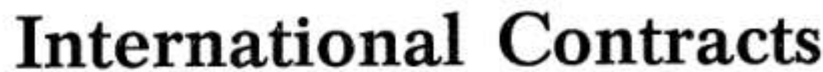
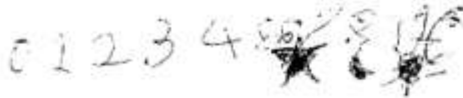
Chapter 5

International Contracts





Whenever a firm gets involved in international business, it enters into a substantial number of contracts, either written or implied, with a number of partners, some of which are located abroad. Examples of such contracts would be:

- The contract of sale between the exporter and the importer
- The contract of insurance between the exporter or the importer (depending on the terms of sale, which will be covered in Chapter 6) and an insurance company
- The contract of carriage between the exporter or the importer and the shipping line
- The contract between an exporter and its agent or distributor
- The contract between an exporter or an importer and its bank, regarding payment arrangements such as documentary collection or letters of credit (concepts that will be covered in Chapter 7)
- and so on.

All of these contracts are formed under the precepts of a multitude of traditions, local laws, multilateral governmental agreements, and international treaties that are sometimes not ratified or only partially ratified by some countries. Frequently, these contracts are further complicated by a profoundly different understanding of what a contract represents. Nevertheless, international traders and logistics managers learn to operate within this complex framework.

5.1 *Lex Mercatoria*

Whenever a contract is established between two parties in the same country, the law governing the execution of this contract is clearly determined by that country's legal system. In the United States, for example, it is the Uniform Commercial Code, and there is ample jurisprudence and expertise to determine how this contract should be executed. However, when the contract is between two parties in different countries, there is no specific law governing this contract, except what is called ***Lex Mercatoria***—trade law—a multitude of international agreements and international trade customs, all of which complement domestic laws.

Lex Mercatoria is complex because it includes a multitude of different sources of law and jurisprudence. There are United Nations treaties and other decisions; international agreements, such as the General Agreement on Tariffs and Trade (GATT), which has given rise to the World Trade Organization (WTO) with its own rules and Court system; multilateral agreements on specific industry issues, such as the Warsaw Convention on international air transport or the textile Multi-Fiber Agreement; regional agreements, such as the European Union or the North American Free Trade Agreement (NAFTA); bilateral agreements, such as the "Open Skies" agreement between the United States and the Netherlands (see Chapter 12) or the special status granted to Hong Kong by the People's Republic of China; International Chamber of Commerce rules,

such as the Incoterms for terms of trade (see Chapter 6) or the UCP-500 for bank documentary credits (se Chapter 7); arbitration decisions and jurisprudence, established by the International Chamber of Commerc Arbitration Court or private arbitrators, and so on. In addition, many countries pick and choose whic treaties they will ratify and, on occasion, which articles of the treaties they will ratify. They can also choos to become "signatories" to a treaty, which means they do not make a full commitment to a treaty, whil others decide to abide by the terms of the treaty, but do not ratify them. Finally, things get even mor "interesting" when courts decide that some domestic principle cannot be violated by an internationa convention or custom. This chapter does not attempt to cover *Lex Mercatoria* in depth; only an overview o three of its major aspects is presented here. The first part covers the issues regarding the contract of sal between an exporter and an importer, which, for most countries, are covered by the United Nations Conven tion on Contracts for the International Sale of Goods (CISG). The second part of the chapter covers th issues regarding contracts between exporters and agents and contracts between exporters and distributors, a well as the resolution of eventual disputes through the arbitration system.

The specific aspects of contracts as they pertain to the terms of sale—the International Commerce Term (Incoterms) of the International Chamber of Commerce (ICC)—will be covered in Chapter 6. Contract relating to banking and payments will be covered in Chapter 7, insurance contracts will be covered i Chapter 10, and contracts of carriage between shippers and carriers will be covered in Chapters 11 and 12

5.2 International Sales Contracts and the CISG

Whether or not a sales contract is "international" is not always self-evident. Courts will generally look a two criteria to decide whether a contract is international: the economic criterion, that is, whether there was a transaction that involved a transfer of merchandise from one country to another, and its mirror image of a transfer of funds; and the judicial criterion, which is based on whether the transaction has "links" to the laws of different states.[1] For example, a sale of office supplies to a French company's subsidiary in Germany by a German supplier is not considered "international"; however, the same sale to the company's headquarters, located just across the border, would be international. Whenever there is a sales contract between two parties in two different countries, then the domestic laws no longer apply, and it is governed by the Vienna Convention.[2]

The Vienna Convention, or the United Nations Convention on Contracts for the International Sale of Goods (CISG), was born in 1980 of two other conventions, the Uniform Law for the International Sale of Goods (ULIS) and the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF). Both had been written in the Hague in 1964, but were ratified by only a few countries because they were somewhat deficient.[3] In contrast, the CISG has been ratified by more than sixty countries,[4] whose export and import activities represent more than 80 percent of all world trade. As often is the case, though, several countries, including the United States, have not ratified all of the convention, and left out some provisions, some of which may have conflicted with domestic law. However, the CISG has become the Law of International Contracts, as traders will often elect to have their contracts governed by the laws of a contracting state (e.g., the United States) and therefore the CISG will apply.

The CISG is substantially different from the Uniform Commercial Code (UCC)—the Commercial Law of the United States—in a few of its aspects, notably the contract formation and remedies in the case of nonconforming goods or late delivery. It is likely to be different from a number of other countries' domestic laws as well, as evidenced by the number of countries that have not ratified specific articles of the CISG. Although these exclusions may make good political fodder, they may not be acceptable to the Courts who will have to handle disputes between traders located in countries that have adopted different versions of the CISG, or have amended it to include some other interpretation.[5]

5.2.1 Contract Formation

The CISG does not consider that a contract has been accepted until both parties agree to all of its terms: It is customary for a seller to make an **offer**. The buyer may respond positively, but indicate that it wants a different schedule of delivery or term of payment, or some other aspect of the transaction to be handled differently. Under the UCC, such a response is construed as an **acceptance** of the offer. Under the CISG, it is understood as a **rejection** of the offer made by the seller and as a **counteroffer** by the buyer, unless the terms suggested do not materially affect the contract. The CISG specifies that changes to "price, payment, quality, and quantity of the goods, place, and time of delivery, extent of one party's liability to the other (most likely to be understood as Incoterms) or the settlement of disputes are considered to alter the terms of the offer materially" and therefore that no acceptance is made in those cases.

Another area of difference between UCC and CISG regarding offer and acceptance of a sales contract is what is referred to by U.S. lawyers as the "Battle of the Forms." For most businesses, an offer or an acceptance is made on some standard business form, with a number of "small print" statements preprinted on it, designed to protect the interests of the party writing the offer (or the acceptance). In most instances, these preprinted clauses do not match. Under the UCC, the Courts have determined that the differences do not matter in the formation of a contract, unless they significantly affect the terms of the contract, and regard these different terms as additions to the terms of the contract, to be sorted by the Court in the case of conflict. Under the CISG, the requirement of a "mirror image" may signify a return to what, for Americans, would be the pre-UCC rules, where the terms of the contract are determined by the form of the party "firing the last shot," or it may signify that there is no contract until all terms match, with little tolerance for differences.[6] There is little evidence that the second interpretation is likely to prevail, especially if both parties thought there was a contract and acted in consequence.

5.2.2 Creation of the Contract

The CISG treats the length of time during which the offer is considered outstanding in a significantly different manner than the UCC does. Most offers contain a clause stating that the offer is open until a certain date; under the UCC, however, the offer can be withdrawn at any time, without prejudice, for almost any reason. Under the CISG, the offer cannot be withdrawn by the seller (or the buyer) before its expiration date, and the other party can accept it at any time until that time. It is considered an irrevocable offer.

The CISG does not dictate that contracts of sale have to be written: Any agreement between a seller and a buyer can form a contract. Obviously, the issues of the proof of the existence of a contract and of the terms of the contract then become quite thorny unless there are witnesses to the discussion between seller and buyer. Even in the event where a contract of sale is signed, the written terms of the contract can be superseded by an oral exchange between the two parties, as long as there is evidence that it was the intent of both parties. In one of the jurisprudence cases contained in the United Nations Commission on International Trade Law (UNCITRAL) database—called CLOUT, for the Case Law on UNCITRAL texts—two witnesses corroborated that the written terms of the contract had been modified orally by the seller and buyer, and the modifications were used by the Court in determining the case.[7] In contrast, the UCC requires that any sales agreement above U.S. $500 must be in writing.

5.2.3 Breach of Contract

Finally, the CISG treats nonconforming goods and delays in shipments much differently than does the UCC. Whereas the UCC applies the "perfect tender" principle (i.e., the goods must exactly conform to the goods

contracted and be delivered within the framework specified in the contract), the CISG grants the seller more latitude. For example, the buyer cannot refuse delivery or cancel unless the non-conformity or the delay "substantially deprives the buyer of what it was entitled to expect under the contract and, even then, only if the seller foresaw, or a party in its position would have foreseen, such a result."[8] In other words, the buyer cannot avoid the contract unless the seller performs a fundamental **breach** of the contract. Therefore, those firms operating on a just-in-time basis should specifically notify their suppliers that they are following such a manufacturing policy, so that their suppliers can then "foresee" the problem that a delay in shipment would cause.

In counterbalance, the CISG allows the buyer to unilaterally apply a price reduction to the amount agreed upon in the contract for nonconforming goods. Such a price reduction should be proportional to the loss of value of the goods (percentage that are nonconforming) or to the loss of market incurred by the buyer, in the event of a delay. However, the burden placed on the buyer to notify the seller in a timely manner and to explain which remedy it will seek has a very high threshold. The notification must be made as soon as possible; it has to be clear and painstakingly detailed in the description of the problem and it has to be extremely clear and specific in the remedies sought. Several cases in CLOUT show that the burden placed on the buyer by the Courts seems unduly harsh: several examples given by McMahon[9] seem that way, anyhow. In addition, this issue is somewhat moot for a buyer paying on a Letter of Credit (see Chapter 7), because it is committed to pay for the full amount in all cases. Finally, the notification by the buyer to the seller that a price reduction will unilaterally be applied must be made within two years; such a long upper limit is also of concern, because the statute of limitations for claims against a carrier may be shorter than that in some countries, preventing the seller from recovering damages caused by a carrier.[10]

5.3 AGENCY VERSUS DISTRIBUTORSHIP LEGAL ISSUES

The second type of contracts of interest are the contracts between an exporter and its representatives in foreign markets; either an agent or a distributor. To briefly repeat ground covered in Chapter 4, an agent is a representative located abroad and earning a commission on the sales it makes on behalf of the exporter. An agent cannot negotiate prices, delivery, or other sales terms with the buyer, but only represents the decisions made by the exporter. A distributor is also located abroad, but it purchases goods from the exporter, with the idea of reselling them in its country, earning a profit in the process. The distributor is setting its own prices and has an inventory of goods to sell: It is most often responsible for after-sale service as well.

It is difficult to generalize about agency and distributorship agreements: There is no international agreement on the way each of these relationships is governed. In most cases, the country of residence of the agent or of the distributor considers that it has jurisdiction over the agreement, and in many cases, despite the fact that the agreement may specify that the laws of another country apply to the contract (see Section 5.4.8 and Section 5.4.9 for specific information regarding the Choice of Law and the Choice of Forum in an international distribution contract). Because each country has its own laws and regulations regarding these agreements and because the jurisprudence of each country may differ even on similar statutes, it is very difficult to be specific without getting into tedious listings of countries. Therefore, only broader issues will be covered, to understand which aspects of a distribution contract should be examined.

5.3.1 Contract Law versus Labor Law

In the absence of specifics, agreements between an exporter and an agent and agreements between an exporter and a distributor will be called **distribution contracts**. One of the greatest differences among

countries is whether they consider such distribution agreements as "contracts between equals" or as "contracts between unequal partners."

In the first case, Courts will consider the terms of the contract when dealing in a dispute: this approach is referred to as **contract law** or case law, where the question is resolved by trying to interpret the meaning of the contract between the two parties. Both parties are considered to have equal sophistication in dealing with legal matters, and therefore none of the parties would have entered a contract without understanding it. Most countries, but certainly not all, consider that agreements between an exporter and a distributor fall into this category: The contract between the two parties is the framework that Courts will consider in dealing with a dispute between the two parties. When the contract is silent about the point in contention, then the Courts will use jurisprudence and what other contracts of the same type have established.

In other cases, though, countries will equate an international distribution agreement as something akin to an "employment contract," where the parties are considered unequal in their ability to interpret and understand a legal contract, and therefore where the "weaker party" has to be protected. This point of view calls for the application of **labor law** or for the application of special statutes, dealing specifically with the relationship between an exporter and an agent, or an exporter and a distributor. Such statutes cannot be overruled by the terms of the contract in any way. Therefore, the Courts, in ruling in a dispute between the two contract parties, will ignore the terms of the contract and use the laws of the country in which the agent or distributor is located. Most countries that follow such an interpretation will tend to protect agents rather than distributors—Belgium being the lone country protecting its distributors but not its agents[11]—but several protect both. In addition, this point of view is often independent of the fact that the agent or the distributor is an individual or a corporation, and labor law has been used to supersede contracts between an exporter and an incorporated agent.

5.3.2 Home Government Restrictions

The main reason some countries use specific statutes to regulate international distribution agreements is that they feel that they need to protect agents and/or distributors against contracts that may not be fair or equitable. Specifically, they want to protect agents or distributors against wrongful or abusive termination (more specific information on this aspect of International Distribution Contracts can be found in Section 5.5).

In addition, those governments can also construct much more complicated systems to manage agents and distributors operating within their borders. They can require the agents and distributors to **register** with the government, which is a system not unlike a professional association, but that often doubles as a tax. They can require that the agents and distributors be nationals of the country in which they represent the exporter; such is the case of most Middle-Eastern countries. They can also mandate that the terms of the contracts be inspected by their administration, in order to monitor the commissions paid to agents, for example, which they sometimes limit with a floor or a ceiling. Other governments will only allow exclusive agents or distributors—a single agent or distributor within a specific geographic area, usually the country itself—as do most South American countries. Finally, some governments will simply not allow agents at all—they mandate a distributor—or not allow any third-party representation, coercing exporters to establish a subsidiary, which they can then tax on income. Unfortunately, it is difficult to generalize about all of these different requirements, as they are very country-specific—they even vary from one region of a country to another, as shown in the laws of the state of Louisiana, which are in contrast with the laws of just about any other area in the United States, or of the laws of the Alsace-Lorraine region, which are significantly different from the remainder of France—and can change at any time. Specific legal expertise and advice is therefore necessary before writing a distribution contract in any country.

5.4 Elements of an Agency or Distributor Contract

There are a number of points that must be covered in any contract, regardless of the country of the world in which it will be used. This section explores a number of these mandatory contract elements. Some country-specific requirements can obviously still influence each one of them.

5.4.1 Contract Language

Because distribution agreements are usually entered into by two parties who do not share a common language, it is often necessary to have these contracts written in two languages. However, as any speaker of a foreign language can attest, it is utterly impossible to translate accurately and precisely contract terminology from one language to another. It is therefore critical to include a clause that specifies that the contract written in Language A is the original contract and that the contract written in Language B is a translation, and that in case of dispute or problems of interpretation, the original contract should prevail.

There are exceptions to this practical rule, however. Most international agreements between countries, such as the UN Convention on Contracts for the International Sales of Goods (CISG) or the International Chamber of Commerce's Inco-terms, are written in several languages, *all of which* are given the same legal status; they are all "originals," which can sometimes present problems when translations cannot precisely duplicate the meaning of the framers of the agreement. These problems could be avoided by having one original and the others translations, but it would create political uneasiness, so it is not done.

5.4.2 Good Faith

Another mandatory clause in a distribution agreement is a clause stating that both parties enter into the agreement in **good faith**. A contract is entered in good faith when neither of the parties has any other ulterior motive about the agreement. It's probably best to understand good faith as the prerequisite for a contract to be formed: Both parties must want to fulfill the terms of the contract rather than pursue some other idea, using the contract agreement to dupe the other party into providing them some necessary material toward that goal.

The same interpretation of good faith applies to the terms of the contract as well; both parties agree that they will adhere to the terms of the contract in good faith (i.e., interpret them without trying to distort them to their advantage). Both parties agree to deal fairly with each other, and not try to dupe the other by attempting to find "loopholes" in the terms of the contract.

5.4.3 Force Majeure

All contracts contain some sort of a ***force majeure*** clause. This is a French expression that translates loosely as "overwhelming power," but which refers to any event that cannot be avoided and for which no one is responsible, at least none of the two parties entering the contract. Contracts may also contain phrases such as "Acts of God" or "Powers of Princes" to address acts beyond the control of the parties. Examples of such events would be a major storm that sinks the ship carrying products to the distributor, or a fire that prevents a firm from producing the goods on time, civil unrest, or a lengthy strike at a port that delays the delivery of the goods. Contracts always contain a clause that absolves either party from not fulfilling their responsibilities in case of *force majeure*, or a cause of non-performance beyond their control. Generally, there is also some statement that qualifies such exemption of liability to perform: "as long as the affected party resumes the performance of this agreement" after the *force majeure*.

5.4.4 Scope of Appointment

The scope of appointment clause principally defines the function that the representative will perform; it is the clause that spells out whether it will be an agent or a distributor and it is generally the first clause in the contract.

It also indicates the products to which both parties agree the contract applies, to define the minimum product line that the agent or distributor is expected to sell, and at the same time to limit the product line the representative is allowed to sell. There is often language to the effect that the representative cannot "cherry pick" the most profitable products and ignore the remainder of the line; this latter requirement may be expressed in quantitative terms. In addition, a list of the products that are to be sold by the representative is often placed in an Appendix and made part of the contract.

The scope of appointment clause also refers to the territory of the agreement and to corporate accounts, both of which are defined later in the agreement.

5.4.5 Territory

The territory clause defines the geographical limits within which the agent or distributor is authorized (expected) to sell. It is generally the entire country in which the representative is located, with some possible exceptions. In very large countries, there may be a regional appointment, and for countries with limited sales potential, there may be several countries included. The clause also spells out whether the agreement makes the agent or distributor an **exclusive representative** in that territory, which essentially grants a monopoly to the representative.

There are many problems associated with the definition of an exclusive territory, specifically in the European Union: While it is possible to write a contract limiting a representative to a single country's territory, the EU considers that a firm operating in one EU country can also legally sell in any other. It is therefore difficult for the exporter to limit the activities of a representative to a single country—it is contrary to the laws of the EU, and has been construed as an antitrust violation[12]—and it is difficult to grant exclusive rights to a territory when neighboring representatives have the right to sell there as well.

In many South American countries, the issue is different: Unless an international representation agreement specifically spells out that it is non-exclusive, then it is always interpreted as an exclusive agreement in that territory.[13]

5.4.6 Corporate Accounts

Some agreements will specify which customers remain corporate accounts, or customers to which the representative is not allowed to sell, for whatever reason. Generally, corporate accounts are very large customers who have negotiated terms that will apply to all their purchases worldwide. The agreement always includes some provisions under which the list of corporate accounts can be amended.

It is important for an exporter to pay close attention to the number of corporate accounts that are included in a representation agreement, because too many of them may discourage the representative. An example of such a counterproductive agreement would be one that specifies that all accounts above a certain level of sales automatically become corporate accounts; consequently, a successful agent, after having developed an account and reached that critical level of sales, would see it removed from its commission basis, and, therefore, from its income. This is certainly not the way to reward a good representative intent on excelling and is likely to limit the sales of the exporter, as such a policy encourages the representative to limit its efforts to stay "just below" the critical threshold.

5.4.7 Term of Appointment

This clause determines the duration of the appointment of the representative. It must always be a definite period, with the possibility of renewal if certain performance criteria are met.

It is critical to determine the original duration of the contract appropriately; finding the balance between a sufficiently long appointment period, so that the representative has enough time to develop the market to the point where it is a sustainable venture, and a sufficiently short period, so that an ineffective representative may be removed and replaced without too much of an opportunity cost to the exporter, is a very delicate task. Most of the time, such an initial appointment period is dictated by the market conditions and by the type of product sold. If the representative is expected to do so-called "pioneer sales," in which it has to sell a new product with little brand awareness and unique characteristics, a longer period is necessary than for a standard product with multiple competitors and a well-known brand. If the market is characterized by personal contacts and long-term relationships between customers and suppliers, then a longer period is necessary than in a market that is more competitive and fluid.

The clause also specifies, once the initial appointment period is completed, the renewal period, and, very importantly, the conditions under which the contract will be renewed for that duration. Renewal periods can be similar in duration to the initial appointment period, or can be shorter; there are no specific recommendations either way. What is important is to specify clearly the performance criteria for renewal: level of sales reached, market share obtained, number of customers contacted, amount spent on advertising, number of sales calls made, and so forth. The issue is to make sure that the contract is not renewed as a matter of course.

Should the representative not meet the criteria for renewal set in the contract at the end of the initial appointment period, then the principal has two alternatives. It certainly can terminate the contract, which is often a bad solution, unless the representative has done particularly poorly, as the exporter is now confronted with the task of finding another representative. This decision also creates ill will: The slighted representative can always retaliate and create problems for the next appointed representative and alienate existing customers by giving them the impression that the firm is not committed to that market.

The other alternative is to renew the contract anyhow: The representative may have been unable to achieve the objectives set in the original agreement because of circumstances beyond its control, or because the difficulties of entering the market had been underestimated, or because the market potential had been overestimated. In any case, what is important is to renew the contract but to make clear to the representative, in a carefully worded communication, that the terms of the renewal had not been met, but that the exporter was willing to renew because of the circumstances.

Should such a communication be omitted and the contract be renewed anyhow, it could then be construed by a Court as an **evergreen contract**; that is, a contract with no determined duration, and a contract that can no longer be terminated for non-performance as there was a precedent of non-performance and simultaneous renewal. Although generally a couple of instances are necessary before such a conclusion is reached, some overprotective Court may not see it that way.

5.4.8 Choice of Law

Because an international contract is a contract that has links to the laws of two different countries, some different interpretations of specific clauses are quite possible. To avoid these problems of interpretation, every contract includes a clause that determines which of the two sets of laws should be used by a Court or by an arbitration panel when a conflict arises between the parties. In general, the Choice of Law is made by the exporter rather than the agent or distributor; however, this does not preclude a possible resolution in the Courts of the importing country, which may assume jurisdiction over the contract because of their country's statutes regarding agents or distributors, despite the clause.

In a well-publicized case, individual American investors in Lloyd's of London insurance syndicates tried to sue the company in U.S. Courts, to circumvent an exemption from liability from negligence that the company enjoys in the United Kingdom. However, because the contract between the investors and Lloyd's clearly stated that the laws of the United Kingdom would prevail in case of dispute—the Choice of Law—the Supreme Court ruled that the U.S. Courts had no jurisdiction over the dispute,[14] even though such an exemption is contrary to generally accepted principles of law in the United States. The peculiarities of Lloyd's insurance market and its functioning, as well as its problems with investors, will be covered in Chapter 10.

The International Chamber of Commerce (ICC) Model Contracts for Agency[15] and for Distributorship[16] approach the issue of Choice of Law innovatively, by giving the contract writer two possibilities: The first is the traditional choice of a specific country's laws, the second being the "principles of law generally recognized in international trade as applicable to international agency [distribution] contracts,"[17] or those principles that constitute the Lex Mercatoria mentioned earlier in this chapter. As more and more arbitration jurisprudence accumulates, this alternative may become the preferred way of wording Choice of Law clauses as it shields both parties from unexpected outcomes.

5.4.9 Choice of Forum or Venue

Strongly linked to the Choice of Law is the Choice of Forum or Venue clause. In it, both parties agree on the location of the Court that will rule on an eventual dispute, using the laws chosen in the Choice of Law clause. In most instances, the Choice of Law somewhat dictates the Choice of Forum, as it makes logical sense to link both, and benefit from a Court experienced in the jurisprudence of the laws governing the contract.

5.4.10 Arbitration Clause

An increasing number of contracts include a clause, which does not call for a Court to settle disputes, but for an **arbitration panel**. Either the arbitration panel is decided upon at the outset of the contract, or a mention is made of the "Rules of Conciliation and Arbitration of the International Chamber of Commerce" to outline how the panel should be chosen. Generally speaking, the panel is made up of three arbitrators, with each of the parties choosing one and the third chosen by the arbitration organization, such as the ICC. In many instances, the clause states that the dispute will be "finally settled"[18] by the panel (i.e., that the panel's decision is binding on both parties). If the country in which the **arbitration** takes place is one of the 130 signatory countries to the New York Convention on the Enforcement of Foreign Arbitral Awards, then the ruling can be enforced just about anywhere;[19] unfortunately, China, although a signatory, has stood out as the only country where arbitration awards have not been enforced.[20] There are several specific advantages to settling a dispute through arbitration, most of which are outlined in Section 5.6.

5.4.11 Mediation Clause

In some contracts, the possibility of **mediation** or conciliation is encouraged before arbitration or **litigation** is undertaken: A mediator is an individual who will encourage and facilitate the communication between both parties in a dispute so that they can reach a compromise satisfactory to both. A mediator will not reach a decision for the parties; she or he will only lead the parties toward a compromise. Mediation is not binding, which means that the decision cannot be enforced and has to be agreed upon by both parties. Because mediation is also done in private, there are no public records of mediation, and it is

an appropriate alternative to settling disputes when one of the parties is concerned about "saving face."[21] Mediation is sometimes initiated by the arbitration panel or the Court for resolutions of disputes where both parties seem open to conciliation. (The advantages of mediation over arbitration and litigation are outlined in Section 5.7.)

5.4.12 Profitability or Commission

This clause is worded quite differently if it spells out the amount of commission that the agent will earn or, reciprocally, the price at which the distributor is expected to sell the product, or the margin that it is expected to add to its costs.

For agency agreements, the exporter spells out the commission that the agent will earn for sales in its territory. It may vary from product to product, so that the agent is given a financial incentive to sell a specific product, but it generally is around 5 percent of the selling price of the products, but obviously depends on the type of industry in which the agreement takes place. A savvy exporter sometimes adds the possibility of negotiating the commission with its agent, in order to win a contract for which the price is critical. Agents usually go along with such reduced commissions, on the philosophy that "a lower commission is better than no commission at all," if the sale is not successful. For sales outside of the territory that the agent may generate accidentally—for example, by attending a trade show and meeting some prospect from a different country—the contract will often call for a lower commission.

Finally, the exporter will also spell out when the commission will be paid to the agent. As a matter of course, the commission is never paid until after the customer has paid the exporter to which the agent sold the product. Commissions can then be paid as they are earned, or monthly, quarterly, even semi-annually or annually.

For distributorship agreements, the issue of price can be thorny; if the distributor is completely free to set its own prices, then there is always the possibility of having substantially different prices for the same product in different countries, therefore creating the possibility of parallel imports (see Section 4.5) and risking the aggravation of customers and distributors alike.

However, if an exporter is attempting to limit the probability of parallel imports, for example by trying to control the price at which the distributor sells the product or the margin—markup—that the distributor can add to the product, then there is always the possibility that such a clause will be construed as "price fixing" and therefore an attempt at reducing competition. Nevertheless, several versions of such clauses exist: Some companies bluntly set exactly the same price worldwide, and argue that they do not want their distributors to compete on price, but rather on such other attributes as service, assortment, and repair facilities. Others make advertising support and other sales help conditional upon the distributor keeping the price in line with the exporter's guidelines. Some others do not contractually state anything but make explicit "threats" of possible delays in delivery for those distributors who do not respect guidelines. Obviously, all of these attempts can be struck by Courts as collusion, but such agreements evidently exist worldwide. Advice from an experienced lawyer in drafting such clauses would be money well spent.

5.4.13 Miscellaneous Other Clauses

There are evidently many more clauses in a foreign distribution contract, whether with an agent or a distributor, most of which are more "managerial" in nature, and become much more specific to the industry, the strategy of the exporter, and its representatives than can be generalized upon.

For example, the **facilities and activities** clause spells out what the exporter and the agent or distributor have agreed with respect to the type of establishment that the representative will maintain; the size of retail establishments, the size of inventory they will carry, the type of training that employees will receive, and the

expectations of managerial policies toward customer complaints, all of which are specific to an industry or a corporate strategy. McDonald's has much more stringent requirements in that respect than does an exporter of agricultural by-products.

The same is true regarding the **advertising** clause, which spells out the obligations of both parties regarding promotional activities such as advertising, trade show attendance, ownership of ideas for advertising campaigns and sales promotion items, and, very importantly, how the costs of such promotional activities will be paid for. For many consumer products, advertising costs are shared by the exporter and the representative in some varying percentages, but for industrial products, the spectrum can go from "entirely the responsibility of the exporter" to "entirely the responsibility of the representative." This may also vary as a function of the country in which the representative operates. A word of caution, though: If there are large discrepancies among the cost burden of distributors in different countries, the sale price may be affected and parallel imports triggered, which is something that an exporter should attempt to avoid.

The clause regarding **competing lines** spells out how an agent or distributor will be allowed to handle products manufactured by competitors. In most instances, an agent is not allowed to represent firms that are competing with the exporter's products, but a distributor is allowed to do so. Both are encouraged to carry products that complement the product line of the exporter, with the understanding that they would increase the attractiveness of the agent or the distributor's assortment. Some exporters, though, prefer that the agent or the distributor sell their products at the exclusion of all others, to ensure that the representative is concentrating its efforts on their products. Such decisions are made generally in function of the bargaining strength of the parties: A Japanese *sogo shosha* will carry whatever it pleases, whereas a small dealer involved in distributing products manufactured by a large firm, such as Caterpillar, will have to abide by whatever its principal dictates.

Exporters who benefit from substantial advantages due to intellectual properties will also want to specify the handling of **trademarks**, **patents**, and **copyrights** particularly carefully, as well as spell out in a **confidentiality** clause how trade secrets and other strategic advantages are handled. Generally, improvements to existing products made by the agent or the distributor become the property of the exporter, with some sort of compensation.

Finally, the issue of the **ownership of the customers' list** has to be resolved for distributors: Because they sell for their own account, the exporter is usually not privy to the identity of these customers. In some cases, the exporter may find out who the distributor's customers are when they are requested to fill out some sort of warranty registration form, but in general, they are unknown to the exporter. Some exporters demand that the distributor report the names of its customers, while others prefer to leave this issue alone. Except for warranty issues, the only reasons an exporter would want to know the names of the distributor's customers are in expectation of poor performance of the distributor or in expectation of the creation of a sales subsidiary in the future, neither of which represent a good basis on which to start a contract. As far as agents are concerned, because the exporter is shipping and billing directly to the customers to whom the agent sold, the exporter is aware of the customers' identity, and therefore the issue is of much lesser significance.

Table 5-1 illustrates what a company, Michigan Marmalades, Inc. (MMI), must review before entering into contract negotiations with a distributor, Confitures de France. Here is the checklist of decisions and issues Michigan Marmalades must cover in its contract with Confitures.

5.5 Termination

Most definitely, the most sensitive issue in an international distribution contract is the issue of termination.

Table 5-1 *Contract Checklist*

Michigan Marmalades, Inc. contract negotiations with a distributor, Confitures de France	
Contract Language	Because the two parties in the contract speak different languages, MMI drafted the contract in English and had it translated into French. They included a clause stating that the English contract was the original and the French one a translation, in case of a dispute.
Good Faith	MMI and Confitures agreed to do business fairly and honorably with one another.
Force Majeure	This standard clause covers any unforeseen and unpreventable incidents that might disrupt the normal course of business. For instance, if a shipment of MMI Lemon Spread sinks during a storm, MMI can't be held responsible by Confitures.
Scope of Appointment	The scope of appointment specifies which products Confitures must sell and what other responsibilities Confitures has as a distributor.
Territory	The territory clause defines the geographical areas in which Confitures is to work as the distributor for MMI. MMI and Confitures decide that Confitures will be responsible for the entire area of France and Belgium. Corporate Accounts This clause states that Confitures cannot sell to certain customers, who will remain corporate accounts. These customers are the two supermarket chains who buy directly from MMI: Carrefour and Auchan.
Term of Appointment	The term of appointment is the definite length of time Confitures will serve as distributor for MMI. MMI and Confitures agree to an initial term of three years. After three years, MMI will renew its contract for another year if it is satisfied with Confitures' performance. The contract will be renewed yearly thereafter.
Choice of Law	Usually, the exporter makes the Choice of Law decision: In the event of a dispute, MMI decides that all legal issues will be settled in the United States. Confitures de France agrees.
Choice of Forum, Mediation and Arbitration	MMI and Confitures de France agree that they want to avoid going to court in case of a dispute. Therefore, they include in the contract a chosen mediator whom they will involve to work out disagreements. The clause in the contract also specifies an arbitration panel that will be used in the event mediation fails.
Profitability and Commission	If Confitures were acting as an agent for MMI, this part of the contract would spell out the price at which Confitures is expected to sell MMI's products, and what commission it would earn by doing so. Because Confitures is used as a distributor, MMI has less control over pricing; however, MMI includes the minimum and maximum prices at which Confitures must sell the jellies in order to avoid parallel import problems.
Miscellaneous Other Clauses	The facilities and activities clause states that Confitures will maintain a specific level of inventory of MMI's products, and clarifies how the employees will be trained, and how Confitures will handle customer service. The advertising clause specifies how Confitures will promote MMI's spreads, how the costs of promotion will be shared, and what public relations activities Confitures will undertake. In the competition clause, MMI and Confitures agree that Confitures may carry other products that will enhance sales of MMI's products. Confitures also is granted the right to carry products that compete with MMI's marmalades. The trademarks, patents, and copyrights clause specifies how Confitures can use MMI's logo and other protected information, and the confidentiality clause allows Confitures' access to MMI's production secrets. Finally, the ownership of customer lists clause resolves that Confitures will share its customer list with MMI.

or the act of ending the relationship between the exporter and the agent or the exporter and the distributor. All contracts will spell out a termination clause, which will include:

- A pre-termination notice, which spells out how many days the exporter must give to the agent or the distributor before the termination becomes effective: This duration usually is shorter for agents than it is for distributors, but country statutes can extend it far beyond the contractual agreement. Some contracts call for no pre-termination notice—the contract is cancelled immediately upon notice[22]—and some go as high as a year.
- A termination compensation, often called a "goodwill compensation," which would be equivalent to the amount of income the agent or distributor would have earned for a certain period. This compensation can be as low as none, and as high as two years' worth of income. Again, this provision of the contract may also be rendered null by the importing country's statutes, which may mandate a specific compensation.

Both of these issues are quite dependent upon the reason behind the termination of the contract, and it can be terminated for either of two reasons.

5.5.1 Just Cause

A **termination for "just cause"** is triggered when either of the parties (exporter, agent, or distributor) is not honoring the terms of the contract. Generally, the representative is not doing something that it is contractually obligated to do, such as meet the sales performance objectives, spend a certain percentage of sales on advertising, or maintain the type of establishment spelled out in the contract; or the representative is doing something that it is contractually not allowed to do: for example, selling competitors' products, applying for patent protection on the improvements it has made to the products, or keeping the list of customers a secret. Only in a few cases is the exporter not performing its obligations, such as not providing the agent with prompt *pro-forma* invoices—quotes—or not shipping diligently: Most terminations for just cause are triggered by a problem with the representative's performance.

In any case, it is relatively easy to terminate a contract for just cause, as there is a reason to terminate it. In most instances, the party "guilty" of not fulfilling its part of the agreement is not entitled to compensation and little or no notice. Nevertheless, statutes may still supersede the agreement in such cases, and mandate a minimum notice period and a minimum compensation, even though there is breach of the contract.

5.5.2 Convenience

A **termination for "convenience"** is a termination for any other reason than non-performance: It can be triggered by any of the parties, but generally, it is the exporter that is seeking to terminate the contract. One of the most egregious—but unfortunately very common—reasons is that the representative is very successful and that the exporter realizes that it is earning "too much," and wants to replace it with a sales subsidiary. Another cause for termination is a change in the exporter's strategy that modifies how the exporter intends to penetrate foreign markets, or, worse, necessitates a complete retrenchment on the domestic market. In any case, the problem is that the termination is not linked to the contract—or the lack of fulfillment of the contract—but due to some extraneous reason.

A termination for convenience should be handled with the greatest care as the potential for damages to the spurned party can be substantial; in those cases, a lengthy termination notice, as well as a generous goodwill compensation package, is the only way to ensure no litigation and a smoother termination. In particular, if there are issues to resolve, such as inventories of unsold merchandise or outstanding orders, every effort should be made by the exporter to compensate the distributor or the agent. If it is not done, the

representatives can very easily ask Courts to intervene: In most instances, Courts look upon terminations for convenience very harshly, sometimes assimilating distributors to agents so as to give them the advantages that the statutes of their country give agents.[23] These statutes usually mandate long notice periods and generous compensation packages. Belgium courts granted three months of income to a distributor in compensation for a contract that lasted only four months, and *three years* of profits in compensation to a distributor who was associated with a manufacturer for twenty-two years, but had been fairly unsuccessful, with yearly sales of BFr. 1,400,000 or roughly U.S. $28,000 at that time.[24]

Unfortunately, going to Court may even be perceived as one of the best case scenarios, as several injured representatives took upon themselves to sabotage the efforts of the exporter later on, through all sorts of means: from mentioning to all of their customers the callous treatment they suffered in the hands of the exporter to attracting new competitors in the market.

5.6 ARBITRATION

Arbitration is fast becoming the preferred way of resolving disputes between international partners. In 1960, the International Chamber of Commerce (ICC) received about fifty requests for arbitration; in 1999, it received 529 requests. In order to accommodate such growth, the ICC developed its "Rules of Conciliation and Arbitration," as did the United Nations Conference on International Trade Law (UNCITRAL), both of which are the most commonly used frameworks under which arbitration takes place.[25] However, there are many alternative venues for arbitration: the London Court of International Arbitration, the Stockholm Chamber of Commerce, the World Intellectual Property Organization, the American Arbitration Association, and countless individual law firms that specialize in this function, a number of which are located in Switzerland.[26]

The advantages presented by arbitration over litigation in court are many:

- Arbitration tends to be perceived as fair: arbitration panels are not a Court in either of the parties' countries and therefore are perceived as being more independent and even-handed. This is, of course, only a perception, because Courts in any developed country using a modern commercial code are fair, but it is often a perception of importance in dealing with sensitive litigants.
- Arbitration tends to be much more expeditious than litigation. Arbitration panels are numerous and do not have the same backlog as traditional Courts, which are generally understaffed and overworked. In some countries, commercial disputes can drag on for years: In India, probably one of the worst cases, there are more than three million backlogged civil cases—by the government's own admission—[illegible] percent of which have gone on for more than ten years![27]
- Arbitration tends to be much more efficient: Because arbitration panels do not have to follow the same rules of evidence as Courts, proceedings go much faster, and testimony can be [illegible] more efficiently. Because other procedures are also simplified—there is no pretrial [illegible]—an arbitration meeting generally lasts a few days, whereas a lawsuit can take weeks.
- Arbitration tends to be much more "creative": Arbitrators seek to resolve the dispute to the satisfaction of both parties, and can find compromises that are impossible in a formal Court, where one of the parties has to win, while the other loses. There is also the possibility of iterative negotiations between the parties and the arbitration panel, a process that can lead to an acceptable compromise. Courts do not have this freedom.
- Arbitration tends to be more effective: Arbitrators generally have a wealth of experience in international business matters and can very quickly understand the issues at stake, draw on their experience and knowledge of arbitration jurisprudence, and settle the dispute to the satisfaction of both parties more effectively than can a Court with limited experience in international business matters.

- Arbitration is not open to the public: Whereas court decision are generally published and available to all, arbitration decisions are private and only the parties involved in the dispute know what steps were taken to resolve the dispute.
- Probably most importantly, arbitration is cheaper: All of the advantages previously presented tend to lower the costs of the litigation. In addition, these lower costs are generally shared by the parties in dispute, whereas Court costs are usually borne by the loser, a custom called "European rules"; in the United States, both parties pay their own costs.

The only step to ensure arbitration in the case of disputes between the exporter and its representatives abroad is to include a clause directing that "any dispute [. . .] shall be finally settled in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce."[28]

5.7 MEDIATION

Mediation is a process by which a mediator will attempt to find a middle ground between the parties who are having a dispute. The mediator will often "shuttle" between the two companies and seek to find a commonly acceptable solution to both parties. Most mediators are people with a legal background or people who have knowledge of the particulars of an industry; they can be found through referrals and within the trade associations of most industries.

Mediation presents several advantages over litigation or arbitration in several cases:

- Mediation is less formal: The parties in a dispute are often concerned about arbitration because it is a fairly formal process, taking place over a few days, involving meetings in a neutral venue and restricted to a few individual managers. Litigation is even more formal. Mediation is often achieved over a longer period of time and each party has the opportunity to meet with the mediator in its own corporate environment, and the mediator can meet with many different people in both organizations, in order to get a better idea of the issue.
- Mediation is nonbinding: It can be the first step in resolving a dispute and can help both parties assess how their positions are perceived by unrelated parties. In other words, it is an indicator for both litigants of the strength of their respective positions, and of their probabilities of winning an arbitration hearing or a court case.
- Mediation is more practical for smaller disputes or when parties are interested in keeping a business relationship: Unfortunately, arbitration is commonly perceived as resulting in the formal severing of all commercial relationships between both parties. Mediation allows both parties to resolve a dispute without affecting the remainder of their business.
- Mediation is often best for disputes that have arisen from misunderstandings: Both parties are unable to reach a compromise because they do not understand what the other was trying to accomplish and the mediator can help them reach that middle ground.

Mediation is often the best approach when there is a genuine interest on the part of both parties to resolve the dispute in a manner that is fair to both parties and when both parties are interested in resuming normal business relationships as quickly as possible.

Review and Discussion Questions

1. What are the general provisions of the United Nations' Convention on Contracts for the International Sale of Goods?
2. What are the issues brought about by the concept of "labor law" in an international distribution agreement?

3. Describe three of the elements generally found in an agency or distributorship agreement.
4. What are the differences between the "Choice of Law" and "Choice of Forum" clauses? How are they related?
5. What two possible forms of termination are there? How differently will they be handled by a Court of Law?
6. What are the differences between mediation and arbitration? How different are they from a proceeding in a Court of Law?