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Negotiating and Drafting Contracts in International Barter and Countertrade Transactions

John C. Grabow*

A popular business periodical recently proclaimed that "[t]he word of the new year for hip international business people is 'countertrade'".¹ The Commerce Department estimates that countertrade now constitutes twenty percent of total world trade.² That figure may be conservative; others have estimated the figure to be one-quarter or more.³ Whatever the exact figure, it is clear that American and other Western companies are today involved in only a small percentage of total world countertrade.⁴

Countertrade can be understood as encompassing any transaction whereby a seller's sale of goods or services to a foreign buyer is contractually linked to the purchase of domestic goods from the buyer equal to a designated percentage of the original sale. Such trade practices have historically been associated with transactions with the Soviet Union and Eastern European nations,⁵ countries with non-convertible currencies that significantly constrain their hard currency trade. Given the severe shortages of convertible currency among many developing countries, particularly non-oil producing Third World nations, countertrade is now playing a substantial role in North-South trade as well.

The countertrade element of an international transaction is rarely suggested by the Western party,⁶ and it is often difficult for western busi-

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¹ Dizard, *The Explosion of International Barter*, FORTUNE, Feb. 7, 1983, at 88.

² *Id.* at 89; VERZARIU, COUNTERTRADE PRACTICES IN EAST EUROPE, THE SOVIET UNION AND CHINA: AN INTRODUCTORY GUIDE TO BUSINESS, OFFICE OF EAST-WEST TRADE DEVELOPMENT, INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPT. OF COMMERCE (1980)[hereinafter cited as COUNTERTRADE PRACTICES].

³ See *Barter Trade*, ECONOMIST, Feb. 20, 1982, at 78.

⁴ The International Trade Commission estimates that the value of U.S. imports from countertrade transactions was \$290 million in 1980, up from \$98 million in 1974. INTERNATIONAL TRADE COMMISSION, ANALYSIS OF RECENT TRENDS IN U.S. COUNTERTRADE 16 (1982).

⁵ Eastern European nations include Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, Romania, and Yugoslavia, who, together with the Soviet Union, Mongolia and Vietnam, are members of the Council for Mutual Economic Assistance ("CMEA").

⁶ It would be a mistake, however, to view countertrade as a practice altogether foreign to

nesspeople to understand the attraction of the practice to Eastern European and developing nations. Although the reasons may seem shortsighted to us, several factors explain the popularity of countertrade in these nations. First, countertrade is seen as a way of increasing a country's international trade when its balance of payments deficit creates a shortage of foreign exchange. Moreover, countertrade may provide a means of unloading poor quality and difficult-to-market products that cannot be sold on hard currency markets. Using Western companies to market countertrade goods may provide access to new markets without the necessity of developing a sophisticated international marketing capacity for the products. Finally, countertrade can be utilized as a means of discounting (for example, oil at less than the fixed OPEC price), or even dumping, products by disguising the true selling price of the product.

The inferiority of goods received in countertrade and the difficulty of utilizing or reselling such goods remain as stumbling blocks to the acceptance of countertrade by Western businesses.⁷ Yet, one fact is indis-

Western nations. The modern era of countertrade began in the West, not the East, when Germany used the practice to help it overcome the depression it was suffering following World War I. See COUNTERTRADE PRACTICES, *supra* note 2, at 2. Many innovations in countertrade practice have been credited to Hjalmar Schacht, president of the Reichsbank under Hitler. See Dizard, *supra* note 1, at 89.

The United States, despite its often expressed disfavor towards countertrade, see *infra* note 7, has had considerable contemporary involvement with the practice. During its seventeen year lifetime, the U.S. Barter Program, begun by the U.S. Department of Agriculture in 1950, exchanged more than \$1.2 billion worth of agricultural commodities acquired by the Commodity Credit Corporation for foreign strategic materials. See COUNTERTRADE PRACTICES, *supra* note 2, at 3. See generally VOGT, JABARA & LINSE, BARTER OF AGRICULTURAL COMMODITIES, INTERNATIONAL ECONOMIC DIVISION, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE (1982). Although the Barter Program was discontinued in 1973, the United States continues to enter into such arrangements on an *ad hoc* basis. For instance, in 1981 the United States exchanged dairy products, metals, and cash with Jamaica for 1.6 million tons of bauxite. See COUNTERTRADE PRACTICES, *supra* note 2, at 3. Similar transactions were entered into in 1982 and 1983, when a total of \$26.6 million worth of surplus United States dairy products were exchanged for Jamaican bauxite of equal value. See 9 INT'L TRADE REP. U.S. IMPORT WEEKLY (BNA) No. 9, at 352 (Nov. 30, 1983).

A number of bills presently pending in Congress would encourage the United States to engage in countertrade to exchange surplus government agricultural products for strategic foreign minerals. See H.R. 3991, 98th Cong., 1st Sess., 129 CONG. REC. H7552 (1983); H.R. 3295, 98th Cong., 1st Sess., 129 CONG. REC. H3961 (1983); S. 1683, 98th Cong., 1st Sess., 129 CONG. REC. S10886 (1983). A somewhat broader proposal, H.R. 3544, 98th Cong., 1st Sess., 129 CONG. REC. H5134 (1983), would empower the government to trade off any kind of surplus goods, not just agricultural goods, for strategic minerals.

⁷ Objections to countertrade have not been raised solely by Western businessmen, but by Western governments as well. Jacques de Miramon, of the Organization for Economic Cooperation and Development ("OECD"), writes:

From the point of view of the general interest of OECD countries, which is to safeguard an open multilateral trading system, countertrade is backward: it runs counter to the progress made in liberalizing trade since the last World War. It is a return to bilateralism through a modernized barter system. It recalls the restricted choice that is characteristic of wartime economies and compartmentalised markets, whereas the policies pursued successfully for the last thirty years by the OECD countries have aimed at opening markets. Increasing opportunities for trade and improving commercial practices.

putable—there are enormous potential markets available today only to companies willing to engage in countertrade.

I. Types of Countertrade

Many businesspeople in the United States have either never heard of countertrade or, if they have, mistakenly believe that the term refers only to the fairly isolated occurrence of trade without money. Countertrade, however, can take a variety of distinct forms. The labels attached to the various forms are often bewildering to the uninitiated. This article discusses the negotiation and drafting of the three basic types of countertrade transactions which Western companies are most likely to encounter: counterpurchase, compensation, and barter.⁸

A. Counterpurchase

Under a counterpurchase agreement, the Western company sells products or services to the second party⁹ and contractually agrees to

Miramón, *Countertrade: A Modernized Barter System*, 114 OECD OBSERVER 12, 15 (1982).

Similarly, W. Douglas Newkirk, the current Assistant United States Trade Representative for GATT Affairs, declared that countertrade is "counter to all the progress made in liberalizing world trade in the post-World War II period and is a return to bilateralism . . ." Newkirk, *Countertrade: Implications for U.S. and International Trade* 33, 34, in COUNTERTRADE: INTERNATIONAL TRADE WITHOUT CASH (1983). Newkirk concluded that "the U.S. government is firmly opposed to all forms of countertrade because it is not in line with our commitment to an open international trade and monetary system." *Id.* at 33. The Reagan Administration's position on countertrade may be moderating, however. The Administration's Trade Policy Group, an interagency working group which has been studying the rapid growth in countertrade, recently concluded that although it continues to be strongly opposed to all forms of government-mandated countertrade, it is "neutral" when such arrangements are voluntarily entered into between the parties. See *Administration Opposes Forced Barter, Countertrade But Not Voluntary Deals*, 9 INT'L TRADE REP. U.S. IMPORT WEEKLY (BNA) No. 9, at 58 (Oct. 12, 1983).

⁸ There are, in addition, several variations of these basic countertrade forms with which a businessperson engaging in countertrade should be familiar.

a. *Bilateral Clearing Arrangements*: Under a bilateral clearing agreement, two countries each agree to purchase a certain volume of goods from the other during a designated period up to a predetermined amount calculated on the basis of an arbitrarily selected third currency, often U.S. dollars or Swiss francs, or, with CMEA countries, "transferrable rubles." The chosen currency represents purchasing power for goods and is not directly convertible into foreign exchange.

b. *Switch*: Switch trade involves the multilateral use of bilateral clearing agreements, whereby a country with a surplus credit under a clearing arrangement transfers the credit to a third party, often a trading house or export company. The third party acquires products from the country with the trade deficit and, after engaging in what often may be multiple exchanges, converts the goods to hard currency. The third party then transfers the hard currency, less a substantial commission, to the country with the original surplus credit.

c. *Swap*: Swap transactions involve the exchange of fungible goods, usually commodities, between four parties to reduce transportation costs. For example, if an American company has a contract to supply a certain chemical to a French company, and a German company has contracted to supply the same chemical to a Mexican company, under the swap, the American company would supply the Mexican company while the German company would supply the French company.

⁹ The term "Western company" is used generically in this article to refer to the party (whether or not from the U.S. or a Western country) which is the seller in the primary transaction and the purchaser in the countertrade transaction. The "second party" refers to the foreign trading partner of the Western company, which may be a Foreign Trade Organization

make reciprocal purchases of generally non-resultant products, *i.e.*, products not derived from the products transferred to the second party in the original sale. Under counterpurchase, the reciprocal purchase commitment of the Western company, stated in terms of a percentage of the original sale, is most often less than one hundred percent. The duration of the counterpurchase commitment, the period in which the Western company must fulfill its purchase obligation, is relatively short, usually from one to three years. Both parties generally pay cash for the products or services received. An example of a counterpurchase transaction is the sale by McDonnell Douglas to Yugoslavia of jet aircraft in exchange for the purchase of various Yugoslavian products, including canned hams.¹⁰

B. Compensation

Under a compensation (or "buy back" or "industrial compensation") agreement, the Western company sells technology, plant facilities, or equipment to the second party and contracts to make reciprocal purchases of resultant products manufactured from the equipment or technology transferred. Because compensation transactions often involve the transfer of complex technology and the setting up of entire production facilities, the total value of these transactions is usually considerably greater than that of counterpurchase transactions. The duration of compensation transactions is also much greater, usually taking place over at least a five year period, with periods of twenty years or more not uncommon.¹¹ The reciprocal purchase commitment of the Western company over the life of the compensation transaction is often one hundred percent or more of the original contract value. Despite the greater costs and risks of these long-term arrangements, the compensation agreement is the most rapidly growing form of countertrade in terms of dollar value.

Compensation agreements have been entered into between a diverse combination of international parties. An American company and Rumania agreed that the American company would sell Rumania equipment and technical help to build a tire plant, and would purchase a certain number of tires manufactured in the plant;¹² a British company and Hungary entered into an agreement whereby the British company sold machinery and yarn for a knitwear factory to Hungary and agreed to purchase knitwear garments manufactured from the exported technology;¹³ in a contract between a Japanese company and the Soviet Union,

("FTO"), the commercial entities of Eastern European nations and the Soviet Union engaged in foreign trade activities, a Foreign Trade Corporation ("FTC") performing a similar role in China, or the equivalent bodies organized in other countries. These FTO's are generally granted exclusive authority to handle transactions, both import and export, for a specified area of products or services.

¹⁰ See N.Y. Times, July 26, 1981, at F15, col. 1.

¹¹ See COUNTERTRADE PRACTICES, *supra* note 2, at 8.

¹² *Inside Romania: Eastern Europe's Pacesetter*, BUS. WK., Dec. 1, 1973, at 41.

¹³ COUNTERTRADE PRACTICES, *supra* note 2, at 84.

the Japanese company sold four ammonia plants to the Soviet Union and agreed to purchase back manufactured ammonia.¹⁴ Undoubtedly the most publicized countertrade agreement in history is the compensation agreement entered into between several European nations and the Soviet Union, whereby the Europeans are to furnish capital, technology and equipment to the Soviet Union for the construction of the transcontinental pipeline between Siberia and Western Europe, in return for commitments from the U.S.S.R. to sell the European nations natural gas from the pipeline.

Many Western companies find compensation arrangements valuable not only to facilitate major sales of equipment and plant facilities, but also to guarantee long-term supplies of raw materials or manufactured goods. An additional, though less frequently admitted, advantage of these arrangements is that they may allow Western companies to manufacture products in countries where workers receive lower wages than workers in the Western company's own country.

C. Barter

Pure barter, the world's most ancient form of commerce, consists of the direct exchange of goods or services having offsetting values, without any cash changing hands. Barter transactions take place over a short period of time, with the offsetting deliveries often made simultaneously. More complicated variations of barter exist, some involving more than two parties, other utilizing currency to offset variations in product value. Such variations may take place over a longer period of time than pure barter transactions.

Pure barter transactions are rarely entered into by Western companies,¹⁵ primarily because of the difficulty of achieving, in the terminology of economists, the "double coincidence of wants" necessary for barter to function.¹⁶ Barter agreements occur more frequently between Communist and developing countries.¹⁷ Nevertheless, examples of barter transactions entered into with Western countries do exist. For instance, the exchange between the Volkswagen Company of West Germany and the government of East Germany of 10,000 Volkswagen automobiles for various East German products.¹⁸

¹⁴ *Id.* at 93.

¹⁵ Domestic barter transactions between U.S. companies are more common and are increasing in frequency. See, e.g., Grusen, *Corporate Barter on the Upswing*, N.Y. Times, Feb. 20, 1983, at F4, col. 3.

¹⁶ See Starr, *The Structure of Exchange in Barter and Monetary Economics*, 86 Q.J. ECON. 290, 302 (1972).

¹⁷ COUNTERTRADE PRACTICES, *supra* note 2, at 11.

¹⁸ *VW to Exchange Rabbits for East German Goods*, Wall St. J., Dec. 1, 1977, at 30, col. 6.

II. Negotiation of a Countertrade Contract

A. *The Initial Contact*

If a Western company's product or technical capabilities are unique or especially valuable to a country, that country may make the initial contact. More commonly, however, the Western company will have to make the initial contact with a potential trading partner to obtain an invitation to negotiate about future exports.

The Western company may begin by sending a mailing to the relevant Foreign Trade Organization (FTO) of the targeted country, describing the company's products and capabilities. Although materials may be submitted in English they might receive wider dissemination and expedited consideration if submitted in the country's native language. For a more personal initial contact, discussions with the commercial attache of the country's embassy or with commercial representatives of the country can be a good first step. Alternatively, the Western company can exhibit at an Export Trade Fair sponsored by the targeted country, or at similar shows sponsored by the United States and other Western countries.

B. *Preparation for Negotiations*

The great majority of negotiations entered into by Western companies involving a potential countertrade commitment end without reaching an agreement. In many instances this result is unavoidable and in the Western company's best interest, since the countertrade demand may have been inflexible and so onerous that the entire transaction between the parties would have been unprofitable. In other instances, however, the failure to reach agreement occurs because the Western company entered into negotiations unprepared for the second party's countertrade demand.

It is therefore critical that, well before beginning negotiations which potentially involve countertrade, the Western company have a clear idea as to the position it will take if a countertrade demand is made. Initially, this involves an examination of the factors that will make up the company's own bargaining position; for instance, determining how large a percentage of the primary sale it can afford to take in countertrade and what kind of products will be acceptable, *i.e.*, only goods that can be utilized internally, only goods that can be marketed by the company, or a broader range of products that may necessitate utilizing a third party trading house.¹⁹

¹⁹ Trading houses perform four basic functions: marketing, including representation; transportation, including warehousing and insurance; finance, including investment management and credit extension; and manufacturing, particularly the upgrading of commodities. *See* COUNTERTRADE PRACTICES, *supra* note 2, at 58. U.S. and European trading houses may specialize in only one of these trade areas, though Japanese trading houses generally perform all four functions. *Id.*

The Western company should also attempt, as far as practicable, to predict what the second party's trading position will be. Sources of information for research by the Western company include the Department of Commerce, United States commercial attaches abroad, foreign chambers of commerce, foreign commercial attaches in the United States, other United States or Western companies engaged in countertrade, and published information.

Knowledge of the second party's past history of negotiations with other Western companies will obviously be of particular interest. Equally important is knowledge about how trading organizations are organized in the country and what the country's current and future import demands may be. For instance, in dealing with a country with a centrally planned economy, examination of the country's five-year plan may provide information concerning the priority it places on the product intended for export. Sales of imports necessary for fulfillment of a five-year plan may be obtainable with no countertrade commitment. Certain low priority consumer goods not included in the plan, on the other hand, may require a one hundred percent commitment. Most imports are likely to fall somewhere in between low and high priority and an intermediate countertrade commitment can probably be negotiated.

C. The Necessity of Separate Contracts

With the exception of pure barter transactions, where products are generally exchanged under a single contract, most countertrade transactions should consist of two separate purchase agreements and a third agreement, the protocol, linking the two together. Separate contracts make it easier to obtain financing from a bank for the primary sale, as well as export guarantees from institutions such as the United States Export-Import Bank (Eximbank), since the agreement is unencumbered by the conditions and requirements of the countertrade side of the transaction. Most important, separate agreements allow the obligations of the two transactions to be insulated from each other. For example, if problems arise with the countertrade obligation and the countertrade goods are not received or accepted, the second party might attempt to withhold payment for goods already received under the primary contract if the two obligations are not clearly distinct and separate.²⁰

D. Simultaneous Negotiation of the Separate Contracts

Although care must be taken to ensure that the two agreements are separate, it is equally important that both be negotiated simultaneously. A common tale told by Western businesspeople who are unfamiliar with countertrade is that after all of the terms of their company's sale were

²⁰ The steps that should be taken to ensure that the two agreements are not deemed to merge into a single instrument are discussed *infra* at notes 24-25 and accompanying text.

thought to be agreed upon, the negotiators for the second party suddenly raised a countertrade demand for the first time. Because the price for the Western company's products must allow for costs that might be incurred in disposing of countertrade goods, the Western company should defer any final price quote until agreement has been reached on all terms of the sale. It is also advisable to seek early assurances from the negotiators for the second party that a countertrade demand will not be made for the transaction or, if it is to be made, to determine early in the negotiations what the expected countertrade commitment will be.

E. The Countertrade Commitment

1. Compensation Ratio

The compensation ratio, the percentage of the value of the Western company's sale to be made the subject of countertrade, is generally open to negotiation. Negotiators from CMEA countries, for instance, often demand a commitment of anywhere from seventy to one hundred percent, or more, but will ultimately settle on much less — say, ten to thirty percent. The range of possible compromise depends on the nature of the products to be imported, *i.e.*, consumer goods as opposed to items integral to a five-year plan, and unique goods as opposed to those easily available from other sources. The willingness to negotiate is likely to vary considerably from country to country.²¹ One word of caution — not only is countertrade being demanded more often, but the percentage of countertrade demanded in each transaction also appears to be increasing.²²

2. Range of Countertrade Products

Just as the compensation ratio is generally open to negotiation, so too are the products offered in countertrade. The Western company obviously wants to choose from as wide a range of products as possible. The negotiators for the second party often submit a list of products available for countertrade. Caution is advisable, however, because these lists

²¹ Countertrade is increasingly being mandated by government legislation. The Commerce Department estimates that seventeen countries now require a countertrade commitment as part of any trade agreement with the country. See *Barter Accounts for Growing Portion of World Trade Despite its Inefficiency*, Wall St. J., Aug. 15, 1983, at 21, col. 5. For instance, Indonesia requires 100% countertrade for all government procurement contracts of over \$750,000. See *Administration Opposes Forced Barter, Countertrade But Not Voluntary Deals*, *supra* note 7, at 58. Other nations with countertrade requirements include Argentina, South Korea, Mexico, Algeria, Iran, Libya, Nigeria, and Romania. The existence of such legislation does not, however, foreclose negotiation over the country's countertrade demand. For instance, Romanian FTO's often demand 100% countertrade commitments. Even in Romania, however, considerable room for negotiation exists, with compensation ratios of 30-50% often obtainable. See generally COUNTERTRADE PRACTICES, *supra* note 2, at 43-44.

²² The Western company may ultimately not have to accept the full percentage of products set forth in the contract, however, because of the inability of many countries to honor their delivery commitments.

are commonly outdated, and many of the listed items may ultimately be unavailable or available only for pure hard currency sales.

A Western company dealing with an FTO may sometimes expand the range of products available for countertrade by negotiating a "linkage" with other FTO's in the country. This allows the Western company to fulfill its countertrade obligation by purchasing products produced by other FTO's, or at least other FTO's controlled by the same industrial ministry. Generally, however, the FTO with which the Western company is negotiating will demand that at least a portion of the countertrade purchases be made from its own products.

Knowledge of the kinds of products available for countertrade is crucial in determining the costs that must be added to the price of the primary contract in order to make the entire transaction profitable. Goods that can be used internally by the company may involve little or no additional costs. On the other hand, the cost of products which must be marketed can vary substantially. For instance, the marketing of raw materials or commodities, which can be done through established channels at standardized prices, will be cheaper than the marketing of consumer goods or other manufactured products, many of which may be of inferior quality and obsolete design.²³ As might be expected, however, raw materials or commodities will generally be sold by the second party on hard currency markets and will be available for countertrade only if the Western company's imports are of high priority to the second party.

3. The Penalty Option

Most countries engaging in countertrade transactions insist upon a prescribed penalty fee — usually ten to twenty percent of the countertrade value — which is imposed on the Western company if its countertrade obligation is either delayed or not fulfilled. One option open to a Western company which does not want to deal with the countertrade products is to avoid its countertrade obligation and absorb this penalty. Considerable caution is advisable with this approach, however, because there is a risk of alienating the country, particularly if the countertrade commitment is being used to fulfill an export quota.

III. Drafting a Countertrade Contract

A. Counterpurchase and Compensation Agreements

1. Separate Contracts

The importance of keeping the two sides of a counterpurchase or compensation transaction separate has already been noted.²⁴ When

²³ If trading houses are used, they will generally charge a "discount" of 5% or less to dispose of raw materials and other commodities, while charging a discount of as much as 30-40% for products which are more difficult to market.

²⁴ See *supra* note 20 and accompanying text.

drafting the two agreements care must be taken to avoid provisions which would cause the two contracts to merge into a single instrument. Therefore, it is critical that no reference be made in the primary sales contract to either the countertrade contract or the Western company's obligations thereunder.²⁵ The linkage between the two agreements should be created by the protocol, which states that the parties are entering into two separate sales agreements simultaneously. Any other references to the relationship of the two agreements should be included only in the countertrade contract, and even those references must be carefully worded to avoid a merger.

Although it is important to keep the two agreements separate, in at least one respect a certain amount of linkage between the agreements is in the Western company's best interest. For instance, if the primary agreement is cancelled because the Western company's performance is prevented by force majeure, or because the second party breaches its obligations, the Western company will want to ensure that it will not be obligated to fulfill its countertrade obligation. This can be accomplished by a statement in the protocol that the cancellation of the primary contract will cause the countertrade contract to be cancelled. It is probably advisable, however, to also include a clause in the countertrade contract providing that the agreement is void or voidable by the Western company in the event that the primary agreement is cancelled. If agreement cannot be reached on such a clause, the same result can be achieved by describing the amount of the company's countertrade obligation in the countertrade contract as a percentage of the value of the primary sale. Thus, if the primary sale is not made, there will be no countertrade obligation under the percentage formula.

2. *The Primary Agreement*

The primary agreement is a standard international agreement for the sale of goods or services. It describes the products to be purchased, purchase price, terms of payment, time and place of delivery, shipping terms, quantity of goods, quality control, inspection rights, insurance, currency to be used, security for deferred purchase price if any, force majeure, choice of law, and arbitration procedures.

Under a compensation agreement, the Western company is transferring equipment or technology to the second party and, thus, creating a potential competitor. It is, therefore, critical that provisions be included in the primary sales contract which will protect the Western company's competitive position. Specific limitations should be placed on the use and transfer of the technology by the second party, the markets in which the second party may distribute products manufactured from the tech-

²⁵ This article refers to the agreement for the sale by the Western company as the "primary contract" and the agreement for the sale by the second party to the Western company as the "countertrade contract."

nology, and what, if any, use of the Western company's brand name the second party will be allowed in distributing the products. The latter provision is necessary to ensure that the reputation of the Western party's product is not damaged by the sale of any inferior products under the Western company's name.²⁶

3. *The Countertrade Agreement*

Like the primary agreement, the countertrade agreement is an independent international agreement for the sale of goods, but it typically contains special provisions reflecting the "involuntary" nature of the transaction. The drafting of these clauses usually requires extensive negotiations, since the interests of the two parties often sharply conflict. The second party, particularly if it is a CMEA country, will frequently present the Western company with a standardized "frame contract" which the second party will want to adhere to. Likewise, the Western company will want to utilize a contract that it has drafted and with which it is familiar. Generally, changes in the second party's frame contract can be negotiated. To ensure the second party's cooperation, however, it is advisable to propose contractual provisions which are familiar to the second party and which have been in previous contracts between the country and Western companies.

(a) *Preambular Clause*

As already discussed, the preambular clause of the countertrade contract can be used in lieu of, or in addition to, the protocol to tie the primary and countertrade transactions together.

(b) *Cancellation Clause*

The countertrade agreement, for the reasons noted, should contain a provision that it is void or voidable by the Western company in the event the primary agreement is cancelled.

(c) *Time Period*

The countertrade contract should specify the time period in which the Western company is required to fulfill its countertrade obligation. A time period of one to three years is common, although negotiators for the

²⁶ It may be advisable for the Western company to register any patents applicable to the technology being transferred in the second party's country. Over 75 nations, including the United States, the Soviet Union, all of the Eastern European countries (with the exception of Albania), Mexico, Argentina, Nigeria, South Korea, Algeria, Libya and Indonesia, are parties to the Paris Convention for the Protection of Industrial Property, July 14, 1967, 21 U.S.T. 1583, T.I.A.S. No. 6923, 192 L.N.T.S. 4459, under which materials of signatory countries are entitled to the same treatment under another signatory's laws as is extended by the country to its own citizens. Many countries, for instance, Czechoslovakia, Yugoslavia, Hungary, Romania and Indonesia, also have trademark laws which permit (some require) registration by foreigners licensing their trademarks for use in the country.

second party will frequently attempt to obtain a much shorter period, say six months to a year. It is obviously advantageous to provide for as long a period as possible. If periodic purchases are to be made during the contract term, the agreement should provide that the Western company will receive a credit for any purchases made ahead of schedule.

(d) Description of the Countertrade Products and Linkage

The countertrade contract should contain a clause with a list of products from which purchases can be made. In situations where there is linkage and purchases are permitted from other FTO's in the country, the other trade organizations from which purchases can be made should be identified.

(e) Quantity of Countertrade Products

The quantity of products to be purchased by the Western party is commonly described in terms of the value of goods to be purchased — the compensation ratio. Another formula that may be preferable to a Western company, particularly in compensation agreements, measures the quantity of countertrade products to be purchased in terms of a percentage of the total output actually produced by the second party. Of course, if the products to be purchased by the Western company are known in advance, the purchase obligation can be designated in exact numerical terms.

(f) Price of the Countertrade Products

If the countertrade involves a sale of specified goods, an exact price can be set in the contract. More commonly, however, the products to be purchased are not determined at the time of contracting, and a pricing formula rather than a set price will be included in the contract. Similarly, where designated goods are to be purchased over a long period, as in most compensation deals, periodic review of the value of the product will generally be necessary, and a pricing formula will also be used. A common formula is "the acceptable international price at the time of purchase" (or a specified percentage below or above that price), which can be defined as the price paid to the second party by other Western buyers for the product or, if the second party does not market the product to other Western buyers, as the price of similar goods sold to Western buyers by other foreign suppliers under competitive conditions of delivery and payment. If the transaction involves raw materials or commodities to be purchased in the future, the pricing formula can be indexed to the price of the materials on a recognized exchange. Whether a fixed price or a pricing formula is utilized, the Western company should seek a "most-favored customer" provision, guaranteeing that the same or similar products will not be sold by the second party to other customers at a lower price.

4. *Quality Control and Contingencies for Breach*

Countertrade products are often of inferior quality and in low demand; if they were not, they probably would not have to be countertraded. Therefore, special care should be taken to specify quality standards for the products in the countertrade contract. If the particular products to be purchased are known in advance, detailed specifications should be included in the contract, with product samples provided if possible. If, as is typical, the specific products to be purchased are unknown at the time of contracting, the contract should state that the products must be of "export quality" or "export standard." Because these terms are susceptible to varying interpretations, a provision should be included in the contract giving the Western company the right to inspect the products before delivery. If the second party does not agree to inspection by the Western company at the manufacturing site,²⁷ the contract should designate a neutral inspector, selected by both parties, to inspect the products and make binding determinations as to their conformity with the contractual quality standards.

The contract should enumerate specific contingencies to deal with products that do not conform to quality specifications. For instance, a clause can be included stating that nonconforming products may be rejected by the Western company, with its countertrade obligation being reduced correspondingly. Alternatively, a penalty provision can be included imposing penalties on the second party for quality deficiencies. If agreement cannot be reached on these provisions, the contract should, at the very least, provide that the Western company may return all nonconforming products to the second party for repair or replacement at the second party's expense.

5. *Delivery Schedule*

Because frequent and often substantial delay in delivery is one of the greatest difficulties Western companies encounter when entering into countertrade transactions, a provision containing a delivery schedule should be carefully drafted to require delivery by a specified date, or, where the Western company will be making periodic purchases, within a specified time after each order is received. The most desirable contingency clause provides that the second party's failure to deliver goods within a specified period after the contractual deadline constitutes a material breach of the entire countertrade contract, giving the Western company the option of an unconditional release from its entire counter-

²⁷ Many nonmarket countries, the Soviet Union for instance, are unwilling to allow on-site inspections by Westerners. The unwillingness of the Soviet Union to allow such inspections apparently prompted one American company, Bendix Corporation, to terminate negotiations over a potential countertrade arrangement. See Weigand, *Apricots for Ammonia: Barter, Clearing, Switching and Compensation in International Business*, 22 CAL. MGMT. REV. 33, 39 (1980).

trade obligation.²⁸ If such a provision cannot be obtained, the contract should provide that in the event ordered goods are unavailable or delivery is delayed, the Western company's countertrade obligation will be reduced correspondingly or, at the very least, that financial penalties will be assessed against the second party for any delays.

6. *Penalty Clause*

The second party will almost certainly insist on a provision in the countertrade contract penalizing the Western party for failure to fulfill its countertrade obligations.²⁹ The penalty will usually be ten to twenty percent of the value of the countertrade obligation, or of the unfulfilled portion of the obligation.³⁰ The Western company should agree to a penalty clause only if the clause specifies that payment of the penalty will release the Western company from all future countertrade obligations and from any and all claims by the second party arising from the countertrade contract. A clause providing that payment of the penalty by the Western party will not affect the obligations of the parties arising under the primary contract should also be included.

7. *Marketing Restrictions*

Unwary companies involved in countertrade commonly complain that when they attempt to market their countertrade products, they discover that the second party has granted exclusive distributorship rights to a third party for the area in which the company had planned to sell the goods. To prevent such occurrences, the contract should provide either that the Western company may market the countertrade products free of any restrictions, or that the company has exclusive distributorship rights in certain specified markets.³¹

8. *Transferability of Countertrade Obligations*

The Western company should have the option of transferring its

²⁸ Such a provision would be in conformity with Article 51 of the Convention on Contracts for the International Sale of Goods, U.N. Doc. A/Conf. 97/18 (1980), reprinted in 19 INT'L LEGAL MATERIALS 668-99 (1980). The Convention has been signed (though not formally ratified) by twenty nations including the United States, East Germany, Czechoslovakia, Hungary, China, Poland, and Yugoslavia.

²⁹ Although the problem does not arise in civil law systems, common law jurisdictions continue to show hostility toward penalty clauses. See generally 5 WILLISTON ON CONTRACTS § 776 (3d ed. 1961). In order to ensure that such a clause is not invalidated, leaving the Western company open to a claim for actual damages, it is advisable that the clause be categorized as a liquidated damages rather than a penalty provision.

³⁰ Although it can be avoided in some instances, the Western company is generally required to obtain a bank guarantee for the penalty clause. Such a guarantee should provide that it will be proportionately reduced as countertrade purchases are made by the Western party.

³¹ An exclusive distributorship provision should be reviewed for potential antitrust problems. For a discussion of the impact of the antitrust laws on countertrade, see Allison, *The Antitrust Implications of Barter*, 58 CHI.-KENT L. REV. 89 (1981); cf. Schwartz, *American Antitrust Laws and Trading with State Controlled Economies*, 25 ANTITRUST BULL. 513 (1980).

countertrade obligation to a trading house or other third party if it cannot utilize the products internally or market them itself. A clause should be included allowing assignment of the Western company's interest in the countertrade agreement to another party who is preferably undesignated. If the second party refuses to allow assignment without its permission, a clause should be included stating that such permission will not be unreasonably withheld.

9. *Force Majeure*

The events that will constitute force majeure permitting suspension or termination of performance under the contract should be specified in detail.³² There is always the risk in countertrade transactions that antidumping or countervailing duties may be imposed, making acceptance of the countertrade goods impossible or unduly expensive. It is therefore desirable to specify that the imposition of such sanctions will constitute an event of force majeure.³³

10. *Dispute Settlement*

(a) *Arbitration Clause*

Both the primary and countertrade contracts should provide for binding arbitration between the parties to resolve all legal disputes that may arise under the contracts. Utilization of arbitration is generally the only practical method of resolving disputes, since neither party is likely to agree to having such disputes adjudicated before the courts of the other. An agreement to arbitrate by the second party is also beneficial because it will likely act as a waiver of the country's sovereign immunity.³⁴ An arbitrating body — such as the International Chamber of Commerce (ICC) in Paris or the Chamber of Commerce in Stockholm or Geneva — can be specified, or the contract may provide that the arbitration will be conducted in the home country of the party complained against, or in a neutral country,³⁵ with each party to select one arbitrator and the third arbitrator to be selected by the other arbitrators. A set of arbitration rules — commonly the ICC or UNCITRAL Rules — should be specified. It may also be useful to specify the language or languages in which the arbitration is to be conducted.

³² If the second party is a communist country, the term "acts of God" will be unacceptable, although "acts of nature" can probably be used as a substitute. See McVey, *Countertrade and Barter: Alternative Trade Financing by Third World Nations*, 6 INT'L TRADE L.J. 197, 212 (1981). Alternatively, the events that would normally be included under "acts of God" can be separately listed.

³³ See Potter, *East-West Countertrade: Economic Injury and Dependence Under U.S. Trade Law*, 13 L. & POL'Y INT'L BUS. 413 (1981).

³⁴ See Kahale, *Arbitration and Choice-of-Law Clauses as Waivers of Jurisdictional Immunity*, 14 J. INT'L L. & POL. 29 (1981).

³⁵ The Western company should seek as the site for arbitration a country which is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, dated June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3.

(b) *Choice-of-Law*

The governing law of the contract should be specified. Often it is that of the arbitration site. For instance, contracts with the Soviet Union frequently designate Stockholm as the arbitration site and call for the application of Swedish substantive law. The impact of the law of the chosen jurisdiction on matters not specifically provided for in the contract should be carefully considered before choosing the applicable law and deciding what matters to leave unanswered in the contract.

B. Barter Transactions

In a pure barter transaction the two parties simultaneously exchange products (presumably of equal value) with no hard currency changing hands. Because barter transactions are generally reflected in a single instrument, a Western company will not have to be concerned with the drafting of separate contracts or with the steps necessary to prevent their merger. Equally difficult drafting problems of a different sort are presented, however, since a single instrument must cover deliveries and counter-deliveries.

1. *Preambular Clause*

The preambular clause should provide that the two parties are entering into a two-way exchange of products, and that the two deliveries are each in consideration of the other.

2. *Quality Control and Delivery Provisions*

Careful attention to the drafting of the quality control and delivery provisions is necessary. Because the delivery of two sets of products must be dealt with, the identification of the goods to be exchanged, the specification of quality standards, delivery schedules, and the right of inspection all become doubly important.

3. *Contingency Clauses*

In addition to the ordinary contingency clauses included in counter-trade transactions, it is advisable to provide that in the event of a full or partial default by one party, the other party has the option of receiving a specified payment in currency in lieu of receiving later delivery of conforming goods.

4. *Bank Guarantees*

Because there are usually no funds transferred in a barter deal, a standard letter of credit cannot be used to provide security. The barter agreement should provide for parallel bank guarantees in the form of standby letters of credit, whereby the non-defaulting party may obtain

payment in hard currency from the other party's bank in the event of default.

IV. Conclusion

Given worldwide shortages of convertible currency and demands to reduce trade deficits, the pressure on American and other Western companies to engage in countertrade transactions is rapidly increasing. The purpose of this article is not to suggest that all companies should engage in countertrade. The complexity and risk of these trade practices are substantial and should not be underestimated. Rather, this article suggests ways to minimize these risks so that a company which has decided to enter into a countertrade transaction can do so without undue burden and, with good fortune, even make a profit.

