

31 July 2006

Ref : Chans advice/67

To: Transport Industry Operators

## **Misdelivery of FOB cargoes**

Is the carrier liable to the shipper under B/L for misdelivery of cargoes which are sold on FOB basis? Judge Reyes of the Hong Kong High Court said "yes" in his Judgment of 19/7/2006 in respect of a shipment of electronic goods worth US\$1,200,000 which were sold on FOB terms.

Between March and August 2003 a forwarder issued 3 Bills of Lading (the B/Ls) (numbered 6390, 6425 and 6790) to the seller of the goods as Consignor. The B/Ls covered shipments of electronic goods from Hong Kong to Naples. The goods shipped were all consigned "To Order of Shipper". The "Notify Party" named under all B/Ls was the buyer, which had ordered the goods from the seller. Although it had paid deposits for the goods shipped under the B/Ls, the buyer experienced difficulty in paying the full price due to the seller. In late 2003, at the buyer's instigation, the seller asked the forwarder to issue new B/Ls. The new B/Ls stated that they had been issued on 24/11/2003. In addition, the "Shipped on Board" dates on the old B/Ls were crossed out from the new B/Ls. The new B/Ls were otherwise similar to the old B/Ls, including the specification that goods shipped were consigned "To Order of Shipper". It was hoped that the new B/Ls would enable the buyer to factor the goods and obtain the financing which it needed to pay the seller. The issue date on the old B/Ls was altered because the factor house would only lend on the security of B/Ls evidencing shipments made no more than 1 month before. In the event, financing never materialised for the goods under the 3 B/Ls. The buyer never paid the balance due on the goods shipped by the seller. The seller consequently never instructed the forwarder to deliver the goods to the buyer. Instead, in December 2003 the seller told the forwarder to transport the goods back to Hong Kong. Eventually, the seller discovered that between May and November 2003 the forwarder's Italian agent had released the goods to the buyer without production of either old or new B/Ls. The seller claimed the value of the goods as damages for the forwarder's wrongful delivery of the goods to the buyer. The seller sought US\$859,275 plus interest.

The goods were sold FOB Hong Kong. The buyer was responsible for paying the freight. The FOB term was reflected in the words "Freight Collect" typed on the face of the B/Ls (old and new). The forwarder submitted that, since the buyer had to (and did) pay freight to the forwarder's Italian agent before obtaining release of the goods, the contracts of carriage (evidenced by the B/Ls) must have been between the forwarder and the buyer. The forwarder said that the seller could consequently assert no rights in relation to the contracts of carriage evidenced by the B/Ls.

The Judge disagreed with the forwarder's submission. The "FOB" term concerned the contractual obligations between the buyer and the seller in respect of the goods ordered. The forwarder was not a party to such agreements between the seller and the buyer. To see what (if any) obligations the forwarder owed to anyone, it was necessary instead to consider the terms of the contract of carriage evidenced by the B/Ls and their Standard Conditions. The B/Ls (both old and new) expressly named the seller as "Consignor". The Standard Conditions governing the B/Ls then defined the "Consignor" named on the face of the B/Ls as "the person who concludes the multi-modal transport contract with the Freight Forwarder". It was therefore plain that the B/Ls and the Standard Conditions treated the seller as party to the contract of carriage. The "Freight Forwarder" was defined as the person issuing the B/Ls and whose name appeared on the face of the B/Ls. Such person "assumes liability for the performance of the multi-modal transport contract as a carrier". In this case, that person must be the forwarder which actually signed the B/Ls "as carrier". The Standard Conditions defined "Merchant" as including "the Shipper, the Consignor, the Consignee, the Holder of this FBL, the Receiver and Owner of the Goods". Clause 13.3 of the B/Ls stipulated that "all dues, taxes and charges or other expenses in connection with the goods shall be paid by the Merchant". It followed that, as Consignor, the seller was liable to pay freight due in respect of the goods to the forwarder as Freight Forwarder. This was confirmed by Clause 13.6 which reads:-

"Despite the acceptance by the Freight Forwarder of instructions to collect freight, charges or other expenses from any person in respect of the transport under this FBL, the Merchant shall remain responsible for such monies on receipt of evidence of demand and the absence of payment for whatever reason."

The seller as Consignor (and thereby "Merchant" and party to the contract of carriage) had undertaken to be responsible for the freight in the event that (say) the forwarder could not collect from the buyer. Such undertaking constituted sufficient consideration for the obligations of carriage owed by the forwarder under the B/Ls. Even if

there had been no contract of carriage between the seller and the forwarder, there would still have been a bailment between them. The seller having bailed the goods with the forwarder for the purposes of carriage, the forwarder as bailee came under an obligation to deal with the goods in accordance with the seller's instructions. The bailment was in the sense of a handing over by the seller as bailor of possession, custody or control of the goods to the forwarder as bailee. The forwarder undertook to perform the carriage in its own name as principal (and not as mere agent). This was explicitly acknowledged in Standard Conditions cls. 2.1 and 2.2. The forwarder chose to fulfil its obligations to the seller by sub-bailing the goods to the Evergreen Line for shipment to Naples. The forwarder contracted in its own name as principal with Evergreen. In those circumstances, the forwarder must have obtained possession, custody or control of the goods from the seller, enabling it to sub-bail the goods to Evergreen for shipment to Italy.

Under a Trade Policy Agreement dated 29/5/2003 the buyer proposed to order electronic goods from the seller from time to time. Under the Policy Agreement, goods would be sold "with FOB (Hong Kong or Yian Tien) term as defined by Incoterms 2000". The Policy Agreement stated that, in supplying goods, the seller could grant the buyer credit of 75 days from shipment date. In such case, the buyer would provide a non-refundable 10% deposit for goods ordered and the balance of 90% would be paid on "D/P terms through bank". Pursuant to the Policy Agreement, the buyer ordered the goods which came to be shipped under the B/Ls. The forwarder argued that, goods having been sold on FOB terms, then absent any indication of a contrary intention, property in the goods passed upon shipment from Hong Kong. It followed that, even without presentation of any B/Ls and despite explicit instructions by the seller to the contrary, the forwarder was bound to release the goods to the buyer upon the latter's demand at Naples.

The Judge disagreed. Although an FOB term may mean that property passes when goods are loaded on board a vessel, there is no invariable rule to that effect. An FOB term notwithstanding, a seller may reserve his right to the disposal of the goods. A seller commonly does this when goods are sold on credit (as was the case here). Where the seller reserves his right to the disposal of the goods, the FOB term simply means that risk of loss or damage to the goods passes to the buyer once the goods are loaded on board ship. The Policy Agreement provided that FOB sales between the seller and the buyer were to be construed in accordance with the International Chamber of Commerce's "Incoterms 2000".

That publication says this of an FOB sale (at p. 49):-

"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. The FOB term requires the seller to clear the goods for export...."

The publication adds the following (at pp. 50-1):-

"A. THE SELLER'S OBLIGATIONS

....

A5. Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have passed the ship's rail at the named port of shipment.

B. THE BUYER'S OBLIGATIONS

....

B5. Transfer of risks

The buyer must bear all risks of loss of or damage to the goods

- from the time they have passed the ship's rail at the named port of shipment; and
- from the agreed date or the expiry date of the agreed period of delivery which arise because he fails to give notice in accordance with B7, or because the vessel nominated by him fails to arrive on time, or is unable to take the goods, or closes for cargo earlier than the time notified in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods."

The explication of FOB in Incoterms 2000 is couched in terms of the passage of risk, rather than of property. That explication does not support the forwarder's argument that the FOB term implied that property (as opposed to risk alone) passed to the buyer upon shipment of the goods from Hong Kong. Indeed, there was every indication that the seller reserved its right to the disposal of the property in the goods. First, the seller expressly stated in the B/Ls that property was consigned to "The Order of the Shipper". This meant that the seller reserved the right to instruct the forwarder to deliver the goods at Naples to whomever the seller might instruct. Second, as stated in their original invoices, the goods shipped under the B/Ls were sold to the buyer on "D/P [Documents against Payment] AT SIGHT" terms. This provision accorded with the Policy Agreement. It meant that the B/Ls were only to be released to the buyer upon payment of the balance of the purchase price due for each lot of goods shipped. Commercially, a D/P term allows a seller (or his bank) to hold onto B/Ls until receipt of payment. Bills of lading are documents of title to goods. Their retention by a seller (or his bank) has the consequence that property in goods does not pass until payment by the buyer in accordance with the sale contract. If a buyer does not pay, the seller retains rights in the goods and can re-sell them to third parties. Third, at least in the case of B/L Nos. 6390 and 6425, the retention by the seller of the right of disposal was corroborated by 2 faxes dated 23 April 2003. In those, the seller instructed that the relevant goods "CANNOT BE RELEASED WITHOUT PRESENTATION OF FULL SET OF ORIGINAL BILL OF LADING". The forwarder's submission did not take account of the consignment of the goods to the shipper's order.

Further, the forwarder's argument would render the D/P term pointless as a commercial arrangement. There would be little use to a seller holding onto documents of title against payment if a freight forwarder could simply release the subject goods to a would-be buyer on demand by the latter.

The forwarder submitted that, since the old B/Ls had been cancelled and the new B/Ls (bearing a deceptive date of issue) were nullities, the forwarder could release the goods to the buyer even without presentation of any bills of lading.

The Judge disagreed. The key consideration was that, by the consignment of the goods to the shipper's order and by the April 2003 faxes, the forwarder must have been fully aware that it was only to release the goods upon the seller's further instruction. Such instruction could come in a number of ways. One way might be by presentation of a bill of lading endorsed by the Plaintiffs to a holder. Another way might be by direct instruction of the seller communicated by (say) fax or letter. An example of this was the 4/12/2003 fax to the forwarder whereby the seller ordered that the goods should be shipped back to Hong Kong. At the time, the seller was unaware that the goods had already been released to the buyer. Nothing in the seller's request for new B/Ls could have reasonably led the forwarder to believe that the forwarder was authorised to release the goods to the buyer without further reference to the seller. If anything, the issue of new B/Ls should have suggested that the seller still required the forwarder to hold onto the goods until at least the new B/Ls were presented to the forwarder by a holder. The forwarder misunderstood the instruction that goods were consigned to the shipper's order. The forwarder erroneously believed that, just because the sale was on FOB terms and the buyer was liable for freight, the buyer somehow automatically became owner of the goods even if it had not fully paid for them. The forwarder apparently thought that house bills of lading (such as the B/Ls) could be ignored and that all along the forwarder had no obligations to the seller. The forwarder's beliefs were wrong. Ignorance of the law, however, does not excuse acting in breach of the terms of a contract or bailment.

The Standard Conditions provided:-

"Clause 6: Freight Forwarder's Liability

6.1 The responsibility of the Freight Forwarder for the goods under these conditions covers the period from the time the Freight Forwarder has taken the goods in his charge to the time of their delivery.

6.2 ....

6.3 Arrival times are not guaranteed by the Freight Forwarder. However, delay in delivery occurs when the goods have not been delivered within the time expressly agreed upon or, in the absence of such agreement, within the time which would be reasonable to require of a diligent Freight Forwarder, having regard to the circumstances of this case.

6.4 If the goods have not been delivered within ninety consecutive days following such date of delivery as determinates in Clause 6.3, the claimant may, in the absence of evidence to the contrary, treat the goods as lost.

6.5 ...

Clause 7: Paramount Clauses

7.1 These conditions shall only take effect to the extent that they are not contrary to the mandatory provisions of International Conventions or national law applicable to the contract evidence by this FBL.

7.2 The Hague Rules contained in the International Convention for the unification of certain rules relating to Bills of Lading, date Brussels 25th August 1924, or in those countries where there are already in force the Hague-Visby Rules contained in the Protocol of Brussels, dated 23rd February 1968, as enacted in the Country of Shipment, shall apply to all carriage of goods by sea and also to the carriage of goods by inland waterways, and such provisions shall apply to all goods whether carried on deck or under deck.

7.3 ....

Clause 17: Time Bar

The Freight Forwarder shall, unless otherwise expressly agreed, be discharged of all liability under these conditions unless suit is brought within 9 months after the delivery of the goods, or the date when the goods should have been delivered, or the date when in accordance with clause 6.4, failure to deliver the goods would give the consignee the right to treat the goods as lost."

The writ was issued on 13/2/2004. The goods shipped under the B/Ls arrived in Naples on 17 April, 6 May and 4 October 2003. The goods under B/L Nos. 6390 and 6425 were released to the buyer on 2 October and 2 May 2003 respectively. The forwarder argued that by cl. 17 the time for bringing suit in respect of the goods shipped under B/L Nos. 6390 and 6425 had long expired by 13/2/2004. The forwarder accepted that the seller had brought suit in respect of the goods shipped under B/L No. 6790 within time.

The Judge did not think that, on its true construction, cl. 17 was applicable. The reference to "delivery" in cl. 17 must mean "delivery in accordance with the terms of the relevant bill of lading". It would be absurd if the forwarder could on a whim simply release the goods to a stranger and then claim that time for suit began to run from such date of "delivery" to the stranger. The seller never instructed the forwarder to deliver to buyer. It followed that the 9 months stipulated by cl. 17 could not run from the date of release to the buyer. Time under cl. 17 would not have run against the seller from the time of purported deliveries to the buyer on 2 October and 2 May 2003. In any event, in the case of goods shipped under B/L No. 6390, the 9 month time limit from date of delivery would not have run out by the time the writ was issued on 13 February 2004. Cl. 17 referred to other dates from which the stipulated 9 month limitation

might run. None of the alternative dates could be applicable here. One such alternative date was "the date when the goods should have been delivered". The goods were consigned to the seller's order. The only order that the seller in fact gave for delivery was in December 2003, when it instructed the forwarder to return all the goods to Hong Kong. Even if time started to run from the making of such order in December 2003, the 9 months would not have expired as at February 2004. The remaining alternative is "the date when in accordance with clause 6.4 failure to deliver ... would give the consignee the right to treat the goods as lost". Clauses 6.3 and 6.4 concerned delays in delivery. However, apart from the forwarder's non-compliance with the December 2003 order to return the goods to Hong Kong, there had been no delay in the delivery of the goods. This was because, aside from the December 2003 instruction, the seller never instructed the forwarder to deliver the goods to any specific person. Instead, the forwarder agreed to hold the goods to the seller's order (subject of course to the seller's undertaking to be responsible for storage charges). It followed that the circumstances envisaged by cls. 6.3 and 6.4 did not bite here. Since this case involved a shipment from Hong Kong, The Carriage of Goods by Sea Ordinance (Cap. 462) had the effect that the Hague-Visby Rules (HVR) governed the carriage by operation of law. HVR Art. III, Rule 6 requires that suit in respect of goods carried by sea be brought "within one year of their delivery or of the date when they should have been delivered". HVR Art. III, Rule 8 states that any clause in a bill of lading which purports to relieve a carrier of liability otherwise than as provided in the HVR "shall be null and void and of no effect". Clause 17 attempted to impose a shorter limit for commencing an action than that found in HVR Art. III, Rule 8. Given the Judge's view that purely as a matter of construction that cl. 17 was inapplicable, it was unnecessary to consider whether cl. 17 would have been nullified by HVR Art III, Rule 8.

The seller claimed the invoice value of the goods shipped to Naples and misdelivered to the buyer. The forwarder suggested that the seller had not adduced sufficient evidence of the damages suffered. The forwarder submitted that the seller's invoices were not good enough evidence.

The Judge disagreed. The measure of the seller's damages was the sound arrived value of the goods at the time of the misdelivery to the buyer in Naples. The invoices (charging the buyer what it had agreed to pay for the seller's goods) constituted good prima facie evidence of that sound arrived value. The forwarder said that the better evidence was a written submission by the buyer to a Livorno court claiming release of the goods from the forwarder. That Livorno submission alleged that the goods had lost half their value since date of shipping. In the Judge's view, the Livorno submission was no evidence at all. It was mere assertion. It was not backed by hard figures. Nor had it been tested by cross-examination as the forwarder did not call the maker of the Livorno submission. The material was pure hearsay and should not be accorded weight.

The forwarder agreed to deliver the goods to the seller's order. The seller specifically instructed the forwarder in April 2003 not to release the goods to the buyer except upon production of a full set of B/Ls. At all times up to the time of their misdelivery to the buyer, the seller remained the owner of the goods, having reserved the right to their disposal. The forwarder ignored the seller's instruction to deliver the goods only to the seller's order. The forwarder instead released the goods to the buyer, under the mistaken belief that the buyer was the absolute owner of the goods. In so doing, the forwarder breached its contract with the seller. The forwarder also acted in breach of bailment. The misdelivery further constituted conversion. The seller was entitled to damages representing the value of the goods at the time of wrongful delivery to the buyer. The seller was prepared to give credit for deposits previously paid by the buyer in respect of the goods. The invoice value of the goods shipped under the B/Ls was prima facie evidence of their value at the time of wrongful delivery. The unpaid balance of the invoiced purchase price of the goods was US\$859,275. The seller was accordingly entitled to judgment in that sum.

Please feel free to contact us if you have any questions or you would like to have a copy of the Judgment.

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Multi-modal transportation involves far more complicated liability regime than port-to-port or airport-to-airport carriage. Pure international sea or air transport often affords better protection by international conventions. Conversely, multi-modal transport entails a variety of operational risk elements on top when the cargo is in-transit warehouse and during overland delivery. Fortunately, these risks are controllable but not without deliberate efforts. Sun-Mobility is the popular risk managers of many multi-modal operators providing professional assistance in liability insurance, contract advice, claims handling, and as a matter of fact risk consultant for their staff around-the-clock.