

INCOTERMS® 2010

The sales contract for every export transaction contains a three letter acronym, most commonly FOB, CFR or CIF. However, most exporters and their overseas customers don't know exactly what they stand for or exactly what they mean, just that they've been using them for years.

In late September 2010 the International Chamber of Commerce (ICC) released their updated Incoterms® 2010. These 11 rules replace the previous 13 terms, and make it easier to understand the seller's and buyer's responsibilities. Among other things they deal with both parties' obligations to each other including providing security information, when delivery occurs, the point at which risk transfers from seller to buyer, and who pays freight, insurance and other charges.

The rules have been extensively rewritten so some of them are now more suitable for domestic transactions. In three of them the long established and traditional concept of the goods being "on board" when swinging precariously at the end of the rope while passing over the ship's rail has been replaced by the simpler concept of the goods actually being placed on board the vessel.

Incoterms® 2010 are now divided into two groups -- the seven any mode or modes of transport rules at the front of the book and the four rules intended only for sea or inland waterway transport at the back of the book.

Very importantly, the much misunderstood and misused rules FAS (Free Alongside Ship), FOB (Free On Board), CFR (Cost and Freight) and CIF (Cost Insurance and Freight) which most people think simply cover all kinds of freight by sea now have very clear instructions that they should not be used for shipments by container. While this has been the case for the last thirty years it nevertheless has not been widely understood. These rules (except FAS) require the seller themselves to load the goods on board. This is a remnant of three hundred years' heritage when sacks and barrels were carried up the gangplank on men's shoulders. A major concern of misusing these rules for shipments in containers is that the seller's direct control is lost beyond the point where they hand over the goods to the carrier yet their risk and costs continue until the goods are on board.

If cargo is loaded directly onto the vessel, generally referred to as "break-bulk", with a separate stevedoring contract and a separate freight contract, then FOB for freight collect, CFR and CIF for freight prepaid, are appropriate. Note that in all three of these the transit risk after the goods are on board is for the buyer, but in CIF the seller takes out insurance for the buyer.

The rules for any mode/s start with EXW (Ex Works) which is now stated as being suitable for domestic trade but not for international trade. This is because it is the buyer who has to carry out export formalities in the seller's country. That is virtually impossible to achieve with the tight security provisions these days. In practice the buyer's forwarder clears the goods for export in the seller's name mostly without the seller's knowledge or permission. This then means that the transaction is not EXW but actually FCA Seller's Premises.



FCA (Free Carrier) is the only "freight collect" multimodal rule, which should be used in place of EXW and FOB for air freight and container shipments by sea. It needs to be qualified with the addition of a place such as "Seller's premises" or "Carrier's premises". The seller's risks and costs cease when they physically deliver the goods out of their own direct control. In FCA the buyer typically arranges the freight through their own freight forwarder and export formalities are carried out by the seller, often via that forwarder. If a seller wishes to keep quoting their usual "FOB" price then wording such as "FCA Carrier's premises plus THC" could be quoted. This indicates that the seller's risks cease at the point of physical delivery but that they will include a specific additional cost in their selling price.

There are two "freight prepaid" any mode/s rules which can be used for air freight and container shipments by sea. The first is CPT (Carriage Paid To) which then needs the destination place to be specified, ie "CPT Taipei". CPT means that the seller delivers when he hands over the goods to the carrier or forwarder of his choice but pays the freight to the destination. The transport risk for loss of or damage to the goods passes to the buyer once the seller hands the goods over to his own carrier or forwarder. This rule should be used in place of the misused CFR for air freight and container shipments by sea .

Often the buyer will ask the seller to also cover the risk by providing insurance. The delivery and risk are still the buyer's, exactly the same as for CPT, however now the seller takes out insurance for the buyer's risk and then "blank endorses" the certificate before giving it to the buyer. Should there be a loss of or damage to the goods in transit then the buyer is able to claim against the seller's insurance policy. This rule is CIP (Carriage and Insurance Paid to) with a destination place to be shown after it, and should be used in place of the misused CIF for air shipments and container shipments by sea.

The old DEQ (Delivered ex Quay) has been replaced with DAT (Delivered at Terminal) rule which expands on the places where this delivery can occur. DAT requires the seller to arrange unloading the goods from the arriving means of transport and make them available to the buyer in the terminal, wharf, airport, warehouse etc as stated in the contract.

Three of the previous rules, DAF (Delivered at Frontier), DES (Delivered ex Ship) and DDU (Delivered Duty Unpaid) have been rolled into one new rule DAP (Delivered at Place). DAP is similar to CIP in cost to the seller but now the seller delivers when the goods have been made available to the buyer, not unloaded from the arriving means of transport, at the specified destination which is often the buyer's premises. So the transit risk remains the seller's until that delivery is achieved. Nevertheless, the buyer is responsible for import formalities and payment of duties and taxes.

Lastly there is DDP (Delivered Duty Paid) which in reality is only suitable for domestic transactions or those within a customs bloc like the EU. This rule requires the seller to carry out import formalities and pay any import duties and VAT. Clearly this is going to be difficult if not impossible in most countries where some form of importer registration will be in force.

The three D rules also delay when the transaction should be taken up in the seller's accounting.

Australia is a developed country known for its expertise and companies should strive to follow world's best practice by using the correct rules as laid out in Incoterms® 2010. Every exporter should have a copy of the new Incoterms® 2010 on hand in their office so that they are able to demonstrate informed leadership even though their trading partners might not yet be aware of the latest rules.

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