CANTERBURY EMPLOYERS' CHAMBER OF COMMERCE

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INTERNATIONAL TRADE

CONTRACTUAL ISSUES FOR EXPORTERS

QUICK GUIDE

CONTRACTUAL ISSUES FOR EXPORTERS

The major differences between a domestic contract and an international contract are:

- the buyer and seller are in different countries;
- the buyer and seller may not have had any prior dealings with each other and are unaware of each other's standing in the business community;
- the buyer and seller know nothing about the applicable laws of the other country;
- international contracts require compliance with government regulations, custom duties and health and inspection requirements;
- as the goods are often in transit for considerable periods of time, the contract needs to carefully cover risk issues and when risk and the property in goods pass from the seller to the buyer;
- considerations are required in respect of the time and method of payment, insurance and carriage;
- there will be requirements for specialised documentation such as a bill of lading or documentary letter of credit.

In international transactions there will be contractual relations between:

- the buyer and the seller;
- a consignor and carrier or freight-forwarder (a contract of carriage);
- insurer and insuree;
- buyer and the bank which issues a documentary letter of credit (or its electronic equivalent);
- buyer and seller with the bank for payment under the terms of the documentary letter of credit;
- buyer and third parties (for pre-inspection of goods);
- other parties to form distributorship agreements, franchise agreements, agency agreements, licence agreements, royalty agreements etc.

The most important matters to be addressed in a contract that are specific to cross jurisdictional transactions are:

1. **The Law Applicable to the Contract**:

   Special rules and regimes will apply generally to each contract, but the parties can override those rules and state in the contract the law that will govern the transaction. This brings certainty. Obviously most companies would like to see that each contract states that the law of New Zealand applies.

   It is most important in every situation to state the intentions of the parties – when parties fail to provide for an issue in their contract (or the intention is not clear) then other regimes come into play.

   The Sale of Goods (United Nations Convention) Act 1994 gives effect to the Vienna Convention for International Sale of Goods 1980 (**CISG**). This regime provides an internationally acceptable set of rules to reduce the difficulties involved in international trade because of differences in the legal systems of the member countries. It is therefore a 'backstop system' - important where parties have failed to deal with a matter in their contract. It is not advisable to contract solely on the basis of the regime, as it is not complete. Needless to say, New Zealand is a member country.

2. ‘**The Passing of Risk and Property in the Goods**:

Delivery: Time of delivery is usually when the documents (bill of lading) are handed over, which usually coincides with the passing of property in the goods. At that time the price should be calculated and the risk in the goods should pass. The point of delivery is usually defined by reference to an **INCOTERM**.

Passing of Risk: Generally, passing of risk occurs upon delivery. Note that there may be a separate right of action against a carrier, therefore insurance provisions are important. The CISG regime is in accordance with the provisions of the incoterms – New Zealand Law, by contrast, provides that risk passes when ownership in the goods passes, not at delivery. This is inappropriate for international transactions, which makes it all the more important to use incoterms or to stipulate the point at which risk passes within the contract.

Passing of Property: This is not dealt with by INCOTERMS or the CISG regime. Passing of property will be dependent on the domestic law applicable to the contract. In New Zealand, priority is given to the parties’ intentions as expressed in the contract. Generally, it will be when the seller has received payment or a legally enforceable promise to pay from the buyer. Note that the passing of property will probably be further clarified in a retention of title/romalpa clause. Note that property need not pass when risk transfers.

3. **Price and Exchange Rates**:

Price: Give consideration to what costs apply over and above the costs of producing the goods (e.g. freight, insurance during transit etc). INCOTERMS not only determine when delivery is and when risk passes – they also determine who pays for the freight, insurance and who organises import and export licences, customs clearances and the like.

Exchange Rates: If a New Zealand exporter is paid in foreign currency, they become exposed to the risk of fluctuation in the exchange rates. This can be avoided by pricing the contract in New Zealand dollars however buyers may not be keen to do business on that basis. Forward exchange contracts and foreign currency accounts are two devices which may be used. The former is a contract to buy or sell a certain amount of foreign currency at a predetermined future date, at an established rate of exchange. The latter is an option which enables export proceeds to be held in the foreign currency until such time as the exchange rate moves favourably to the New Zealand exporter.

The Payment Process: An exporter will hesitate to send goods without assurance as to payment, and the other party will hesitate to pay for goods not yet received. There are four methods usually used in international trade:

- *Open Account*: All risk lies with the seller, as the seller dispatches the goods before payment is made.

- *Payment in Advance*: All risk is with the buyer, as the goods are paid for when the contract is entered into. It is used usually for small transactions only and where there is an established relationship between the parties etc.

- *Documentary Collection*: Here the international banking system is utilised to collect payment from the buyer. Both the seller’s and the buyer’s banks are involved. The transport documents are shown by the seller’s bank to the buyer’s bank and the originals sent once payment has been made. The difficulty with documentary collection is that the seller is not assured of payment when the goods are dispatched. Payment is received on presentation of documents to show that the goods have been sent, and there can of course be a delay.

- *Documentary Letter of Credit*: This was established to overcome the difficulties in documentary collection. The whole system operates on the premise that certain documents relating to the transaction are treated as representing the goods themselves.

The buyer has its bank provide credit to the seller on receipt of documents (which constitute title to the goods). The seller's bank forwards documents to the buyer's bank on an undertaking that, upon receipt of the documents, the contract price will be forwarded through the international telecommunication network SWIFT (Society for Worldwide Inter-Bank Financial Communications) to it. The buyer's bank undertakes to the buyer not to pay the contract price until the documents are received in proper form.

Payment from a seller's bank may be on one of the following bases:

- *Sight payment*: The seller's bank is to pay to the seller on presentation of documents.

- *Deferred payment credit*: The seller's bank is to pay at some future date determinable in accordance with the terms of the letter of credit. It may provide, for example, payment 180 days from the date of the transportation documents – if the seller requires the cash prior to that date, they can negotiate the letter of credit at a discount, which obviously reduces the amount of credit due to the seller.

- *Acceptance credit*: The seller draws a bill of exchange on the buyer's bank and the buyer's bank is committed to pay the face value of the bill on its maturity. The seller may of course turn it into cash by negotiating it for a discounted figure with the buyer's bank or perhaps even selling it to its own bank.

- *Negotiation credit*: The seller's bank is only authorised to negotiate a bill of exchange drawn by the seller on the buyer or the buyer's bank.

Credits may be revocable or irrevocable. The former may be amended or cancelled at any time and therefore provide no more protection to a seller than a documentary credit would. Under an irrevocable credit payment is assured (provided that documents are presented and the seller complies with the terms and conditions of credit).
A seller's bank is involved to facilitate performance of a credit – it is unconfirmed when the seller's bank doesn't give the seller any independent undertaking as to payment against presentation of conforming documents. It is confirmed when the advising bank does undertake to make such payments.

4. **Insurance**:

The INCOTERMS should be used to make it clear who will be responsible for arranging and paying for insurance. The party who is at risk should insure the goods. The type or extent of insurance should be specified.

'Floating Policies' cover many different shipments of cargo in the one policy. The buyer is entitled to a policy covering only the type of goods contracted for, and pays a lump sum premium.

- 'Open Cover' is one of the most common forms of general cover – it covers a number of shipments either for a fixed period of time or on a permanent basis subject only to termination by notice. A shipper declares the individual shipments and the premium is calculated on the basis of the values declared. A certificate of insurance is then issued for each shipment.

- 'Marine Insurance Policies' can be either valued or unvalued – if the latter, the value has to be proved by invoices.

- 'Institute Cargo Clauses' – the Institute of London Underwriters with Lloyd's Underwriters Association drafted standard clauses that are used in the London market and elsewhere. This is the most commonly used form of cargo insurance. There are three standard clauses:

  - An 'all risks' clause – this policy covers damage caused by insufficient packing, ordinary wear and tear, losses resulting from delay, insolvency of the carrier, unseaworthiness of the ship, loss of damage caused by wars, revolutions, strikes and lockouts.

  - Specified risks only – covers fire, explosion, stranding of vessel, collision, certain natural disasters, action taken to protect the ship and the cargo, jettison or washing overboard, damage caused by entry of sea, lake or river water.

  - Specified risks only – covers even fewer than (b) above, e.g. water damage and washing overboard are not included.

  There is also an institute cargo clause for air travel which is similar. Air Cargo Transit Insurance can be taken out in the marine insurance market or the aviation market.

- 'Export Credit Risks Insurance' – covers the risk that the buyer may not pay. It will cover the commercial risk and those risks outside the control of the seller or buyer, e.g. adverse foreign government intervention or exchange control regulations intervention.

5. **Dispute Resolution**:

- Mediation: The parties will need to make it clear in the contract as to how the mediator will be appointed.

- Arbitration *(where the third party has the authority to determine how the matter is to be settled)*: Domestic laws on arbitration differ significantly. Many countries opt towards international commercial arbitration and several forums exist. The two most important are as follows:

  - UNCITRAL (United Nations Commission on International Trade Law).

  - The International Chamber of Commerce Court of Arbitration.

  The Reciprocal Enforcement of Judgements Act 1934 provides that Court decisions of any Commonwealth Country can be enforced in any other Commonwealth Country.

  Force Majeure or the "Doctrine of Frustration" is based on the notion that relief should be given where performance of a contract is defeated through no fault of the parties (acts of God, war, new legislation etc). Such clauses should be inserted.

6. **Distribution Agreements**:

- Rather than simply exporting, sellers may wish to impose some degree of control over the promotion, marketing and distribution of goods in foreign jurisdictions. A distribution agreement may be more appropriate than a straight export contract.

- Distribution Agreements involve the exporter granting an overseas buyer (distributor) trading rights in respect of goods of a specified kind within a particular territory. The distributor may be granted sole or exclusive rights:

  - Sole – the seller may undertake sales in the territory of the distributor on its own account without any liability to the distributor;
  - Exclusive – the seller is not allowed to compete with the representative in the allotted territory.

In essence, distributor agreements provide that the seller grants the buyer (an overseas merchant) sole or exclusive trading rights within a particular territory with respect to goods of a specified kind while the buyer may undertake to rely on the seller as the source of supply.

Such agreements are not contracts for sale of goods – they simply lay down the terms on which later individual contracts of sale will be concluded. Distribution contracts should include:

- description of territory;
- provision relating to the ascertainment of the price;
- definition of goods;
- provision for the buyer to undertake minimum amounts of advertising;
- provision for the buyer to inform the seller of market information;
- provisions to protect the seller's patents and trademarks;
- general conditions;
- length and effectiveness of the contract.

7. **GST**:

The general rule is that when goods are exported from New Zealand the supply will be zero rated.

For further information regarding Contractual Issues for Exporters, or any other aspect of international trade, please contact The Chamber, email info@cecc.org.nz or phone 03 366 5096.