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INCOTERMS 2010 – What you need to know (Part 1)!

The ICC reviews INCOTERMS from time to time to ensure that they reflect and respond to current trade practices and trends. INCOTERMS 2010 will be the eighth revision of INCOTERMS since their inception in 1936.

This client alert looks at what you need to know about INCOTERMS 2010 and what you need to do next. We will follow this alert with a detailed review of changes within the next two weeks.

The Basics

What is INCOTERMS?

A series of internationally recognised standardised trade terms published by the International Chamber of Commerce (ICC) and widely used in international sales.

What do INCOTERMS cover?

Who does what/who pays for what/when risk in the goods passes from seller to buyer/when delivery occurs, as well as issues such as insurance, export and import clearance and the divison of other costs pertaining to the delivery of goods.

What do INCOTERMS not cover?

There is nothing on ownership/title to the goods, nothing in detail on payment obligations (when/how/what security/against what documents) nothing on detailed vessel requirements, force majeure, termination, insolvency...In short INCOTERMS do not constitute a complete contract of sale, but rather provide convenient, internationally recognised rules for the sale of goods.

How are they used?

They are incorporated into many contracts by express reference (e.g. "DAP one safe berth Rotterdam, INCOTERMS 2010") or are referred to in standard contracts (eg SCoTA – "FOB means free on board as defined by INCOTERMS 2000"). They may also provide some guidance as to the generally accepted meaning of trade terms such as CIF/FOB/DES[1] but you must expressly refer to them if you want them to apply.

Why are they changing?

To take account of the spread of customs-free zones, the increase in use of electronic communications, concerns about security following 9/11 and latest developments in trade since the 2000 version.

When are they changing?

Publication date for INCOTERMS 2010 was 27 September 2010, with the new rules coming into force from 1 January 2011.

What about contracts already entered into?

For existing contracts, INCOTERMS 2000 will continue to apply even if performance of the contract will be made in 2011.

For contracts entered into between September 2010 – January 2011, parties should expressly say which set of INCOTERMS is to apply.

After 1 January 2011, it will be assumed any reference to "INCOTERMS" in new contracts is a reference to INCOTERMS 2010.

Do I really need to bother about INCOTERMS 2010?

It depends on your usual contract terms. GAFTA/FOSFA/Sugar (SAL/RSA) contracts do not incorporate INCOTERMS at all, so you can ignore the change! Standard petroleum product contracts (BP/Exon Mobil) refer to INCOTERMS, as do many Ethanol, coal and metals contracts, so you will need to:

1. N.B. INCOTERMS 2010 replaces DES with DAP. This is explained further in this alert.

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- check your standard contract forms;
- consider changes in 2010 INCOTERMS;
- make any necessary consequent changes (for example changing DES to DAP) to your standard forms for new contracts; and
- publicise the changes to your counterparties and to your traders/execution people.

What are the main changes in INCOTERMS 2010 that you should be aware of?

1. Removal of four terms (DAF, DES, DEQ and DDU) and introduction of 2 new terms (DAP – Delivered at Place and DAT – Delivered at Terminal).
2. Creation of two classes of INCOTERMS – (1) rules for any mode or modes of transport and (2) rules for sea and inland waterway (INCOTERMS 2000 had four categories).
3. Rules which are able to serve both domestic and international trade.
4. Express reference to the use of "equivalent electronic records", if the parties agree or it is customary.
5. Amended insurance cover to reflect the alterations made to the Institute Cargo Clauses.
6. Allocation of parties' respective obligations to obtain or to provide information in order to obtain security–related clearances.
7. Responsibility for Terminal handling charges expressly allocated.
8. Including an obligation to "procure" goods to reflect current practices in string sales.

The Detail

1. Removal of four terms from INCOTERMS 2000

The onward march of containerisation and point-to-point deliveries appear to have persuaded the ICC to introduce two new "Delivered" terms:

- Delivered At Place (DAP) which should be used in place of DAF, DES and DDU; and
- Delivered At Terminal (DAT) which replaces DEQ.

These terms may be used irrespective of the agreed mode of transport.

Part of the reasoning for fewer terms/simplification was that traders often chose the "wrong" term or muddled terms, leading to contradictory or unclear contracts.

2. Creation of two, rather than four categories of terms

The 11 terms have been categorised under two categories:

- deliveries by any mode of transport (sea, road, air, rail) – EXW, FCA, CPT, CIP, DAP, DAT and DDP. These may all be used where there is no maritime transport at all; and
- deliveries by sea/inland waterway – FAS, FOB, CFR and CIF.

This, again, is to make the new INCOTERMS easier to use.

3. Adapted Rules

The new INCOTERMS are expressly stated to be for *"both domestic and international trade"*. In fact, this is stated on the front page! This is achieved by statements within the rules that the obligation to comply with export/import formalities only exists where applicable.

For trade blocs (eg the EU) where "border" formalities have largely disappeared and in the US, where there has been an increasing willingness to use INCOTERMS rather than the former Uniform Commercial Code shipment and delivery, the new terms are now easier to apply.

4. Electronic Records

The buyer's and seller's obligations to provide contractual documentation may now be by *"electronic record if agreed between the parties or customary"*, reflecting recognition by the ICC of the increasing importance and contractual certainty (owing to speed of transfer) provided by electronic communication. This will also "future-proof" INCOTERMS 2010 as electronic procedures/communications develop over time.

5. Institute Cargo Clauses

Where an INCOTERM requires that one party obtain insurance, the insurance requirements have been amended to reflect the changes to the Institute Cargo clauses. The parties' obligations regarding insurance have also been clarified.

6. Security

The issue of security of goods /vessels, etc, is now at the front of most people's minds when considering international trade. Given that many countries now require heightened security

checks, the rules now require that both parties are obliged to provide all necessary information (e.g. chain of custody information) in order to obtain import/export clearance. The previous INCOTERMS did not require this degree of co-operation.

7. Terminal Handling Charges

Where the seller is required to arrange and pay for the carriage of the goods to an agreed destination (CIP, CPT, CFR, CIF, DAT, DAP and CCP) it may be the case that terminal handling charges are passed on to the buyer as part of the contractual price for the goods. However, historically, in come cases, the buyer also had to pay the terminal for this service (i.e. a double charge).

INCOTERMS 2010 has attempted to remedy the situation by clarifying who is responsible for terminal costs. It remains to be seen, however, whether this will put an end to the double charging previously experienced.

8. String Sales

In contracts for the sale of "commodities", as opposed to manufactured goods, it is often the case that a cargo is on-sold a number of times during transit (i.e. a string sale). In such situations, sellers in the middle of the string do not ship the goods, as the goods have already been shipped by the seller at the top of the string. As such, the obligation on sellers in the middle of the string is to procure goods that have been shipped. The new INCOTERMS clarify this by including an obligation to "procure goods shipped" as an alternative to the obligation to ship goods.

Conclusion

We expect INCOTERMS 2010 to be well received by the trade. However, as with any change, work will be required within trading companies to make sure that they are ready for this change and have made the necessary amendments to their standard contracts going forward. If this work is not done, this is a potential recipe for disputes.

Next Alert

Our next alert will deal with:

1. FOB and CIF – Key Terms/Changes
2. DAP – When to use/Key Terms
3. DAT – When to use/Key Terms

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Reed Smith's energy, trade and commodities group is pleased to make the following announcements:

Gordon Bell has joined our energy, trade and commodities group (ETC group) in London. He brings with him a wealth of experience in all types of international arbitration, with a particular focus in the energy and construction sector.

Gordon's practice is distinctly international and he represents clients in a project counsel role as well as providing disputes resolution advice in jurisdictions across Europe, the Middle East and Asia.

For more information on Gordon's expertise please visit: www.reedsmith.com/our_people.cfm?cit_id=28864&widCall1=customWidgets.content_view_1.

You may remember that throughout the year we've been in touch with details of a number of new partners joining the team. Partners Peter Cassidy, Keith Hartley, Gordon Bell and Vincent Rowan will bring to thirteen the number of London based partners. Peter and Keith joined the firm in July and Gordon in October, whilst Vincent will join in November. Earlier this year partners Siân Fellows and John Varholy joined the Reed Smith team from Shell and Troutman Sanders respectively.

The energy team's expertise and geographic footprint enables it to provide a full and effective service to clients including advice on infrastructure development projects, engineering and construction, related financing, mid and down stream advice including trading, storage and transport of crude oil and oil products as well as the trading of European and U.S. gas, power and emissions, regulatory and environmental issues, U.S. and European sanctions and regulatory compliance.

Samantha Roberts joined our Europe and Middle East corporate group from Holman Fenwick & Willan LLP (HFW) in September where she had previously been head of the firm's Ports and Terminals industry focus group.

Samantha specialises in transactional corporate and commercial law particularly in the ports and terminals and the shipping sectors. Samantha has represented a broad spectrum of clients working within the ports and terminals industry, including port operators, commodity traders, producers and financiers. Her corporate experience covers national and international M&A and joint ventures. On the commercial side, Samantha has been involved in a broad spectrum of arrangements and agreements relating to the establishment and operation of mono functional and multimodal port facilities, including concession agreements, terminal management agreements, terms and conditions of use, terminal user agreements, storage arrangements and facilities agreements.

Samantha's specialisation has taken her across the world. When she was based in HFW's Singapore office, Samantha concentrated on the Far East market gaining a wealth of experience particularly in relation to Chinese and Malaysian port arrangements. Since returning to Europe, Samantha has worked on port projects in every habitable continent and she has had the opportunity to represent clients establishing and operating facilities in countries as diverse as Nigeria, Bahrain and Belgium.

Samantha's expertise will create a strong synergy with our market leading energy, trade and commodities group and will greatly enhance our existing offering to clients in these sectors.

For more information on Samantha's expertise please visit: www.reedsmith.com/our_people/directory_search.cfm?cit_id=28536&widCall1=customWidgets.content_view_1.

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