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INTERNATIONAL COMMERCIAL TERMS - INCOTERMS 2010

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Abstract: *The Incoterms are a set of International rules that provide an interpretation for the most used commercial terms in foreign trade operations. The aim of Incoterms is standardization and interpretation of contractual trade terms. In this paper Incoterms are presented in more detail and explained through theory and practical application in certain situations. We shall review the changes made in the new compilation of terms, Incoterms 2010, and their impact in both local and international trade.*

Keywords: *Incoterms, trade, rules*

1. INTRODUCTION

With the ever rising global trade, there are more and more issues regarding the international commerce. Both sellers and buyers may be unaware of the existing dissimilarities in trade practices in different countries, leading to misunderstandings, disputes and litigations. In order to avoid negative consequences of poorly composed contracts of sale, there was a need to standardize the rules. In 1936 in Paris, The International Chamber of Commerce defined and published Incoterms, a set of rules to define trade terms. Amendments were added respectively in 1953, 1967, 1980, 1990, 2000 and finally 2010. As of 1st January 2011, the 2010 version is in effect.

Incoterms is a set of international rules regarding shipment when trading internationally. The aim of Incoterms is to create a standardized, unified interpretation of trade terms in contracts and agreements, and conditions of delivery by all who take part in international trade. Incoterms provide definitions of key elements of purchase agreements, indicating to all contractual parties their obligations.

The main difference between the 2000 and 2010 version of Incoterms® is that the number of Incoterms has been reduced from thirteen to eleven. The 2010 edition has introduced two new clauses, DAT and DAP, while four have been removed, namely DAF, DES, DEQ, and DDU. Furthermore, the 2000 edition is divided into 4 groups according the starting letter (E, C, F, and D), while the 2010 edition is divided into 2 groups (all types of transport as opposed to marine transport). In this paper we shall further define all of the Incoterms, as they are divided into the abovementioned groups. The table 1. shows all eleven Terms of Delivery with their breaking points that will be explained in next chapter.

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Table 1.Tearms of Delivery

Incoterms and Services	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAP	DAT	DDP
	Named place	Named place	Named port of dest.	Named port of dest.	Named port of dest.	Named port of dest.	Named port of dest.	Named port of dest.	Named place	Named teminal	Named place
Warehouse at point of origin	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Warehouse labor charge at origin	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Export packing	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Loading at point of origin	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Inland freight	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Port receiving charges	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Forwarding fees	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Loading on ocean carrier	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Ocean freight	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Charges in foreign port	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER
Delivery charges to final destination	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER
Customs duties and taxes abroad	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER

2. INCOTERMS FOR ALL MODES OF TRANSPORT

EXW (Ex Works) Term of Delivery requires that the seller has fulfilled their obligation once they have made the goods available to the buyer at their premises or another designated place (e.g. a workshop, factory, warehouse etc), duty-free and not loaded on any means of transportation. EXW places the maximum obligation on the buyer because they have to organize the entire shipment. It also gives opportunity to the buyer to demonstrate their creativity and business acumen. Although the buyer is free to manage the shipment to their liking, it might not be as beneficial to them since they bear all costs of shipment and incur full risk if the goods are damaged during transport to the final destination, with the seller not liable from the moment of handing the goods over to the buyer's carrier. EXW is not recommended when exporting, due to the fact that the goods may be stolen before leaving the country, or resold in another country. Furthermore, if the submitted invoice has no VAT (Value add tax) included, there may be no evidence that the goods have been exported. When using this particular Incoterm, various issues have been known to occur in different countries. For example, the US market requires an American citizen to be the legal entity when taxing the goods during export and import, all of which makes complications for the buyer. Regardless of the legal issues, this Incoterm remains the reference of choice when importing to the USA (in 95% of cases).

FCA (Free Carrier) involves the obligation of the seller to deliver the goods at the place nominated by the buyer. FCA is equally beneficial to both seller and the buyer, because their obligations are derived from the nominated place of delivery and mode of transport of goods. If the nominated place of delivery is at the seller's premises, the seller is obligated to load the goods on to the carrier chosen by the buyer, whereupon the delivery is considered concluded. In another case, it is required that the goods be delivered to the buyer at the nominated place of destination, not unloaded on the seller's carrier. Here, the place of takeover of goods is to be clearly stated, since this is crucial when determining who is responsible if the goods are lost. For example, if a seller from Company A sold a buyer in Company B 20 tons of wheat flour using FCA, the seller would be obligated to pay the cost of export fees and loading of goods on to the buyer's carrier. During the customs taxing and loading, the seller is responsible for the loss of or damage to the goods. Upon the loading, all further obligations and risks pertain to the buyer.

According to CPT (Carriage Paid To), the seller is obligated to deliver the goods to the carrier nominated by themselves. This means that the buyer is responsible for the risk and all other costs after the goods have been delivered to the carrier. CPT demands that the seller pay for the export fees. If the delivery includes more than one successive carriers, the risk is transferred when the goods is delivered to the first carrier. CPT is more beneficial to the seller, since they may offer their logistics, thus increasing the profit, on top of selling the goods.

CIP (Carriage And Insurance Paid To) means that the seller fulfills their obligation of delivery to their own carrier, but they also have to pay the additional cost of transport in order to dispatch the goods at the designated destination. This Incoterm demands that the seller provide insurance at the minimum cover rate. If the buyer wishes a better insurance with higher coverage, they need to explicitly agree on it with the seller, or to obtain their own additional insurance.

DAT (Delivered At Terminal) is a new Term of Delivery which replaced the old 2000 DEQ. DAT indicates that the seller has delivered the goods once, upon being unloaded, they are available to the buyer at the nominated terminal, a nominated port, or the nominated destination. The seller covers all the costs and risks that may occur until the delivery to the terminal, including the unloading at the terminal or the nominated port or destination. The seller is obligated to pay the cost of export, but not import, fees.

DAP (Delivered At Place) is also a new Term of Delivery replacing the 2000 DAF, DES and DDU. Delivered at place means that the seller has completed the delivery once the goods have been made available to the buyer on the arrived carrier ready for unloading (not unloaded at the named place of destination). The seller is responsible for all the costs and risks during the delivery to the nominated place. DAP demands that the seller pays the export fees, where required, but not the import fees.

DDP (Delivered Duty Paid) requires the seller to deliver the goods to the buyer by paying the import fees as well, but not the cost of unloading, at the nominated destination. The seller is responsible for costs and risks during the delivery, including duties for import at the destination country. DDP places the maximum obligation on the seller, as opposed to EXW, which places the maximum obligation on the buyer. DDP cannot be used in European Union due to the EU value added tax, VAT, directive which regulates which country's VAT should be charged on the transaction.

Figure 1. shows Terms of Delivery used in all modes of transport and breaking points between sellers and buyers. The red line shows sellers obligations in cost and the blue line shows to what point goes sellers risk over the goods. Insurance that seller has to provide is presented with gray line and it can only be seen in CIP.

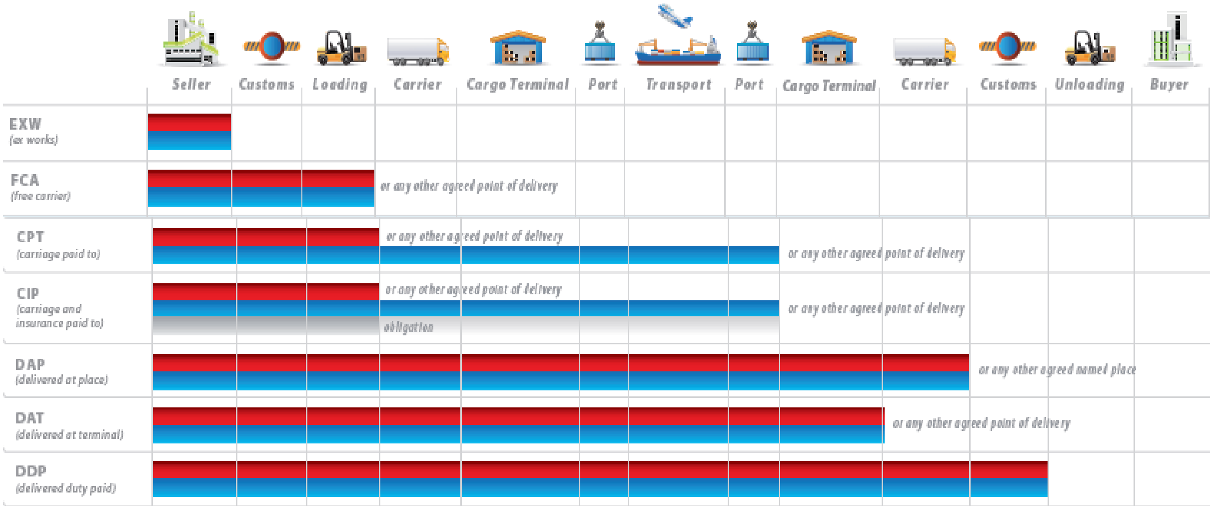

Figure 1. Terms of Delivery for all modes of transport

3. SEA AND INLAND WATERWAY TRANSPORT

FAS (Free Alongside Ship) means that the seller is obligated to deliver the goods by placing it alongside the buyer's vessel at the nominated port. This means that, from that moment, the buyer has to bear all costs and risks of loss of or damage to the goods. FAS requires that the seller pay the export fees. It is more beneficial for the buyer since he determines the place of loading and nominates the vessel. FAS is used only for sea and inland waterway transport, but may also be used if the transport is multimodal, where the initial or the final mode of transport is via sea or inland waterway. It is rarely used, mostly when delivering oil or bulk goods.

FOB (Free On Board) requires the seller to deliver the goods on to a vessel. From that point, the buyer bears all the costs and risk of loss of or damage to the goods. The seller is obligated to pay the export fees. This Incoterm is suitable for the seller, especially the one who cannot impose a more beneficial arrangement for them, or is inapt in transport and risk management when it comes to long distance operations. Since FOB is used in marine transport, there are additional clauses relating to the loading obligations:

- FIO (the deliverer and the recipient both accept the obligation to load and unload the goods from or on to the vessel)
- FIOS (the deliverer is the one bearing the cost of laying out the goods, while the recipient bears the cost of the goods takeover, handling and unloading)
- FIOT (is used in the same way as FIOS, but refers to the bulk goods)

It should be noted that FOB is mainly used in China, when exporting. When transferring the risk from the seller to the buyer, there is a dilemma as to who is responsible if something happens to the goods while loading on to a vessel. When loading with a crane, the goods are elevated above the vessel's railing. If the cargo unhooks and drops outside the vessel, the cost is borne by the seller. If it drops on to the vessel the cost is borne by the buyer.

CFR (Cost and FReight) stipulates that the seller delivers the goods over the ship's railing at the designated loading port, as well as to pay the cost of transport and delivery to the nominated port of destination. But the risk of loss or damage, being additional expenses that may occur from the moment of delivery onwards, is transferred to the buyer (the railing has been passed over). This means that the moment of transfer of risk coincides with the moment and place of transfer of costs from the seller to the buyer. CFR is more beneficial to the seller because the seller not only sells the goods, but also the services arising from the seller's obligations, e.g.: carrier services, export duty, transport from the port to the designated place etc. At times, the seller may sell these services for a higher profit than that obtained from selling of the goods themselves.

CIF (Cost Insurance and Freight) stipulates that the seller must deliver the goods when they are located on board the ship at the loading port. The seller has to pay the costs and freight at the nominated port of destination, but the risk of loss and damage, as well as any additional costs are transferred from the seller to the buyer once the goods have passed the ship's railing at the loading port. The seller takes care of the insurance, covering the basic insurance.

In order of better understanding the Terms of Delivery used in sea and river transport figure 2. shows graphical sellers and buyers obligations. The red line shows sellers obligations in cost, the blue line shows to what point goes sellers risk over the goods. Insurance is shown with gray line that can be seen only in CIF, like it is mentioned before.

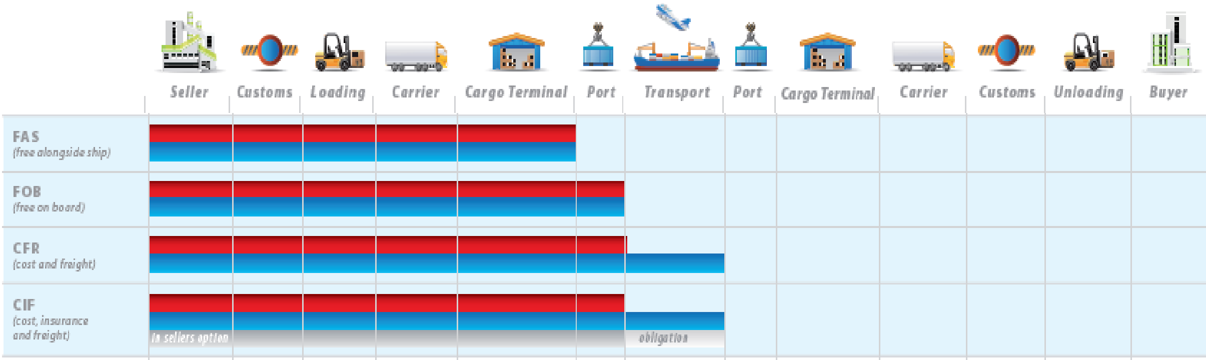

Figure 2.Terms of Delivery for sea and inland waterway transport

3. THE ROLE OF FREIGHT FORWARDER IN 2010 INCOTERMS IMPLEMENTATION

In international trade, alongside sellers and buyers, freight forwarders are also a common sight, taking the role of counselors. When implementing Incoterms, the freight forwarders have a major role, since they possess information and knowhow about all processes occurring in any given supply chain. An international freight forwarder should always be consulted for advice when negotiating the most beneficial Incoterm. To give an example, when exporting the goods, the seller should seek to negotiate the Incoterms CIF, CFR, CPT, CIP, DAT, or DAP, whereas the importing buyer will always prefer one of the following: EXW, FOB, FAS, or FCA. Also smaller companies should trade with DAP or DAT because it doesn't require great amount of work for both sides. Further, freight forwarder may warn their clients that taking on CIP or CIF includes insurance cost, but with minimum coverage. Thus both the seller and the buyer should insure the goods additionally from the possible risks.

The Term Of Delivery provides the seller and the buyer with different obligations and responsibilities, but Term Of Delivery can also create possibilities for the part that has insight into the matter. It decides who controls the external flow of goods. If the seller for instance, wants to achieve this possibility of control, he would come to an agreement with the buyer that gives him that possibility. The more extensive a Term Of Delivery is for the seller, the more control he has over the flow. Also the seller or the buyer can hire a freight forwarder to represent them in this contract, so they can be assured that the flow of goods is in control.

4. CONCLUSION

The ever present conflicts of interests in the backdrop of contemporary globalized production and trade afflict all who take part in international trade. In order to overcome these disagreements, we need to simplify the process of international trade of goods. These issues have been surmounted by defining the Incoterms used in international contracts of sale when goods flow across national borders. Bearing in mind the presented problems, Incoterms gives a unique insight for standardizing the terms and eliminating ambiguities arising from local interpretations. In general, one Term of Delivery is not better than the other, the choice depends on various factors. A good Term of Delivery is the one that is decided after negotiations between aware and initiated buyers and sellers. The chosen Term of Delivery should give reasonable advantages for both parties involved and contribute to achieve the best solution at a given delivery situation.

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