

Incoterms 2010: The Newest Revision of Delivery Terms

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Abstract: *This paper considers the changes between the Incoterms 2000 and the Incoterms 2010 from a risk management perspective, and highlights the challenges that traders may encounter when dealing with some of these terms. For example, the problematic FOB term and its use in containerisation is not likely to have been totally resolved, although the Incoterms 2010 have attempted to ameliorate the situation. The new terms DAT (Delivered at Terminal) and DAP (Delivered at Place) should be useful for cross border transactions within Customs Union blocs, such as the European Union. The paper concludes that the new Incoterms 2010 provide improved definitions, and more effectively contextualise the use of old terms that are out of synch with today's modern practices. However, if traders continue to cling to their old habits and fail to update their delivery terms and arrangements to reflect contemporary practices, much of the work and progress that the ICC has put into this change process will be lost.*

Key words: Incoterms 2010 · Delivery Terms · Risk Management

JEL Classification: F10 · F13

1 Introduction

This early paper focuses on the latest revision of delivery terms (that are part of trade terms): Incoterms 2010, effective from 1 January 2011. An historical perspective is provided first. This is followed by comments about the application and limitations of Incoterms 2010, before discussing some of the most important elements of these delivery terms, together with the challenges faced by traders and their service providers in the adopting these terms. The paper concludes with recommendations that include staff training as a means to reduce contract and performance risk in international trade transactions.

Incoterms 2010 literature review

As Incoterms 2010 apply from 1 January 2011, it is not possible to provide an extensive literature review as little has been published to date in these terms, as a body of knowledge is still developing, particularly in relation to major changes. Literature of previous Incoterms editions (2000 and earlier) is not considered appropriate due to changes in the relative position of sellers and buyers over successive editions. At the time of writing, apart from International Chamber of Commerce (ICC) publications, there is dearth of literature on this topic. There are two short articles in trade magazines (Reynolds, 2011; Thornley, 2010), that are very general in nature and, consequently, do not particularly focus on any aspects of Incoterms 2010. The same comments apply to an article by Barron (2011).

The article by Glitz (2011) focuses on legal aspects of Incoterms in a Brazilian context and, therefore, has limited application outside that country. As the majority of references refer to Spanish

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text, it is difficult to further analyse this author's work. For contextual purposes, the following section provides a brief historical perspective of Incoterms.

Incoterms: a brief historical perspective

Incoterms are an acronym for **I**nternational **C**ommercial **T**ERMS. These terms were developed by the International Chamber of Commerce (ICC). Incoterms were first codified in a pre-Incoterms edition of 1923 (International Chamber of Commerce, 2010), comprising of six terms: FOB (Free On Board), FAS (Free Alongside Ship), FOT (Free On Truck), FOR (Free on Rail), Free Delivered CIF (Cost Insurance and Freight) and C&F (Cost and Freight). These terms were subsequently released as the first revision of Incoterms in 1936. Although it is known that international commerce had been taking place over several millennia, the problems faced by traders were the different interpretations given to various delivery terms across the globe. Incoterms were introduced to address the problem of interpretation, with the aim of bringing more certainty into commercial transactions and reducing the number of disputes between sellers and buyers.

Shortly after the launch of Incoterms 1936, an alternative set of delivery terms was promulgated in the USA – The Revised American Foreign Trade Definitions (RAFTD) of 1941. The original American Foreign Trade Definitions were issued in 1919. The RAFTD were subsequently incorporated into the 1951 Uniform Commercial Code (UCC), where until 2004, the UCC “contained definitions of ‘terms of sale’ (also called ‘shipping and delivery terms’) in section 2-319 through 2-324” (Petersen and Primus, 2008, p. 6).

Unlike Incoterms that are not a body of law, the USA terms were. The UCC created problems for international traders, not so much because it was an alternative to the Incoterms, but because it used the same abbreviations with completely different meanings. For example, the term FOB in Incoterms is a departure term, that is, the seller fulfils their obligations prior to the goods leaving from the agreed export port, whereas the RAFTD use the term FOB as an arrival term, meaning the seller has extended obligations beyond the port of export. The FOB term as used in the context of the RAFTD has several different Incoterms interpretations. It is not difficult to imagine confusion between sellers and buyers.

Notwithstanding the existence of the RAFTD, Incoterms were regularly updated to reflect changes in current practices on handling and delivery of goods. In fact Incoterms were updated in 1953, 1967, 1976, 1980, 1990, 2000 and 2010 (the current edition). Incoterms did not gain immediate global acceptance. In fact, in 1969 an unsuccessful attempt was made to have the Incoterms (year 1953) endorsed by UNCITRAL, but the existence of the RAFTD appears to have prevented that endorsement. However, over time Incoterms grew in popularity, to the point where they are now the set of international delivery terms of choice recommended by UNCITRAL (1992, 2000), for use in all international transactions involving the delivery of tangible goods.

In 2004, the UCC was amended and the delivery terms that had been embedded in USA legislation were removed, effectively allowing the Incoterms to become the definitive set of delivery terms in contracts of sale. The Incoterms 2010, for the first time in their history, refer to themselves as ‘rules’ and may be used for domestic contracts, although this paper limits its discussion to international applications. Interestingly, a recent survey of economists reports that nearly three quarters of respondents agreed that “the government of their country should adopt the Incoterms rules into national legislation (Plenk, J., G. Nerb and K. Abberger, 2010)”. It is argued here, that such recommendations should not proceed, for they are likely to bring back the problem experienced with the USA legislation mentioned above. It seems best if Incoterms remain voluntary. How the Incoterms 2010 may be applied to contracts and the limitations of these terms are discussed in the next section.

Incoterms 2010: application and limitations

As Incoterms 2010 are not a body of law, they must be specifically incorporated into the contract of sale for these rules to apply, and this may be achieved “through such words as [*the chosen Incoterms rule, including the named place, followed by*] Incoterms 2010” (International Chamber of Commerce, 2010a, p. 5).

It should be noted that previous editions of Incoterms may be used, although this is not recommended as earlier versions are unlikely to reflect current practices. Therefore, to avoid ambiguity, it is important to specify the revision year to be incorporated into the contract of sale. This is a very important consideration, especially where a new revision is being introduced, as is the case at the time of writing this paper, when the international trade community is in a period of transition.

Whilst Incoterms 2010 will be progressively introduced into new contracts executed from 1 January 2011, there will also be a variety of contracts using Incoterms 2000, executed until 31 December 2010, the delivery for which will be concluded post 1 January 2011. Consequently, sellers and buyers are likely to experience the concurrent use of Incoterms 2000 and Incoterms 2010 in the workplace during this transition period.

Incoterms 2010 are a useful inclusion in an international contract of sale as they over-ride the default position of Article 31 of the United Nations Convention on Contracts for the International Sales of Goods (CISG) that requires the specification of a specific point of delivery. This is because under each of the eleven Incoterms 2010, the point of delivery is one of the paramount stipulations. Indeed the point of delivery under Incoterms 2010 is also the point of risk transfer and, depending on the term chosen, it may also be the division of cost point.

Incoterms 2010 provide the basis for apportioning the rights, duties, obligations and responsibilities of sellers and buyers on a mutually exclusive basis. These issues will be further discussed later in this paper. The application of Incoterms 2010 to a contract is limited to that portion of the contract that concerns itself with the delivery of the goods, that is the physical movement of the consignment from origin to destination and the matters associated with such movement, including barrier clearance, documentation and security information, and contracts of carriage and insurance.

It is important to know that whilst Incoterms 2010 binds sellers and buyers through the contract of sale, other contracts and arrangements formed to discharge the obligations of the seller and the buyer are independent of third party contracts. Thus, if the responsibility for contracting for carriage falls on the buyer, the contract of carriage will not bind the seller, because the seller is not a party to it. These considerations form part of the decision making process that should take place at the negotiating table during the pre-contractual phase. The relative costs to be borne by the seller, in particular, should influence the choice of term, because the further the delivery point from the seller's premises, the higher the finance costs of servicing the contract. Further discussion on this point is provided later in the paper.

Incoterms 2010 exclude aspects of the contract of sale. These are “the price to be paid or the method of payment, the transfer of ownership of the goods, or the consequences of breach of contract” (International Chamber of Commerce, 2010a, p. 6). There is also a further exclusion in the definition of packaging where the Incoterms 2010 “do not deal with the parties’ obligations for stowage within a container or other means of transport” (International Chamber of Commerce, 2010b, p. 11). The exclusion of packaging is particularly important in the context of the movement of goods as neither sellers nor buyers have access to stowing cargo on means of conveyance, therefore, they cannot be held responsible for the actions of third parties, that is, the carriers. Container packaging is also excluded, except for circumstances where the seller specifically agrees to pack, or

procure goods packed, inside a container. The most important elements of Incoterms 2010 and the challenges of adopting and adhering to these rules are discussed in the next section.

The Incoterms 2010 challenges

A number of significant changes have been introduced by the Incoterms 2010, as shown in table 1. The shaded cells in table 1 represent the terms removed from Incoterms 2000 that were replaced with their equivalent in Incoterms 2010. It can be observed from table 1 that the number of terms has been reduced from thirteen to eleven, but in so doing, four Incoterms 2000 were deleted and two new Incoterms 2010 were added.

Table 1 Comparison of Incoterms 2000 and Incoterms 2010

| Incoterms 2000 | | Incoterms 2010 | |
|----------------|--------------------------------------|--|--------------------------------------|
| Group E | Ex Works (EXW) | Any mode or modes of transport (including multi-modal) | Ex Works (EXW) |
| Group F | Free Alongside Ship (FAS) | | Free Carrier (FCA) |
| | Free Carrier (FCA) | | Carriage Paid To (CPT) |
| | Free On Board (FOB) | | Carriage and Insurance Paid to (CIP) |
| Group C | Cost and Freight (CFR) | Sea and inland waterways transport inly | Delivered at Terminal (DAT) |
| | Cost Insurance and Freight (CIF) | | Delivered at Place (DAP) |
| | Carriage Paid To (CPT) | | Delivered Duty Paid (DDP) |
| | Carriage and Insurance Paid to (CIP) | | Free Alongside Ship (FAS) |
| Group D | Delivered at Frontier (DAF) | | Free On Board (FOB) |
| | Delivered Ex Ship (DES) | | Cost and Freight (CFR) |
| | Delivered Ex Quay (DEQ) | | Cost Insurance and Freight (CIF) |
| | Delivered Duty Unpaid (DDU) | | |
| | Delivered Duty Paid (DDP) | | |

Source: International Chamber of Commerce (2010b), own research

Furthermore, whereas the Incoterms 2000 were categorised within four groups by cost, the Incoterms 2010 only have two categories based on the mode of transport to be used for the delivery of the goods. Whilst most terms have remained unchanged, in a general sense, there has been a significant change to the FOB term, and by implication, CFR and CIF.

Consistent with the message from the Incoterms 1990 and Incoterms 2000, the use of the terms FOB, and by implication CFR and CIF, is not recommended for container traffic. This is simply because the seller loses physical control over the consignment at a point prior to the goods reaching the vessel. In fact, it is not unusual for ten lift-on and lift-offs to occur, through various third parties, from the time the consignment leaves the seller's premises until it is placed on board the vessel, as shown in table 2. The number of movements may vary slightly. They may be reduced where the seller does the container packing in-house, or they may be increased where port congestion warrants the container being moved a number of times within the wharf apron, for operational reasons.

Incoterms 2010 introduce a new FOB risk transfer point that also applies to CFR and CIF transactions. Although CFR and CIF require the seller to prepay freight charges at origin, the risk transfer point is the same as for FOB.

The ship's rail risk transfer point under FOB has been replaced in the Incoterms 2010, with a requirement for the seller to "deliver the goods by placing them on board the vessel, pursuant to Article A4 (International Chamber of Commerce, 2010b, p. 88). As this is a new principle, the precise meaning of the words have not been tested in a court of law, however, the best definitions currently available is that the seller does not complete their delivery obligation until the whole consignment has been placed on board the vessel, but this does not extend to the goods being stowed or lashed on

board. In other words, as long as the goods have been placed on deck, delivery has been completed, and this is not affected by subsequent cargo movements for carrier operational reasons.

Table 2 Possible cargo movement from the seller's premises to loading on board the vessel

| Action | Number of movements (lift-on and lift-off) |
|--|---|
| Loose cargo collected from sellers premises and taken to a container packing depot | 2 |
| Container taken to freight forwarder | 2 |
| Container taken to wharf and stored in marshalling area | 2 |
| Container moved to the loading stack | 2 |
| Container loaded on board | 2 |

Source: International Chamber of Commerce (2010b), own research

In considering the FOB Incoterms 2010, it is not difficult to see that where maritime containers are concerned, the seller carries a higher risk profile than necessary, and that the risk is retained beyond the seller's physical control of the goods. As shown in table 2, the seller would lose physical control of the consignment once they release this to a third party at their premises. Therefore, the term FOB has been limited to sea and inland waterways and not recommended for container traffic. Instead, the term FCA should be used.

Under FCA, the seller delivers the goods at a named place – a specified point agreed to between the seller and the buyer as part of the contract of sale. The named place may be anywhere between the seller's premises and the export wharf. Under FCA, the risk in transit transfers where the goods are “delivered to the carrier or another person nominated by the buyer” (International Chamber of Commerce, 2010b, p. 23). It should be noted that for the purpose of this paper risk in transit is defined as all the risks that may occur during the journey of a consignment from origin to destination, including the transportation, transit warehouse storage, transshipment and customs clearance points, as determined by the chosen Incoterm.

If the consignment is to be made available at the seller's premises, the seller has delivered “when the goods have been loaded on the means of transport provided by the buyer” (International Chamber of Commerce, 2010b, p. 24). Otherwise the seller delivers under FCA “when the goods are placed at the disposal of the carrier or another person nominated by the buyer on the seller's means of transport ready for unloading” (International Chamber of Commerce, 2010b, p. 24). This means that under FCA, the seller and the buyer may agree to the delivery point being the export wharf, and if so, the risk in transit would transfer from seller to buyer when the consignment (containerised or not) is lifted from the delivery vehicle, and not once it is loaded on board. Therefore, under FCA, the loading on board the vessel is done at the buyer's risk. The same situation remains unchanged for CPT and CIP contracts for, even though the seller prepays the charges to destination, the risk in transit transfers on placing the consignment at the disposal of the first carrier involved in the journey.

It is known that there are significant problems in getting traders to change from the established routines to the more appropriate and correct use of Incoterms. It seems strange that the term FOB, coined at least two hundred years before the era of containerisation (from the 1960's), has been so readily adopted and inappropriately applied to modern day container handling practices, as discussed earlier.

Perhaps one explanation for the popularity of FOB may be that in customs processes, declarations for the valuation of goods may only be made at either the FOB or CIF value, pursuant to the World Trade Organisation /World Customs Organisation Valuation Agreement. The majority of the developed world uses the FOB term. However, border control activities, as important as they may be, are neither concerned with contractual matters, nor risk transfer in transit. Consequently, customs authorities' interests in this context, are limited to the declaration of a value for the purposes of determining duties and taxes that may be payable on exportation or importation.

There is an additional problem with the use of FOB, and this is where the payment method chosen is via a Documentary Letter of Credit (DLC). A DLC is an undertaking by the buyer's bank to pay the seller (beneficiary) so long as they present documents with data content that comply with the requirements of the DLC. DLC operate under a special set of rules: Uniforms Customs and Practice for Documentary Credits, commonly abbreviated to UCP 600. The UCP 600 are developed by the ICC. There are two fundamental principles that apply to DLC transaction that are of interest to the discussion here. One is the principle of autonomy, pursuant to Article 4 of the UCP 600 that state, in part, that a DLC "by its nature is a separate transaction from the sale or other contract on which it may be based" (International Chamber of Commerce, 2006b, p. 20).

The separation of the contract from the method of payment is both one of practice and legality. Given the banks are not a party to the commercial contract, they are not bound by it and they have no responsibility for performance under it. This leads to the second (associated) principle, that is, according to Article 5 of the UCP 500 that "banks deal with documents and not with goods, services or performance to which the document may relate" (International Chamber of Commerce, 2006, p. 20). As can be observed, therefore, under a DLC transaction, there are two concurrent processes operating. One is the commercial consideration created by the contract, and not of concern to the banks, but of concern to the traders. The other is the payment arrangement through the DLC.

The requirements of the DLC dictate the types of documents and their data content, so payment may be exercised by the bank. Where the container traffic is concerned, the bank may unwittingly create problems for the seller in establishing an incorrect payment arrangement. This may be for example, where the DLC shows FOB as the term of delivery, and further requires the presentation of a transport document, typically a Bill of Lading (B/L).

The first problem is that the term FOB, as discussed before, is not suitable for container traffic. The second problem is that under the term FOB "the seller has no obligation to the buyer to make a contract of carriage" (International Chamber of Commerce, 2010b, p. 88). Yet, in order to obtain payment, the seller may be 'forced' to comply with the banker's requirement. The problem for the seller in this circumstance is a blurring of the risk transfer point. We return, therefore, to the issue of the correct delivery term. If the term FCA were to be used, the risk transfer point in container traffic may be constructed in such a manner as to coincide with the physical loss of control over the goods, something that cannot be done under FOB terms.

The two new terms that have been introduced replace previous delivery options. DAT replaces the former DEQ. This is where delivery takes place at a nominated terminal. The word terminal has been defined under Incoterms 2010 to include "any place, whether covered or not, such as a quay, warehouse, container yard or road, road, rail or air cargo terminal" (International Chamber of Commerce, 2010b, p. 53). Typically, in the context of international transactions, this will be a customs entry point. The seller is responsible for all costs and risks until the goods are delivered to the terminal unloaded from the delivery vehicle.

DAP replaces the former DAF, DES and DDU. In DAP, the delivery point may be beyond the terminal, however the seller has no import customs clearance obligations. With both DAT and DAP

it is too early to tell what problems may occur. It does not appear as though there are significant differences between DAP and the terms it replaces, however, the situation under DAT is currently unknown.

The Incoterms 2010 have introduced two clarifying clauses. One is the responsibility for the provision of information for security purposes, in the context of customs and permit authorities declaration and legislative compliance. Each term indicates who is responsible for border clearance, but there is also an underlying requirement for the non-responsible party to assist with the process, all be it at the responsible party's expense, if charges are applicable. This highlights the need for traders to adopt a co-operative rather than adversarial approach in their dealings.

The other clause deals with double payment of terminal charges. The responsibility for loading and unloading goods from their carrying conveyances has now been worded in such a way that a party will be responsible, or not, as the case may be, depending on the Incoterms 2010 chosen, to the extent that such charges form part of the contract of carriage, or not, as the case may be. As an example, in a CIP contract, the seller may have paid for the unloading of a container as part of the contract of carriage. Upon arrival, the stevedore may attempt to charge for the unloading again. The buyer, under such circumstances may unwittingly pay for these charges twice. The Incoterms 2010, by virtue of their wording, encourage a dialogue between the trading parties to avoid circumstances of double charging.

Conclusion

The Incoterms 2010 bring both good news for traders, and challenges too. By far the biggest obstacle to their full adoption will be the mind-shift required to get traders and bankers using the correct terms for the correct modes of transport. This will require a considerable education effort by all involved in the transactions. The Incoterms have been designed for use as a standard application, so it is important for their success, that they are understood with the same meaning by everyone. Incoterms 2010 try to induce clarity into transactions, by removing ambiguity over a number of the most fundamental issues.

It is too early to be able to know how widely and how quickly these terms will be adopted, but it is hoped that they will continue to increase in popularity and adoption because, if nothing else, Incoterms 2010 present opportunities for traders and their service providers to manage the risks associated with the movement of cargo. There is scope for more in-depth research into this topic in the future, to discover whether any particular problems are being experienced in the field, and whether these are similar across the globe, or whether they are localised to specific geographical areas or industries. However, such research cannot be conducted until these terms have been in use for at least two or three years, to allow for a more reasonable body of data to be gathered.

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