insights

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International Sales Contracts:

Square Peg, Round Hole

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The purpose of a sales contract is to define the parties' obligations and to optimize outcome if a dispute arises. As such, a contract is a tool to manage risk and prevent loss. The good news is the vast majority of contracts are performed as planned, and no issues arise. The bad news is when issues arise, they can be costly, eroding or eliminating the anticipated profits, or causing loss from the transactions.

by David H. Conaway

In particular, sales contracts for the sale of goods are based on Article 2 of the Uniform Commercial Code, which has been adopted by every U.S. state. When disputes have arisen, U.S. court rulings have been largely uniform and predictable. Litigation outside the U.S. can be less predictable and before courts that are less impartial.

We have noted a prevalent use of U.S. contracts, originally designed for domestic sales, in transactions involving foreign customers or supply chain. Usually these contracts have few or no modifications to address the laws, court systems or country risks of the foreign country.

Companies ideally would have bespoke contracts that address these differences. However, given that many companies do business in numerous foreign countries, it may be impractical to have a bespoke contract for every country. A reasonable approach would be to consider an over-arching "international" sales or supply contract, and variations for key market countries, or material customer relationships.

The key provisions to address in international sales contracts, other than normal trade terms, include:

What Law Applies?

Most contracts provide that the laws of a particular U.S. state apply, which would incorporate Article 2 of the Uniform Commercial Code. However, the United Nations Convention on Contracts for the International Sale of Goods ("CISG") is a treaty that, as a species of federal law, would trump

application of U.S. state law. The CISG applies to any sales contract between parties from signatory countries. To date, 84 countries (covering over 80% of world trade) are signatories to the CISG treaty including the U.S., Canada, China, Germany, Japan, and Mexico. To exclude application of the CISG and to provide for the UCC to control, the contract must expressly exclude application of the CISG, and provide that the UCC governs.

The relative bargaining position of the parties may compel using an "international" law, rather a U.S. law. Whether or not the UCC or the CISG is preferable focuses on a comparison of the seemingly similar, but materially different, laws. A comparison of the UCC and the CISG is beyond the scope of this article, but one example relates to a common occurrence in commercial transactions: the battle of the forms. Often parties utilize purchase orders, order acknowledgements, invoices, terms and conditions of sale, and sales contract, some or all of which may be electronic. Naturally the seller's and buyer's forms have materially conflicting provisions reflecting the parties' differing interests. When this occurs, the UCC would nevertheless create a contract, incorporating all the terms that are in common, and any non-material additional terms. However, any material additional terms, such as a warranty disclaimer, an arbitration clause, or an attorneys' fees provision, are excluded.

By contrast, the CISG utilizes more of a "mirror-image" rule. Unless the parties' forms are virtually identical, there is no contract. The seller's order acknowledgement, for example, containing additional terms or conditions, would be considered a counter-offer, typically accepted by performance of the parties. In this sense, the seller gets the "last shot", and the CISG protects the seller's forms to a greater extent.

In the context of a customer Chapter 11 filing, a seller of goods may have an enhanced recovery opportunity for goods shipped to and received by the customer within 20 days prior to the filing. The UCC provides that goods are received upon physical possession, while the CISG does not define when receipt occurs. A recent Bankruptcy Court (*World Imports*, E.D.Pa. 2014), in the context of Chinese suppliers of goods, ruled that the CISG applied and that the U.S. buyer received the goods when "delivered", which is when goods are loaded for delivery in an FOB plant contract. The CISG "receipt" would almost always occur earlier and outside the 20 day period, denying the seller the Section 503(b)(9) remedy. Of course, whether or not a seller of goods may or may not obtain a favorable Section 503(b)(9) treatment in future Chapter 11 filings of customers is not sufficient business justification to exclude application of the CISG. Rather, it is a factor to consider.

Where Will Disputes be Resolved?

Parties naturally seek the "home court advantage" of courts in their particular jurisdiction. Again, this may not be possible depending on relative negotiating advantage of the parties.

More importantly, parties should consider how a judgment would be enforced, which largely depends on where the counter-party's assets are located. The U.S. is not a signatory to any ratified international treaty for the recognition or enforcement of foreign court judgments. U.S. courts have and will enforce foreign judgments in the U.S. based on comity and U.S. state's laws, but without a treaty, foreign courts likely will not reciprocate. Thus, obtaining a U.S. judgment may be a waste of time, if the counter-party has no assets in the U.S.

To enforce any judgment obtained from a U.S. court, the U.S. company would be required to commence a separate, essentially duplicative, action in the customer's jurisdiction.

Arbitration of Foreign Disputes

By contrast, the U.S. is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). 156 countries are signatories, including the U.S., Canada, China, Germany, Japan, and Mexico. Clearly, arbitration has developed to be the preferred dispute resolution mechanism for international business disputes.

U.S. companies naturally gravitate to U.S.-based arbitration institutions such as the American Arbitration Association to conduct arbitrations in the U.S. However, if an arbitration award must be enforced by a foreign court (where assets are located), it is necessary to consider whether the foreign court favors or disfavors the arbitration rulings of certain arbitration institutions. For example, Chinese courts generally will only enforce arbitral awards of CIETAC (China International Economic and Trade Arbitration Commission). Mexican courts generally favor the arbitral awards of the ICC (International Chamber of Commerce), CAM (Arbitration Center of Mexico) and ICDR (International Center for Dispute Resolution), CAMCA (Commercial Arbitration and Mediation Center of the Americas).

Contract parties may not be willing to submit to the jurisdiction of the other party's forum. An international arbitration institution provides a neutral forum for dispute resolution.

Who Pays the Costs of Dispute Resolution?

In the U.S., the majority "American" rule is that each party to a dispute bears its own legal costs, unless that risk is shifted by contract.

By contrast, most countries have adopted the "English" rule that requires the loser to pay the winner's reasonable attorneys' fees.

Because legal costs of dispute resolution are material, and shifting the risk among the parties can impact incentives to initiate a dispute in the first instance, and to efficiently resolve a dispute, it is important that such provisions in international sales contracts are clear and comprehensive. The enforceability of such provisions varies among countries, but increasingly courts are recognizing the parties' rights to shift risks in their business dealings.

Miscellaneous Important Contract Provisions

A. Intellectual Property Rights should be protected by appropriate registration. Patent, trademark and copyright protection varies on a country-by-country or regional basis. Because of the time required to obtain these rights, the need to file should be anticipated, and initiated as soon as the need is recognized. Because of the cost involved, whether and how to shift these costs should also be taken into account.

   A seller of goods with associated patents or trademarks may also consider provisions terminating any express or implied license to sell or use its goods upon a default by the counter-party.

B. Certain goods may require special import/export or other regulatory compliance or government approvals.

C. As financial distress of contract counter-parties increases, parties should consider hedging the credit risk with security, title retention, credit insurance, or vigorous internal credit risk assessment, which includes country risk analysis.

D. Force majeure (act of God, strikes, political unrest) clauses are increasingly important to hedge risks created by turbulent financial markets and global conflicts and crises.

E. Currency fluctuations and risks are important considerations in contract profitability. Parties should certainly include contract provisions that allocate this risk. Moreover, parties are well-advised to evaluate financial products that hedge such risks.

F. The parties must also take care about the flow of electronic information that may be shared pursuant to the Agreement, particularly if it involves the transfer between countries of any sensitive personal information of customers, employees, or other users. Some countries may prohibit the transfer of certain information, and others, most notably the EU countries, require agreements addressing data privacy and breach, with additional EU data protection regulations effective in 2017.

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