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in this issue

CREATING A ROBUST
CONTRACTING
PROCESS

F.O.B. TERMS DEFINED

Greetings

Thank you for the very positive feedback on our newsletter. We're thrilled that the information and advice are being put to good use. Please keep your comments coming!

In this month's edition we have included the following articles:

F.O.B. TERMS DEFINED

CREATING A ROBUST CONTRACTING PROCESS

We hope you'll find the information contained herein to be of substantial value to your company. Bottom-line, we want to be considered a valued advisor for you and your firm.

Enjoy your Fourth of July and best wishes for a happy and healthy Summer.

CREATING A ROBUST CONTRACTING PROCESS

In last month's issue, we described several key areas that both shippers and carriers should focus on in order to ensure that the contracts they negotiate are successful, not for one party, but for both. In this issue, we take this process to the next level by providing details for creating a robust contracting process.

By robust, we mean the following:

Results Oriented: Make sure your contracting process produces the results you want to produce.

Optimizes Resources: Always make the best possible use of resources available to you.

Balanced: Make sure that there is complete balance in the process. You must make sure that the results justify the input and that all costs are appropriate to the result.

User Friendly: Make sure the process is completely satisfactory to all parties.

Simple: Make sure the process is easily understood by all parties as well as simple to navigate.

Trackable: Finally, and one of the key steps in the process is to make sure the process is quantified and constantly monitored to ensure the desired results are met.

In creating Win-Win-Win contracting, the contract negotiation has little to do with bargaining, compromise and competition. It should not be a verbal and mental sparring session. The real successful deal makers approach contract negotiations as a mutual problem-solving process. Both parties must strive to understand the other party's wants and needs. Each party should attempt to meet the other parties' needs and should also be cognizant of their own needs during the negotiation process. Always adopt a mindset of flexibility rather than rigidity. Focus on "enlarging the pie", rather than dividing it up. Remember, always aim for Win- Win-Win outcomes. While all this makes perfect sense, few parties practice this philosophy. Why? Because it is counter cultural. We are socialized to seek control, to win by defeating others whether consciously or unconsciously.

Be prepared for conflicts along the way. Many conflicts are due to misunderstandings or a lack of preparation. Some conflicts are due to different interests. But the real key is to understand that conflicts will be present and that they need to be addressed towards mutual satisfaction. If something needs to be said, Say it! But then continue the dialogue. Give each party the opportunity to do what they need to do to confirm agreement. Become aware of the need. Who do you need to set up the contract with? What are the real reasons, not the perceived reasons? Understand your feelings towards the other party and what were the conditions and behaviors that lead to these feelings?

Think through the reasons. What are the values that underlie the need to set up this contract? Are you going to be opened to being influenced by the other party? Are you stereo-typing the other party? These are all critical questions that need to be asked and answered before the initial contact is made. Remember that the initial contact is critical to a successful partnership. Both parties need to describe their needs in complete, understandable terms. Both parties must have a complete understanding of the outcome to be achieved if both parties agree to agree. Both parties need to determine if the other party shares the desired outcome and finally, both parties need to explore various options to achieve the desired results.

When you get down to the actual negotiation process and are negotiating the contract details, always keep an open mind. Use terms like, "In the future", "I would like you to", "What do you think?" These are positive terms and clearly signal a meeting of the minds. Be sure to explore all available options. Instead of assuming the first idea is best, enter into a dialogue. Both parties will come up with better ideas. Continue to foster the dialogue to explore better ways for both parties to accomplish their goals.

Now you are ready to finalize the details. Work out the contract language that both parties agree to and believe will help monitor performance. Always be as specific as possible concerning who, what, where, when, how and why. The next step is to protect the contract. Since both parties have put real effort to establish value, how are you going to protect the contract? What does each party need to do to ensure success of the program? Are there any other people that need to be involved in the process to ensure success? Do both parties have the resources and buy-in to fully support the agreement? If not, go back to the drawing board immediately! And finally, continually monitor the process. How do you know the contract is working? Who is responsible for keeping track? As we have heard over and over again, do not assume anything and take nothing for granted.

F.O.B. TERMS DEFINED

The term F.O.B., often used in the transportation industry, is also many times misused. The actual meaning of F.O.B. is --- Free-On-Board which indicates that all expenses of placing the sold goods on board the carrier's vehicles is born by the seller and free to the buyer. F.O.B. terms are used to actually spell out the point at which title passes from the seller to the buyer. F.O.B. terms also place the responsibility for filing claims for lost or damaged merchandise while in transit on a specific party to the sales agreement, usually the owner unless, of course, the vendor may as a courtesy and for good customer relations file the claim and refund the buyer.

Very often companies will purchase their inbound raw materials and supplies on an F.O.B. delivered basis. Under these terms, the supplier is responsible to deliver the goods to the consignee's door. It is understood that the freight charges are included in the cost of the delivered

product.

One of the benefits of this type of purchase term, is that many buyers feel there are less "headaches" with this type of arrangement since the supplier assumes the full responsibility for shipping until actual delivery. There are, however, disadvantages as well. The buyer pays for the freight expense as part of the purchase price but is not controlling the freight movement, and it is assumed that the seller has added a little "extra" in the selling price to cover unforeseen contingencies, a shipping and handling charge so to speak.

Buyers that receive raw materials and supplies should work very closely with their purchasing staff to seek out suppliers that ship on an F.O.B. delivered basis. Where possible, the same supplier should be requested to supply a price for his product F.O.B. factory. The difference between the two prices represents the freight expense and handling charge which the buyer must "beat." Very often a lower freight charge can be negotiated with a company's preferred carriers.

It should be brought out that any savings in freight expense goes directly to the company's "bottom line profit." A company that works on a 10% profit margin would have to sell two million dollars worth of goods to achieve a \$200,000 profit. This same savings may be achieved easily through proper freight negotiations.

Information as to F.O.B. terms usually appears in purchase orders or sales contracts of both parties to specify where title passes but quite often this data is absent. When this information fails to show up in such documents and consequently their intent is not clear the Uniform Commercial Code specifies where the transfer of ownership takes place. The U.C.C. consists of the Nation's state laws on sales contracts and other commercial transactions.

As a guide to our readers, we are including a chart indicating the risk of loss in transit listing various terms of sale, where the title passes, who pays the freight charges, and which party is responsible for filing freight claims.

<u>Terms of Sale</u>	<u>Title Passes</u>	<u>Freight Charges Paid By</u>	<u>Claims Filed By</u>
F.O.B. Origin Freight Collect	At Seller's Dock	Buyer	Buyer
F.O.B. Origin Freight Prepaid	At Seller's Dock	Seller	Buyer
F.O.B. Origin Freight Prepaid & Charged	At Seller's Dock	Seller but Freight Borne by Buyer	Buyer
F.O.B. Destination Freight Collect	On Delivery	Buyer	Seller
F.O.B. Destination Freight Prepaid	On Delivery	Seller	Seller
F.O.B. Destination Freight Collect & Allowed	On Delivery	Buyer, but Deducted From Invoice by Buyer	Seller

"The meaning of F.O.B. (free on board) is, that the seller is to put the goods on board of the carrier's car or truck, at his own expense, on account of the person for whom they are shipped; delivery is made, and the goods are at the risk of the buyer from the time when they are so put on board (of the carrier)." - Sparta Produce Exchange v. Wilson, 223 Ill. App. 126. See also Uniform Commercial Code, and Bill of Lading Act (Sec. 8 and 9).

Section 46 of the Uniform Sales Act which is now part of the Uniform Commercial Code provides in part as follows (UCC Sec. 2-401, sec. 2-303-319):

"Where, in pursuance of a contract to sell or a sale, the seller is authorized or required to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transportation to the buyer is deemed to be a delivery of the goods to the buyer - unless a contrary intent appears."

The following may be concluded regarding passage of title (excerpts from "When Does Title Pass From Shipper to Consignee of Loss or Damage in Transportation" by Thomas G. Bugan).

1. On an F.O.B. origin shipment, the title and risk of loss or damage in transit is upon the buyer in the absence of a contrary intent.
2. Delivery to the origin carrier is a delivery to the buyer, and for purposes of transportation the carrier is the agent of the buyer.
3. The title and risk will pass wherever or whenever designated in connection with the words "free

on board" (F.O.B.) unless there is a contrary intent.

4. Where the contract provides for a delivery (F.O.B. cars or other vehicles, title does not pass until the goods are actually placed on board of carrier's vehicle and the shipper has performed all his duties incident thereto.

5. The intention of the parties is controlling for they may make any contract they desire regarding passage of title and assumption of risk in transit or at any other place

As you can see from the aforementioned chart, Terms of Sale and Freight Terms are completely independent of each other. In the sales transaction, both the buyer and seller are free to negotiate the terms that make the most sense for both parties. Both parties also need to be cognizant of the impact the Terms of Sale and Freight Terms will have on the total cost of the sales transaction. Ignorance of these terms could cost a company a significant amount of money. So remember, knowledge is power.