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REVIEW OF THE INTERNATIONAL COMPENSATION REGIME

CONTRACTS INVOLVED IN THE CARRIAGE OF CARGO BY SEA

An information paper

Submitted by the Oil Companies International Marine Forum (OCIMF)

Summary:	This document is intended to assist delegates with their understanding of how international trade in oil is structured.
Action to be taken:	The Working Group is invited to take note of the information in this document.

1 **Introduction**

There are a number of different types of contracts involved in the movement of cargo by sea from an exporting country to an importing country. This document is intended to give a brief description of the different types of contracts to assist delegates with their understanding of how international trade in oil is structured.

2 **Contract for sale of cargo**

- 2.1 The two most common types of international sales contracts are 'free on board' (fob) and 'cost, insurance, freight' (cif) contracts.

Fob

- 2.2 Under the fob, 'free on board' contract, the buyer pays for and arranges carriage and the seller's duty is to load the goods onto a vessel nominated by the buyer. It is likely that the buyer will therefore be the charterer of the vessel. In terms of the ownership of the cargo, the risk and usually title to the cargo transfers from the seller to the buyer at the load port (usually as the cargo passes across the vessel's permanent hose connection).

Cif

- 2.3 In contrast, under a cif, 'cost, insurance and freight', contract the seller is obliged to pay for and arranges the carriage and insurance. Here it is likely that the seller will be the charterer of the

vessel. Under cif contracts the risk and usually title to the cargo also transfers from the seller to the buyer at the load port (usually as the cargo passes across the vessel's permanent hose connection).

Des

- 2.4 As well as fob and cif contracts, des or 'delivered ex-ship' contracts are fairly common. Under a des contract the seller is obliged to pay for and arrange the carriage. The seller is, therefore, likely to be the charterer. In this case risk and usually title to the cargo pass at the discharge port (as the cargo crosses the vessel's permanent hose connection).
- 2.5 It should be noted that it is common in the oil trade for a cargo to change hands on numerous occasions, even up to a hundred times. The initial sale contract sets out the obligations between the buyer and the seller in terms of which party has responsibility for arranging and paying for the cost of sea carriage. It is likely that either the initial buyer or seller will charter the vessel. In the subsequent sale contracts, there will be the same 'theoretical' obligations between the buyer and the seller to arrange and pay for the cost of sea carriage but, in practice, they are unlikely to have any direct contact with the vessel or any influence over the selection of the vessel.

3 Contract for use of vessel

- 3.1 Invariably, a charter-party will be used as the contract for the use of the vessel. Charter-parties come in various forms.

Bareboat charter-party

- 3.2 A bareboat charter-party is a contract usually for a number of years in which the charterer controls, mans and uses the vessel for its own purposes. A bareboat charterer is often viewed in the same way as the registered owner and effectively has overall operational control over the vessel.

Time charter-party

- 3.3 Under a time charter-party the charterer contracts to use the vessel for a set period of time for which it will pay a daily rate of hire. The owner of the vessel remains responsible for controlling, manning and operating the vessel on a day-to-day basis. The time charterer is simply entitled to give the vessel voyage instructions but has no control over vessel operations.

Voyage charter-party

- 3.4 Finally, under a voyage charter-party, the charterer contracts for the use of the vessel for a specific voyage or voyages. In return the charterer must pay freight which is a lump sum payment. As with a time charter, the owner of the vessel remains responsible for controlling, manning and operating the vessel on a day-to-day basis. The voyage charterer has no control over vessel operations.

4 Contract for carriage of goods by sea

- 4.1 The contract for the carriage of goods by sea will be, initially, between the shipper and carrier and is usually evidenced in the terms in a bill of lading. The carrier may be the registered owner of the vessel but is often the bareboat charterer or time charterer of the vessel (sometimes referred to as the bareboat owner or time-chartered owner).
- 4.2 The shipper is often the initial buyer or seller of the cargo (under the sale contract described above) or it may be an agent of the initial buyer or seller. As a cargo is bought and sold through a string of sale contracts, each contract will usually provide that the seller must present the buyer

with the bill of lading as a condition of payment for the cargo. In this sense the bill of lading provides evidence that the cargo has been loaded or shipped on a named vessel at a named load port to a named port of discharge. It is also evidence of the condition of the cargo.

5 Parties named in bill of lading

- 5.1 The three parties typically named in a bill of lading are the 'shipper', 'consignee' and 'notify address'.
- 5.2 The shipper is often the initial buyer or seller of the cargo (or agent of the buyer or seller) and is frequently the party that prepares the bill of lading for the master or carrier's agent to sign.
- 5.3 The consignee is the party to whom the shipowner is contractually obliged to make delivery. It depends on the nature of the underlying sales transaction as to who or what is entered in the consignee box. It may name a consignee; it may show the words 'to order' with or without the name of the consignee; or the box may simply be left blank. What is written here will affect the transferability of the bill of lading and, with it, control over delivery of the goods. The party named as the consignee may not necessarily be the owner of the cargo at a particular point in time. It is also common to have a bank named as the consignee.
- 5.4 The notify address is the address (and usually the name) of the person to whom the shipper requires the shipowner/carrier to give notice when the cargo arrives at its destination. Typically the notify address will be the consignee, an agent that has been appointed to receive the goods on arrival or a bank.

6 Movement of the bill of lading under the sale contract string

- 6.1 It should be noted that the lawful bill of lading holder has rights against and liabilities towards the carrier under the carriage contract. For example, if there is contamination of the cargo during the voyage the lawful bill of lading holder will be entitled to sue the carrier for breach of the carriage contract.
- 6.2 Typically a sales contract will require the seller to provide the original bill of lading to the buyer (or the buyer's bank) as a condition for payment. Where there is a string of contracts the bill of lading will usually be passed down the chain from initial seller to the final buyer. As the bill of lading is transferred down through the string it is 'endorsed' to the new bill of lading holder. An endorsement typically consists of the shipper signing the back of the bill of lading and inserting the name of the person to whom delivery should be given. If the words 'to order' are inserted following the name, then that person can also endorse the bill of lading to subsequent parties.
- 6.3 When a bill of lading is transferred or endorsed it must be made by the current lawful bill of lading holder in order to be valid. When an endorsement is made the new lawful bill of lading holder becomes party to the carriage contract with the carrier/shipowner and gains rights against and liabilities towards the carrier/shipowner in accordance with the terms in the bill of lading.
- 6.4 Because the oil trading market is a highly liquid, competitive market in which cargoes change hands many times between loading and discharging, in practice, it causes problems with the transfer of the bill of lading. This is because the endorsement of the bill of lading in most cases does not 'keep up' with the sale contract and will often be endorsed to the final buyer many months after the cargo has been discharged.
- 6.5 Theoretically, the final consignee or cargo receiver must provide the original bill of lading to the master of the vessel before the master is obliged to discharge the cargo. In practical terms, however, because of the delay in passing the bill of lading down the string of sale contracts, the bill of lading is usually not available. To solve this problem, the party receiving the cargo usually

provides an indemnity to the shipowner/carrier in lieu of providing the original bill of lading in order to effect cargo discharge.

- 6.6 Although, in theory, the bill of lading should indicate the owner of the cargo, in practice, because of the nature of the international oil trade, it is unlikely to give a true indication of the cargo owner at the time of any incident during a voyage. It would be necessary to delve into the trading contracts of many parties to get some indication of the owner at the time and, even then, it is possible there would be disputes between the parties as to who had title to the cargo at the time.
- 6.7 It is also quite common in some contracts for the sale of crude oil to oblige the seller to provide a warranty of title for payment rather than a bill of lading. In such contracts the buyer does not become entitled or party to a bill of lading.

7 Conclusions

The description above of the primary contracts involved in the movement of cargo by sea is not intended to be exhaustive. However, it should be clear that many of the parties involved will have little if any knowledge of the ship, its safety and incident record, detention history, compliance with international regulations etc. In particular, the seller, buyer, receiver or cargo owner may, depending on the circumstances, have no direct relationship with the vessel.
