Incoterms® 2010: Risks and Costs Defined

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ABSTRACT:

The Paper presents the key features of the revised Incoterms® 2010 rules. The first part defines basic definitions and rules used in Incoterms® 2010 terms, specifying the two most important features of the Incoterms® rules, the transfer of risk and the division of costs between the buyer and seller. Noting the major changes in the Incoterms® 2010 rules, the Paper then provides for a basic overview of each Incoterms® 2010 term. Where applicable, certain benefits and deficiencies of specific terms, as observed in the practice, are pointed out and where possible, practical solutions in the form of an alternative term to be used are offered. In addition, particular attention is devoted to the choice of a proper term, having in mind the interests and capabilities of the parties involved.

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INTRODUCTION

As the Incoterms® 2010 rules publication's editorial stipulates, the Incoterms® rules "... facilitate the conduct of global trade"¹. The main purpose of the Incoterms® rules, published by the International Chamber of Commerce (ICC), is to simplify international trade of goods² by setting clear rules regarding specific rights and obligations of the involved parties (buyer and seller)³. Additional goal is to harmonize⁴ the legal standard of "risk-transfer" moment⁵. In the Incoterms® 2010⁶ rules, this transfer is defined under the term "delivery", referring to a specific moment "... where the risk of loss of or damage to the goods passes from the seller to the buyer"⁷. Incoterms® 2010 are applicable for both the international and national trade agreements, as this became an accepted practice between traders⁸.

¹ ICC, Incoterms® 2010: ICC rules for the use of domestic and international trade terms, 2010, Paris: ICC Services Publications, 2010, at 4.

² For more information on the inter-relationship between the Incoterms® rules and the 1980 UN Convention on Contracts for the International Sale of Goods (CISG), see: Ramberg, *Incoterms* 2000 - *The Necessary Link Between Contracts of Sale and Contracts of Carriage*, Zbornik PFZ, 58, 1-2 (2008). Also, see: Ramberg, *To What Extent Do Incoterms* 2000 vary Articles 67(2), 68 and 69?, Journal of Law and Commerce, 25, (2005-2006).

³ These primarily concern the: (a) responsibility for costs during shipping of the goods, (b) distribution of risks during shipping, and, (c) transfer of risk. For a historical overview of the Incoterms® rules, starting with the 1936 version, see: Ramberg, *Incoterms*® 2010, Penn St. Int'l L. Rev, 29, 3 (2010-2011), at 416-418. Also, see: Szabo, *Incoterms* 2000 in light of its practice, Special Report, Balázs & Holló Law Firm, 2008. For a comprehensive comparison of Incoterms® 2000 and Incoterms® 2010, see: Andersson, *Incoterms* 2010: An Essential Revision or a Pointless Custom?, Jönköping International Business School, Jönköping University, 2010.

⁴ For a more general consideration on Incoterms® rules and their applicability, see: Coetzee, *Incoterms and the Lex Mercatoria*, Cadernos da Escola de Direito e Relações Internacionais, 1, 12 (2010). For a comprehensive study, see: Coetzee, *INCOTERMS as a form of standardisation in international sales law: an analysis of the interplay between mercantile custom and substantive sales law with specific reference to the passing of risk, Doctoral Dissertation, University of Stellenbosch, 2010.*

⁵ For a background study over the issue of risk in the supply chain, see: Nilsson, *Reallocation of risks within supply chains: The practice of enhanced liability clauses*, Nofoma 2011, Harstad University College in Harstad, 2011.

⁶ For a summarized list of major changes in the 2010 revision, see: Reynolds, *Revised Incoterms 2010 Take Effect January 1, 2011*, Managing Credit, Receivables & Collections, January, (2011). Also, see: Cummins, *Incoterms*® 2010: A Special Presentation by the Louisiana District Export Council and the U.S. Export Assistance Center of New Orleans, Special Incoterms Report, J.P. Morgan Chase, 2010.

⁷ ICC, supra note 1, at 10.

⁸ *ICC*, *supra note 1*, at 8. One of the intended goals of the latest revision was to expand the use of Incoterms® rules in the United States, see: *Ramberg*, *supra note 3*, at 418. Also, due to the European Union's effort to minimize the border formalities (the so-called "customs free zones"), additional benefit is to be derived within such blocks/clusters, see: INCE, *New Incoterms 2010: A summary of the*

Incoterms® 2010 provide specifications regarding two critical points: (a) the transfer of risk – when the seller fulfills the obligation to deliver the goods, and, (b) responsibility for costs – a point to which the seller is responsible for transport and insurance costs.

The shipment of goods can be divided into different stages. The so-called "pre-carriage" involves inland transportation organized by the seller, being either domestic or international, up to the departure point from where the carrier (contracted either by the seller or buyer) takes on the goods. The "main carriage" can also be domestic or international, from the departure to the arrival point. The "on-carriage" is the continuation of transportation of goods from the arrival point (usually organized by the buyer). The so-called "door-to-door" contract of carriage includes all the above named stages of carriage, and is performed by the same carrier.

Oduntan argues¹⁰ that in practice, only a few of the terms are frequently used (FOB and CIF being such terms), due to the fact that they "support" the use of the transport documents like the bill of lading which is important for the re-sale of goods during carriage, which in turn allows parties greater liberty regarding the disposition of the goods. Keeping this in mind, and due to the fact that the "first" seller is responsible for the goods when Incoterms® rules apply, the Incoterms® 2010 recognize the need of an appropriate transport document to be issued in order to resolve possible difficulties arising from the damaged goods during the overall carriage¹¹. It is hoped that such a stipulation will prove helpful in order to tackle the observed deficiency in the practice.

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principal changes to Incoterms 2000, International Trade Special Report, Ince & Co International LLP, 2011, at 1. Based on a survey conducted among traders, around 37% regularly use Incoterms® terms, see: Kee, International Sales Law -The Actual Practice, Penn St. Int'l L. Rev., 29, 3 (2010-2011), at 437. This position has been reconfirmed at several place in: Gabriel, The Advantage of Soft Law in International Commercial Law: The Role of UNIDROIT, UNCITRAL and the Hague Conference Brook. J. Int'l L., 5, (2008-2009).

⁹ Different variants of this category include: (a) "door-to-(air)port – pre-carriage and main-carriage, (b) "(air)port-to(air)port" – main carriage only, (c) (air)port-to-door – main carriage and on-carriage. For more information, see: ISM, *Incoterms 2010 - What do the Changes Mean?*, Special Report, Institute for Supply Management, 2010.

¹⁰ Oduntan, "C.I.F. Gatwick" and other such nonsense upon stilts: Incoterms and the law, jargon and practice of international business transactions, I.C.C.L.R., 21, 6 (2010), at 215.

¹¹ Certain terms contain an obligation to "... contract or procure a contract for the carriage of the goods", per ex, see: CIP, Clause A3, in: ICC, supra note 1, at 46.

Incoterms® 2010 are not to be confused with: (a) a contract of sale (or related contract elements such as is the title of transfer of ownership, the price, a breach of contract, available remedies, or contractual obligations other then issue concerning the delivery) or a contract of carriage (including the issues such as packaging and stowage), and, (b) a law governing any of these two contracts.

Their purpose is to define the: (a) responsibility regarding obtaining export and import clearances, (b) responsibility regarding arranging carriage, (c) responsibility regarding insurance coverage during carriage, (d) responsibility regarding the delivery of the goods, and, (e) risk transfer moment¹².

In practice however, Incoterms® rules are usually supplemented with additional terms/meaning, making it difficult to assess to what extent the original guidance supplied by the ICC is valid for the particular rule as modified by the parties¹³. Also, traders often choose, as Malfliet calls it, "wrong terms"¹⁴, under which a particular term of parties' choice is not sufficiently aligned with other "connected" contracts and legal documents, such as is the contract of carriage, marine insurance coverage, letter of credit, letter of finance and others¹⁵.

Two important modifications in the Incoterms® 2010 are noted before proceeding to the basic overview of the terms. The traditional risk transfer point "ship's rail" has been replaced by "placing on board". However, it is unclear to what

¹² For detailed explanation, see: Street, *Some Pitfalls in Using the Incoterms*, Legal Corner, April, (2011).

¹³ For more on this issue, see: Glitz, *Transfer of Contractual Risk and INCOTERMS*, Journal of International Commercial Law and Technology, 6, 2 (2011), at 111.

¹⁴ Malfliet, *Incoterms 2010 and the mode of transport: how to choose the right term*, Management Challenges in the 21st Century: Transport and Logistics - Opportunity for Slovakia in the Era of Knowledge Economy Bratislava, 2011, at 164. The author suggests that the proper choice of the most appropriate terms should incorporate the evaluation of the: (a) nature of goods traded, (b) means of transportation, (c) method of payment, and, (d) most rational and affordable method of delivery, *Malfilet*, *id*.

¹⁵ Regarding cases where parties place a "correct" term into the contact, but omit the word "Incoterms® 2010", it is considered that a specific term is to be evaluated according to the Incoterms® 2010 guidelines. For court and arbitration practice on this matter, see: Graffi, *Remarks on Trade Usages and Business Practices in International Sales Law*, Annals FLB - Belgrade Law Review, LIX, 3 (2011), at 112 *et seq*.

extent "placing of the goods on board a transportation vehicle" defines obligations of the involved party, as placing goods on board may include different activities regarding the safe acceptance and storage of such goods, depending on the type of cargo, mode of transportation, and particulars as agreed by the parties¹⁶. Thus, the practice may resemble that of the "ship's rail" era¹⁷.

Furthermore, following the modern trends in electronic communication and trade, the Incoterms® 2010 recognize the electronic documentation as a valid form of communication, equal to its paper counterpart, a fact which will considerably lessen the complications that traders (potentially) face when using electronic means of communication whilst contracting and carrying out contract obligations.

¹⁶ For issues arising within the maritime Incoterms® terms concerning the "placing on board" moment, see: *Malfliet, supra note 14*, at 172-173.

¹⁷ Cf.: Ramberg, supra note 3, at 422.

Incoterms® 2010 Rules

The 2010 Rules incorporate two clusters of rules: (a) Rules for Any Mode or Modes of Transport (which can be used for any mode of transport), and (b) Rules for Sea and Waterway Transport (to be used exclusively for the maritime transport). What follows is a basic overview of the most important elements of each term, with certain considerations regarding practical problems occurring in practice.

Any Mode of Transport

The first category consist of the following terms: EXW (Ex Works), FCA (Free Carrier), CPT (Carriage Paid To), CIP (Carriage and Insurance Paid TO), DAT (Delivered at Terminal), DAP (Delivered at Place), and DDP (Delivered Duty Paid).

Under the EXW term, the seller will fulfill the obligation to deliver the goods by placing them at the buyer's disposal at a designated place (seller's premises or any other place) without having to load the cargo or clear it for export¹⁸. Such a stipulation may prove to be difficult in cases where the goods need to be transported to the location where the buyer's vehicle is waiting for delivery, if such transport is conducted by road in a country that is a contracting party to the Convention on the Contract for the International Carriage of Goods by Road (CMR)¹⁹. As Malfliet notes, according to the Article 17/4(c), CMR 1956, the carrier will not be held liable for the damage to the goods made during the loading by the shipper or the carrier acting as shipper's agent. In addition, the buyer may experience a lack of insurance coverage during the period between the delivery and the acceptance of goods by the carrier, should such a gap occur²⁰. Despite this noted deficiency, this term is generally considered as a term providing a minimum liability for the seller, and due to this reason, EXW is commonly used by the sellers (usually, when smaller volumes of

¹⁸ Malfliet warns that in practice sellers are usually better suited to load the cargo and procure necessary (export) permits. For that reason, the use of "FCA *seller's premises*" is advised instead of EXW, see: *Malfliet, supra note 14*, at 165.

¹⁹ Done at Geneva, 19 May 1956.

²⁰ *Malfliet*, supra note 14, at 175.

goods are involved; however, if sellers trade in large volumes, this may not be the best term, see: *infra*, where the choice of a proper term is discussed).

Under the FCA term, the seller is responsible for loading the cargo on a transportation vehicle provided by the buyer (at the "seller's premises", or at "another place"), but it is also possible to stipulate seller's obligation to organize the transport of goods ("additional services", this usually includes the export clearances). This term is common in practice, since sellers often perform the loading procedure.

Under the CPT term, the point of delivery is a place of departure, when the seller hands the goods to the carrier. The seller remains responsible for the costs of freight, whereas the buyer is responsible for the risk.

The CIP term closely resembles the CPT term, with the additional obligation on the seller's side to procure (at least minimal) insurance coverage (at least to the point of destination) to the benefit of the buyer.

The 2010 revision of the Incoterms® rules replaced DAF (Delivered at Frontier), DES (Delivered Ex Ship), DEQ (Delivered Ex Quay)²¹ and DDU (Delivered Unpaid) with two new rules: DAT and DAP. As Ramberg notes²², FOB rule (see: infra, the next section) has been commonly used in international trade, often without a maritime "leg" present within the chain of carriage of goods. What caused confusion for the parties was the unclear procedure after the "means of transport" have arrived at the destination (delivery point). Clause A4 of the DAT term (replacing DEQ and DES) clearly stipulates that the seller is in charge of the unloading and delivery at a specified place (quay, warehouse, yard, or terminal)²³. Up to this point, responsible for transport costs, risk (including the seller is possible detention/demurrage) and clearing goods for export.

According to the DAP term (replacing DAF and DDU), the seller's obligation is fulfilled when the goods have arrived (up to this point, DAP is similar to DAT) and

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²¹ When comparing DAT and DAP with DES and DEQ, no change of substance is noted regarding the maritime transportation. See: *Ramberg*, *supra note 3*, at 421.

²² Ramberg, ibid., at 421.

²³ "The seller must unload the goods from the arriving means of transport and must then deliver them by placing them at the disposal of the buyer at the named terminal referred to in A3 a) at the port or place of destination on the agreed date or within the agreed period", ICC, supra note 1, DAT, Clause A4, at 54.

are made available for the unloading²⁴. Seller is also responsible for export clearances.

The DDP, as opposed to the EXW, represents the maximum obligation for the seller, where, combined with all the responsibility as present in DAP, the seller is also required to secure all (import) charges and fees (customs, clearances, authorization and etc. – thus, the seller is the "importer" of goods). The use of DDP term corresponds to a number of observed benefits in the practice: (a) the sale price includes the costs of transportation and customs clearances, (b) the buyer has to get engaged only after the goods are made available for unloading at the specified place (making things "simple" for the buyer), and, (c) the sale/carriage process is simplified. Possible deficiencies include: (a) a lack of control over the goods during shipment, and, (b) a possible negative publicity for the buyer provided that the goods in carriage carry his label²⁵.

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²⁴ "The seller must deliver the goods by placing them at the disposal of the buyer on the arriving means of transport ready for unloading at the agreed point, if any, at the named place of destination on the agreed date or within the agreed period", ICC, supra note 1, DAP, Clause A4, at 61. Cf., DDP, Clause A4, ICC, ibid., at 70.

²⁵ For more benefits and deficiencies, see: Wright, *The New 2010 Incoterms*® - *What has changed?*, STTAS 2010 Special Report, Sandler & Travis Trade Advisory Services, Inc., 2010.

Sea and Waterway Transport

The second category consist of the following terms: FAS (Free Alongside Ship); FOB (Free On Board); CFR (Cost and Freight); and, CIF (Cost Insurance and Freight).

Under the FAS term, the seller has an obligation to deliver the goods alongside the ship (in practice, at the terminal) and arrange export clearances. From that point on, risk passes to the buyer, including the responsibility to pay for transportation and insurance costs.

Under the FOB, rights and obligations of the parties are similar to FAS, with the exception of the point of delivery being situated on board the ship. The use of FOB may create certain difficulties in the practice. A good example was placed forward by Docherty²⁶, involving a FOB Dublin Incoterms® 2010 and a letter of credit payment stipulating a presentation of an on board bill of lading. The seller arranges the precarriage of goods by truck in a container to the Dublin port, where the goods are handed to the carrier after unloading from the truck, who in turn issues a delivery receipt. Since no on board bill of lading was issued, the seller may have serious difficulties in getting paid. Also, the FOB stipulates the risk transfer moment at the point of loading the goods onto ship, whereas in reality the seller lost the control over the goods after unloading. In addition, the buyer may be in a position to recharge the seller for terminal handling charges. Docherty suggests the use of FCA in such scenarios, and encourages the traders to make sure that they can in reality receive the documents required by the letter of credit.

Regarding the container transportation, a number of authors and practitioners²⁷ advise against the use of certain terms, such as FAS, FOB, CFR and CIF, when contracting container carriage over sea, primarily due to incompatibility with customs regulations and delivery options, where in practice it is rarely the seller who makes the actual delivery of the goods for the main carriage²⁸. Similarly, another expressed view suggests that the confusion created by the FOB regarding the use of containers

²⁶ Docherty, An Overview of Incoterms 2010, October, Special Report, IIFA, 2010.

²⁷ For example, see: Bergami, *Incoterms 2010: What You Need to Know for Smooth Trading*, MHD Supply Chain Sollutions, January/February, (2011), at 39. Also, particularly concerning FOB, see: Merrington, *ICC Incoterms update*, Special Incoterms Report, Export & Import Training, 2010.

²⁸ For concretization of this issue, see: *Bergami*, *ibid*., at 40.

(which, in practice, are usually loaded by a carrier acting as seller's agent) could be avoided by using FCA, CPT and CIP²⁹.

The CFR term confirms the point of delivery as present under the FOB rule, with the addition of seller being responsible for arranging and paying the transport and freight.

Finally, the CIF term is same as the CFR term, with an addition of seller being responsible for insurance costs (under the Institute Cargo Clauses C).

²⁹ Street, *Changes to the Incoterms*, Legal Corner, March, (2011).

The Choice of a Term

The choice of a proper term may be difficult. Parties are usually advised to take into a consideration one of the following issues, when choosing a most suitable term³⁰: (a) who is responsible for the furnishing and packaging of the goods for export, (b) who is responsible for pre-carriage, (c) who is responsible for the export clearances and charges, (d) who is responsible and who pays for the main carriage and insurance cover, (e) who is responsible for the import clearances, charges and other relevant documentation, and, (f) who is responsible for on-carriage.

Parties decide which term to use depending on the circumstances of a particular contract of sale. A choice of person to be made responsible for carriage may very well depend on the individual capabilities. If a seller has expertise in transportation³¹, this may be a deciding factor in choosing an appropriate Incoterms® term (preferably one of the terms where the seller is handling the carriage). If on the other hand, as Malfilet notes³², the seller cannot calculate in advance the cost of carriage³³, and has little experience in the field, it is advisable to resort to terms that stipulate the transport responsibility on the side of the buyer. Practice often favors the shared responsibilities, as buyers and sellers are generally unwilling to deal with specifics of legislation in each other's countries³⁴.

Parties should keep in mind what individual terms and term groups are intended to achieve, as groups E-term, F-term, C-term and D-term (based on the first letter of each term) will have certain similarities and certain differences. Regarding the duty to arrange the carriage of the goods, the terms in the groups C and D stipulate that the seller is obliged to contract the carriage services (and required to make sure that the

³⁰ See: *ISM*, supra note 9.

³¹ Malfliet mentions a number of reasons why the seller is in a better position to arrange the contract of carriage: (a) reduction of costs depending on the volume, (b) choice of a carrier, (c) choice of law governing the contract of carriage and specific instructions to the carrier regarding the transport documents, (d) cost of carriage as a part of the selling price (this being a benefit for the buyer due to presumed lower overall freight prices and easier capability of comparison with other offers), and, (e) minimization of packaging and storage costs, see: *Malfliet*, *supra note 14*, at 169-170.

³² Malfliet, ibid., at 169.

³³ Disadvantages include the: (a) change of a freight price (due to a change of other factors such as is the fuel and insurance prices), and, (b) the carrier's right of retention if the seller does not pay the freight (forcing the buyer to pay the freight, and then enter the reimbursement process against the seller). For more, see: *Malfliet*, *ibid.*, at 170-171.

³⁴ *Malfliet*, *ibid*., at 168.

buyer receives a transport document enabling the buyer to receive the goods at a place of destination). In the C^{35} group, the seller only needs to arrange the carriage (and minimal cargo insurance cover with the buyer as a beneficiary³⁶), whereas in the D^{37} group, the seller is responsible for the goods during the carriage. In E^{38} and F^{39} groups, the buyer bears that responsibility.

It is also noteworthy to mention that the Group E falls under the so-called "departure" category, and Group F under the "main carriage unpaid" category, both denominating a situation where the buyer is required to pay for the freight. Group C is also known as the "main carriage paid" category, where the seller: (a) handles pre-carriage and contracts main carriage (including the export clearance), (b) is responsible for the choice and performance of the carrier (also forwarder), and, (c) handles freight costs and documentation At the same time, the buyer is required to name the place of delivery and bear the risk during the transit (main-carriage). Group D falls under the "arrival" category, where the seller has the same obligations, but remains to be responsible for the risk during the main-carriage, until the goods arrive at the arrival point. Thus, the buyer in general bears less risk then in the C group.

Both C and D groups require that the seller pays the freight.

³⁵ Also known as "sent to, freight prepaid".

³⁶ For more information, see: Ramberg, *Incoterms 2010 - why and how*, International Academy of Commercial and Consumer Law, 15th Biennial Meeting, Toronto, 2010, at 3.

³⁷ Also known as "delivered at", marking the D group as the "arrival contracts" group, where delivery is preformed upon arrival of the goods to the designated place, see: *Malfilet*, *supra note 14*, at 165. The other groups are usually referred to as "shipment contracts", where the seller's principal responsibility ends upon the handing of the goods to the first carrier.

³⁸ Also known as "come to collect the goods".

³⁹ Also known as "sent from".

⁴⁰ This is usually understood as an obligation for the seller to make the goods available to the buyer at seller's premises.

⁴¹ Where a seller delivers the goods to a carrier that is contracted by the buyer.

⁴² In this category, it is the responsibility of the seller to arrange the contract of carriage, but without accepting the risks after the shipment.

⁴³ Due to the wide scope of influence, this group is often referred to as the "shipment seller-friendly contracts".

⁴⁴ Where a seller is responsible for all costs and risks until the goods are delivered at a nominated place of destination.

CONCLUSION

The use of Incoterms® terms is beyond the doubt a great advantage at the disposal of traders around the World. The popularity of their use is visible both at the international and domestic trade, a fact which prompted the ICC Draft Committee to stipulate the availability of Incoterms® terms for both the domestic and international trade within the Incoterms® 2010 rules guidelines. The domestic trade might be particularly influenced by Incoterms® rules in large economies, such as is the United States, or custom-free blocks such as is the European Union.

When parties choose to use Incoterms® terms, they are interested in setting out clear expectations regarding the division of risks and costs present during the shipment of goods. Each term is specifically designed to address specific needs of the traders, depending on the type of goods sold, mode of transportation used, and the capabilities of parties to handle specific risks and costs related to the contract of sale and contract of carriage.

Provided that the parties choose the most appropriate terms, and have a clear understanding of those terms, the use of Incoterms® 2010 should lessen the risk of misunderstanding between the parties, and decrease the risk of legal complications arising out of such misunderstandings.

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Naslov i sažetak na hrvatskom

Incoterms® 2010: Definicija rizika i troškova

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SAŽETAK:

Rad proučava temeljne odrednice revidiranih Incoterms® 2010 pravila. Prvi dio rada predstavlja temeljne definicije i pravila koja se koriste u Incoterms® 2010 terminima, te pobliže određuje dva glavna obilježja Incoterms® pravila, prijenos rizika i podjela troškova između kupca i prodavatelja. Nakon isticanja glavnih novina koje Incoterms® 2010 pravila donose, rad pruža osnovan uvid u svaki pojedinačni Incoterms® 2010 termin. Ukoliko je primjenljivo, naznačuju se određene prednosti i mane pojedinih termina, kako su ustanovljene kroz praksu, a gdje je moguće, nude se praktična rješenja u smislu uporabe alternativnih termina. Ujedno, posebna pažnja usmjerava se na izbor prikladnog termina, imajući na umu interese i mogućnosti zainteresiranih stranaka.

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