

December 11, 2024

## The Importance of Incoterms in International Trade

### Client Updates

Established by the International Chamber of Commerce (ICC), Incoterms (International Commercial Terms) provide a set of internationally recognized rules that define the allocation of certain risks, obligations, and costs between buyers and sellers in the global trade of goods. When used effectively, Incoterms can significantly reduce confusion in cross-border transactions and ensure smooth logistics. However, while Incoterms offer many advantages, companies need to be aware of the risks and pay careful attention to their selection, implementation, and consistency with the terms of their agreements. It is important to note that Incoterms do not address the transfer of ownership of the goods; this must be specifically defined in the agreement. Additionally, if contractual provisions contradict the chosen Incoterms, the contract's specific terms will generally govern, which could lead to unexpected outcomes if inconsistencies are not resolved upfront.

### Key Advantages of Using Incoterms

1. Clarity and Consistency – one of the most significant benefits of using Incoterms is that they provide a clear and consistent framework for allocating risks and responsibilities between parties. This standardization reduces potential misunderstandings that can arise in cross-border transactions where language, legal systems, and business practices vary widely.
2. Cost Allocation – Incoterms specify who is responsible for the costs associated with the transportation, insurance, and loading or unloading of goods. By choosing the correct term, companies can avoid unexpected charges and better manage their budget. For example, under **CIF** (Cost, Insurance, and Freight), the seller is generally responsible for paying for insurance against the buyer's risk of loss or damage to the goods from the port of shipment to at least the port of destination, which can be a significant advantage for buyers. However, under **EXW (Ex Works)**, the seller's responsibility for such shipment insurance (as well as for various other costs) generally ends when the goods are made available for the buyer at a named place (such as the Seller's premises).
3. Risk Management – Incoterms define the point at which the risk of loss or damage to goods transfers from the seller to the buyer. For instance, generally under **FOB** (Free On Board), the buyer assumes the risks for the goods as soon as they are loaded onto the ship (which allows the seller to transfer risk relatively early in the process), but under **DDP** (Delivered Duty Paid), the seller generally bears all the risk involved in bringing the goods to the named place of destination (such as the buyer's premises). Understanding this transfer of risk is essential to avoid disputes and potential financial losses.

### Key Risks of Using Incoterms

1. Improper Selection of Incoterms – not all Incoterms are suitable for every transaction. Using the wrong term can lead to misunderstandings, unexpected liabilities, and increased costs. For instance, some Incoterms, such as **FOB** (Free On Board), **FAS** (Free Alongside Ship) or **CFR** (Cost and Freight), are only applicable to sea or inland waterway transport. Companies that use this term in air or land transport could find themselves in difficult situations when disputes arise.
2. Failure to Specify Key Locations – many Incoterms require the parties to indicate a specific location, such as a place of delivery, loading, or destination. For example, under **DAP (Delivered at Place)**, the indicated location shall be the final destination of the goods in the country of import. In contrast, under **FCA (Free Carrier)**, the indicated location shall be the place of delivery to the carrier in the country of origin (and not the final destination). Failure to identify these locations correctly can lead to delays, misunderstandings, or disputes over when and where risk transfers.
3. Misunderstanding Risk and Cost Transfer Points – companies often confuse the transfer of risk with the transfer of costs. The fact that one party is responsible for paying the transportation costs does not necessarily mean it bears the risk for the goods during transport. For example, under **CPT (Carriage Paid To)**, the seller pays for the carriage of the goods to the agreed final destination in the country of import, but the risk transfers to the buyer as soon as the goods are handed over to the first carrier in the country of origin. This means that even though the seller covers transportation costs, the buyer is responsible if the goods are damaged or lost during transit from the country of origin to the country of import.

### **Practical Tips for Companies Using Incoterms**

1. Choose the Right Incoterm for the Mode of Transport – as mentioned above, not all Incoterms apply to every mode of transport. When negotiating a contract, it is critical to ensure that the chosen Incoterm aligns with the transportation method.
2. Ensure Clarity in Key Locations – Clearly indicate locations that the Incoterm refers to, as mentioned above.
3. Understand the Transfer of Risk and Costs – make sure to differentiate between when costs transfer and when risk transfers, as detailed above.
4. Consult Legal and Logistical Experts – companies should always seek professional advice when selecting Incoterms, especially for complex international deals. Misunderstandings about Incoterms are often at the heart of costly disputes, and an expert can ensure that both parties' obligations are aligned with their expectations.
5. Review and Update Contracts Regularly – as international trade evolves, it is essential to ensure that your contracts reflect the latest version of the Incoterms, which are updated periodically by the ICC. The most recent version, Incoterms 2020, contains several changes from previous versions, including adjustments to insurance obligations and new delivery points for some terms.

Incoterms are a valuable tool for companies engaged in international trade, providing a clear structure for managing the complex risks, costs and responsibilities involved. However, incorrect usage or failure to pay

attention to key details can expose companies to unnecessary risks, including the imposition of unintended obligations and costs as well as delays in delivery. By choosing the appropriate Incoterm, specifying key locations, and consulting with experts, companies can enhance the efficiency and reliability of their cross-border transactions, while mitigating potential liabilities.

Our team has extensive experience in advising on international trade and the strategic use of Incoterms in cross-border transactions. Should you need assistance with optimizing your international trade contracts or ensuring compliance with the latest standards, we would be happy to assist and provide tailored advice to suit your specific needs.

**\*This update is intended to provide general and concise information only. It does not constitute a full or complete analysis of the issues discussed, does not constitute a legal opinion or legal advice, and should not be relied upon as such.**

## Key Contacts



**Asaf Avtuvi**  
Partner



**David Goldman**  
Partner



**Rebecca Genis Shepetovsky**  
Senior Associate