

## INCOTERMS

Language is one of the most complex and important tools of International Trade. As in any complex and sophisticated business, small changes in wording can have a major impact on all aspects of a business agreement.

Word definitions often differ from industry to industry. This is especially true of global trade. Where such fundamental phrases as "delivery" can have a far different meaning in the business than in the rest of the world.

For business terminology to be effective, phrases must mean the same thing throughout the industry. That is why the International Chamber of Commerce created "INCOTERMS" in 1936. INCOTERMS are designed to create a bridge between different members of the industry by acting as a uniform language they can use.

Each INCOTERM refers to a type of agreement for the purchase and shipping of goods internationally. There are 11 different terms, each of which helps users deal with different situations involving the movement of goods. For example, the term FCA is often used with shipments involving Ro/Ro or container transport.

INCOTERMS also deal with the documentation required for global trade, specifying which parties are responsible for which documents. Determining the paperwork required to move a shipment is an important job, since requirements vary so much between countries. Two items, however, are standard: the commercial invoice and the packing list.

INCOTERMS were created primarily for people inside the world of global trade. Outsiders frequently find them difficult to understand. Seemingly common words such as "responsibility" and "delivery" have different meanings in global trade than they do in other situations.

In global trade, "delivery" refers to the seller fulfilling the obligation of the terms of sale or to completing a contractual obligation. "Delivery" can occur while the merchandise is on a vessel on the high seas and the parties involved are thousands of miles from the goods. In the end, however, the terms wind up boiling down to a few basic specifics:

**Costs:** who is responsible for the expenses involved in a shipment at a given point in the shipment's journey?

**Control:** who owns the goods at a given point in the journey?

**Liability:** who is responsible for paying damage to goods at a given point in a shipment's transit?

It is essential for shippers to know the exact status of their shipments in terms of ownership and responsibility. It is also vital for sellers & buyers to arrange insurance on their goods while the goods are in their "legal" possession. Lack of insurance can result in wasted time, lawsuits, and broken relationships.

INCOTERMS can thus have a direct financial impact on a company's business. What is important is not the acronyms, but the business results. Often companies like to be in control of their freight. That being the case, sellers of goods might choose to sell CIF, which gives them a good grasp of shipments

moving out of their country, and buyers may prefer to purchase FOB, which gives them a tighter hold on goods moving into their country.

In this glossary, we'll tell you what terms such as CIF and FOB mean and their impact on the trade process. In addition, since we realize that most international buyers and sellers do not handle goods themselves, but work through customs brokers and freight forwarders, we'll discuss how both fit into the terms under discussion.

INCOTERMS are most frequently listed by category. Terms beginning with F refer to shipments where the primary cost of shipping is not paid for by the seller. Terms beginning with C deal with shipments where the seller pays for shipping. E-terms occur when a seller's responsibilities are fulfilled when goods are ready to depart from their facilities. D terms cover shipments where the shipper/seller's responsibility ends when the goods arrive at some specific point. Because shipments are moving into a country, D terms usually involve the services of a customs broker and a freight forwarder. In addition, D terms also deal with the pier or docking charges found at virtually all ports and determining who is responsible for each charge.

Recently the ICC changed basic aspects of the definitions of a number of INCOTERMS, buyers and sellers should be aware of this. Terms that have changed have a star alongside them.

#### **EXW (EX-Works)**

One of the simplest and most basic shipment arrangements places the minimum responsibility on the seller with greater responsibility on the buyer. In an EX-Works transaction, goods are basically made available for pickup at the shipper/seller's factory or warehouse and "delivery" is accomplished when the merchandise is released to the consignee's freight forwarder. The buyer is responsible for making arrangements with their forwarder for insurance, export clearance and handling all other paperwork.

#### **FOB (Free on Board)**

One of the most commonly used-and misused-terms, FOB means that the shipper/seller uses his freight forwarder to move the merchandise to the port or designated point of origin. Though frequently used to describe inland movement of cargo, FOB specifically refers to ocean or inland waterway transportation of goods. "Delivery" is accomplished when the shipper/seller releases the goods to the buyer's forwarder. The buyer's responsibility for insurance and transportation begins at the same moment.

#### **FCA (Free Carrier)**

In this type of transaction, the seller is responsible for arranging transportation, but he is acting at the risk and the expense of the buyer. Where in FOB the freight forwarder or carrier is the choice of the buyer, in FCA the seller chooses and works with the freight forwarder or the carrier. "Delivery" is accomplished at a predetermined port or destination point and the buyer is responsible for Insurance.

#### **FAS (Free Alongside Ship)**

In these transactions, the buyer bears all the transportation costs and the risk of loss of goods. FAS requires the shipper/seller to clear goods for export, which is a reversal from past practices. Companies selling on these terms will ordinarily use their freight forwarder to clear the goods for

export. "Delivery" is accomplished when the goods are turned over to the Buyers Forwarder for insurance and transportation.

### **CFR (Cost and Freight)**

This term formerly known as CNF (C&F) defines two distinct and separate responsibilities-one is dealing with the actual cost of merchandise "C" and the other "F" refers to the freight charges to a predetermined destination point. It is the shipper/seller's responsibility to get goods from their door to the port of destination. "Delivery" is accomplished at this time. It is the buyer's responsibility to cover insurance from the port of origin or port of shipment to buyer's door. Given that the shipper is responsible for transportation, the shipper also chooses the forwarder.

### **CIF (Cost, Insurance and Freight)**

This arrangement similar to CFR, but instead of the buyer insuring the goods for the maritime phase of the voyage, the shipper/seller will insure the merchandise. In this arrangement, the seller usually chooses the forwarder. "Delivery" as above, is accomplished at the port of destination.

### **CPT (Carriage Paid To)**

In CPT transactions the shipper/seller has the same obligations found with CIF, with the addition that the seller has to buy cargo insurance, naming the buyer as the insured while the goods are in transit.

### **CIP (Carriage and Insurance Paid To)**

This term is primarily used for multimodal transport. Because it relies on the carrier's insurance, the shipper/seller is only required to purchase minimum coverage. When this particular agreement is in force, Freight Forwarders often act in effect, as carriers. The buyer's insurance is effective when the goods are turned over to the Forwarder.

### **DAT (Delivered at Terminal)**

This term is used for any type of shipments. The shipper/seller pays for carriage to the terminal, except for costs related to import clearance, and assumes all risks up to the point that the goods are unloaded at the terminal.

### **DAP (Delivered at Place)**

DAP term is used for any type of shipments. The shipper/seller pays for carriage to the named place, except for costs related to import clearance, and assumes all risks prior to the point that the goods are ready for unloading by the buyer.

### **DDP (Delivered Duty Paid)**

DDP term tend to be used in intermodal or courier-type shipments. Whereby, the shipper/seller is responsible for dealing with all the tasks involved in moving goods from the manufacturing plant to the buyer/consignee's door. It is the shipper/seller's responsibility to insure the goods and absorb all costs and risks including the payment of duty and fees.

The International Chamber of Commerce (ICC) published the 8th and current version of its International Commercial Terms, also known as INCOTERMS® on January 1, 2011.

The revised rules, originally designated "INCOTERMS 2010", contain a series of changes, such as a reduction in the number of terms to 11 from 13. The DAF, DES, DEQ, and DDU designations have been eliminated, while two new terms, Delivered at Terminal (DAT) and Delivered at Place (DAP), have been added. INCOTERMS 2010 also attempt to better take into account the roles cargo security and electronic data interchange now play in international trade.

### **WHAT INCOTERMS ARE?**

INCOTERMS are a set of three-letter standard trade terms most commonly used in international contracts for the sale of goods. First published in 1936, INCOTERMS provide internationally accepted definitions and rules of interpretation for most common commercial terms. In the US, INCOTERMS are increasingly

### **WHAT INCOTERMS DO?**

INCOTERMS inform the sales contract by defining the respective obligations, costs and risks involved in the delivery of goods from the Seller to the Buyer.

### **WHAT INCOTERMS DO NOT DO - INCOTERMS by themselves DO NOT:**

1. Constitute a contract;
2. Supersede the law governing the contract;
3. Define where title transfers; nor,
4. Address the price payable, currency or credit terms.

These items are defined by the express terms in the sales contract and by the governing law.

## INCOTERMS are grouped into two classes:

### 1.) TERMS FOR ANY TRANSPORT MODE

#### **a) EXW - EX WORKS (... named place of delivery)**

The Seller's only responsibility is to make the goods available at the Seller's premises. The Buyer bears full costs and risks of moving the goods from there to destination.

#### **b) FCA - FREE CARRIER (... named place of delivery)**

The Seller delivers the goods, cleared for export, to the carrier selected by the Buyer. The Seller loads the goods if the carrier pickup is at the Seller's premises. From that point, the Buyer bears the costs and risks of moving the goods to destination.

#### **c) CPT - CARRIAGE PAID TO (... named place of destination)**

The Seller pays for moving the goods to destination. From the time the goods are transferred to the first carrier, the Buyer bears the risks of loss or damage.

#### **d) CIP - CARRIAGE AND INSURANCE PAID TO (... named place of destination)**

The Seller pays for moving the goods to destination. From the time the goods are transferred to the first carrier, the Buyer bears the risks of loss or damage. The Seller, however, purchases the cargo insurance.

#### **e) DAT - DELIVERED AT TERMINAL (... named terminal at port or place of destination)**

The Seller delivers when the goods, once unloaded from the arriving means of transport, are placed at the Buyer's disposal at a named terminal at the named port or place of destination. "Terminal" includes any place, whether covered or not, such as a quay, warehouse, container yard or road, rail or air cargo terminal. The Seller bears all risks involved in bringing the goods to and unloading them at the terminal at the named port or place of destination.

**f) DAP - DELIVERED AT PLACE (... named place of destination)**

The Seller delivers when the goods are placed at the Buyer's disposal on the arriving means of transport ready for unloading at the named place of destination. The Seller bears all risks involved in bringing the goods to the named place.

**g) DDP - DELIVERED DUTY PAID (... named place)**

The Seller delivers the goods -cleared for import - to the Buyer at destination. The Seller bears all costs and risks of moving the goods to destination, including the payment of Customs duties and taxes.

## **2. MARITIME-ONLY TERMS**

**a. FAS - FREE ALONGSIDE SHIP (... named port of shipment)**

The Seller delivers the goods to the origin port. From that point, the Buyer bears all costs and risks of loss or damage.

**b. FOB - FREE ON BOARD (... named port of shipment)**

The Seller delivers the goods on board the ship and clears the goods for export. From that point, the Buyer bears all costs and risks of loss or damage.

**c. CFR - COST AND FREIGHT (... named port of destination)**

The Seller clears the goods for export and pays the costs of moving the goods to destination. The Buyer bears all risks of loss or damage.

**d. CIF - COST INSURANCE AND FREIGHT (... named port of destination)**

The Seller clears the goods for export and pays the costs of moving the goods to the port of destination. The Buyer bears all risks of loss or damage. The Seller, however, purchases the cargo insurance.

## **PRACTICE POINTS**

### **BE SPECIFIC:**

If you use INCOTERMS in the Sales Contract or Purchase Order, you should identify the appropriate INCOTERM Rule [e.g. FCA, CPT, etc.], state "INCOTERMS 2010" and specify the place or port as precisely as possible.

### **RECOGNIZE WHERE THE RISK OF LOSS TRANSFERS:**

A common misconception when the Seller pays the freight is that the Seller has the risk of loss until the goods are delivered to the place or port specified on the bill of lading or airway bill. Actually, when using INCOTERMS CPT, CIP, CFR or CIF, risk transfers to the Buyer when the Seller hands the goods over to the carrier at origin, not when the goods reach the place or port of destination.

Understand that under CIP and CIF, the Seller is only obliged to obtain insurance on minimum cover.

**UNDERSTAND WHO HAS RESPONSIBILITY FOR LOADING AND UNLOADING CHARGES. FOR EXAMPLE:**

- DAT obliges the Seller to place the goods at the Buyer's disposal after unloading at the named terminal at port or place of destination.
- DAP and DDP oblige the Seller to place the goods at the Buyer's disposal on the delivering carrier ready for unloading at the named place of destination.
- CPT, CIP, CFR or CIF on the other hand, require the parties to identify as precisely as possible the point at the agreed port of destination because the costs up to that point are for the account of the Seller.
- Under FCA terms, the seller satisfies his obligation to deliver when he has handed over the goods, cleared for export, into the charge of the carrier named by the buyer at the named place or point. The buyer is responsible for inland freight, unloading at port of embarkation and loading on ocean carrier/airline.
- **UNDERSTAND WHO HAS RESPONSIBILITY FOR U.S. CUSTOMS ENTRY DECLARATIONS:**
- DDP is the only INCOTERM where the Seller has responsibility for U.S. Customs entry declarations.

**IMPORTANT NOTE:** An important factor to be considered when asking the Seller to be responsible for international carriage, is if the goods ship by Ocean Freight, an Importer Security Filing (ISF) must be electronically submitted to Customs 24 hours before the cargo is laden on the vessel bringing the cargo to the U.S. The Buyer should specify in the contract either (a) the shipper is responsible for the ISF or (b) the Seller is responsible for providing the required data in a timely manner (i.e. 72 hrs before lading) to the Buyer's appointed agent (e.g. Customs Broker). In practice, when the broker and the international forwarder are unrelated parties, this requirement is honored more in the breach than in the observance. The Buyer responsible for customs entry should indemnify against the penalties (US\$5,000) for filing a late, inaccurate or incomplete ISF. The ISF does not apply at this time to airfreight shipments

## **DETERMINE THE IMPORTANCE OF SUPPLY CHAIN VISIBILITY**

- When CPT, CIP, CFR or CIF are used the Seller fulfills its obligation to deliver when it hands the goods over to the carrier, not when the goods reach the place of destination.
- DAT, DAP and DDP the Seller fulfills its obligation to deliver at the named destination. The Seller has no obligation to provide transit status updates.

### **EXW Ex Works**

“Ex Works” means that the seller delivers when it places the goods at the disposal of the buyer at the seller’s premises or at another named place (i.e., works, factory, warehouse, etc.). The seller does not need to load the goods on any collecting vehicle, nor does it need to clear the goods for export, where such clearance is applicable.

### **FCA Free Carrier**

“Free Carrier” means that the seller delivers the goods to the carrier or another person nominated by the buyer at the seller’s premises or another named place. The parties are well advised to specify as clearly as possible the point within the named place of delivery, as the risk passes to the buyer at that point.

### **CPT Carriage Paid To**

“Carriage Paid To” means that the seller delivers the goods to the carrier or another person nominated by the seller at an agreed place (if any such place is agreed between parties) and that the seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.

### **CIP Carriage and Insurance Paid To**

“Carriage and Insurance Paid to” means that the seller delivers the goods to the carrier or another person nominated by the seller at an agreed place (if any such place is agreed between parties) and that the seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.

‘The seller also contracts for insurance cover against the buyer’s risk of loss of or damage to the goods during the carriage. The buyer should note that under CIP the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements.’



### **DAT Delivered at Terminal**

“Delivered at Terminal” means that the seller delivers when the goods, once unloaded from the arriving means of transport, are placed at the disposal of the buyer at a named terminal at the named port or place of destination. “Terminal” includes a place, whether covered or not, such as a quay, warehouse, container yard or road, rail or air cargo terminal. The seller bears all risks involved in bringing the goods to and unloading them at the terminal at the named port or place of destination.

### **DAP Delivered at Place**

“Delivered at Place” means that the seller delivers when the goods are placed at the disposal of the buyer on the arriving means of transport ready for unloading at the named place of destination. The seller bears all risks involved in bringing the goods to the named place.

### **DDP Delivered Duty Paid**

“Delivered Duty Paid” means that the seller delivers the goods when the goods are placed at the disposal of the buyer, cleared for import on the arriving means of transport ready for unloading at the named place of destination. The seller bears all the costs and risks involved in bringing the goods to the place of destination and has an obligation to clear the goods not only for export but also for import, to pay any duty for both export and import and to carry out all customs formalities.

## **RULES FOR SEA AND INLAND WATERWAY TRANSPORT**

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### **FAS Free Alongside Ship**

“Free Alongside Ship” means that the seller delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) nominated by the buyer at the named port of shipment. The risk of loss of or damage to the goods passes when the goods are alongside the ship, and the buyer bears all costs from that moment onwards.

### **FOB Free On Board**

“Free On Board” means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards.

### **CFR Cost and Freight**

**“Cost and Freight” means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. the seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.**

### **CIF Cost, Insurance and Freight**

**“Cost, Insurance and Freight “means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.**

**‘The seller also contracts for insurance cover against the buyer’s risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements.’**

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