

From Incoterms to Complete Contracts: A Practical Approach



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In international trade, buyers and sellers are often located in different countries and follow different business practices. In such situations, even simple questions like who will arrange transport, who will bear the cost, and when, where and how the risk and ownership will pass from seller to buyer if not addressed well can lead to confusion and disputes.[1]

Earlier, common trade terms like “FOB” or “CIF” were used in contracts, but different countries understood these terms differently. This created misunderstandings and legal issues between parties. To solve this problem, the International Chamber of Commerce (ICC) introduced Incoterms (International Commercial Terms) in 1936. This created a common set of rules that clearly explain the responsibilities of a buyer and a seller in a transaction.

Over the time, these rules were updated to match modern trade practices and transport systems. The latest version, Incoterms 2020, is widely used in international contracts today.

However, it is important to understand that Incoterms are not automatically applicable. They are effective only when properly mentioned in a contract. If they are used incorrectly or without proper clarity, they may end up causing disputes rather than preventing them.

There are 11 Inco-term rules in circulation currently. They are divided into two classes:

- **Class I: Rules for Any Mode of Transport**

1. EXW (Ex Works);
2. FCA (Free Carrier);
3. CPT (Carriage Paid To);
4. CIP (Carriage And Insurance Paid To);
5. DPU (Delivered At Place Unloaded);
6. DAP (Delivered At Place);
7. DDP (Delivered Duty Paid)

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.



- Class II: Rules for Sea and Inland Waterway Transport
 - 1.FAS (Free Alongside Ship);
 - 2.FOB (Free On Board);
 - 3.CFR (Cost & Freight);
 - 4.CIF (Cost Insurance & Freight)

1. When Should Incoterms Be Used?

- Incoterms should be used in contracts where there is movement of goods, especially:
 - Import and export transactions
 - Sale of goods involving transportation (by road, sea, air, or rail)
 - Supply contracts where delivery responsibility is important
- They are helpful in clearly deciding:
 - Who will arrange transport
 - Who will pay for freight and insurance
 - At what point the risk passes from the seller to buyer

However, Incoterms should not be used without careful consideration. For instance, in purely service contracts or in situations where tangible delivery obligations do not apply, they may not be necessary.

Example: In case of Aluminium Window manufacturing and supply company, reference of Incoterms for installation or service obligations is not relevant.

2. How Should Incoterms Be Referenced?

Simply writing “FOB” or “CIF” in a contract is not sufficient. A proper reference must include:[2]

- Correct Incoterm (e.g., FOB, CIF, DDP)
- Exact place/location (very important)
- Version of Incoterms (e.g., Incoterms 2020)

Example of correct usage: “FOB Nhava Sheva Port, Mumbai, Incoterms 2020”

If the place is not clearly mentioned, it may create confusion about where delivery is completed and at what event/place the risk transfers.

[2] <https://iscosafricashipping.org/wp-content/uploads/2020/02/ICC-INCOTERMS-2020.pdf>

3. Importance of Choosing the Right Term

Each Incoterm allocates different levels of responsibility and risk.

For example:

- **FOB (Free on Board):** Suitable where buyer controls shipping. However, risk transfers at port—any damage during transit becomes buyer's responsibility.
- **CIF (Cost, Insurance and Freight):** Seller arranges insurance and freight, but risk still transfers earlier (at shipment stage), which is often misunderstood.
- **DDP (Delivered Duty Paid):** Seller takes maximum responsibility, including delivery to site. This is useful for buyers but increases seller's risk significantly.

Choosing the wrong term can lead to:

- Unexpected costs
- Delays in delivery
- Disputes on liability



4 .Comparison of Common Incoterms (India Practice)

Incoterm	Best Used For	Delivery Point	Risk Transfer	Who Pays Freight	Who Pays Insurance	Customs Responsibility
FOB (Free on Board)	Exports	On board vessel at export port	When goods loaded on ship	Buyer	Buyer	Export: Seller / Import: Buyer
CIF (Cost, Insurance & Freight)	Imports	Destination port	When goods loaded on ship	Seller	Seller (minimum cover)	Export: Seller / Import: Buyer
EXW (Ex Works)	Buyer-controlled logistics	Seller's premises	At seller's premises	Buyer	Buyer	Export & Import: Buyer
DAP (Delivered at Place)	Project / machinery supply	Buyer's location (before import clearance)	At place of delivery	Seller	Seller (not mandatory)	Export: Seller / Import: Buyer
DDP (Delivered Duty Paid)	Rare in India	Buyer's location (after customs clearance)	At place of delivery	Seller	Seller	Export & Import: Seller

5. Common Mistakes to Avoid

Some practical mistakes often seen in contracts:

- Mentioning Incoterms without the year/version
- Not clearly defining the delivery location
- Assuming Incoterms cover everything (they do not cover ownership transfer, payment terms, or dispute resolution)



6. Practical Tip for Contract Drafting

Incoterms should always be read together with the other clauses of the contract.

For example:

- Payment terms should match the delivery term
- Insurance clause should align with the chosen Incoterm
- Risk and liability clauses should not contradict the Incoterm

Indian courts have recognised that disputes often arise not due to Incoterms themselves but due to their improper incorporation.

Case Law: Nordic Intertrade AS v. Steel Authority of India Ltd. FAO(OS)(COMM) 205/2017/ Delhi High Court

This case arose from an FOB export contract between Nordic Intertrade (buyer) and SAIL (seller) for supply of steel plates. During the execution of the contract, the Government of India imposed an export duty after the contract was entered into. The core dispute was who should bear this additional cost, the buyer or the seller.

Nordic argued that under FOB terms (as per Incoterms), the seller is responsible for export duties, whereas SAIL relied on a specific contractual clause (the “Red Clause”) which provided that once the buyer failed to nominate a vessel within the agreed time, title and risk would pass to the buyer, even if the goods remained in seller’s custody. Since the export duty was imposed after such transfer of title, SAIL contended that the buyer must bear the cost.

The arbitral tribunal accepted SAIL’s interpretation and rejected Nordic’s claims. The Delhi High Court upheld this view, emphasizing that:

- Incoterms are only interpretative tools and do not override express contractual terms
- Specific clauses in the contract (like transfer of title/risk) prevail over general FOB principles
- Incoterms do not deal with supervening events, breach, or allocation of liability in such situations

Accordingly, the Court refused to interfere with the arbitral award and held that the buyer was liable for the export duty.



Conclusion:

Incoterms, issued by the International Chamber of Commerce, help businesses clearly understand who is responsible for delivery, costs, and risks in a transaction. However, they only work well when they are used correctly and clearly mentioned in the contract. Even a small mistake in using Incoterms can lead to serious financial loss or disputes. Thus, INCOTERMS should always be used along with proper contract terms, especially with respect to ownership of goods, payment, taxes, and what happens if something goes wrong.

It is important to remember that Incoterms do not override the actual contract. If they are used carelessly or without full clarity, they can create confusion instead of solving it. Therefore, businesses should treat Incoterms as a supporting tool, and not a replacement for a well-drafted contract.

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