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The right clause for worldwide container shipping

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It is well known that about 70% of all general cargo is transported in containerships.

There are currently around 5,400 container ships worldwide. The Ever Ace of the Taiwanese shipping company Evergreen, for example, is the world's largest container ship; measuring 400 meters in length and 61.5 meters in width, it accommodates 23,992 standard 20-foot-containers (TEU), i.e. around 10,000 large 40-foot-containers.

Containers come in a variety of sizes, and virtually all sizes can be stacked on top of each other; according to ISO minimum requirements (ISO 668:2013), at least six fully loaded containers must be able to be stacked on top of each other, but many containers are designed to stack nine or more fully loaded containers.

The average container loss per year is about 1,500 units, which is about 0.001% of the total number of containers transported. About 2/3 of the losses are due to disasters.

Freight rates peaked in September 2021 at USD 10,323 for a 40-foot-container. By comparison, freight rates averaged only USD 1,290 in November 2019 and USD 2,443 in November 2020. These values are averages of all shipments on all routes. freight rates for shipments from China and Southeast Asia are many times higher than shipments on the return journey, as many more goods are exported in containers from this region than are imported. Many containers are shipped back to Asia from the USA and Europe completely empty, only to be refilled there.

I. What are Incoterms?

Over the years, standardized, predefined commercial terms have been developed to shorten the time needed to negotiate such transactions. The best known of these predefined terms are the International Commercial Terms (Incoterms).

The Incoterms were first introduced in 1936 by the International Chamber of Commerce (ICC, Paris). Since 1980, they have been adapted every ten years to changing legal, economic and technological circumstances.

Every international contract of sale of goods should contain an Incoterm clause regulating important issues such as the time, place and manner of transfer of the goods, payment of shipping costs, insurance and customs and, in particular, the regulation of the transfer of risk

The latest version of the Incoterms was published in 2020. However, older versions may still be used if the parties so wish. Therefore, it should be explicitly stated which version of the Incoterms is to be applied, e.g. "Incoterms 2020".

Regulation of Incoterms at a glance:

Incoterms **regulate** the rights and obligations of the parties with respect to:

- delivery and transport documents (or equivalent electronic communications);
- sharing of costs for buyer and seller for freight, export or import duties, taxes, insurance, etc.;

- the transfer of the risk of (accidental) loss of the sold goods (due to accidents, force majeure, theft or similar).

The Incoterms **do not regulate**:

- The transfer of ownership and other rights arising from ownership;
- breach of contract and its consequences;
- description or quality of the goods;
- the time and method of payment;
- the applicable law; or
- issues related to specifiers/transporters.

II. Applicability

The Incoterms shall only apply if the (two or more) trading parties have expressly declared their applicability in the purchase contract itself or if they have been validly included and agreed in the relevant offer, the general terms and conditions of purchase or sale, the purchase order, the order confirmation, etc. Most clauses are multimodal, i.e. they can be used for a variety of transport modes.

Due to the differences between the various versions (e.g. Incoterms 2010 and 2020), a blanket reference to the "Incoterms" can lead to significant problems. In addition, it is important to specify the destination point. Without this specification, the Incoterm is useless since it is not clear where exactly the goods are to be provided or delivered.

Therefore, the Incoterms should be agreed in the contract as follows:

1. indication of the specific Incoterm
2. indication of the place of destination
3. reference to the relevant version of the Incoterms

Template for a delivery clause: "*Delivery shall be made* FCA BANGKOK- *Pratunam Storehouse Hall 5*, Incoterms 2020."

If necessary, a letter of credit can be used to process international payment transactions.

III. Categories of Incoterms

Incoterms clauses can be roughly divided into the following four groups:

(1) The E-Clauses (EXW) as pure pick-up clauses, where the seller's only obligation is to make the goods available to the buyer at the seller's premises;

(2) The F-Clauses (FCA, FAS and FOB) as so-called one-point clauses, where the seller has to deliver the goods to a carrier appointed by the buyer;

(3) The C-Clauses (CFR, CIF, CPT, and CIP), which are two-point clauses that require the seller to arrange for transportation of the goods but do not assume the risk of loss or damage to the goods or additional costs resulting from events occurring after shipment; and

(4) The D-Clauses (DAT, DPU and DDP) as so-called arrival clauses, where the seller bears all costs and risks for the delivery of the goods to the final destination.

The main distinction introduced by Incoterms 2010 between the "*clauses for all modes of transport*" (EXW, FCA, CPT, DAP, DPU – formerly DAT – and DDP) and the "*clauses for sea and inland waterway transport*" (FAS, FOB, CFR and CIF) is maintained in Incoterms 2020.

The four "*sea clauses*" are intended for situations where the seller unloads the goods on board of a particular ship (or alongside if the

FAS clause is chosen). This is the place where the delivery of the goods from the seller to the buyer takes place. When using these clauses, the buyer bears the risk of loss of or damage to the goods from this specified place.

The seven "*multimodal*" transportation clauses, on the other hand, are intended for use in situations where

- the point at which the seller hands over or makes the goods available to a carrier, or
- the point at which the carrier hands over the goods to the buyer, or the point at which the goods are made available to the buyer, or
- the places already mentioned are not on board (or, if the FAS clause is chosen, alongside) a vessel.

IV. The right clause for container goods

In the past, the FOB clause was used in container traffic in addition to the CIF clause. However, the FOB clause does not correspond to the actual processes in container shipping.

The FOB clause is as a "*sea clause*" only for sea and inland waterway transport initially intended. According to the FOB clause, delivery must be made on board the ship at the named port of shipment. In order to pass the risk of loss or damage to the goods to the buyer, the containerized goods must be set down on the cargo deck (This is an innovation of Incoterms 2020; previously, the risk passed when the goods (first) crossed the railing of a ship. This had the unfortunate consequence that it made a difference for the passing of risk whether the goods fell into the water or onto the deck during loading). In modern container traffic, the seller actually always hands over the container to the carrier ex works. From this moment he also loses any possibility of influence over his container. The loading of the ship itself is then handled exclusively by the container terminal. Thus, the FOB-Clause is not suitable for container traffic.

For general cargo and bulk cargo transported on conventional cargo ships the FOB clause is still suitable.

V. Recommendation: Agree on the FCA clause

According to the Incoterms 2010 the following problem existed: Very often the financing of the sales contract is secured by a documentary Letter of Credit issued by a bank.

In many cases, the banks require a Bill of Lading with an On-Board Endorsement, a so called On-Board Bill of Lading, which proves that the (ordered) goods have been loaded (intime) on the (correct) ship in order for the disbursement conditions to apply. I.e. only when the bank has the On-Board Bill of Lading will it service the Letter of Credit (LC).

However, the FCA terms did not provide for the issuance of an On-Board Bill of Lading until 2020.

Under the FCA terms (A6/B6) of Incoterms 2020, the contracting parties can now agree that, in accordance with the FCA, delivery will be made to a container terminal, but that the buyer will instruct its carrier to provide the seller with an On-Board Bill of Lading. The seller can then present this to the bank confirming the Letter of Credit (LC) and thus receive payment from the LC. This adaptation of the FCA clause takes into account the interests of the seller, who regularly cannot and does not want to assume liability for the handling at the export terminal/port.

We hope that the information provided in this brochure was helpful for you.
If you have any further questions, please do not hesitate to contact us.

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