

Optimizing shipper contracting: the correct usage of Incoterms for containerized/intermodal freight

Drew Stapleton, Ph.D., MBA (Astapleton@uwlax.edu)

University of Wisconsin La Crosse

Incoterms 2010 clarifies which terms are and are not intended for maritime intermodal shipping. Nonetheless, many continually misuse Incoterms, leaving themselves vulnerable. I elucidate key changes in Incoterms 2010, paying attention to the oft-misunderstood, misused FOB. I suggest FCA might close this vulnerability gap, giving buyers greater visibility and control.

Keywords: Contracts of Sale, Incoterms, Risk/Cost Curves

Introduction

Incoterms are an acronym for **IN**ternational **CO**mmercial **TERMS** and were developed by the International Chamber of Commerce (ICC) and were first codified in a pre-incoterms edition of 1923 (International Chamber of Commerce 2010a). The 1923 edition consisted of six terms: 1) FOB-Free On Board; 2) FAS-Free Alongside Ship; 3) FOT-Free On Truck; 4) FOR-Free On Rail; 5) CIF-Cost Insurance and Freight, and; 6) C&F-Cost and Freight (International Chamber of Commerce 2010b). These terms were subsequently released as the first revision of Incoterms in 1936. Although it is well known that international trade had been transpiring over several millennia (Beragami 2012), Incoterms came into being to address the problem of interpretation amongst trading partners and to harmonize transactions. Incoterms were crafted to harmonize the world's maritime traders and their shipping policies; reduce the number of disputes between trading partners, and; to clearly define dyadic responsibilities (e.g., costs, risks, documentation, contracting for transport, etc.) between buyers and sellers (Stapleton and Saulnier 1999, 2000).

Incoterms have undergone substantial changes in 1957, 1967, 1976, 1980, 1990, 2000, and most recently in 2010, taking effect in 2011 (Ramberg 2010). INCOTERMS 2000 were presented by the ICC in four groups: E, F, C, and D, each group representing classes of terms that varied slightly within groups but significantly across groups in terms of delivery points, risk, and cost responsibilities, and the point at which those costs and risks shifted from the seller to the buyer. The new Incoterms (i.e., rules) are presented in two distinct groups instead of four, specifically to guide traders in using the appropriate terms. That is, INCOTERMS 2010 are compressed and now presented in two groups—the new classification makes it easier for

shippers to discern between Incoterms that are to be used only for ocean and inland waterway, and those that should be used for multi-modal contracts (i.e., intermodal transportation transactions). The new Incoterms, or Rules, are separated as follows: 1) Rules for use in relation to any mode or modes of transport, which can be used where there is no maritime transport at all, or for transportation transactions in which maritime transport is used for only part of the carriage (i.e., intermodal maritime); and 2) Rules for ocean and inland waterway transport, where the point of dispatch and delivery are both ports. Thus, FAS, FOB, CFR, and CIF belong to the latter class of Rules; while EXW, FCA, CPT, CIP, DAP, DAT, and DDP belong to the former.

A major change in the latest version of Incoterms is the separation of the place-to-place delivery terms, commonly known in the industry as “multimodal,” from the delivery terms that are simply port-to-port ocean freight terms. There are seven terms to be used when delivery is from place-to-place (i.e., EXW EX-Works, FCA Free Carrier At, CPT Carriage Paid To, CIP Carriage and Insurance Paid to, DAT Delivered At Terminal, DAP Delivered At Place, and DDP Delivery Duty Paid). The remaining four terms are purely ocean freight terms and often involve bulk carriage (i.e., CFR Cost and Freight, CIF Cost, Insurance and Freight, FAS Free Alongside Ship, FOB Free on Board). In the definitions of FOB, CFR, and CIF, the phrase “ship’s rail” - the point at which cost and risk shifted parties in the previous Incoterms - has been deleted and the reference now is to delivery of goods “on board.” FAS and FOB do not apply to multimodal sea transport in containers (Rosenberg et al. 2011). While the ICC’s purpose in periodically updating Incoterms is to harmonize policy and trade practices (Malfliet 2011), problems remain because parties continue to use the “wrong” term (Ramberg 1999) given the circumstances and nuances of their trading relationships. Using the “right” term, on the other hand, may prevent disputes (Richardson 1998), and provide clarity. But an Incoterm is only “right” if it is in harmony and congruent with the other trade facilitating documents (e.g., contract of sale, contract of carriage, insurance documentation, Bills of Lading, DLC, etc.), as well as compliant with the ICC’s Incoterm policies and procedure as codified in the latest Incoterms (i.e., Incoterms 2010).

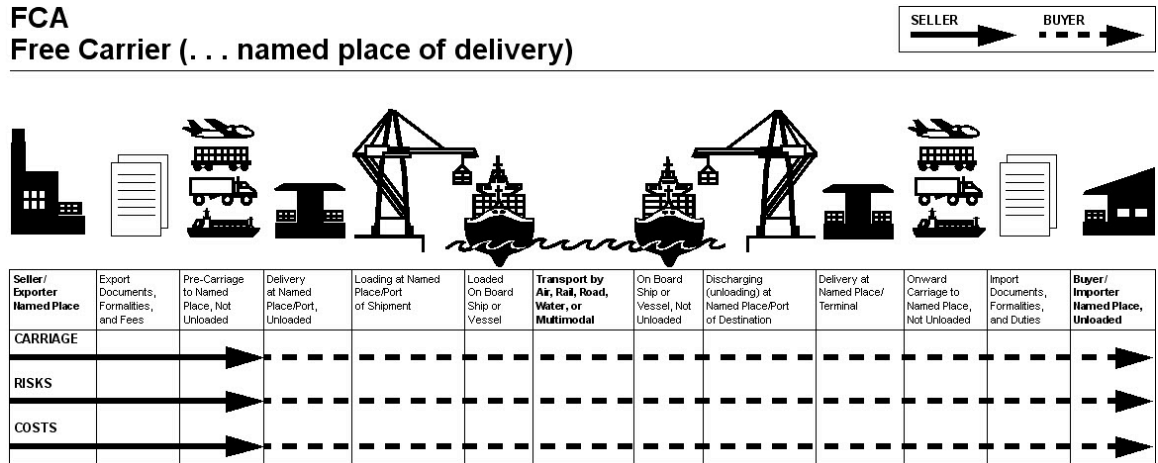
Why FCA Instead of FOB? Visibility and Control

The ICC encourages the appropriate use of Incoterms for containerized traffic (Stapleton et al. 2013, Malfliet 2011). That is, the ICC encourages the use of “multimodal” terms such as FCA, CPT, CIP, etc. instead of “maritime” Incoterms (i.e., FAS, FOB, CFR and CIF). According to the ICC, maritime terms are not appropriate, and thus should not be used in containerized trade. Additionally, the seller does not “deliver” the container onboard the vessel, but instead most often hands over the goods to the carrier at an inland point or terminal (Malfliet 2011: 163). F Terms represent those terms where delivery takes place at the buyer’s carrier. The FCA term’s delivery point is where the seller loads the goods onto the transport the buyer has designated. The seller does not have to unload the cargo. FCA is typically a better option than FOB because it encompasses both ocean shipping and multi-modal transport. In considering the FOB Incoterm 2010, Bergami (2012) writes,“(I)t is not difficult to see where maritime containers are concerned, the seller carries a higher risk profile than necessary, and that the risk is retained beyond the seller’s physical control of the goods” (Bergami 2012: 17). Consequently, in an era where traders are highly concerned about supply chain intelligence and visibility (Barratt and Oke 2007), supply chain risk assessment, mitigation, and management (Manuj and Mentzer 2008), and supply chain security (Williams et al. 2008; Willis and Ortiz 2004), using the wrong

Incoterm (FOB) for containerized freight or intermodal freight, unnecessarily increases risk, and costs while decreasing control. In such circumstances, the misuse of FOB needlessly places the supply chain in a vulnerable position. The proper and appropriate use of shipping terms can mitigate this vulnerability and provide greater Supply Chain visibility and control.

Table 1: FCA Free Carrier

FCA-Free Carrier



Modes of Transport Covered: All modes of transport including multimodal.

In Free Carrier, the Seller/exporter/manufacturer clears the goods for export and delivers them to the carrier specified by the Buyer at the "named place of delivery." If the named place of delivery is the Seller's place of business, the Seller is responsible for loading the goods onto the transport vehicle. If the named place is any other location, such as the loading dock of the carrier, the Seller is not responsible for unloading. When using the FCA term, it is advisable to clearly specify in the contracts of sale and carriage the precise point of delivery. "Carrier" has a special meaning. Technically, a carrier is a firm that itself transports goods or passengers for hire, rather than simply arranging for such transport. Examples are a shipping line, airline, trucking firm, or railway. In the FCA term, however, the carrier can be any person who by contract "undertakes to perform or procure" such services by any of the above methods of transport including multimodal. Therefore, a person, such as a freight forwarder, can act as a "carrier." With the FCA term, the Buyer nominates the "carrier," and the Seller need only accept the nomination for the term to work. The FCA term may be used for any mode of transport including multimodal. With FCA, the named place of delivery is domestic to the Buyer. The FCA term is often used when making an initial quotation for the sale of goods. Crafted and condensed from: http://www.worldtraderref.com/wtr_nl/WTR_site/incoterms_2010.asp

Table 2: FOB Free on Board

FOB-Free on Board

FOB
Free On Board (. . . named port of shipment)



Seller/Exporter Named Place	Export Documents, Formalities, and Fees	Pre-Carriage to Named Place, Not Unloaded	Delivery at Named Place/Port, Unloaded	Loading at Named Place/Port of Shipment	Loaded On Board Ship or Vessel	Transport by Sea or Inland Waterway Only	On Board Ship or Vessel, Not Unloaded	Discharging (unloading) at Named Place/Port of Destination	Delivery at Named Place/Terminal	Onward Carriage to Named Place, Not Unloaded	Import Documents, Formalities, and Duties	Buyer/Importer Named Place, Unloaded
CARRIAGE					→	→						→
RISKS					→	→						→
COSTS					→	→						→

Modes of Transport Covered: Used only for ocean or inland waterway transport.

In Free On Board, the Seller/exporter/manufacturer clears the goods for export and delivers them on board the named vessel at the "named port of shipment." This is a change from Incoterms 2000, where the Seller was responsible only to deliver the goods "past the ship's rail." With FOB, the Seller has the option to deliver the goods on board the vessel, or to "procure goods already so delivered." This is a reference to so-called "string sales," where a single shipment might be resold multiple times during transport, as is common in the commodity trade. The named place in FOB is a port and therefore the term is used only for ocean or inland waterway transport. With FOB, the named port of shipment is domestic to the Seller. If the shipment is containerized or to be containerized, common practice is to deliver the shipment to the carrier at a terminal and not on board a ship. In such situations, the FCA term is recommended. The FOB term is commonly used in the sale of bulk commodity cargo such as oil, grains, and ore. The key document in FOB transactions is the "On Board Bill of Lading." The named place in FOB is a port, and therefore the term is used only for ocean or inland waterway transport. Sellers and Buyers often misuse the FOB term. FOB does not mean loading goods onto a truck or train at the Seller's place of business. FOB is used only in reference to delivering the goods on board a ship in ocean or inland waterway transport. The FCA term, on the other hand, is applicable to all modes of transport. Crafted and condensed from: http://www.worldtraderref.com/wtr_nl/WTR_site/incoterms_2010.asp

Every contract of sale should include a trade term (Malfliet 2011, Jiminez 2008, Ramberg 1999). The use of any Incoterm should be followed by an appropriate geographic place name (Stapleton et al. 2013, Stapleton and Saulnier 1999, 2002). "Naked" Incoterms are thus Incoterms not followed by a named place or port, which is an improper use of Incoterms, yet is quite common. This is only somewhat acceptable if the seller is clearly actually located in or near a port. But an inland seller further away usually has a choice of several possible ports with different shipping charges, and in such cases, the name of the applicable port should be specified for clarity to prevent surprises where ultimately the buyer and seller's contemplated choice of ports do not match.

Under FCA, the seller delivers the goods at a named place, a specific place the buyer and seller agree to as part of the contract of sale. The named place may be anywhere between the seller's premises and the export wharf (Bergami 2012). Under FCA, the risk in transit transfers where the goods are delivered to the carrier or another person nominated by the buyer

(International Chamber of Commerce 2010b: 23). This means that under FCA, the buyer and seller may agree to the delivery point being the export wharf, wherein the risk would transfer from the seller to the buyer when the consignment is lifted from the delivery vehicle, and not once it is loaded on board as it is in FOB. Therefore, under FCA the loading on board the export vessel is done at the buyer's risk.

Under FOB, the seller delivers the goods in a manner customary at the port of shipment, and if there are no port customs, by placing them on board the vessel (Montflier 2011), as the reference to the critical point of the "ship's rail" has been eliminated (Stapleton et al. 2013). Importantly, in the latest Incoterms, the term FCA refers to "loading" the goods; while the FOB term uses the nomenclature "placing" the goods.

The inappropriate use of FOB or other ocean freight Incoterms for multi-modal transport: As the ICC has repeatedly pleaded, FCA is the appropriate F term for multi-modal transport. The erroneous use of FOB exposes sellers to a "risk gap." Under FOB, the risk point is when the goods have been loaded aboard an ocean carrier. Accordingly, if a container is dispatched from the seller's place of business, the risk does not pass until it is loaded aboard the ship. However, many sellers wrongfully believe that since the container is now in the hands of the carrier, the risk has already transferred to the buyer. It has not. And accidents do happen - trucks crash, port warehouses catch fire, cranes topple during loading, goods are stolen from containers on piers etc. In all such circumstances, if FOB is the designated Incoterm, these mishaps are at the risk of the seller who is usually blithely unaware of this. Any use of FOB by an inland producer of manufactured goods is rather suspect because such goods travel in containers and FCA is the more appropriate choice. Consistent with the spirit of INCOTERMS 1990 and INCOTERMS 2000, in INCOTERMS 2010 the use of the term FOB, and by implication CFR and CIF, is not recommended for container traffic (Bergami 2012: 36).

Conclusion

It is well known that it is difficult to get buyers and sellers to change well established behavioral patterns (Malflit 2011). Specifically, as Bergami (2012) argues, "(T)here are significant problems in getting traders to change routines to the more appropriate and correct use of Incoterms. The term FOB has been around long before Malcolm McLean's idea of containerization revolutionized the world of international trade. Yet, it continues to be misused and misunderstood by the global trading partners in the 21st century. I agree with Bergami's (2012) assessment: "It seems strange that the term FOB, coined at least two hundred years before the era of containerization (from the 1950s-1960s), has been so readily adopted and inappropriately applied to modern day container handling practices," (Bergami 2012:17-18).

The problematic FOB term and its misuse in containerization is not likely to be totally resolved. Though the ICC through INCOTERMS 2010 sought to more closely match the way in which trading partners utilize information technology (Paliu-Popa 2012), blur the formalities of border technicalities by taking advantage of trading blocs, and more clearly define which terms are appropriate for ocean intermodal (Stapleton et al. 2013), and containerized goods, changing behaviors will take time. The biggest challenge is in getting buyers, sellers, freight forwarders (including Ocean Intermediaries and Custom House Brokers) and their bankers to use the correct Incoterms for the proper mode of transport on a consistent basis. Incoterms have always sought

to standardize meaning and remove ambiguity of both the largest details of the transport transaction and of the smallest details. Key to their success is that all parties (i.e., buyers, sellers, freight forwarders, Customer House Brokers, and bankers) fully understand each of the 11 INCOTERMS 2010, and especially those that are inappropriate for containerized traffic or intermodal maritime transport.

The proper use of FCA over FOB is a step in the right direction. As long as traders continue to cling to old habits and fail to update their delivery terms and arrangements to reflect contemporary business practice and to protect their supply chains and visibility, much of the progress the ICC put into the change process will continue to be lost. When a buyer shifts from FOB to FCA, not only the point of risk changes, but the point of cost division may change as well. The thrust behind the ICC's presentation in INCOTERMS 2010—presenting them in two groups (i.e., “any mode” and “multimodal”)—instead of the traditional four: E,F,C, and D; was to reinforce that traders should avoid applying the old maritime terms where and when they should actually apply multimodal terms. It is not simply a matter of using the old terms, including the misuse of FOB, for convenience or expediency sake. It is a legal matter as well (Malfliet 2011). That is, if traders continue to misuse Incoterms in their international shipping contracts and carriage they must be willing to assume the risks of loss or damage during a period of time where they have lost visibility and control over the goods, which ultimately leaves their supply chains vulnerable.

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