

International Business Transactions
Outline
Fall 2001 – Prof. Anderson

I. Introduction to IBT

- a. Elements in an economic analysis:
 - i. Risk – who bears the risk?
 - 1. Volatility – possibility of a good/gain or bad/loss thing happening. Distribution of outcomes around some point. An economist will not take a risk if possibility of loss is greater than potential gain.
 - ii. Return – who receives the return?
 - 1. Possibility of profit.
 - iii. Control – who has the control?
 - 1. Ability to determine what risks need to be taken to make certain gains.
 - iv. Cost of Capital

II. What Law Governs International Business Transactions – Lex Mercatoria [NOT ON EXAM!!]

- a. Historical System - Lex Mercatoria – The law merchant
 - i. Common law between merchants based on custom. This is the law of international merchants based on common usage.
 - ii. Authorities wanted commercial disputes to be heard in courts to give them control.
 - iii. Merchant courts were established with arbitrators which facilitated trade.
 - 1. Used shut-out of merchants from market as punishment
- b. Modern System
 - i. Most systems include mandatory arbitration.
 - ii. Some court systems (NY, London, HK) allow other contracting parties to select their jurisdiction.

III. International Contract Formation

- a. Contract as narrative
 - i. What does each party want?
 - 1. Reciprocal flows of value
 - ii. Reduce it to writing
 - 1. Standard documents may have adopted their own language over time and should not be changed.
 - 2. However, contract should be very clear.
 - iii. Sections of a contract (see also *infra*):
 - 1. Definitions
 - 2. Exchange being made – what each party expects to get
 - 3. Covenants, representations, warranties – assurance that the exchange promise is okay
 - 4. Breach – defining breach and remedies
 - 5. Legal framework for enforcement – arbitration; which jurisdiction
- b. Structure of the Contract
 - i. Definitions
 - 1. Loan – K between 2 people where borrower gets money and lender gets promise to repay principal plus interest.
 - 2. Interest – Rental cost of money.
 - 3. Debt – Borrowing money with a promise to repay the principal amount plus agreed upon interest over a certain schedule of time/
 - ii. Documents required in a lending transaction
 - 1. Promissory note – promise to repay in writing.
 - a. Moves law from K law into debtor/creditor law giving creditor stronger rights.
 - b. Removes failure to perform defenses and simply asks if the debtor owes.
 - c. Increases ability of lender to take debtor's property to protect loan.

- iii. Sections of a K (cont.):
 - 1. Conditions Precedent
 - a. Requirements which must be done before there is any obligation on the lender.
 - 2. Representations and Warranties
 - a. Assertions of fact at the moment the K is signed
 - 3. Covenants
 - a. Can be one-sided, unlike K's.
 - b. A unilateral promise, not an agreement.
 - c. Forward looking promise to do something after the K is signed and for the life of the K.
 - d. Can have affirmative or negative covenants.
 - 4. Events of default and remedies
 - a. Must declare in time to prevent government from stopping re-payment.
 - 5. Acceleration provision
 - 6. Liquidated Damages
 - a. Must not be an arbitrary amount, but should be lost value of K.
- c. Offers
 - i. Art. 14(1) – “A proposal for concluding a K addressed to one or more specific persons constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance.”
 - ii. A proposal is sufficiently definite if it indicates the goods and expressly or implicitly makes provision for determining the quantity and price.
 - iii. *UNCITRAL Abstract 106*
 - 1. Art. 55 – if the price is not explicit or implicit in the K, the parties are considered to have agreed to the usual market price.
 - 2. German supplier of chinchilla pelts. Austrian buyer of the pelts. Italian re-purchaser.
 - 3. Price was specified. Quantity determined. 13 pelts were returned for being poor quality.
 - 4. Ct. of Appeals finds that the CISG applies since the parties are member states. Constituted an offer under Art. 14. Austrian buyer's behavior showed acceptance. Currency was specified.
 - iv. *The Supreme Court of the Republic of Hungary*
 - 1. Facts: Letter of Intent was signed Dec 1990 about negotiations for aircraft engines. Π provided 2 parallel offers, one for Boeing engines and one for Airbus. Δ did not sign any acceptance, but sent a letter to Π indicating that they had chosen the PW4000 model. Δ later wrote a letter specifying that they did not want to purchase the PW4000. Π initiated a suit in 1991 asking for a declaration that the K was in force and its provisions violated.
 - 2. Issue: Whether Π's offers comply with Section 14 ¶1 of the CISG and whether Δ's letter constitutes acceptance.
 - 3. Discussion: A bid must define the product expressly and the price and quantity or directions as to how to calculate it. The price was not specified, and contrary to Π's contentions, cannot be determined since there is no market value for these products. Neither offer complied with CISG 14(1).
 - 4. Δ's stipulation that it chose the PW4000 model was an intention to close the K, not to create one.
 - 5. Holding: No sales K is established.
 - v. Good Faith
 - 1. CISG only suggests it as an interpretive guide.
 - 2. UNIDROIT obliges parties to deal in good faith upon negotiations.
- d. Revocation
 - i. Art. 2.3 and 2.4 - Acceptance is not effective until it reaches the offeror.

- ii. Art. 16(2)(a) – An offer is presumed revocable unless otherwise stated.
- iii. Art. 16(2)(b) – An offer is irrevocable where there is presumed reliance.
- iv. Art. 15(2) – Even an irrevocable offer may be revoked if the revocation reaches the offeror prior to the offer.
- e. Timing of Acceptance
 - i. Art. 18(1) – A statement or other conduct made by the offeree indicating assent is acceptance. Silence alone does not indicate acceptance.
 - ii. Art. 18(2) – Acceptance becomes valid the moment it reaches the offeror, so long as it is within the time frame specified.
 - iii. Art. 18(3) – Acceptance by act is valid when designated by prior course of dealing.
 - iv. *German Court of Appeals, Cologne*
 - 1. Facts: Parties contracted to sell wood. Wood delivery was agreed upon in oral negotiations. A purchase order by buyer confirmed this agreement. Buyer then cancelled the order. Seller issued a letter expressing regret about her cancellation, but not accepting the letter.
 - 2. Discussion: Since the CISG applies (Germany is a contracting party), the German Conflict of Laws statute that would allow for silence to indicate acceptance, does not apply.
 - 3. Article 18(1) prevents mere silence from indicating acceptance; however, further activity by buyer (refraining from further activity) does indicate acceptance. Seller lost her claim to the purchase price.
 - v. Art. 21(1) – late acceptance may be ratified by the offeror through notice.
 - vi. Art. 19(1) – Mirror Image Rule – the acceptance must match exactly the terms of the offer. Otherwise, it constitutes a counter-offer.
 - vii. Art. 19(2) – If the additional terms do not materially alter the offer, the reply is an acceptance and the offer is concluded.
 - viii. *Filanto, S.p.A. v. Chilewich International*
 - 1. Facts: Action to impel arbitration in Moscow. NY importer-exporter made deal with Russian distributor to ship shoes from Italian manufacturer, Filanto. Δ sent K which included a stipulation that the Russian K attached would be binding in full. Π accepted with the stipulation that they would only adhere to 3 sections of the Russian K. A memo was later sent indicating that the Russian K and arbitration clause apply in full. Π did not sign it immediately, and in the meantime, credit account was opened for Π by Δ pursuant to the agreement. Π later signed and opted out of all but 3 provisions of Russian K. Breach arose.
 - 2. Issue: Whether the parties agreed to accept the Russian K.
 - 3. Discussion: Prior course of dealing indicates acceptance by conduct of the Russian K. When an offeree, knowing that the offeror has commenced performance, fails to notify its objection to certain K terms within a reasonable time, has assented.
 - 4. Held: Π's cannot have it both ways. They must arbitrate in Moscow.
- f. Contract Performance
 - i. CISG Sections:
 - 1. CISG Art. 2 – Seller must tender goods that conform to the K. Disputes are resolved using the warranty clause.
 - 2. CISG Art. 35(1) – Warrant clause. Seller must tender goods of the quantity, quality, and description required by the K. Interpretation of the terms is guided by Art. 8.
 - 3. Art. 35(2) – Implied warrant of merchantability.
 - ii. Warranties:
 - 1. A buyer's expectation of quality derived from seller's implied or express representations is more protected under UCC Art. 2 than CISG Art. 2.

2. Disputes over quality turn on what the buyer expected under 35(1) and what was otherwise specified under 35(2).
- iii. *TJ Stevenson v. 81,193 Bags of Flour* involved a K to ship flour from a US producer to a Bolivian government distribution center. The flour was infested with weevils upon arrival.
 1. Δ Argument: The amount of infestation was not significant enough to prohibit resale.
 2. Held: CISG was not in existence at this time. The person buying for resale purposes must honestly be able to resell them in normal course of business because the product is what it says. Although no food is completely pure, the complete infestation present here made it unfit for human consumption. However, merchantability is an evolving standard and will change with each new case.
- iv. *Abstract 168 (Germany)* involved the sale of a used car from one car dealer to another. The represented mileage and license year were specified incorrectly. A disclaimer excluding any warranty was present.
 1. Held: CISG Art. 74 allows damages to be claimed from a seller if they were foreseeable. Also, Art. 35(3) affords the seller no protection since he acted fraudulently.
- v. Force Majeure:
 1. Force Majeure – nothing short of total impossibility will excuse nonperformance or partial performance. Must be tested under hardship article 6.2.1.
 2. *Abstract 168 (Russia)* involved a Russian buyer that purchased and received equipment from a German seller but did not pay because the bank did not have sufficient funds from the Russian gov. to transfer.
 - a. Δ Argument: The inability to produce the necessary currency was a force majeure that prevented it from paying.
 - b. Held: The K specified certain conditions which would qualify as force majeure and this was not one of them. Art. 54 required the Buyer to take necessary measures to ensure payment.
- vi. Hardship:
 1. Hardship alone does not excuse nonperformance. Where the performance of the K becomes onerous for one of the parties, that party is still bound to perform subject to the hardship provisions.
 2. For hardship to exist, there must first be events that fundamentally alter the equilibrium of the K either because the cost of performance has drastically increased or the value of receipt has drastically decreased. (Alteration of 50% or more).
 3. Must be shown that the events were not foreseen. If it is foreseeable, it must be dealt with in the K.
 4. Parties should specify the contingencies which invoke force majeure.
 5. Effects of Hardship:
 - a. If circumstances become onerous, party can request negotiations to adjust K.
 - i. Performance must continue throughout.
 - b. If negotiations fail, court may be applied to.
 - c. If hardship is found, court may revise or terminate K.
- g. Delivery Obligations
 - i. Seller's obligations
 1. CISG Art. 30 – The seller must deliver the goods and hand over any required documentation (title) and transfer the property of the goods (transfer title legally) according to the K and the Convention (can be modified by K).
 2. Delivery occurs when and where the buyer receives the goods.
 3. *Phillips Puerto Rico v. Tradax Petroleum* involved a K for the sale by Δ to Π of petrol that is to be shipped from a 3rd party in Algeria (where Δ purchased the oil). The K accepted

Incoterms and declared a “C & F” (Cost and Freight) K whereby buyer assumes risk of loss as soon as the goods are shipped.

- a. Dispute: An unusual delay of transport occurred as a result of a Coast Guard stop and bad weather after the shipment was packed up and shipped off. Upon tender of the documents, Π refused to pay and invoked the *force majeure* clause claiming that the latent defect in the ship made performance impossible. Another ship was arranged by Δ but payment was still refused.
 - b. Held: A C & F clause places all responsibility on the buyer once the goods are shipped. Since the shipment in this case had begun, and the documents were not defective, Δ is relieved of liability and entitled to a remedy. The delay of the ship did not frustrate the purpose of the K.
- ii. Buyer’s obligations
1. CISG Art. 53 – buyer must pay the price for the goods and take delivery of them as specified in the K. Also must take whatever action necessary to assure payment.
 2. If time of payment is not specified, it is assumed to be upon delivery.
 3. Unless otherwise specified, buyer must pay at seller’s place of business. If you made delivery arrangements, must pay at delivery.
 4. Seller need not hand over goods if buyer refuses to pay.
 5. Buyer is not obligated to pay until he inspects the goods.
 6. *Abstract – Austria (p. 157)* involved the sale of metal sheets from Austria to Germany. Arrangements for installment shipments with payment expected upon delivery were made. Buyer did not pay for some goods, but took delivery of them.
 - a. Held: CISG applies. Seller had the right and duty to mitigate its losses. Seller entitled to difference between contract and sale price.
- h. Risk of Loss
- i. Once the seller has performed, risk of loss passes to the buyer and buyer is still obligated to pay.
 - ii. Buyer is not required to pay if seller is responsible for damage or loss.
 - iii. Risk of Loss Default Rules under CISG Art.:
 1. 67 – K for sale of goods in carriage
 - a. Seller is not bound to deliver at a particular location.
 - b. Risk passes to buyer when goods handed to 1st carrier.
 2. 68 – K for sale of goods in transit
 - a. Risk of loss passes to buyer when K is made.
 3. 69 – K for sale of goods neither in transit or carriage
 - a. Risk passes to buyer when seller delivers goods. Goods picked up by buyer.

IV. Covenant on the International Sale of Goods (CISG)

- a. Basic Concepts:
 - i. CISG covers all subjects pertaining to the international sale of goods
 - ii. CISG is a treaty
 1. Most countries have adopted it and elevated it above their national law.
 2. The US does not do this but makes it equal with national law.
 - iii. No application to goods purchased for home use or bought by action of law
 - iv. Incoterms – List of ICC (Int’l Chamber of Commerce) terms that give definition for international trade concepts.
 - v. Oral offers must be accepted immediately.
- b. Application Questions:
 - i. CISG applies to contracting parties unless otherwise specified in the agreement.
 - ii. If the CISG applies, evidentiary rules change – no more parol evidence or statute of frauds.
- c. Article Interpretation:
 - i. Article 1: (a) CISG applies to sale of goods across contracting party borders.

- ii. Article 1: (b) CISG applies when Private International Law leads contracting state to apply.
 - 1. If a contracting state contracts with a non-contracting state and the conflict of laws provision of the non-contracting state incorporates contracting party laws, CISG applies.
- iii. Article 2: Transactions excluded from CISG application.
 - 1. *Kaminsky v. MAP* – distributorship agreement between Australian producer and American distributor. Producer goes bankrupt and tries to claim insolvency to distributor/creditor. Held, the goods sold are not specified in the distributorship agreement and thus CISG does not apply.
- iv. Article 3: Supply contracts are sale of goods for purposes of CISG unless receiver opts out.
- v. Article 8, 11: No parol evidence rule – you are not limited to the language of the K.
 - 1. No statute of frauds – Contract may be proven by any means and does not have to be in writing.
 - 2. *Beijing Metals v. American Business Ctr.* – US distributor wishes to sell gym equipment ordered from China. Bad quality in goods identified after K begins. *Oral agreement* to adjust prices to make up for defective shipment. Held, since suit is brought in Texas, court does not apply CISG and thus does not permit oral evidence.
 - 3. *MCC Marble v. Ceramica Nuova* – Distributor of tiles makes agreement with Italian manufacturer. A dispute arises and manufacturer claims that the forms contained exclusions that were not adhered to. Oral modifications are not considered by lower court. Held, CISG applies since both parties are contracting members. Evidence of oral modifications must be considered.
- vi. Article 14: Marketing must be targeted to specific individuals – no mass marketing.
 - 1. Must be intention to be bound by offer.
 - 2. Definite price and quantity must be included.
- vii. *Article 15(2): An offer, even if irrevocable, may be withdrawn if the withdrawal reaches the offeree before or with the acceptance.
- viii. *Article 16: (1) An offer can generally be revoked anytime prior to acceptance being dispatched.
 - 1. (2) An offer cannot be revoked if it indicates a fixed time for acceptance or if it was reasonable for the offeree to rely on the offer as irrevocable and the offeree has acted in reliance on the offer.
- ix. *Article 17: An offer, even if irrevocable, is terminated when a rejection reaches the offeror.
- x. *Article 18: A statement by or assent to an offer is an acceptance. Patterns of behavior also may constitute acceptance. Silence or inactivity does NOT indicate acceptance.
- xi. Article 19: Changing the terms of an offer is a counter-offer and NOT an acceptance.
 - 1. However, if a reply includes minor modifications that are immaterial, it is acceptance.
- xii. Article 20: If a period of time is given for acceptance, it begins when handed in for dispatch.
- xiii. Article 35(1): Seller must deliver goods as specified in contract in manner agreed to.

V. Contract Performance under CISG

- a. Conformity of goods – do the goods conform to the K requirements – were they shipped to the right place; are they of the right quality, etc.?
 - i. Issue usually arises on seller's side since they produce the goods.
 - ii. Warranties:
 - 1. Express – written out in K.
 - 2. Implied – generally accepted in line of business; enforced by courts.
 - iii. Risk of loss – who bears the risk at each point of sale?
- b. Distinguish UCC
 - i. Warranties are applied even if not specified in K:
 - 1. Implied warranty of merchantability – goods provided in condition that can be resold.
 - 2. Implied warranty of fitness – goods fit for use by certain end-user.
 - ii. CISG uses more flexible approach – goods must conform to contract specifications.

- iii. *TJ Stevenson* – Applied UCC. Flour was shipped from US to Bolivia under an implied warranty of merchantability. Risk of loss shifted to the buyer upon transport, where the batch became infected with pests. The pests made the flour unmarketable. Held, the products would be returned by consumers and do not conform to standard for this line of business. Not expected in this line of trade.
 - 1. NOTE: CISG Art. 35, 8 and 9 would have applied and result would be the same.
- c. Exemptions from Performance:
 - i. Force Majeure – Acts of God; Acts of government (performance becomes illegal; nationalization); Civil war/War.
 - 1. Performance must be rendered *impossible*.
 - ii. Hardship/Undue Burden – Most flexible standard.
 - 1. Impossibility NOT required.
 - 2. Performance must be more costly, impracticable, unduly burdensome, onerous, or fundamentally altered in its commercial assumptions.

VI. Delivery Obligations of the Seller

- a. CISG Applications:
 - i. Article 30: General seller obligations
 - ii. Article 31(a): Default rule for when seller's obligation ends absent K terms.
- b. Risk of Loss
 - i. Must be allocated between seller and buyer.
 - ii. Could be transferred to: 1) transport company 2) insurance company
 - iii. Merchants become creditors.
- c. Letters of Credit
 - i. Purpose:
 - 1. Confirms that seller will be paid and goods will conform.
 - ii. Types:
 - 1. Cash-in-advance: Good for buyer/Bad for seller.
 - 2. Open Account: Good for seller/Bad for buyer.
 - iii. Documentary Credits (larger category):
 - 1. Application for Letter of Credit
 - a. K between Buyer and Issuing Bank
 - b. Opened in a certain amount in favor of Seller
 - c. Seller named as beneficiary (no right to sue)
 - d. Buyer deposits funds
 - 2. Letter of Credit
 - a. K between Issuing Bank and Seller
 - b. Bank's irrevocable promise to pay if *documents* conform (not goods)
 - 3. Contract of Sale
 - a. K between Buyer and Seller
 - b. No bank specification
 - iv. Structure: Types of Letters -
 - 1. Straight Irrevocable Letter of Credit (basic form)
 - a. Routing money from buyer to bank to seller.
 - b. Bank charges fee for service.
 - c. If conducting business in 2 different areas, another bank (or branch of first) is added to transaction to establish trust with seller.
 - i. Issuing bank and Paying bank.
 - d. The required documentation is usually a standardized one-page form which is a negotiable instrument.
 - e. Seller is assured payment so long as goods conform. If buyer disputes with bank, seller is unaffected.

2. Stand-by Letter of Credit
 - a. L/C used as a guarantee – not necessarily cash put up, but more as security to be used when necessary.
 - i. Similar to insurance policy without the hassle of litigation.
3. Back to Back L/C
 - a. Two letters of credit standing back to back.
 - b. Used by importer who does not want to put up full cash since he will just sell goods when he receives them anyway.
 - c. Letter #1: Importer gets L/C from Issuing Bank to put up money and charge interest to importer
 - d. Letter #2: Retailer gets L/C in favor of Importer
 - e. Terms of the two letters usually match.
 - f. Retailer has L/C with Importer who has L/C with exporter.
- v. Structure: Types of Banks (often all one bank) -
 1. Issuing Bank – Establishes letter of credit
 2. Paying Bank – Examines documents; commonly acts as issuing bank also
 3. Confirming Bank – Guarantees performance of issuing bank; confirms other bank's L/C
 4. Advising Bank – Advises Issuing bank when payment is made; receives documents; not obligated to make payments
- vi. Caselaw:
 1. Overruling L/C bank:
 - a. **Power Curber International* – An American seller shipped goods to a Kuwaiti buyer under a letter of credit. The Kuwaiti courts refused to allow the Kuwait bank to pay seller. They agree to have UK court make final determination. Held, L/Cs must be respected in the interest of international commerce.
 2. Completeness of compliance with L/C:
 - a. **Equitable Trust Company of NY v. Davson Partners* – Agreement to ship vanilla beans and have them certified by *experts*. Shipping company discovers that the Dutch government does not provide such certificates and this they secured an outside expert. The bank paid and the seller disappeared. Held, L/C must adhere with strict compliance – no exceptions! Multiple experts were required here.
 - b. *Voest Alpine International Corp.* – Strict and literal compliance is necessary. No common-law history to L/Cs.
 - c. *Beyene v. Irving Trust* – Seller trying to sell 2 houses in Yemen through a paying bank wrote misspelled name on Bill of Lading. Held, since this is not a common American name, a misspelling makes this a material error and prevents enforcement. Even one wrong letter = non-compliance.
- vii. Fraud
 1. What constitutes fraud depends on what legal system you are in.
 - a. Requires intent
 - i. As distinguished from disputes over merchantability
 - b. Must intend to perpetrate deceit on the other party
 2. Types of fraud:
 - a. Fraud at level of goods
 - i. Bank's knowledge is extrinsic – it does not check the goods
 - ii. If buyer learns of fraud and tells bank, bank NOT obligated to withhold payment
 - b. Fraud of documents
 - i. Bank's knowledge is intrinsic – it does check documents
 - ii. Bank is entitled to withhold payment pending investigation.
 - iii. If buyer tells banks of fraud and bank pays, bank may be liable.

VII. Model Credit Agreement

- a. Structure
 - i. Guarantee backed up by stand-by L/C.
- b. Required contracts:
 - i. Lending Agreement
 - ii. Promissory Note
 - iii. Agreement between banks
 - iv. Agreement with central bank for guarantee
 - v. L/C between central and outside bank
- c. Revolving credit arrangement – money can be drawn out and paid back (similar to credit card)
- d. Short-term cash needs:
 - i. LIBOR (London Inter-bank Offer Rate) + Interest = rate charged
- e. Long term cash needs:
 - i. Lower rate

VIII. Franchising

- a. Purpose
 - i. Consistent quality across various locations
 - ii. Driven by quality and consistency but dependent upon services
 - iii. Essential components of the business must remain stable
 - iv. Profit motive drives franchisee to run the business well
 1. Split ownership and control increases profits
 2. Risk and capital should be spread
 3. Franchisee must be an active participant
- b. Franchisor --> Franchisee
 - i. *Brand name* – increases customer base and recognition
 1. Also creates risk if something goes wrong under your name
 - ii. Transfer certain *goods and services*
 - iii. Transfers *intellectual capital* through service manual or instructions on success of business