INCOTERMS® 2020 RULES

A Short Summary of Key Changes, Advantages and Disadvantages

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THE RULES

RULES FOR ANY MODE OR MODES OF TRANSPORT

EXW
EX WORKS (insert named place of delivery)

FCA
FREE CARRIER (insert named place of delivery)

CPT
CARRIAGE PAID TO (insert named place of destination)

CIP
CARRIAGE AND INSURANCE PAID TO (insert named place of destination)

DAP
DELIVERED AT PLACE (insert named place of destination)

DPU
DELIVERED AT PLACE UNLOADED (insert named place of destination)

DDP
DELIVERED DUTY PAID (insert named place of destination)

RULES FOR SEA AND INLAND WATERWAY TRANSPORT

FAS
FREE ALONGSIDE SHIP (insert named port of loading)

FOB
FREE ON BOARD (insert named port of loading)

CFR
COST AND FREIGHT (insert named port of destination)

CIF
COST INSURANCE AND FREIGHT (insert named port of destination)

What are the potential advantages and disadvantages of each rule? Do they work with letters of credit?

It all depends upon, firstly, whether you are the seller or the buyer; secondly, what level of expertise you have in trading goods; and thirdly, what level of buying power you have. The Incoterms® 2020 rules, like the versions before them, relate not to the "warm and fuzzy" marketing aspects of a sale, not to the technical descriptions of the goods, not even to the payment arrangements, but to the essentials of who does what, when and at whose risk and whose expense. Without a good working knowledge of these rules the sales and marketing people can still make a sale but it is the logistics and often finance people who then have to tie all the loose ends together to make the sale into a reality. After all, a sale is not a sale until the goods move from seller to buyer and are paid for.

Let's now look at the advantages and disadvantages to both seller and buyer for each of the eleven rules.

EXW – Ex Works

Ex Works (EXW) is the Incoterms® 2020 rule used to describe the delivery of goods by the seller at their place of business, normally in their factory, offices or warehouse. The seller does not need to then load items onto a truck or ship, and the remainder of the shipment is the responsibility of the buyer (e.g. overseas shipment and customs duty). EXW is therefore more favourable to the seller as they do not need to worry about the freight once it has left their premises. However it is vital to note that once the seller has informed the buyer that the goods for the contract are identified and set aside, the delivery has been made, the buyer bears the risk from that moment and is obliged to pay, even though the goods are still in the possession and physical control of the seller.

Not only that, it is not the seller's responsibility to load the goods onto the buyer's collecting means of transport. How would this play out in real life? Will the seller allow the buyer's transport contractor to bring their own forklift and labour, and allow them to rampage around the seller's warehouse? What would be the insurance, workplace safety and other ramifications of this?

If the goods are being exported there are more problems. It is the buyer who must export clear the goods, and in most countries only an entity registered in that country can export. Add to that potential VAT/GST issues because unless the seller has evidence of the export they must charge this tax as it would be seen as a local sale.

In effect, using EXW as described in Incoterms 2020 is almost impossible.

FCA – Free Carrier

The FCA (Free Carrier) rule requires the seller to deliver the goods to the buyer or its carrier either at the seller's premises loaded onto the collecting vehicle or delivered to another premises (typically a forwarder's warehouse, airport or container terminal) not unloaded from the seller's vehicle. The seller must carry out any export formalities and the buyer carries out any import formalities. From this it can be seen as a step up from the largely unworkable EXW in that the seller is now responsible for physically handing the goods over with risk transferring to the buyer only when delivery has been made, This rule works well for land transport within the Europe/Central Asia landmass, because often the truck collecting the goods will be the one transporting the goods to the destination.

Despite being recommended in place of FOB for cross-ocean container shipments this rule in practice is largely unworkable for them. This is because in such shipments the buyer wants to only take on the risk of damage or loss of the goods when they have actually been exported. They don't want to be faced with any possibilities of having to deal with any problems whatsoever in the exporting country.

The 2020 version introduced a new obligation on the buyer, if agreed, to instruct its carrier to issue an on board bill of lading but while it is well-intentioned it is not a well-thought out provision and will fail in its execution. It still leaves delivery being when the seller hands over the goods to the buyer's carrier. The seller has no obligation to actually put the goods on board, and if anything was to happen to the goods between delivery and going on board, while at the buyer's risk, the reality in such trade is that not only would the seller not be given an board bill of lading but the buyer would not consider the goods exported and refuse payment. This new provision was added mainly to deal with the seller's needs for letters of credit but an unintended consequence would be that usually the seller would end up being named as shipper on that bill of lading, imposing on them liabilities that they neither knew about or accepted. It is also the only provision in the Incoterms® 2020 rules which requires a party to instruct a carrier yet gives no direct remedy to the other party should the carrier fail to act accordingly.

CPT – Carriage Paid To

The CPT (Carriage Paid To) rule requires the seller to deliver the goods to its carrier but does not indicate whether that is either at the seller's premises loaded onto the collecting vehicle or delivered to another premises not unloaded from the seller's vehicle. The seller must carry out any export formalities and the buyer carries out any import formalities. It is the seller's responsibility to contract for carriage and of course the cost of that will be built into the selling price. Like FCA, the risk transfers to the buyer immediately when delivery has been made, This rule works well for land transport within the Europe/Central Asia landmass, because often the truck collecting the goods will be the one transporting the goods to the destination.

The CPT rule has two important places, the place of delivery in the seller's country and the destination to where the seller contracts the carriage. It is important to not confuse the two.

Despite being recommended in place of CFR for cross-ocean container shipments this rule in practice is largely unworkable for them. This is because in such shipments the buyer wants to only take on the risk of damage or loss of the goods when they have actually been exported. Initially the buyer is not only unaware of when or where delivery has occurred but also to whom, as it will be the seller's carrier. They don't want to be faced with any possibilities of having to deal with any problems whatsoever in the exporting country. The seller has no obligation to put the goods on board a ship by a given date, but as it is using its own contracted carrier it should be easily able to obtain an on board bill of lading.

CIP – Carriage and Insurance Paid To

The CIP rule is similar to CPT with one very important difference. This rule requires the seller to take out maximum insurance cover under Institute Cargo Clauses (A) or (Air) or similar, for the buyer's risk. The seller must give the buyer any insurance document the buyer will need in case it must claim under that insurance.

DAP – Delivered at Place

DAP requires the seller to deliver to a place named by a buyer, typically the buyer's premises. The buyer is responsible for unloading the means of transport. The seller has to carry out any export formalities and the buyer has to carry out any import formalities. Like with CPT and CIP the seller contracts for carriage and risk transfers only upon delivery which now is at the buyer's premises. The seller has no obligation to the buyer to insure for its risk. This rule works well for transport of goods by land within the Europe/Central Asia landmass but strikes potential problems once there is a change in mode of transport along the way.

For example, if the shipment is by air and requires import clearance formalities in the destination country these must be carried out by the buyer while the goods sit at the airport. Once cleared the seller's carrier (typically a freight forwarder) must then be given whatever paperwork they require to move the cargo from the airport to its final destination. The same situation exists for cross-ocean container shipments with the added complication that the empty container must be returned by the seller at its own expense.

It should be noted too that the buyer should not be the consignee on any air waybill or bill of lading, that should be the seller who has to arrange for its forwarder to take possession of the goods from the airline or shipping company and arrange local inland transport typically by truck.

If the goods are damaged or lost at any stage before the final destination then the seller will be unable to deliver and may well be in breach of contract, with the additional complication that the buyer will have already paid import duty and VAT/GST. If the buyer is unable to import clear the goods expeditiously then it might find that it bears the risk while the goods sit in customs control and is itself in breach of contract if the seller cannot deliver as contracted.

DPU – Delivered at Place Unloaded

This is a new rule for 2020. While it is often stated as simply being a change of name from the previous DAT (Delivered At Terminal) it is in fact just that little bit more. DAT itself was introduced 2010 as an expansion of DEQ (Delivered Ex Quay) to cover any mode of transport. The implication in DAT was that the seller delivered the goods, unloaded, into a terminal whether that be an open area of land such as a container yard or a covered warehouse such as at an airport. Regrettably that explanation was not clear in the wording of DAT though its location before DAP in the order of the 2010 rules tends to reinforce that. The difference now between DPU and DAP is that it means any place including the buyer's premises and therefore is shown now after DAP.

Certainly for land transport within the Europe/Central Asian land mass it is feasible, and with courier parcels delivery it represents what typically happens as the driver takes the parcel from the truck and hands it to the buyer. It is even feasible for smaller airfreight parcels which the truck driver can lift.

How it will turn out in practice for heavier packages by airfreight and cross-ocean container shipments is yet to be seen. Not only must the seller's carrier obtain from the buyer the appropriate paper work to take possession of the goods from the airline or shipping line but now it must also provide the means of unloading the truck at the destination place. For a container this could mean providing additional labour and a forklift plus a pallet jack for moving the goods within the container. Add to that potential insurance and workplace safety issues when labour and machinery not employed or contracted by the buyer operate within the buyer's premises.

DDP – Delivered Duty Paid

DDP functions much like DAP with one most important exception. It is the seller's obligation to import clear the goods in the buyer's country and pay any duties and VAT/GST. This rule should be used with great care as the seller might need to be a registered entity both for import and VAT/GST in the buyer's country, a fairly unlikely scenario. If the seller finds itself unable to be the importer or to be able to recover any VAT/GST paid then the parties should instead contract on DAP terms.

FAS – Free Alongside Ship

The FAS (Free Alongside Ship) rule goes back to the days of sailing ships, and requires the seller to place the goods alongside the vessel nominated by the buyer.

FAS is rarely used these days but still might be appropriate typically in shipments of heavy machinery which is brought to the wharf or barged up to the alongside the vessel, in both cases to be loaded on board by the buyer or its vessel's equipment. The goods are not delivered until the vessel is available in the port of shipment for the goods to be next to it. The seller must carry out export formalities and the buyer must carry out import formalities. The buyer contracts for carriage therefore the shipper on the bill of lading should be the buyer not the seller. The seller will most likely require at least a mate's receipt or some other form of evidence of export such as a copy of the bill of lading for their VAT/GST purposes.

FOB – Free on Board

FOB (Free on Board) is the most commonly-used trade term but in practice it is used without reference to any version of the Incoterms® rules. In such cases it is then up to the seller and buyer to agree in their contract on what they mean when they use these three letters.

This trade term goes back to the days of sailing ships, and in the Incoterms® 2020 rules, as in previous versions, requires the seller to place the goods on board the vessel nominated by the buyer. From that point on risk of loss or damage to the goods transfers to the buyer. "On board" is no longer defined as placing the goods "across the ship's rail" and in fact is not defined any further as it will be a matter for the contract to specify depending on the nature of the goods. Cost of carriage is payable by the buyer, the bill of lading usually indicating "freight collect".

The seller must carry out all export formalities and the buyer must carry out import formalities. The buyer contracts for carriage therefore the shipper on the bill of lading should be the buyer not the seller. The seller will most likely require at least a mate's receipt or some other form of evidence of export such as a copy of the bill of lading for their VAT/GST purposes. Often where there is a letter of credit involved the seller is shown on the bill of lading as the shipper, in which case the seller would be wise to inform themselves of the additional liabilities they might be taking on under the terms and conditions of the bill of lading.

Under the Incoterms® 2020 rules FOB is inappropriate for container shipments because the cargo is given to the carrier at a place some distance from the port, such as a container yard or even the seller's premises.

CFR – Cost and Freight

CFR (Cost and Freight) is one of the most commonly-used trade terms after FOB but in practice it is used without reference to any version of the Incoterms® rules. In such cases it is then up to the seller and buyer to agree in their contract on what they mean when they use these three letters.

This trade term goes back to the days of sailing ships, and in the Incoterms® 2020 rules, as in previous versions, requires the seller to place the goods on board the vessel contracted by themselves. From that point on risk of loss or damage to the goods transfers to the buyer. “On board” is no longer defined as placing the goods “across the ship’s rail” and in fact is not defined any further as it will be a matter for the contract to specify depending on the nature of the goods. The seller must carry out all export formalities and the buyer must carry out import formalities. Cost of carriage is payable by the seller, the bill of lading usually indicating “freight prepaid.”

It is important to understand that in this rule there are two ports concerned. The seller delivers at the port of loading, but pays freight to the port of destination where the buyer is obligated to receive the goods from the carrier. Given that the word “carrier” does not appear elsewhere in this rule it might have been better-worded as receiving the goods from the vessel. The seller and buyer should agree in their contract who should pay for unloading: the seller in the contract of carriage, or the buyer.

Under the Incoterms® 2020 rules CFR is inappropriate for container shipments because the cargo is given to the carrier at a place some distance from the port, such as a container yard or even the seller’s premises.

CIF – Cost, Insurance & Freight

The CIF rule is identical to CFR except in one aspect. Even though the risk transfers to the seller upon loading the goods on board the vessel, in CIF the seller is obliged to take out the minimum level of insurance cover for the buyer's risk.

This will be at Institute Cargo Clauses (C) or similar. The seller must give the buyer the insurance policy or a certificate under a policy – this document usually evidences the seller as the party being insured so it must then blank endorse the document on the back to allow the buyer to claim should it so require.

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