RISK FOR: BUYERS, SELLERS, VENDORS

By Joe Chillino and Theresa Garcia

Incoterms are helpful guidelines buyers and sellers use to determine each party's obligations, risks and costs associated with sales transactions. The pre-defined International Commercial terms, of which there are 11 from which to choose as of 2010, are published by the International Chamber of Commerce.

Understanding the finer points of the more common terms and subsequent insurance implications can give importers and exporters an upper hand in negotiating terms with suppliers or clients by helping reduce costs. By the same token, transportation specialists can assist clients by suggesting ways to make the Incoterm work in their favor and more effectively manage supply and distribution chain costs. Additionally, insurance providers should understand terms of sale and contractual obligations to help avoid coverage gaps.

For the purposes of this article, we'll review Free On Board and Free Alongside Ship. FOB and FAS are almost identical in nature, as neither obligates buyer or seller to purchase insurance. In both cases, each party has an insurable interest in the goods at some point during the transit, with the transfer of risk taking place at the port of loading. The primary difference is that FAS only obligates the seller to deliver the cargo to the dock next to the ship, whereas FOB requires the seller to safely deliver the cargo on board the vessel. This difference may seem trivial when dealing with containerized cargo, but it can have significant cost implications for breakbulk cargo.

Consider a high-value heavy-lift breakbulk shipment where the terms of sale are FOB Houston. The risks of loading the cargo rest with the seller, whose cargo insurance underwriters decide to warrant a Load Survey to ensure the cargo is loaded properly. The costs of surveys required by cargo insurance are customarily paid by the named insured independent of insurance premiums. If the seller anticipated this expense, it may have included it in its price to the buyer. If not, the seller may be forced to absorb the survey cost against its profit margin.

If the seller decided it couldn't increase its cost to account for the survey, it could consider changing the terms to FAS. In that scenario, the assumption of risk transfers to the buyer alongside the ship, and so the responsibility and risk of loading the cargo would fall to the buyer and its cargo insurance underwriters. Understanding these slight nuances separating two very similar Incoterms could provide the seller with an advantage when negotiating sales price and terms of sale with buyers.

In addition to understanding how these nuances can affect insurance costs, it's important to see where coverage gaps may occur. For example, in a typical FOB sale, the seller, although not obligated to do so, may secure insurance for transit from its facility or vendors until loaded on board the vessel. From this point, the buyer will most likely secure insurance for transit to final destination. Although this separation of coverage is customary and may appear adequate, it could result in a dispute over which insurance company is responsible to pay the claim.

For instance, damage occurs on a shipment covered by two insurance companies, each representing one side of the sales transaction. The damage was not discovered until delivery, upon which the buyer noticed significant rough handling. Each insurance company assigned surveyors to investigate the loss. While the seller's surveyor determined it occurred after loading, the buyer's surveyor concluded the damage occurred in the inland transit prior to arrival at the port of loading. These disputes can result in delays of payment to the party at loss and potentially a partial settlement offer to bring the claim to a close.

Ideally, either party should seek to control the insurance through one insurer providing door-to-door coverage. In absence of this option, buyers and sellers should work with their insurance providers to find alternative solutions. One such coverage option is contingency insurance, which can be provided through a marine cargo policy. Contingency insurance provides coverage to protect the seller and/or buyer in instances where they don't have a primary insurable interest, but could be at risk for financial loss if a claim occurs.

Incoterm rules serve as a good starting point for buyers and sellers to evaluate risk of loss from cargo damage in their sales transactions. However, as demonstrated above, this task is often complex and requires thorough analysis and input from experienced cargo insurance specialists and transportation service providers. Implementing these practices can be the difference between a successful buy/sell experience or one that you never want to repeat again — and worse, hear about for years to come. **BB**

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