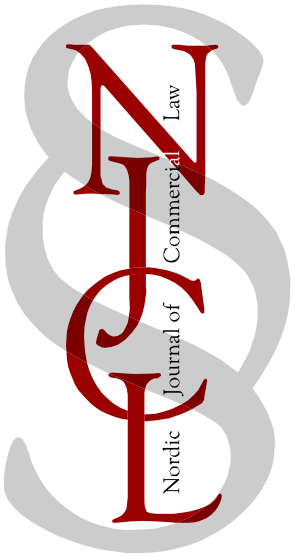
Is The Ship's Rail Really Significant?



IS THE SHIP'S RAIL REALLY SIGNIFICANT?

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Nordic Journal of Commercial Law

issue 2005 #2

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I. INTRODUCTION

The development of containerisation has not only simplified the carriage of goods but has also changed the legal relationship between seller and buyer. As a consequence some of the INCOTERMS 2000 such as Free on Board (FOB) are now often used incorrectly. Traders instead should make use of the more suitable multimodal term, namely Free Carrier (FCA). A comparison of the two terms on the basis of risk transfer indicates that differences occur and significant implications arise if parties incorporate the 'wrong' term into their contract. For instance, FOB's risk transfer point of the 'ship's rail' is synonymous with shipping and should not be misapplied to transactions involving containerisation where the risk transfer is not the 'ship's rail.' The risk transfers when the first carrier takes charge of the goods. This simple fact alone requires a clear understanding of the two terms in order to avoid unnecessary legal complications in case of lost or damaged cargo.

It is common knowledge that an incorporation of any INCOTERMS 2000[1] term into an international contract requires specific reference in the contract. The main functions of INCOTERMS, being a code of acronyms, are to facilitate intentional trade by eliminating uncertainties and differences in interpretation of trade or shipping terms.[2] However merely agreeing to transact under INCOTERMS is not enough to finalise a transaction. INCOTERMS do not cover all aspects of the sale of goods contract and to facilitate a smooth transaction, parties should include provision as to transfer of title of the goods, remedies for breaching the contract, exception or limitation clauses, exemptions from liability, and any other duties the parties may wish to include in the sale contract.[3] Parties further have the choice of incorporating an INCOTERM as well as making additional provision in the sales contract for 'the export customs clearance, carriage from warehouse (works) to port of export, contract of affreightment (carriage), contract of insurance, import customs clearance, and local delivery in country of import'.[4]

This paper will compare the operation of FOB and FCA, two frequently used International Commercial Terms. The question of risk transfer from seller to buyer is used to demonstrate the significance of the 'ship's rail', and the consequences of choosing the wrong term.

1 *International Commercial Terms 'INCOTERMS'* (2000).

2 Gabriel, H. Contracts for the Sale of Goods,: A Comparison of Domestic and International Law, (2004) Oceana Press, at 241.

3 John Levingston, 'A Commentary on INCOTERMS 2000- FOB Contracts' (January 1999) Findlaw Australia Database, <http://www.findlaw.com.au/articles/default.asp?task=read&id=4156&site=GN> cited at 14-04-05.

4 Bergami, R., *International Trade: A practicalIintroduction*, (2004), Eruditions Publishing: Melbourne, at 135.

II. SALIENT FEATURES OF FOB

F Group terms in essence require the seller to deliver goods to a carrier which has been appointed by the buyer. The terms are; FCA (free carrier), FAS (free alongside ship) and FOB (free on board). The element of the F terms is that the main carriage is unpaid by the seller, and the risk is passing to the buyer at the point where the goods are delivered to a named carrier.[5]

The FOB term enjoys wide usage in the international shipping of goods, being originally developed to clarify responsibilities and liabilities for parties to the transaction.[6] English law and American law did not give the same meaning to the FOB term which was considered to be a general delivery term.[7] In England Devlin J, in *Pyrene v Scindia*[8] defined the existence of three variations of the FOB contract, depending on the intent of the parties. The classic FOB contract occurs when the seller draws up the contract of carriage, with the buyer nominating a vessel. As explained in *El Amira & El Amina*[9] it is also possible under FOB that the seller acts as the principal shipper. Furthermore in *Wimble Sons v Rosenberg and Sons*[10] the possibility has been confirmed that occasionally the seller 'ships', not because he is obliged to do so, but as a favour to the buyer.

The second variation of FOB is explained as obliging the seller to make the shipping and insurance arrangements for the buyer's account, with the seller nominating a suitable ship. Thirdly the most common form that FOB exists in today occurs with the buyer nominating the vessel and making the contract of carriage.[11]

Consequently if the buyer fails to nominate a ship within the contractually stipulated time, the contract is effectively repudiated. The seller may then sell goods to a third party, recovering any losses from the buyer.

The INCOTERMS definition of FOB is based on the buyer being the shipper as demonstrated in the *Pyrene*[12] with the buyer nominating the vessel. The buyer commonly makes the contract of carriage today because of the lack of options the seller had in recovering damages or loss against the carrier in the nineteenth century. *Dunlop v Lambert*[13] established that - because property and risk had transferred to the buyer on delivery and because the buyer would most likely sue for losses or damages, - the buyer was the party that needed to make the contract of carriage:

> *Where there is a delivery to a carrier to deliver to a consignee, he is the proper person to bring the action against the carrier should the goods be lost; yet that if the consignor made a special contract with the carrier, and the carrier agreed to take the goods from him, and to deliver them to any particular person at any particular place, the special contract supersedes the necessity of showing the ownership in the goods;*

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5 Mo, J., *International Commercial Law*, (2000), Butterworths: New South Wales. P11.
6 Sanson, M., *Essential International Trade Law*, (2002), Cavendish Publishing: New South Wales. P79-80.
7 Gabriel. H. above n 2, at 249.
8 (1954) 2 QB 402.
9 *The El Amira & El Amina* [1982] 2 Lloyds Rep 28, 32.
10 [1913] 3 K.B. 743.
11 Todd, P., 'Pyrene v. Scindia Navigation Co. Ltd.' (December 1998) Our world Database, http://ourworld.compuserve.com/homepages/pntodd/cases/cases_p/pyrene.htm cited at 21-03-05.
12 Ibid.
13 (1839) 7 ER 824, at 627.

> *and that, by the authority of the cases of Davis v. James (1770) 5 Burr 2680 and Joseph v. Knox (1813) 3 Camp 320, the consignor, the person making the contract with the carrier, may maintain the action, though the goods may be the goods of the consignee.* [14]

Interestingly, this case asserted that even where the 'consignor' doesn't hold the risk liability (or property) he might still recover damages from the carrier.

Stemming from the developments of *Dunlop v. Lambert*,[15] the *Bills of Lading Act*[16] made it possible for the seller to make the contract for carriage because unlike previously thought, the contract wasn't transferred with the bill of lading:

> *The main problem was that a buyer of goods, whether or not there had been a transfer of a document of title, and even though the buyer was at risk in relation to the goods, was unable to sue or to be sued on a contract of carriage to which the buyer was not a party. Section 1 of the 1855 Act sought to deal with this problem by providing that the transfer of a bill of lading also affects the transfer of the contract of carriage. A consignee named in a bill of lading, and an endorsee to whom the property in the goods passes upon or by reason of consignment or endorsement, has the same rights, and the same liabilities, as if an original party to the contract.*[17]

This was an early attempt to equalise buyer and seller's rights in the transaction.

a) The correct usage of FOB

FOB's prominent status today is a result of its inclusion in most contracts over the past two centuries. FOB was the usual way of conducting international trade and it can be argued that it took on the mantle of "customary law". As with all enshrined practices and customs, implementing changes is problematic. Traders are reluctant to use another term when formulating their contracts and as a result, FOB is often incorrectly incorporated into contracts to indicate any point of delivery, for instance FOB Factory or FOB plant.[18] The International Chamber of Commerce specifically states in the explanatory notes to the INCOTERMS that FOB means 'Free on Board' and should be used in that manner only in the contract.[19]

FOB, besides being a term of choice, can at times serve a specific purpose, for instance where the buyer requires a particular type of vessel or where currency restrictions exist and carrier and buyer are the same nationality. In this latter example, FOB is the best and most correct term to apply to the transaction, as FOB prices are lower than CIF prices.[20]

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14 *Dunlop v. Lambert* (1839) 7 ER 824, at 627.
15 (1839) 7 ER 824.
16 1855 (UK), Section 1.
17 Gleeson, A.M., 'Privity of Contract and Maritime Law' (January 1993) Findlaw Australia Database, <http://www.findlaw.com.au/article/4734.htm> cited at 06-06-2005.
18 Bergami, above n 4, at 147.
19 International Chamber of Commerce, 'Incoterms 2000'. (2000) ICC Publication 560. <http://www.iccwbo.org/incoterms/preambles/pdf/FOB.pdf> cited at 10-03-05.
20 Todd, above n 11.

Despite the widespread and effective use of FOB, the risk transfer point at the 'ship's rail' has been criticised for not reflecting the current situation at seaports. Arguments were advanced to abolish FOB but because many port customs and commercial practices have developed as a result of the term and therefore FOB was retained in INCOTERMS 2000.[21] Furthermore FOB is still applicable in certain instances were cargo is not shipped in containers.

III. RISK TRANSFER: SIGNIFICANCE OF THE SHIP'S RAIL

The use of FOB in contracts, whilst common, is not applied correctly in all cases. Frequently when goods are containerised parties misuse FOB, most likely mistaking it for the more appropriate FCA term. This misapplication could result in complications in situations where goods are damaged during loading. In relation to risk transfer crossing the 'ships rail' is of significance and requires some commentary.

In *Pyrene & Co v Scindia Steam Navigation Co*,[22] the plaintiff Pyrene Co Ltd was able to recover £200 from the defendant carrier, after the carrier was found to be negligent in loading the goods which caused damage prior to the goods crossing the 'ship's rail'. *Pyrene* raises questions of liability if the damage occurs at any point other than after crossing the 'ship's rail'. Devlin J stated that if the goods are damaged during loading, whether that damage occurs on either side of the 'ship's rail', then the carrier's liability for negligence would have to extend to cover the damages:

> *Only the most enthusiastic lawyer could watch with satisfaction the spectacle of liabilities shifting uneasily as the cargo sways at the end of the derrick across a notional perpendicular projecting from the ship's rail.*[23]

The problem that emerged from the early 'ship's rail' cases and the judgement in *Pyrene* is: who bears the responsibility if the goods sway back over the 'ship's rail' and fall on the wharf? However it still stands that in general FOB holds the seller/exporter responsible for delivering the export-cleared goods to a named port and loading them onto a vessel. As the goods pass over the 'ship's rails' the risk of loss or damage to the goods is transferred from the seller to the buyer.[24] In sum, the buyer assumes all peril of loss or damage after the goods passed the 'ship's rail.' If, as the goods are being loaded they fall on the wharf or water, then the seller bears the loss. If however, the goods fall on the deck or any point over the 'ship's rails', the buyer bears the loss.[25]

The risk transfer point at the 'ship's rail' is very specific and should not be misapplied to situations where it contains no adequate purpose, as is too often the case with containerised traffic and roll on-roll off traffic.[26] FOB should only be applied in a shipping capacity, in reference to ocean or inland waterway transport, though the term is frequently used to describe inland movement of

21 ICC, above n 19, at 14.
22 [1954] 2 QB 402.
23 *Pyrene & Co. v Scindia Steam Navigation Co* [1954] 2 QB 402, at 419.
24 National Australia Bank, *Finance of International Trade*, (1996), NAB: Australia. P44.
25 Zaritski, J., 'International Commercial Terms.' (2002) *Australian Export Online*, <http://www.export61.com.au/export-tutorials.asp?ttl=tict> cited at 20-02-05.
26 Bergami, above n 4, at 147.

cargo.[27] FOB would be best suited for bulk commodity cargo such as oil or grain, where it is imperative that the goods pass the 'ship's rail'.

a) Developments in case law

The concept of delivery being effected as the goods pass the 'ship's rail' is not a new development, however the confusion surrounding the concept has never been laid totally to rest, as demonstrated by case law spanning the past three decades. Early forms of FOB saw the property (and consequently risk) transfer at the 'ship's rail', with the ship being treated as the buyer's floating warehouse.[28] *Brown v Hare*[29] established that the point of delivery and property transfer was also the point of risk transfer. The principle that property and risk would transfer together was anchored in legislation.[30] *Inglis v Stock*[31] clarified that risk always passed on shipment that is crossed the ships rail, even when property passes at a later date. In *Frebold and Sturznickel (Panda OHG) v. Circle Products Ltd*,[32] Widgery L.J made specific mention of delivery being at the 'ship's rail'. However in *Colley v Oversees Exporters*[33] , it appears that the judge held property and risk to pass once loading is complete:

> *I need only deal with f.o.b. contracts. The presumed intention (see s. 18 of the Act) of the parties has been settled. It seems clear that in the absence of special agreement the property and risk in goods does not in the case of an f.o.b. contract pass from the seller to the buyer till the goods are actually put on board.* [34]

When parties fail to understand the intricacies of the 'ship's rail' concept, conflicts can arise. *Thermo Engineers Ltd v. Ferry Masters Limited*[35] , illustrates this point well. The English seller of a heat exchanger entered into an FOB contract with a buyer located in Copenhagen. The heat exchanger was carried by trailer onto the vessel, at which point the lower deck of the vessel was damaged. Uncertainty arose as to where the responsibility would fall – as technically the trailer had crossed the line of the stern, hence 'the ship's rail'. The damage was ultimately covered by virtue of the *Hague Rules*.[36] If the damage had occurred prior to the crossing of the 'ship's rails', it would have been governed by road provisions instead[37] . *Thermo Engineers* acts as a warning to parties when entering transactions with incorrect INCOTERMS. The transfer of risk can vary depending on the chosen terms and therefore it is imperative that parties clearly understand the terms which will indicate where their liabilities begin and end.

27 Ibid.
28 *Cowas-Jee v Thompson* (1845) 3 Moore Ind. App. 422, 430, 18 ER 560, 563 (PC).
29 (1859) 4 H. & N. 822.
30 *Bills of Lading Act 1855*, section 1.
31 (1885) 10 App. Cas. 263.
32 [1970] 1 Lloyds Rep 499, at 504.
33 [1921] 3 KB 302.
34 Ibid at 307
35 [1981] 1 Lloyds Rep 200.
36 *The International Convention for the Unification of Certain Rules Relating to Bills of Lading* (1924)
37 Carriers and Innkeepers Act (1958) Vic, Convention on the Contract for the International Carriage of Goods by Road (CMR) Geneva, 19 may 1956.

IV. DEVELOPMENT OF FCA

If the parties intend to apply an INCOTERM to the contract and intend to govern the risk transfer at a point other than 'the ship's rail'. FCA – that is Free Carrier - provides the best alternative. Of importance is that this term is suitable for all modes of transport including multimodal transport. As defined in the INCOTERMS 2000, FCA:

> *Means that the seller delivers the goods, cleared for export, to the carrier nominated by the buyer at the named place. It should be noted that the chosen place of delivery has an impact on the obligations of loading and unloading the goods at that place. If delivery occurs at the seller's premises, the seller is responsible for loading. If delivery occurs at any other place, the seller is not responsible for unloading.*[38]

The development of containerisation meant that FOB failed to address the increasing multimodal transport requirements international trade. As pointed out above, FOB means that the risk passes once goods cross the ships rails. This is a vital concept because if not careful, the seller will remain liable for the goods, even after 'delivering' them to the carrier. When the seller remains liable beyond the point of delivery, the seller is responsible for goods that are under the control of the carrier. As such, a gap emerges in liability, from the point of delivery to the point somewhere down the line where the goods cross the 'ship's rail'.

By way of solving the emerging gap in liability, the FCA term was introduced with the INCOTERMS 2000. The development of the Free Carrier (FCA) INCOTERM was necessary to offer an alternative to the usage of the Free on Board (FOB) term. The introduction of the FCA term in the INCOTERMS 1990 resulted from the narrowing of some of the previous terms that were specific to a particular mode of transport, namely, Free on Rail/Truck as well as Free Airport. The 13 terms in the 1990 version also saw a name change of Free Carrier from FRC to FCA.[39] Free Carrier (FCA) denotes the seller/exporter's responsibility over all risks and costs, until the goods are 'delivered to the named place and collected by the carrier nominated by the buyer'.[40] A carrier is defined as:

> *Any person whom in a contract of carriage, undertakes to perform or to procure the performance of carriage by rail, road, sea, air, inland waterway or by a combination of such modes. The buyer must give the seller in time the necessary instructions for despatch and take responsibility of the goods from the time when they have been delivered into the custody of the named carrier.*[41]

FCA is a term that can be used for all modes of transport, including Multimodal. FCA has particular use with containers and roll on-roll off traffic by trailers and ferries.[42] The development of containerisation paved the way for the introduction and implementation of the FCA term, often now being used to replace the more outdated FOB term. FCA is based on the same principle as FOB, except the risk transfer point stops with the first carrier at the named place, not the 'ship's

38 Levingston, above n 3.
39 See The International Convention for the Unification of Certain Rules Relating to Bills of Lading (1924)
40 Zaritski, above n 25,
41 National Australia Bank, 1996, *Finance of International Trade*. NAB, Australia. P45.
42 Pinka, V., 'INCOTERMS 2000' (2002) Airkargo Database, <http://www.airkargo.sia.lv/INCOTERMS2000.htm> cited 04-02-05.

rail'.[43] It is only by considering the risk transfer point of FOB and FCA that the critical differences in the terms emerge. The significance of shifting liability at the 'ship's rail' can have dire consequences if not incorporated correctly into the contract of sale.

V. CONSEQUENCES OF CHOOSING THE WRONG TERM?

Since the 1960's, growth in containerisation and changed cargo handling patterns has meant that FOB puts undue pressure on the seller as the goods are prepared and stowed in containers before the arrival of the ship.[44] As such FOB should not be used unless the goods specifically transfer to the carrier at the ship's rails. When considering an FOB contract, this point of the 'ship's rail' means prior to that point the buyer has no insurable interest. Likewise, after that point the seller has no insurable interest. Hence, the seller in the FOB transaction remains liable until this point, which means that if the parties incorrectly use FOB instead of FCA the seller remains at risk even after the goods have been handed over to the first carrier. The seller has no control over the goods from this point, as the buyer usually nominates the carrier:

> *Normally, sellers have general insurance arrangements (so called open cover) which protects them in such cases. However, a seller who fails to cover himself adequately in these situations will no not normally benefit from the buyer's insurance, even if that insurance contains a so-called transit clause to the effect that the insurance protection lasts from warehouse to warehouse, thereby covering the period before loading the goods on board. There are two reasons for this: first, the FOB-seller is not a contracting party to the FOB-buyer's insurance contract; and second, the FOB-buyer has no insurable interest before the goods have passed the ship's rail.*[45]

However, incorporating FCA into the contract of sale benefits the seller as the risk transfer point occurs when goods transfer to the first carrier. The buyer is put in a clearer position than if trading under FOB, because he now bears responsibility from the point in which the first carrier takes charge of the goods. The third major party in a standard transaction is the carrier that agrees to transfer the goods from the seller's hand to the buyer's. FCA further benefits the seller because the liability of the carrier extends to cover the loading of the goods, which was previously completed to the point of the ship's rail, with the seller bearing the risk.

VII. CONCLUSION

First published in 1936, the INCOTERMS are uniform rules defining costs, risks and obligations of buyers and sellers in international transactions. INCOTERMS, if expressly provided for, will govern the sales contract. Other law applies to transactions, for instance, international conventions such as the *CISG*, *Hague-Visby Rules* and domestic laws. When used correctly, the INCOTERMS allow 'prudent and efficient' allocation of duties and risks in agreement.[46] Incorrect use of the

43 Ibid.
44 ICC, above n 19, at 14.
45 bid at 26.
46 Gabriel, H., 'The International Chamber of Commerce INCOTERMS 1990 - A Guide to their Usage' (1999), CISG Database, Pace, <http://www.cisg.law.pace.edu/cisg/biblio/gabriel1.html> cited at 21-02-05.

terms may bind parties to obligations that are not only beyond their understanding, but also beyond their capabilities.

The operation of FOB and FCA terms differ dramatically, best evidenced by comparing the risk transfer point in the transaction. Where the contract for sale of goods was entered into on an FOB basis, the seller is required to deliver the goods via the named vessel, to the named port, place and time stipulated in the contract. The risk transfer point changes from buyer to seller as the goods cross over the ship's rail, up until this point the seller bears all risk pertaining to loss or damage. Ultimately, once the appropriate goods cross the 'ship's rail' on the named vessel, the seller is free from further liability; all that remains is for the seller to endorse the bill of lading to the buyer when the goods are onboard the ship.[47] The buyer must also meet a number of obligations under an FOB sales contract. The buyer assumes all risks of loss or damage from the point of risk transfer, the 'ship's rail'. The concept of risk transfer at the 'ship's rail' is confusing, and often misused in practice. FCA is the appropriate Multimodal term that should be applied to situations where the containers used for shipping do not pass the 'ship's rail'. [48]

Where the contract for sale of goods was entered into on an FCA basis, the seller effects delivery by either delivering the goods to the named carrier (freight forwarded etc), or by making the goods available at the seller's premises to the first carrier. The seller is responsible for the goods until one of the above delivery methods is accomplished. The buyer must also meet a number of obligations under an FCA sales contract; the buyer assumes all risks of loss or damage from the point of risk transfer, where the goods are delivered to the first carrier.

The consequences of using the wrong term in the transaction can be problematic. It could involve the seller in unnecessary legal expenses as – transacting under FOB with containers instead of FCA – the seller remains liable until the goods cross the 'ship's rail'. In practice, this often occurs after the carrier has taken possession of the goods and they have been stowed at the carrier's facility. If the seller had instead transacted under the FCA term, then the seller's liabilities and responsibilities would conclude the moment the carrier takes delivery of the goods, either via truck at the seller's premises or at the named place. When FOB is incorrectly used, a gap emerges where it is difficult to assign liability if the goods are damaged before the risk transfer point of the 'ship's rail'. The *Hague-Visby Rules* provide that the carrier is only liable from the point that the goods are loaded onto the ship. Consequently, these widely accepted rules do not solve the problem of assigning liability to fill the gap. The *Hamburg Rules*, although not widely accepted and not binding on Australian contracts, bind the carrier with liability from 'the moment the carrier is in charge of the goods at the port of loading'.[49] The *Hamburg Rules*, if adopted, would successfully solve the problem of assigning liability to parties that don't have control over the goods. Unfortunately, the *Hamburg Rules* are problematic, particularly in regards to the effect their adoption would have on the uniformity of the law governing carriage of goods by sea.[50]

47 Sanson, above n 6, at 79.

48 Mo, above n 5, at 19.

49 *United Nations Convention on the Carriage of Goods by Sea, Hamburg,* (1978), Article 4.(1).

50 Parliament of Australia, Parliamentary Library, 'Carriage of Goods by Sea Amendment Bill 1997', (1997), *Bills Digest* (No.15), <http://www.aph.gov.au/library/pubs/bd/1997-98/98bd015.htm> cited at 06-06-05.

The CISG is also not helpful as it only offers default rules. Despite the fact that article 67(1) in essence mirrors the FCA term articles 8 and 9 oblige a tribunal or court to take either the subjective or objective intent of the parties into consideration or pursuant to article 9 the "usage to which they have agreed." Hence a term such as FOB will "trump" article 67(1) and will be enforced.

In sum, FOB, whilst enjoying widespread usage, is often inaccurately applied to the sale of goods contract. The FOB contract undoubtedly has a place in commercial transactions, but where containerisation is involved, parties need to choose FCA, as otherwise the risk management of the transaction is not properly executed.