The latest in a series of best-selling guides explaining how ICC’s world-famous trade terms apply in practice, ICC Guide to Incoterms® 2010 provides answers to the most important and recurring questions that will be asked about Incoterms® 2010 rules.

The Guide explains the changes since the last Incoterms rules, looks at the differences between the terms, and provides an overview of buyers’ and sellers’ obligations. The present guide also explains the evolution of the Incoterms rules since 1936 and how they work in conjunction with contracts of sale, insurance and payment as well as the consequences following from the choice of the different terms. Detailed section-by-section comments on each of the Incoterms rules are accompanied by full-colour graphics and a clear, user-friendly presentation.


The International Chamber of Commerce, the world business organization, based in Paris, is the global leader in the development of standards, rules and reference guides for international trade.
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INTRODUCTION
The Evolution of the Incoterms rules from 1936 to 2010

After their initial introduction in 1936, the Incoterms rules were revised for the first time in 1957 and thereafter in 1967, 1976, 1980, 1990 and 2000. This appears to suggest that, in recent times, the Incoterms rules have been revised at 10-year intervals. This, however, is a false impression. It is merely a coincidence that the last three revisions are separated by 10-year periods. Indeed, the main purpose of the Incoterms rules is to reflect international commercial practice. Needless to say, commercial practice does not change at a set interval.

It is a common misunderstanding that the Incoterms rules represent nothing more than standard contract terms that could be revised at any time. In fact, the value of the Incoterms rules as an expression of international commercial practice would be endangered by frequent changes for some purpose or other, such as to make them more reader-friendly or to clarify a few points of minor importance. A revision of the Incoterms rules therefore requires that something important has taken place in commercial practice.

The first version of the Incoterms rules was clearly focused on commodity trading and fixed the important delivery points at the ship’s side or at the moment when the goods are taken on board the ship. The risk transfer point in the latter case was deemed to be the moment when the goods passed the ship’s rail. This point was relevant in the important and well-known trade terms FOB, CFR and CIF. In cases where the goods were to be delivered alongside the ship rather than across the ship’s rail, the trade term FAS was available. The Incoterms 1936 rules also contained a trade term representing the minimum obligation of the seller, namely EXW (“Ex-Works”).

After the Second World War, work on the revision of the Incoterms rules was resumed. Carriage of goods by rail had now increased, and it was necessary to introduce appropriate terms. In railway traffic, the seller frequently undertakes to arrange for the carriage in the same manner as under FOB. In 1957, two trade terms were added for this purpose, namely FOR and FOT (“Free on Rail” and “Free on Truck”). In 1976, a specific term for air transport was added, namely FOB Airport. All these trade terms, which applied to a specific mode of transport, were removed from the 1990 version of the Incoterms rules, as it was deemed unnecessary at that time to have specific terms for different modes of non-maritime transport. It was sufficient to use the general term FCA signifying “Free Carrier named point”. This term was first introduced in the 1980 version of the Incoterms rules, as by this time the carriage of goods in containers had increased to such an extent that it was necessary to introduce a new trade term (then with the acronym FCR). This was all the more necessary because the existence of various container terms could, at worst, lead to a chaotic proliferation of variants to the detriment of international trade. Nevertheless, the innovation represented by FCA was regarded as an experiment, which explains why it was introduced as an additional trade term at the very end of the relevant ICC publication. However, in the 1990 version, FCA became one of the more important Incoterms rules. Nevertheless, it took a considerable amount of time before merchants realized that it was no good using trade terms such as FOB when, in practice, the goods were not handed over to the carrier on board the ship but at earlier reception points in the country of shipment: so-called container yards or container freight stations. It was difficult for merchants to understand that a seller should not remain at risk after the goods had been handed over to a carrier nominated by the buyer.

In the 1980 revision of the Incoterms rules, it was necessary to add CIP for non-maritime transport as an equivalent to CIF, under which the seller undertakes to arrange and pay for the carriage and insurance. As a result, the terms CPT and CIP, corresponding to CFR and CIF for maritime transport, were both added to the Incoterms rules. The transport document used for maritime transport – the bill of lading – is not used for non-maritime transport, the reason being that, except when carried by
ship, goods are normally not sold in transit. Therefore, there is no need for a specific document like
a bill of lading, which enables the holder to sell the goods by transferring the document to a new
buyer. Consequently, CPT and CIP only make reference to the “usual transport document”.

In 1967, it was necessary to add terms for cases in which the seller undertakes to deliver the goods at
destination. In such cases, the seller concludes a contract of carriage in order to fulfil his obligation to
deliver the goods to the buyer at destination. Although he also pays for the freight under CFR and CIF,
he actually fulfils his obligation upon the shipment of the goods. Under these trade terms, his
obligation is reduced to arranging and paying for the transport and rendering a document that enables
the buyer to receive the goods from the carrier at destination. However, the seller assumes no risk for
loss of or damage to the goods after they have passed the ship’s rail in the country of shipment.

It is sometimes difficult for merchants to understand that a contract in which the point at destination
is named – such as “CIF New York” – nevertheless signifies that the risk is transferred from the seller
to the buyer before the indicated point, namely the point in the country of shipment where the goods
are taken on board the ship. Indeed, all terms starting with the letter C signify that there are two critical
points: one concerning the transfer of risk at the port of shipment and the other being the point up
to which the seller has the obligation to arrange and pay for transport.

In the 1990 revision of the Incoterms rules, it was deemed unnecessary to retain the earlier trade terms
relating to specific modes of transport (FOR, FOT and FOB Airport). The revision was also triggered
by the shift from paper documents to electronic communication. As a result, a paragraph was added
in the clauses dealing with the seller’s obligation to tender documents to the buyer stating that paper
documents could be replaced by electronic messages if the parties had agreed to communicate
electronically.

What then is the reason for the revision of the Incoterms rules resulting in the Incoterms® 2010 rules?
It appears that the main problem with the Incoterms 2000 rules was not so much what they contained
but rather that it was not sufficiently clear how they should be used in practice. In addition, it is
important to expand the use of the Incoterms rules, particularly in the United States, where a possibility
to do so has arisen as a result of the removal of the 1941 definitions of trade terms from the Uniform
Commercial Code. Indeed, the key trade term FOB is understood differently in the United States than
in the Incoterms rules. In the United States, FOB merely represents a point that could be anywhere.
In order to achieve an equivalent to FOB under the Incoterms rules, it would be necessary to add the
word “vessel” after the term FOB. A new trade term – DAP (“Delivered at Place”) - has therefore been
added. When using this term, it is possible to indicate any appropriate place. However, DAP is
inappropriate in cases where the goods should be made available to the buyer unloaded from the
means of transport. Another new term – DAT (“Delivered at Terminal”) – has therefore been added
for use when the unloading of the goods from the means of transport should be performed at the
seller’s cost and risk. This means that the maritime terms DES and DEQ in the Incoterms 2000 rules
have been replaced, respectively, by DAP and DAT, since the “terminal” in DAT corresponds to the
“quay” in DEQ where the goods are unloaded from a ship. In the event that parties continue to use
DES or DEQ under the Incoterms 2000 rules, the result will be the same as under DAP and DAT in the
Incoterms® 2010 rules.
There are limits to what can be done to increase the understanding of the Incoterms rules. In particular, merchants retain old habits and are not easily persuaded to depart from the traditional maritime terms, although this is clearly necessary when contemplating non-maritime transport. In order to promote a better understanding of the Incoterms rules, the 2010 version starts by presenting trade terms that can be used for any mode or modes of transport and only then presents trade terms that can be used for sea and inland waterway transport. Hopefully, this will induce merchants to first consider the use of the “all modes terms”. Nevertheless, it is important to consider the different needs of trading in commodities as compared to manufactured goods. Commodity trading will continue to focus on carriage of goods by ship, and it remains to be seen whether merchants will choose to use the new terms. Be that as it may, merchants need to understand that trading in manufactured goods – which frequently involves containerization – requires a range of trade terms that are tailored to contemporary commercial practice.

Another frequent misunderstanding concerns the very purpose of the Incoterms rules. Although they are needed to determine key obligations of sellers and buyers with respect to the different modalities of delivery, transfer of risk and cost, the terms do not represent the whole contract. It is also necessary to determine what rules apply when the contract is not performed as expected, owing to various circumstances, and how disputes between the parties should be resolved. While the Incoterms rules tell the parties what to do, they do not explain what happens if they do not do so! For this purpose, the parties need to lay down applicable rules in a contract or by using a standard form contract as a supplement. In practice, disputes might nevertheless arise owing to unexpected events that the parties have failed to consider in their contract in a clear and conclusive manner. In such cases, the applicable law may provide a solution. Fortunately, the 1980 UN Convention on Contracts for the International Sale of Goods (CISG) has now become recognized worldwide, thus contributing significantly to transparency and effective dispute resolution in international trade.
The ICC Model International Sale Contract (ICC pub. 556)

Although the applicable law may provide the necessary solutions when parties have not expressly agreed on certain issues in their contract, this is sometimes undesirable or the applicable law is not sufficiently precise to solve the matter. It is therefore necessary to deal with these issues in the individual contract or by reference to a standard form contract. ICC provides assistance to the parties in this respect by means of various standard forms. In the context of the international sale of goods, the ICC Model International Sale Contract (the “ICC Sale Form”) is particularly important. Section A of the ICC Sale Form invites the parties to select appropriate solutions themselves. First of all, it is essential to identify the parties and to specify the goods, the price and how the buyer should pay. It is also essential to choose the appropriate term for the delivery of the goods.

It is here that, for the first time, we see a distinction between terms appropriate for the delivery of manufactured goods as opposed to commodities. It is this distinction between the various categories that now appears in the Incoterms® 2010 rules.

Payment conditions can be chosen by ticking the appropriate boxes for payment on open account, payment in advance, documentary collection or the use of a documentary credit. The various documents required for a documentary credit are also specified.

Section B of the ICC Sale Form lists general conditions with respect to liability for non-conforming goods and the consequences of late delivery (payment of liquidated damages and termination when the maximum amount has been reached). There is also a provision relating to default interest in case of delayed payment. The interest rate refers to the average bank lending rate to prime borrowers with an increment of 2%.

In some cases, a party may fail to perform its obligation under a contract. If this failure is due to a certain type of event, it is not reasonable to hold that party liable for its failure to perform. Such events appear under the heading Force Majeure.

Even though parties are able to settle their disputes amicably in most cases, there is a need to provide for the unfortunate event in which they fail to do so. Consequently, there is a provision in Section B referring to arbitration according to the ICC Arbitration Rules.

The parties may depart from the provisions in Section B by completing boxes in Section A. They may wish to insert a particular cancellation date, given the difficulty of determining when cancellation of the contract is possible under the applicable law. In addition, they may wish to depart from the provisions on termination in the case of the late delivery or non-conformity of the goods in Section B. Alternatively, they may wish to provide for a form of compensation other than liquidated damages, for instance a fixed amount, in the case of delay.

The general conditions in Section B provide for a deadline for the institution of an action against the seller for non-conformity of the goods, namely a period of two years from the date of the arrival of the goods. In the specific conditions of Section A, however, the parties may wish to provide for another time period.
With respect to choice of law, the parties may specify in Section A that a domestic sale of goods act should apply instead of the CISG or that the CISG should be supplemented by the law of a specific country or by generally recognized principles of law, such as the UNIDROIT Principles of International Commercial Contracts. They may also choose a form of arbitration other than arbitration according to the ICC Arbitration Rules or litigation before a court of law rather than arbitration.

The ICC Sale Form thus contains highly flexible and important guidelines for parties that wish to draft a contract. They may use the ICC Sale Form “as is” and complete it in the above-mentioned manner or they may use it as a model when drafting their own individual contract. In this context, it should be noted that the ICC Sale Form is designed for the sale of manufactured goods intended for resale, in cases where substitute goods are normally available if the goods delivered do not conform to the relevant specifications. Thus, the ICC Sale Form may be inappropriate in cases where the goods are manufactured specifically for the buyer as end-user.

In any event, with the introduction of the ICC Sale Form, ICC has provided a useful service to the international trading community.
Additional Contracts

An international trade transaction requires not only a contract of sale but also additional contracts. In the first place, the goods will have to be moved from the seller’s location to the location selected by the buyer. Therefore, it is necessary to arrange and pay for their transport. This means that three parties are now involved: the seller, the buyer and the carrier. This can lead to complications. One of the main purposes of the Incoterms rules is to define the different roles of the parties in relation to the contract of carriage.

Under the terms starting with the letter C or D, it is for the seller to conclude the contract with the carrier. In contrast, under the terms starting with the letter E or F, it is for the buyer to do so. When the seller contracts for carriage, it is important to ensure that the buyer is able to receive the goods from the carrier at destination. This is particularly important with respect to shipment contracts. The buyer must then receive a document from the seller – such as a bill of lading – that will enable him to receive the goods from the carrier by tendering an original of the document in return for the goods. If the seller has concluded a contract of carriage under one of the D terms, he must be in control of the goods during the entire transit to the place where they are to be delivered to the buyer. It is the seller’s obligation to ensure that the goods can be delivered to the buyer at the indicated place of destination. If something goes wrong during the carriage, the seller bears the risk. This is different in situations involving terms starting with the letter C, where the seller merely has to arrange and pay for the carriage. If something goes wrong during the carriage, the risk is on the buyer.

It is common for the seller to want to escape the risk of loss of or damage to the goods while they are in transit, even in cases where he undertakes to deliver the goods at destination. This is not only a matter of insurance. The fact that the seller may be protected by insurance in the case of loss of or damage to the goods in transit does not relieve him of his obligation under the contract of sale to deliver the goods to the buyer. If the goods have been lost, it is for the seller to provide substitute goods wherever possible. If this is impossible, he may escape liability under the applicable law or
according to the individual contract terms. The standard expression “no arrival, no sale” signifies that the parties are relieved from the contract of sale if the goods fail to arrive at their destination. Nevertheless, it is better not to use such expressions but to clearly specify the consequences in the individual contract of sale or by using standard form contracts with elaborate relief clauses that apply in specified circumstances. ICC has provided solutions in its 2003 Force Majeure and Hardship Clause (ICC Pub. No. 650).

With respect to the buyer’s obligations, it is important to use appropriate services by commercial banks for payment. When the parties have established a continuing relationship, the seller normally trusts the buyer and sells the goods on open credit. In other cases, it is important for sellers to protect themselves. They can do so by various means. Either party may, of course, arrange for bank guarantees to be opened in its favour, so that money can be collected from the guarantee in the case of non-performance. The most important type of guarantee that is provided in a standard form is described in the ICC Uniform Rules for Demand Guarantees (URDG 758). It is possible to call upon this type of guarantee by means of a so-called simple demand. There are various options to reduce the danger of an abuse of the guarantee (“unfair calling”).

In cases where the parties do not know each other well from previous dealings, it is quite common that the buyer is required to open a documentary credit with the seller as beneficiary. ICC has for a long time provided rules for such documentary credits, which are currently known as UCP 600. It is particularly important for the seller to present the correct documents in order to get paid. These documents are specified by the buyer in the instructions to the bank opening the credit. It is therefore essential that the seller is given sufficient time to check whether these instructions conform to the terms of the contract of sale. If they do not, the buyer has committed a breach of contract that, at worst, entitles the seller to cancel the contract. The seller must take care to ensure that the documents presented to the bank comply with the buyer’s instructions.

With respect to the terms of the contract of carriage, the Incoterms rules merely state that the seller should provide “the usual transport document”. The liability of carriers for loss of or damage to the goods in transit is rather limited. They are not liable for so-called “nautical fault” (errors in the navigation or management of the ship). This exception was abolished by the 1978 UN Convention on the Carriage of Goods by Sea, also known as the Hamburg Rules. However, these rules have only entered into force on a limited scale. A new convention, also known as the Rotterdam Rules, was concluded in September 2009, but it remains to be seen whether it will come into force. In addition to this rather lenient liability regime, maritime carriers are entitled to limit their liability to specific amounts, which may sometimes prove insufficient for compensating shippers and consignees for their losses. The seller or buyer, as the case may be, is usually protected by cargo insurance, which under the Incoterms rules CIF or CIP is arranged and paid for by the seller with the buyer as beneficiary. CIF and CIP only require the seller to provide insurance with minimum cover, the reason being that the insurance terms in so-called “string sales” involving commodities must be standardized to take account of the fact that the insurance requirements of prospective buyers down the string are not known. However, the buyer may ask for additional cover, which will be provided by the seller if procurable. When paying the insured party, the cargo insurer obtains the right to hold the carrier liable under a so-called letter of subrogation, whereby the insured party assigns his right to claim damages from the carrier to the insurer. The carrier’s liability is covered by liability insurance. In practice, the loss of or damage to the goods in transit therefore results in a battle between these various types of insurers.