Ladies and gentlemen, good afternoon.

Before I begin, I would like to thank the Singapore Maritime Foundation and the General Insurance Association for their excellent work in organizing this lecture series.

It is a *distinct* pleasure to be here with all of you today and thank you all for your time and your attention.

My name is Sumeet Malhotra (and full marks to anyone who can pronounce that perfectly on their first try!). I am an in-house legal counsel at Cargill. I serve Cargill's ocean freight, ferrous trading and energy trading businesses. I am here today to discuss International Trade transactions, and how these transactions are affected by General Average incidents.

Let's deal with each of these terms – "International Trade" and "General Average" one at a time, before we discuss how they interact.

"International Trade" simply refers to the sale and purchase of goods and services across international borders. For us in the shipping industry, it is the sale of goods that is immediately relevant. So how are these transactions structured? Let me draw your attention to this next slide for a minute (slide of trade string with freight string and banking string). At a glance, this trade structure seems rather complicated. You have multiple buyers and sellers, a ship owner, multiple charterers, opening banks, confirming banks and negotiating banks, and each of these parties employs agents and appoints underwriters. How then, does one make sense of this seemingly complicated structure?

When I first started out in law practice (back in the days when we still used rotary telephones and used carrier pigeons for sending out urgent messages!) I often struggled with complex legal concepts or situations. My pupil master at that time was India's leading maritime lawyer. He was a wonderfully successful lawyer and was very renowned at the Bar as a formidable litigator. However, where he *truly* excelled was as a *teacher* and a *mentor*. His best advice to me was on how to approach complex situations or concepts. His advice was – when confronted with a complex problem, break down the problem into understandable pieces and then take each piece at a time.

So it is with an international trade string. Let's break this complex string down into its various parts. The very purpose of the existence of this complicated structure is the *sale of goods.* By definition therefore, there is a buyer and there is a seller. If there is a buyer and there is a seller, by definition there should be some goods which the buyer shall buy from the seller.

Let's take for example these colorful paper clips. Say these are the goods.

Now it would be awfully convenient if the buyer and the seller were both situated in this very room. One would simply be able to walk up to the buyer, deliver the goods and receive payment. But what if the buyer and the seller are situated in different countries many thousands of miles apart? In other words, what if the buyer and seller are engaged in *international trade* and have never met and do not know each other? In such a situation, the relationship between the buyer and the seller would have to have the following elements:

1. Firstly, the buyer and the seller would have to have a common understanding of their respective rights , obligations and risks, and;

2. Secondly, the buyer and the seller would have to make arrangements for the discharge of their rights and obligations. These arrangements essentially relate to delivery of the goods or "shipment", and receipt of monies for the goods, or "payment".

The first element here is a common understanding in relation to rights and obligations. How does one reach this common understanding? Well, for starters the buyer and seller would need a written document which sets out their rights and obligations, i.e.; an international trade contract. But what terms would this international trade contract contain? In the early days of international trade, before the standardization of international commercial terms, parties in different countries tended to have divergent understandings of common trade terms. For example, consider this situation. It is the year 1909. You happen to be a seller at New Orleans. You want to sell a shipment of cotton bales to a buyer in Santiago. In order for this transaction to work, you would want to be very sure that the buyer and seller understood their rights and obligations in exactly the same way. Unfortunately, custom, practice and law would tend to differ from country to country and from port to port. Therefore, a seller in New Orleans would understand his rights under a sale contract very differently from how a buyer in Santiago would understand those same rights. This inevitably led to misunderstandings, disputes and litigations, with the wastage of time and money that this entails. In order to remedy these problems, the International Chamber of Commerce (god bless them!) first published in 1936 a set of international rules for the interpretation of trade terms. These terms are also known as International Commercial Terms, or Incoterms and the latest iteration of these terms is called Incoterms 2000.

I should stress here that the scope of Incoterms is limited to matters relating to the rights and obligations of the parties to the contract of sale, i.e.; the buyer and the seller. Incoterms *does not* deal with the contract of shipment and *neither* does it deal with arrangements for financing and payment. So let's talk about what the Incoterms *do* deal with.

Incoterms deal with a limited number of identified obligations imposed on the parties to an international sale, such as the seller's obligation to place the goods at the disposal of the buyer or hand them over for carriage or deliver them at destination, and with the distribution of risk between the parties in these cases. Additionally they deal with the obligations to clear the goods for export or import, the packing of the goods, the buyer's obligation to take delivery as well as the obligation to provide proof that the respective obligations have been duly fulfilled.

It is extremely important to remember that while the Incoterms provide a crucial framework to any international trade contract, they do not deal with transfer of title and property rights or with the consequences of breaches of contract. Incoterms are not intended to replace the usual contract terms which deal with matters such as these.

So let's look at how Incoterms actually work.

The common Incoterms are – EXW or "Ex Works", FAS or "Free Along Side", FOB or "Free on Board", CFR or "Cost and Freight", CIF or "Cost, Insurance and Freight", DES or "Delivered Ex Ship", and DEQ or "Delivered Ex Quay".

"Ex Works" means that the seller delivers when he places the goods at the disposal of the buyer at the seller's premises or another named place. In an EXW sale the goods are not cleared for export and are not loaded onto any collecting vehicle by the seller. This particular sale term therefore represents the minimum obligation for the seller, and the buyer has to bear all costs and risks involved in taking the goods from the seller's premises.

"Free Alongside Ship" means that the seller delivers when the goods are placed alongside the vessel at the named port of shipment. Once goods are delivered by the seller in this manner, the buyer bears the costs in relation to and the risk of loss of or damage to the goods. In an FAS sale the goods are cleared for export by the seller.

“Free on Board”, means that the seller delivers when the goods pass the ship’s rail at the named port of shipment. This means that the buyer has to bear all costs and risks of loss of or damage to the goods from that point. In FOB contracts the seller clears the goods for export.

“Cost and Freight” which is referred to interchangeably as C&F or CFR means that the seller delivers when the goods pass the ship’s rail at the port of shipment. Additionally, the seller must pay the costs and freight necessary for the shipment of the goods to the port of destination. *However*, the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time of delivery, are transferred to the buyer upon delivery across the ship’s rail. In a CFR sale the seller clears goods for export.

“Cost, Insurance and Freight” means that the seller delivers when the goods pass the ship’s rail at the port of shipment. Additionally, the seller must pay the costs and freight necessary for the shipment of the goods to the port of destination, and procure Marine Insurance against the buyer’s risk of loss of or damage to the goods during the carriage. *However*, like in the FOB and CFR terms, the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time of delivery, are transferred to the buyer upon delivery across the ship’s rail. In a CFR sale the seller clears goods for export.

“Delivered Ex Ship” means that the seller delivers when the goods are placed at the disposal of the buyer on board the ship not cleared for import at the named port of destination. The seller has to bear all of the costs and risks involved in bringing the goods to the named port of destination *before* discharging. If the parties wish the seller to bear the costs and risks of discharging the goods, then the DEQ or “Delivered Ex Quay” term should be used.

“Delivered Ex Quay” means that the seller delivers when the goods are placed at the disposal of the buyer not cleared for import on the quay (wharf) at the named port of destination. The seller has to bear costs and risks involved in bringing the goods to the named port of destination and discharging the goods on the quay. The DEQ term requires the buyer to clear the goods for import and to pay for all formalities, duties, taxes and other charges upon import.

In summary, if you look at the slide up on the screen here, you will see that the light gray band which represents the seller's obligations is the smallest for an EXW sale. This obviously represents the very limited scope of obligations placed upon a seller in an EXW transaction. This light gray band grows progressively as we proceed from EXW through the "C" terms and onwards to the "D" terms. By comparison, you will see that in the "D" terms, it is the buyer's obligations and risks that are the most limited in scope. The "C" terms strike the most effective balance of rights and obligations between the buyer and the seller.

To recap, Incoterms deals with a few limited rights and obligations of the buyer and the seller, such as the right to receive goods at a certain place, or conversely the obligation to place goods at the buyer's disposal at a certain place, and the transfer of risk between the buyer and the seller. Crucially, the specific terms of shipment of goods, payment and transfer of title to the goods are not dealt with by the Incoterms. The specific terms in relation to the shipment itself are set out in a contract between the owner of the carrying ship (usually called the "carrier") and the person who engages the services of this shipowner (usually called the "shipper"). This contract is often in the form of a charterparty. The identity of the "shipper" shall differ, depending on which Incoterm is used. For example, in an EXW sale, the shipper for the ocean voyage shall be the buyer. On the other hand, in a CIF sale, the shipper shall be the seller, since it is the seller who arranges and pays for freight in a CIF sale.

It is apparent therefore in international sales, parties can often wear more than one hat. A seller might also be a shipper, and in that respect he might also commonly be the charterer of an ocean-going ship. In other cases, the charterer of a ship might act as the disponent owner of the same ship in respect of a sub-charterer. Therefore, while assessing an international trade dispute it is extremely important for lawyers and insurance practitioners like yourselves to ascertain the identities of a each and every participant in the trade string.

The other crucial element of international sales which is not covered by Incoterms is financing and payment arrangements and transfer of title. Very briefly, transfer of title, or property rights in the goods often goes hand in hand, i.e.; I pay for the goods as a buyer, and once I pay I receive property rights over the goods. It is however, important to note that this is equally often *not* the case, and parties are free to define the method of payment and the specifics of transfer of title as they please. In the illustration on this slide, payment is via letter of credit, and title is transferred immediately upon receipt of payment by the seller. In order to arrange payment via letter of credit parties require to engage issuing banks and negotiating banks. Additionally the seller might require an LC to be confirmed, and so a confirming bank might be involved, and lastly in some cases correspondent banks or advising banks might also be involved.

I appreciate that not everyone in this audience is engaged in international trading on a day to day basis, and so all of this information given at one go can be rather daunting and confusing. Just to clarify matters, let's revise what we have covered so far:

1. International trading is the sale of goods across international borders;
2. The essential parties to an international trade are the buyer and the seller;
3. The buyer and seller need to agree upon their rights and obligations. This is done by way of an international trade contract, which may or not

be subject to the standardized International Commercial Terms or Incoterms;

4. The common obligations of the parties are – to deliver the goods or take delivery of the goods and to make payment for the goods;
5. Delivery of goods in international trade is commonly performed by ocean transportation, i.e.; on board ships and payment in international trades is usually facilitated by banks.

Therefore, the parties who are involved in an international trade are: the buyer, the seller, traders who buy and sell, the carrier and the various banks who facilitate payment and financing. In addition to these parties various service providers who render services to each of these participants might also be involved. Each of these parties has competing interests and common interests. The competing interests are varied – for example the seller wants to receive payment before he parts with his goods and the buyer on the other hand wants to receive the goods before he parts with payment. The common interest of all of the parties is the safe and efficient delivery of the goods.

What happens then, if the common interest of the parties is imperiled? What if, the maritime adventure that these parties have embarked upon is endangered by a peril of the seas? Take for example, a situation where a fully laden container vessel is en-route from Rotterdam to Singapore. Everyone who has taken a walk along the East Coast Park would be familiar with container vessels, which carry cargo in twenty-foot or forty-foot containers in tall stacks one on top of the other. What if one of the containers in the middle of a stack surrounded on all sides by other stacks of containers catches fire? The fire in this single container threatens to spread, and if not controlled shall set alight other containers and eventually consume the entire ship, her cargo and her crew. In order to access the blazing container, the vessel's firefighting team needs to jettison the containers that are in the way. The master decides that his ship, his crew and the remainder of the cargo are far more valuable than the few containers which he has to jettison, and he delivers the order to throw these containers overboard. In throwing these containers overboard and fighting the fire, the master saves the vessel and her crew, and is able to safely deliver the remaining cargo carried on board. In other words, the master, when faced with a common danger to the entire maritime adventure, is forced to make an extraordinary and voluntary sacrifice. A sacrifice of this nature is known as a "General Average Sacrifice". When a General Average Sacrifice is made, the ship-owner, cargo-owner or rightful recipient of freight is entitled to declare general average and call for parties to the maritime adventure to make good that sacrifice pro rata in proportion to the extent of their interest in the saved maritime adventure.

To recap, in order to be able to claim general average contributions, the following conditions must be satisfied:

1. There must be a real and common danger to the maritime adventure;
2. There must be a necessity for a sacrifice;
3. The sacrifice must be voluntary;
4. There must be a real sacrifice and not a mere casting off of that which has been already lost;
5. There must be a saving of the imperiled property through the sacrifice, and;
6. The common danger must not arise from the default of the interest claiming in general average.

Sacrifices which attract general Average contributions include sacrifices of cargo, of ship or equipment or of freight.

So armed with this knowledge – the definition of international trade and commonly used incoterms, on one hand and the definition of general average on the other, let us examine how a general average incident affects the various parties in a trade string. In order to illustrate the effect of a general average incident, I have prepared the following case study:

A cargo of 150,000 MTs of coal is sold by Ozzie Coal Inc. to International Trade LLC on a CIF basis vide a contract dated 10 January 2010. The contract provides for the sale of premium grade Australian thermal coal from the Summer Valley Mines, to be shipped from the port of Fremantle no later than 23 January 2010. The port of destination is Qingdao in China. International Trade LLC in turn sells the cargo on a CIF basis in parcels of 50,000 MTs each to three different buyers vide three distinct contracts, all dated 12 January 2010. The three buyers are CoalTrad Ltd., Big China Steel Co. Ltd., and Sino Electric Co. Ltd. Ozzie Coal Inc. engages Ocean Trans Pvt. Ltd. vide a single trip time charter on an NYPE form dated 11 January 2010 for the carriage of the agreed cargo. Ocean Trans owns the vessel MV Aquarius, and they deploy her to service Ozzie's needs. The vessel loads the cargo at Fremantle, and sets sail for Qingdao on 20 January 2010. While en-route, on 22 January 2010 an alarm goes off on the bridge warning the master that the level of carbon monoxide in hold no.1 has risen to unusual levels. The master notices wisps of smoke rising from hold no. 1. He sends his crew to investigate, and they report that the hatch-cover over hold no. 1 just aft of the forepeak is radiating intense heat. The Master concludes that part of the coal cargo in hold no.1 has somehow ignited. If allowed to burn, the heat generated from hold no.1 could ignite the cargo in the other holds and spread to the rest of the ship. The Master immediately alerts the crew, and activates the ship's remote firefighting system. The system automatically floods holds no.1 with CO_2. However, the system is unable to contain the blaze. The only option now left for the master is to flood hold no.1 with sea water in order to control the fire. Now, the master knows that only *part* of 30,000 MTs of cargo in hold no.1 is burning. However, if he floods the hold with sea water the entire 30,000 MTs will suffer water damage and will be rendered useless. On the other hand, if the master does not flood no.1, the fire shall spread and shall destroy the MV Aquarius together with her entire cargo. Knowing this, the master floods hold no.1 and thereby sacrifices 30,000 MTs of cargo in order to save the vessel, her cargo and her crew. By flooding, the fire in hold no.1 is extinguished, the vessel sails on without further incident to Qingdao and discharges a cargo of 150,000 MTs of coal, of which 30,000 MTs is water damaged, and the remaining 120,000 MTs is intact.

In simple words therefore, the master when faced with a *common peril* makes a *necessary, extraordinary and voluntary sacrifice*. In making this sacrifice, the master *saves the imperiled property* namely the ship and the remainder of the cargo. Lastly, the peril is found to arise due to improper stowage of the cargo, which is not the responsibility of the shipowner under the charterparty between Ozzie and Ocean Trans.

Having satisfied the requirements for general average, Ocean Trans declares General Average and calls for contributions from the parties whose imperiled properties have been saved by the master's sacrifice.

And so, how does this incident affect the various parties involved? The basic rule of general average is that if your property was imperiled, and was then saved by the general average sacrifice, then you are liable to contribute towards general average. Let's examine how this principle works in the example we are presently dealing with. The first order of business is to discharge the cargo and deliver it to the various buyers. However, in this case, if Ocean Trans simply delivers the cargo to the buyers CoalTrad, Big China Steel, and Sino Electric then Ocean Trans will have no guarantee that these buyers or any of the other parties will later contribute towards general average. If these parties fail to contribute, Ocean Trans will eventually be stuck with a bill for damaged cargo. It is therefore prudent for Ocean Trans to obtain security from the buyers and from all other parties involved before releasing the cargo. It is in fact *the duty* of Ocean Trans to obtain security from all parties because after all, Ocean Trans is the only party in this transaction who can compel the other parties to place security because Ocean Trans has effective control over the cargo on board the MV Aquarius. The question then arises, what is the extent of security that each party should put up? Logically, each party would have to contribute proportionate to the extent of its interest in the maritime adventure. However, while the MV Aquarius awaits discharge orders at her berth at Qingdao the parties have not had the opportunity to agree upon the extent of their respective contributions. Security is therefore provided by way of an "average bond". The average bond is essentially a document which declares that "I have an interest in this maritime adventure, and I hereby agree to contribute in general average when validly called on to do so". These bonds, as you are all aware, are rarely issued by the parties themselves. They are in fact issued by the insurers of each respective party.

Once the average bonds issued on behalf of Ozzie, International Trade, CoalTrad, Big China Steel, and Sino Electric have been exchanged, Ocean Trans shall release the cargo to the rightful receivers. Bear in mind here, that Ocean Trans too needs to furnish an average bond. After all, the sacrifice of part of the cargo resulted in the saving of the MV Aquarius. Now that all parties are secured towards contributions, the task of determining each party's precise liability can commence. The professionals who perform the extremely technical task of determining these precise liabilities are called average adjusters. After issuing and exchanging average bonds, the respective underwriters will usually agree upon an average adjuster. This average adjuster determines the quantum of liability on the basis of the law of the port of discharge or any other mutually agreed legal regime, most commonly the York Antwerp Rules, 1994.

In our example, the voyage has been performed, average bonds have been exchanged and the cargo has been delivered. Let us now see, how each of the parties has fared.

Ozzie is the original seller. Ozzie to International Trade sells on a CIF basis. Therefore, risk in the goods passed from Ozzie to International Trade when the cargo passed the ship's rail. Ozzie was therefore not exposed to risk in the goods at the time when the goods suffered damage. Therefore Ozzie's property was not saved by the general average sacrifice, and Ozzie shall not be liable for contributions.

International Trade too sold goods on a CIF basis. Like in Ozzie's case risk in the goods passed from International Trade to CoalTrad, Big China Steel, and Sino Electric at the ship's rail well before the general average incident. Therefore International Trade, like Ozzie, is not liable for contributions in general average.

On the other hand CoalTrad, Big China Steel, and Sino Electric as CIF buyers, assumed risk for the goods when the goods passed the ship's rail, and the cargo was at the risk of these buyers when the general average incident occurred. Therefore the sacrifice made by the Master of the MV Aquarius benefitted these three parties, and they are liable for contributions to make good this sacrifice.

Additionally property owned by Ocean Trans, namely the MV Aquarius was saved by the same sacrifice, and therefore Ocean Trans too shall be liable for contributions.

There is a slight twist to these positions in respect of title. As we discussed, Incoterms does not provide for transfer of title. Let us suppose then that the CIF Sale Agreements in our example provided for title (or property rights) in the goods to pass immediately upon receipt of funds by the seller. Remember that the vessel loaded her cargo and sailed on 20 January and the incident took place on 22 January. If payment is by letter of credit, then chances are Ozzie (and

International Trade) had not yet received payment as on 22 January. Therefore, although the goods were at the risk of the buyers, they continued to be the property of the sellers.

And so, ladies and gentlemen, we are the end of our journey together. We have discussed today the basic structure of international trade transactions, and common international trade terms. We have discussed general average, and how general average incidents affect the principal parties to an international trade. Thank you all for your attention, and I am happy to take further questions that you might have.