

Newsletter No 55 (EN)

**Trade Terms in International Sale of Goods
and International Commercial Terms
(INCOTERMS)**

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Newsletter No 55 (EN)

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What are Trade Terms?

In a sale of goods contract, apart from discussing in the goods being sold, it is important that the seller and the buyer discuss the issues regarding time, place and manner of transfer of such goods. Such issues are so-called trade terms. Thus simply defined, Trade terms are the sets of responsibilities of the buyer and seller in a sale relating to delivery of goods i.e. the method of delivery, the payment of costs such as shipping, insurance and customs as well as the arranging of the performance of these activities. Additionally, trade terms also play a key role in other parts of an agreement in the sale of goods e.g. 'price of goods' etc. In other words, trade terms are designed primarily to define the terms of delivery of the goods sold and used to determine the calculation of the purchase price. Generally trade terms deal with 2 main issues i.e. i) the allocation of the obligations e.g. loading and unloading fees, documentation charges, import and export duty, insurance, handling charges, package for export etc. and ii) delivery matters e.g. place of delivery etc.

Use of Trade Terms

The objective of trade terms is to help the seller and the buyer to settle mentioned issues. Predefined trade terms have been developed in form of abbreviations which already allocate the obligations of seller and buyer so that the parties do not need to consume much time for discussing the conditions in each issue. Once they are in agreement on trade terms, the parties recognize mutual understanding i.e. the seller realizes what he and the buyer must do to fulfil their obligations and vice versa.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

Over the time, various standard forms of trade terms in various countries have individually been developed. Although similar trade terms are used in international transaction, care must be taken as they may be interpreted differently in different countries. It is important to the parties to have a common understanding regarding the terms applied. Despite various standard forms, the most commonly used standard is 'International Commercial Terms' (or so-called INCOTERMS).

What are International Commercial Terms (INCOTERMS)?

Introduced by the International Chamber of Commerce, INCOTERMS are the sets of international rules for the interpretation of the most commonly used trade terms in foreign trade. The purpose of INCOTERMS is to standardize the trade usage of terms so that the uncertainties of different interpretation of trade terms in different countries can be avoided or at least reduced to a considerable degree. At present, there are three valid versions of INCOTERMS i.e. INCOTERMS 1980, 1990 and 2000.

Validity

INCOTERMS are only valid if one of them has been agreed upon explicitly in the contractual terms and has been named in agreements, offers/quotations, general purchase and sales conditions, orders, order confirmations etc. or included in separate agreements. It needs to be specified clearly in agreements or contracts that it is INCOTERMS 2000 (or some other earlier versions) that applies, so the parties know precisely what their rights and obligations are. A reference to the term, without further details, might cause problems, because the difference among the three valid versions can be significant. Formulation proposal: e.g. CIF BANGKOK INCOTERMS 2000 etc.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

What areas does it cover?

Generally INCOTERMS cover the duties of the parties in certain aspects of an international contract of sale. They define the rights and obligations of buyers and sellers with regard to:

- Delivery and transportation documentation (or equivalent electronic notifications)
- Allocation of costs for freight, tax and duty, insurance etc.
- Transfer of risk

INCOTERMS do not govern:

- The transfer of ownership and other rights arising from ownership
- Breaches of contract and the consequences thereof
- Description or quality of goods
- The timing and method of payment
- Choice of law
- Conditions with forwarders/carriers

Description of commonly used trade terms in INCOTERMS

The definitions of INCOTERMS have broadly divided into four groups of terms as follows:

- i) The E-terms (EXW) whereby the seller only makes the goods available to the buyer at the seller's premises;
- ii) The F-terms (FCA, FAS and FOB) whereby the seller is called to deliver the goods to a carrier appointed by the buyer;
- iii) The C-terms (CFR, CIF, CPT and CIP) whereby the seller has to contract for carriage, but without assuming the risk of loss of or damage to the

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

goods sold or additional costs due to events occurring after shipment and dispatch;

- iv) The D-terms (DAF, DES, DEQ, DDU and DDP) whereby the seller has to bear all costs and risks needed to bring the goods to the place of destination.

However, there are only a few commonly used terms in international trade in which their natures are described as follows:

1) Ex Works (EXW)

Main obligations for the parties in this term are as follows:

a) Delivery

The seller must provide the goods in proper packaging, and placing at the disposal of the buyer at the seller's premises e.g. works, factory, warehouse etc., not loaded on any collecting vehicle, on the agreed time or, if no such time is agreed, at the usual time for delivery of such goods. If no specific point has been agreed within the named place, the seller may select the point at the place of delivery which best suits his purpose. The risk of loss or damage in the goods sold passes to the buyer as soon as the seller fulfils his delivery obligation i.e. placing the goods at the disposal of the buyer.

b) Contract of Carriage and Insurance

Since the seller merely obliges to place the goods under heading a) so that he has no obligation to take out a contract of both carriage and insurance. The buyer has to undertake these matters by himself.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

c) Custom formalities for export and import of the goods

The buyer must obtain at his own expense any export and import document and carry out both export and import custom formalities.

This term represents the minimum obligations for the seller, and the buyer has to bear all costs and risks involved in taking the goods from the seller's premises.

2) Free On Board (FOB)

The term 'FOB' applies particularly for maritime and inland waterway transport. Main obligations for the parties in this term are as follows:

a) Delivery

This term obliges the seller to deliver the properly packaged goods on board the vessel in the manner customary at the port of shipment. The seller fulfils his obligations to deliver when the goods have passed over the ship's rail. As a result, he must bear all risks to the goods until the time it so passes.

b) Contract of Carriage and Insurance

The vessel in heading a) must be provided and contracted by the buyer at his own expense. And due to non-obligation in 'Insurance' for the seller, the buyer has to apply at his own expense if he wants the carriage to be covered by insurance.

c) Custom formalities for export and import of the goods

The seller must obtain at his own expense any necessary export document and carry out export custom formalities; meanwhile the buyer has to do the same in terms of import procedure.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

3) Cost and Freight (CFR)

The term 'CFR' applies particularly for maritime and inland waterway transport. Main obligations for the parties in this term are as follows:

a) Delivery

The nature of delivery and passing of risk of CFR is the same as that of FOB. See heading FOB a).

b) Contract of Carriage and Insurance

The seller must contract at his own expense for the sea carriage of goods to the named port of destination. In other words, he has to bear the cost and freight in the contract of carriage. However he is not obliged to take out insurance policy. It is the buyer's duty in case he wants insurance coverage.

c) Custom formalities for export and import of the goods

The character of this obligation is again identical to that of FOB. See heading FOB c).

It should be noted that in practice, many traders worldwide frequently continue to use the traditional expression 'C&F'. If C&F INCOTERMS is used, the court of law will use INCOTERMS 1980's meaning which is different from INCOTERMS 2000's. Thus it is strongly suggested that the parties use the correct term i.e. CFR in order to avoid any unexpected dispute.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

4) Cost, Insurance and Freight (CIF)

The term 'CIF' applies particularly for maritime and inland waterway transport. Main obligations for the parties in this term are as follows:

a) Delivery

The nature of delivery and passing of risk of CIF is the same as that of FOB. See heading FOB a).

b) Contract of Carriage and Insurance

In this section the seller is obligated at his expense to procure not only contract carriage of good, which shares the same nature as CFR, but also 'minimum insurance cover of the Institute Cargo Clause' for the goods transported. In other words, he has to bear the cost, freight and marine insurance cost to the named port of destination.

c) Custom formalities for export and import of the goods

The character of this obligation is again the same as that of CFR. See heading CFR c).

Conclusion

While negotiating an international sales contract, both parties need to pay much attention to trade terms. Each party must be aware of the extent of his/her responsibilities as agreeing on certain trade terms might result in additional cost. To make it as clear as possible, INCOTERMS should be adopted in the light of the fact that they define exactly the responsibilities and risks of both the buyer and the seller. It also helps speed up the process of trade negotiation. From the given fact, INCOTERMS are the most useful and absolutely common trade terms of its kind, though a lawyer should be consulted as to the best alternative.

Newsletter No 55 (EN)

Trade Terms in International Sale of Goods and International Commercial Terms (INCOTERMS)

	EXW	FOB	CFR	CIF
SERVICES	Ex Works	Free On Board	Cost and Freight	Cost, Insurance & Freight
Warehouse Storage	Seller	Seller	Seller	Seller
Export Packing	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller	Seller	Seller
Inland Freight	Buyer	Seller	Seller	Seller
Terminal Charges	Buyer	Seller	Seller	Seller
Forwarder's Fees	Buyer	Buyer	Seller	Seller
Loading Onto Vessel	Buyer	Seller	Seller	Seller
Ocean/Air Freight	Buyer	Buyer	Seller	Seller
Duty, Taxes & Customs Clearance for Export	Buyer	Seller	Seller	Seller
Charges On Arrival At Destination	Buyer	Buyer	Buyer	Buyer
Duty, Taxes & Customs Clearance for Import	Buyer	Buyer	Buyer	Buyer

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