# The FOB and CIF Contracts

The FOB (Free On Board) and CIF (Cost, Insurance and Freight) contracts are involved with international export sale contracts also called 'export transactions', although the FOB contract is loosely used in local commercial transactions [1] . These terms have been put in place so as to maintain uniformity, certainty and predictability in international trade agreements.

These terms are not strictly binding as a standard on the parties to the export contract as they can be modified [2] by agreement or necessity as the parties have the freedom to contract. These contracts are part of the standard trade terms developed by the International Chamber of Commerce (ICC) called Incoterms 2010 [3] and have been constantly modified to fit in with commercial practice of the time since they were first established in 1936. These trade terms are important to international export sale contracts as they set out the duties and obligations of the contracting parties including price, method of delivery and any other incidental charges relating to the transaction. [4]

## FOB Contract

The case of Pyrene [5] established that there are three types of FOB Contracts, indicating the flexible nature of such contracts.

Strict or Classic FOB Contract

FOB " with additional services"

"Simple" FOB

In the classic FOB contract, the seller is free of any obligation to pay insurance and freight [6] but undertakes to place the export goods board a nominated vessel and port of shipment. The buyer nominates the carrier [7] , obtains insurance and bears the costs of ocean freight to port of destination including all other costs incidental to shipping and unloading. However, the seller has to obtain a clean bill of lading and tender it together with other documents to the buyer [8] once the goods have crossed the rail and been safely placed on board ship.

The Seller has the following obligations:

Supply conforming goods in accordance with the contract.

Deliver the goods by placing them on board nominated ship and port of shipping.

Pay any costs up to delivery, i.e. when goods have safely crossed the ship's rail.

Obtain export licence and bill of lading

Produce a commercial invoice

Tender documents to the buyer.

This means that the total price quoted by the seller will be lower as it only includes the price of the goods, in-land transportation, export documentation and other charges incidental to the export up to the placing of the goods on board ship.

The seller is absolved from all liability once the goods have passed the ship's rail and been placed on board ship which is an advantage as he does not need to worry about freight, insurance and destination costs as long as he tenders the necessary documents to the, hence the main difference with a CIF Contract.

Buyer's Obligations

Notify the seller of nominated vessel and port of shipment.

Receive the goods.

Pay for the goods and incidental charges.

The FOB Contract is advantageous to the buyer in that he controls the movement of the goods from the seller in as far as controlling the time of shipment and would negotiate reduced insurance and freight charges when they contract with companies that they frequently do business with.

## CIF Contract

This type of contract resembles the FOB "with additional services" and is the most comprehensive and widely used international export trade contracts [9] and embodies three different contracts.

Contract of sale between seller and buyer.

Contract of carriage (seller/carrier and buyer/carrier). [10]

Contract of marine insurance.

The seller's obligations include the following [11] :

Ship the goods as described in the contract and within agreed shipping period [12] .

Arrange for marine insurance.

Obtain a bill of lading evidencing the contract of carriage by sea.

Procure a contract of carriage.

Produce a commercial invoice.

Tender the documents to the buyer to effect payment. [13]

In a CIF contract, the price paid by the buyer would normally be inclusive of all costs up to the agreed port of destination at which point the buyer has a duty to receive the goods. This type of contract as can be seen from above frees the buyer form the seller's local export customs. Also, this eases the work burden on the buyer of arranging for insurance and freight as he might find it difficult in a foreign country.

This type of contract is advantageous to the seller as he is more conversant with the local export customs and would negotiate reduced rates on insurance and freight as a regular exporter and hence reducing the costs for the importing party.

Buyer's duties

To accept the documents.

Receive the goods at agreed port of destination.

Bear all costs incidental to the export.

The buyer has to accept the documents even though the goods have not arrived at the port of destination and without knowing as to the condition of the goods at sea as the buyer is protected against damage or loss whilst in transit.

The CIF is advantageous to the buyer as the documents could be used as security to obtain bank credit or could sell the goods whilst on high seas if they are for trade purposes.

## 2. ABC / XYZ CIF Contract

## Passing of risk and title

It should be noted that the passing of risk from the seller to the buyer is when the goods have been safely placed beyond the ship's rail [14] and this point also indicates the passing of property in the goods. [15] However, it has been held in some instances that whilst risk passes when the goods cross the ship's rail, the title to property only passes when the buyer receives the documents and makes payment [16] .

The contract between ABC and XYZ was CIF, which would be termed as CIF-Hamburg indicating the port of destination.

According to a CIF contract, the goods should conform to the contract terms as to their description and the seller has a duty to deliver such goods as described.

The scenario where the seller has delivered goods not as described in the contract would render the contract invalid 'ab initio'. However, the parties could reach an agreement so as to remedy the breach as commercial trading partners as they have the freedom to contract.

## Bill of lading (500 damaged boxes)

The bill of lading noted some containers as being 'slightly damaged' and such qualification as to the state of the goods is not clean and converts it to a 'received for shipment bill of lading' although it has been held to be clean in some instances [17] .

The indication of 'slight damage' means that the damage occurred before the goods crossed the ship's rails, so termed the legal frontier [18] between the seller and buyer and hence the seller should be held liable [19] .

Advice:

XYZ would be advised that they could recover for the damaged items from the seller by way of either replacement of damaged items or recovery of price and damages.

## Insurance policy (500 undelivered boxes)

Marine insurance covers the buyer from any loss or damage to goods during shipment and hence XYZ should be able to off-set the loss against the marine insurance cover as the consignment was insured against loss.

Advice:

XYZ will be able to recover the loss as the goods were covered by marine insurance for any loss or damage whilst in transit.

## Seller to deliver conforming goods

According to the CIF Contract terms, the seller is under obligation to deliver conforming goods as per contract. The 1000 boxes of 'red memory sticks' are incorrect items and hence not conforming goods as per CIF Contract terms. This is in breach of contract and XYZ would be held liable for supplying goods not conforming to the CIF contract.

Advice:

XYZ would be able to recover for the 1000 boxes of incorrect items supplied by either the buyer replacing the items with memory sticks of the correct colour refund of cost price and damages.