# CONSTRUCTING AN INTERNATIONAL COMMERCIAL TRANSACTION: A PRIMER

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## I. INTRODUCTION

Ask law students to describe the practice of international law, and they might tell you that it involves issues such as treaties, U.N. Resolutions, and permissible use of military force. Ask practicing lawyers the same question, and they would probably answer that it involves negotiating transactions that cross national borders. These radically different perspectives reflect the gulf between the study and practice of international law; between the theory of public

international law and the in-the-trenches reality of structuring transnational deals.

While it would be wonderful to proclaim that this paper provides the link that bridges this gap, its goals are in fact more modest. Instead of building bridges, the idea is to provide roadmaps and signposts to assist the lawyer in constructing an international sale of goods. The paper addresses topics in the order in which they usually arise in practice. Thus, the paper deals sequentially with issues such as the contract of sale, financing the purchase, shipment and insurance, export and import controls, and other problems that confront those who participate in international trade.

This approach, however, carries with it the danger of becoming hopelessly mired in generalities unless the substantive discussions are married to a specific scenario. For this reason, the topics are presented in the context of a hypothetical transaction involving the movement of specific goods between identified countries. The model scenario is bilateral, in order to simplify the discussion of the underlying principles of international transactions. Although such an approach necessarily entails discussion of matters peculiar to the transaction at hand, the general principles discussed are applicable to a variety of international sales.

## II. Setting the Parameters

### A. *Alternative Approaches to Selling Goods Overseas*

One way to enter a foreign market is to construct a new manufacturing facility there. This is referred to as "direct investment." Direct investment allows a foreign business to place its manufacturing and selling functions at the same location, and to avoid barriers to the entry of goods into the country. Realistically, however, establishing a new plant is a viable option only for manufacturers with significant financial strength and exporting experience.

If risk minimization were the sole consideration, a company might simply designate an employee to travel abroad to sell directly to retail customers. This method is of limited usefulness, however, because of the difficulty and expense involved in ascertaining potentially successful target countries and the marketing methods that would be most effective in those countries. This haphazard approach is likely to result in little more than frustration and a burgeoning frequent-flyer account for the salesman.

Because of these uncertainties, most firms appoint a person or firm to

represent them in the foreign market.[1] There are several different types of representatives. To retain maximum control, the client might simply hire an employee who is a resident of the country in question. By authorizing the local employee to execute contracts on the firm's behalf, however, the firm may inadvertently establish a legal presence in the foreign country sufficient to subject itself to local laws (such as income tax laws). An American firm might also be surprised by the protections that many countries extend to employees, which are often far more extensive than those in the United States.

Instead of hiring an employee, the client might want to consider appointing an intermediary, of which there are two general types: the commercial agent and the distributor. A commercial agent is an independent contractor who solicits customers for the manufacturer. Unless otherwise agreed, the commercial agent does not possess the authority to sign contracts for the manufacturer, but rather obtains orders from customers and places them with the manufacturer. Thus, when working through a commercial agent, there is only one contract involved in each transaction: the contract between the manufacturer and the customer. Commercial agents are usually paid by commission.

A distributor, on the other hand, is an intermediary who purchases the goods from the producer outright and receives compensation by selling the goods at a higher price. As a result, there are two contracts involved in each sale: the contract between the manufacturer and the distributor, and the contract between the distributor and the customer. The "best" method of selling goods abroad will always depend upon the resources, experiences and desires of the company. With a distributor, however, the manufacturer can develop an ongoing relationship with a single debtor and the manufacturer will have to secure at most one letter of credit. Sale through a distributor is appealing to manufacturers because a large portion of the risk of non-payment is shifted from the manufacturer to the distributor, whereas with a commercial agent the risk of each transaction rests squarely on the shoulders of the manufacturer. It is necessary to assess the creditworthiness of each customer in each sale through a commercial agent, or to insist upon a separately negotiated letter of credit.

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1. For an excellent discussion of the law of agents and distributors, *see* T.F. CLAUSEN, INTERNATIONAL AGENCY AND DISTRIBUTOR CONTRACTS (1990), ch. 3. Much of the material in this section was inspired by Clausen's work.

### B. *Some Initial Thoughts on the Practice of Law Internationally*

Structuring international transactions is a process of balancing risks against rewards. Certainly, the element of risk is common to all commercial transactions: risk of non-payment; risk of receiving defective merchandise; etc. When the parties conduct business across national borders, however, the quantity and quality of risks increase exponentially. Risk minimization is therefore peculiarly necessary to maximization of return in international transactions.

The increased risk of international transactions, however, is only one of the challenges facing the manufacturer. If the parties to a transaction are located in different states in the U.S., they will probably not be concerned with differences between the laws of their respective home states. Of course, they would pay attention to the differences, but ultimately the parties' shared legal traditions would provide common ground for mutual understanding. If the parties are located in different countries, on the other hand, neither party can be assured that the other possesses the same core beliefs, or that the laws of their respective countries will be at all similar. Few American attorneys appreciate that the common law as practiced in the U.S. has evolved separately from the common law practiced in other common law countries, and is no longer substantially similar to the legal systems of those countries. The differences between the legal system of the U.S. and those of the civil law countries are even more extreme.[2] Other countries *do not* necessarily do things the same way that we do.

### C. *A Model Scenario*

Tiny Trucks Toys, Inc. (TTT) is a corporation organized under the laws of the State of Delaware, with its principal place of business in Fort Worth, Texas. Since the early 1930's, TTT has manufactured cast iron toy cars and trucks, the diminutive size of which originally gave rise to the company's name. Heretofore, TTT has limited its sales efforts to the United States, but the company now seeks to expand into foreign markets. In large part, this decision is the result of declining demand in the U.S., which has probably been caused by the increasing market share held by electronic toys. TTT has conducted numerous market studies, which have all indicated that Latin America is a

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2. For an interesting, albeit lengthy, comparative analysis of the divergent approaches of civilian and common-law jurisdictions to civil litigation, *see* RUDOLF B. SCHLESINGER, ET AL., COMPARATIVE LAW 339 (1988).

potentially fertile market because of the unprecedented growth in the percentage of the Latin American population between the ages of four and thirteen (TTT's typical customers), and because the lower average wage in Latin America makes expensive electronic toys a luxury for many Latin American families. TTT's initial distributorship in Latin America will serve as a model for similar future arrangements.

TTT believes that Colombia is the best location for its initial Latin American distributorship. In October 1991, the Commercial Section of the American Embassy in Bogota issued a report (entitled "The Country Marketing Plan") that analyzed Colombia's business and economic climate and concluded that toys and games were among the best products for export to Colombia. The report indicated that the toy and game sector has grown rapidly in Colombia, nurtured by the government's liberalization of imports. The U.S. currently maintains a fifty percent share of the import market in the toy sector, and moderate worldwide growth of sales of traditional toys is expected.

TTT is considering selecting Dollar Export/Import, Ltd. (DE), a Colombian corporation with its principal place of business in Cali, Colombia, as its Columbian distributor. DE has distributed children's clothing and games since 1981, and has proved to be a successful operation with a strong reputation for aggressive representation of its foreign suppliers. DE's previous experience suggests that the firm is familiar with the market for toys in Colombia.

## D. Questions, Questions

In considering this scenario, what kinds of risks come to mind? From TTT's point of view, the most obvious risk is non-payment. If the distributor breaches its obligation to pay, there is also the question of whether U.S. courts would have jurisdiction over the defendant in a collection action. Even if U.S. courts could render a judgment, Colombian courts might refuse to enforce the judgment against a local defendant.

But what if the problem is non-performance by DE, not non-payment? How can the distribution agreement be worded to provide an escape clause for TTT? Does Colombian law limit the manufacturer's ability to terminate a distribution contract? Is Colombian law applicable? If so, could the parties select some other law to apply? Is there some "international" law of contracts that could be chosen?

What if the problem is malfeasance by DE, rather than non-performance? For example, what if DE imports cheap imitations of TTT's products and sells them under TTT's label? How can TTT protect its trademark rights abroad?

On a different level, what are the structural barriers that control the export of a product from the U.S and its import into Colombia? What about the logistics of transporting the toys between the two countries? Which party bears the risk of loss while the goods are in transit? Who is responsible for providing insurance? Who pays the freight?

From the standpoint of the Colombian distributor, what remedies will it possess if it is sent non-conforming goods? If the distribution agreement assures DE of exclusivity within Colombia, are there anti-trust implications for this arrangement?

Though a road map punctuated by an endless series of questions may not seem useful, this process of creative inquiry is actually very helpful to those who are new to international business. Only by considering the potential misadventures, mistakes, and misunderstandings is it possible to develop a meaningful approach to structuring the transaction.

## II. CHOICE OF CONTRACT LAW

The starting point for any sale of goods is the development of a written contract that accurately reflects the parties' agreement. In order to begin this process, the parties must first agree on the substantive law that will apply to the transaction. Attorneys experienced in domestic transactions may believe that resolution of this issue will turn more on the relative dominance of the parties to the transaction than on the relative suitability to the transaction of the legal systems of the parties' home countries. Indeed, the relative bargaining power of the parties will be an important factor. However, the range of choices of law is greater in international transactions than in domestic transactions. In addition to the laws of the parties' countries, the parties may also choose to govern their relationship under the Convention on Contracts for the International Sale of Goods (CISG or Convention),[3] which is not associated with the law of any particular country. Prior to examining the CISG, however, a brief digression is in order.

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3. United Nations Convention on Contracts for the International Sale of Goods, U.N. Doc. A/Conf. 97/18 (concluded at Vienna on Apr. 11, 1980) (the Convention entered into force Jan. 1, 1988, in accordance with art. 99(1)), in United Nations Conference on Contracts for the International Sale of Goods: Documents of the Conference and Summary Records of the Plenary Meetings and of the Meetings of the Main Committee, Official Records, U.N. Doc. A/Conf. 97/19, U.N. Sales No. E.81 IV.3 (1981) [hereinafter CISG].

### A. *Party Autonomy*

The degree to which parties are free to choose the terms of their relationship is a recurring issue in international law. Stated differently, the question often arises of whether a court will honor the decisions of parties to international transactions, or whether it will substitute its judgment for that of the parties. There are many choices to make: choice of law; choice of forum; choice of dispute resolution mechanisms; etc.

In the choice-of-law area, U.S. courts generally permit the parties, as autonomous actors, to select the law to be applied to their transactions.[4] If the country whose law is selected has no substantial relationship to the parties or the transaction, however, U.S. courts may refuse to abide by the parties' choice.[5] U.S. courts may also refuse to honor the parties' choice if the result of applying the law of the chosen state would be contrary to fundamental U.S. public policy.[6]

Civil law countries also profess to permit party autonomy. For example, Article 3 of the Convention on the Law Applicable to Contractual Obligations (the Rome Convention), to which many European nations are signatories, provides that "[a] contract shall be governed by the law chosen by the parties."[7] Significantly, the Rome Convention permits the parties to select the law of a country regardless of whether there is a connection between that country and the transaction. There is a proviso, however, that the parties cannot select a law that conflicts with certain "mandatory rules,"[8] which are often quite similar to the "fundamental policies" with which U.S. courts are concerned. In any event, no such mandatory rules are likely to be relevant to a commercial sale of goods.

Both common and civil law countries are also hospitable to choice-of-forum clauses. In the U.S., choice-of-forum clauses were initially deemed to be impermissible attempts to deprive courts of jurisdiction, but as the U.S. Supreme Court held in *Bremen v. Zapata*,[9] expanding world trade necessitates that parties be permitted to make reasonable choices in the selection

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4. *See, e.g.*, U.C.C. § 1-105 (1987).

5. *Id.*

6. *Id.*

7. Convention on the Law Applicable to Contractual Obligations, 1980 O.J. (L 266) 1, art. 3 [hereinafter the Rome Convention].

8. *Id.*

9. 407 U.S. 1 (1972).

of a forum to hear their disputes. Civil law countries (where choice-of-forum clauses are called "prorogation" agreements) have consistently respected the parties' right to select the forum in which their disputes are to be heard.[10] Courts for these countries recognize exceptions to this general rule, however, in the contexts of certain consumer contracts and actions involving questions of status and title to real property.[11]

### *B. Convention on Contracts for the International Sale of Goods*

Returning to the TTT scenario, the parties might choose to govern the transaction under the substantive law of either party's home country. The party whose law is not selected, however, may be troubled by the ramifications of conducting business under unfamiliar laws. TTT and its attorneys, who have been trained in the common law tradition may not be comfortable working under a commercial code such as Colombia's. Problems such as finding a reliable translation of the code, divining its meaning, and determining the authority of the courts to interpret the Code would make even the simplest arguments difficult to present effectively. Similarly, DE and its attorneys might find common law institutions disconcerting.

Instead, it may be more fruitful for both parties if the transaction were governed by the CISG, the first successful supranational code regarding the international sale of goods.

#### 1. Background

The CISG was opened for signature in 1980, after negotiation under the auspices of the United Nations Commission on International Trade Law (UNCITRAL).[12] The Convention became effective in the U.S. on January 1, 1988.[13] As of April 1, 1992, there were 33 other signatory countries.[14]

The CISG is a treaty, so it becomes a source of domestic law that is

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10. SCHLESINGER, *supra* note 2, at 387.

11. *Id.* The law of the European Community concerning choice-of-forum clauses is found in the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 8 I.L.M. 229 (1969). Its approach is essentially consistent with that described above.

12. CISG, *supra* note 3.

13. 52 Fed. Reg. 6262 (1987).

14. Multilateral Treaties deposited with the Secretary General update as of Feb. 12, 1992. U.N. Doc. ST/LEG/SER.E/9 (1992).

nation's courts can apply only if that nation has signed it, and in some countries, only if the national legislature has ratified it. Once ratified, courts in Contracting States are obligated to apply the CISG to transactions within its scope, to the exclusion of other law. The Convention thus has preemptive effect.[15]

The terms of the CISG were the result of political debate and compromise, as are the terms of any treaty. Some commentators believe that the political give-and-take involved in drafting the CISG impacted adversely on the text's consistency and usefulness.[16] Others, however, consider the Treaty to be a fair compromise, worthy of commendation.[17]

The CISG is an attempt to synthesize elements of the common law and civilian traditions. As such, it fulfills at least two useful functions. First, it provides parties from different legal systems with a choice of law that bears some relation to the substantive law with which both parties are familiar. Moreover, the existence of a third choice provides the possibility that neither party will "lose" in negotiations regarding the choice of law, and thereby facilitates compromise and amicable agreement.

### 2. Scope

Article 1 of the CISG provides that its terms will apply to contracts involving the sale of goods between parties whose places of business are in different countries that are both Contracting States, or the rules of private international law lead to the application of the law of a Contracting State.

When each party has a single place of business, application of Article 1 is simple enough. Difficulties arise when the parties have multiple places of business. Article 10 defines a company's "place of business" not as its "principle place of business" (the U.S. approach) or as its "seat" (the civilian approach), but as the country having the closest relationship to the contract and its performance.

Article 95 expressly permits Contracting States to make a reservation to

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15. In the U.S., treaties made "under the Authority of the United States" are the supreme law of the land. U.S. CONST. art IV, cl. 2. *See also* Missouri v. Holland, 252 U.S. 416, 433 (1920).

16. Thomas E. Carbonneau and Marc S. Firestone, *Transnational Law-Making: Assessing the Impact of the Vienna Convention and the Viability of Arbitral Adjudication*, 1 EMORY J. INT'L DISP. RESOL. (1986).

17. Isaak I. Dore, *Choice of Law Under the International Sales Convention: A U.S. Perspective*, 77 AM. J. INT'L LAW 521, 523 (1983).

subparagraph (b) of Article 1. The U.S. has made such a reservation, and subparagraph (b) therefore does not apply to disputes heard in U.S. courts. In countries that did not make this reservation, if a court determines that the law of any Contracting State is controlling, then subparagraph (b) mandates application of the CISG, regardless of the location of the parties' businesses.[18] Article 2 lists transactions that are excluded entirely from the CISG: goods purchased for personal, family or household use; sales made at auction; sales of securities and negotiable instruments; and sales of ships and aircraft.

Article 6 permits the parties to exclude application of the CISG. If the parties' choice-of-law provision states only that the law of a certain country will govern the transaction, however, the courts of that country may interpret the law to include the CISG if the country is a signatory.[19] A contract should therefore specifically exclude the CISG if that effect is desired.[20]

3. Substantive Provisions

Article 6 adopts the philosophy of party autonomy regarding choice-of-law decisions, and permits the parties to derogate from specific provisions of the CISG.[21]

The substantive rules get off to an uneven start in Article 4. While proclaiming that the CISG applies to the formation of the contract (and to the parties' rights and duties), Article 4 indicates that it is inapplicable to questions concerning the validity of the contract.[22] Thus, there is ambiguity in the CISG at the outset, because contract formation and validity are closely related concepts. Examination of the drafting history reveals that the CISG exclusion of contract validity was intended to preserve the competence of the Contracting States with respect to issues such as those relating to regulatory law and the affirmative defenses of fraud, undue influence, mistake, and illegality.[23]

Articles 7 through 9 establish some interpretive rules. Article 7(1) provides that in interpreting the CISG, a court should respect the international

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18. *Id.* at 530.

19. RALPH FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 70 (3d ed. 1991); *See also* CISG, *supra* note 3, art. 6.

20. FOLSOM, *supra* note 19.

21. CISG, *supra* note 3, art. 6.

22. *Id.* art. 4.

23. FOLSOM, *supra* note 19, at 73.

character of the transaction.[24] This directive is strengthened by Article 9(2), which provides that a court should apply all generally accepted usages of international trade of which the parties should have been aware, unless the parties explicitly agree otherwise.[25] One commentator has suggested that this Article is significant because it requires courts to ignore positive law in favor of a sort of customary transnational law merchant.[26]

Article 11, in a striking departure from the legal traditions of many countries, provides that "a contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses."[27] The CISG thus abandons the Statute of Frauds.

Treatment of offer and acceptance under the CISG is similar to the approach taken by the U.S. Uniform Commercial Code (U.C.C.). According to Article 14 of the CISG, an offer must be definite and indicate an intention to be bound.[28] As a general rule, an offeror may revoke its offer at any time prior to acceptance, provided that the revocation reaches the offeree before the offeree has dispatched its acceptance.[29]

The CISG exceptions to the offeror's right to revoke are similar to those contained in the U.C.C. Like the U.C.C. § 2-205 firm offer exception, Article 16(2) of the CISG provides that a statement that an offer is irrevocable or that the offeree has a certain number of days to accept the offer will preclude revocation prior to the time stated in the offer.[30] The applicability of this exception does not depend on whether the offer is in writing.[31] Courts may also treat an offer as irrevocable if the offeree has reasonably relied on it.[32] However, any offer is terminated by the offeree's rejection, regardless of whether the offer is revocable.[33]

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24. CISG, *supra* note 3, art. 7(1).

25. *Id.* art. 9(2).

26. Bernard Audit, *The Vienna Sales Convention and the Lex Mercatoria*, *in* LEX MERCATORIA AND ARBITRATION 139, 143-144 (T. Carbonneau ed., 1990).

27. CISG, *supra* note 3, art. 11.

28. *Id.* art. 14.

29. *Id.* art. 16(1).

30. *Id.* art. 16(2).

31. *Id.*

32. *Id.*

33. *Id.* art. 17.

An acceptance is valid if it indicates the offeree's assent and reaches the offeror within the time prescribed by the offer or within a reasonable time, if no time is prescribed.[34] Generally, if the acceptance modifies the terms of the offer, it is a counter-offer, rather than an acceptance.[35] Additional or differing terms that do not materially alter the offer, however, become a part of the contract unless the offeror objects within a reasonable time.[36] An alteration is "material" for purposes of the CISG if it affects terms relating to price, payment, quality, or quantity.[37]

Consistent with the civil law approach, the CISG does not include consideration as a prerequisite for a valid contract.[38] Even if consideration were an element of validity, however, consideration is rarely lacking in international sales of goods.

Similarly, no consideration is necessary to support a modification of an existing contract under the CISG. In addition, the modification need not be in writing: the "mere agreement of the parties" can effect a modification or termination.[39] A clause contained in a written contract requiring modification to be in writing is enforceable; however, a party may waive the right to rely on this requirement through conduct inconsistent with the clause.[40]

Since most international sales are documentary in nature,[41] the seller is obligated to deliver all necessary documents, as well as the goods specified in the contract.[42] The seller must "deliver goods which are of the quantity, quality and description required by the contract."[43] Subject to waiver by the parties, goods conform to the contract only if:

> (1) the goods are fit for the purposes for which such goods are ordinarily used;

34. *Id.* art. 18.

35. *Id.* art. 19(1).

36. *Id.* art. 19(2).

37. *Id.* art. 19(3).

38. *Id.* art. 14(1).

39. *Id.* art. 29.

40. *Id.* art. 29(2).

41. In a documentary sale, transfer is effected through the transfer of paper as opposed to a physical transfer of the goods themselves.

42. CISG, *supra* note 5, art. 30.

43. *Id.* art. 35.

(2) the goods are fit for any particular purpose made known by the buyer to the seller;
(3) the goods conform to any sample or model shown to the buyer; and
(4) the goods are adequately packaged.[44]

The similarity of these provisions to U.C.C. §§ 2-313 to 2-315 is apparent. Although the CISG deviates in some respects from the U.C.C., the departure is not so great that it would cause much difficulty to an experienced common law commercial lawyer. The CISG is therefore an appropriate choice-of-law alternative from the U.S. attorney's perspective.

## III. Documentary Sales

### A. *Tracing the Path of a Documentary Sale*

The prudent seller is reluctant to rely on the good faith of a buyer to pay for goods received. Conversely, the prudent buyer will not pay for goods before the seller has actually delivered conforming goods. As a result, international sales would probably be impossible without the aid of third parties whom both the seller and the buyer trust.[45] Problems of trust and good faith may be overcome by negotiation of a series of contracts involving many different parties, through which risk is divided into discrete unites that are distributed among the parties.[46]

#### 1. Assuring Payment

In a traditional sale, the buyer directly promises to pay the seller for goods. Alternatively, the buyer can arrange for a "letter of credit" payable to the seller. In a transaction involving a letter of credit, a bank ("the issuer") adds its own promise to pay the seller to the buyer's promise.[47] The letter of credit arrangement is usually provided in the contract of sale, and the seller should take

44. *Id.*

45. Folsom, *supra* note 19, at 45.

46. *Id.*

47. *Id.* at 47.

care to insist that the credit be irrevocable.[48]

To create a letter of credit, the buyer must deposit money with the bank, in order to assure the bank that it will be repaid for the funds released.[49] The bank then issues the letter of credit, which is sent to the seller.[50] The letter of credit is effective once the seller receives it, operating as a draft on the buyer's account.[51] Because the credit is the vehicle through which the seller is assured of payment, the seller is often referred to as the "beneficiary" of the letter of credit.[52]

The bank that issues the letter of credit may be either an advising or a confirming bank.[53] An "advising bank" assists the seller in securing payment from the buyer's bank, but has no financial obligation to the seller.[54] A "confirming bank" also assists the seller in securing payment from the buyer's bank, but in addition, the confirming bank guarantees that it will pay the seller if payment is not forthcoming. For this added risk, the confirming bank will charge a higher fee than the advising bank.[55]

2. Assuring Receipt of Goods

One of the parties to the transaction must contract with a carrier to transport the goods from the buyer to the seller. This contract, if between the seller and the carrier, is called a "bill of lading."[56] In the bill of lading, the seller agrees to pay the shipper in exchange for the carrier's promise to deliver the goods.[57] The bill of lading serves as a receipt for the goods, formally acknowledging transfer of the goods and indicating their quantity and

48. *Id.* at 48.
49. *Id.* at 49.
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.* at 50.
55. *Id.*
56. *Id.* at 46.
57. *Id.*

condition.[58] The bill of lading also enables the seller to transfer the right of possession to the goods, even if they are in transit.[59]

When the sale is by letter of credit, the carrier gives the seller a "negotiable bill of lading," which is a species of negotiable instrument.[60] Through endorsement and delivery, the seller transfers the bill of lading to the buyer (the "holder"), who presents it to the carrier in order to obtain the goods.[61] This is called a "documentary sale," and over ninety percent of all international sales are handled in this manner.[62] The contract must also stipulate the type of insurance to be provided, and the party who is to procure it.[63]

### 3. The Model Scenario Revisited

Returning to the model, suppose that DE will procure a letter of credit from a Colombian bank, and TTT will arrange a contract of carriage (alternatively, the parties may agree that DE will undertake this responsibility). The goods will be insured according to the terms of the agreement. The carrier will deliver a bill of lading to the seller. We will assume that the letter of credit provides for payment to be made upon receipt of proof that the goods have been shipped to their Colombian destination, and that a U.S. bank has been selected to confirm the letter of credit.

The confirming bank will be responsible to pay the letter of credit to the seller upon receipt of the documents specified in the letter of credit. The requisite documents typically include:

> (1) the negotiable bill of lading, which assures the bank that the goods have been shipped;
> (2) a copy of the invoice that accompanies the goods, which will establish that the goods shipped are the goods for which the parties have contracted;

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58. *Id.* at 47.

59. *Id.* at 46-47.

60. *Id.*

61. *Id.* at 47.

62. Note, *Documentary Letters of Credit and the Uniform Customs and Practice for Documentary Credits (1974 Revision). A Selective Analysis*, 3 J. CORP. L. 147 (1977).

63. *Id.*

(3) the insurance policy on the goods shipped;
(4) copies of the U.S. export license and the Colombian import license, and any other documents required under local law; and
(5) an inspection certificate prepared by a third party, attesting to the condition of the goods and their conformity to specifications.

If the documents appear to be in order, the bank will request the seller to prepare a draft, whereby the seller (as drawer) orders the bank (the drawee) to pay the contract price to a named payee. Typically, the seller will designate itself as the payee. The seller will then endorse and deliver the draft to the bank, which will pay to the seller the money due him. The bank will, in turn, endorse the draft and bill of lading to the buyer's bank, which will repay the first bank for the amount of the draft. All of the documents mentioned above will accompany the draft and bill of lading.

Under DE's letter of credit contract with its Colombian bank, when DE pays the bank the value of the letter of credit, the bank will release the bill of lading to DE. DE will then present the bill of lading to the carrier, which will deliver the goods to DE.

### B. *Further Discussion of Letters of Credit*

In the U.S., U.C.C. Article 5 governs most issues concerning letters of credit. The Uniform Customs and Practice for Documentary Credits (UCP), promulgated by the International Chamber of Commerce in Paris,[64] also governs letters of credit, and is accepted throughout the world.[65]

A letter of credit eliminates not only the risk that the buyer will be insolvent or will unjustifiably refuse to pay, but also the risk that the goods will not conform to the contract.[66] In a documentary sale, the seller is paid the proceeds of the letter of credit before the buyer receives the goods. This is, in the words of one author, a requirement to pay "cash against documents."[67] This

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64. ICC Pub. No. 400 (1983) [hereinafter UCP].

65. PAUL H. VISHNY, GUIDE TO INTERNATIONAL COMMERCE LAW 2-20 (1991).

66. Note, *Letters of Credit: The Role of Issuer Discretion in Determining Documentary Compliance*, 53 FORDHAM L.R. 1519, 1521 [hereinafter *Letters of Credit*].

67. J. WHITE AND R. SUMMERS, HANDBOOK ON THE LAW UNDER THE UNIFORM COMMERCIAL CODE 807 (3d ed. 1988).

is view is corroborated by Article 4 of the UCP, which states that "all parties concerned deal in documents, and not in goods . . . ." The buyer should demand an inspection certificate in the contract of sale; while not foolproof, the certificate will at least provide assurance that the correct goods will be received.

Implicit in the foregoing is the bank's obligation to base its decision to pay the letter of credit only on whether the documents conform to the requirements of the letter of credit, regardless of whether the goods conform to the contract.[68] This duty is frequently referred to as the "doctrine of independence."[69] For example, in its discussion of the bank's obligations, the UCP provides only that:

> Banks must examine all documents with reasonable care to ascertain that they appear on *their* face to in accordance with the terms and conditions of the credit. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the credit.[70]

Exceptions to the doctrine of independence are few.[71]

Closely related to the doctrine of independence is the "doctrine of strict compliance." Banks are to make disbursement decisions only with reference to the documents. Thus, it should come as no surprise that courts permit banks to be quite exacting in the degree of conformity they require. In the case of *Bank of Italy v. Merchants National Bank*,[72] for example, the Court of Appeals of New York upheld a bank's decision not to pay, when the letter of credit required delivery of raisins but the invoice indicated that dried grapes had been sent. In another case, the Fourth Circuit Court of Appeals upheld a bank's decision not to honor a letter of credit that referenced a sale of "100% acrylic yarn" when the invoice given to the bank by the seller indicated that it had shipped "imported acrylic yarn."[73]

This approach has been assailed by some commentators as unnecessarily

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68. VISHNY, *supra* note 65, § 2.19.

69. *Id.*

70. UCP, *supra* note 54, art. 15.

71. *See, e.g.*, Sztejn v. J. Henry Schroder Banking Corp., 31 N.Y.S.2d 631 (Sup. Ct. 1941).

72. 236 N.Y. 106, 108 (1923).

73. Courtaulds North America, Inc. v. North Carolina Nat'l Bank, 528 F.2d 802 (4th Cir. 1975).

harsh to sellers.[74] Some courts appear to employ the equitable consideration of substantial performance to circumvent the doctrine of strict compliance.[75] The UCP states only that "[t]he description of the goods in the commercial invoice must correspond with the description of the credit."[76] The seller should read the letter of credit closely as soon as it is received from the buyer's bank and, if the requirements of the credit differ from the requirements of the parties' contract of the parties, the seller should immediately communicate the problem to the buyer and insist on changing the language of the letter of credit.[77] The contract should provide that the seller has the right to insist on such changes.

### C. *Trade Terms*

Over the years, convenient shorthand expressions have arisen to designate which party to an international transaction is responsible for procuring insurance and paying for the costs of shipping. These trade terms first arose as a matter of trade usage, although the International Chamber of Commerce in Paris has promulgated a synthesis of their accepted international usages, called the "Incoterms" document.[78] While they are not included in the positive law of any country, Incoterms are widely recognized by courts as reflective of international practice.

"Ex seller's factory" (or "ex works") indicates that the seller is obligated only to make the goods available to the buyer at the seller's factory and to notify the buyer that the goods are available there.[79] It is the buyer's responsibility to arrange for shipment and insurance of the goods, and the risk of loss falls on the buyer once the goods are made available.[80] This term is uncommon in international sales because it is often difficult for a foreign buyer to make shipping arrangements for transport out of the U.S.

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74. *Letters of Credit*, *supra* note 66, at 1525-6.

75. *See, e.g.*, Crocker Commercial Services, Inc. v. *Countryside Bank*, 538 F. Supp. 1360 (N.D. Ill. 1981); Banco Espanol de Credito v. State St. Bank and Trust Co., 385 F.2d 230, 237 (1st Cir. 1967).

76. UCP, *supra* note 64, art. 41(c).

77. One banker has estimated that discrepancies in the letter of credit occur nearly 80% of the time. *See International Banking/Update 1992*, INT'L BUS., March 1992, at 92 [hereinafter *International Banking Update*].

78. ICC Pub. No. 166 (1953).

79. ICC Pub. No. 350, at 16 (1980).

80. *Id.* at 18.

"F.A.S." (free alongside ship) means that the seller is obligated to deliver the goods at his/her expense alongside an appropriate vessel at the designated port.[81] When the seller quotes a price for the goods to be shipped F.A.S., it should include the cost of shipping and insuring the goods to this point. Once the seller or its agent unloads the goods alongside the ship, the risk of loss passes to the buyer.[82]

"F.O.B." (free on board) means that the seller is obligated to deliver the goods onto a ship named by the buyer.[83] After the goods are placed on board, the seller is obligated to notify the buyer that this has occurred. At this point, the responsibility to pay for shipping shifts to the buyer.[84] The risk of loss passes to the buyer at the moment the goods pass over the rail of the ship.[85] Incoterms also recognize the term "F.O.B. Airport," whereby the seller is obligated to arrange for transportation to the airport of departure, and the cost of the air freight is the buyer's responsibility.[86]

"C.I.F." (cost, insurance and freight) is the most common trade term in international sales. Unlike the terms previously examined, an agreement to ship C.I.F. unifies the shipping obligations. The seller is obligated to arrange and pay for the shipment of the goods to the port of destination, and to procure insurance for the goods while they are in transit.[87] The buyer need only receive the goods at the port of destination and effect any necessary further delivery.[88]

Use of Incoterms is not mandatory.[89] The parties may otherwise specify their respective obligations with regard to shipment, insurance, and risk of loss. The near-universal recognition of Incoterms, however, weighs heavily in their favor. The U.C.C. contains its own provisions defining delivery terms, and to avoid ambiguity the contract should specify whether the ICC's Incoterms control interpretation of the contract. The contract should also specify which Incoterms apply to the transaction.

A firm that is new to exporting might consider the use of an agent to

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81. *Id.* at 28. The contract should indicate the name of the port, i.e., "F.A.S. Houston."
82. *Id.* at 30.
83. *Id.* at 34.
84. *Id.* at 34, 36.
85. *Id.*
86. *Id.* at 92, 98.
87. *Id.* at 48-54.
88. *Id.* at 54-56.
89. VISHNY, *supra* note 68, § 3.21.

assist in the shipment of the goods. Called "freight forwarders," these agents are familiar with the nuances involved in moving goods internationally.[90]

### D. *Alternative Financing*

Occasionally, the circumstances of a sale make it impossible for the seller to insist on a letter of credit to finance the sale of goods. For example, a seller new to a particular market might have to accept a promissory note from the buyer in order to make the sale, or the buyer may lack the credit history necessary to obtain a letter of credit. Without a letter of credit, however, the risk of non-payment is greater, and the seller should explore methods of minimizing this risk.

The risk can be shifted through "factoring," which is essentially sale to a "factor" of one's accounts receivable. As with any sale of a right to receive money in the future, the factor will purchase the receivables at a discount, and may have full recourse against the seller if the buyer fails to pay.[91]

"Farfaiting" occurs when the buyer issues a series of notes to the seller, the payment of which is guaranteed by a bank or state trading agency. The seller then discounts these notes to a third party. Because of the underlying guarantee, the sale should be without recourse against the seller in case of default by the buyer.[92]

### E. *Insurance*

Of interest to U.S. exporters is a program administered by the Foreign Credit Insurance Association (FCIA), an agent of the Export-Import Bank, through which the FCIA provides exporters with insurance against commercial and political risks.[93] While not as relevant to sales secured by letters of credit, the FCIA program is an important alternative when the purchase price is payable over time or where the goods are sold on open account.[94] All U.S. firms are

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90. *Id.* § 2.33.

91. *International Banking Update*, *supra* note 77, at 92.

92. *Id.*

93. *Export Insurance*, Investigating Licensing and Trading Conditions Abroad (Sept. 1, 1991). Political risks include cancellation of an import license, loss of an export license, impoundment of goods by customs officials, revolution, confiscation of goods, expropriation of the buyer's business, and similar risks. VISHNY, *supra* note 65, at 13-19.

94. *Export Insurance*, *supra* note 93.

eligible to apply.[95]

Under its Short-Term Single Buyer Policy, the FCIA provides insurance with payment periods of 180 days or less, when the sale is to a single purchaser.[96] The Single Buyer Policy is available to finance such products as raw materials, consumer durable goods, spare parts, services, capital goods, and agricultural commodities.[97]

The FCIA also provides a Medium Term Policy, which is designed to finance more expensive items such as autos, trucks, and construction and agricultural equipment.[98] The period of payment under this Policy ranges between 181 days and five years.[99]

As of October 1, 1991, FCIA insurance covers 100 percent of commercial losses and 100 percent of political risk losses.[100] To obtain coverage, the seller must receive a fifteen percent down payment from the buyer, who can finance the remaining eighty-five percent.[101] The FCIA prescribes its own form of promissory note. Premiums range from one percent to 6.5 percent, depending on the extent and length of coverage, terms of the loan, creditworthiness of the buyer, etc.[102]

Although of primary interest to firms involved in direct investment abroad, the Overseas Private Investment Corporation (OPIC) is worth mentioning. OPIC's principle purpose is to provide insurance against political risks to firms investing in certain nations defined as "developing."[103] In 1980, OPIC began to offer insurance coverage for transactions in which U.S. suppliers are asked to post a letter of credit or other financial guarantee as security for the buyer's performance. This situation typically occurs in contracts in which the buyer is a foreign government. The insurance protects the seller when the buyer wrongfully draws down on the credit.[104]

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95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Eximbank Expedites Financing for Exporter*, INT'L BUS., Mar. 1992, at 93.

101. *Id.*

102. *Export Insurance*, *supra* note 93.

103. FOLSOM, *supra* note 19, at 385-386.

104. *Eximbank, TDP, and OPIC are Active in South America*, BUS. AM., June 5, 1989, at 20.

### *F. Currency Issues*

The currency in which the seller is to be paid is often an important contract term, and managing the risk of currency fluctuations is a key concern for the drafter of an international sales contract.

If the contract is silent on the issue, the CISG provides that the seller is to be paid at its place of business.[105] One writer has suggested that, although it is not a model of clarity, this provision effectively mandates payment in the seller's currency.[106]

From the seller's point of view, it is preferable to provide in the contract that the buyer will pay in the seller's currency. This eliminates any risk that the value of the buyer's currency will decline between the time of the contract of sale and the time of payment. Conversely, the buyer will want to reserve the right to make payment in its own currency.

As a middle ground, some contracts provide for payment in the seller's currency, but contain safeguards for the buyer in the event of serious devaluations. For example, a contract might state a total price that is subject to adjustment downward in the event of a drop in the buyer's currency. Such adjustment clauses typically do not become operative unless the extent of the devaluation is greater than a predetermined threshold (e.g. five percent).[107]

In addition to the currency problem, the parties must comply with the laws of the buyer's country, which may impose additional requirements. For example, until recently, Colombian regulations required an importer to make an advance deposit of Colombian pesos, whereupon the importer would be given certificates to pay for incoming goods.[108]

This reference to Colombian regulations provides a bridge between the discussion of the "contractual" phase of the exporting process and the "regulatory" phase. The impact of government regulation on the exporting process varies in significance depending upon the country and the activity involved. The U.S. has eliminated most of its barriers to exports, as have most exporting countries worldwide. On the other hand, the U.S. regulates imports to a greater extent, in order to retain control over the kind and quantity of imported

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105. CISG, *supra* note 3, art. 57.

106. VISHNY, *supra* note 65, § 2.08.

107. *Id.* § 2.09.

108. Laurie J. MacNamara and Herbert A. Lindow, U.S. Dept. of Commerce, *Marketing in Colombia* 17, DOC No. OBR 90-04 (U.S. Dept. of Commerce ed. 1990). This requirement was eliminated in November of 1990.

goods that reach the U.S. market. In Colombia, however, a U.S. exporter will find greater administrative and financial barriers to the importation of goods.

## IV. GOVERNMENT REGULATION

### A. *Export Controls in the U.S.*

The U.S. regulates the flow of exports via the Export Administration Act.[109] Although this Act is administered primarily by the Department of Commerce, a number of other federal agencies have jurisdiction over special categories of products:

(1) defense articles and services: Department of State;[110]
(2) nuclear equipment and material: Nuclear Regulatory Commission;[111]
(3) natural gas and electric power: Department of Energy;[112]
(4) controlled substances: Department of Justice;[113]
(5) endangered wildlife, birds: Department of Interior;[114]
(6) tobacco products: Department of Agriculture;[115] and
(7) transfer of technology as a part of transfer of a foreign patent: Patent/Trademark Office.[116]

The definition of the term "export" is broad enough to include not only the transfer of goods but also the transfer of technology.[117] A transfer may be an "export" not only if the goods or technology are shipped directly to a person

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109. 50 U.S.C.A. §§ 2401-2420 (West 1991).

110. 22 C.F.R. §§ 121.1-130.17 (1992).

111. 10 C.F.R. §§ 110.10-110.135 (1992).

112. 10 C.F.R. §§ 590.100-590.505; 18 C.F.R. §§ 32.30-32.52; 10 CFR §§ 474.1-476.8 (1992).

113. 21 C.F.R. §§ 1312.21-1312.29 (1992).

114. 50 C.F.R. §§ 222.1-222.41 (1992).

115. 7 C.F.R. §§ 34.1-34.11 (1992).

116. 37 C.F.R. §§ 5.11-5.25 (1992).

117. 50 U.S.C. § 2415(5)(a) (1991).

or firm abroad, but also if the goods or technology are transported domestically, when the seller intends the item to be shipped abroad.[118] The penalties for violating U.S. export control laws are usually imposed even if the seller acted innocently,[119] and can be severe.[120]

Two principal licenses are provided for under the Act: the general license[121] and the validated license.[122] Whether a general or validated license is required (or whether an export will be denied entirely) depends not only upon the classification of the product but also upon the destination of the product.[123] Products are classified into ten groups in what is called the Commodity Control List. The combination of the country of destination and the product classification determines the right to export and the type of license required. For example, no exports are permitted to countries such as North Korea and Cuba, which are in "Group Z."[124]

A general license is required if the Commodity Control List does not require a validated license for shipment to the country in question.[125] No application is necessary to obtain a general license, because in reality the "license" is statutory permission to export that attaches automatically to exports for which only a general license is necessary. In other words, if no license is required, the seller "self-licenses."[126] When the goods are turned over to the shipper, the shipper will designate on the "Shipper's Export Declaration" that the item is subject to a general license.[127]

If no general license is available, the exporter must apply for a validated license. These fall into four categories:

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118. 50 U.S.C. § 2415(5)(c).

119. 15 C.F.R. § 787.12(a)(2)(iii) (1992).

120. 15 C.F.R. §§ 787.1-787.3 (1992).

121. 15 C.F.R. § 771.1.

122. 15 C.F.R. § 772.1.

123. 15 C.F.R. § 785.1.

124. 15 C.F.R. § 785.1.

125. There are other instances when a general license is available. For a complete discussion, see W. Clark McFadden, et al., *The Structure of Export Licensing* 381-423 (PLI Corp. Law & Practice Course Handbook, Series No. 570, 1987).

126. *Some Advice On Export Control: An Imaginary but Practical Discourse*, in BUSINESS AMERICA, at 709 (PLI Corp. Law & Practice Course Handbook, Series No. 668, 1990).

127. *Id.*

(1) Individual License (providing authority to export a specific product to a specific importer);[128]
(2) Distribution License (providing authority to export any quantity of a given product to an importer for one year);[129]
(3) Project License (authority to export goods or technical data to support a specific project abroad);[130] and
(4) Service Supply License (providing authority to export parts to repair the exporter's equipment located overseas).[131]

Since a general license will suffice in the model scenario, there will be no discussion of the procedure for applying for validated licenses.[132] The U.S. Government offers assistance in classifying products and determining the type of license required.[133]

### B. *Import Controls and Customs in Colombia*

INCOMEX is the agency through which the Colombian government controls the flow of imports.[134] INCOMEX classifies imports into three categories: prohibited, subject to prior license, and automatically approved.[135] The importer must file an Import Registration Form with INCOMEX prior to the arrival of the goods, so that the Agency can classify the goods.[136]

The list of goods prohibited from importation is comprised primarily of luxury items.[137] If importation of a good is not prohibited, the INCOMEX

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128. 15 C.F.R. § 772.2(b)(1).

129. *Id.* § 773.3.

130. *Id.* § 773.2.

131. *Id.* § 773.7(d)(1).

132. McFadden, *supra* note 125.

133. The Export Assistance Staff can be reached at: (202) 377-4811.

134. MacNamara and Lindow, *supra* note 108, at 15.

135. *Id.*

136. *Id.*

137. *Id.*

Board on Imports will determine whether to classify the good as automatically approved or subject to prior license according to the following criteria:

(1) the extent of local production of the item;
(2) the existence of locally produced substitutes;
(3) national interests; and
(4) availability of foreign exchange reserves.[138]

An import license granted is generally valid for three to six months.

To clear Colombian customs, an importer of goods from the U.S. will need the following documents:

(1) import registration form (approved by INCOMEX);
(2) import manifest or customs declaration, accompanied by:
   (a) bill of lading or air waybill,
   (b) commercial invoice from the seller (INCOMEX prescribes certain minimum requirements for the bill of lading and commercial invoice); and
   (c) any special permits required by other governmental entities;
(3) payment of import duties, surcharges and VAT; and
(4) in the case of goods carrying a trademark registered under Colombian law, a document authorizing the importer to use the trademark (typically a license).

Since November 1990, the average import tariff in Colombia has declined from 58.98 percent to 14.35 percent.[139] Colombia is currently in the process of opening its borders to foreign trade, and has begun to relax import controls and customs procedures.

## V. The Colombian Distributor

Thus far, our concern has been to identify methods of exporting goods that are consistent with risk minimization. It is now necessary to examine the relationship between the U.S. manufacturer and the Colombian intermediary.

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138. *Id.*

139. *Latin America: Private Sector Group Focuses on Expanding U.S. - Colombian Trade*, 9 Int'l Trade Rep. (BNA) 284 (Feb. 12, 1992).

Upon concluding the initial agreement, the parties should focus on the development of a contract that not only complies with applicable law, but that also accommodates the particular needs of both buyer and seller.

In the context of domestic transactions within the U.S., apart from state contract law, there are few laws regulating the distribution contract. In an international transaction, however, there are regulations governing the relationship between the seller and its representative. For example, in the European Community, an EC directive governs the relationship between manufacturers and their commercial agents.[140] This directive requires notice prior to cancellation of the arrangement, and contains a mandatory procedure for compensating the agent after termination.[141] The regulatory schemes of many countries contain similar provisions.

The U.S. exporter is concerned primarily with the enforceability of the contract against the Colombian distributor, because regardless of the jurisdiction in which a controversy is originally heard, the U.S. party will ultimately have to seek enforcement of any award or judgment in Colombia. If the Colombian court in which enforcement is sought believes that the judgment is based on contract provisions that are at odds with mandatory Colombian rules of law, it might simply refuse to enforce the judgment. The U.S. manufacturer should therefore refer to Colombian law to determine whether Colombian law can be incorporated comfortably into the agreement.

Colombia, as a civil law country, regards its codes as the repository of all of its legal rules. A lawyer trained in a common-law country might be surprised to learn that case law assumes a decidedly inferior role in Colombian jurisprudence. In order to be assured of the accuracy of its interpretation of foreign law, the U.S. party should independently verify its interpretation, such as by soliciting the aid of local counsel.

The Colombian Commercial Code defines the scope of Colombian regulation of the relationship between the seller and the distributor: it applies to any firm that "is in charge of promoting or exploiting business in a given field . . . as a distributor of one or various products of that . . . foreign business."[142] Articles 1318 and 1319 of the Code speak to the exclusivity of the relationship. The foreign seller cannot appoint more than one agent to serve any particular territory, but can provide in the agreement that the distributor will not represent

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140. Council Directive 86/653, 1986 O.J. (L 382) 17.

141. Id. arts. 15, 17.

142. COLOMBIAN COMMERCIAL CODE [COM. C.] art. 1317 (Col.).

any of its competitors.[143]

The Commercial Code also requires that all distribution agreements contain certain information relating to the nature of the distributor's activities, its territory, and the duration of the appointment. The contract must then be filed in the Mercantile Registry of the Chamber of Commerce.[144]

The Code bifurcates the determination of the consequences of termination of the agreement: if the termination is for good cause or at the behest of the distributor, then the seller has no liability; if the seller terminates the agreement unilaterally in the absence of good cause, then the seller is subject to an action for "equitable indemnification."[145] Equitable indemnification is a cause of action for damages, the determination of which depends upon the extent, importance, and volume of the distributor's activities on behalf of the seller.[146] Good cause sufficient to justify termination includes grave violation by the distributor of a term in the contract or of law, acts or omissions by the agent that gravely affect the interests of the principal, or insolvency of the agent.[147]

Finally, the contract of agency, if it is to be performed in Colombia, must be governed by Colombian law; the parties may not by agreement choose to apply the law of another nation to the agency contract.[148] This rule effectively abrogates the parties' freedom to choose the law under which they will be governed, because although a U.S. court or arbitration panel would certainly honor an agreement to be bound by the law of a country other than Colombia, enforcement must eventually be sought in Colombia. Even if the Colombian rules of enforcement preclude reexamination of the merits of the action, there is a substantial risk that a Colombian court would refuse enforcement on public policy grounds. The Colombian court might rule that no derogation from the Columbian law is permitted. This might advance the Columbian domestic policy of protecting domestic distributors from overreaching by foreign manufacturers. An attempted derogation by the parties might therefore violate Colombian public policy, in which case the seller's award or judgment would be unenforceable in the only country where the distributor has any assets.

This problem may be overcome if the parties agree that those provisions

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143. COM. C. arts. 1318-1319.

144. COM. C. art. 1320.

145. COM. C. arts. 1324, 1325.

146. *Id.*

147. COM. C. art. 1325.

148. COM. C. art. 1328.

of the contract dealing with the termination of the agency relationship will be governed by the relevant articles of the Colombian Commercial Code. Even though the Code imposes greater requirements than U.S. law, the U.S. seller would still be permitted to terminate the agreement if the distributor fails to fulfill its duties, and the seller could terminate even in the absence of good cause if it is willing to compensate the distributor.

In addition, the parties can make the CISG applicable to the provisions of the contract that are unrelated to the distributor's termination. This would enhance the probability of enforcement in Colombia, as well as provide the seller with the opportunity to demonstrate its willingness to compromise and to accept the validity of the Colombian point of view. This sympathetic approach would render both the Colombian authorities and the U.S. firm's Colombian business partner more receptive to the U.S. seller's point of view.

## VI. PROTECTION OF INTELLECTUAL PROPERTY ABROAD

The protection of patents, trademarks and copyrights is a central concern of firms conducting international transactions. Given its intangible nature, intellectual property is easily susceptible to appropriation. This problem is especially acute in countries that do not protect intellectual property as vigorously as the U.S.

In our scenario, TTT owns a trademark registered with the Patent and Trademark Office in the United States. TTT has spent considerable time and resources developing a strongly identifiable trademark, and the firm is properly concerned about the possibility that another firm might appropriate the value of its mark and affix it to counterfeit "TTT" toys. Consequently, TTT must consider methods of protecting its mark outside of the U.S.

The U.S. Government estimates that American firms lose $23.8 billion dollars in revenue annually through the unauthorized use of intellectual property rights.[149] In 1985, this loss was responsible for five percent of the U.S. trade deficit.[150] It is therefore understandable that intellectual property rights are an important issue in the latest round of trade talks among the GATT nations.

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149. United States International Trade Commission Pub. No. 2065 (Foreign Protection of Intellectual Property Rights and the Effect on U.S. Trade 4-3) (Feb. 1988).

150. *Id.*

### A. The Territoriality Principle

U.S. firms cannot rely on U.S. patent, trademark and copyright laws alone to prevent infringements abroad. 28 U.S.C. Section 1338 provides that "[t]he District Courts shall have original jurisdiction of any civil action *arising under any Act of Congress* relating to patents, copyrights and trade-marks."[151] Therefore, whether U.S. intellectual property laws protect U.S. firms from appropriation of intellectual property rights abroad depends upon whether the relevant statute provides for the extraterritorial reach.

The Patent Act prohibits making, using, or selling a patented invention in the U.S. without permission, but by its terms the Patent Act is restricted to infringement that takes place within the U.S.[152] The Copyright Act of 1976 neither expressly limits its application to domestic infringements nor extends its reach to foreign nations.[153] The Lanham Act, governing trademarks and service marks, applies to any wrongful use in commerce,[154] which is defined to include "all commerce which may lawfully be regulated by Congress."[155] Congress has the constitutional authority to regulate domestic and foreign commerce, so the potential reach of the Lanham Act is broad.[156]

The seller must also establish the existence of sufficient minimum contacts with the forum to justify the exercise of personal jurisdiction, consonant with principles of due process principles.[157] Although intellectual property violations may be actionable in the U.S., the defendant's activities frequently bear a connection with the U.S. insufficient to establish either subject matter or

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151. 28 U.S.C. § 1338.

152. Patent Act 35 U.S.C. § 271(a). Recent amendments to the Act have extended the reach of the Patent Act where the Defendant is found to have exported the components of a patented invention abroad in such a manner so as to actively induce their assembly. 35 U.S.C. § 271(f)(1). Also, 35 U.S.C. § 271(f)(2) makes a defendant liable where he supplies a component of a patented invention to an overseas manufacturer knowing that it will be used to produce same.

153. Copyright Act of 1976, 17 U.S.C. § 501.

154. Lanham Act, 15 U.S.C. § 1118.

155. 15 U.S.C. § 1127.

156. U.S. CONST. art. I, § 8, cl.3.

157. *See* Honeywell, Inc. v. Metz Apparatewerke, 509 F.2d 1137 (7th Cir. 1975) (explaining personal jurisdiction in patent cases); United Merchants and Mfrs., Inc. v. David and Dash, Inc., 439 F. Supp. 1078 (D. Md. 1977) (explaining personal jurisdiction in a copyright case); Wells Fargo and Co. v. Wells Fargo Express Co., 556 F. 2d 406 (9th Cir. 1977) (explaining personal jurisdiction in a trademark case).

personal jurisdiction. For that reason, the seller must seek additional sources of protection for its property.

### *B. Securing Extraterritorial Protection*

An owner who licenses intellectual property to a party in a country that does not recognize such an ownership interest risks losing those rights. Historically, many countries have prohibited foreigners from registering intellectual property there, while other nations have permitted foreigners to register such property but have limited the scope of protection and the effectiveness of enforcement remedies. In response to this problem, nations began to negotiate for national treatment of foreigners and for certain basic rights that would be available universally.

#### 1. Copyright Protection

The Berne Convention is the oldest and most widely subscribed treaty for the protection of copyrights.[158] The U.S. became a signatory in 1988.[159] Prior to the adoption of the Berne Convention, the U.S. was a party to the Universal Copyright Convention.[160] The Berne Convention requires that foreign copyright owners receive national treatment, and that the existence of such rights shall not be conditioned on compliance with formalities in that country.[161]

Foreign owners are also entitled to receive "rights specially granted by [the Berne] Convention."[162] This clause requires signatories to provide foreign owners with the minimum rights created under the Convention regardless of

158. Berne Convention for the Protection of Literary and Artistic Work, as last revised, *July 24, 1971*, 828 U.N.T.S. 221 [hereinafter Berne Convention]. *See* Iris C. Geik, *Direct Broadcast Satellites and the Determination of Authors' Rights Under the Berne Convention: Lucy in the Sky Without Rights?*, 15 SUFFOLK TRANSNAT'L L. J. 563, 570-71 (1992).

159. Berne Convention Implementation Act of 1988, Pub. L. No. 100-538, 102 Stat. 2853, codified in scattered sections of 17 U.S.C. (1988).

160. The Universal Copyright Convention is a treaty that is still in force in the U.S. Sometimes a copyright owner residing in the U.S. will be need to secure protection in a country that is not a member of the Berne Convention, but that is a signatory to the Universal Copyright Convention. In such cases, the Uniform Copyright Convention controls.

161. Berne Convention, *supra* note 158, arts. 3(2) and 5(2).

162. *Id.* art 5(1).

whether nationals are accorded the same rights. Such rights include a minimum copyright term of the life of the author plus fifty years,[163] and the right to object to distortion, mutilation, or modification of the owner's work.[164]

Notwithstanding its creation of a set of core protections, the Berne Convention leaves to signatories a substantial amount of flexibility in certain areas.[165] Moreover, if a country fails to satisfy the requirements of the Berne Convention or to provide for effective enforcement, there is no provision for effective system to compel compliance by signatories.[166] The Berne Convention therefore provides the owner of a copyright with uncertain protection.

### 2. Protection of Industrial Property

The 1883 Convention of the Union of Paris (the Paris Convention) provides an international regime for the protection of patents and trademarks.[167] More than one hundred nations (including the United States) are signatories.[168] Like the Berne Convention, the Paris Convention establishes the principle that nationals of one signatory state shall be accorded national treatment in signatory states, and it provides certain minimum rights.[169] Unlike the Berne Convention, however, the owner must comply with "the conditions and formalities imposed upon nationals" in order to be entitled to protection.[170]

## C. *Trademark Protection in Colombia*

Colombia is a signatory to the Berne Convention, but has not signed the Paris Convention. Fortunately, however, both the U.S. and Colombia have

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163. *Id.* art. 7(1).

164. *Id.* art. 6bis. This provision of the Berne Convention necessitated that the U.S. Copyright Law be harmonized, so as to grant similar protection to U.S. copyright owners.

165. Geik, *supra* note 158, at 573.

166. *See e.g.*, Berne Convention, *supra* note 158, arts. 2(7) and 7(4) (requiring member states to protect works of art, but allowing the states to determine the criteria for distinguishing protectable and nonprotectable designs, and to determine the conditions under which designs and models are to be protected).

167. Paris Convention for the Protection of Industrial Property, as last revised July 14, 1967, 828 U.N.T.S. 305 [hereinafter Paris Convention].

168. David Syrowik, *International Software Protection*, 70 MICH. B. J. 656 (1991).

169. Paris Convention, *supra* note 167, art. 2(1).

170. *Id.*

signed the General Inter-American Convention for Trade-mark and Commercial Protection (the Inter-American Treaty).[171] The Inter-American Treaty mandates national treatment[172] and requires compliance by the owner with any preconditions of protection required by the country in which protection of a trademark is sought.[173]

Any natural or legal person may register a trademark in Colombia, regardless of whether the mark has been used in Colombia or abroad.[174] Colombia's trademark law therefore complies with the requirement of the Inter-American Treaty that signatory nations not discriminate against foreign trademark owners. A trademark in Colombia is protected for five years, and the protection may be renewed for an additional five years if the trademark has actually been used.[175]

Even if a trademark is validly registered, however, Colombian law does not protect the mark *vis a vis* infringement in Andean Pact countries.[176] Thus, even if TTT is careful to obtain Colombian registration, counterfeit goods may still be legally imported into Colombia.[177]

## VII. International Arbitration

The parties to an international sale of goods will frequently be reluctant to resort to traditional litigation to resolve any disputes that arise as to the terms or enforceability of their agreements. Neither party will want to litigate a dispute in the courts of the other party's home country, and in any event the difficulties presented by international litigation are enormous. Arbitration may therefore be an attractive alternate form of dispute resolution.

Arbitration is a system of privatized justice under which the parties agree to submit their dispute to a panel of designated arbitrators for resolution, rather than to a court. Arbitration was originally conceived as an informal, expeditious

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171. *Treaties in Force*, Office of the Legal Advisor, Dept. of State (Jan. 1, 1990). [hereinafter General Inter-American Convention]

172. *Id.* art. 1.

173. *Id.* art. 2.

174. Ethan Horwitz, World Trademark Law Colombia § 1.02 (1991).

175. *Id.*

176. *Id.* The Andean Pact countries are Bolivia, Colombia, Ecuador, Peru and Venezuela.

177. *Colombian Economic Policy and Trade Practices*, 1991 National Trade Data Bank, Feb. 1991, at 70.

process, unburdened by the expense and uncertainty of traditional litigation, although to some extent arbitration is now beset by the same weaknesses that instigated its development.

Even though it operates outside the authority of the state, arbitration is ultimately dependent upon the state for its legitimacy. The existence of the right to arbitrate is initially dependent upon the agreement by the parties. No court can command resort to arbitration at the request of only one party, but the binding force of an award ultimately depends on the nations' willingness to recognize and enforce the right.[178]

### A. *Benefits of Arbitration*

Arbitration occurs outside of the court systems of all countries. The arbitrators are therefore more neutral with respect to the parties to a dispute than would be the judges of a party's home country. While the arbitration may occur within one of the countries, it will not be heard by officials of that country. This neutrality is comforting to the parties, who are freed from the fear that they will have to litigate in a foreign and unfamiliar court system, the officials of which might be hostile to foreigners.

Arbitration is also very confidential, because the general public and press are not granted access to the arbitral proceeding, as they are to traditional court trials. Additionally, neither the arbitral panel's decision nor the facts on which the panel based its decision will be divulged to the public. This secrecy may be very important to the parties when the dispute involves trade secrets or other proprietary information.

Additionally, arbitration permits the parties to submit their dispute to a panel of experts, while traditional litigation requires that laymen decide issues that are frequently difficult to understand without specialized training.

### B. *The Enforceability of Arbitral Awards*

In the absence of a treaty between the countries of which the parties to an arbitration agreement are nationals, either country may refuse to enforce the arbitration agreement. The most widely adopted treaty in this area is the United

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178. The U.S. Supreme Court has demonstrated an increasing willingness to uphold the validity of agreements to arbitrate, even as to matters that are purely regulatory in nature. *See, e.g.*, Mitsubishi v. Soler, 473 U.S. 614 (1985). Absent an affirmative defense to the agreement itself, such as fraud, arbitration agreements are presumptively valid, irrevocable, and enforceable. 9 U.S.C. § 2.

Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).[179] Approximately ninety countries are signatories to this Convention, including the U.S.[180]

Especially since the mid-1980's, Colombia has endeavored to liberalize its policies relating to international trade and investment. To that end, the Colombian Legislature ratified the New York Convention in 1990.[181]

The New York Convention applies to awards rendered in a signatory nation that are sought to be enforced in another signatory nation.[182] In the model scenario, if the U.S. manufacturer obtained an award in the U.S. and sought enforcement in Colombia, then the New York Convention would clearly apply. If the distributor were the plaintiff, any award against the U.S. party would be enforceable in the U.S. A signatory may enter a reservation to the effect that it will enforce only those arbitral awards made in another Contracting State,[183] and Colombian law so provides.[184] Since the U.S. is a Contracting State, however, this presents no obstacle to enforcement of the arbitration clause.

The New York Convention establishes the duty of each signatory to recognize written agreements to submit existing or future disputes to arbitration.[185] If such an agreement exists, a court in a Contracting State must "refer the parties to arbitration, unless it finds that the said agreement is null and void."[186] The grounds under which a court can refuse to enforce an award are therefore extremely important. The New York Convention provides that courts of signatory nations may refuse to enforce an agreement to arbitrate if:

> (1) the parties to the agreement were under some incapacity, or the agreement was not valid;
> (2) the party against whom enforcement was sought was not given notice of the proceedings or was not

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179. United Nations Convention on the *Recognition and Enforcement of Foreign Arbitral Awards*, 21 U.S.T. 2517, 330 U.N.T.S. 3 (1959) [hereinafter NY Convention].

180. *Treaties in Force*, Office of the Legal Advisor, Department of State, January 1, 1991.

181. Law No. 39 (Nov. 20, 1990).

182. NY Convention art. 1.

183. *Id.*

184. Article 693 of Colombia's Code of Civil Procedure makes the duty of Colombian Courts to enforce dependent upon reciprocity.

185. NY Convention art. II.

186. *Id.*

permitted a chance to present its case;

(3) the arbitrators resolved matters not submitted to them for resolution;

(4) the panel was not constituted in accordance with the parties' agreement;

(5) the award is not yet final and binding;

(6) the subject matter of the arbitration may not be settled by arbitration under the laws of that country; or

(7) the recognition of the award would violate that country's public policy.[187]

The New York Convention, like most arbitration statutes, does not permit courts to consider the merits of the case in determining whether to uphold the arbitration agreement.[188] Even if the arbitrators applied the wrong legal principle or relied on facts that were completely contrary to the weight of the evidence, the award will be enforced.[189] The finality of arbitration is possibly its most distinguishing characteristic.

## C. *Disadvantages of Arbitration*

The finality of arbitration can also be one of its most significant drawbacks. Arbitration is expensive,[190] and it is frequently no faster than litigation because of the increasing "legalization" of the process.[191] However, the benefits of arbitration have proved sufficiently forceful that it is now the favored method of resolving disputes internationally.

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187. *Id.* art. V.

188. *Id. See also* 9 U.S.C. § 10 (1993) (stating that the merits of a case are not among the grounds on which U.S. courts may decide not to enforce an agreement to arbitrate).

189. NY Convention, *supra* note 179, art V.

190. If arbitration is conducted within the context of an arbitration organization (such as the I.C.C. in Paris), there is a fee to be paid to the organization. In addition, the arbitrators will each charge a fee that can approach $500.00 per hour. When one then adds the costs of the lawyers representing the parties, it is easy to see that arbitration can end up being as expensive as traditional litigation.

191. The absence of appeals may in some cases compensate for the slower decisional process.

### D. *Negotiating the Arbitration Clause*

In negotiating an arbitration clause, the parties are able to control virtually every aspect of the arbitration. For example, the parties are able to predetermine the procedure that will be used in the arbitration. In addition to regulating the procedure, however, the parties should address a number of other questions:

(1) where the arbitration will be held;
(2) whether express time limits will be set, within which arbitration must commence;[192]
(3) how the arbitration panel will be selected;
(4) whether the arbitrators will have the authority only to consider contractual issues or whether they can consider statutory claims (e.g., Antitrust);
(5) the kinds of damages the arbitrators can award, and especially whether punitive damages will be available;
(6) which party will be responsible for the costs and attorney's fees associated with the arbitration;
(7) whether the arbitrators will provide a "speaking" award (an award containing the reasoning behind the decision);
(8) what law will govern the arbitration;[193]
(9) if the arbitration is held in the United States, it is especially important to provide that the arbitrators will be competent to determine their own jurisdiction (frequently referred to as *Kompetenz-Kompetenz*);
(10) whether the arbitrators should rule as judges (ruling according to the substantive rules governing the contract) or whether they should have the discretion to rule on the basis of

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192. The I.C.C. in Paris has recently announced a new "fast track" procedure to answer the growing concern that international arbitration is too slow.

193. In this regard, it should be recognized that the law controlling the interpretation of the contract is a separate issue from the national law that controls the arbitration. The Federal Arbitration Act will control (absent an agreement to the contrary) an arbitration that takes place in the U.S.

commercial custom, equity and fairness;[194] and

(11) whether the parties will be required to negotiate their dispute informally through non-binding mediation prior to arbitration.

Arbitration need not take any particular form. On the contrary, arbitration is an extraordinarily malleable device that enables the parties to tailor the dispute-resolution process to fit their needs. Its enforceability, procedural flexibility, and provision for decision by experts make arbitration a useful option.

## VIII. The Contract

It is time to bring the preceding observations into sharper focus by examining how the substantive rules affect the terms of the contract. A complete copy of the agreement is set out in the Appendix.

### A. *Choice of Law*

TTT and DE agreed that the CISG will control interpretation of the contract, Colombian law will govern the relationship between the parties, the UCP will govern issues surrounding the letter of credit, and Incoterms will define the meaning of trade terms. These choices of law are set forth in article 7.5 of the contract:

> 7.5 *Governing Law.* The following provisions regarding the Governing Law are subject to the provisions of Article 7.4, paragraph 4 above: Articles 1317 through 1328 of the Colombian Commercial Code shall govern those provisions of this contract to which those Articles relate, specifically, to those questions arising hereunder regarding the appointment and termination of the distributor. Any issue relating to the issuance, interpretation or effect of the letter of credit provided for herein will be governed by the Uniform Customs and Practice for Documentary Credits (UCP). Construction of any trade terms will be in accordance with Incoterms. In all other matters, this agreement shall be governed by the Vienna Convention on the International Sale of Goods.

194. When arbitrators rule on the latter basis, they are said to be acting as amiable compositeurs.

The first sentence of this Article indicates that the use of the foregoing substantive rules is subject to paragraph 4 of Article 7.4, which provides that, in determining the rights of the parties, the arbitrators will first look to the contract, and then to the substantive rules contained in Article 7.5. If neither of these sources resolves a dispute, then the arbitrators may decide on the basis of equity and fairness.

I. Compliance with Colombian Law

Article 1.1 of the contract complies with the prohibition contained in Article 1318 of Colombian Commercial Code against appointing multiple agents within a single defined territory:

> **1.1** *Appointment and Products.* During the term of this agreement (and subject to the conditions contained herein), TTT appoints DE as the sole and exclusive distributor of the entire line of TTT toys for the country of Colombia.

Article 1.2 satisfies the Code requirement that the distributor must not sell competitive products:

> **1.2** *Competitive Products.* Consistent with Article 1319 of the Colombian Commercial Code, DE agrees that it shall not, during the life of the agreement, distribute products which are directly competitive with the products it purchases from TTT. "Directly competitive" products shall include toy cast iron vehicles and such other products as TTT shall hereafter produce.

Article 6.2 indicates the circumstances under which the parties may terminate the distribution agreement:

> **6.2** *Early termination.* This agreement may be terminated earlier by either party upon a showing of just cause as that term is hereinafter defined. In the case of an attempted early termination by TTT, just cause shall include DE's grave violation of a term of the contract, DE's violation of law, acts/omissions (by DE) which gravely affect the interests of TTT, DE's insolvency, or finally DE's failure to perform its activities under the contract. In the case of an attempted early termination by DE, just cause shall include TTT's failure to obey contractual or legal

> obligations, acts/omissions (by TTT) which gravely affect the interests of DE, TTT's insolvency or finally TTT's failure to perform its obligations under the contract. In providing for termination only upon a showing of just cause, it is the intention of the parties to comply with Articles 1324 and 1325 of the Colombian Commercial Code.

2. Compliance with the CISG

Only one article of the agreement specifically implicates the CISG, which grants the parties substantial autonomy and usually operates only to fill gaps. The parties have reached a compromise on the warranty issues: the manufacturer warrants the goods to be of average quality and fit for their ordinary use (consistent with Article 35 of the CISG), but excludes any other warranties. Moreover, the parties have expressly considered the respective liability of the parties in the event of an injury suit brought by some third party. Article 2.7 codifies the above terms of warranty and limitation of liability.

> 2.7 *Warranty and Limitation of Liability*. TTT warrants the products sold hereunder to be merchantable and consistent with and samples or models supplied by TTT. A product shall be "merchantable" if it is of average quality and fit for the purpose intended. Beyond these warranties, DE hereby waives any other warranties, including any express warranties made or any warranties of fitness for a particular purpose. Further, in the event of a breach of one of the warranties given, TTT shall not be liable beyond replacement of the defective products. Specifically, TTT shall not be liable for any special or consequential damages. Notwithstanding anything contained herein to the contrary, if DE should be successfully sued by a consumer who is injured by the product, DE shall be able to pursue any rights it may have for contribution or indemnity against TTT.

*B. Documentary Sales*

Article 2 of the contract deals with the prices and terms of sale. Article 2.4 requires the distributor to obtain an irrevocable letter of credit to finance the sale:

> 2.4 *Payment*. Except when payment for an order is made in advance, payment for each order placed by DE will be secured by

> and effected through an irrevocable letter of credit, in such form and issued by a bank or banks as are acceptable to TTT, delivered to TTT together with the order and containing an expiry date not sooner than 60 days after the date when TTT proposes to ship the order. Each letter of credit must be such that a bank selected by TTT in the United States to be a confirming bank will be willing to act in such capacity. The cost of any confirmation desired by TTT shall be borne by TTT. Each such letter of credit will provide for payment in full of the amount TTT's invoice. Presentation of all documentation may be made at the counter of the confirming bank in the United States. The letter of credit will specify that the following documents will be supplied by the seller to obtain payment: a bill of lading (or air waybill) indicating shipment of the goods, a copy of the invoice indicating the goods that were shipped, proof of insurance (insofar as required under Article 2.5 below), copies of any required export license and an inspection certificate verifying the condition of the goods prior to shipment.

Apart from mandating that the letter of credit be irrevocable, the provision is significant in that it gives the seller the ability to determine the acceptability of the letter of credit. This is common, because the seller bears the risk of non-payment. This provision also eliminates the necessity of specifying the minute details of the letter of credit in the contract.

The buyer is protected by the requirement that the seller present certain specified documents prior to receiving payment, including proof of insurance. The obligation to provide insurance is intertwined with the particular trade term selected. The contract provides:

> 2.5 *Trade terms, modification.* All products sold to DE shall be sold C.I.F. Aeropuerto Alfonso Bonilla Aragon in Cali, Colombia. Interpretation of the term C.I.F. will be interpreted according to Incoterms.

Under the C.I.F. term, the seller is obligated to pay the air freight charges and to procure insurance covering the goods until they reach Cali, Colombia.

Finally, the parties have agreed that payments to the seller will be made in U.S. dollars:

> **2.5** . . . Payment will be made by DE for all products ordered in lawful money of the Unitnd States. All payments shall be made without deduction for any change in exchange rates and without deduction for any taxes levied by any governmental authority.

## C. *Export and Import Controls*

The contract provides that the seller, TTT, will arrange for any required export licenses and that the buyer, DE, will do what is necessary to procure an import license:

> **2.3** *Order Acceptance and Rejection.* If TTT receives an order from DE offering to purchase products at the prices specified in the most recent distributor price list, TTT shall be obligated to fill such order in a timely manner. Provided however, that should events beyond the control of TTT prevent it from making delivery, TTT's sole obligation will be to notify DE of same. It shall be the responsibility of TTT to procure any U.S. export license that may be required.

> **2.5** . . . The placing of an order by DE shall constitute a warranty by DE that it has obtained all necessary approvals and permits required from any appropriate governmental agency which relate to the import of the products to Colombia. Any tariffs or other duties will be paid by DE.

## D. *Protection of the Trademark in Colombia*

Of great significance to the seller is the assurance that the contract does everything possible to assist in the protection of its trademark rights. Article 2.2 addresses protection of trademark rights related to resales:

> **2.2** *Resales.* Nothing herein shall limit the right of DE to determine the prices or terms of sales made by DE. Any suggested retail price list supplied by TTT shall not bind DE to sell products at those prices.
>
> Buyer agrees that it will not resell the goods to persons or firms outside of its exclusive territory.

The final sentence, while not directly related to the protection of the trademark,

furthers the seller's desire to establish a series of exclusive distributorships throughout Latin America. If the seller has distributorships in many different countries, market conditions may require that it establish different prices in each country. If a distributor that purchases the product at a low price in one country can sell it outside its exclusive territory, however, "seepage" of goods between countries would limit the seller's ability to maintain different prices.

The goal of Article 3.1 is to protect TTT's trademark and image, and to prevent cheap imitations from becoming linked with TTT's product in the minds of Colombian consumers:

> 3.1 *Markings or other names.* The parties understand and agree that all products sold to DE will bear markings, legends or trademarks placed thereon by TTT. Said markings, legends or trademarks shall not be removed, concealed or covered by DE.

Article 3.2 likewise is directed toward the development of a successful trademark:

> 3.2 *Distributor's business.* DE agrees to maintain a suitable place of business and to employ suitable personnel at DE's expense as is necessary to actively promote the sale of the products in the territory of Colombia. DE shall use its best efforts to promote the sale of said products. DE shall not engage in any activity that would diminish or detract from the sales potential of the products or their attractiveness to potential customers. DE agrees to act in the mutual interest of the parties in dealing with its customers and promptly to advise TTT of any complaints with respect to the products.

Further, TTT wants to license to DE the right to use the trademarks in question in connection with the sale of the products, because certain countries[195] require an importer to present proof of the trademark owner's authorization before it will permit the goods to enter the country. Article 4.1 creates proof of authorization:

> 4.1 *Use of names or marks.* TTT hereby licenses to DE the right to use its trademark TTT and TTT Toys, Inc. during the existence of this

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195. *E.g.*, the United States and Colombia. *See, e.g.*, 19 U.S.C. § 1526; 19 C.F.R. §§ 133.0 - 133.24.

agreement insofar as such use is related to the efforts of DE to sell products under this agreement. Upon termination of this agreement, for any reason, DE agrees immediately to discontinue all uses of such trademarks or tradenames, and shall immediately discontinue all representations that it is or was the distributor of TTT. DE, by virtue of its limited license herein, shall acquire no rights in the trademarks or tradenames mentioned above.

Finally, the importer will be very interested in preventing the shipment into Colombia of both counterfeit and genuine TTT toys, other than according to the agreement. In this regard, although even a mark registered in Colombia will not stop infringement by citizens of other members of the Andean Pact, the following clauses may be useful:

4.2 *Border Control.* To the extent possible under Colombian law, DE will assist TTT in discovering and preventing entry into Colombia of counterfeit or genuine goods bearing one of the trademarks indicated in 4.1 above.

### E. *The Arbitration Clause*

The parties have agreed on a specific arbitration clause that deals comprehensively with many of the issues that may arise. The clause establishes the law that will govern the conduct of the arbitration:

7.4 *Arbitration.*

1. In determining the rules that govern the arbitration, it is the intention of the parties to create a hierarchy of controlling law. The terms contained in this contract are the primary source of law applicable to the arbitration. If the contract is silent, the parties select the International Bar Association rules of arbitral procedure to control. If neither the contract nor the International Bar Association Rules of Evidence apply to the issue in question, then the parties intend that the International Chamber of Commerce rules control.

The place of arbitration and the institution selected to conduct are also

specified in the first paragraph:

> 7.4 . . . The parties select the ICC as the institution to conduct the arbitration. The arbitration shall be held in San Juan, P.R.

The parties selected Puerto Rico because they wanted to establish a geographically and linguistically neutral location in which they would both feel comfortable, and because the Federal Arbitration Act (FAA) governs arbitration there.[198] The FAA is advantageous because it is one of the few arbitration statutes that permits the parties to apply to a court of law to issue subpoenas as an aid to discovery.

In order to obtain the efficiency benefit of arbitration, the parties have placed strict time limits on the selection of the arbitrators, the time in which a hearing must be conducted, and the time for rendering an award within Article 7.4:

> 2. Each of the parties shall, within thirty (30) days of a party making a demand for arbitration to the ICC, appoint one arbitrator. The two arbitrators so nominated shall then choose a third arbitrator. If the arbitrators chosen by the parties cannot agree on the third arbitrator within thirty (30) days of their being nominated, then the third arbitrator shall be appointed by the ICC.
> 7. The arbitration hearing will be convened within six (6) months from the date on which the arbitration panel is finally constituted. Discovery will be conducted during this time period. The arbitration panel shall issue its final award within sixty (60) days of the conclusion of the hearing. The parties may, by written agreement, extend any of the time periods herein contained.

It is important for the parties to select the language in which the arbitration will be conducted:

> 3. The arbitration shall be conducted in the English language. Relevant documents in other languages shall be translated into English if the arbitrators so direct.

198. The applicability of the FAA to actions brought within the U.S. District Court in Puerto Rico was assumed in *Mitsubishi v. Soler*, 473 U.S. 614 (1985).

Paragraph 6 of the clause requires the arbitrators to render a "speaking" award.

> 6. The arbitrators shall in writing state the reasons upon which the award is based.

This requirement has a number of potential benefits. First, it will likely have a disciplining effect on the arbitrators, in that they will feel constrained to think carefully before they commit it to writing. Also, a written award might help the parties to understand the decision of the panel and enable them to accept it more easily. Finally, reviewing courts are better able to determine whether the panel exceeded its authority under the arbitration clause if the panel's reasoning is in writing.

Paragraph 8 addresses the competence of the arbitrators:

> 8. The arbitrators shall be competent to determine the extent of their jurisdiction under this contract. Moreover, the arbitrators are granted the authority to hear not only any contractual disputes but are competent to rule on any statutory issues that arise out of the relationship of the parties.

It is a topic of some controversy whether arbitrators should be empowered to hear statutory issues. If the contract is silent on the issue, the U.S. rule is that arbitrators have such power.[197] TTT and DE believe that the benefits of granting the arbitrators this right outweigh any disadvantages. Preventing the arbitrators from hearing statutory claims may result in the same dispute being the subject of two actions occurring simultaneously, which might interfere with the efficient and speedy resolution that motivated them to create the arbitration clause. There is some risk involved in permitting arbitrators to consider statutory issues, however, because the arbitrators are not always familiar with the statutes in question, and they will not necessarily be lawyers.[198]

The final paragraph of the arbitration agreement allocates the costs of

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197. *See, e.g.*, Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (demonstrating the arbitrability of a § 10b claim under Securities Exchange Act of 1934); Mitsubishi v. Soler, 473 U.S. 614 (1985) (sharing the arbitrability of antitrust actions).

198. In *Mitsubishi*, *supra* note 197, for example, the effect of the Supreme Court decision declaring Antitrust to be arbitrable was that the defendant had to present its Antitrust claim to the Japan Commercial Arbitration Association.

arbitration and defines the authority of the panel to award damages:

> 9. The arbitrators shall have the authority to award compensatory damages only. No award of punitive or exemplary damages is permitted. Irrespective of which party prevails in the arbitration, the parties will each pay one-half of the costs of the arbitration (including arbitrators' fees, any institutional charges and the cost of any expert appointed by the arbitration panel). Provided however, that each party will pay its own attorney's fees and will pay for any experts it chooses to employ.

## IX. Conclusion

As is the case with all form contracts, the sample agreement discussed in this note will not resolve every question regarding contracts for the international sale of goods. Instead, this sample is intended only to sensitize the drafter to the types of issues that arise in the practice of contract law in the context of international sales of goods.

APPENDIX

CONTRACT

This agreement made and entered on this the ____ day of ______, 19__, by and between Tiny Trucks Toys, Inc. (hereinafter TTT) and Distribution Enterprises, Ltd. (hereinafter DE). TTT is a corporation organized under the laws of the State of Delaware and has its principal place of business at 2900 South University Drive, Fort Worth, Texas. DE is organized under the Colombian Commercial Code and has its principal place of business at 740 First Avenue, Cali, Columbia.

WITNESSETH:

*Whereas*, TTT is engaged in the manufacture of certain molded steel toys and is desirous of having its products distributed in the country of Colombia, and, *Whereas*, DE is engaged in the distribution of products for children and desires to expand its product line to include Tiny Trucks™ toys,

Now, therefore, in consideration of the mutual promises hereinafter set forth, it is agreed between the parties as follows:

**ARTICLE ONE - APPOINTMENT AND PRODUCTS**

**1.1** *Appointment and Products*. During the term of this agreement (and subject to the conditions contained herein), TTT appoints DE as the sole and exclusive distributor of the entire line of Tiny Trucks™ toys for the country of Colombia.

**1.2** *Competitive Products*. Consistent with Article 1319 of the Colombian Commercial Code, DE agrees that it shall not, during the life of the agreement, distribute products that are directly competitive with the products it purchases from TTT. "Directly competitive" products shall include toy cast iron vehicles and such other products as TTT shall hereafter produce.

**ARTICLE TWO - PRICES AND TERMS OF SALE**

**2.1** *Price and Invoicing*. TTT will, from time to time, advise DE of its current prices for products covered by this agreement. All deliveries made by TTT to DE will be invoiced by TTT to DE in United States dollars at TTT's regular distributor prices as of the date of acceptance of the order by TTT, or at such other prices as TTT may otherwise charge with respect to special orders or for

items not on the current price list.

2.2 *Resales.* Nothing herein shall limit the right of DE to determine the prices or terms of sales made by DE. Any suggested retail price list supplied by TTT shall not bind DE to sell products at those prices. Buyer agrees that it will not resell the goods to persons or firms outside of its exclusive territory.

2.3 *Order Acceptance and Rejection.* If TTT receives an order from DE offering to purchase products at the prices specified in the most recent distributor price list, TTT shall be obligated to fill such order in a timely manner. Provided however, that should events beyond the control of TTT prevent it from making delivery, TTT's sole obligation will be to notify DE of same. It shall be the responsibility of TTT to procure any U.S. export license that may be required.

2.4 *Payment.* Except when payment for an order is made in advance, payment for each order placed by DE will be secured by and effected through an irrevocable letter of credit, in such form and issued by a bank or banks acceptable to TTT, delivered to TTT together with the order and containing an expiry date not sooner than 60 days after the date when TTT proposes to ship the order. Each letter of credit must be such that a bank selected by TTT in the United States to be a confirming bank will be willing to act in such capacity. The cost of any confirmation desired by TTT shall be borne by TTT. Each such letter of credit will provide for payment in full of the amount TTT's invoice. Presentation of all documentation may be made at the counter of the confirming bank in the United States. The letter of credit will specify that the following documents will be supplied by the seller to obtain payment: a bill of lading (or air waybill) indicating shipment of the goods, a copy of the invoice indicating the goods that were shipped, proof of insurance (insofar as required under Article 2.5 below), copies of any required export license and an inspection certificate verifying the condition of the goods prior to shipment. Payment will be made by DE for all products ordered in lawful money of the United States. All payments shall be made without deduction for any change in exchange rates and without deduction for any taxes levied by any governmental authority. The placing of an order by DE shall constitute a warranty by DE that it has obtained all necessary approvals and permits required from any appropriate governmental agency which relate to the import of the products to Colombia. Any tariffs or other duties will be paid by DE.

2.5 *Trade terms; modification.* All products sold to DE shall be sold C.I.F. Aeropuerto Alfonso Bonilla Aragon in Cali, Colombia. Interpretation of the term C.I.F. will be interpreted according to Incoterms.

2.6 *Force Majeur.* Failure of TTT to make delivery when due, if occasioned in whole or in part by an Act of God, public enemy, fire, explosion, perils of the

air or sea, flood, drought, war, riot, civil insurrection, sabotage, accident, embargo, governmental priority, requisition or allocation, any action of any governmental authority, shortage, failure of supply or labor, strikes or other labor trouble, or any occurrence, act, cause or thing beyond the control of TTT, shall excuse any such failure on the part of TTT and TTT shall have no obligation or liability whatsoever arising out of such failure.

**2.7** *Warranty and Limitation of Liability.* TTT warrants the products sold hereunder to be merchantable and consistent with and samples or models supplied by TTT. A product shall be "merchantable" if it is of average quality and fit for the purpose intended. Beyond these warranties, DE hereby waives any other warranties, including any express warranties made or any warranties of fitness for a particular purpose. Further, in the event of a breach of one of the warranties given, TTT shall not be liable beyond replacement of the defective products. Specifically, TTT shall not be liable for any special or consequential damages. Notwithstanding anything contained herein to the contrary, if DE should be successfully sued by a consumer who is injured by the product, DE shall be able to pursue any rights it may have for contribution or indemnity against TTT.

**2.8** *All sales final.* All sales to DE are final, and no products may be returned without prior written authorization from TTT, except as hereinafter provided.

## ARTICLE THREE - DUTIES OF DE

**3.1** *Markings or other names.* The parties understand and agree that all products sold to DE will bear markings, legends or trademarks placed thereon by TTT. Said markings, legends or trademarks shall not be removed, concealed or covered by DE.

**3.2** *Distributor's business.* DE agrees to maintain a suitable place of business and to employ suitable personnel at DE's expense as necessary to actively promote the sale of the products in the territory of Colombia. DE shall use its best efforts to promote the sale of said products. DE shall not engage in any activity that would diminish or detract from the sales potential of the products or their attractiveness to potential customers. DE agrees to act in the mutual interest of the parties in dealing with its customers and promptly to advise TTT of any complaints with respect to the products.

**3.3** *Market information.* DE will keep itself and TTT informed of all conditions of the market in the territory including competitive prices, and, when requested, will furnish TTT with trade statistics and other information relating to the territory.

**3.4** *Local laws.* DE will comply with all laws relating to the sale of the

products sold hereunder. Further, it shall be DE's obligation to comply with and satisfy any Colombian laws related to the import of products into Colombia.

**ARTICLE FOUR - INTELLECTUAL PROPERTY RIGHTS**

4.1 *Use of names or marks.* TTT hereby licenses to DE the right to use its trademark Tiny Trucks and Tiny Trucks Toys, Inc.™ during the existence of this agreement insofar as such use is related to the efforts of DE to sell products under this agreement. Upon termination of this agreement, for any reason, DE agrees immediately to discontinue all uses of such trademarks or tradenames, and shall immediately discontinue all representations that it is or was the distributor of TTT. DE, by virtue of its limited license herein, shall acquire no rights in the trademarks or tradenames mentioned above.

4.2 *Border Control.* To the extent possible under Colombian law, DE will assist TTT in discovering and preventing entry into Colombia of counterfeit or genuine goods bearing one of the trademarks indicated in 4.1 above.

**ARTICLE FIVE - LIMITATIONS OF REPRESENTATIONS**

5.1 *Limitations on representation.* DE shall have no authority to represent TTT in the territory or elsewhere as agent beyond the distribution of products contemplated under this agreement. Specifically, DE shall have no authority to bind TTT to any contract nor does TTT authorize DE to perform acts on its behalf other than as before indicated. Nothing herein shall be construed to effect a partnership or joint venture between the parties.

5.2 *Sales by distributor.* All sales of products made by DE shall be in its own name and for its own account, it being understood that DE is an independent organization which is reselling products which are purchased from TTT.

5.3 *Indemnity by distributor.* DE agrees to indemnify TTT against all claims and suits arising out of or from any actions or omissions of DE or its agents or employees.

**ARTICLE SIX - TERM AND CANCELLATION**

6.1 *Term and renewal negotiation.* This agreement shall be effective the date first above written and shall continue in effect for two years thereafter. During the final six months of this agreement, the parties agree to meet and attempt in good faith to agree on the renewal or extension of this agreement or the entering into of a new agreement, neither party being bound to the other after the expiration of this agreement unless such new agreement, renewal, or extension is executed in writing by both parties. Such negotiations shall be carried on in San Juan, P.R. unless otherwise agreed.

6.2 *Early termination.* This agreement may be earlier terminated by either party upon a showing of just cause as that term is hereinafter defined. In the case of an attempted early termination by TTT, just cause shall include DE's grave violation of a term of the contract, DE's violation of law, acts/omissions (by DE) which gravely affect the interests of TTT, DE's insolvency or finally DE's failure to perform its activities under the contract. In the case of an attempted early termination by DE, just cause shall include TTT's failure to obey contractual or legal obligations, acts/omissions by TTT that gravely affect the interests of DE, TTT's insolvency, or TTT's failure to perform its obligations under the contract. In providing for termination only upon a showing of just cause, it is the intention of the parties to comply with Articles 1324 and 1325 of the Colombian Commercial Code.
6.3 *Disposition of stock on termination.* Upon termination of this agreement, TTT agrees to repurchase from DE its supply of products sold hereunder at the price paid to TTT for same (excepting any costs of shipment or insurance); provided however, that TTT shall not be obligated to repurchase any products which are not in the same condition as when received by DE and in their original packaging. Shipment of repurchased products will be effected by DE in accordance with TTT's instructions. Payment therefore will be made upon receipt by TTT.

## ARTICLE SEVEN - MISCELLANEOUS

7.1 *Assignment.* The rights created hereunder are not assignable or transferable without the prior written consent of TTT.
7.2 *Separability.* Any provision(s) which in any way contravenes the law of any state or country in which this agreement is effective shall, in such state or country, to the extent of such contravention, be deemed separable and shall not affect any other provision hereof or the validity of this agreement.
7.3 *Entire Agreement.* The terms which appear herein shall constitute the entire agreement of the parties and neither party shall have the right to add to, vary, amend or contradict the terms hereof except by a subsequent agreement signed by both parties.
7.4 *Arbitration.*

1. In determining the rules that govern the arbitration, it is the intention of the parties to create a hierarchy of controlling law. The terms contained in this contract are the primary source of law applicable to the arbitration. If the contract is silent, the parties select the International Bar Association rules of arbitral procedure to control. If neither the contract nor the International Bar Association Rules of Evidence apply to the issue in question, then the parties

intend that the International Chamber of Commerce rules control. In that regard, the parties select the ICC as the institution to conduct the arbitration. The arbitration shall be held in San Juan, Puerto Rico.

2. Each of the parties shall, within thirty (30) days of a party making a demand for arbitration to the ICC, appoint one arbitrator. The two arbitrators so nominated shall then choose a third arbitrator. If the arbitrators chosen by the parties cannot agree on the third arbitrator within thirty (30) days of their being nominated, then the third arbitrator shall be appointed by the ICC.

3. The arbitration shall be conducted in the English language. Relevant documents in other languages shall be translated into English if the arbitrators so direct.

4. In resolving the substantive issues, the arbitrators shall make every effort to find a solution to the dispute by reference to the provisions of this Contract and shall give full effect to all parts thereof. However, if the solution does not appear from the provisions of this Contract, then the arbitrators will apply the Governing Law as specified in Article 7.5 immediately below. If neither the contract nor the Governing Law provides a solution to the substantive dispute, then the arbitrators are invited to apply international commercial custom and practice and to decide the case generally on the basis of equity and fairness.

5. The parties agree that after either files a Notice of Demand for arbitration, they shall, upon request, make discovery and disclosure of all materials relevant to the subject of the dispute in accordance with the International Bar Association Rules of Evidence. Also in accord with said Rules, examination of witnesses by the parties and by the arbitrators shall be permitted. A written transcription of the hearing shall be made and furnished to the parties upon request of either party. The cost thereof shall be borne equally by the parties.

6. The arbitrators shall in writing state the reasons upon which the award is based. The award of the arbitrators shall be final and binding upon the parties. Enforcement shall be made in accordance with the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

7. The arbitration hearing will be convened within six (6) months from the date on which the arbitration panel is finally constituted. Discovery will be conducted during this time period. The arbitration panel shall issue its final award within sixty (60) days of the conclusion of the hearing. The parties may, by written agreement, extend any of the time periods herein contained.

8. The arbitrators shall be competent to determine the extent of their jurisdiction under this contract. Moreover, the arbitrators are granted the

authority to hear not only any contractual disputes but are competent to rule on any statutory issues that arise out of the relationship of the parties.

9. The arbitrators shall have the authority to award compensatory damages only. No award of punitive or exemplary damages is permitted. Irrespective of which party prevails in the arbitration, the parties will each pay one-half of the costs of the arbitration (including arbitrators' fees, any institutional charges and the cost of any expert appointed by the arbitration panel). Provided however, that each party will pay its own attorney's fees and will pay for any experts it chooses to employ.

7.5 *Governing Law*. The following provisions regarding the Governing Law are subject to the provisions in Article 7.4, paragraph 4 above: Articles 1317 through 1328 of the Colombian Commercial Code shall govern those provisions of this contract to which those Articles relate; specifically, to those questions arising hereunder regarding the appointment and termination of the distributor. Any issue relating to the issuance, interpretation or effect of the letter of credit provided for herein will be governed by the Uniform Customs and Practice for Documentary Credits (UCP). Construction of any trade terms will be in accordance with Incoterms. In all other matters, this agreement shall be governed by the Vienna Convention on the International Sale of Goods.

7.6 *Language*. The English version of this contract shall be the official language of the contract.

IN WITNESS HEREOF, the parties, by and through their duly authorized representatives, do hereby execute this agreement.