NEWSLETTERS

INCOTERMS - Ground Zero for Negotiating Tariff Impact

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The INCOTERMS published by the International Chamber of Commerce (ICC) have long served the international community by offering a "shorthand" for communicating key shipping terms. INCOTERMS are so ubiquitous in international procurement that their use is hardly remarkable-until now. The United States' unprecedented tariff activity, particularly the Section 301 tariffs on imports from China, has drawn INCOTERMS front and center in the down-and-dirty negotiations of which party to a transaction will bear the dramatic increase in import duties. Those three letters-the INCOTERM in question-in supply contracts and shipping documents are at this moment the fulcrum upon which many trading relationships pivot.

INCOTERMS and International Trade War

One INCOTERM in particular, DDP, also identifies the party responsible for the payment of duties upon entry at the country of import. The recent Section 301 tariff action against China has caused participants in global supply chains to dust off their supply contracts in addition to their tariff classifications. Foreign manufacturers, domestic buyers and domestic end-users are all at this moment wrestling with internalization of a 25% ad valorem increases in duties. Some contracts specifically identify the parties responsible for duties and taxes. For example, it is not uncommon for contracts to reference "shipping terms" generally, which would incorporate INCOTERMS, as indicative of the party responsible for duties.

INCOTERMS are performing in this era of lightning-fast tariff action as intended. They provide a tool for communicating party intent with respect to certain transaction costs. Use of the DDP INCOTERM indicates that the seller is responsible for costs and duties associated with entry of goods into the United States. However, the absence of a DDP term does not foreclose the possibility that a foreign supplier is responsible for duties. Many parties are finding (or at least arguing in favor of) different interpretations, absence of terms, or even ambiguity in their contracts as a means to position for more favorable price negotiations. As with all contract disputes, this is ultimately a question of party intent and resolution may require looking to the rules of contract construction that attorneys are skilled in applying to determine meaning.

Every day across the United States, buyers and sellers are engaged in heated contract interpretations and negotiations over whether and how the parties intended to accommodate tariff action. These commercial disputes are at their essence matters of price. The key question, of course, is which party will bear duties and whether that burden will be shared. We are aware of recent instances where suppliers in China have approached domestic buyers in a less-than-forthright fashion on this very issue. Proposed changes from DDP terms to alternates, such as DAP (Destination), have been presented to domestic buyers as merely ministerial changes

for administrative convenience. This is, of course, not a change without cause, and accepting it could result in bearing a 25% increase in landed cost based upon the customs value.

INCOTERMS are Shorthand, not a Short Cut

We very often remind our clients that INCOTERMS are only shorthand. They should not be taken for granted. While simple, INCOTERMS convey the responsibilities, obligations and risks of both seller and buyer from the point of origin, through transportation, to the point of delivery. Every supplier and importer must consider the totality of its deal terms before looking to memorialize those in contract language. Drafting in plain language, especially on complex issues such as responsibility for duties, is sometimes preferred if INCOTERMS convey different or conflicting meanings. Some domestic importers take this a step further by expressly stating that INCOTERMS are for convenience only and do not change the parties intentions. Clearly drafting deal terms, and taking time to consider unintended consequences, can mean the difference between having the upper hand in price negotiations or accepting a 25% ad valorem increase in duties due to three simple letters.

An INCOTERMS Primer

The ICC publishes and maintains the INCOTERMS as a uniform set of rules to clarify any uncertainty in supply contract interpretation. A single three-character INCOTERM establishes the precise point at which key responsibilities transfer from seller to buyer. Thus, the INCOTERMS are a means of communicating the intent of the parties in a way that is both simple and useful to all participants in international trade, including the importers, exporters, transporters, lawyers and insurers who rely upon those terms every day.

The first set of INCOTERMS was published in 1936, and that list has been subsequently amended and restated seven times, most recently in 2010. The INCOTERMS have withstood the test of time due to the ICC's great work in recognizing modernization of international transportation, such as the rise in non-maritime transportation, advances in air travel, proliferation of container traffic, increased use of electronic messages, and need to cooperate on information sharing.[i] The ICC's next update to the INCOTERMS is scheduled for 2020.

Today, the ICC maintains 11 INCOTERMS:[ii]

CFR Cost and Freight: "Cost and Freight" means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

CIF Cost, Insurance and Freight: "Cost, Insurance and Freight" means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination. The seller also contracts for insurance coverage against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree to as much expressly with the seller or to make its own extra insurance arrangements.

CIP Carriage and Insurance Paid To:

“Carriage and Insurance Paid To” means that the seller delivers the goods to the carrier or another person nominated by the seller at an agreed place (if any such place is agreed between parties) and that the seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination. The seller also contracts for insurance cover against the buyer’s risk of loss of or damage to the goods during the carriage. The buyer should note that under CIP the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will either need to agree to as much expressly with the seller or to make its own extra insurance arrangements.

CPT Carriage Paid To: “Carriage Paid To” means that the seller delivers the goods to the carrier or another person nominated by the seller at an agreed place (if any such place is agreed between parties) and that the seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.

EXW Ex Works: “Ex Works” means that the seller delivers when it places the goods at the disposal of the buyer at the seller’s premises or at another named place (i.e., works, factory, warehouse, etc.). The seller does not need to load the goods on any collecting vehicle, nor does it need to clear the goods for export, where such clearance is applicable.

FCA Free Carrier: “Free Carrier” means that the seller delivers the goods to the carrier or another person nominated by the buyer at the seller’s premises or another named place. The parties are well advised to specify as clearly as possible the point within the named place of delivery, as the risk passes to the buyer at that point.

DAT Delivered At Terminal: “Delivered at Terminal” means that the seller delivers when the goods, once unloaded from the arriving means of transport, are placed at the disposal of the buyer at a named terminal at the named port or place of destination. “Terminal” includes a place, whether covered or not, such as a quay, warehouse, container yard or road, rail or air cargo terminal. The seller bears all risks involved in bringing the goods to and unloading them at the terminal at the named port or place of destination.

DAP Delivered At Place: “Delivered at Place” means that the seller delivers when the goods are placed at the disposal of the buyer on the arriving means of transport ready for unloading at the named place of destination. The seller bears all risks involved in bringing the goods to the named place.

DDP Delivered Duty Paid: “Delivered Duty Paid” means that the seller delivers the goods when the goods are placed at the disposal of the buyer, cleared for import on the arriving means of transport ready for unloading at the named place of destination. The seller bears all the costs and risks involved in bringing the goods to the place of destination and has an obligation to clear the goods not only for export but also for import, to pay any duty for both export and import and to carry out all customs formalities.

FAS Free Alongside Ship: “Free Alongside Ship” means that the seller delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) nominated by the buyer at the named port of shipment. The risk of loss of or damage to the goods passes when the goods are alongside the ship, and the buyer bears all costs from that moment onwards.

FOB Free On Board: “Free On Board” means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards.

Click here for a visual representation of INCOTERMS and their practical implications for each party to the purchasing agreement.

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[i] https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-history/.

[ii] These short descriptions were reproduced from the International Chamber of Commerce website at https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-2010/. The full text of the 2010 edition of the Incoterms rules is available for purchase at http://store.iccwbo.org/.