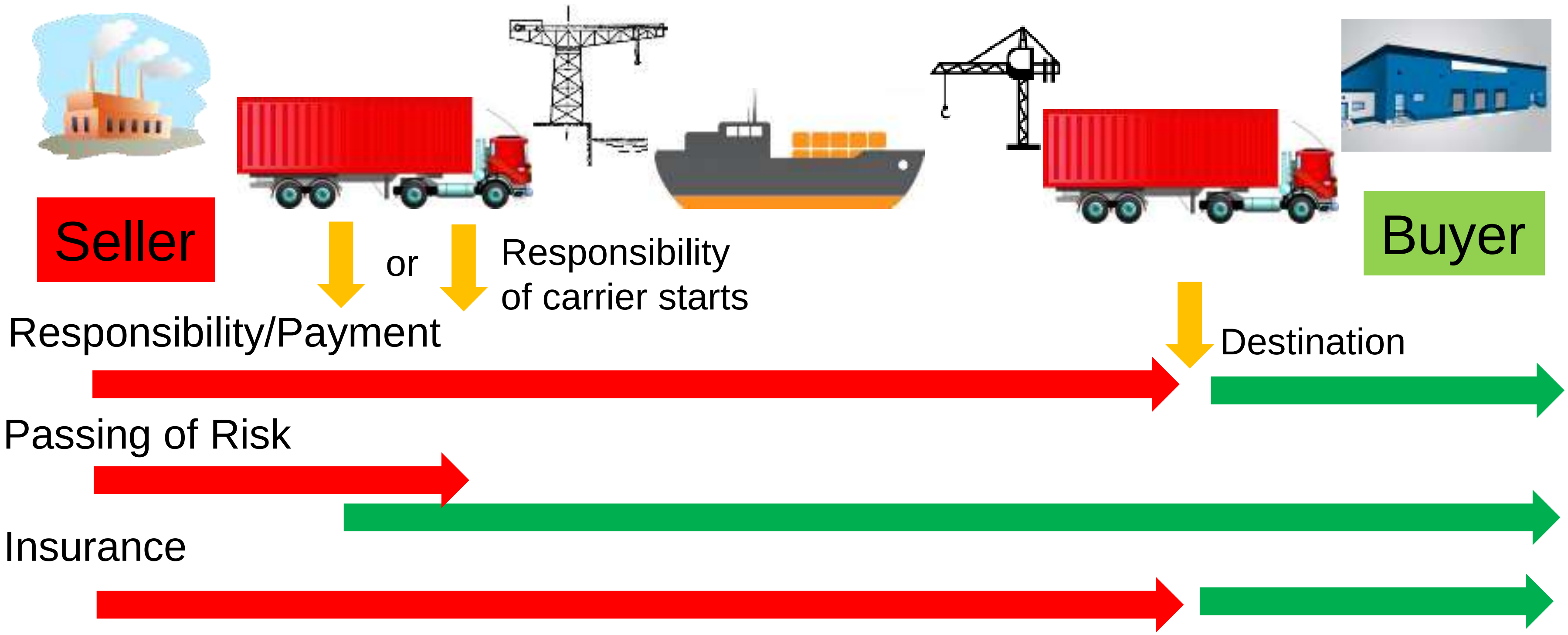
- Seller responsible for arranging/paying for carriage to named port, and for insurance (insurance for the buyer’s benefit)
- Risk transfers from seller to buyer at loading port – this should be spelled out

CARRIAGE PAID TO (named place) - CPT



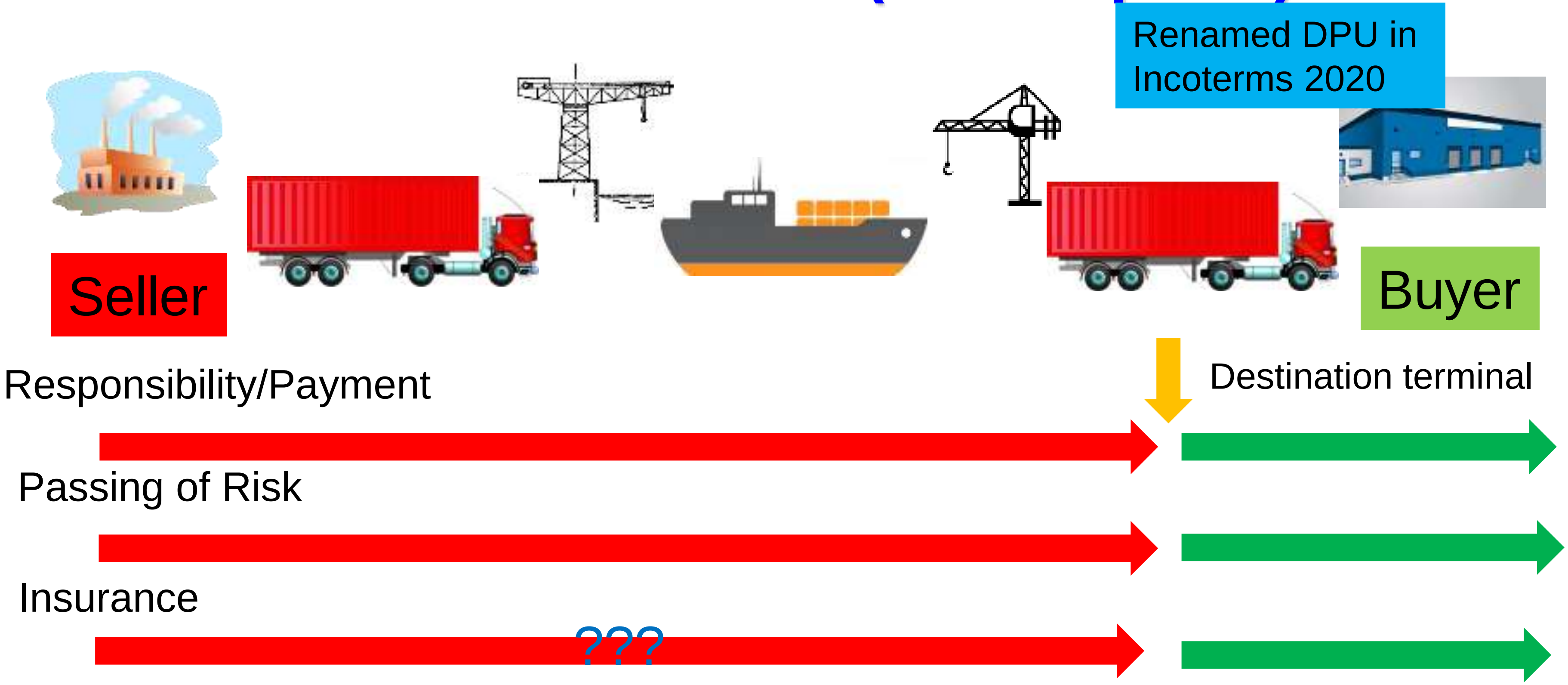
- Seller responsible for arranging/paying for carriage to named place, but not for insurance
- Risk transfers from seller to buyer at point where first carrier takes responsibility – this should be spelled out
- Buyer may therefore wish to take out insurance from this point

CARRIAGE AND INSURANCE PAID TO (named place) - CIP



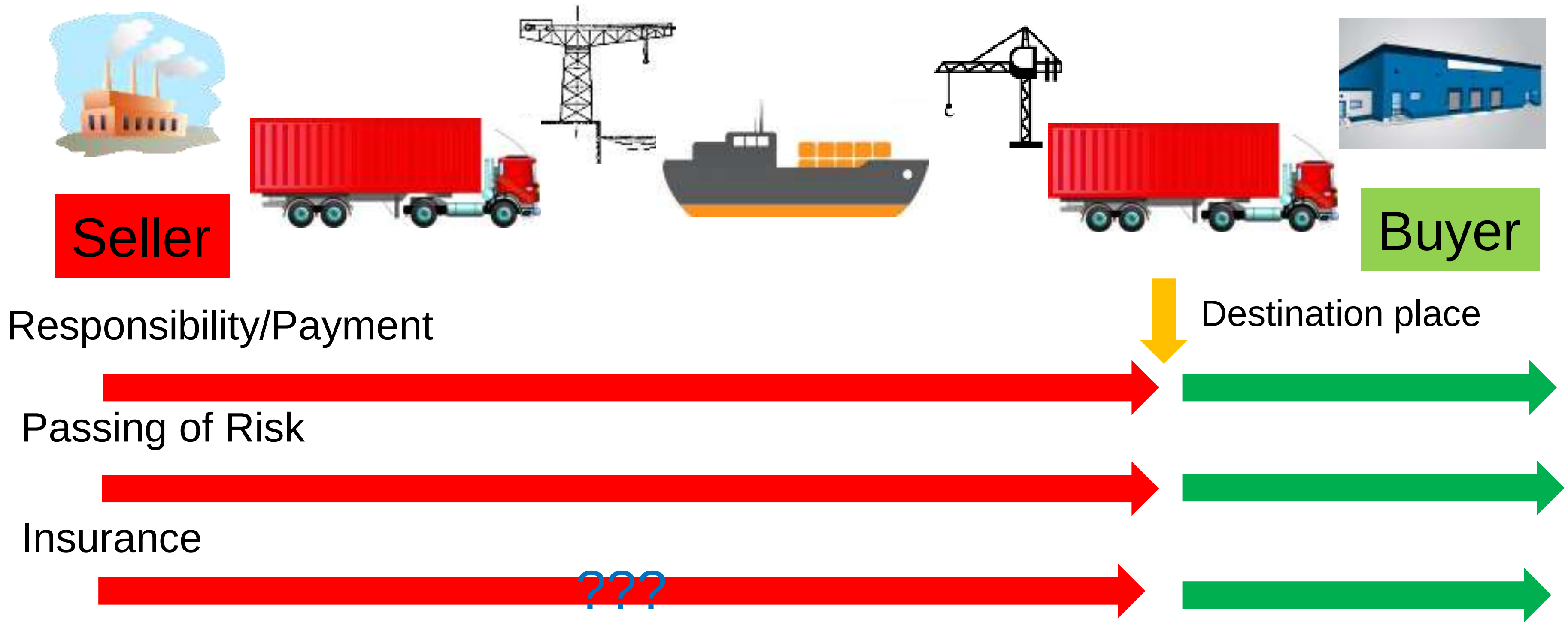
- Seller responsible for arranging/paying for carriage to named place
- Risk transfers from seller to buyer at point where first carrier takes responsibility – this should be spelled out
- Seller takes out insurance for the buyer’s benefit to cover main carriage

DELIVERED AT TERMINAL (named place) – DAT



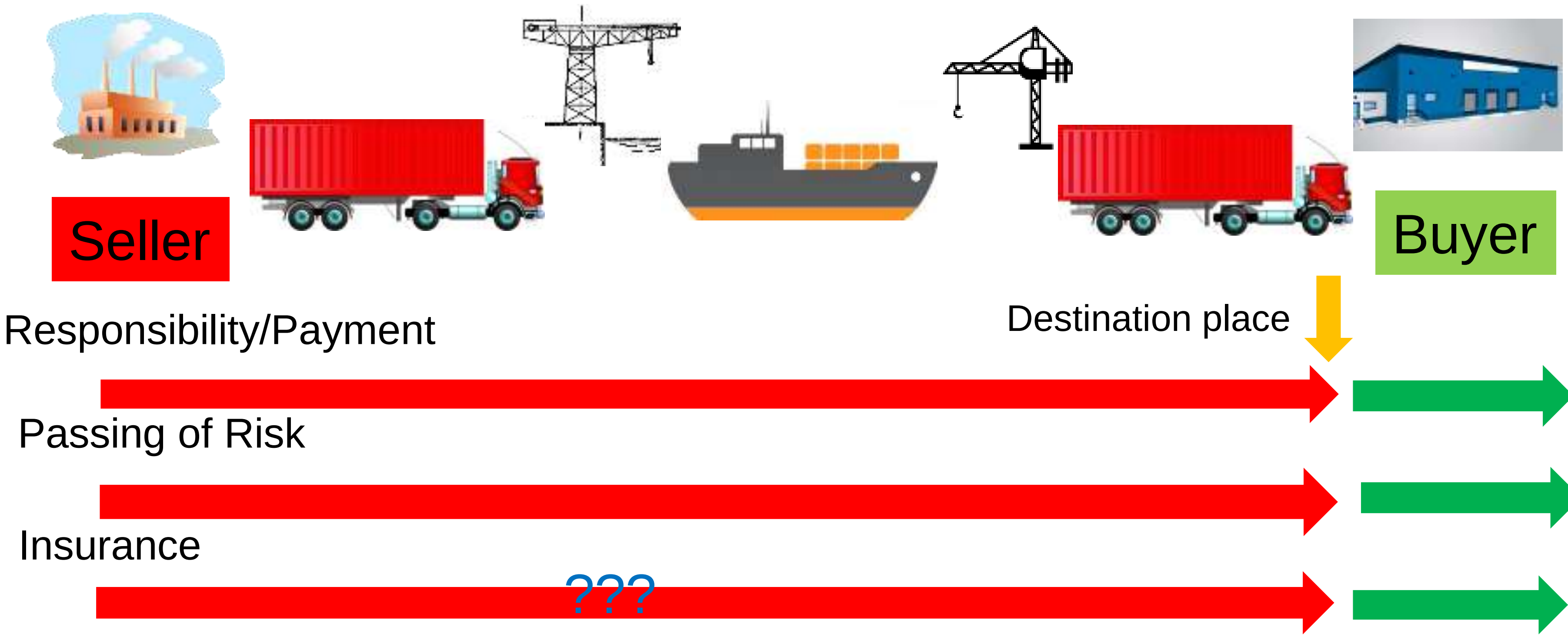
- Seller responsible for arranging/paying for carriage to named terminal, and for delivering goods, **unloaded**, at that point
- Terminal can be any place – quay, container yard, warehouse
- Buyer is responsible for import clearance
- Seller bears risk during transport – their choice whether to insure

DELIVERED AT PLACE (named place) - DAP



- Seller responsible for arranging/paying for carriage to named place, **ready for unloading**
- Risk transfers when ready for unloading which is at buyer's risk
- Buyer is responsible for import clearance
- Seller bears risk during transport – their choice whether to insure

DELIVERED DUTY PAID (named place) – DDP



- Seller responsible for arranging/paying for carriage to named place, **ready for unloading**
- Risk transfers when ready for unloading which is at buyer's risk
- **Seller** takes responsibility for import clearance, taxes etc.
- Seller bears risk during transport – their choice whether to insure

INCOTERMS 2020 – SUMMARY OF CHANGES

- DAT changed into DPU (Delivered at Place unloaded)
- Change in required level of insurance for CIP to provide increased level of cover for container shipments (Institute Cargo Clause A)
- No change to insurance for CIF (Institute Cargo Clause C)
- Clarification in the detail for e.g. cost allocation, security requirements, use of own transport
- Addressing issues for FOB vs FCA when shipper requires a shipped on board b/l to comply with letter of credit

How to choose an Incoterm

- Which party wishes to control the main transport activity??
- ‘E’ or ‘F’ term will suit an importer with a strong supply chain (‘JIT’)
- FCA is useful for an importer who wishes to consolidate shipments at origin
- ‘C’ or ‘D’ term if exporter wishes to control shipping and/or importer wants goods at a known price in the destination country
- Do you want to be responsible for customs and other formalities in a foreign country? (if not, avoid EXW and DDP)
- Only choose a ‘maritime’ term if carriage by ship or inland waterway
- FOB and CIF are ‘traditional’ and popular terms but FCA or DAT may be more appropriate for container shipments
- Can be confusion over who pays the THC for a container shipment (spell it out in the contract of sale)
- Ultimately it is a matter of commercial negotiation between buyer and seller

How (not) to choose an Incoterm

- Buyer chooses DPP rather than EXW or FOB so he doesn't have to pay the transport costs (and import duties)?
- But **this doesn't work** because seller will quote a cheaper price for goods sold EXW than sold DDP
- A seller should always specify the Incoterm when quoting a price

  e.g $8 per widget FOB Rotterdam

  $12 per widget DAT Durban Terminal
- So unlikely to save money through choice of Incoterm – unless one party thinks they can get a cheaper freight rate than the other party
- Choice of Incoterm is more about control and risk

INCOTERMS QUIZ 1 (1)

How many different Incoterms could be used for the carriage of goods in a container by sea from Shanghai to Rotterdam

- 4
- 11
- 7
- 1

INCOTERMS QUIZ 1 (2)

Which Incoterms require the seller to take out insurance?

(a) All Incoterms require insurance to be taken out

(b) All the ‘C’ terms require that the seller takes out insurance

(c) There is no obligation on the seller to take out insurance

(d) The seller is required to take out insurance under CIF and CIP

INCOTERMS QUIZ 1 (3)

In which Incoterms is there a **difference** between

(a) The points where the buyer takes over the risk for the shipment and

(b) The point where the buyer starts meeting the transport costs

(a) All the ‘C’ terms

(b) All the ‘F’ terms

(c) CFR and CIF only

(d) None of the Incoterms

INCOTERMS QUIZ 1 (4)

A major importer of consumer goods based in the USA buys from a number of different suppliers in China.

The importer wants to arrange for the consolidation of different shipments in China in order to optimise the utilisation of containers.

Which Incoterm would you recommend that the importer uses?

- CIF
- EXW
- FCA
- FOB

Methods of Payment in International Trade

- Open Account
  - Payment by bank draft or credit transfer
  - Issue of **when** payment is to be made, given time involved between despatch and receipt of goods
  - A degree of trust is involved – used for shipments within a company/group, or when there is a long standing relationship between seller and buyer
  - Also used for short sea passages, where time elapsed is short
- Bills of Exchange
  - Stipulates for payment to be made by a bank at a future date e.g. a ’30 Day Bill’
  - The date may be set as a compromise between date of despatch and date of receipt of goods
  - A bill of exchange is a negotiable instrument – if you don’t want to wait for your money, you can sell the bill to a bank at a discount for immediate payment
  - However it can’t be cancelled once issued – so to an extent the buyer still takes it on trust that the cargo will arrive as expected
- Documentary Credits/Letters of Credit
  - Next slide

Documentary Credits

- Also referred to as **Letters of Credit:**
- One method for financing international sale contracts, and for transferring funds between the buyer and the seller
- This method gives a degree of protection to both buyer and seller by interposing banks in the transaction so providing a guarantee to the seller that they will be paid once the goods have been shipped
- The buyer has the reassurance that the seller will only be paid once the seller has lodged agreed documents with the bank, which will include:
  - Shipped on board bill of lading
  - Commercial invoice
  - (if required) cargo inspection certificate
- The transaction is carried out against a transfer of documents, rather than a physical transfer of goods.

Let's have a look at the process involved

Documentary Credits (1)

- First, the buyer and seller must conclude the contract of sale which will stipulate that the transaction will be carried out via a documentary credit

Documentary Credits (2)

- First, the buyer and seller must conclude the contract of sale which will stipulate that the transaction will be carried out via a documentary credit

Contract of Sale

Buyer → Advising Bank → Confirming Bank → Seller

- instructs bank to open L/C
- advises seller

- passes details to confirming bank (in seller's country)
- confirming bank 'confirms' to advising bank and seller

Cargo is shipped

Documentary Credits (3)

- First, the buyer and seller must conclude the contract of sale which will stipulate that the transaction will be carried out via a documentary credit

Contract of Sale

Buyer → Advising Bank → Confirming Bank → Seller

- instructs bank to open L/C
- advises seller

- passes details to confirming bank (in seller's country)
- confirming bank 'confirms' to advising bank and seller

Cargo is shipped

- documents passed to buyer in return for payment

- documents pass from confirming bank in return for payment

- seller presents agreed documents to the bank
- as long as they conform to L/C, shipper is paid

Documentary Credits (4)

- First, the buyer and seller must conclude the contract of sale which will stipulate that the transaction will be carried out via a documentary credit

Contract of Sale

Buyer → Advising Bank → Confirming Bank → Seller

- instructs bank to open L/C
- advises seller

- passes details to confirming bank (in seller's country)
- confirming bank 'confirms' to advising bank and seller

Cargo is shipped

- documents passed to buyer in return for payment

- documents pass from confirming bank in return for payment

- seller presents agreed documents to the bank
- as long as they conform to L/C, shipper is paid

Buyer surrenders B/L and takes delivery of cargo

Cargo is transported to destination

Types of Documentary Credits

Irrevocable letter of credit

- Cannot be cancelled or modified without the consent of the seller

Confirmed letter of credit

- The confirming bank guarantees the payment to the seller, even if the buyer’s bank (the advising bank) fails to pay

Transferable letters of credit

- Can be transferred from one ‘beneficiary’ (person receiving payment) to another.
- Used when the transaction is passed through an intermediary

Standby letters of credit

- This is a ‘back up’ assurance from a bank that a buyer is able to pay a seller. The seller doesn’t expect to have to draw on the letter of credit to get paid (payment will take place by other means)

Revolving letters of credit

- Covers more than one transaction between the same buyer and seller.

Sight letters of credit

- Payment is to be made on presentation of the documents (**deferred term letter of credit** if payment is to be made at a fixed future date)

Key information in a letter of credit

- Names and addresses of the Buyer and Seller
- Names and addresses of Advising and Confirming Banks
- Description of goods
- Main terms and conditions as per contract of sale (incl INCOTERM)
- Documents which are to be provided
- Date of expiry of the letter of credit
- Ports to be shipped from and to
- Date by which goods must be shipped
- Payment terms/amount/currency
- Is partial shipment/transhipment allowed?
- Who is responsible for insurance
- UCP600 terms included

What documents are normally required

- Bill of Lading (specify number of originals)
  - Clean and endorsed 'shipped on board'
- Insurance documents
- Certificate of origin
- Packing List
- Commercial Invoice
- Inspection Certificate (if it is specified that the goods are to be inspected for quantity/quality before shipment)

UCP600

- Uniform Customs and Practices for Documentary Credits
- Rules of engagement between the parties to a Letter of Credit
- Produced by ICC, in co-operation with major banks
- UCP600 = 6th edition (2007)
- Examples of articles with particular relevance to shipping aspects:
  - Article 5 Documents vs Goods, Services or Performance
    - Makes it clear that banks only deal with documents
  - Article 14 Standard for Examination of Documents
    - Spells out timescales, compliance with dates, data does not have to be identical as long as it does not conflict
  - Article 17 Original Documents and Copies
    - What constitutes an original document
  - Article 20 Bill of Lading
    - Requirements of a bill of lading; acceptability of transhipment clauses in the B/L
  - Article 26 Acceptability of various clauses on the B/L
    - Deals with clauses such as ‘on deck’, ‘shipper’s load and count’, ‘said to contain’
  - Article 27 Clean Transport Documents
    - What is a clean document

Documentary Credits - Summary

- One way of financing ‘arms length’ transactions
- Gives a level of financial security to both buyer and seller
- Transaction is carried out based on documents not physical goods – therefore accuracy of documents is critical
- UCP600 provides standard terms – so that there is consistency in how banks check documents etc.

HOWEVER

- Contract of Sale is still the vital document with the important commercial terms between the parties
- A Letter of Credit is no substitute for a good relationship between buyer and seller, and confidence being established between the parties

Documentary Credits Quiz 2 (1)

1 Why might a seller insist on having a ‘confirmed’ letter of credit?

(a) They want to have an email confirmation that the buyer has opened the letter of credit

(b) If the L/C is confirmed, the buyer cannot cancel or amend it

(c) A ‘confirmed’ L/C guarantees the payment by the bank in the seller’s country, even if there is a problem with the buyer or the buyer’s bank

(d) The seller doesn’t trust the buyer

Documentary Credits Quiz 2 (2)

2 Why might a buyer and a seller decide to use a Letter of Credit in their contract of sale

(a) To prevent fraud

(b) Because both the buyer and the seller need to borrow money

(c) To provide a level of assurance to both parties to the contract of sale

(d) Because the buyer doesn’t trust the seller

Documentary Credits Quiz 2 (3)

3 What wording on a bill of lading might lead to it being rejected when presented by the shipper to the confirming bank (tick all which apply)

(a) There is a clause on the face of the bill of lading which states that cargo is damaged

(b) There is no wording 'clean on board' on the bill

(c) For a container shipment, the bill of lading allows transhipment but the L/C prohibits transhipment

(d) There is not a clear statement that the cargo has been shipped on board with a date

Questions from Past Exam Papers

Define and explain any FOUR Incoterms 2010 terms and where the selected terms would be best applied for specific cargo

(November 2019 Q4)

Answer BOTH parts of the question.

Incoterms 2010 is an essential shipment term in international sale contracts with FOB and CIF being amongst the most popular

(a)Explain and contrast these two terms with regard to an FCL shipment from both a seller's and buyer's point of view

(b)Explain TWO terms from the list below:

(i)DDP

(ii)CPT

(iii)DAP

(iv)EXW

(November 2015 Q3)