FOB Contracts: An Examination of Their Principles and Practical Application in Internal Trade

by

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Introduction

This article is a brief study of various legal aspects and practices of international trade; principally those drawn from the personal experience of the writer in conducting an export company owned by himself. For commercial reasons all references to that particular company have been deleted from this article, however the broad overview and commentary on FOB contracts has been retained. The article studies certain aspects of the export trade from New Zealand: in particular, FOB sales and the obligations of the buyer and seller, and documentary letters of credit. The writer has attempted to show how the law of international trade can be applied to a practical export situation, and vice versa. However, because of the special interests of the writer, some areas of the law are considered in detail, whereas other areas of the law of international trade are not discussed, depending upon the relevance to the writer's export operations.

FOB Contracts

Before discussing FOB contracts generally, it should be stated that it is not possible to construe the FOB terms in a contract as terms of price only, rather than as terms of shipment and delivery. The FOB term is very flexible, allowing it to take account of the various factors concerning a particular transaction. The FOB contract has, in effect, evolved with the development of trade practices, and different variants of FOB contract now exist. Thus, definitions which are applicable to one type of FOB contract might not be applicable to another type. Recognition of the variation in FOB types by the courts in *Pyrene v Scindia Naviga-*

tion Co Ltd[1] marked a legal "turning-point", after which a less dogmatic and more flexible approach was adopted by the courts. Considerable variation is therefore allowed in FOB contracts.

In *N.V. Handel My. J. Smits Import-Export v English Exporters Ltd*[2] it was stated that a contract does not cease to be FOB, merely because the seller has agreed to secure the shipping space. An extreme example of the variation permitted in FOB terms is seen in *Carlos Federspiel & Co S.A. v Charles Twigg & Co. Ltd*[3], where the contract was held to be FOB, even though the seller agreed to pay for the freight and insurance.

The cases of *Stock v Inglis*[4] and *J. Raymond Wilson & Co. Ltd v N. Scratchard Ltd*[5] allow one to determine two basic functions of the FOB term. Firstly, the seller must pay the cost and bear the responsibility of putting goods "free on board" a ship. The seller must therefore bear full liability for the cost and safety of the goods until they pass over the ship's rail. Secondly, delivery is then completed, and the risk in the goods is thereupon transferred to the buyer.

These are, however, only the most basic and essential features of the FOB term. There are also a number of marginal responsibilities and expenditures which must be considered in every potential FOB contract. It is these marginal responsibilities which often lead to controversy and litigation between FOB parties, as there is no precise division of responsibilities under an FOB contract.

"Strict" FOB Variant

FOB contracts can be classified by their features, under three major headings, termed as the "strict", the "additional services" and the "shipment to destination" variants.[6] The "strict" FOB term and the "additional services" variant will be studied in detail.

Detailed definitions of the FOB term have been suggested by various trade and export organisations and institutions — however the courts appear to avoid relying on such definitions, because of the wide variation between individual contracts.

The UK Institute of Export definition of the FOB term[7], however, provides a good example of the "strict" interpretation of the term. Under this definition, the seller's responsibilities are as follows (paraphrased as far as is relevant to the NZ context):

1. To make available at the port of loading and to ship free on board goods answering in all respects the description in the contract of sale.

*LLB.

1 [1954] 2 QB 402, 424.
2 [1957] 1 Lloyd's Rep. 517, 521.
3 [1957] 1 Lloyd's Rep. 240.
4 (1884) 12 QBD 564, affirmed by HL (1885) App Cas 263.
5 (1944) 77 Ll. L. Rep. 373, 374.
6 Sassoon & Merren, *CIF and FOB Contracts* (3rd ed. 1984) para 441.
7 14 *Export* (1951) 221 et seq, paras 19-20.

2. To pay all handling and transport charges in connection with the above operation.
3. To meet all charges arising in connection with the goods up to the time of their passing over the ship's rail.

Under the Institute of Export definition, the FOB buyer's responsibilities are as follows:

1. Advise the seller in good time on what ship at the port of loading agreed in the contract the seller has to put the goods free on board.
2. Secure shipping space in the designated vessel.
3. Obtain an export licence where necessary.
4. Designate an effective ship in time to enable the seller to deliver within the period agreed in the contract.
5. Enter and declare the goods at customs . . . and meet all charges arising from the making of such an entry.
6. In the event of a breakdown of his arrangement with the ship arrange for substitute vessel or vessels with the least possible delay, and pay all additional cost of transport, rent, and other charges incurred on account of substitution and/or transfer.

This interpretation is known as the "strict" or "classical" variant of FOB contract, because it requires the performance of a lesser number of responsibilities by the seller than other interpretations.

Schmitthoff has also suggested[8] the following additional obligation of the seller:

> 4A To comply with [section 34 (3) Sale of Goods Act 1908] which provides that the seller must give the buyer such notice as would enable him to procure marine insurance for the goods, failing which, the seller retains the risk of loss during sea transit.

It is therefore the duty of the buyer to arrange the freight and marine insurance cover. These expenses have to be paid by the buyer, and thus if the seller has given the buyer credit, the seller should perhaps take out contingency insurance relating to the goods.

Nomination of Vessel

The buyer's duty, under the "strict" definition to nominate the vessel, requires further discussion. Although the ship or line upon which the goods are to be delivered is sometimes specified in the contract, where this is not done it is the duty of the buyer to inform the seller of the name of the effective ship in which he has booked shipment space or chartered, and of the date when the vessel will be available for loading. This duty of the buyer is a condition precedent to the obligation of the seller to load goods under the contract.

The seller is entitled to claim damages for the delay caused by the buyer's omission to name a ship — however the seller will not be able to claim the purchase price if the buyer has not nominated an effective ship since property in the goods will remain with the seller. Thus, in *Colley v Overseas Exporters*[9] the seller was only entitled to damages,

[8] Schmitthoff, *Export Trade — The Law and Practice of International Trade* (8th ed. 1986).

[9] [1921] 3 KB 302.

and not to the purchase price, in a case where the buyer failed to name a ship (due to a chain of unfortunate circumstances) and therefore property in the goods never passed to the buyer.

Because of this uncertainty, the seller is well advised to insist on a contract clause requiring the purchase price to become due on a fixed date, whether or not an effective ship has been named.

Some FOB contracts require that the buyer's notice of the vessel's nomination and readiness to receive delivery of the goods be given to the seller some time in advance of delivery. Then, if the buyer fails to nominate a vessel on time, he is in breach of a condition of the contract, and the seller may refuse to make delivery, as was decided in *Bunge Corp v Tradex Export S.A.*[10]. In this case it was held that:[11]

> The court will require precise compliance with stipulations as to time, wherever the circumstances of the case indicate that this would fulfil the intention of the parties . . .

and that:

> it is clearly essential that both buyer and seller . . . should know precisely what their obligations are, most especially because the ability of the seller to fulfil his obligation may well be totally dependent on punctual performance by the buyer.

With some contracts, there is no stipulation in the contracts between the buyer and the seller as to any particular shipping-line, nor is there any specific requirement that the buyer's nomination of a vessel be made by a particular date.

Shipping space can be booked at the discretion of a broker, acting as agent for the buyer. The buyer is often indirectly required to nominate a vessel within a reasonable period, by the fact that documentary letters of credit must be opened with the seller's (beneficiary's) bank, before the goods are released from the broker. These letters of credit frequently state that shipment is to be by a certain date (e.g. within six weeks of when the credit is opened).

The clause in the letter of credit allowing for a shipment period (e.g. shipment by August 1) is in actual fact provided for the benefit of the seller. The seller can, at his option, ship the goods at any time until the date specified in the letter of credit. Cases such as *Harlow & Jones Ltd v Panex (International) Ltd*[12] suggests that the seller must notify the buyer approximately when the seller expects to load, before the buyer need nominate an effective ship.

Whilst there is no absolute guarantee that the buyer will, in fact, nominate the vessel, and the broker could theoretically be instructed by a buyer not to name an effective ship, this would clearly result in a breach of contract. In an FOB contract, the time to nominate an effective ship is usually of the essence of the contract, and the seller is entitled to treat the contract as repudiated if the buyer fails to nominate

10. [1981] 2 All ER 540: [1981] 1 WLR (HL): affirming [1981] 2 All ER 524.
11. Ibid, 542, 716 (HL).
12. [1967] 2 Lloyd's Rep. 509, 526-527.

a vessel in the stipulated time, or, if no time is stipulated, in a reasonable time. (See: *Olearia Tirrena S.p.A. v N.V. Algemeene Oliehandel, The Osterbek*[13].)

Regarding the question of the port of shipment, the Australian case of *Cumming & Co Ltd v Hasell*[14] held that an agreement for the sale of goods FOB without any stipulation, express or implied, as to the port of shipment, was too uncertain to constitute a binding agreement. The later case of *David T. Boyd & Co. Ltd v Louis Louca*[15] resolved the difficulty, by stating that in the absence of express agreement, trade custom or any inference which can be drawn from surrounding circumstances, the buyer is to choose the loading port, if the contract does not name a port of shipment. A contractual clause which provides for a sale on the basis of "FOB New Zealand port" is known as a multi-port clause.[16]

However, if a buyer were to nominate, for example, Lyttleton or Wellington as the port of shipment, the seller would have a good case for demanding that shipment be from Auckland if all previous shipments had been made from Auckland. Subject to the above, however, the naming of the port in an FOB contract is the buyer's duty, under a "strict" or "classic"-type FOB contract.

It should, however, be noted (and will be discussed later) that where the seller agrees to provide the vessel for and on behalf of the buyer, the seller undertakes the duty of selecting the appropriate port. Schmitthoff[17] supports this view, stating that "the party responsible for the shipment has normally the choice of the port of shipment". Sassoon, on the other hand, suggests that it would be possible for the buyer to retain the choice of selecting the port of departure, while delegating the responsibility of reserving shipping space to the seller. Thus, there is some flexibility in determining the parties' responsibilities.[18]

Substitute Vessel

It should be noted that the buyer is not bound by having nominated a particular ship; and hence, the seller is not able to claim that the buyer is prohibited from nominating another vessel. Thus, if the nominated ship is withdrawn, or the nomination fails for some other reason, the buyer is obliged to name a substitute vessel, on condition that loading can be completed within the contract period, as was held in *Agricultores Federados Argentinos v Ampro S.A.*[19]. The buyer must share any additional expense caused by the substitution.

It may be necessary to name a substitute vessel, either because the

[13] [1973] 2 Lloyd's Rep. 86 (C.A.).
[14] (1920) 28 CLR 508.
[15] [1973] 1 Lloyd's Rep. 209.
[16] Schmitthoff, supra at note 8 at 26.
[17] Ibid.
[18] Supra at note 6, at para 457.
[19] [1965] 2 Lloyd's Rep. 157.

shipping company has overbooked shipping space, or because of port strikes. Whilst the buyer has a right to name a substitute ship, any amendment to the letter of credit is only with the permission of the beneficiary (seller). Likewise, the buyer cannot claim that the seller has not completed delivery, as per the contract, if this is caused by a last-minute designation by the buyer, as was held in *F.E. Napier v Dexters Ltd*[20].

Therefore, if a letter of credit stipulates that shipment be made from Auckland by "21 August", the buyer would be precluded from claiming breach of contract if he nominated a vessel on 18 August, for example.

The question of time is less critical with respect to many goods which can be shipped by container. However, the buyer must nominate the ship in reasonable time, to allow the seller to containerise and transport the goods to the port for loading.

The seller must also deliver the goods in time for loading on board by the end of the contract period. Likewise, the seller, if permitted to elect the date or places of delivery, must (in the words of Sassoon[21]):

> exercise his option and communicate the date or place, or both, at which he proposes to deliver to the buyer in proper time, before any obligation rests on the buyer, and before he can complain of the buyer's failure to nominate the ship.

"Additional Services" FOB Variant

The "strict" or "classic" classification of FOB is perhaps now an outmoded term in the majority of FOB export transactions. Moreover, the strict FOB classification does not really take account of the fact that the seller does not wish to lose his interest in the goods before the purchase price is paid. Thus, it is the seller who usually obtains the bill of lading, thereby retaining control over the goods until payment is arranged through a documentary letter of credit.

Whereas under the "strict" definition, the FOB buyer is deemed to be the shipper of the goods, and the bills of lading are issued to his order; if the seller obtains the bills of lading, he assumes certain responsibilities regarding the shipment and export of the goods.

For these reasons, an "additional services" variant of the FOB term has evolved, whereby the seller acts as shipper and exporter. Under the FOB clause providing for additional services, the seller undertakes to make such arrangements at the expense of the buyer. However, further study of this variant is important, as it is often necessary to determine whether a company is acting as agent for the buyer or the seller, and whether the broker is sometimes acting as agent or principal. Resolution of these issues is necessary to determine the payment of expenses and liability, and is somewhat confusing.

20 (1926) 26 Ll. L. Rep. 184 (C.A.).
21 Supra at note 6, at para 459.

A sensible background to the problem is outlined in Sassoon, where it is stated that:[22]

> in writing about the responsibilities of the parties to an f.o.b. contract, most authorities mention only the buyer and the seller, but it is suggested that a notional third party — the shipper — has duties to perform and expenses to bear. The shipper's duties and expenses have to be borne either by the seller or by the buyer, depending on the contract.

Usually, the seller is the shipper in an FOB export sale, as outlined by the court in *Pyrene v Scindia*[23]:

> Sometimes the seller is asked to make the necessary arrangements; and the contract may then provide for his taking the bill of lading in his own name and obtaining payment against the transfer, as in a c.i.f. contract.

The seller usually only retains the bill of lading — and hence property — as security for payment, and once the goods are shipped, the seller must transfer those goods to the buyer under the contract.

If the seller retains the bill of lading, as security for payment, there is a presumption that the seller is acting as principal, especially if the bill of lading is made out in the seller's name. Hence the seller is not acting as agent of the buyer. In such a case, section 21 (3) Sale of Goods Act 1908 applies, which provides that:

> Where goods are shipped, and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserve the right of disposal.

Whereas property will normally pass on shipment of the goods, when the bill of lading is in the buyer's name if on the other hand, property is in the name of the seller, property will pass only when the price is paid, and the bill of lading is transferred to the buyer. (See: *Mirabita v Imperial Ottoman Bank*[24].)

Although the seller is acting as shipper, he is not obliged or expected to pay for freight. Syrett in *Finance of Overseas Trade*[25] states that "it is no part of his [the seller's] duty to pay for the carriage, and the bill of lading he will get will usually be a 'freight collect' one. The freight is then collected from the foreign importer".

Refusal by the carrier to consent to freight collect items does not usually oblige the seller to pay the freight on behalf of the buyer. This principle was upheld in *Green v Sichel & Ors*[26]. However, the cost of custom entries, port rates, and expenses incurred in lodging the bills of lading are normally paid by the seller, when the seller is acting as shipper. Even in the "strict" FOB cases, the seller often bears these expenses, as the amount of work and expense is relatively small.

[22] Ibid, para 477, citing Davis, "The Various Types of FOB Contract" [1957] 3 Business Law Review 256, at 258.

[23] Supra at note 1.

[24] (1878) 3 ExD 164.

[25] Syrett, *Finance of Overseas Trade,* (2nd ed. 1949), 25-26.

[26] (1860) 7 C.B. (N.S.) 747; 29 L.J. (N.S.) C.P. 213; 2 L.T. 745; 6 Jur. (N.S.) 827; 8 W.R. 663; 141 E.R. 1009.

Bills of Lading

Where the seller acts as shipper, it is usually his duty to obtain and tender bills of lading in the "terms usual in the trade", as was stated in *Pyrene v Scindia*[27]. Such documents would then constitute prima facie evidence of performance and delivery FOB, and the bills of lading will usually be "shipped on board" bills of lading. Sassoon notes[28] that in the United Kingdom, a "received for shipment" bill of lading is not usually a good tender under an FOB contract, as it provides no evidence of actual loading or acceptance on any particular ship, nor any date of loading. He further suggests that a "received for shipment" bill of lading implies that the risk and property in the goods will have been transferred prior to the goods crossing the ship's rail. Cases such as *Yelo v S.M. Machado & Co. Ltd*[29] suggests that there is a strong presumption that "shipped" bills of lading are required in FOB contracts, where the seller is acting as shipper.

Nonetheless, a contract may specifically allow for "payment against shipping documents to include 'received for shipment' bills of lading", so as to facilitate earlier payment to the seller. A "received for shipment" bill of lading is valid in New Zealand.[30] In reality, the difference in time of payment between the two types of bill of lading is usually only two or three days, as the bales are containerised immediately prior to the arrival of the vessel.

Both buyers and bankers usually require clean bills of lading, containing no specific declaration that the condition of the goods or packaging was defective upon receipt. The bills of lading must be transferable, and provide continuous documentary cover.

"Shipment To Destination" Variant

If all services connected with provision of the vessel, including prepayment of freight and insurance are undertaken by the seller, under an FOB contract, the seller will be acting as agent of the buyer. Such services are always at the cost of the buyer, and this rule is termed, by Sassoon, as the "shipment to destination" variant of the FOB term.

Whereas for the "additional services" variant, the seller usually acts as principal; with the "shipment to destination" variant, the seller is, in effect, the buyer's agent.

General

The question of whether the seller is undertaking certain duties as agent or principal can lead to considerable confusion. In *The Tromp*[31], for example, the FOB seller was the shipper of the goods, through a

27 Supra at note 1.
28 Supra at note 6, at para 481.
29 [1952] 1 Lloyd's Rep. 183.
30 Mercantile Law Act Amendment Act 1922, section 3 (4).
31 [1921] P. 337.

forwarding agent, but the same forwarding agent acted for the buyer "for a variety of purposes", such as securing the shipping space and insurance of the cargo. The consignor was therefore acting as agent for both parties.

This problem occurs frequently in case law. It is the writer's view that most New Zealand exporters undertake a number of shipping obligations for reasons of goodwill and efficiency, without any knowledge or concern as to whether they are acting as principal or as agent of either party. Problems inevitably occur, however, when legal disputes as to liability or expenses arise.

A very interesting analysis of the confusion is to be found in a statement by Bailhache J, in *D.H. Bain v Field & Co Fruit Merchants Ltd*[32]:

> This case shows, as all these cases do now, that as a matter of fact the practice in f.o.b. contracts for the sale of comparatively small parcels, as distinguished from cargoes, it is the universal practice now for the sellers at the port of shipment, when that port is abroad, to busy themselves in securing the shipping space, and I am inclined to think that the court, in holding the view that the duty is still on the buyer and that the seller is acting merely in a friendly way or as an agent for the buyer, is deciding in a manner not in accordance with the commercial practice or the views of commercial men. Some day I shall expect that point to be raised, but if it is one will have to have evidence of the universality of the practice. My own view is that in the case of small parcels sold f.o.b. it is the duty of the seller to take the necessary steps to provide the shipping accommodation. That is contrary to what is always held in these courts, and it will be interesting — if anybody has enterprise enough to raise the point — to know what view this court will take of the matter.

This writer tends to sympathise with Bailhache J.'s concerns.

Realistically, circumstances have probably rendered the "classic" or "strict" definition of FOB contracts academic and unrealistic in many modern-day export transactions. The "strict" FOB term clearly outlines the division of responsibilities in an export sale, and the respective obligations of the parties. Additional services performed by the sellers in many cases have now led to an adjustment in the respective obligations of the parties.

It is clear that in all FOB cases, the seller bears all charges and responsibilities up to and including the delivery on board the nominated vessel. Further marginal responsibilities undertaken by the seller are of doubtful status, due to unclear and conflicting judicial decisions.

The "additional services" variant of the FOB term is definitely recognised now — however, the division of liabilities and responsibilities under this variant is not clear, and probably varies from contract to contract. When the seller undertakes various additional services (which are the responsibility of the buyer in "strict" FOB contracts) as "agent" for the buyer, the buyer assumes the cost, risk and liability. Where the seller undertakes these additional services as principal, on the other hand, he bears a personal responsibility, and is thus liable for failure of performance. Therefore, it is certainly not correct to claim that the

32 (1920) 3 Ll. L. Rep. 26, at 29.

seller is always acting as the buyer's agent when undertaking such additional obligations.

It is a pity that the courts appear to have avoided formally acknowledging the various changes that have occurred with regard to FOB terms. When non-performance or damage occurs, for example, the legal capacity of the seller will be of critical importance in determining liability. Because of this confusion, any established course of dealing between the parties will be relevant, as will the terms of the payment.

SHIPPING REBATES

One significant problem that arises when the seller agrees to secure the vessel, is the question of conference shipowner rebates, and their "exclusive patronage" provisions which cover both FOB and CIF shipments. There is frequent disagreement between parties as to whether the buyer or the seller should receive the benefit of such conference rebates. Sassoon suggests that if the seller is acting as shipping agent for the buyer, the buyer should receive the benefit of the rebate. The subject of rebates is very contentious — however, there appears to have been no litigation on the matter.[33]

Whilst it seems logical that the party paying for the freight (i.e. the buyer) should receive the rebate to reduce his freight costs, NZ conference carriers have advised the writer that the rebates are an incentive for the party reserving the shipping space, and that rebates are unrelated to the payment of freight by the buyer. In practice, shipping rebates are often added to the account of the seller, and not passed on to the buyer, especially when payment of the rebate is deferred, rather than immediate, thereby allowing the seller to conceal the rebate from the buyer.

A company, which reserves all FOB and CIF shipping space itself as principal and as agent of either party, may sign "exclusive patronage" agreements with the European lines, but often will not pass the benefit of the rebates on to the buyers.

A practical difficulty for FOB sellers who are conference signatories will occur when the FOB buyer nominates a non-conference vessel for the seller's goods. In such cases, even where the seller has no right to select a carrier, the seller may be penalised by the conference lines. This is one reason why sellers often wish to secure shipping space for their buyers, under the "additional services" FOB variant.

FOB Airport

Some consignments may be airfreighted to Europe, rather than shipped. This mode of transport, for bulky products, is highly expensive — however, the buyer may require the goods urgently. A special term called the "FOB Airport" was introduced into Incoterms in 1976,

[33] Supra at note 6, at para 512.

for the sale of goods which are to be transported by air. "FOB Airport" is based on the same principles as the ordinary FOB term.

The point of delivery in air transport is when the goods are delivered to the air carrier, or his agent, at the transit shed in the airport. Loss or damage to the goods between the point of delivery and the carrier and before they are lifted into the aircraft is at the buyer's risk.

There is a practice that the seller is to arrange for air transport, at the buyer's expense, unless prompt notice is given to the contrary (this would be an "additional service" under FOB terms). Otherwise, the seller must give prompt notice to the buyer that he does not wish to do so.

The buyer has the option to name the air carrier, and must, as Sassoon notes[34], give the seller any instructions necessary to have the goods carried. Likewise, the seller must give the buyer notice of the delivery of the goods to the carrier. It is the seller, and not the buyer, who becomes the contracting party — the "shipper" — in the contract of carriage, when the seller makes the contract of carriage in his own name, with the air carrier, as is customary.

Packing

On arrival of the nominated ship, the FOB seller is obliged to place on board the vessel goods which satisfy the description of the contract in all respects. It is the duty of the seller to ensure that the goods are properly packed and delivered "to the ship's rail". The goods must also be in a suitable condition for sea transit, as was discussed in *A. Hamson & Son (London Ltd v S. Martin Johnson & Co. Ltd*[35]. In this case, goods were not adequately prepared for shipment during cold weather and were damaged. The court held that this would normally have been the responsibility of the FOB seller; but that, because evidence showed that the goods were not placed in a suitable condition, due to instuctions by the buyer's representative, the seller could not be compelled to suffer the loss caused.

The question of packing goods for shipment is very important. Faulty packing can lead to considerable litigation, as the buyer might be entitled to reject the goods, or to claim damages. Regardless of the conditions of sale, it is the seller's duty to pack the goods in such a way as to ensure their safe arrival, and to facilitate their handling in transit and at the place of destination. Similarly, the buyer is entitled to refuse acceptance of a bill of lading which refers to goods marked and/or branded differently to the directions of the buyer.

A study of the Institute of Export's definition of the FOB term will show that there is no mention of an obligation on the part of the seller to adequately pack the goods. Sassoon suggests[36] that an obligation can be implied from the fact that the goods are bought on FOB terms with a seaborne voyage in mind.

[34] Supra at note 6, at para 538.
[35] [1953] 1 Lloyd's Rep. 553.
[36] Supra at note 6, at para 461.

Whilst generally, contracts may have a clause outlining a duty to pack goods, there is a trade custom in the wool and speciality fibre business that all such fibre is traded world-wide in bales. For FOB and CIF sales generally, the price quotation includes packing charges, unless it is stated expressly that an extra charge will be made for packing.

The requirement of adequate packing is to minimise the risks of damage to the goods during shipment and transportation, and the cases indicate that the seller must normally bear the responsibility for any loss or damage caused by defective or unsuitable packing. (See: *G. Willis & Sons Ltd v T. Brown & Sons and Ors*[37].)

If goods are damaged during shipment, due to inadequate packing, the carrier will assume no responsibility, by claiming that the damage was caused by "the inherent vice" of the goods.

Risk and Property

The FOB term is a term of delivery. Delivery FOB is completed when the goods pass over the ship's rail at the named port of shipment. Section 22 of the Sale of Goods Act 1908 states that risk prima facie passes with property. In export law, however, the two concepts of the passing of risk, and the transfer of property, are often separated, and "the statutory presumption is displaced by agreement between the parties".[38]

For export sales, risk will usually pass when the goods leave the custody of the seller. Thus, the seller must bear the risk of loss or damage to the point of delivery FOB. Immediatley after the goods have been delivered over the ship's rail, the risk passes to the buyer in FOB (and CIF) contracts. It should be noted that this transfer or risk is subject to section 34 (3) Sales of Goods Act 1908, and any duty of notification to permit the buyer to insure the sea transit.

Subsequent loss or damage to the goods is at the buyer's risk, because the seller has shipped the goods FOB as required. The buyer will presumably have insured the goods. When payment is made by the buyer, the seller loses all interests in the goods, and the buyer gains all interests in the goods.

Under section 21 (3) Sales of Goods Act 1908, reservation of right of disposal is assumed where the goods are shipped, and by the bill of lading the goods are deliverable to the order of the seller or his agent. Hence, Sassoon notes[39] that retention of the bill of lading by the seller as security against payment does not mean that the risk of loss or damage has been transferred, as stated in *Stock v Inglis*[40].

Therefore, where property in the goods has been retained by the seller merely to secure performance by the buyer of his obligations under the contract, the goods are at the buyer's risk from the date of delivery.

37 [1922] 12 Ll. L. Rep. 292.
38 Supra at note 8, at 107.
39 Supra at note 6, at para 563.
40 Supra at note 4, at 573 (CA).

Where payment is facilitated by documentary letters of credit, performance is complete between buyer and seller upon presentation of the required documents to the bank, and as Sassoon notes[41], "there is no question as to the seller reserving any property rights in the goods, after he has been paid their price".

Surprisingly, a contract may state that both property and risk are to pass to the buyer on presentation of shipping documents — thereby apparently rebutting the presumption that risk passes after the goods have been delivered over the ship's rail. It is unclear why the sellers may require this stipulation that transfer be after the FOB point, as the seller would apparently bear the risk of loss in transit, until such time as the documents were presented to the buyer. Such a stipulation is quite legal — however, Sassoon believes[42] that "in situations where the evidence is not overwhelming in favour of displacing the ordinary meaning of the term FOB, the usual construction will prevail".

Payment

Letters of Credit

An increasing number of sales require payment by a documentary letter of credit. Documentary letters of credit are probably the most common and the most efficient means of payment in international trade. Diplock J. stated as follows in *Ian Stach Ltd v Baker Bosley Ltd*[43]:

> International trade has to an increasing extent . . . been financed by banker's confirmed credits. So much so that the classic FOB and CIF contracts of the textbooks providing for cash or acceptance against documents without the intervention of the banker are now probably the exception rather than the rule.

It is advisable for the particular contract to specify the precise and particular form of credit required, as documentary credits can, for example, be revocable or irrevocable, confirmed or unconfirmed, and transferable or non-transferable. Irrevocable and confirmed letters of credit are the most common form of payment — primarily because they alleviate the problem of the seller's security.

A common feature of all letters of credit is that the buyer arranges with his bank to provide finance for the seller (in the seller's country) on delivery of the shipping documents. When the seller presents the shipping documents, the banker pays the purchase price. The banker, in effect, assumes liability for payment of the price, in consideration of the security of the documents of title to the goods.[44]

Therefore, as Schmitthoff notes[45], where the goods are represented

[41] Supra at note 6, at para 554.
[42] Ibid, para 603.
[43] [1958] 2 QB 130, 137-138.
[44] See: Gutteridge and Megrah, "The Law of Bankers' Commercial Credits" (6th ed. 1979), 1; this passage is not reproduced in the 7th ed. 1984.
[45] Supra at note 7, 336-337.

by the bill of lading, this document of title is used as a means of financing the transaction. The actual documentary nature of this method of payment is thus highly important.

The International Chamber of Commerce has standardised banking practice in relation to documentary letters of credit, by the "Uniform Customs and Practice for Documentary Credits 1974", which has standardised this area of international trade law globally.

This codification of the law (referred to as "Uniform Customs") is adopted either specifically or generally into most letters of credit, by banks worldwide.

Article 1 of the 1983 "Uniform Customs" edition states that:

> These Articles apply to all documentary credits . . . and are binding on all parties thereto unless otherwise expressly agreed. They shall be incorporated into each documentary credit by wording in the credit indicating that such credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication No. 400.

The "Uniform Customs" clearly stipulates a strict separation of the documentary side of the export sale from the goods aspect, as the banks are only concerned with the documentary aspect. Article 3 "Uniform Customs" states that:

> Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.

Article 5 suggests that issuing banks should discourage any attempt by the buyer to include excessive detail, in order to avoid confusion. However, a key problem with the Swiss Mohair contract, is that the scientific evidence required by the letter of credit is too detailed, and invariably leads to rejection of documents by the bank.

Schmitthoff outlines the stages of a letter of credit[46] (paraphrased):

(i) The buyer and seller, in the contract of sale, agree that the payment will be by letter of credit. Whereas the British Mohair contract stipulates payment by "irrevocable letter of credit", the Swiss contract merely requires payment by "letter of credit". In practice, however, the Swiss have always opened irrevocable letters of credit.

(ii) The buyer then instructs his bank ("issuing bank") to open a letter of credit for the seller, on the terms specified by the buyer in his instructions to the issuing bank, which

(iii) arranges with a "correspondent bank" in the seller's country "to negotiate, accept and pay the exporter's draft" upon delivery of the shipping documents by the seller.

(iv) The correspondent bank then advises the seller that it will do so, upon delivery of all documentation. The correspondent bank in

[46] Ibid, at 339.

effect guarantees to the seller to pay the purchase price on delivery of the shipping documents.

As a result, the correspondent bank is entitled to reject documents which do not conform literally with the instructions received from the issuing bank (and hence from the buyer). The seller must therefore be extremely careful in the preparation of documents — and it is here that this writer experiences most problems with letters of credit.

In *Equitable Trust Co. of NY v Dawson Partners Ltd*[47] it was stated that "there is no room for documents which are almost the same, or which will do just as well".

The doctrine of strict compliance is the term for the legal principle that the bank is entitled to reject documents which do not strictly conform with the terms of the letter of credit. Schmitthoff justifies this principle by noting that the issuing bank is a special agent of the buyer, and the correspondent bank is a special agent of the issuing bank.[48] The principal is permitted to disown the act of the agent if that agent acts outside of his limited authority or "mandate"). Such an agent, if acting outside his mandate, would then bear the commercial risk of the transaction.

The banks involved deal in credit and finance, and not in the goods themselves (as stated in Article 4 "Uniform Customs") and the banks must usually rely on the documents because they have no expert knowledge in the practices of a particular trade (e.g. the terminology of wool scouring, as per Swiss Mohair letters of credit).

Buyers will often be tempted to reject documents which one of the banks has accepted for currency reasons, or because of a falling market, and hence banks must be wary.

Schmitthoff notes[49] that adherence to the doctrine of strict compliance by banks in rejecting even insignificant discrepancies in documentation will be upheld by the courts, if litigation ensues.

New Zealand trading banks have advised this writer that on average, seventy percent of all documents presented to New Zealand banks for the purposes of letters of credit, are rejected initially, due to inconsistencies. This high rate of rejection would suggest that most exporters do not fully appreciate the reasons underlying this doctrine of strict compliance. It is of interest to note that New Zealand banks are less strict for some letters of credit than for others, depending upon the domicile of the issuing bank. It should be noted that documents which are rejected are usually amended accordingly and resubmitted.

Once communicated to the beneficiary, there is an absolute obligation under an irrevocable letter of credit to pay on the tender of the stipulated documents, and no subsequent instructions from the buyer will be valid, unless approved by the beneficiary. Because of changes

[47] (1927) 27 Ll. L. R. 49, 52.
[48] Supra at note 8, at 342.
[49] Ibid.

to shipping timetables or scientific data there may be a request to amend a letter of credit. Any contractual dispute which subsequently arises between the buyer and the seller will not affect the letter of credit, which cannot be cancelled by the buyer if irrevocable.

This absolute obligation to pay on tender of stipulated documents is, however, subject to limitations as to the time-period for which it is valid. Letters of credit can therefore lapse, if documents are not submitted to the correspondent bank in time.

Where no shipping date and no specified data for the opening of the credit are provided, the credit must be opened prior to the earliest possible shipping date, as was held in *Ian Stach Ltd v Baker Bosley Ltd*[50]. Since the time of establishing the credit is a condition of contract, failure to meet it may be treated as a repudiation by the seller.

This situation occurred in 1985, when a British buyer who was a party to a contract with the writer's company, delayed opening an irrevocable letter of credit, as per the contract, in order to profit from currency shifts of the Kiwi dollar; and when instructed to open a letter of credit, the buyer had the letter of credit sent to the correspondent bank by airmail, rather than by the usual method of telex or cable. The seller, in this case, waived its right to treat the contract as repudiated.

The banks are under an obligation of strict performance, and the case of *Midland Bank v Seymour*[51] shows that if a bank mistakenly makes payment without adhering strictly to the instructions received, or to the specific documents required, it is in default towards the buyer, and the buyer has no obligations towards the bank.

J.H. Rayner & Co. Ltd v Hambro's Bank Ltd[52] is a clear example of the above, where it was held that a bank acted at its peril if it departed from the precise terms of its customer's mandate.

The bank is not obliged to go beyond the particulars mentioned in the credit, nor is it advisable to do so. The legal significance and validity of the documents to be presented is therefore of no concern to the bank, and "it is not for the bank to reason why" as stated in *Midland Bank Ltd v Seymour*[53]. Thus, a requirement in a letter of credit specifying a particular description of the goods on the bill of lading must be observed, however meaningless to the bank.

In *British Imex Industries Ltd v Midland Bank Ltd*[54] it was stated that the obligation of the bank is

> to satisfy themselves that the correct documents are presented to them, and that the bills of lading bear no indorsement or clausing by the shipowners or shippers which could reasonably mean that there was, or might be, some defect in the goods or their packing.

Where correctness of the documents cannot be resolved by reference

[50] Supra at note 38, at 140.
[51] [1955] 2 Lloyd's Rep. 147.
[52] [1943] KB 37, 40.
[53] Supra at note 51.
[54] [1958] 1 QB 542, 552.

to the letter of credit, the definitions in the "Uniform Customs" must be consulted.

The buyer must be careful, when opening a letter of credit, to avoid ambiguous requirements, as the bank is not liable if it accepts documents within the ambit of the ambiguity or generality.

The letter of credit should always state a date of expiry, after which the correspondent bank will refuse to accept documents presented by the seller, as per Article 46 "Uniform Customs". The expiry date of the letter of credit is different from the shipment date, which is the date shown in the bill of lading. As well as an expiry date, the credit might also stipulate that the bills of lading evidence a certain shipment date (e.g. "from Auckland to Bremen latest 10 July 1987"). In such cases, the bills of lading must not show a later shipment date.

If documents are presented to the correspondent bank before the expiry date, and are then checked and rejected, not allowing enough time to amend the documents before the expiry date, it is unclear whether the correspondent banks are obliged to accept, negotiate and make payment upon the amended documents re-submitted after the expiry date. This is a problem which the writer's company has encountered on a number of occasions, and it is of concern that the banks themselves appear uncertain as to their legal position.

An example of this problem occurred which involved the writer's company in mid-1986, when incorrect documentation was presented to the seller's (correspondent) bank, and accepted by that bank, who paid out on two letters of credit, to the seller's bank account. The incorrect documents were sent by the correspondent bank to the issuing bank in Switzerland, which discovered the irregularities, and rejected the documents at the request of the buyer. because the correspondent bank had paid out too early, the payment was, in effect, a "loan" for NZ$500,000.00 at 20 percent interest.

Amendment of the bills of lading was difficult, as the documents were by then in Switzerland, and the whole process of amendment lasted several weeks. As a result of the delay, the corrected documents were not presented until after the expiry date, and it was uncertain whether the issuing bank (and the buyer) would accept the amended documents.

This problem raises a number of questions covering letters of credit.

The buyers rejected the documents primarily because of movements in the Kiwi dollar. However, the issuing bank had every right to reject the documents, which were not per the requirements of the letter of credit.

There was considerable delay in time between when the correspondent bank accepted the documents and when the issuing bank notified it that the documents were unsatisfactory. Article 16 (d) "Uniform Customs" states that:

> If the issuing bank decides to refuse the documents, it must give notice to that effect without delay . . . to the bank from which it received the documents.

However, the issuing bank appears protected by Article 16 (c) which allows it "reasonable time in which to examine the documents".

Likewise, the correspondent bank might appear to be protected from charges of negligence, as Article 15 "Uniform Customs" merely requires that

> Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit . . .

It would be difficult to prove that the bank had not used reasonable care. Thus, the question of liability for the interest due has not been determined. (The two letters of credit in question, as with most such credits, state that "all banking charges outside Switzerland are for the beneficiary's account".)

Sassoon suggests[55] that even if the letter of credit has lapsed, and the issuing bank does not accept the amended documents, the credit is not the exclusive source of payment. Whereas non-payment for some reason under a letter of credit, once gave rise to uncertainties as to whether the credit was the exclusive source of payment, the present view is that the credit is merely the primary source of payment.

In *W.J. Alan & Co. Ltd v El Nasr Export & Import Co*[56] it was held that failure of the method of payment agreed normally does not release the buyer from his liability for the purchase price. Lord Denning M.R. considered[57] that ". . . a letter of credit is not to be regarded as absolute payment, unless the seller stipulates, expressly or impliedly, that it should be so.".

This would enable the seller to claim the price direct from the buyer if the issuing bank is not able to pay the agreed purchase price, upon presentation of the documents. A similar decision was also reached in the Australian case of *Saffaron v Societe Miniere Cafrika*[58] where the buyer unsuccessfully claimed that the seller had lost his right to be paid, because the buyer's obligation to pay was discharged by furnishing the credit.

Conclusion

International trade law is a fairly specialised area of commercial law.

The writer's company is involved primarily with the export of wool and speciality fibres. However, the topics covered in this article would be applicable to most exporting situations.

In attempting to apply the law of international trade to a particular export operation, it is evident that legal theory and business practice do not always equate.

The writer believes that the law relating to the export trade has not kept pace with developments in some areas of trade practice. The legality of many export transactions is unclear, and will probably remain so, until disputes arising from such uncertainties are brought before the courts.

55 Supra at note 6, at para 621.
56 [1972] 2 QB 189.
57 Ibid at 210; 811; 137.
58 [1958] 100 CLR 231.