

INCO: International Commercial Terms of Sale

Application, Use and Implications for U.S. Business

Joseph Zodl
International Business Consultant

Joseph Zodl is an international business consultant based in Phoenix, Arizona. He has over 20 years experience with international business, and is a licensed customs broker. His educational background includes a B.A. (Fordham University); M.A. (The New School); and an M.B.A. (Western International University). His book, *Export-Import: Everything You and Your Company Need to Know to Compete in World Markets* is now in its third edition.

As consumers, we may buy electronic equipment at a mall retailer on a will-call basis, or pick up our own groceries at a food market. We understand that we own these goods at the time of purchase (title has passed). While no customs clearance is involved in taking them home, we expect a receipt, which is usually in more or less the form of an invoice (document). We understand that if we drop the goods in the parking lot, and there is damage to them, that the damage is our problem and not the vendor's problem. (Delivery of goods has been made and risk of loss or damage has passed from the seller to the buyer.)

A retailer may deliver a refrigerator to us, or a food market may deliver groceries. If the goods are damaged en route, we expect the store to bring the truck back and replace the damaged goods with new merchandise. The appliance or food are not ours until delivered. (FOB destination term of sale.)

If we do not pick up our will-call goods, but call in a trucking company to make the pickup for us, and the goods are lost or damaged in transit, we expect that a claim will be filed against the trucking company. But we will expect that the claim will be filed by us, as the buyer as delivery was made by the seller to our trucker and risk of loss or damage has passed to us. If we have arranged with the store to make delivery and their own retailer's

truck is undergoing repairs, perhaps they will be the ones to hire an independent trucking company which loses or damages the goods.

Again we will expect that a claim will be filed. But here we will expect the seller to file the claim, and new merchandise sent to us. Delivery was not made, and risk of loss or damage remains with the seller. Note that the trucker (carrier) never owns the goods in transit. Although they may ultimately own goods as salvage, paying for damaged goods and then retaining them for their own use or disposal. Here, matters are clear. In commercial domestic sales and purchases, likewise, matters are generally understood on both sides. In international business, the confusion surfaces.

Incoterms

Incoterms are the “International Commercial Terms” developed by the International Chamber of Commerce.¹ While not having the force of law, they are adopted contractually by sellers and buyers. Once an Incoterm becomes part of the contract, the provisions of that particular Incoterm are part of the contract. On January 1, 2000, Incoterms 2000 went into effect. This is the sixth revision since the original publication in 1936, hence the seventh published version.²

Ex Works Phoenix (EXW Phoenix)³

Ex Works in Incoterms is when the seller is responsible for having the goods available for the buyer. In a sale negotiated as EXW, the buyer is (contractually) to handle export clearance. But since the seller is the U.S. party who benefits most from the transaction, he is designated the U.S. Principal Party in Interest (USPPI.) within the meaning of U.S. law.⁴ Therefore, a sale EXW can put the U.S. seller in the position of having the responsibility for the export clearance but without the control. In some instances, under an EXW sale, a foreign buyer may designate a U.S. freight forwarder to handle the details of the shipment. But the foreign buyer may not be so situated as to be able to be named on export license applications or export declarations. Therefore, it is possible for the foreign buyer to purchase goods that he cannot take out of the United States unless the U.S.P.P.I. undertakes the clearance anyway.

An additional question is: "When are the goods available?" Does it mean when the goods are on the shipping dock ready for pickup? Does it mean when the goods are moved on the computer system from "Available to Promise" to "Promised?" There is a lack of clarity here which makes it a difficult term under which to sell.

Within this term, as it is currently written, the seller has no responsibility for loading the shipment onto the truck making the pickup. Clearly, we do not expect the foreign buyer to fly in with a forklift and undertake the

loading. Incoterms recognizes that “as a matter of practical reality, the seller would frequently assist the buyer in loading the goods on the latter’s collecting vehicle.”⁵

EXW may be used for any mode of transportation: air, ocean, or truck.

Free Carrier Phoenix (FCA Phoenix)⁶

This is an extremely flexible term of sale which takes us a step further in the seller’s responsibilities. The seller is responsible for all the requirements under Ex Works, plus loading on the carrier and arranging export clearance.

Because export clearance is included in the seller’s contractual responsibilities, it is usually the seller who selects the forwarder and pays the forwarder’s invoice. This puts the U.S. seller in control of the export compliance as well as under the responsibility for it. It also alleviates the practical question as to loading. As a result of the loading responsibility of the seller, it is clear when the goods are delivered to the buyer.

FCA can be utilized in two distinct ways:⁷

- A) FCA the seller’s premises (when the goods are delivered upon loading the first carrier).
- B) FCA anywhere else on the seller’s side (when the goods are delivered to the named point. E.G: FCA Phoenix Airport Cargo Terminal).

Because of the two distinctions, it is imperative that a quotation “FCA” is specific as to the place (city) and point within the place (seller’s premises, airport cargo goods that he cannot take out of the United States unless the U.S.P.P.I. undertakes the clearance anyway.

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Because of the two distinctions, it is imperative that a quotation "FCA" is specific as to the place (city) and point within the place (seller's premises, airport cargo terminal) where the delivery is to be made. Indeed, our Phoenix seller could sell FCA Los Angeles International Airport Cargo Terminal and be responsible for the cost of moving the goods to that point. Or the seller could negotiate FCA Nogales, Arizona Broker's Warehouse". Free Carrier is an extremely flexible Incoterm and may be used for any mode of transportation: air, ocean, or truck.

Free on Board Phoenix (FOB Phoenix): Free on Board Los Angeles (FOB Los Angeles)⁸

Note that this is the one term which in name resembles the United States' Uniform Commercial Code term, and as a result, it is the most misunderstood Incoterm among Americans. 'Free on Board' term of sale dictates that the seller is responsible until the goods are "on board the vessel."⁹ Period. It is a term of sale for which, in fact, there should be no confusion.

The first confusion among Americans is to use this for air shipments. As airplanes are not vessels, a sale for an air shipment under the FOB term is inappropriate and should never be used. FCA is the proper term, e.g., FCA Phoenix Airport Cargo Terminal. The second confusion is to use this for truck shipments to Canada or Mexico, i.e., FOB Phoenix. This is almost a reflex, because a truck shipment, freight collect, is routine for U.S. businesses, and is indeed accurate under the Uniform Commercial Code.

Suppose a U.S. seller in a seaport city negotiates a sale under the FOB term, considering the UCC definition. For example, a price FOB Los Angeles is quoted on an ocean shipment, such as our sale to Yokohama. A seller in Los Angeles may expect the shipment to be the same as FOB Los Angeles under the UCC, which he deals with every day. Since the UCC is not in force in Japan, and Incoterms requires the seller

to arrange export clearance and load the goods on board the vessel!

Our buyer in Yokohama, familiar with Incoterms (and having no UCC terms to confuse him), probably knowing that Los Angeles is a seaport city, simply stipulates the steamship line he would like to use, (let us say Mitsui Lines) and awaits word that his shipment is en route to him, via Mitsui, freight collect.

Our buyer believes this is what has been negotiated. If our surprised U.S. seller now raises the price because of the extra costs he is now aware of, it appears to the Japanese buyer that there has been a deliberate “low-ball” quotation to get the order and now the “real price” is revealed.

This is not good for repeat business. The other choice the seller has is to absorb the charges first time around, and raise the prices later. But perhaps he has already negotiated a one-year contract for bi-weekly shipments on an FOB Los Angeles basis.

FOB Phoenix or any other inland point can constitute a different, serious problem: The foreign buyer may not know that Phoenix is not a seaport. If FOB Phoenix terms are offered, he is quite clear that delivery by the seller will have been made when the cargo has been loaded “on board the vessel” at Phoenix seaport, and simply names his ocean carrier and awaits word of shipment.

Through bill of lading service may be available, but it is still not, strictly speaking, “FOB Phoenix.” The banks

sometimes will accept a through bill issued showing Phoenix as the port of loading/”on board truck”, but this is technically incorrect. The remedies here are threefold; first, education of Incoterms among exporters and potential exporters, second, clarification with the banks, and third, far greater use of FCA as a term of sale. Note that up to this point, no matter what else has happened, the consignee is paying the ocean freight.

FOB may be used only for water transportation. So the ocean bill of lading will be collect on an EXW, FCA, or FOB shipment. The seller is responsible for providing the invoice and packing list, and perhaps other documents. Hence, we can deal quickly with four more terms of sale, widely used, and relatively clear.

Cost and Freight (Paid to) Yokohama (CFR Yokohama)¹⁰

This was previously, prior to the 1990 revision, known as C&F, CF, or C+F, and those abbreviations are still widely used, but under the current version those abbreviations are not recognized. Under CFR, the seller is responsible for paying the ocean freight. He selects the ocean carrier, and is responsible for turning over the original ocean bills of lading, along with the invoice and packing list. Said ocean bills of lading must say “freight prepaid” and the seller is permitted to select the ocean carrier. He will include the cost of freight in his price and perhaps markup the total price as well for additional profit. Note that the seller is responsible for

paying the ocean freight to the seaport in Japan. He is not responsible for customs clearance in Japan, or for the local cartage to the buyer's warehouse. CFR may be used only for water (inland and ocean) transportation.

Cost, Insurance and Freight (to) Yokohama, (CIF Yokohama)¹¹

This term of sale is exactly the same as CFR except that the seller must provide a certificate of insurance, which is so written as to make it possible for the buyer to file a claim. This is because the seller, being in the shipping country, finds it most convenient to arrange the insurance before shipment, and the buyer, in receipt of the goods, is best able to determine the loss or damage. The author recommends insurance on all shipments of nominal value.

The above two terms are specifically for ocean only according to Incoterms 1990, but are frequently specified for other modes of transportation. The difficulty is that, although the freight is paid to the destination seaport, the delivery is still made upon loading the vessel on seller's side. CF may be used only for water transportation.

Carriage Paid To Yokohama Container Freight Station (CPT Yokohama Container Freight Station)¹²

This term offers some solutions to CFR limitations. It is related to Free Carrier, therefore, it

can be used for any mode of transportation. The delivery here is made when the cargo is released to the carrier (at seller's door or elsewhere, as negotiated between seller and buyer) but the freight is paid by the seller to a destination point. Because the point is not necessarily the seaport, it must be named. Otherwise, we are not clear if we mean the Container Freight Station (near the seaport) or the buyer's premises in Yokohama (some distance away).

An advantage of CPT is that it may be used for any mode of transportation. A caveat is that because it is based on FCA, it is important to also indicate the point at which the cargo is released to the carrier. In common with FCA, when the cargo is released to the carrier it is "delivered" to the buyer, even though the seller pays the freight to the agreed destination point and selects the carrier. CPT may be used for any mode of transportation: air, ocean, or truck.

Cost, Insurance, Paid To: Yokohama Container Freight Station (CIP Yokohama Container Freight Station)¹³

This Incoterm is essentially the same as CPT except that it includes the responsibility of the seller to provide insurance. CIP may be used for any mode of transportation: air, ocean, or truck.

There are other Incoterms that are useful to know, but less frequently used. For ocean only shipments, ~~these include~~ **Free Alongside Ship (FAS)¹⁴**, which requires the seller to deliver alongside ship. Outside of

charter shipments, this term is becoming obsolete as most ocean shipments are delivered to a Container ~~Freight Station or Container Yard~~. **Delivered Ex Ship (DES)**¹⁵ designed for charter shipments where the seller is responsible for delivering the goods, ready to be unloaded, at the foreign seaport. **Delivered Ex Quay (DEQ)**¹⁶ designed for charter shipments where the seller is responsible for delivering the goods, unloaded, at the foreign seaport.

Incoterms that may be used for all modes of transportation include **Delivered at Frontier (DAF)**¹⁷, which is substantially the same as FCA border point. **Delivered Duty Unpaid (DDU)**¹⁸ is where the seller is responsible for delivering the goods at a place and point within the foreign country. **Delivered Duty Paid (DDP)**¹⁹ where the seller is responsible for delivering the goods, customs cleared, at a place and point within the foreign country. This is the only Incoterm under which the seller is contracting to undertake import clearance.

In our overview of Incoterms, we have covered much ground and have learned that by not using Incoterms properly, we lose control of international business. We find ourselves quickly doing business according to our customer's, or even our vendor's, terms without our vote being considered. Business is properly a negotiation between seller and buyer. If we establish object, price, and other considerations without negotiating the terms of sale, we are leaving part of the agreement entirely up to whatever the other side decides. Good financial

management dictates that we control as much of our costs as possible. Accordingly, one necessary step is the proper use of terms of sale towards that control. While terms of payment, such as a letter of credit or open account, determine the actual payment arrangement, the terms of sale determine the allocation of the expenses of freight, export clearance, insurance, etc.

The conclusion is that by not properly using Incoterms, you lose a competitive advantage. It is therefore imperative that businesses involved in international trade make it a priority to ensure that the appropriate company representatives develop a working knowledge of Incoterms. It is just as important to realize how many different parts of the company must have a working knowledge. Marketing, sourcing, and purchasing are all involved in negotiating the terms of sale on a transaction. The transportation group must respond to the terms of sale properly, staying within the parameters as negotiated. Accounting and finance have the responsibility to see that the company is fully and promptly paid on a sale, as well as that it pays appropriate charges only, and pays only once on a purchase.

With a working knowledge of Incoterms in exporting and importing, businesses will become and stay more competitive in world trade. Truly, this is an

educational priority for businesses in the international business environment of the twenty-first century.

Notes:

¹ Incoterms 2000, (New York, International Chamber of Commerce, 1999), 4.

² Incoterms 2000, 4.

³ Incoterms 2000, 27-31.

⁴ Federal Register (Washington, DC, U.S. Government Printing Office), 42,556-42,575.

⁵ Incoterms 2000, 12.

⁶ Incoterms 2000, 33-39.

⁷ Incoterms 2000, 34

⁸ Incoterms 2000, 49-55.

⁹ Incoterms 2000, 50.

¹⁰ Incoterms 2000, 57-63.

¹¹ Incoterms 2000, 65-71.

¹² Incoterms 2000, 73-79.

¹³ Incoterms 2000, 81-87.

¹⁴ Incoterms 2000, 41-47.

¹⁵ Incoterms 2000, 97-103.

¹⁶ Incoterms 2000, 89-94.

¹⁷ Incoterms 2000, 41-47.

¹⁸ Incoterms 2000, 113-119.

¹⁹ Incoterms 2000, 121-125.

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