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EXPORTING—AN OVERVIEW

The Pitfalls of Making International Contracts

by E. Allan Farnsworth*

The subject of this discussion is the "Pitfalls of Making International Contracts." As the only academic on the program, I have been sitting here uneasily considering the pitfalls of speaking on this subject to an audience filled with practitioners. One might suspect that my talk was scheduled first so that the remaining speakers would have the entire day to correct my mistakes.

Since the subject is drafting, I plan to talk about the writing that you are going to draft: the importance of putting the agreement in writing; the type of writing; the ways to ensure the integrity of the writing and the possibilities of being bound without a writing.

Of course, you would put your agreement in writing. A wise man once said, "An oral contract is not worth the paper it is written on."¹ He could have added that an oral contract is worth even less in an international transaction because of the greater likelihood of initial misunderstanding and subsequent trouble. If possible, your writing should be in the English language. It is a sophisticated, developed language replete with technical terms. It is widely understood by others, including the foreign judges and arbitrators who may hear disputes. Finally, it is your language.

If you use a language other than English in an important matter, you should probably seek expert advice from someone who practices in that particular legal system. Some time ago, I was consulted by a foreign client in regard to a major dispute arising out of the interpretation of several agreements covering dozens of papers, all in English. The agreements had been drafted by a New York lawyer and were expressly governed by New York law. Before my client's signing, none of the agreements had been reviewed by other than a foreign lawyer. The risks

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¹ Samuel Goldwyn, *reprinted in* J. BARTLETT, *FAMILIAR QUOTATIONS* 967 (1968).

are clear. If the contract is translated into several languages, state, if possible, that the English version controls.

The second key question is what sort of a writing do you want? Try to draft the agreement as a simple document signed by both or all parties. An agreement embodied in an exchange of letters raises the spectre of the "mirror image rule"² under which there is no contract unless the acceptance is the image of the offer. Although Section 2-207 of the Uniform Commercial Code³ considerably softens this rule, the rule exists in its most virulent form in most parts of the world—civil as well as common law. (An interesting exception is the German Democratic Republic, which has a recently enacted code with a provision based on Section 2-207.) If you are contracting by correspondence and utilizing a standard form printed contract, consider one of two traditional devices for ensuring a deal on your own terms: (1) a provision saying that the other party's acceptance must be by its signature on your form; or (2) a "home office approval" clause saying that there is no contract until your form, signed by the other party, is approved by your home office.

Be careful of the length of what you draft. For reasons that are not entirely clear, lawyers from civil law systems tend to draft shorter contracts than we do. This may be explained by several reasons. Civil lawyers may have been spared the uncertainty and paranoia engendered by the Socratic method in law school, or they may lack the resources of the large American law firm with its files of boilerplate. Additionally, the bureaucrats in our great multinationals like to have every detail in their

² In the words of one court, "It is uniformly held that to consummate a valid contract an acceptance must be unconditional and must not change, add to, or qualify the terms of the offer." *Burkhead v. Farlow*, 266 N.C. 595, 598, 146 S.E.2d 802, 804 (1966); *see also* RESTATEMENT OF CONTRACTS § 60 (1932); Llewellyn, *On Our Case Law of Contract: Offer and Acceptance I*, 48 YALE L.J. 1, 30 (1958).

³ (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of the Act.

U.C.C. § 2-207. *See also* N.C. GEN. STAT. § 25-2-207 (1965). Section 1-105 of the U.C.C. provides which transactions the Code governs:

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

files. Finally, the civilians say that they repose great confidence in their codes in filling gaps in the agreement. It is suggested that the Russians, who also draft long agreements, are paranoid, well-organized bureaucrats. The Italians, however, are not and a foreign lawyer I know tells how he lost a deal for an American client who insisted on such a long and detailed agreement that the Italian party felt that his good faith was impugned and backed out.

Recitals seem to cause particular amazement among civilians, who wonder whether such detail is necessary. Recitals are not unknown elsewhere, however, as shown by the following opening phrase of a somewhat dated Chinese-Japanese standard form: "desirous of promoting friendly relations between the peoples of China and Japan, in keeping with the . . . trading principles set forth by Premier Chou En-Lai and through friendly negotiations. . ."⁴ Nevertheless, avoid unnecessary recitals.

Now that you have a writing, how can you preserve its integrity against, for example, the claim that prior negotiations contain additional terms? The answer, of course, is a merger clause,⁵ involving the parol evidence rule codified in Section 2-202 of the Uniform Commercial Code.⁶ Here is an example from a large American exporter: "These Standard Conditions of Sale together with any applicable written Proposal of Seller supersede all prior discussions and writings and constitute the entire and only agreement between Buyer and Seller with respect to the terms and conditions governing any order." Are such clauses honored in other legal systems? Here is a foreign example: "After the Contract has been signed all the preceding negotiations and correspondence pertaining to it become null and void." This example is from the standard form of the USSR foreign trade organization that buys from the American exporter whose clause I previously read. Each party wants to preserve the integrity of the writing—its writing—so that what it has in its files is the whole contract.

Several years ago, I looked for similar merger clauses in French do-

⁴ Hsiao, *Communist China's Foreign Trade Contracts and Means of Settling Disputes*, 22 VAND. L. REV. 503, 521 (1969).

⁵ See RESTATEMENT (SECOND) OF CONTRACTS § 242 (Tent. Draft, 1969); Murray, *The Parol Evidence Process and Standardized Agreements Under the Restatement (Second) of Contracts*, 123 U. PA. L. REV. 1342 (1975).

⁶ Terms with respect to which confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

- (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
- (b) by evidence of consistent additional terms unless the court finds the writing to have been intended as a complete and exclusive statement of the terms of the agreement.

U.C.C. § 2-202. See also N.C. GEN. STAT. § 25-2-202 (1965).

mestic contracts and found none. In discussions with distinguished French legal scholars it was suggested both that merger clauses were unnecessary under French law and that they were ineffective under French law. Finally, a young law professor explained that neither was the case. The French put merger clauses in international contracts. International practitioners had learned this from the Americans (and perhaps also from the Russians).

In addition to the risk of an attack on the writing based on prior negotiations, there is the risk of an attack based on subsequent oral modification, as in the case of an employee installing or servicing goods sold. There is, you may recall, a conflict in American case law as to whether, in the colorful prose of one judge, "the hand that pens a writing may . . . gag the mouths of the assenting parties."⁷ Section 2-209 of the Uniform Commercial Code⁸ authorizes a clause prohibiting oral modification. Here is one from the same American exporter: "No waiver or modification of these Conditions shall be binding upon Seller unless made in writing and signed by a duly authorized representative of seller." Will this clause work in other countries? An answer in the affirmative for the USSR is suggested by this clause from the same state trading organization: "All amendments and addenda to the present Contract are valid only when made in writing and signed by the Contracting Parties." Lingerin doubts as to whether such a clause will work in other legal systems can be allayed, at least in part, by trying to arrive at the same result by a different route: providing that no one outside of the home office has the authority to bind the company and then only in writing.

Finally, as to a writing, can you be bound even before you put it in writing? A moment's thought about the Statute of Frauds⁹ might sug-

⁷ J. Musmanno in *Wagner v. Graziano Constr. Co.*, 390 Pa. 445, 448, 136 A.2d 82, 84 (1957); see also 17 AM. JUR. 2d *Contracts* § 466. But see *Lamberton v. Connecticut Fire Ins. Co.*, 39 Minn. 129, 39 N.W. 76 (1888).

⁸ (1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this Article (section 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

U.C.C. § 2-209. See also N.C. GEN. STAT. § 25-2-209 (1965).

⁹ "[T]he theory of statutes of frauds, past and present, is that they are means to the end of preventing successful courtroom perjury. The means to this end is simply the requirement of a writing signed by the party to be charged [in order to prove the existence of a contract] . . .

gest that you cannot be so bound. However, in 1954 the British repealed their original Statute as to the sale of goods, and in most civil law countries, no formalities are required between merchants. Therefore, you must be careful of what you agree to orally. A notable exception is Soviet law, which requires a writing signed by representatives whose authority is publicly on file in order to bind its foreign trade organizations.

I turn now to a problem that is especially acute in international transactions: reducing conflict of laws problems. An obvious solution to these problems is a choice of law clause, at least when it specifies the applicable law as that of your own state. Perhaps a word of caution is in order, however. If it is likely that a dispute will end up in a foreign court—as where you are a buyer who must pay under a letter of credit—such a clause has drawbacks. In order to prove the law of North Carolina in a French court, for example, you will need the written opinions of experts. In a common law court, however, the experts must appear in person. Some years ago I was involved as an expert in a controversy between a British seller and an American-owned Swiss buyer, over a contract with a clause choosing New York law. After two days in Geneva with the client and his Swiss lawyers and after the exchange of documents which then had to be translated into French in the court by the opposing experts, the parties decided to ask the court to apply Swiss law. Obviously, it would have been simpler never to have chosen New York law.

The difficulty of asking a foreign forum to apply your law can be solved by choosing your forum as well. Choice of forum clauses¹⁰ are, however, more suspect than choice of law clauses, and not every foreign court will conclude that it is ousted from jurisdiction by such a clause.

An easy answer in this dilemma is an arbitration clause, which can be used to fix both the place where the issues will be tried and the law that is to govern. The American Arbitration Association, with headquarters in New York,¹¹ has facilities for arbitration, as does the International Chamber of Commerce, with headquarters in Paris.¹² The American Arbitration Association is particularly knowledgeable about special problems, such as those in dealings with Latin America or the communist countries.

[T]heorists have defended statutes of frauds on the basis that it is harder for a party to succeed at forgery than at perjury and that writing requirements imposed by law have the salutary effect of encouraging parties to put at least the terms of important deals into writing." J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 2-8 (1972). See, e.g., Perillo, *The Statute of Frauds in the Light of the Functions and Dysfunctions of Form*, 43 *FORD. L. REV.* 39 (1974); Burdick, *A Statute for Promoting Fraud*, 16 *COLUM. L. REV.* 273 (1916).

¹⁰ See generally, Gilbert, *Choice of Forum Clauses in International and Interstate Contracts*, 65 *KY. L.J.* 1 (1976).

¹¹ The address of the American Arbitration Association is: 140 W. 51st St., New York, N.Y. 10020.

¹² The address of the New York Liason Office of the International Chamber of Commerce is: 1212 Ave. of the Americas, New York, N. Y. 10036.

Another way of avoiding conflict of laws problems is to resolve foreseeable questions by express provision in the contract. This, of course, is not entirely consistent with my earlier suggestion that you may have to reduce the length of your contract. The inclusion of such express provisions depends somewhat on the tolerance of your trading partner.

Finally, it is important to mention some representative standard terms. They commonly include price and payment terms (including those dealing with risks of currency fluctuation), delivery terms (such as F.O.B., F.A.S. and C.I.F.), warranty and disclaimer clauses, "force majeure" (impossibility) clauses and liquidated damages or penalty clauses. The provisions one wants, even in a printed standard form, depend very much on the circumstances of the transaction. Are you buyer or seller? Are the goods raw materials, manufactured soft goods or manufactured hard goods? Are there services to be provided after delivery?

Where can you find representative clauses used in international trade? An excellent source is the set of forms prepared by the United Nations Economic Commission for Europe.¹³ These forms were constructed during the 1950s and 1960s in Geneva by representatives of both buyers and sellers from several European countries. There are form contracts for such goods as machinery, lumber and cereals. They are available in three official languages—English, French and Russian—and have been unofficially translated into a number of others. They have the advantage of an aura of fairness when utilized in negotiations between the competing interests of sellers and buyers. The International Trade Law Branch at the United Nations is just now embarking on a project to study representative clauses in international sales contracts and will surely have a report with examples within a few years. Another possible source is the text of the draft Convention on the International Sale of Goods,¹⁴ just approved by the United Nations Commission on International Trade Law. It contains, for example, an implied warranties section similar to Section 2-314 of the Uniform Commercial Code,¹⁵ which

¹³ For a general outline of considerations in the drafting of contracts, see, *Guide on Drawing Up Contracts for Large Industrial Works*, U.N.DOC. ECE/TRADE/117 (1973). The Commission has also published a variety of Conditions and Clauses suitable for specific circumstances. *E.g.*, General Conditions for the Supply of Plant and Machinery for Export, Nos. 188 and 574; General Conditions of Sale for the Import and Export of Durable Consumer Goods and of other Engineering Stock Articles, No. 730.

¹⁴ U.N.DOC. A/CN.9/116, annex I; *See*, 7 COMMISSION ON INTERNATIONAL TRADE LAW YEARBOOK 87 (1976). U.N.DOC. A/CN.9/Ser.A (1976).

¹⁵ (1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

- (a) pass without objection in the trade under the contract description; and
- (b) in the case of fungible goods, are of fair average quality within the description; and

suggests what is generally expected by way of quality in the international arena.

Question and Answer

Question: Where can one obtain a copy of representative clauses used in international sales contracts?

Mr. Farnsworth: A copy of these clauses may be obtained from the International Trade Law Branch, United Nations, New York. After the summer of 1979, the International Trade Law Branch may be in Vienna, so contact them while it is in New York. I might also mention that the International Trade Law Branch is the Secretariat arm that serves the United Nations Commission on International Trade Law, on which I represent the United States. In addition, that is the Commission that has drafted the Convention on the International Sale of Goods (CISG). The CISG is a draft law that will go to a diplomatic conference in 1980 and will very likely be adopted by a good many of the countries with which you may want to be dealing. The CISG is the successor to the Uniform Law on International Sales, a law which is in effect in a small number of significant countries including Italy, West Germany, Netherlands, Belgium and some others. It governs the international sale of goods, so it is conceivable that if you were dealing with a West German firm and a sales question arose, their court would apply the Uniform Law and not West German domestic law. The Uniform Law has the advantages of having some common law elements and an English text.

Question: Should the right to assign an international sales contract be treated differently than in American practice?

Mr. Farnsworth: I confess that I do not know the answer to that. I have dealt with contracts which had elaborate provisions on assignability and non-assignability. However, none of the problems that I have ever confronted have raised questions on domestic law in that respect. Additionally, none of the international laws that I am concerned with have felt it prudent to get into that very difficult question.

Question: Does consideration merit special treatment?

Mr. Farnsworth: I think it best to virtually forget about it. If you are

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- (c) are fit for the ordinary purposes for which such goods are used; and
 - (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
 - (e) are adequately contained, packaged, and labeled as the agreement may require; and
 - (f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

U.C.C. § 2-314. See also N.C. GEN. STAT. § 25-2-314 (1965).

dealing with a contract for the sale of goods and are dealing with other common law countries, you may have a problem with their notions of consideration. For example, we can make a firm offer under the Uniform Commercial Code (UCC) which is an irrevocable offer in writing. I do not believe that is the law of any of the common law countries. If you are dealing with the United Kingdom, Australia or Ghana, I would mistrust such offers insofar as firmness was in issue as a legal matter. However, if you are dealing with the rest of the world, the offer is irrevocable for a reasonable time even though you do not say that the offer is firm. Hence, the firm offer field is one where we have just caught up with most of the world via UCC § 2-205. It is at least as easy to make a firm offer in any other country, other than common law countries, as it is in the United States. Therefore, you do not need to worry about consideration.

As far as the main agreement is concerned, there could hardly fail to be consideration. The only remaining topic is modification. Can you make a modification without consideration? The rule under UCC § 2-209 is basically that you can modify a contract for the sale of goods, so you do not need to worry extensively about consideration. Superficially, I can say that is the general rule in civil law countries. They have no notion of consideration if a fair modification is negotiated. Also, it makes little difference whether the concession is all on one side, unsupported by consideration on the other side. Of course, a fairly negotiated contract presumes that there are changed circumstances to justify all the concessions being on one side.

The only problem is in common law countries, where it seems that the preexisting duty rule does exist in its pristine form and you would have to worry about modification. However, I do not think that the problems with common law countries should be overexaggerated. Despite the similarities over consideration, I think that the civil law countries still present more mysteries to American lawyers. In fact, without wishing to insult the common law countries, except for the repeal of the Statute of Frauds, the law of the common law countries is essentially what an American law student would study in a contracts course if he studied law in about 1910.

Question: What normally constitutes the date and place of making the contract when not otherwise clear?

Mr. Farnsworth: In the absence of a clause, I think that must be raised in the context of choice of law. First, I think that that question suggests the advantage of both parties sitting down and signing the document rather than trying to do it by correspondence. These questions are more or less relevant depending on whether the applicable law has the center of gravity theory or the last act theory. I note that North Carolina has the last act theory. If, as in New York, for example, you have a center of gravity theory and you look at everything including elements of

performance particularly, it does not make much difference where the offer and acceptance took place because they often are not controlling.

My belief is that as far as an American court is concerned, if you were dealing with one of the countries that had the Uniform Law on International Sales, you could choose that as the governing law. If your German trading partner did not want American law and you did not want German law, the Uniform Law might give you a way out that was more satisfactory than not choosing any law. When the Convention on the International Sale of Goods gets through a diplomatic conference and on the track, it would seem to me to be another possibility.

