Free On Board (FOB)

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What Is Free On Board (FOB)?

Free On Board (FOB) is a shipment term used to indicate whether the seller or the buyer is liable for goods that are damaged or destroyed during shipping. "FOB shipping point" or "FOB origin" means the buyer is at risk and takes ownership of goods once the seller ships the product.

For accounting purposes, the supplier should record a sale at the point of departure from its shipping dock. "FOB origin" means the purchaser pays the shipping cost from the factory or warehouse and gains ownership of the goods as soon as it leaves its point of origin. "FOB destination" means the seller retains the risk of loss until the goods reach the buyer.

Free On Board

Free On Board (FOB) Explained

Contracts involving international transportation often contain abbreviated trade terms that describe matters such as the time and place of delivery, payment, when the risk of loss shifts from the seller to the buyer, and who pays the costs of freight and insurance.

The most common international trade terms are Incoterms, which the International Chamber of Commerce (ICC) publishes, but firms that ship goods in the United States must also adhere to the Uniform Commercial Code (UCC). Since there is more than one set of rules, the parties to a contract must expressly indicate which governing laws they used for a shipment.

KEY TAKEAWAYS

- Free On Board is a term used to indicate who is liable for goods damaged or destroyed during shipping.
- The terms of FOB affect the buyer's inventory cost; adding liability for shipped goods increases inventory costs and reduces net income.
- FOB contracts have become more sophisticated in response to the increasing complexities of international shipping.

How Free On Board Works

Assume, for example, that Acme Clothing manufactures jeans and sells them to retailers such as Old Navy. If Acme ships $100,000 in jeans to Old Navy using the term FOB shipping point, Old Navy is liable for any loss while the goods are in transit and would purchase insurance to protect the shipment. On the other hand, if the goods are shipped FOB destination, Acme Clothing retains the risk and would insure the shipment against loss.

Factoring in Inventory Costs

Shipping terms affect the buyer's inventory cost because inventory costs include all costs to prepare the inventory for sale. Using the same example, if the jeans were shipped using FOB shipping point terms, Old Navy's inventory cost would include the $100,000 purchase price and the cost of insuring the goods against loss during shipment.

Similarly, when Old Navy incurs other costs related to inventory, such as renting a warehouse, paying for utilities, and securing the warehouse, those costs are also added to inventory. This accounting treatment is important because adding costs to inventory means the buyer does not immediately expense the costs and this delay in recognizing the cost as an expense affects net income.

Examples of Inventory Cost Management

The more often a company orders inventory, the more shipping, and insurance costs it will incur. Also, a business may incur costs to place an order, hire labor to unload the goods and rent a warehouse to store the goods. A company can lower its inventory costs by ordering greater quantities and reducing the number of individual shipments it brings in.

FOB Example

A 2018 study by Ki-Moon Han of the Korea Research Society for Customs looks at the complexities of FOB contracts and explains that they are often misunderstood. According to Han, more sophisticated contracts are increasingly used to meet the needs of international traders. The author states that there is often confusion because the parties involved in the contracts misunderstand incoterms FOB, sales contracts, carriage contracts, and letters of credit. Han urges companies to use caution and to clarify which type of FOB they are entering into so that the risks and liabilities are clear.

Related Terms

Incoterms Definition

International commercial terms—Incoterms for short—clarify the rules and terms buyers and sellers use in international and domestic trade contracts.

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Learn About the Free Carrier – FCA Delivery Option
Free carrier is a trade term requiring the seller to deliver goods to a named airport, shipping terminal, or warehouse specified by the buyer.
more
Delivered Duty Paid (DDP)
Under delivered duty paid (DDP), the seller is responsible for the cost of transporting goods until customs clears them for import at the destination.
more
Cost and Freight (CFR) Definition
Cost and freight (CFR) is a trade term obligating the seller to arrange sea transportation to a port of destination and provide the buyer with the documents necessary to obtain the goods from the carrier.
more
The Seller Pays Cost, Insurance, and Freight (CIF) to Protect Shipments
Cost, insurance, and freight (CIF) is a method of exporting goods where the seller pays expenses until the product is completely loaded onboard ship.
more
Warehouse-to-Warehouse Clause Definition
A warehouse-to-warehouse clause in an insurance policy provides financial protection of cargo in transit, from the origin to the destination warehouse.
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Free on Board Shipping vs. Free on Board Destination: What's the Difference?

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By STEVEN NICKOLAS
Updated May 13, 2019

Free on Board – FOB Shipping Point vs. Free on Board Destination: An Overview

International commercial laws have been in place for decades and were established to standardize the rules and regulations surrounding the shipment and transportation of goods. Having special contracts in place have been important since international trade can be complicated, and because trade laws differ between countries.

These international contracts outline provisions including the time and place of delivery as well as the terms of payment agreed upon by the two parties. When the risk of loss shifts from the seller to the buyer, and who foots the bill for freight and insurance all depends on the nature of the contract.

Free onboard (FOB) shipping point and free onboard destination are two of several International Commercial Terms (Incoterms) published by the International Chamber of Commerce (ICC).[1] FOB shipping point and FOB destination indicate the point at which the title of goods transfers from the seller to the buyer. The distinction is important in specifying who is liable for goods lost or damaged during shipping. The primary difference between the two contracts is in the timing of the transfer of the title for the goods.[2]

An update to the ICC's Incoterms is due in 2020.

Free on board, also referred to as freight on board,[3] only refers to shipments made via waterways, and does not apply to any goods transported by vehicle or by air.[2]

According to the U.S. Department of Transportation's Bureau of Transportation Statistics (BTS), 884 million tons of product moved by water in 2015. Of this total, 95 million tons were export goods, 246 million tons were imported goods, and the remaining 544 million tons were moved by water within the United States. BTS projects the amount of cargo transport that will increase each year at around 1.4% until 2045.[4]

KEY TAKEAWAYS

- Free on Board is a trade term used to indicate whether the buyer or the seller is liable for goods that are lost, damaged, or destroyed during shipment.
- Free on Board Shipping Point indicates that the buyer takes responsibility for loss or damage the moment the goods get to the shipper.
- Free on Board Destination indicates that the seller retains liability for loss or damage until the goods are delivered to the buyer.
- FOB contracts have become more sophisticated in response to the increasing complexities of international shipping.

Free on Board – FOB Shipping Point

FOB shipping point, also known as FOB origin, indicates that the title and responsibility of goods transfer from the seller to the buyer when the goods are placed on a delivery vehicle.[3]

Since FOB shipping point transfers the title of the shipment of goods when the goods are placed at the shipping point, the legal title of those goods is transferred to the buyer. Therefore, the seller is not responsible for the goods during delivery. FOB shipping point is a further limitation or condition to FOB as responsibility changes hands at the seller's shipping dock.

For example, assume Company ABC in the United States buys electronic devices from its supplier in China, and the company signs a FOB shipping point agreement. If the designated carrier damages the package during delivery, Company ABC assumes full responsibility and cannot ask the supplier to reimburse the company for the losses or damages. The supplier is only responsible for bringing the electronic devices to the carrier.

The ICC was established in 1919.

Free on Board – FOB Destination

Conversely, with FOB destination, the title of ownership is transferred at the buyer's loading dock, post office box, or office building. Once the goods are delivered to the buyer's specified location, the title of ownership of the goods transfers from the seller to the buyer. Consequently, the seller legally owns the goods and is responsible for the goods during the shipping process.[3]

For example, assume Company XYZ in the United States buys computers from a supplier in China and signs a FOB destination agreement. Assume the computers were never delivered to Company XYZ's destination, for whatever reason. The supplier takes full responsibility for the computers and must either reimburse Company XYZ or reship the computers.

Shipping terms affect the buyer's inventory cost because inventory costs include all costs to prepare the inventory for sale. This accounting treatment is important because adding costs to inventory means the buyer does not immediately expense the costs and this delay in recognizing the cost as an expense affects net income.

Special Considerations

Another key difference between these two terms is the way in which they are accounted. Since the buyer assumes liability after the goods are placed on the ship for transport, the company can record an increase in its inventory at that point. Similarly, the seller records the sale at the same time. If there is any damage or loss of goods during transport, the buyer may file a claim since the company holds title during delivery.

The accounting rules change for FOB destination. In this case, the seller completes the sale in its records once the goods arrive at the receiving dock. That's when the buyer records the increase in its inventory.

There is also a difference in the division of costs. When it comes to the FOB shipping point option, the seller assumes the transport costs and fees until the goods reach the port of origin. Once the goods are on the ship, the buyer is financially responsible for all costs associated with transport as well as customs, taxes, and other fees. For FOB destination, the seller assumes all costs and fees until the goods reach their destination. Upon entry into the port, all fees—including customs, taxes and other fees—are borne by the buyer.

FOB (shipping)

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Dockers loading bagged cargo

For other uses, see Fob.

FOB (Free On Board) is a term in international commercial law specifying at what point respective obligations, costs, and risk involved in the delivery of goods shift from the seller to the buyer under the Incoterms standard published by the International Chamber of Commerce. FOB is only used in non-containerized sea freight or inland waterway transport. As with all Incoterms, FOB does not define the point at which ownership of the goods is transferred.

The term FOB is also used in modern domestic shipping within the United States to describe the point at which a seller is no longer responsible for shipping costs.

Ownership of a cargo is independent from Incoterms. In international trade, ownership of the cargo is defined by the bill of lading or waybill.

Contents

Incoterms[edit]

Further information: Incoterms

Under the Incoterms 2010 standard published by the International Chamber of Commerce, FOB is only used in sea freight and stands for "Free On Board". The term is always used in conjunction with a port of loading.[1]

Indicating "FOB *port*" means that the seller pays for transportation of the goods to the port of shipment, plus loading costs. The buyer pays the cost of marine freight transport, insurance, unloading, and transportation from the arrival port to the final destination. The passing of risks occurs when the goods are loaded on board at the port of shipment. For example, "FOB Vancouver" indicates that the seller will pay for transportation of the goods to the port of Vancouver, and the cost of loading the goods on to the cargo ship (this includes inland haulage, customs clearance, origin documentation charges, demurrage if any, origin port handling charges, in this case Vancouver). The buyer pays for all costs beyond that point, including unloading. Responsibility for the goods is with the seller until the goods are loaded on board the ship. Once the cargo is on board, the buyer assumes the risk.

Ship loading at a wharf

The use of "FOB" originated in the days of sailing ships. When the ICC first wrote their guidelines for the use of the term in 1936,[2] the ship's rail was still relevant, as goods were often passed over the rail by hand. In 1954, in the case of *Pyrene Co. Ltd. v. Scindia Steam Navigation Co. Ltd.*,[3] Justice Devlin, ruling on a matter relating to liability under an FOB contract, described the situation thus:

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

In the modern era of containerization, the term "ship's rail" is somewhat archaic for trade purposes, as with a sealed shipping container, there is no way of establishing when damage occurred after the container has been sealed. The standards have noted this. Incoterms 1990 stated,

When the ship's rail serves no practical purpose, such as in the case of roll-on/roll-off or container traffic, the FCA term is more appropriate to use.

Incoterms 2000 adopted the wording,

If the parties do not intend to deliver the goods across the ship's rail, the FCA term should be used.[1]

The phrase *passing the ship's rail* is no longer in use, having been dropped from the FOB Incoterm in the 2010 revision.

Due to potential confusion with domestic North American usage of "FOB", it is recommended that the use of Incoterms be explicitly specified, along with the edition of the standard.[4][5] For example, "FOB New York (Incoterms 2000)". Incoterms apply to both international trade and domestic trade, as of the 2010 revision.

North America[edit]

In North America, FOB is written into a sales agreement to determine where the liability responsibility for the goods transfers from the seller to the buyer. FOB stands for "Free On Board". There is no line item payment by the buyer for the cost of getting the goods onto the transport. There are two possibilities: "FOB origin", or "FOB destination". "FOB origin" means the transfer occurs as soon as the goods are safely on board the transport. "FOB destination" means the transfer occurs the moment the goods are removed from the transport at the destination. "FOB origin" (also sometimes phrased as "FOB shipping" or "FOB shipping point") indicates that the sale is considered complete at the seller's shipping dock, and thus the buyer of the goods is responsible for freight costs and liability during transport. With "FOB destination", the sale is complete at the buyer's doorstep and the seller is responsible for freight costs and liability during transport.[6][7]

The two terms have a specific meaning in commercial law and cannot be altered. But the FOB terms do not need to be used, and often are not. In this case the specific terms of the agreement can vary widely, in particular which party, buyer or seller, pays for the loading costs and shipment costs, and/or where responsibility for the goods is transferred. The last distinction is important for determining liability or risk of loss for goods lost or damaged in transit from the seller to the buyer.[7][8]

For example, a person in Miami purchasing equipment from a manufacturer in Chicago could receive a price quote of "$5000 FOB Chicago", which would indicate that the buyer would be responsible for the shipping from Chicago to Miami. If the same seller issued a price quote of "$5000 FOB Miami", then the seller would cover shipping to the buyer's location.

International shipments typically use "FOB" as defined by the Incoterms standards, where it always stands for "Free On Board". Domestic shipments within the United States or Canada often use a different meaning, specific to North America, which is inconsistent with the Incoterms standards.

North American FOB usage corresponds to Incoterms approximately as follows:

North America	Incoterms
FOB shipping point ***or*** FOB shipping point, freight collect	FCA shipping point
FOB shipping point, freight prepaid	CPT destination
FOB destination ***or*** FOB destination, freight prepaid	DAP destination

A related but separate term "CAP" ("customer-arranged pickup") is used to denote that the buyer will arrange a carrier of their choice to pick the goods up at the seller's premises, and the liability for any damage or loss belongs to the buyer.

Although FOB has long been stated as "Freight On Board" in sales contract terminology, this should be avoided as it does not precisely conform to the meaning of the acronym as specified in the UCC.[7]

Sometimes FOB is used in sales to retain commission by the outside sales representative. It is unclear where this originated.

Accounting and auditing[edit]

Container ship loading

In the past, the FOB point determined when title transferred for goods. For example, at year- and period-end goods in transit under "FOB destination" (North American usage) appear on the seller's balance sheet but not in the buyer's balance sheet, as the risk and rewards of ownership change to the buyer at the "destination" port.

It is much easier to determine when title transfers by referring to the agreed upon terms and conditions of the transaction; typically, title passes with risk of loss. The transfer of title may occur at a different time (or event) than the FOB shipping term. The transfer of title is the element of revenue that determines who owns the goods and the applicable value.

Import fees when they reach the border of one country to enter the other country under the conditions of FOB destination are due at the customs port of the destination country.[9]

With the advent of e-commerce, most commercial electronic transactions occur under the terms of "FOB shipping point" or "FCA shipping point".

"Freight On Board"[edit]

Some sources claim that FOB stands for "Freight On Board". This is not the case. The term "Freight On Board" is not mentioned in any version of Incoterms, and is not defined by the Uniform Commercial Code in the USA.[10] Further to that, it has been found in the US court system that "Freight On Board" is not a recognized industry term.[11] Use of the term "Freight On Board" in contracts is therefore very likely to cause confusion.

Uniform Commercial Code

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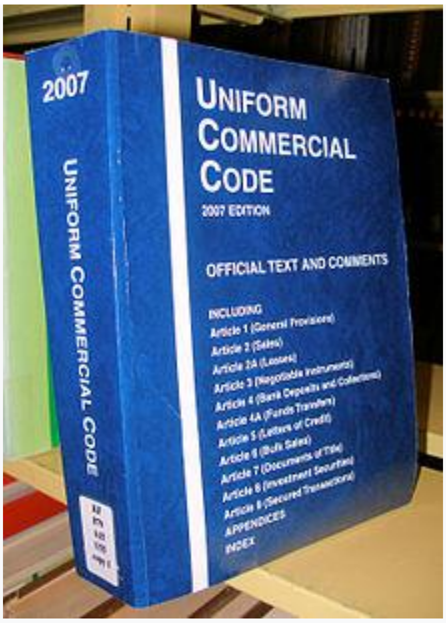

The official 2007 edition of the UCC.

The **Uniform Commercial Code** (**UCC**), first published in 1952, is one of a number of Uniform Acts that have been established as law with the goal of harmonizing the laws of sales and other commercial transactions across the United States through UCC adoption by all 50 states, the District of Columbia, and the Territories of the United States.

While largely successful at achieving this ambitious goal, some U.S. jurisdictions (e.g., Louisiana and Puerto Rico) have not adopted all of the articles contained in the UCC, while other U.S. jurisdictions (e.g., American Samoa) have not adopted any articles in the UCC. Also, adoption of the UCC often varies from one U.S. jurisdiction to another. Sometimes this variation is due to alternative language found in the official UCC itself. At other times, adoption of revisions to the official UCC contributes to further variation. Additionally, some jurisdictions deviate from the official UCC by tailoring the language to meet their unique needs and preferences. Lastly, even identical language adopted by any two U.S. jurisdictions may nonetheless be subject to different statutory interpretations by each jurisdiction's courts.

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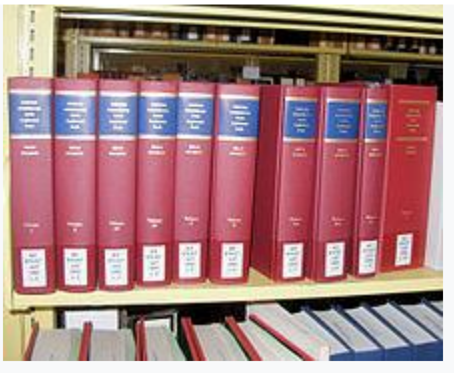
Goals[edit]

The goal of harmonizing state law is important because of the prevalence of commercial transactions that extend beyond one state. For example, goods may be manufactured in State A, warehoused in State B, sold from State C, and delivered in State D. The UCC achieved the goal of substantial uniformity in commercial laws and, at the same time, allowed the states the flexibility to meet local circumstances by modifying the UCC's text as enacted in each state. The UCC deals primarily with transactions involving personal property (movable property) and not real property (immovable property).

Other goals of the UCC were to modernize contract law and to allow for exceptions from the common law in contracts between merchants.

History[edit]



Even the confidential rough drafts of the UCC were saved and published as a 10-volume set.

The UCC is the longest and most elaborate of the Uniform Acts. The Code has been a long-term, joint project of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI),[1] which began drafting its first version in 1942.

Judge Herbert F. Goodrich was the Chairman of the Editorial Board of the original 1952 edition,[2] and the Code itself was drafted by some of the top legal scholars in the United States, including Karl N. Llewellyn (the prime leader in the project),[3] William A. Schnader, Soia Mentschikoff, and Grant Gilmore. The UCC contained important principles and concepts borrowed from German law, although they were unacknowledged by Llewellyn.[3]

The Code, as the product of private organizations, is not itself the law, but only a recommendation of the laws that should be adopted in the states. Once enacted by a state, the UCC is codified into the state's code of statutes. A state may adopt the UCC verbatim as written by ALI and NCCUSL, or a state may adopt the UCC with specific changes. Unless such changes are minor, they can seriously obstruct the Code's express objective of promoting uniformity of law among the various states. Thus, persons doing business in various states must check local law.

The ALI and NCCUSL have established a permanent editorial board for the Code. This board has issued a number of official comments and other published papers. Although these commentaries do not have the force of law, courts interpreting the Code often cite them as persuasive authority in determining the effect of one or more provisions. Courts interpreting the Code generally seek to harmonize their interpretations with those of other states that have adopted the same or a similar provision.

In one or another of its several revisions, the UCC has been fully enacted [4] with only minimal changes in 49 states, as well as in the District of Columbia, Guam,[5] the Northern Mariana Islands,[6] and the U.S. Virgin Islands. Louisiana and Puerto Rico have enacted most of the provisions of the UCC with only minimal changes, except Articles 2 and 2A, preferring instead to maintain their own civil law tradition for governing the sale and lease of goods.[7][8] Also, some Native American tribes have adopted portions of the UCC, including the Navajo Nation, which has adopted Articles 1, 2, 3, and 9 with only minimal changes.[9]

Although the substantive content is largely similar, some states have made structural modifications to conform to local customs. For example, Louisiana jurisprudence refers to the major subdivisions of the UCC as "chapters" instead of articles, since the term "articles" is used in that state to refer to provisions of the Louisiana Civil Code. Arkansas has a similar arrangement as the term "article" in that state's law generally refers to a subdivision of the Arkansas Constitution. In California, they are titled "divisions" instead of articles, because in California, articles are a third- or fourth-level subdivision of a code, while divisions or parts are always the first-level subdivision. Also, California does not allow the use of hyphens in section numbers because they are reserved for referring to ranges of sections; therefore, the hyphens used in the official UCC section numbers are dropped in the California implementation.

UCC articles[edit]

The 1952 Uniform Commercial Code was released after ten years of development, and revisions were made to the Code from 1952 to 1999.[1] The Uniform Commercial Code deals with the following subjects under consecutively numbered Articles:

Art.	Title	Contents
1	**General Provisions**	Definitions, rules of interpretation
2	**Sales**	Sales of goods
2A	**Leases**	Leases of goods
3	**Negotiable Instruments**	Promissory notes and drafts (commercial paper)
4	**Bank Deposits and Collections**	Banks and banking, check collection

		process
4A	**Funds Transfers**	Transfers of money between banks
5	**Letters of Credit**	Transactions involving letters of credit
6	**Bulk Transfers and Bulk Sales**	Auctions and liquidations of assets
7	**Warehouse Receipts, Bills of Lading and Other Documents of Title**	Storage and bailment of goods
8	**Investment Securities**	Securities and financial assets
9	**Secured Transactions**	Transactions secured by security interests

In 2003, amendments to Article 2 modernizing many aspects (as well as changes to Article 2A and Article 7) were proposed by the NCCUSL and the ALI. Because no states adopted the amendments and, due to industry opposition, none were likely to, in 2011 the sponsors withdrew the amendments. As a result, the official text of the UCC now corresponds to the law that most states have enacted.

In 1989, the National Conference of Commissioners on Uniform State Laws recommended that Article 6 of the UCC, dealing with bulk sales, be repealed as obsolete. Approximately 45 states have done so. Two others have followed the alternative recommendation of revising Article 6.[citation needed]

A major revision of Article 9, dealing primarily with transactions in which personal property is used as security for a loan or extension of credit, was enacted in all states. The revision had a uniform effective date of July 1, 2001 although in a few states it went into effect shortly after that date.[10] In 2010, NCCUSL and the ALI proposed modest amendments to Article 9. Several states have already enacted these amendments, which have a uniform effective date of July 1, 2013.[citation needed]

The controversy surrounding with what is now termed the Uniform Computer Information Transactions Act (UCITA) originated in the process of revising Article 2 of the UCC. The provisions of what is now UCITA were originally meant to be "Article 2B" on Licenses within a revised Article 2 on Sales. As the UCC is the only uniform law that is a joint project of NCCUSL and the ALI, both associations must agree to any revision of the UCC (i.e., the model act; revisions to the law of a particular state only require enactment in that state). The proposed final draft of Article 2B met with controversy within the ALI, and as a consequence the ALI did not grant its assent. The NCCUSL responded by renaming Article 2B and promulgating it as the UCITA. As of October 12, 2004, only Maryland and Virginia have adopted UCITA.

The overriding philosophy of the Uniform Commercial Code is to allow people to make the contracts they want, but to fill in any missing provisions where the agreements they make are silent. The law also seeks to impose uniformity and streamlining of routine transactions like the processing of checks, notes, and other routine commercial paper. The law frequently distinguishes between merchants, who customarily deal in a commodity and are presumed to know well the business they are in, and consumers, who are not.

The UCC also seeks to discourage the use of legal formalities in making business contracts, in order to allow business to move forward without the intervention of lawyers or the preparation of elaborate documents. This last point is perhaps the most questionable part of its underlying philosophy; many[who?] in the legal profession have argued that legal formalities discourage litigation by requiring some kind of ritual that provides a clear dividing line that tells people when they have made a final deal over which they could be sued.

Article 2[edit]

Article 2 deals with sales, and Article 2A deals with leases.

Contract formation[edit]

- Firm offers (offers to buy or sell goods and promising to keep the offer open for a period of time) are valid without consideration if signed by the offeror, and are irrevocable for the time stated on the purchase order (but no longer than three months), or, if no time is stated, for a reasonable time.[11]
- An offer to buy goods for "prompt shipment" invites acceptance by either prompt shipment or a prompt promise to ship. Therefore, this offer is not strictly unilateral. However, this "acceptance by performance" does not even have to be by conforming goods (for example, incomplete sets).[12]
- Consideration—modifications without consideration may be acceptable in a contract for the sale of goods.[13]
- Failure to state price—In a contract for the sale of goods, failure to state a price will not prevent the formation of a contract if the parties' original intent was to form a contract. A reasonable price will be determined by the court.[11]
- Assignments—a requirements contract can be assigned, provided the quantity required by the assignee is not unreasonably disproportionate to the original quantity.[14]

Contract repudiation and breach[edit]

- Nonconforming goods—If non-conforming goods are sent with a note of accommodation, such tender is construed as a counteroffer, and if accepted, forms a new contract and binds the buyer at previous contract price. If the seller refuses to conform and the buyer does not accept, the buyer must return all non conforming goods at sellers expense within thirty days of receipt.
- Perfect tender—The buyer however does have a right of "perfect tender" and can accept all, reject all, or accept conforming goods and reject the rest; within a reasonable time after delivery but before acceptance, he must notify the seller of the rejection. If the buyer does not give a specific reason (defect), he cannot rely on the reason later, in legal proceedings (akin to the cure before cover rationale). Also, the contract is not breached per se if the seller delivered the non-conforming goods, however offensive, before the date of performance has hit.

- "Reasonable time/good faith", four weeks' minimum lead time, standard—Such standard is required from a party to a contract indefinite as to time, or made indefinite by waiver of original provisions.
- Requirements/Output contracts—The UCC provides protection against disproportionate demands, but must meet the "good faith" requirement.
- Reasonable grounds for insecurity—In a situation with a threat of non-performance, the other part may suspend its own performance and demand assurances in writing. If assurance is not provided "within a reasonable time not exceeding 30 days", the contract is repudiated.[15]
- Battle of forms—New terms will be incorporated into the agreement unless:
  - the offer is limited to its own terms,
  - they materially alter the original terms (limit liability etc.),
  - the first party objects to new terms in a timely manner, or the first party has already objected to new terms. Whether the new terms "materially alter" the original offer may depend on the nature of the item (e.g. a delay in delivery of nails is not the same as for fish).
- Battle of forms—A written confirmation of an offer sent within a reasonable time operates as an acceptance even though it states terms that are additional to or different from those offered, unless acceptance is expressly made conditional to the additions.
- Statute of frauds as applicable to the sale of goods—The actual contract does not need to be in writing. Just some note or memo must be in writing and signed. However, the UCC exception to the signature requirement is where written confirmation is received and not objected to within 10 days.[16]
- Cure/cover—The buyer must give the seller time to cure the defective shipment before seeking cover.
- FOB place of business—The seller assumes risk of loss until the goods are placed on a carrier. FOB destination: the seller assumes risk of loss until the shipment arrives at its destination. If the contract leaves out the delivery place, it is the seller's place of business.
- Risk of loss—Equitable conversion does not apply. In the sale of specific goods, the risk of loss lies with the seller until tender. Generally, the seller bears risk of loss until the buyer takes physical possession of the goods (the opposite of realty).
- Reclamation—Successful reclamation of goods excludes all other remedies with respect to the goods.[17] The seller can reclaim goods upon demand within 20 days after the buyer receives them if the seller discovers that the buyer received the goods while insolvent.
- Rightfully rejected goods—A merchant buyer may follow reasonable instructions of the seller to reject the goods. If no such instructions are given, the buyer may make a reasonable effort to sell them, and the buyer/bailee is entitled to 10% of the gross proceeds.
- Implied warranty of fitness—Implied warranty of fitness arises when the seller knows the buyer is relying upon the seller's expertise in choosing goods. Implied warranty of merchantability: every sale of goods fit for ordinary purposes. Express warranties: arise from any statement of fact of promise.
- UCC damages for repudiating/breaching seller—Difference between 1) the market price when the buyer learned of breach and the 2) contract price 3) plus

incidental damages. An aggrieved seller simply suing for the contract price is economically inefficient.[18]

- Specially manufactured goods—Specially manufactured goods are exempt from statute of frauds where manufacturer has made a "substantial beginning" or "commitments for the procurement" of supplies.

Section 2-207: Battle of the forms[edit]

Main article: Offer and acceptance § Battle of the forms

One of the most confusing and fiercely litigated sections of the UCC is Section 2-207,[19] which Professor Grant Gilmore called "arguably the greatest statutory mess of all time".[20] It governs a "battle of the forms" as to whose boilerplate terms, those of the offeror or the offeree, will survive a commercial transaction where multiple forms with varying terms are exchanged. This problem frequently arises when parties to a commercial transaction exchange routine documents like requests for proposals, invoices, purchase orders, and order confirmations, all of which may contain conflicting boilerplate provisions.

The first step in the analysis is to determine whether the UCC or the common law governs the transaction. If the UCC governs, courts will usually try to find which form constitutes the offer. Next, the offeree's acceptance forms bearing the different terms is examined. One should note whether the acceptance is expressly conditional on its own terms. If it is expressly conditional, it is a counteroffer, not an acceptance. If performance is accepted after the counteroffer, even without express acceptance, under 2-207(3), a contract will exist under only those terms on which the parties agree, together with UCC gap-fillers.

If the acceptance form does not expressly limit acceptance to its own terms, and both parties are merchants, the offeror's acceptance of the offeree's performance, though the offeree's forms contain additional or different terms, forms a contract. At this point, if the offeree's terms cannot coexist with the offeror's terms, both terms are "knocked out" and UCC gap-fillers step in. If the offeree's terms are simply additional, they will be considered part of the contract unless (a) the offeror expressly limits acceptance to the terms of the original offer, (b) the new terms materially alter the original offer, or (c) notification of objection to the new terms has already been given or is given within a reasonable time after they are promulgated by the offeree.

Because of the massive confusion engendered by Section 2-207, a revised version was promulgated in 2003, but the revision has never been enacted by any state.

Article 8[edit]

A stock certificate, as distinct from a dematerialized interest in a security

The ownership of securities is governed by Article 8 of the Uniform Commercial Code (UCC). This Article 8, a text of about 30 pages,[21] underwent important recasting in 1994. That update of the UCC treats the majority of the transfers of dematerialized securities as mere reflections of their respective initial issue held primarily by two American central securities depositories, respectively The Depository Trust Company (DTC) for securities issued by corporations and the Federal Reserve for securities issued by the Treasury Department. In this centralised system, the title transfer of the securities does not take place at the time of the registration with the issuer's registrar for the account of the investor, but within the systems managed by DTC or by the Federal Reserve.

This centralization is not accompanied by a centralized register of the investors/owners of the securities, such as the systems established in Sweden and in Finland (so-called "transparent systems"). Neither DTC nor the Federal Reserve hold an individual register of the transfers of property reflecting beneficial owners. The consequence for an investor is that proving ownership of its securities relies entirely on the accurate replication of the transfer recorded by DTC and FED and others in the intermediated holding system at the lower tiers of the holding chain of the securities. Each one of these links is composed respectively of an account provider (or intermediary) and of an account holder.

The rights created through these links are purely contractual claims: these rights are of two kinds:

1. For the links where the account holder is itself an account provider at a lower tier, the right on the security during the time where it is credited there is characterized as a "securities entitlement", which is an "ad hoc" concept invented in 1994: *e.g.,* designating a claim that will enable the account holder to take part to a prorate distribution in the event of bankruptcy of its account provider.
2. For each link of the chain, in which the final account holder is at the same time the final investor, its "security entitlement" is enriched by the "substantial" rights defined by the issuer: the right to receive dividends or interests and, possibly, the right to take part in the general meetings, when that was laid down in the account agreement concluded with the account provider. The combination of these reduced material rights and of these

variable substantial rights is characterised by article 8 of the UCC as a "beneficial interest".

This decomposition of the rights organized by Article 8 of the UCC results in preventing the investor to revindicate the security in case of bankruptcy of the account provider, that is to say the possibility to claim the security as its own asset, without being obliged to share it at its prorate value with the other creditors of the account provider. As a consequence, it also prevents the investor from asserting its securities at the upper level of the holding chain, either up to DTC or up to a sub-custodian. Such a "security entitlement," unlike a normal ownership right, is no longer enforceable "erga omnes" to any person supposed to have the security in its custody. The "security entitlement" is a mere relative right, therefore a contractual right.

This re-characterization of the proprietary right into a simple contractual right may enable the account provider to "re-use" the security without having to ask for the authorization of the investor. This is especially possible within the framework of temporary operations such as security lending, option to repurchase, buy to sell back or repurchase agreement. This system the distinction between the downward holding chain which traces the way in which the security was subscribed by the investor and the horizontal and ascending chains which trace the way in which the security has been transferred or sub-deposited.[22]

Contrary to claims suggesting that Article 8 denies American investors their security rights held through intermediaries such as banks, Article 8 has also helped US negotiators during the negotiations of the Geneva Securities Convention, also known as the Unidroit Convention on Substantive Rules for Intermediated Securities.

Article 9[edit]

Further information: Secured transactions in the United States

Article 9 governs security interests in personal property as collateral to secure a debt. A creditor with a security interest is called a *secured party*.

Fundamental concepts under Article 9 include how a security interest is created (called *attachment*); how to give notice of a security interest to the public, which makes the security interest enforceable against others who may claim an interest in the collateral (called *perfection*); when multiple claims to the same collateral exist, determining which interests prevail over others (called *priority*); and what remedies a secured party has if the debtor defaults in payment or performance of the secured obligation.

Article 9 does not govern security interests in real property, except fixtures to real property. Security interests in real property include mortgages, deeds of trusts, and installment land contracts. There may be significant legal issues around security interests in Bitcoin.[23]

The obligee which is the debtor shall return all assets stated in the collateral to secured party after the perfection of default by secured party in response to protest by the Obligee within specified time frame in the civil code and UCC Article 9-3.

The Model Tribal Secured Transactions Act (MTSTA) is a model act written by the Uniform Law Commission (ULC) and tailored to provide Native American tribes with a legal system to govern secured transactions in Indian country. It was derived from the UCC, primarily Article 9.

International influence[edit]

Certain portions of the UCC have been highly influential outside of the United States. Article 2 had some influence on the drafting of the United Nations Convention on Contracts for the International Sale of Goods (CISG), though the end result departed from the UCC in many respects (such as refusing to adopt the mailbox rule). Article 5, governing letters of credit, has been influential in international trade finance simply because so many major financial institutions operate in New York. Article 9, which established a unified framework for security interests in personal property, directly inspired the enactment of Personal Property Security Acts in every Canadian province and territory except Quebec from 1990 onwards, followed by New Zealand's Personal Property Securities Act 1999 and the Australian Personal Property Securities Act of 2009.[24]

See also[edit]

Contract law

Part of the common law series

Contract formation

- Offer and acceptance
- Posting rule
- Mirror image rule
- Invitation to treat
- Firm offer
- Consideration
- Implication-in-fact
- Collateral contract

Defenses against formation

- Lack of capacity
- Duress
- Undue influence

- Illusory promise
- Statute of frauds
- *Non est factum*

Contract interpretation

- Parol evidence rule
- Contract of adhesion
- Integration clause
- *Contra proferentem*

Excuses for non-performance

- Mistake
- Misrepresentation
- Frustration of purpose
- Impossibility
- Impracticability
- Illegality
- Unclean hands
- Unconscionability
- Accord and satisfaction

Rights of third parties

- Privity of contract
- Assignment
- Delegation
- Novation
- Third-party beneficiary

Breach of contract

- Anticipatory repudiation
- Cover
- Exclusion clause
- Efficient breach
- Deviation
- Fundamental breach

Remedies

- Specific performance
- Liquidated damages
- Penal damages
- Rescission

Quasi-contractual obligations

- Promissory estoppel
- *Quantum meruit*
- Unjust enrichment

Related areas of law

- Conflict of laws
- Commercial law

Other common law areas

- Tort law
- Property law
- Wills, trusts, and estates
- Criminal law
- Evidence

- v
- t
- e

- UCC-1 financing statement
- Uniform Commercial Code adoption
- United States contract law
- Codification
- Commercial law
- Uniform act
- United Nations Convention on Contracts for the International Sale of Goods (CISG)
- Convention on the Limitation Period in the International Sale of Goods
- Certified Commercial Contracts Manager (CCCM) professional certification in contract management offered by the National Contract Management Association (NCMA) and specifically covering the UCC

CIF vs. FOB: What's the Difference?

- FACEBOOK
- TWITTER
- LINKEDIN

By CHRISTINA MAJASKI
Updated Feb 27, 2020

CIF vs. FOB: An Overview

Cost, Insurance, and Freight (CIF) and Free on Board (FOB) are international shipping agreements used in the transportation of goods between a buyer and a seller. They are among the most common of the 12 international commerce terms (Incoterms) established by the International Chamber of Commerce

(ICC) in 1936.[1,2] The specific definitions vary somewhat in every country, but, in general, both contracts specify origin and destination information that is used to determine where liability officially begins and ends, and outline the responsibilities of buyers to sellers, as well as sellers to buyers.

Melissa Ling {Copyright} Investopedia, 2019.
KEY TAKEAWAYS

- Cost, Insurance and Freight and Free on Board are international shipping agreements used in the transportation of goods between a buyer and a seller.
- CIF is considered a more expensive option when buying goods.
- FOB contracts relieve the seller of responsibility once the goods are shipped.

CIF

CIF is considered a more expensive option when buying goods. This is because the seller uses a forwarder of his or her choice who may charge the buyer more in order to increase the profit on the transaction. Communication can also be an issue because the buyer relies solely on people who are acting on behalf of the seller. The buyer might still have to pay additional fees at the port, such as docking fees and customs clearance fees before the goods are cleared.

Volume 75%

1:19

Cost, Insurance and Freight (CIF)

FOB

FOB contracts relieve the seller of responsibility once the goods are shipped. After the goods have been loaded—technically, "passed the ship's rail,"—they are considered to be delivered into the control of the buyer. When the voyage begins, the buyer then assumes all liability.[2] The buyer can, therefore, negotiate a cheaper price for the freight and insurance with a forwarder of his or her choice. In fact, some international traders seek to maximize their profits by buying FOB and selling CIF.

With FOB contracts, when the voyage begins, the buyer assumes all liability for the shipped goods.

Key Differences

CIF and FOB mainly differ in who assumes responsibility for the goods during transit. In CIF agreements, insurance and other costs are assumed by the seller, with liability and costs associated with successful transit paid by the seller up until the goods are received by the buyer. The responsibilities of the seller include transporting the goods to the nearest port, loading them on a vessel and paying for the insurance and freight.[2]

In some agreements, goods are not considered to be delivered until they are actually in the buyer's possession; in others, the goods are considered delivered—and are the buyer's responsibility—once they reach the port of destination.

Each agreement has particular advantages and drawbacks for both parties. While sellers often prefer FOB and buyers prefer CIF, some trade agreements find one method more convenient for both parties. A seller with expertise in local customs that the buyer lacks would likely assume CIF responsibility to encourage the buyer to accept a deal, for example. Smaller companies may prefer the larger party to assume liability, as this can result in lower costs. Some companies also have special access through customs, document freight charges when calculating taxation, and other needs that necessitate a particular shipping agreement.

CFR vs. CIF: What's the Difference?

- FACEBOOK
- TWITTER
- LINKEDIN

By J.B. MAVERICK
Updated Jul 13, 2020

Cost and Freight vs. Cost, Insurance, and Freight: An Overview

Cost and freight (CFR) is a trade term that requires the seller to transport goods by sea to a required port. Cost, insurance, and freight (CIF) is what a seller pays to cover the cost of shipping, as well as the insurance to protect against the potential damage of loss to a buyer's order.

The two are part of a larger group of international trade rules known as Incoterms. These global guidelines for traders were devised by the International Chamber of Commerce (ICC), with the first version published in 1936. Each term refers to an agreement governing the responsibilities of shipping that fall respectively to buyers and sellers in an international trade transaction. This system of agreements aids in an orderly process of international trade by making contract models available that are easy to identify and understand in all languages.

KEY TAKEAWAYS

- Cost and freight (CFR) and cost, insurance, and freight (CIF) are terms used in international trade for the shipping of goods by sea.
- CFR requires the seller to arrange for the transport of goods by sea to the buyer's (required) destination. This includes the cost of shipping but excludes the purchase of marine insurance.
- CIF is similar to CFR, except it also requires the seller to take out an agreed amount of marine insurance to protect against the loss, damage, or destruction of the order.

Cost and Freight

Cost and freight is a legal agreement between a buyer and a seller in international trade. The rule applies to goods that are transported by sea.

It requires the seller to transport goods by sea to the buyer's (required) destination. The cost, therefore, is borne by the seller. Under CFR, the seller is also required to give the buyer the documentation necessary to pick up the goods from the carrier.

With CFR agreements, the shipping party has a greater amount of responsibility in arranging and paying for transportation than with minimal free on board (FOB) shipping, where the shipper is only responsible for delivering goods to the port of origin for shipping.

The agreement does not, however, require the seller to purchase marine insurance against the loss, destruction, or damage to the goods during transit. The risk to the goods passes once they reach the vessel, so the seller is not liable.

The receiver—or buyer—assumes responsibility once the ship has docked in the destination port. All remaining costs including those for unloading and any further transportation costs are then assumed by the receiver or buyer.

Cost, Insurance, and Freight

Like CFR, CIF is restricted for use between parties who deal in goods that are transported by sea.

CIF agreements are also nearly the same as CFR agreements. The seller is still responsible for all arrangements and transport costs for shipping goods to the agreed-upon destination port. The receiver then assumes all cost responsibilities once the ship has reached port.

The difference between the two agreements, though, lies in one additional responsibility that falls on the shipper (seller), who must also provide a minimum amount of marine insurance on the goods being shipped.

The amount of insurance is typically agreed upon between the buyer and seller. The seller is also responsible for any additional costs that come with transporting the goods. This includes any extra paperwork required for customs or inspections or any rerouting that must be done during transport.

The goods are the responsibility of the buyer or receiver once the goods arrive at the required port and are taken off the vessel.

The terms of the contract will outline the exact nature of the responsibilities of the seller prior to transport. Most CIF contracts will outline the following for the seller:

- The purchase of export licenses for the product as required
- Covering the cost and contracts of transporting the goods
- The requirement of insurance to protect the order
- Providing the necessary inspections for the products
- If required, paying for any damage or destruction to the order

The Bottom Line

CFR and CIF are both very similar terms that relate to transporting goods by sea where the primary responsibility lies with the seller, particularly in the cost of shipping the freight. The difference between the two is that CIF requires marine insurance to be included, paid by the seller, that provides protection against any damages to the goods.

Cost and Freight—CFR vs. Free on Board—FOB: What's the Difference?

- FACEBOOK
- TWITTER
- LINKEDIN

By J.B. MAVERICK
Updated Feb 17, 2020

Cost and Freight—CFR vs. Free on Board—FOB: What's the Difference?

The primary difference between using cost and freight (CFR) and free on board (FOB) shipping lies in who must pay for various shipping or freight costs—the buyer or the seller.

The terms refer to the point at which transfer of responsibility for goods shipped occurs, from the seller/shipper to the buyer/receiver. The terms also specify who is responsible for which costs.

Both cost and freight and free on board are legal terms in international trade. You will see these terms as part of the International Chamber of Commerce (ICC)'s collection of global commerce terms, known as Incoterms. These terms govern shipping responsibilities for international trade.

KEY TAKEAWAYS

- Cost and Freight, or COF, and Free on Board, or FOB, are legal terms in international trade.
- Free on Board means the seller is responsible for the product only until it is loaded on board a shipping a vessel, at which point the buyer is responsible.
- With CFR, the seller must arrange and pay all costs to ship the product to a destination port, at which point the buyer becomes responsible.

The purpose of establishing Incoterms, such as FOB and CFR, was to facilitate trade by providing standard contract terms. This standardization allows for easy understanding of responsibility, regardless of the language spoken.

Understanding the Difference Between Cost and Freight—CFR vs. Free on Board

Cost and Freight

Under a cost and freight (CFR) agreement, the seller has a weightier responsibility for arranging and paying for transportation the ordered products. For goods shipped CFR, the shipper is responsible for organizing and paying for the shipping of the products by sea to the destination port, as specified by the receiver.

Also, under CFR, the seller must provide the buyer with the documents necessary to obtain them from a carrier. Usually, this includes providing the required customs forms to clear the cargo through the customs inspection process. However, using CFR, the seller doesn't have to buy marine insurance against the risk of loss or damage to the cargo during transit.

Responsibility for the goods only transfers to the buyer or receiver when the ship reaches the designated destination port. The buyer is then responsible for unloading costs and any further transportation costs to the final destination.

Free on Board

Free on board refers to a shipping arrangement in which the seller or shipper retains ownership and responsibility for the product only until they are loaded on board a shipping a vessel. Once they are on the ship, or "over-the-rail," the obligation transfers to the buyer.

The supplier is only responsible for providing transportation of the goods sold to a designated main shipping origin point. This point is typically a port, since Incoterms are most commonly used for international trade where goods are transported by sea.

Delivery is considered to be accomplished, and responsibility for the goods transferred from the shipper to the buyer or receiver, at the point when goods are loaded aboard the ship at the designated port of origin.

The receiver is responsible for arranging and paying for the actual shipping cost from the port of origin to the destination port and for arranging and paying for transportation to any further destination. The shipper is, thus, free of responsibility once the goods are on board the ship.

FOB destination is another form of this contract type. In this case, it indicates the onus for the goods remains with the seller until the product reaches the specified port.

Ex Works (EXW) vs. Free On Board (FOB): What's the Difference?

- FACEBOOK
- TWITTER
- LINKEDIN

By TROY SEGAL
Updated Mar 22, 2020

Ex Works (EXW) vs. Free On Board (FOB): An Overview

Ex works (EXW) and free on board (FOB) are both international trade terms, known as Incoterms that dictate the responsibilities of buyers and sellers, including which parties are required to cover all costs and arrangements related to the shipping of goods.

With ex works, the seller is not obligated to load the goods on the buyer's designated method of transport. Instead, the seller must make the product available at a selected location, and the buyer must incur transportation costs. With free on board, the seller does have to load the goods on the buyer's method of transport at the shipping point and may be responsible for them throughout the trip and to the final destination. Free on board means the seller retains ownership and responsibility for the goods until they are loaded ‘on board’ a shipping vessel. Once on the ship, all liability transfers to the buyer.

KEY TAKEAWAYS

- Ex works and Free on Board are both international shipping terms.
- With Ex works, the seller makes the product available at a designated location, and the buyer incurs transport costs.
- With Free on Board, the seller is responsible for the goods until they are loaded on a shipping vessel; at which point, all liability transfers to the buyer.

Ex Works

Shipping using the designation of ex works (EXW) indicates the seller has a responsibility to make sure the cargo the buyer can access and pick up the cargo at their place of business. Transportation costs and associated risks are no longer a burden for the seller under the EXW option, and this favors the shipper.

For example, say a seller of electronic products is located in San Francisco, Calif. The buyer is located in New York, N.Y. The buyer and seller agree on the price for these products and sign an ex works trade agreement. The buyer wants to pick up the products in two weeks, and the seller must have the products ready for transport. However, the buyer is responsible for all of the further costs associated with delivering the goods to New York City. The buyer pays for all the transportation costs, and if the products get lost along the way, the seller is not liable.

Free On Board

Unlike EXW, when a buyer and a seller enter a free on Board (FOB) trade agreement, the seller is obligated to deliver the goods to a destination for transfer to a carrier designated by the buyer. The location designation in the FOB trade agreement is the point at which ownership is transferred from the seller to the buyer. The responsibility often shifts at this arrival location. The seller is responsible for transporting goods up until this point, but the buyer may or may not be responsible for all transportation arrangements from this point to his location, depending on the terms of the agreement.

For example, suppose a buyer located in Los Angeles, Calif., wants to purchase computers from a seller located in Chicago, Ill. The buyer and seller sign a FOB trade agreement. The buyer designates that the computers be shipped by airplane, and the seller is obligated for the transportation expenses associated with transporting the computers to the airport located in Los Angeles. At this point, the responsibilities shift and the buyer is responsible for all further costs related to transporting the computers to the final destination. The buyer is also liable for any damages that may occur during this phase of the shipping process.

Special Considerations

Contracts involving international transportation often contain abbreviated trade terms that describe conditions such as the time and place of delivery, payment, when the risk of loss shifts from the seller to the buyer. Other items include who pays the costs of freight and insurance considerations. The more common terms are called Incoterms, which the International Chamber of Commerce (ICC) publishes.[1]

However, companies that ship goods in the United States must also follow the Uniform Commercial Code (UCC).[2] Due to their being more than one set of rules, the parties in a contract must specify which governing laws they used for a shipment.

When do you buy CIF and when do you buy FOB?

- FACEBOOK

- TWITTER
- LINKEDIN

By INVESTOPEDIA
Updated Jan 26, 2015

The abbreviation CIF stands for "cost, insurance and freight," and FOB means "free on board." These are terms are used in international trade in relation to shipping, where goods have to be delivered from one destination to another through maritime shipping. The terms are also used for inland and air shipments.

CIF is considered a better way to buy goods for those who are new to international trade. It might also be a better option for new traders who have small cargos. In CIF, the seller is responsible for transporting goods to the nearest port, loading the goods on the ship and paying freight for the goods to be delivered to a port chosen by the buyer. The seller is also responsible for paying insurance for the goods.

It is better to buy FOB for those who are already familiar with international trade. These traders have their own forwarding agents and logistic agents in place at the port where the buyer loads the goods to be imported. In FOB trading, the seller is only responsible for taking the goods to the nearest port on his or her end. This location is indicated after FOB, and it is important to accountants, as goods become assets to the buyer on the day they reach that location. The goods are considered delivered once they cross the ship's rail. The buyer is therefore responsible for paying the ship's freight and insurance. The advantage of buying FOB is that the buyer can get better deals on freight services, unlike in CIF where the buyer has to rely on the freight services chosen by the seller. This is because the seller might be looking to make profit from the freight services. The buyer therefore makes profit from buying FOB.

A simple rule of thumb in international trade is to buy FOB and to sell CIF. Following this rule can lead to some profit for the trader.

Do CIF charges affect customs duties?

- FACEBOOK
- TWITTER
- LINKEDIN

By INVESTOPEDIA
Updated Oct 26, 2018

The abbreviation CIF stands for "cost, freight and insurance." It is a term used in international trade in reference to transporting goods from one destination to another through maritime shipping. The term has changed to include inland and airline shipments.

The CIF Model

When a buyer purchases goods and chooses to have them delivered using the CIF model, the seller does most of the work. The seller is therefore responsible for paying the transport to deliver goods to the nearest port, the freight to deliver goods to a destination chosen by the buyer, and insurance for the goods.

The responsibility of the seller ends once the goods reach the buyer's port of choice. The buyer is then responsible for other charges that enable the goods to be cleared from the port. These charges include customs clearance fees, port security fees, docking charges and warehouse storage fees.

The Free On Board Model

CIF charges do not affect customs charges. The buyer still has to pay customs duty whether shipping is done through CIF or the Free On Board model (FOB). The FOB model is better for a buyer in terms of profit, because the buyer is responsible for insuring the goods and paying freight when using FOB. In FOB, the goods are considered delivered once they cross the ship's rail. The buyer can negotiate a better price for freight than the seller who might be looking to make extra profit. There is also better communication when the buyer uses his or her own forwarder rather than relying on one selected by the vendor who might charge extra to make a profit.

Free on Board Shipping vs. Free on Board Destination: What's the Difference?

- FACEBOOK
- TWITTER
- LINKEDIN

By STEVEN NICKOLAS
Updated May 13, 2019

Free on Board – FOB Shipping Point vs. Free on Board Destination: An Overview

International commercial laws have been in place for decades and were established to standardize the rules and regulations surrounding the shipment and transportation of goods. Having special contracts in place have been important since international trade can be complicated, and because trade laws differ between countries.

These international contracts outline provisions including the time and place of delivery as well as the terms of payment agreed upon by the two parties. When the risk of loss shifts from the seller to the buyer, and who foots the bill for freight and insurance all depends on the nature of the contract.

Free onboard (FOB) shipping point and free onboard destination are two of several International Commercial Terms (Incoterms) published by the International Chamber of Commerce (ICC).[1] FOB shipping point and FOB destination indicate the point at which the title of goods transfers from the seller to the buyer. The distinction is important in specifying who is liable for goods lost or damaged during shipping. The primary difference between the two contracts is in the timing of the transfer of the title for the goods.[2]

An update to the ICC's Incoterms is due in 2020.

Free on board, also referred to as freight on board,[3] only refers to shipments made via waterways, and does not apply to any goods transported by vehicle or by air.[2]

According to the U.S. Department of Transportation's Bureau of Transportation Statistics (BTS), 884 million tons of product moved by water in 2015. Of this total, 95 million tons were export goods, 246 million tons were imported goods, and the remaining 544 million tons were moved by water within the United States. BTS projects the amount of cargo transport that will increase each year at around 1.4% until 2045.[4]

KEY TAKEAWAYS

- Free on Board is a trade term used to indicate whether the buyer or the seller is liable for goods that are lost, damaged, or destroyed during shipment.
- Free on Board Shipping Point indicates that the buyer takes responsibility for loss or damage the moment the goods get to the shipper.
- Free on Board Destination indicates that the seller retains liability for loss or damage until the goods are delivered to the buyer.
- FOB contracts have become more sophisticated in response to the increasing complexities of international shipping.

Free on Board – FOB Shipping Point

FOB shipping point, also known as FOB origin, indicates that the title and responsibility of goods transfer from the seller to the buyer when the goods are placed on a delivery vehicle.[3]

Since FOB shipping point transfers the title of the shipment of goods when the goods are placed at the shipping point, the legal title of those goods is transferred to the buyer. Therefore, the seller is not responsible for the goods during delivery. FOB shipping point is a further limitation or condition to FOB as responsibility changes hands at the seller's shipping dock.

For example, assume Company ABC in the United States buys electronic devices from its supplier in China, and the company signs a FOB shipping point agreement. If the designated carrier damages the package during delivery, Company ABC assumes full responsibility and cannot ask the supplier to reimburse the company for the losses or damages. The supplier is only responsible for bringing the electronic devices to the carrier.

The ICC was established in 1919.

Free on Board – FOB Destination

Conversely, with FOB destination, the title of ownership is transferred at the buyer’s loading dock, post office box, or office building. Once the goods are delivered to the buyer’s specified location, the title of ownership of the goods transfers from the seller to the buyer. Consequently, the seller legally owns the goods and is responsible for the goods during the shipping process.[3]

For example, assume Company XYZ in the United States buys computers from a supplier in China and signs a FOB destination agreement. Assume the computers were never delivered to Company XYZ's destination, for whatever reason. The supplier takes full responsibility for the computers and must either reimburse Company XYZ or reship the computers.

Shipping terms affect the buyer's inventory cost because inventory costs include all costs to prepare the inventory for sale. This accounting treatment is important because adding costs to inventory means the buyer does not immediately expense the costs and this delay in recognizing the cost as an expense affects net income.

Special Considerations

Another key difference between these two terms is the way in which they are accounted. Since the buyer assumes liability after the goods are placed on the ship for transport, the company can record an increase in its inventory at that point. Similarly, the seller records the sale at the same time. If there is any damage or loss of goods during transport, the buyer may file a claim since the company holds title during delivery.

The accounting rules change for FOB destination. In this case, the seller completes the sale in its records once the goods arrive at the receiving dock. That's when the buyer records the increase in its inventory.

There is also a difference in the division of costs. When it comes to the FOB shipping point option, the seller assumes the transport costs and fees until the goods reach the port of origin. Once the goods are on the ship, the buyer is financially responsible for all costs associated with transport as well as customs, taxes, and other fees. For FOB destination, the seller assumes all costs and fees until the goods reach their destination. Upon entry into the port, all fees—including customs, taxes and other fees—are borne by the buyer.

Cost, Insurance, and Freight – CIF Definition

By ALEXANDRA TWIN
Reviewed By AMY DRURY
Updated Apr 30, 2020

What Is Cost, Insurance, and Freight (CIF)?

Cost, insurance, and freight (CIF) is an expense paid by a seller to cover the costs, insurance, and freight of a buyer's order while it is in transit. The goods are exported to a port named in the sales contract. Until the goods are fully loaded onto a transport ship, the seller bears the costs of any loss or damage to the product. Further, if the product requires additional customs duties, export paperwork, or inspections or rerouting, the seller must cover these expenses. Once the freight loads, the buyer becomes responsible for all other costs. CIF is similar but not the same as carriage and insurance paid to (CIP).

KEY TAKEAWAYS:

- Cost, insurance, and freight (CIF) is a common method of import and export shipping.
- CIF determines when the responsibility for goods transfers from the seller to the buyer.
- CIF is one of the international commerce terms known as Incoterms.

Terms of Cost, Insurance, and Freight (CIF)

The contract terms of CIF define when the liability of the seller ends and the liability of the buyer begins. CIF is a conventional method of shipping goods for importers. It is similar to free on board shipping with the primary difference being which party is responsible for the expenses up to the point of loading the product onto the transport vessel. Usually, exporters who have direct access to ships will use CIF. Under CIF terms, the seller is responsible for specific protections for an order. The seller's responsibilities include:

- Purchasing export licenses for the product
- Covering the cost and contracts of moving or carrying the goods
- Insurance to protect the value of the order
- Providing inspections of products
- Covering the cost of any damage or destruction to the goods

The seller must deliver the goods to the ship within the agreed-upon timeframe. They must also give the buyer sufficient notice of delivery and provide proof of delivery and loading.

The exact details of the sales contract will determine when the liability for the goods transfers from seller to buyer. In most cases, the seller's obligation ends once cargo loading is complete. However, a buyer may stipulate that the seller is responsible until the goods reach a port of import or even their final destination.

Following the terms in the sales contract, once the goods change hands, the buyer must pay the agreed price and must, now, cover any additional transportation, inspection, and licensing costs. Other typical expenses include customs duties, taxes, and the shipment of goods to their final location.

CIF is different from cost and freight provision (CRF) whereby sellers are not required to insure goods in transit.

The ICC and Cost, Insurance, and Freight

CIF is one of the international commerce terms known as Incoterms. Incoterms are common trade rules developed by the International Chamber of Commerce (ICC) in 1936. The ICC established these terms to govern the shipping policies and responsibilities of buyers and sellers who engage in international trade. Incoterms are often similar to domestic terms (such as the U.S. Uniform Commercial Code) but with international applications. For example, the parties to a contract must state the locale of the governing law for their terms. The ICC limits the use of CIF of transport goods to only those that move via inland waterways or by sea.

The ICC's official definition of CIF reads,

"The seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination. The seller is also responsible for insuring to cover the risk of loss or damage during carriage. Further insurance beyond the required minimums must be agreed upon between the buying and selling parties or must be arranged for separately by the buyer. It is also important to note that the term applies only to sea and inland waterway transport."

Real World Example

Consider this hypothetical example: Best Buy orders 100 containers of flat-screen televisions from Sony using CIF to Kobe, a Japanese port. Sony delivers the order to the port and loads them onto the *Yantian Express*. Once loading is complete, Best Buy becomes liable for all costs associated with transporting the ordered goods to their final destination. As the container ship is en route, a fire breaks out in one of the cargo bays. The Best Buy television order receives damage from water during fire fighting efforts. Since the company used CIF shipping, Best Buy is responsible for ensuring the product is safe against damage during the voyage and assumes the cost of the damaged goods.

If you ship goods domestically, you may wonder why you need to know Incoterms too. FOB is FOB, isn't it?

Well, actually, no—it's not!

While the vast majority of companies in the United States use the shipping terms identified under the U.S. Uniform Commercial Code (UCC) when shipping domestically, these shipping terms aren't appropriate to use when exporting.

The codes you use for domestic shipping mean something different when shipping internationally. Domestic shippers often use a variation of the term FOB, for instance, which isn't appropriate internationally because of its very different meaning in that regard. Not only are the Incoterms 2020 rules different for both scenarios, but they also happen to be acronyms, which can make them even more confusing and difficult to remember.

In this article, we'll look in-depth at Incoterms 2020—what they are and how they originated, how to apply them, how exporters and importers benefit from them, and why they matter.

What Are Incoterms 2020 Rules?

Incoterms 2020 rules are the official terms published by the International Chamber of Commerce (ICC). They are a voluntary, authoritative, globally-accepted, and adhered-to text for determining the responsibilities of buyers and sellers for the delivery of goods under sales contracts for international trade. Incoterms closely correspond to the U.N. Convention on Contracts for the International Sales of Goods. Incoterms are known and implemented by all major trading nations.

Incoterms are only part of the whole export contract. They don't say anything about the price to be paid or the method of payment that is used in the transaction. Furthermore, Incoterms 2020 rules don't deal with the transfer of ownership of the goods, breach of contract, or product liability; all of these issues need to be considered in the contract of sale. Also, Incoterms 2020 rules can't override any mandatory laws.

The Origin of Incoterms

Differences in trading practices and legal interpretations between traders of different countries necessitated a need for a common set of rules. These rules needed to be easy to understand by all of the participants in order to prevent misunderstandings, disputes and litigation.

Incoterms were first conceived by the ICC in 1921, and the first Incoterms rules were created in 1936. They were officially designated as Incoterms in 1936. Since then, Incoterms have evolved into a codified worldwide contractual standard. They are periodically updated as events in international trade occur and require attention. Amendments and additions were made in 1953, 1967, 1976, 1980, 2000, 2010 and 2020.

Who Decides Incoterms Rules?

It's no small task to be in charge of an international standard. These international trade terms are decided upon by 13 ICC commissions made up of experts from the private sector from across the world. These individuals specialize in everything from fields of immediate concern to international business.

How Are Incoterms Rules Revised?

The Incoterms 2020 drafting group, led by co-chairs Christoph Martin Radtke and David Lowe, were in charge of revising the Incoterms rules. According to the ICC, "The group is formed by experts from various nationalities chosen for their extraordinary contribution to international commercial law and to the International Chamber of Commerce along the years."

Here’s a look at the process followed to revise Incoterms rules:

After the drafting group made its revisions, the revised drafts were circulated broadly and internationally through ICC National Committees, with the resulting comments and suggestions channeled back to the drafting group.

The final draft, once approved by the ICC Commission on Commercial Law and Practice, was submitted for adoption by the ICC Executive Board.

This broad, international consultation aimed to ensure that official ICC products possess an authority as representing the true consensus viewpoint of the world business community.

Incoterms 2020 Rules

The most current revision of the terms, Incoterms 2020, went into effect on January 1, 2020, and consists of 11 Incoterms.

The latest revision’s changes include the following:

- The most obvious change is renaming the term Delivered at Terminal (DAT) to Delivered at Place Unloaded (DPU).
- The most significant change relates to the term Free Carrier (FCA). Under this term, the buyer can now instruct its carrier to issue a bill of lading with an on-board notation to the seller so that they may satisfy the terms of a letter of credit.
- Under the revised term CIP, the seller is now responsible for purchasing a higher level of insurance coverage—at least 110% of the value of the goods as detailed in Clause A of the Institute Cargo Clauses. The insurance requirement hasn't changed for CIF.
- Incoterms 2020 rules recognizes sellers who may use their own transport to deliver the goods. The terms now expressly state that sellers can make a contract for carriage or simply arrange for the necessary transportation.

- Incoterms 2020 rules now specifically call out the import and export security requirements and identify whether the buyer or seller is responsible for meeting those requirements.

You'll find a detailed discussion of what's new with Incoterms 2020 rules and how to use them in my blog post, *Incoterms 2020: Here's What's New*.

While you can still use previous versions of Incoterms rules, like Incoterms 2010, it's not preferred; if you're not using Incoterms 2020 rules, you must clearly state which version you're using and make sure your documentation is correct throughout the transaction. If you're looking to streamline the export documentation process, Shipping Solutions export documentation and compliance software can help.

Get an overview of Incoterms® 2020 that everyone can understand.

Incoterm 2020 Definitions

Because each of the different Incoterms identify the responsibilities of the seller and the buyer in the transaction at different points in the shipping journey, certain Incoterms work better for certain modes of transportation.

Each of the 11 Incoterms is summarized below based on the mode of transport. For a more complete list of the responsibilities for each of the terms, you should get a copy of ICC's *Incoterms® 2020* book.

Incoterms for Any Mode of Transport

EXW (Ex Works)

The seller fulfills its obligations by having the goods available for the buyer to pick up at its premises or another named place (i.e. factory, warehouse, etc.). With Ex Works, the buyer bears all risk and costs starting when it picks up the products at the seller's location or other named place until the products are delivered to its location. Seller has no obligation to load the goods or clear them for export.

Keep in mind that under the U.S. Export Administration Regulations and the Foreign Trade Regulations, the seller cannot escape their responsibilities for export compliance and the requirement that they provide required data elements to the buyer's freight forwarder or some other designated party that has been authorized to submit the electronic export information through AESDirect. Read the article, *Who Is Responsible for Filing the Electronic Export Information?*

FCA (Free Carrier)

The seller is responsible for either making the goods available at its own premises or at a named place. In either case, the seller is responsible for loading the goods on the buyer's transport and is responsible for delivery to the port and export clearance including security requirements. Risk transfers once the goods are loaded on the buyer's transport.

This term has changed the most in the Incoterms 2020 rules. Previously, problems occurred with this term when the seller was responsible for loading the goods on a truck or some other transport hired by the buyer and not directly on the international carrier. If the seller and buyer had agreed on using a letter of credit as the payment method for this transaction, banks often require the seller to present a bill of lading with an on-board notation before they can get paid.

An international carrier won't typically provide a seller who did not present the goods directly to them with such a bill of lading. Under the new Incoterms 2020 rules, FCA allows the parties to agree in the sales contract that the buyer should instruct its carrier to issue a bill of lading with the on-board notation to the seller.

CPT (Carriage Paid To)

Seller clears the goods for export and delivers them to the carrier or another person stipulated by the seller at a named place of shipment, at which point risk transfers to the buyer. Seller is responsible for the transportation costs associated with delivering goods to the named place of destination but is not responsible for procuring insurance.

CIP (Carriage and Insurance Paid To)

Seller clears the goods for export and delivers them to the carrier or another person stipulated by the seller at a named place of shipment, at which point risk transfers to the buyer. Seller is responsible for the transportation costs associated with delivering goods and procuring insurance coverage to the named place of destination.

In Incoterms 2020 rules for CIP, the seller is now responsible for purchasing a higher level of insurance coverage—at least 110% of the value of the goods as detailed in Clause A of the Institute Cargo Clauses.

DAP (Delivered at Place)

Seller clears the goods for export and bears all risks and costs associated with delivering the goods to the named place of destination not unloaded. DAP means the buyer is responsible for all costs and risks associated with unloading the goods and clearing customs to import the goods into the named country of destination.

DPU (Delivered at Place Unloaded)

Previously named Delivered at Terminal (DAT), this Incoterm has been renamed Delivered at Place Unloaded (DPU) because the buyer and/or seller may want the delivery of goods to occur somewhere other than a terminal.

This term is often used for consolidated containers with multiple consignees, and it is the only term that tasks the seller with unloading the goods. Seller clears the goods for export and bears all risks and costs associated with delivering the goods and unloading them at the terminal at the named port or place of destination. Buyer is responsible for all costs and risks from this point forward including clearing the goods for import at the named country of destination.

DDP (Delivered Duty Paid)

DDP Incoterms means the seller bears all risks and costs associated with delivering the goods to the named place of destination ready for unloading and cleared for import. DDP is a risky term for the seller, because they may not be fully aware of the import clearance procedures in the country of import or how to find a competent local customs broker. It's also of questionable value to importers, since they must depend on the seller to successfully navigate the intricacies of the destination country.

Incoterms for Sea and Inland Waterway Transport

FAS (Free Alongside Ship)

Seller clears the goods for export and delivers them when they are placed alongside the vessel at the named port of shipment. Buyer assumes all risks/costs for goods from this point forward.

FOB (Free on Board)

Seller clears the goods for export and delivers them when they are on board the vessel at the named port of shipment. Buyer assumes all risks and costs for goods from this moment forward.

CFR (Cost and Freight)

Seller clears the goods for export and delivers them when they are on board the vessel at the port of shipment. Seller bears the cost of freight to the named port of destination. Buyer assumes all risks for the goods from the time the goods have been delivered on board the vessel at the port of shipment.

CIF (Cost, Insurance, and Freight)

Seller clears the goods for export and delivers them when they are on board the vessel at the port of shipment. Seller bears the cost of freight and insurance to the named port of destination. The seller is required to purchase the minimum level of insurance under Clause C of the Institute Cargo Clauses. This requirement is unchanged from Incoterms 2010.

Buyer is responsible for all costs associated with unloading the goods at the named port of destination and clearing goods for import. Risk passes from seller to buyer once the goods are on board the vessel at the port of shipment.

Indicating Incoterms 2020 Rule Usage

If parties want Incoterms 2020 rules to apply, the best way to make that clear in their sales contracts and on their export paperwork as follows:

“[the chosen incoterms rule], [named port, place, or point] Incoterms 2020”.

For example:

- CIF, Shanghai, Incoterms 2020, or
- DAP, No. 123, ABC Street, Importland, Incoterms 2020

When you display the Incoterms rule you are using, it should be followed by a location and which version of Incoterms—Incoterms 2020, Incoterms 2010, or Incoterms from some other year—that you are using.

The location depends on which Incoterm you are using. Sometimes you follow the Incoterm rules with the seller’s premises and sometimes the buyer’s. Sometimes you follow the Incoterm rule with the ocean port of shipment and sometimes the ocean port of destination.

Using Incoterms for Domestic Sales

Because they use Incoterms for international sales, some companies have started using Incoterms for their domestic sales as well instead of using the Uniform Commercial Code (UCC) terms. This is perfectly acceptable as long as their contracts identify what set of terms they’re using.

The Importance of Incoterms 2020

Each Incoterms rule provides exporters and importers clear, succinct rules that help them understand their responsibilities, clarify any gray areas in contracts, and can save a lot of headaches when used correctly. When a seller and a buyer agree to employ a particular Incoterm, each accepts the corresponding obligations and responsibilities as clearly set forth and defined under that particular Incoterm. Incoterms reduce the risk of legal complications by giving buyers and sellers a single home base from which to reference trade practices.

With the changes in Incoterms 2020 rules, you may be looking for more resources. We can help!

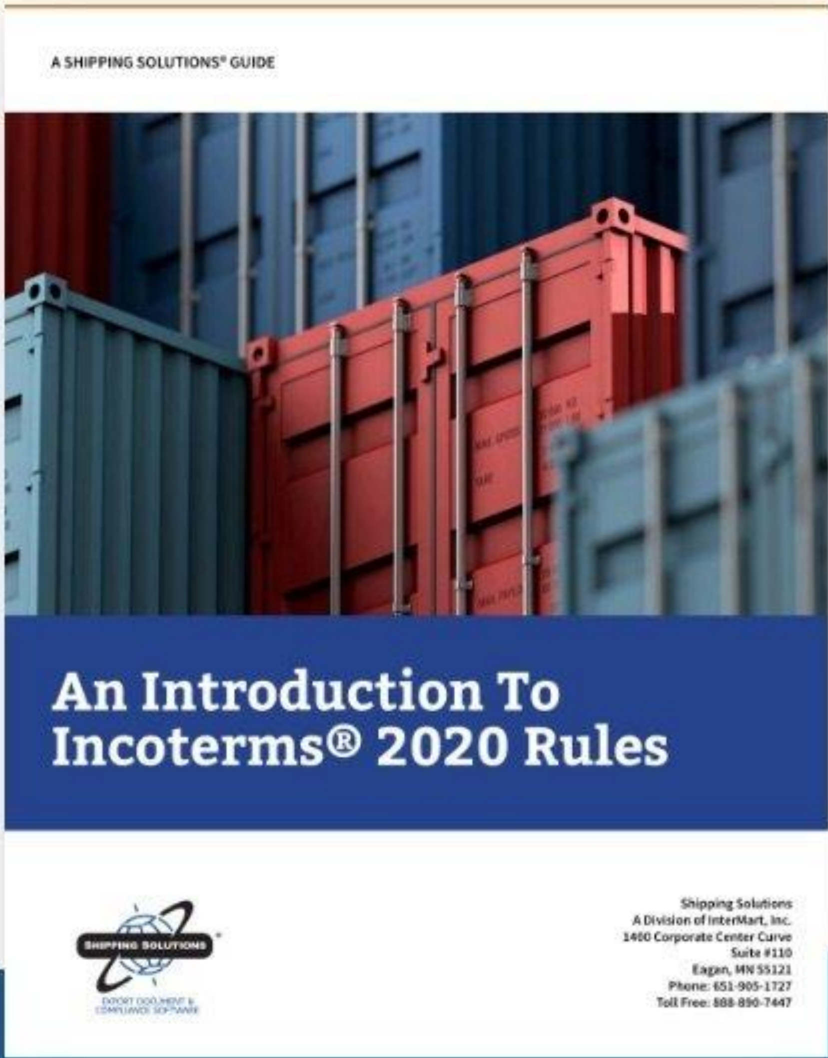
I'd suggest getting a copy of ICC's *Incoterms® 2020 Rules* book.

For a more detailed understanding of which term or terms your company should be using in your international transactions, register for an Incoterms® 2020 Rules webinar offered by International Business Training. If you don't want to attend a half-day class, you can get the book provided at these seminars and webinars: *Incoterms® 2020 for Importers and Exporters*.

For a basic understanding of the Incoterms 2020 rules, download the free *Chart of Responsibilities and Transfer of Risk*.

By correctly using Incoterms, you'll be able to partner more harmoniously, transport and deliver your goods more easily, and get paid more quickly. And who doesn't want that?

This article was first published in two parts in October and November 2014 and has been updated to include current information including the Incoterms 2020 rules, new links, and subtle formatting changes.



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