

8.2. INCOTERM (RC)

Introduction

The International Commercial Terms, or short, INCOTERM, provide a standard framework for obligations and transfer of risk during transportation of goods from the vendor to the buyer.

Especially for international goods transactions, you should make sure that you understand the implications of the terms that are being used in the contract.

While it might be assumed that the formal ownership, the title, is dependent on the chosen INCOTERM, this is not the case. This should be declared separately in the sales contract.

Cost and Risk components

Depending on the described INCOTERM in the contract, the cost of the following items will be borne by either the buyer or the seller.

- Packing
- Loading Charges
- Inland Freight at exporter
- Terminal Charges at the departure port
- Insurance during transport
- Loading on vessel at the departure port
- Freight on the vessel
- Arrival charges
- Duty and Taxes
- (Inland) delivery to destination at the destination country

Most common INCOTERM

The most commonly used INCOTERM in China are:

EX WORKS (EXW)

This INCOTERM means that the goods will be picked up at the factory of the Supplier and the buyer is immediately responsible afterwards.

This this can be domestically a good choice for a goods transfer, in some countries the export has to be declared by the exporting company.

Free Carrier (FCA)

Free Carrier makes the seller responsible for delivering the goods to the carrier. If the destination is defined at the factory, from the logistics flow there is actually no difference to EXW, except that the export declaration has to be prepared by the seller which might be required by the export regulations of the country.

If several carriers are involved, it should be considered that compensation for damages by the first carrier, e.g. an domestic carrier to the port, might be hard to realize if it is a small domestic local company of the exporting country.

Free on Board (FOB)

The seller is responsible for all cost until the goods have been loaded on the ship, including domestic transport and the loading charges in the port of export.

Dan Harris in his amazing ChinaLawBlog mentions in several articles that FOB mostly is the wrong choice: Chinese factories tend not to insure the period between the products leaving the factory and being loaded in board while demanding payment already after the products leave the factory.

Cost, Insurance, Freight (CIF)

The seller is responsible to deliver the goods to the arrival port, including all charges until the goods get unloaded from the vessel. Starting from the arrival charges at the port, the buyer is responsible for all charges, including Customs Duty, Taxes and the transport to the final destination.

A possible pitfall is that goods might be insured by the exporter but the insurance coverage is not sufficient.

Delivered at place (DAP)

The seller is responsible to deliver the goods until the defined place and pays for all the fees, including Freight and Insurance, but excluding Duty and taxes.

Delivered Duty Paid (DDP)

The seller is responsible to deliver the goods to the final place, including duty and taxes. Similar to the exporting process with EXW, importing procedures at the destination country might not be possible for the exporting company even if the contract asks for it.

Common pitfalls

- When the handover time seems to be short for the vendor, e.g. if the INCOTERM specify "FOB", vendors sometimes do not have an insurance for the short period between their warehouse and when the articles reach the ship. Big disasters which destroy or damage the goods are improbable but not impossible. Ensure that the Insurance is being paid until the goods get handed over.
- When describing INCOTERM, be sure that it is not conflicting with the rest of the contract, otherwise it might weaken your chance of regress in front of a court.
- When using INCOTERM, you usually describe when in the process the goods and their risk will be handed over from the vendor to the buyer. Instead of just writing "FOB" you should use a more specific location, e.g. "FOB Tianjin".
- INCOTERMs describe which kind of cost has to be borne by which party. It does not describe when the goods and the risk will actually be handed over. This should be described in the contract separately.