



Avoiding the Incoterms® Trap: Dos and Don'ts

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Bio: I have nearly 15 years work experience that spans the gamut of logistics and supply chain management functions across a variety of industries. I recently completed a Ph.D. in Business Administration with emphasis in Logistics and Supply Chain Management from the University of Missouri-St. Louis (UMSL), and I also hold a MBA and BSBA from the same university. I am also a Board Member for the Central Florida Roundtable of the CSMP.

- Increased awareness of Incoterms® rules
 - Severity and breadth of misunderstandings
 - Correct application
 - Tips and watch outs
 - Training impact

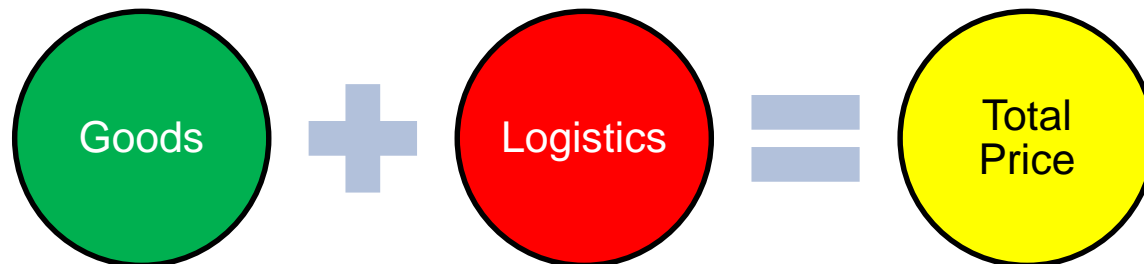
Incoterms[®] rules are important to negotiations

Buyer-seller relationships and negotiations affect each party's benefits and are critical for supply chain management¹, but prior research has not focused on Logistics Cost, an important total cost component.

Published by International Chamber of Commerce (ICC), Incoterms[®] rules (3 character acronyms) define & designate responsibilities for tasks, costs, and risks involved in delivery of goods from sellers to buyers².

- EXW - Ex Works, FCA - Free Carrier, CPT - Carriage Paid To , CIP - Carriage And Insurance Paid To, DAT - Delivered At Terminal, DAP - Delivered At Place, DDP - Delivered Duty Paid, FAS - Free Alongside Ship, FOB - Free On Board, CFR - Cost and Freight, CIF - Cost, Insurance and Freight

Correct understanding of Incoterms[®] makes a difference leading to better negotiations, fewer misunderstandings, and reduced costs³, but researchers have found that errors in Incoterms[®] rule usage⁴ can lead to buyer-seller misunderstandings⁵



¹ Atkin & Rinehart, 2006; Ramsay, 2004; Rinehart et al., 1988;. ² International Chamber of Commerce, 2010; Stapleton et al., 2014b; ³ Stapleton & Saulnier, 1999; 4 Bergami, 2011; Bergami, 2012; Bergami, 2013; Glitz, 2011; Malfliet, 2011; Ramberg, 2011; Reynolds, 2010; Roos, 2011; Stapleton, 2014; Stapleton et al., 2014a; Stapleton et al., 2014b; Stapleton & Saulnier, 2001; ⁵ Reynolds, 2010

11 Incoterms® Rules Acronyms¹

- RULES FOR ANY MODE OR MODES OF TRANSPORT
 - EXW - Ex Works
 - FCA - Free Carrier
 - CPT - Carriage Paid To
 - CIP - Carriage And Insurance Paid To
 - DAT - Delivered At Terminal
 - DAP - Delivered At Place
 - DDP - Delivered Duty Paid
- RULES FOR SEA AND INLAND WATERWAY TRANSPORT
 - FAS - Free Alongside Ship
 - FOB - Free On Board
 - CFR - Cost and Freight
 - CIF - Cost, Insurance and Freight

¹ International Chamber of Commerce, 2010

Problematic Incoterms® usage example¹

Manufacturing location in St. Louis Missouri U.S.A. placed an purchase order to a supplier in Europe using “FCA St. Louis”. Supply Manager was perplexed that once the material was ready to ship the supplier insisted that they would only take care of export formalities per the FCA St. Louis agreement. The buyer maintained that the supplier should be responsible for shipment to location in St. Louis. After further investigation, the supplier in Europe was found to be located in St. Louis, France!

Result: Buyer paid too much for the material that shipped late and required expedited air freight shipment, further increasing the materials total costs.

Problematic Incoterms® usage example¹

Manufacturing location in Mississippi signed a large contract with a Canadian supplier for goods that qualified for North America Free Trade Agreement (NAFTA) using EXW Incoterms® rule. The purchase orders were weekly.

With EXW Incoterms® rule, the supplier did not need to clear goods for export, and hence, the supplier did not feel obliged to provide a NAFTA form, which would have saved the buyer's company from paying import duty.

Result: This resulted in \$8,500 duty per shipment on a product that shipped weekly.

Problematic Incoterms® usage example²

Surveyed bank letter of credit forms for container transport

- Waterway Incoterms® (FOB, CFR, CIF) = 55%
- Multimodal Incoterms® (FCA, CPT, CIP) = 34%
- Others made up, outdated, or other terms

If FOB used with container transport, there is a mismatch between loss of physical control (e.g. can be handled 6 to 8 times before vessel loading) & risk transfer point.

Concluded that banks not knowledgeable about Incoterms®

Bank requirements increase risk to seller

“Strange that the term FOB, coined at least two hundred years before the era of containerisation (from the 1960’s), has been so readily adopted and inappropriately applied to modern day container handling practices”

Problematic Incoterms® usage example³

Stapleton et al. (2014b) surveyed 1,000 Freight Forwarders

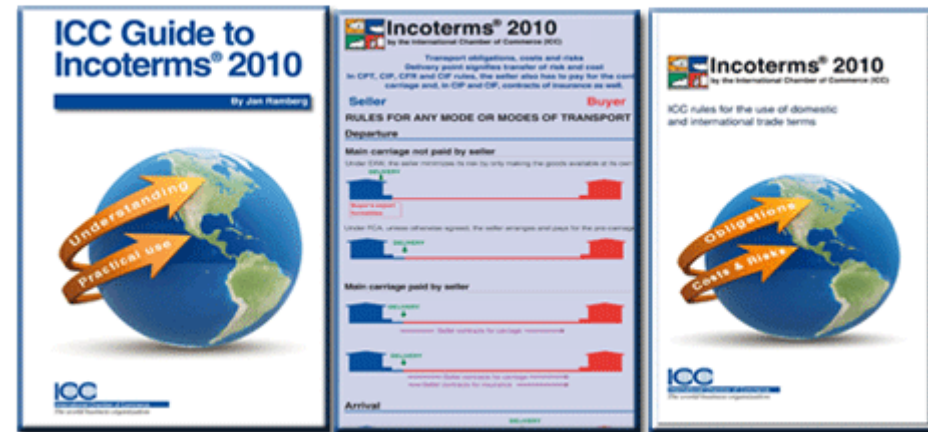
Incoterms® misuse was prevalent.

- 49% have used FOB for containerized freight
- 37% reported using CIF for containerized freight
- 60% used CFR for containerized freight
- 14% reported using C&F (not official Incoterms® for decades)

Also, they found that Incoterms® rules are sometimes deliberately misused in certain countries to manipulate, game the system, or even sometimes, enable kickbacks

Why Do We Have Incoterms® Rules

- Avoid misunderstandings and disputes among parties over sharing of costs and transfer of risk or damage of goods
- Abbreviation of International Commercial Terms
- Written, argued, and published by the International Chamber of Commerce (ICC), Paris
- First published in 1936
- Latest publication is Incoterms® 2010
 - Effective January 1, 2011
- You NEED a copy in the office
 - <http://www.iccbooks.com>



What Incoterms® Rules Do Not

- **DO NOT DETERMINE PASSAGE OF TITLE AND/OR OWNERSHIP**
 - You can “own the house” and be responsible for the care of the structure, but the Bank can still own it.
- Only tells us the responsibility of the buyer and seller for the delivery of goods under sales contract and determine how costs and risks are allocated
- Use sales agreement or terms & conditions to determine passage of title and/or ownership
- **DO NOT REPLACE SALES AGREEMENTS, TERMS AND CONDITIONS, OR PROVIDE A TRANSPORT CONTRACT**

How to Use Incoterms® Rules: Spell It Out

- Incoterm® Rule / Named Place, Port or Terminal / Incoterms® 2010
 - Example: CPT XYZ Inc. Orlando FL USA Incoterms® 2010
- ICC advises that the named place, port, or terminal is specified as clearly as possible and the Incoterms® version is stated
 - Do not assume, Ambiguity leads to misunderstandings
- Do it correctly, or else you will eventually regret it
 - Remember the FCA St. Louis (France or Missouri USA?) example

These are Uniform Commercial Codes (UCC) terms of sale, and not Incoterms® rules

FOB Terms and Responsibilities					
FOB Term	Payment of Freight Charges	Who Bears Freight Costs	Who Owns Goods in Transit	Who Files Claim (if any)	Explanation
FOB Shipping Point, Freight Collect	Buyer	Buyer	Buyer	Buyer	Title and control of goods passes to the buyer when the carrier signs for the goods at the shippers location. Carrier bills the buyer directly.
FOB Shipping Point, Freight Prepaid	Seller	Seller	Buyer	Buyer	Title passes to the buyer at the shippers location. Carrier bills the seller. Seller absorbs all freight costs.
FOB Shipping Point, freight Prepaid and added to invoice	Seller	Buyer	Buyer	Buyer	Title passes to the buyer at the shippers location. Carrier bills the seller. Seller adds the shipping cost to their invoice.
FOB Destination Freight Collect	Buyer	Buyer	Seller	Seller	Title passes to the buyer when the goods are delivered. Carrier bills the buyer for the freight cost.
FOB Destination Freight Prepaid	Seller	Seller	Seller	Seller	Title passes to the buyer when the goods are delivered. Carrier bills the seller. Seller absorbs all freight costs.
FOB Destination Freight Prepaid and add to invoice	Seller	Buyer	Seller	Seller	Title passes to the buyer when the goods are delivered. Carrier bills the seller. Seller adds the shipping cost to their invoice.

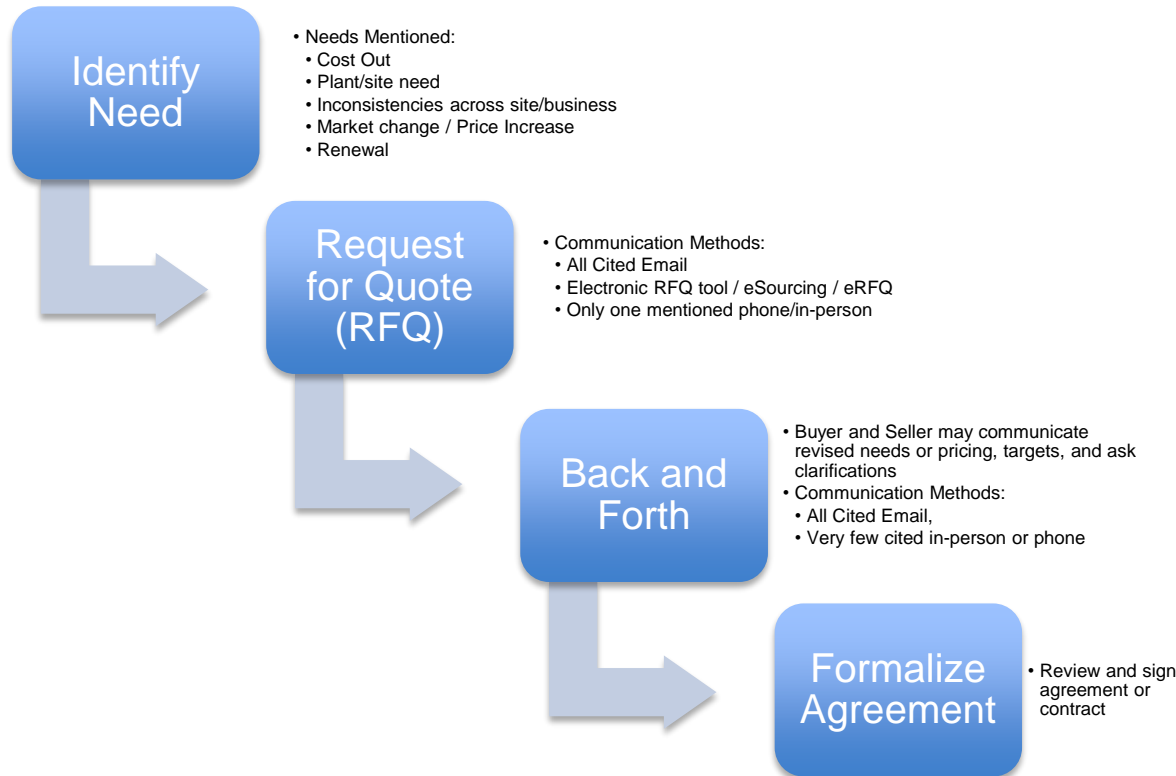
Uniform Commercial Codes (UCC)

- Revised American Foreign Trade Definitions (RAFTD) of 1941 incorporated into the 1951 Uniform Commercial Code (UCC) “contained definitions of ‘terms of sale’ (also called ‘shipping and delivery terms’) in section 2-319 through 2-324”¹
 - UCC ‘terms of sales’ are a body of law (unlike Incoterms[®]) – Indicate transfer of title¹
 - UCC created problems for international traders - Used same abbreviations with completely different meanings¹
 - For example, Incoterms[®] term FOB is a departure term (i.e. seller fulfils their obligations prior to the goods leaving from the agreed point). Whereas the UCC term FOB is an arrival term, meaning the seller has extended obligations beyond the agreed point¹
 - The FOB term as used in the context of UCC ‘terms of sales’ has several different Incoterms[®] interpretations¹
- In 2004, UCC was amended and ‘terms of sale’ removed¹
- Incoterms[®] 2010 now refer to themselves as ‘rules’ and may be used for domestic contracts¹

Conversion from UCC to Incoterms 2010¹

Former UCC Term	Conversion to Incoterm 2010	Comment
UCC FOB Origin, Freight Collect	EXW (named origin point)	EXW Where the Seller also has no carriage obligation and delivers at the origin place. FCA Origin place seems like it would be a match but it doesn't because it obligates the Seller to load the collecting vehicle.
UCC FOB Origin, Car or other Vehicle, Freight Collect	FCA (named origin point)	FCA Both hold the Seller responsible for loading. Seller has no carriage obligations. Delivered by loading the collecting vehicle.
UCC FOB Origin, Freight Prepaid & Billback	CPT (named destination point)	The Seller contracted for carriage but delivered by handing over the goods to the carrier. Freight is paid by the Seller and invoiced to the Buyer. Risk transfers at place of shipment.
UCC FOB Destination, Freight Collect	No matching Incoterm	Seller had no carriage obligation but remained responsible for the condition of the goods until they arrived. No matching incoterms because as carriage was contracted by the Buyer, how would the Seller claim for in-transit damage? Should not be used.
UCC FOB Destination, Freight Prepaid & Allowed	DAP (named destination point)	DAP Both situations, the Seller contracts for carriage and is responsible for the performance of the carrier as delivery occurs at destination. Risk of loss transfers at destination point.
UCC FOB Vessel	FOB (Named port of export)	Risk and Cost pass to Buyer when cargo clears ship's rail at origin port. Contract of carriage responsibility of the Buyer.

Buyer-seller negotiation of logistics management¹



- Negotiation of logistics management starts in the RFQ stage, with back-and-forth thereafter
- Buyer and seller dyads primarily use email to communicate

- All participants stated Incoterms[®] rules were used as the primary means to communicate logistics management decisions
- This form of communication places a very heavy reliance on both buyers and sellers understanding correct use of Incoterms[®] rules

Misunderstandings¹

- Thorough understanding of all aspects of the appropriate use of Incoterms[®] rules aspects is exceedingly uncommon
 - Remember the earlier examples: FCA St. Louis, EXW in Canada to US, etc.
- Consequences of communication errors: *Cost, time, **relationship**, company reputation, change of transport provider*
- Buyer: “Anytime I have to carry extra inventory, or I have to spend more time, or the buyer has to spend more time managing the day to day, that's money.”
- Buyer: “From buyers' side, cost is very important. But sometimes we still need to support from supplier. So, relationship's still very important as well.”

Five Common Incoterms® Usage Errors

1. Sea and inland waterway Incoterms® applications for containerized transport
2. FOB applied as Incoterms® rule as opposed to UCC term of sale
 - Uniform Commercial Code (UCC) shipping term acronyms (FOB, FAS, and CIF) overlap with Incoterms® 2010 rules acronyms³
 - Frequent mix-ups regarding the Incoterms® rule vs. UCC terms
3. Correct specification of a geographic place with Incoterms®
4. Correct specification of the Incoterms® version (2010, 2000)
5. Correct application of FCA relative to EXW²



Rules For Any Mode or Modes of Transport

EXW – **Ex Works** (named place of delivery)

FCA – **Free Carrier** (named place of delivery)

Tips: EXW is risky, You probably really mean FCA

- Buyer beware:
 - Are you in a position to export from the foreign country?
 - How about handling or paying for loading?
- Seller beware:
 - Are there country custom's obligations related to export?
 - Will your company location allow a customer or their carrier on premise to load goods?

Rules For Any Mode or Modes of Transport

CPT – **C**arriage **P**aid **T**o (named place of destination)

CIP – **C**arriage and **I**nsurance **P**aid To (named place of destination)

Tips: Think before using Incoterms® rules with “I” (example: CIP)

- May add cost to the supply chain.
- Does your company already have insurance coverage?

Rules For Any Mode or Modes of Transport

DAT – **D**elivered **A**t **T**erminal (named terminal at port or place of destination)

DAP – **D**elivered **A**t **P**lace (named place of destination)

Tips: Think through using DAT or DAP with a post customs clearance delivery point

- Requires coordination between the carrier and customs authorities
- Can result in time delays and extra costs beyond your control

Rules For Any Mode or Modes of Transport

DDP – **D**elivered **D**uty **P**aid (named place of destination)

Tips: Sounds like a good deal, but Be Weary

- Think about whether the Seller can fulfill all the import customs formalities
- Example:
 - Can a small supplier from India fulfill U.S. customs clearance and pay the required U.S. duty?
- Import duty, VAT, GST rates and other regulatory items (i.e. anti-dumping, free trade agreements, etc.) can change over time

Rules For Sea And Inland Waterway Transport (Not In a Container)

FAS – **F**ree **A**longside **S**hip (named port of shipment)

FOB – **F**ree **O**n **B**oard (named port of shipment)

CFR – **C**ost and **F**reight (named port of destination)

CIF – **C**ost, **I**nsurance, and **F**reight (named port of destination)

Tips: Do not use FAS, FOB, CFR, CIF if goods ship in a container

- Taking on unnecessary risk if use for containerized shipments
- Confusing: FOB is used both in UCC terms of sales and Incoterms® rules

How Bad is Incoterms® Application?

Five common errors addressed in five scenario experiment via survey¹

(708 respondents, 25.74% response rate)

1. Applying sea and inland waterway Incoterms® with containerized freight - **23.9% correct**
2. Usage of FOB applied as an Incoterms® rule as opposed to a UCC term of sale - **37.3% correct**
3. Not specifying a geographic place when using Incoterms® - **22.7% answered correctly**
4. Not specifying version of Incoterms® (i.e. Incoterms® 2010, Incoterms® 2000) - **27.3% correct**
5. Correct application of FCA relative to EXW - **49.3% answered correctly**



Overall Survey Results			
Total Correct	Respondents	Percent	Cumulative %
0	134	18.9%	18.9%
1	211	29.8%	48.7%
2	221	31.2%	79.9%
3	103	14.5%	94.5%
4	37	5.2%	99.7%
5	2	0.3%	100.0%

Improve quality of buyer-seller communication of logistics management decisions¹

Perception that partner does not fully understand Incoterms[®] rules

- Buyer: “Just a better understanding of Incoterms[®]”

Incoterms[®] **Training** has BIG impact.

- Training has biggest statistical impact of two factors tested to improve the quality of buyer-seller communication of logistics management decisions

Questions Correctly Answered	0	1	2	3	4	5	Expected Number of Correct Answers	Error Percent
Untrained, No Operational Definitions								
Probability	0.343	0.344	0.217	0.072	0.023	0.001	1.091	78.18%
Operational Definitions Only								
Probability	0.255	0.335	0.271	0.104	0.034	0.002	1.334	73.32%
Trained Only								
Probability	0.173	0.295	0.322	0.152	0.055	0.003	1.629	67.42%
Both Trained & Operational Definitions								
Probability	0.160	0.284	0.330	0.163	0.060	0.003	1.689	66.23%

¹ Schaefer, 2017

Summary for Purchasing (Buyer)*

- Don't use UCC terms of sale
- External Supplier for General Cargo Goods
 - FCA “insert supplier name & location” Incoterms 2010
 - DAP “insert your company delivery site name & location” Incoterms 2010
 - Use only if you did due diligence to compare total costs, including transportation, duty, customs clearance, inventory, etc.
- Internal Supplier for General Cargo Goods
 - CPT “insert your company delivery site name & location” Incoterms 2010
 - FCA “insert your company supplier site name & location” Incoterms 2010

*This is a general advice. Please refer to the Incoterms® 2010 book by the ICC for full details on the Incoterms® rules that you want to use.

Summary for Sales/Marketing (Seller)*

- Move quickly away from UCC terms of sale
 - If needed, educate customers on Incoterms® rules
- External Customer for General Cargo Goods
 - **CPT** “insert customer name and location” Incoterms 2010
 - **FCA** “insert your company site name & location” Incoterms 2010
- Internal Customer for General Cargo Goods
 - **CPT** “insert your company customer site name & location” Incoterms 2010
 - **FCA** “insert your company origin site name & location” Incoterms 2010

*This is a general advice. Please refer to the Incoterms® 2010 book by the ICC for full details on the Incoterms® rules that you want to use.

Remember

- Incorporate Incoterms® 2010 rules into contract of sale/purchase order
- Choose the appropriate Incoterms® rule
- Remember that Incoterms® rules DO NOT give you a complete contract of sale nor indicate transfer of ownership/title
- Use for both domestic & international trade, avoid UCC terms of sale
- Fully spell it out, be specific, don't assume, state Incoterms® version
 - DAP XYZ St. Louis MO U.S.A. Incoterms® 2010

Additional Reference Guides

- Incoterms[®] 2010 by the ICC.
- Incoterms for Americans (Completely Rewritten for Incoterms[®] 2010) by Frank Reynolds.
- Incoterminology 2010: Manual for the practical use of Incoterms by Piet Roos.

Session Takeaways

- Increased awareness of Incoterms® rules
 - Severity and breadth of misunderstandings
 - Correct application
 - Tips and watch outs
 - Training impact

Don't forget to fill out the session evaluation on the Conference App

sponsored by LeanLogistics

***“I shall participate, I shall contribute, and
in doing so, I will be the gainer.”***

– Walter Annenberg



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