Incoterms® 2010 - A Commentary

Note: Refer "Common Incoterms 2020" for current version of the Incoterms

Incoterms are usually revised in ten-year cycles to keep pace with developments in the environment of international trade. The 2010 terms take notice of the continued spread of customs-free zones, the increased use of electronic business transactions, heightened security requirements concerning the movement of goods internationally, and changes in transport practices.

What are Incoterms? First, it is an acronym for International Commercial Terms. These are International Chamber of Commerce terms that can be incorporated into a contract for the sale of physical goods, which stipulate which party (i.e. seller or buyer) has the obligation to make carriage or insurance arrangements, when the seller delivers the goods to the buyer, and the allocation of costs between each party. Incoterms are only part of the transactional clauses between the parties: other terms negotiated determine price, method of payment, and transfer of ownership.

Ownership of goods ('title') transfers, often upon actual payment, or some specific contractual agreement. It can be retained specifically by the seller until a specified point-in-time which includes the receipt of a final payment (as in so-called 'Romalpa Clauses'). Risk, however, transfers as per the Incoterms. Risk has a specific meaning: the risk of physical loss of or physical damage *to the* goods. Note that a buyer can have contracted to have had this risk transferred to them but as yet they have not acquired title. They are therefore contractually obliged to pay for the goods even after they have been destroyed. This is why marine transit insurance is so important. The risk of loss or damage of the goods is generally transferred when the seller has fulfilled its delivery obligations in accordance with the particular Incoterms rule. Delivery has multiple meanings in trade law and practice, but in the Incoterms® 2010 rules, the term is used to indicate where the risk of loss or damage to the cargo passes from seller to buyer.

The separate risk of loss or damage *caused by the goods* is not part of the Incoterms. This is a separate matter of the seller's products liability and products liability insurance in the contract of sale.

Whilst international trade terms, Incoterms form part of a private contract and, along with its other provisions, will be overridden by any domestic law that governs that contract or the parties. Whilst there are few, if any, such restrictions in New Zealand, exporters can find that political sanction and foreign exchange laws may frustrate their ability to negotiate freely.

In the Incoterms® 2010 there has been more than the usual 10-year gradual transition. The Incoterms have been revised into the different and simpler categories of 'Any Mode of Transport' and 'Sea & Inland Waterway Only'. The 'Delivered' terms have been revised, with DAF, DDU, DES and DEQ lapsed and replaced by two new Delivered terms, DAT and DAP:

Any Mode(s) of Transport				
2000	DAF	Delivered at Frontier	(… named *place*)	Replaced by DAT and DAP
2000	DDU	Delivered Duty Unpaid	(… named *place* of destination)	
2000	DDP	Delivered Duty Paid	(… named *place* of destination)	*Remains in 2010*

DDP represents the maximum obligation for NZ exporters, as they deliver the goods, cleared for import into the buyer's country, having paid any duties and fulfilled any customs formalities.

Sea & Inland Waterway Transport Only				
2000	DES	Delivered Ex Ship	(… named *port* of destination)	Replaced by DAT and DAP
2000	DEQ	Delivered Ex Quay	(… named *port* of destination)	

The two new Incoterms are:

Any mode(s) of transport			
2010	DAP	Delivered at Place	e.g. 'DAP Fruit Distribution Coolstore, Belgium - Incoterms® 2010' The parties should specify the place as succinctly as possible, as the risks to that point are the seller's. The main differences between this and DDP is that the seller is not responsible for the costs of unloading, or the costs of import duties or import customs formalities.
2010	DAT	Delivered at Terminal	e.g. 'DAT Container Terminal 3, Rotterdam - Incoterms® 2010' The seller places the goods at the disposal of the buyer at the named terminal (which can be 'any place, whether covered or not') at the named place or port of destination. Again, the parties should be as specific as possible, even naming a specific location within the terminal as the risks up to that point remain the seller's. The seller has the responsibility of clearing the goods for export but does not have the obligation to clear the goods for import or import customs.

The main distinctions between these two new Incoterms are the delivery terms. For DAP, the seller's obligation is to deliver the goods to the named place when they are then at the buyer's disposal, and ready for unloading (at the buyer's expense) from the arriving conveyance. Under DAT the seller delivers to the 'terminal' (or quay, warehouse, container yard) and bears the risks and costs of unloading.

So, from 2010 Incoterms are -

Any mode(s) of transport		**Risk transfers**
EXW	Ex Works	At the disposal of the buyer at a named place, usually the seller's premises, but not loaded on any collecting vehicle.
FCA	Free Carrier	On delivery at the named place (usually the seller's premises) to the carrier or other party nominated by the buyer.
CPT	Carriage Paid To	On delivery at the named place by the seller to the carrier, with the seller then paying for carriage to destination. CPT has two critical points, because risk passes and costs are transferred at different places.
CIP	Carriage and Insurance Paid To	On delivery at the named place by the seller to the carrier, with the seller then paying for carriage and (minimum) insurance to destination. CIP has two critical points, because risk passes and costs are transferred at different places.
DAT	Delivered At Terminal	Once the goods have been delivered and unloaded at the buyer's disposal at the named port or place of destination. If the intention is that the seller bear the risks and costs from the terminal to another place, then the DAP or DDP terms should be used.
DAP	Delivered At Place	Risk transfers once the seller has delivered the goods to the named place at the disposal of the buyer: the goods are 'on the arriving means of transport ready for unloading'.
DDP	Delivered Duty Paid	Risk transfers when the seller has delivered the goods at the buyer's disposal at the named place, cleared for import on the arriving means of transport, ready for unloading. DDP represents the maximum obligation to the seller. The seller not only has to clear the goods for export and for import, and to pay any of the associated customs duties and formalities.

It is important to note that these rules above can be used where a ship is used as part of the carriage.

Sea and Inland Waterway Only		**Risk transfers**
FAS	Free Alongside Ship	The seller delivers and risk transfers when the goods are placed alongside the vessel (e.g. on a quay or barge) at a named port of shipment. FAS is not well suited to containerised cargo, as they are typically delivered at a terminal. In such situations, FCA should be used.
FOB	Free On Board	Risk transfers when the goods are 'on board the vessel nominated by the buyer at the named port of shipment'. FOB is not well suited to containerised cargo, as they are typically delivered at a terminal. In such situations, FCA should be used.
CFR	Cost and Freight	The seller delivers and risk transfers when the goods are on board the vessel at the port of shipment. However, the seller pays for the costs and freight necessary to take the goods to the named port of destination. Like CPT, CFR has two critical points where risk and costs are transferred at different places. Like FOB, CFR is not well suited to containerised goods. CPT should be used instead.
CIF	Cost Insurance and Freight	Risk of loss or damage transfers when the goods are placed on board the vessel at the port of shipment. The seller must also contract for and pay the costs and freight necessary to bring the goods to the named port of destination. CIF is not well suited to containerised cargo, as they are typically delivered at a terminal. In such situations, CIP should be used.

In the 'Sea and Inland Waterway Only' rules, the point of delivery and the place to which the goods are carried to the buyer are both ports.

Therefore, the overall number of rules is reduced from 13 to 11, by eliminating four terms (DAF, DES, DEQ and DDU) and adding two (DAP and DAT).

The biggest change for the 'Sea and Inland Waterways' Incoterms is the time that risk passes from seller to buyer. Previously the transfer of the risk of loss of or damage to the goods passed "from the time they have passed the ship's rail at the named port of shipment". Now, under FOB and CIF, risk transfers once the seller has delivered the goods on board the vessel at the named port of shipment.

Note that FAS, FOB, CFR and CIF are not recommended for use where containers are used. This is because the practicalities of container handling are not suitable for the chosen risk transfer point. For example, the ICC recommends that FCA be used instead of FOB for goods in a container, as the container is handed over to the carrier at a terminal, which is obviously a point-in-time before they are on board the vessel. Instead of CIF, the ICC recommends CIP for containerised goods. Nevertheless, even though much of NZ's exports are carried in containers, we'll no doubt, in the short term, continue with the existing practice of overseas buyers stipulating CIF as a term of trade for containerised shipments. This could give rise to some misunderstandings. Now the risk transfer point is when the entire cargo has been loaded, rather than that theoretical vertical line above the ship's rail. Buyers will want to insist on shipped onboard notations on transport documents. Should a set of documents (including the bill of lading) have a number of containers listed then risk would only transfer when the last of the cargo (i.e. containers) is on board the vessel. 'Stowed on board', which is not the phrase used in the Incoterms® 2010, carries an implication of the cargo's final placement on the ship. It will be interesting to see whether there are any difficulties in interpreting what 'placing the goods on board the vessel' actually means, as this could be less obvious than the stark reality of gravity's definition of 'ship's rail'.

On their website (http://www.iccwbo.org/incoterms_faq/) the ICC also state these as important changes:

"… the new rules are classified according to the mode of transport (maritime vs. any other mode[s]), reflecting a consolidation and updating of the delivered rules, replacing the precedent categorization into families of rules. In addition, it includes the importance of cargo security and the 2004 revision of the United States' Uniform Commercial Code, which resulted in a deletion of the former US shipment and delivery terms. The revised Incoterms® rules also reflect the adoption in 2009 by insurance markets of the revised Institute Cargo Clauses (LMA/IUA) (2009)."

Insurance Requirements

Under CIF, where requested by the buyer, the seller is to procure cover additional to Institute Cargo Clauses (C) or any similar clauses, at the buyer's expense. For dry goods, this means Institute Clauses (B) or (A) cover. The requirements to obtain cover for 110% of the goods' contract price, and to meet the buyer's request for additional War and Strikes cover, are also similar to the 2000 Incoterms. Where the Incoterms® 2010 differ is in their being more precise in their language as to when cover is to commence and terminate, because the rules in each Incoterms® 2010 now describe the requirements for the contracts of carriage and insurance separately. For example, under the new CIF, the insurance 'shall cover the goods from the point of delivery … to at least the named port of destination'. The 2000 CIF, by contrast, stipulates that the insurance cover is to be from at least ship's rail at the port of shipment but remains silent as to termination. There is one other subtle difference in the Incoterms® 2010 concerning insurance: the new terms (e.g. CIF) expressly stipulate that 'the seller must provide the buyer with the insurance policy or other evidence of insurance cover', whereas previously the seller was obliged to provide the commercial invoice 'and any other evidence of conformity which may be required by the contract'.

This more specific reference to an insurance policy or other evidence of insurance cover is interesting, as it seems to acknowledge some different terminology used in different parts of the world. A cargo insurance certificate is sometimes called an insurance policy, particularly by US insurers. However, at least in New Zealand and other Commonwealth countries, the term 'insurance certificate' has a distinct nuance that is different to 'insurance policy'.

A cargo insurance certificate is a stand-alone subset of cover, issued from a wider open policy cover (which may be 'reviewed' annually) that protects the NZ exporter. The cargo insurance certificate cover still meets (and usually exceeds) the requirements of the contract of sale, but it remains a lesser and distinct stand-alone cover compared with the exporter's open insurance policy, and the certificate cover exists only for the specific sale. Such a cargo insurance certificate is therefore 'evidence of insurance cover' and meets the 2010® Incoterms' insurance requirements providing it meets the requirements set out in the individual contract of sale concerning the amount of insurance cover bought.

However, the cargo insurance certificate, being a specific cover issued from an exporter's open insurance policy but being stand-alone and separate from the open policy that produced it, does not confer any of the additional covers that might be available to the exporter. Common examples of these additional covers found in an annual open cargo cover are Expediting Expenses and Cargo Debris Removal.

The terminology can be confusing: the cargo insurance certificate is technically, of course, also an insurance policy in its own right, albeit for a collection of self-sufficient cargo clauses that give cover for loss or damage to the cargo, that exists only for a specific cargo and a specific time-span.

This means that there may be two cargo insurance covers in place at the same time: that of the contracted cover evidenced by the cargo insurance certificate, that transfers by assignment from seller to buyer as per the Incoterms and the sales contract; and some less visible persistent contingent covers available to only the Insured (i.e. the seller, exporter) in existence due to the wider issuing open cover. These contingent covers may remain invisible but can act behind the scenes to assist an exporter who is willing to further dent his insurance loss record to maintain good ongoing marketing relations with a longstanding trading-partner buyer.

The important point to note is that these contingent covers are only available to the Insured who holds the open cover, as that open policy facility is outside of the scope of the individual short-term contract of sale for specific goods. At destinations where the costs of dumping spoiled organic material can be greater than one-third of its undamaged value, these costs can be significant. However, contracts for the sale of goods generally only deal with insuring physical damage but not its aftermath. The Incoterms® 2010, similar to their previous iterations, do not deal with post-casualty costs at all.

Documentary changes?

Where the correct term is used, it will be of interest to see how bankers react in relation to the risk transfer point under FOB, CFR and CIF, and the documentary data requirements under letters of credit. This will also be of interest to NZ exporters and their clients in their dealings with Customs authorities, as there are now two distinct groups of terminologies used: one for airfreight, and one for ocean.

Whilst EXW represents the minimum obligation to the seller, the seller has to take into consideration that under EXW the buyer is not obliged to provide any information regarding the export of the goods. However, the seller might require such information for tax liability purposes. If that is the case, the parties are probably best advised to choose FCA instead, as there is then an obligation on the buyer to assist the seller (at the seller's expense) to meet any reasonable documentary requirements for tax purposes, and 'security-related information' such as final destination etc.

Make it clear which terms you are using

The ICC is very specific in its advice to buyers and sellers as to how to nominate one of the 2010 Incoterms. 'Incoterms' itself is a registered trademark, and the correct way to incorporate a 2010 rule into a contract of sale is "[the chosen Incoterms rule including the named place, followed by] Incoterms® 2010". In the text accompanying the expiring 2000 edition, the ICC was less strident, stating "… merchants wishing to use the Incoterms 2000 should… clearly specify that their contract is governed by "Incoterms 2000".

Whilst the 2000 Incoterms will be replaced in January 2011, there is no compulsion on traders to begin using the 2010 terms in their private contractual arrangements. Insurers and other third parties, in interpreting these contracts of sale, will need to look to established commercial practices between the parties where there is an absence of any clear efforts to identify the use of these new Incoterms. With the changes to the risk transfer point in the more common Incoterms utilised in exports by sea from New Zealand, and the less-than-perfect fit of the commonly used Incoterms (e.g. CIF) with containerised cargo, it is important for NZ importers and exporters to make sure that the Incoterms used at least stipulate the year-edition.

A 20' of chilled beef sold 'CIF Osaka' might be fraught with more difficulties than before.

For more information, please contact John McKelvie, Technical Underwriting Manager, Vero Marine, phone 09 352 7292.

Useful links

International Chamber of Commerce (ICC) - Incoterms® 2010 http://www.iccwbo.org/incoterms

International trade restrictions as a result of domestic law http://www.aimu.org/cargorestrictions2008.pdf

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