

# Understanding INCOTERMS 2010

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*Source : <http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>*

## 1. INTRODUCTION

When it comes to International Trade, INCOTERMS (or International Commercial Terms) as defined by International Chamber of Commerce (ICC) play a very important role. You may have everything in place, a secure order, LC from your Bank, trusted Suppliers of Raw Materials, the best quote from Shipping Company, an excellent opinion report on your Buyer/Seller and all the regulatory permissions for your order, but the slightest misunderstanding of INCOTERMS can lead to unforeseen circumstances or even loss in some cases (the most popular term CIF is a good example of this as we will see later on). Hence, thorough understanding of INCOTERMS is critical for error-free and risk-free execution of an order.

Mutual understanding, amicable relationship and trust between Trading Partners is what everyone involved in International Trade aspires for. However, such a relationship and trust is not developed overnight and can take years to develop. People are hesitant to start business relations with a party that sits in a different Country altogether and whom they have never seen or met before. It is to remove this hesitation that ICC published the INCOTERMS.

The primary intention of INCOTERMS is to remove any ambiguity in international trade. They are a set of predefined rules that help to clearly communicate the various costs, risks and responsibilities of both the trading partners viz. the seller and the buyer. First published in 1936, today they are used world over and have greatly contributed in facilitating and improving International Trade.

## 2. THE PRESENT VERSION - INCOTERMS 2010

As per the changing needs and trends, INCOTERMS are updated periodically and the latest version, the 18<sup>th</sup> one is known as INCOTERMS 2010. These came into effect from 1<sup>st</sup> Jan 2011 and have 11 defined terms, down from the 13 in the previous version. Three of the previous terms DAF, DES and DDU have been merged to form a new term DAP. Also, DEQ has been renamed a DAT. The following table shows the comparison of old terms with the new ones –

Sr. No.	INCOTERMS 2000	INCOTERMS 2010	Changes
1	EXW	EXW	No Change
2	FAS	FAS	Now, the Seller does Export Clearance instead of the Buyer.
3	FOB	FOB	No Change
4	FCA	FCA	No Change
5	CFR	CFR	No Change
6	CIF	CIF	No Change
7	CPT	CPT	No Change
8	CIP	CIP	No Change
9	DDP	DDP	No Change
10	DAF	DAP	3 terms merged to form a new term DAP
11	DES		
12	DDU		
13	DEQ	DAT	Terminology Changed.

(**DAF**- Delivered at Frontier; **DES**- Delivered ex-Ship; **DDU**- Delivered Duty Paid & **DEQ**- Delivered ex-Quay are no longer in use. Others are discussed in detail in section 5.)

### **3. A BIRD'S EYE VIEW OF INCOTERMS – DIVISION AND CLASSIFICATION**

INCOTERMS are divided in two ways –

1. On the basis of obligations.
2. On the basis of mode of transportation.

#### **1. On the Basis of Obligation**

In this format the INCOTERMS are divided into 4 groups, i.e. the “E Group”, the “F Group”, the “C Group” and the “D Group”. The following table gives the brief idea of the same –

<b>GROUP</b>	<b><u>Seller's Obligation</u></b>	<b><u>Buyer's Obligation</u></b>	<b><u>Remark</u></b>
<b>E Group</b> (EXW)	Minimum	Maximum	Responsibility of the buyer to arrange everything from seller's premises. Main carriage is to be paid by the buyer.
<b>F Group</b> (FAS,FOB,FCA)	Distributed	Distributed	Seller's responsibility ends at Port/Place of Loading. Main carriage is to be paid by the buyer.
<b>C Group</b> (CFR,CIF,CPT,CIP)	Distributed	Distributed	Seller's responsibility ends at Port/Place of Loading but arranges for Freight or Insurance on behalf of the Buyer. Main carriage is prepaid for the buyer.
<b>D Group</b> (DAT, DAP, DDP)	Maximum	Minimum	Seller's responsibility ends at either the Port of Destination or agreed place in buyer's country. Main carriage is prepaid for the buyer.

#### **2. On the Basis of Mode of Transportation**

1. The 4 terms FAS, FOB, CFR and CIF are used only for Sea or Inland Waterway mode of transportation.
2. The term DAT can be used for sea as well as other modes of transportation. This is because the definition of “Terminal” includes a terminal at Seaport, Airport or Inland Terminal as well.
3. The remaining 6 terms can be used for any mode of transportation.

### **4. CONTAINERIZED vs. NON-CONTAINERIZED SHIPMENTS**

It is advised that the 4 Sea terms be used only for non-containerized shipments i.e. where it is possible to actually verify the goods at the time they are being loaded on the ship. This is advised so as to help protect the buyer against fake or substandard delivery of goods by the seller. The reason for the same is that the buyer should be in a position to verify them before being loaded on the ship. This is critical because in these 4 terms, the seller's obligation ends as soon as the goods are laden on board the vessel. If a container with substandard quality of goods is laden on board with these INCOTERMS, the buyer has no protection against the payment (except for a long legal process to recover his money), if the transaction is under LC, which is in most cases.

However, today with the help of third party inspection agencies like SGS or by having his own agent present at seller's factory during the loading of goods or simply on the basis of trust, these terms are widely used even in Containerized transportation, in spite of the contractual risk or loss that might arise due to its use.

## 5. DETAILS OF INDIVIDUAL TERMS

Now let us look at each of the 11 INCOTERMS–

### 1. **Ex-works** [*EXW- agreed place of the seller, INCOTERMS 2010*]

Here the seller has minimum responsibilities and just has to make export packed goods ready for pickup at his factory. The buyer assumes all responsibilities and costs right from loading them onto his carrier at the factory.

- **PRICE INCLUDES** – Export packing.
- **RESPONSIBILITY OF SELLER ENDS** – at his premises.
- **INSURANCE** - Lookout of the buyer.

### 2. **Free Alongside Ship** [*FAS- agreed port of loading, INCOTERMS 2010*]

The seller is responsible for all cost and risks till the goods are placed alongside the Ship at the agreed Port of Loading. This also includes clearing them for export. All costs and risks from this point onwards are borne by the buyer. The buyer will appoint his own carrier (shipping co.) who will load the goods on board the ship for conveyance to port of discharge.

- **PRICE INCLUDES** – EXW cost + loading and transportation of goods till Port of Loading + Export clearance + Port of Loading charges.
- **RESPONSIBILITY OF SELLER ENDS** – once goods are placed alongside the vessel at Port of Loading.
- **INSURANCE** - Lookout of the buyer.

**(Note – In INCOTERMS 2000, the export clearance was to be done by the Buyer. However, INCOTERMS 2011 requires the Seller to do the Export Clearance.)**

### 3. **Free on Board** [*FOB- agreed port of loading, INCOTERMS 2010*]

In FOB, apart from the FAS costs and responsibilities, seller also has to additionally pay for loading the goods on board the vessel and getting the B/L issued from the Buyer appointed carrier. All costs and risks from this point onwards are borne by the buyer.

- **PRICE INCLUDES** – FAS cost + cost of loading goods on board the vessel + B/L issuing fee.
- **RESPONSIBILITY OF SELLER ENDS** – once goods are laden on board the vessel at port of loading.
- **INSURANCE** - Lookout of the buyer.

### 4. **Free Carrier** [*FCA- agreed place in seller's country, INCOTERMS 2010*]

This is the FAS/FOB equivalent for modes of transport other than sea. The seller is required to clear the goods for export and hand them over to the carrier appointed by the Buyer at the agreed place. Now, the catch in FCA is that the “agreed place” can be any place, airport or railroad, except for a seaport. It can also be the seller’s warehouse, in which case it is often mistaken with EXW, which is a completely different term. Let us see how the seller’s obligation changes with respect to the “agreed place”-

- If the “agreed place” is the seller’s warehouse, then the seller has to clear the goods for export and load them onto the buyer’s carrier at his warehouse.
- If the “agreed place” is anywhere else, the seller has to clear the goods for export and transport them to that agreed place. It is the buyer’s responsibility to unload them and reload onto his choice of conveyance. In this case it becomes the FAS equivalent.

- **PRICE INCLUDES** – FAS cost + loading on board the means of conveyance, if applicable.
- **RESPONSIBILITY OF SELLER ENDS** – once goods handed over to the buyer appointed carrier.
- **INSURANCE** - Lookout of the buyer.

5. **Cost and Freight** [*CFR- agreed port of discharge, INCOTERMS 2010*]

In this, the seller agrees to ship the goods till the agreed Port of Discharge by a carrier of his choice, but he is doing so only on behalf of the buyer. His responsibility still ends the moment goods are laden on board the vessel at the Port of Loading.

- **PRICE INCLUDES** – FOB Cost + Freight cost till Port of Discharge
- **RESPONSIBILITY OF SELLER ENDS** – once goods are laden on board the vessel at Port of Loading.
- **INSURANCE** - Lookout of the buyer.

6. **Cost, Insurance and Freight** [*CIF- agreed port of discharge, INCOTERMS 2010*]

This is the same as CFR but the seller also arranges for insurance on behalf of the buyer. Here also, his responsibility ends the moment goods are laden on board the vessel at the port of loading.

The seller is not insuring himself, but arranging to insure the buyer on his behalf by buying an insurance policy in favor of the buyer. If something does go wrong, it is the buyer who has to go through the insurance formalities and get his claim passed. He cannot withhold the payment for non delivery of goods.

- **PRICE INCLUDES** – CFR Cost + Marine Insurance till Port of Discharge.
- **RESPONSIBILITY OF SELLER ENDS** – once goods are laden on board the vessel at Port of Loading.
- **INSURANCE** – Seller arranges for insurance on behalf of the buyer.

7. **Carriage Paid To** [*CPT- agreed place in buyer's country, INCOTERMS 2010*]

This is same as CFR, except that this term is used to all other modes of transport except sea. It is commonly used for Air, Road or Rail shipments.

8. **Carriage and Insurance Paid to** [*CIP- agreed place in buyer's country, INCOTERMS 2010*]

This is same as CIF, except that this term is used to all other modes of transport except sea. It is commonly used for Air, Road or Rail shipments.

9. **Delivered at Terminal** [*DAT- agreed terminal at port/place of destination in buyer's country, INCOTERMS 2010*]

Here the Seller is responsible for all costs and risks till the agreed terminal at seaport or a non-sea terminal in buyer's country and is also obliged to deliver the same to the buyer. As mentioned earlier, DAT can be used for sea as well as other modes of transportation. This is because the definition of Terminal includes a Terminal at Seaport, Airport or Inland Terminal as well. It is the responsibility of the seller to make available the goods to the buyer at the terminal, by paying the destination port charges and unloaded the goods from the vessel.

Import clearance and further cost and responsibilities have to be borne by the Buyer.

- **PRICE INCLUDES** – All costs till Port of Discharge + Port of Discharge charges and unloaded goods from the vessel.
- **RESPONSIBILITY OF SELLER ENDS** – once goods are unloaded at Port of Discharge.
- **INSURANCE** – Lookout of the seller.

10. **Delivered at Place** [*DAP- agreed place in buyer's country, INCOTERMS 2010.*]

DAP is the extension of DAT, wherein the seller is responsible for all costs and risks till the agreed destination in buyer's country, which is beyond the terminal. Seller is obliged to deliver the goods, and also unload them at the agreed destination. As in DAT, the import customs clearance formalities are borne by the buyer.

- **PRICE INCLUDES** – DAT cost + delivery till the agreed place + unloading at the agreed place.
- **RESPONSIBILITY OF SELLER ENDS** – once goods are unloaded at the agreed place.

- **INSURANCE** – Lookout of the seller.

#### 11. **Delivered Duty Paid** [DDP- agreed place in buyer's country, INCOTERMS 2010.]

DDP is where the seller has the maximum responsibilities as he has to bear all risks and costs till the delivery of the goods at the agreed place in buyer's country, including import customs clearance. Note that unlike DAP, here it is the responsibility of the buyer to unload the goods at the agreed place.

- **PRICE INCLUDES** – DAT cost + delivery till the agreed place + Import duties and charges.
- **RESPONSIBILITY OF SELLER ENDS** – once goods reach the agreed place.
- **INSURANCE** – Lookout of the seller.

## 6. **UNDERSTANDING INCOTERMS**

It is very important to understand the point at which the risk and responsibility of the seller ends and is transferred to the buyer, because that is the foundation of INCOTERMS. There are a lot of explanations that show which costs are borne by whom. While it is equally important to classify the costs, but it is a wrong approach to understand INCOTERMS, as it can create a false impression about seller's responsibilities. The reason for this is; it is the first aspect (transfer of risk and responsibility) that decides who will bear which costs and in case of "C term" some costs are borne by the seller on behalf of the buyer. In case of "C Terms", it is not necessary that the seller's responsibility is up to the point at which the costs are covered by him (it ends much prior to that).

Consider the following table. Now put yourself in the shoes of a buyer and understand the place where the seller's obligation ends and the place till which the costs are covered by him-

INCOTERM	Seller's Obligation Ends	Costs covered by Seller
<b>EXW</b>	At his own Premises.	Export Packing.
<b>FCA</b>	After Export Clearance and delivery at named place of destination in seller's country.	Export Packing & Export Clearance. Delivery till agreed Place in seller's country.
<b>FAS</b>	After Export Clearance and placing the goods alongside the ship at port of loading.	Export Packing & Export Clearance. Delivery till agreed Port of Loading and the charges at Port of Loading.
<b>FOB</b>	After Export Clearance and once the goods are laden on board the ship at Port of Loading.	Export Packing & Export Clearance Delivery till agreed Port of Loading. Loading on board the vessel and charges at Port of Loading.
<b>CPT/CFR</b>	After Export Clearance and once the goods are laden on board the ship at Place/Port of Loading.	Export Packing & Export Clearance. Delivery till agreed Port of Loading. Loading on board the vessel and charges at Port of Loading. Carriage/Freight till Place/Port of Discharge.

<b>CIP/CIF</b>	After Export Clearance and once the goods are laden on board the ship at <b>Place/Port of Loading</b> .	Export Packing & Export Clearance
		Delivery till agreed Port of Loading
		Loading on board the vessel and charges at Port of Loading.
		<b>Carriage/Freight and Insurance till Place/Port of Discharge.</b>
<b>DAT</b>	After the goods are delivered at the destination terminal.	All costs till Port of Discharge.
	<i>NOTE- Import Customs Clearance is done by the buyer.</i>	Unloading from Vessel and charges at Port of Discharge.
<b>DAP</b>	After the goods are delivered at the named place in Buyer's country beyond the Port of Discharge.	All costs till Port of Discharge.
	<i>NOTE- Import Customs Clearance is done by the buyer.</i>	Unloading from Vessel and charges at Port of Discharge.
		Delivery (with unloading) till named place of destination.
<b>DDP</b>	After the goods are delivered at the named place in Buyer's country beyond the Port of Discharge.	All costs till Port of Discharge.
		Unloading from Vessel and charges at Port of Discharge.
		Import Customs Clearance.
		Delivery (without unloading) till named place of destination.

As we can see, in the "C terms" although the seller covers the cost till the destination port, his responsibility ends at the port of loading itself. So once the goods are laden on board, the seller has fulfilled his obligation and the buyer is obliged to pay him whether or not the goods are delivered to him for any reason.

It is only in "D Terms" that the seller undertakes to deliver the goods at the named port or place of destination in buyer's country. In case of his failure to do so, the buyer is not obliged to pay him and can reject a payment for non delivery of goods.

**For example –**

1. Consider a CIF shipment. Although the cost and insurance till port of discharge is included in the quotation, they are still the responsibility of the buyer. So if the ship sinks during the voyage (or some other problem that doesn't deliver the goods), it is the buyer who has to do the insurance formalities and get his claim passed. He cannot delay the payment to the seller for this reason. If he has not arranged for insurance (CFR/CPT shipment), or if the claim is not passed, it is a loss to the buyer.

2. Now, in a CIP/CPT shipment, the agreed place can be the buyer's factory, but that doesn't mean the seller is obliged to deliver the goods at the factory (which would have been the case in DAP, DDP shipment). He is just arranging the carrier to carry the goods till the factory. His responsibility still ends the moment goods are handed over by him to the carrier in the seller's country (just like in CFR/CIF, his obligation ends at port of loading).

3. Conversely, in a DAP, DAT or DDP shipment, the buyer is not concerned till the goods are delivered to him and insurance is the seller's lookout. The buyer is obliged to pay only on successful delivery of goods. So if the ship sinks during the voyage (or some other problem that doesn't deliver the goods), it is the seller who has to do the insurance formalities and get his claim passed. If he has not arranged for insurance or if the claim is not passed, it is a loss to the seller.

## 7. CORRECT AND INCORRECT USAGE

As we have seen in the previous section, INCOTERMS have a certain format. They are a three letter abbreviation, followed by a named place, seaport or airport followed by the applicable version. In some terms we have to use a specific port whereas in others we have to use a specific place. Following are a few examples of correct and incorrect usage –

Incorrect Usage	Reason	Correct Usage*
EXW, XXX Airport	Since in EXW, the obligation ends at the factory premises itself.	EXW, XXX Warehouse
FOB, XXX Airport	Since FOB is used for Sea Shipments only.	FCA, XXX Airport
DAP, XXX Seaport	Since DAP used only for named place and not port.	DAT, XXX Seaport
FCA, XXX Seaport	Since there is a equivalent term for Sea Shpt i.e. FOB.	FOB, XXX Seaport
CIP, XXX Seaport	Since there is a equivalent term for Sea Shpt i.e. CIF.	CIF, XXX Seaport
CIF, XXX Airport	Since CIF is used for Sea Shipments only.	CIP, XXX Airport.
CFR, XXX Airport	Since CFR is used for Sea Shipments only.	CPT, XXX Airport
DDP, XXX Airport	Since in DDP, the final delivery place is beyond the destination port/place.	DAT, XXX Airport

(\*with the version "INCOTERMS 2010" mentioned at the end.)

## 8. IMPORTANT POINTS TO REMEMBER

- INCOTERMS are applicable only when it is explicitly mentioned that they are subject to a certain version. For example, simply stating "CFR, Nhava Sheva India" in Goods Description is incorrect. The correct format is "CFR, Nhava Sheva India, INCOTERMS 2010." [Ref. clause 61 of ISBP].
- Every INCOTERM has two aspects-
  - The point where the risk and responsibility of the seller ends and is transferred to the buyer.
  - The Costs covered.
- It is always the buyer who bears all the costs. The seller always incurs them on behalf of the buyer.** This is the reason why EXW price is the lowest whereas CIF or DAP price is much higher. The choice of INCOTERMS depends on the buyer's ability to execute the logistical requirements in that foreign country. Also, sometimes if the seller has a lot of shipments to the buyer's country, then he has a better freight negotiation capacity and in such cases CFR or CIF may be preferred. The converse can also be true, in which case, FOB, FCA or even EXW may be preferred.
- Always use the correct format and correct port/place depending on whether it is an Import or Export transaction, as the case may be.
- Understand the "C Terms" properly when you are the buyer. Your responsibility starts from Port of Loading itself and not from the Port of Discharge, although the costs till port of discharge are covered.
- Understand the "D Terms" properly when you are the seller. Your responsibility ends only on successful delivery of the goods at the agreed place in buyer's country.



7. The responsibilities of the buyer begin immediately from the point where it ends for the seller.
8. **INSURANCE** –In the “E term” and “F Terms” the buyer arranges for insurance. In “C Terms”, the seller insures the buyer on buyer’s behalf, and not himself. Whereas in “D Terms” the seller insures himself.
9. Always try to keep the Sales Contract simple and as clear as possible.

## **9. References**

1. Foreword to INCOTERMS® 2010 by ICC available at-  
<http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>  
Accessed on 08.01.2016.

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