Chapter XV. Settlement of disputes

Footnote to paragraph 12

The following model clause is recommended in the UNCITRAL Conciliation Rules:

"Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force."

Footnote to paragraph 28

The following clause is recommended in the UNCITRAL Arbitration Rules:

"Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force.

"*Note—Parties may wish to consider adding:*

"*(a)* The appointing authority shall be . . . (name of institution or person);

"*(b)* The number of arbitrators shall be . . . (one or three);

"*(c)* The place of arbitration shall be . . . (town or country);

"*(d)* The language(s) to be used in the arbitral proceedings shall be . . ."

C. International countertrade: draft chapters of legal guide on international countertrade transactions: report of the Secretary-General (A/CN.9/362 and Add.1-17) [Original: English]

CONTENTS

[A/CN.9/362]	*Page*
DRAFT CHAPTERS OF LEGAL GUIDE ON INTERNATIONAL COUNTERTRADE TRANSACTIONS: REPORT OF THE SECRETARY-GENERAL	92
[A/CN.9/362/Add.1]	
I. INTRODUCTION	93
[A/CN.9/362/Add.2]	
II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE	94
[A/CN.9/362/Add.3]	
III. CONTRACTING APPROACH	98
[A/CN.9/362/Add.4]	
IV. COUNTERTRADE COMMITMENT	105
[A/CN.9/362/Add.5]	
V. GENERAL REMARKS ON DRAFTING	116
[A/CN.9/362/Add.6]	
VI. TYPE, QUALITY AND QUANTITY OF GOODS	119
[A/CN.9/362/Add.7]	
VII. PRICING OF GOODS	125
[A/CN.9/362/Add.8]	
VIII. PARTICIPATION OF THIRD PARTIES	132
[A/CN.9/362/Add.9]	
IX. PAYMENT	139
[A/CN.9/362/Add.10]	
X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS	149
[A/CN.9/362/Add.11]	
XI. LIQUIDATED DAMAGES AND PENALTY CLAUSES	153

Page

[A/CN.9/362/Add.12]
XII. SECURITY FOR PERFORMANCE 158

[A/CN.9/362/Add.13]
XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION 164

[A/CN.9/362/Add.14]
XIV. CHOICE OF LAW 173

[A/CN.9/362/Add.15]
XV. SETTLEMENT OF DISPUTES 177

[A/CN.9/362/Add.16]
DRAFT ILLUSTRATIVE PROVISIONS 185

[A/CN.9/362/Add.17]
CHAPTER SUMMARIES 189

[A/CN.9/362]

DRAFT CHAPTERS OF LEGAL GUIDE ON INTERNATIONAL COUNTERTRADE TRANSACTIONS: REPORT OF THE SECRETARY-GENERAL

1. The Commission considered its possible work on the topic of countertrade at its nineteenth session (1986) in the context of the discussion of a note by the Secretariat entitled "Future work in the area of the new international economic order" (A/CN.9/277). There was considerable support in the Commission for undertaking work on the topic, and the Secretariat was requested to prepare a preliminary study on the subject (A/41/17, para. 243).

2. At its twenty-first session (1988), the Commission had before it a report entitled "Preliminary study of legal issues in international countertrade" (A/CN.9/302). The Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up countertrade contracts. In order for the Commission to decide what further action might be taken, the Commission requested the Secretariat to prepare for the twenty-second session of the Commission a draft outline of such a legal guide (A/43/17, paras. 32-35).

3. At its twenty-second session (1989), the Commission considered the report entitled "Draft outline of the possible content and structure of a legal guide on drawing up international countertrade contracts" (A/CN.9/322). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare for the twenty-third session of the Commission draft chapters of the legal guide (A/44/17, paras. 245-249).

4. At its twenty-third session (1990), the Commission considered an outline of the introductory chapter to the legal guide, and draft chapter II, "Scope and terminology of legal guide" (both in A/CN.9/332/Add.1), as well as the following draft chapters: III. "Contracting approach" (Add.2); IV. "General remarks on drafting" (Add.3); V. "Type, quality and quantity of goods" (Add.4); VI. "Pricing of goods" (Add.5); IX. "Payment" (Add.6); and XII. "Security for performance" (Add.7). The discussion in the Commission is reflected in A/45/17, annex I. There was general agreement in the Commission with the overall approach taken in preparing the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein (A/45/17, para. 16). The Commission decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them to the Working Group on International Payments. It was also decided that the final text of the legal guide should be submitted to the twenty-fifth session of the Commission in 1992 (A/45/17, paras. 17 and 18).

5. The Working Group on International Payments, at its twenty-third session in September 1991, considered draft chapters VII. "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8); VIII. "Participation of third parties" (A/CN.9/WG.IV/WP.51/Add.1); X. "Restrictions on resale of countertrade goods" (Add.2); XI. "Liquidated damages and penalty clauses" (Add.3); XIII. "Failure to complete countertrade transaction" (Add.4); XIV. "Choice of law" (Add.5); XV. "Settlement of disputes" (Add.6); and draft illustrative provisions (Add.7). The discussion in the Working Group is reflected in document A/CN.9/357. The Working Group requested the Secretariat to revise the draft chapters and illustrative provisions in the light of the Working Group's deliberations and decisions and to present them to the twenty-fifth session of the Commission (A/CN.9/357, para. 13).

6. Addenda 1 to 17 to the present document contain the following revised draft chapters and other materials relating to the Legal Guide:

I. "Introduction" (Add.1)
II. "Scope and terminology of Legal Guide" (Add.2)
III. "Contracting approach" (Add.3)

IV. "Countertrade commitment" (Add.4) (draft chapter IV incorporates revised earlier draft chapter VII, "Fulfilment of countertrade commitment" and revised section C of earlier draft chapter III, "Contracting approach")

V. "General remarks on drafting" (Add.5)

VI. "Type, quality and quantity of goods" (Add.6)

VII. "Pricing of goods" (Add.7)

VIII. "Participation of third parties" (Add.8)

IX. "Payment" (Add.9)

X. "Restrictions on resale of countertrade goods" (Add.10)

XI. "Liquidated damages and penalty clauses" (Add.11)

XII. "Security for performance" (Add.12)

XIII. "Failure to complete countertrade transaction" (Add.13)

XIV. "Choice of law" (Add.14)

XV. "Settlement of disputes" (Add.15)

Draft illustrative provisions (Add.16)

Chapter summaries (Add.17)

Index (Add.18)[a]

[A/CN.9/362/Add.1]

I. INTRODUCTION

A. Origin and purpose of the Legal Guide

1. This Legal Guide was prepared by the United Nations Commission on International Trade Law (UNCITRAL) and by its Working Group on International Payments. In addition to representatives of member States of the Commission, representatives of many other States and of a number of international organizations participated actively in the preparatory work.

2. The Commission considered work to be undertaken in the area of countertrade in 1986, in the context of the discussion of the Commission's work in the field of the new international economic order.[1] In 1989 the Commission decided to prepare a legal guide on international countertrade transactions and requested the Secretariat to prepare draft chapters of such a guide.[2] The draft chapters were discussed at the twenty-third session of the Commission in 1990,[3] and at the twenty-third session of the Working Group on International Payments in 1991.[4] [The Commission reviewed the revised draft chapters and approved the Legal Guide at its twenty-fifth session in 1992, subject to editorial modifications left to the Secretariat.[5]]

3. In preparing draft materials for consideration by the Commission and the Working Group, the Secretariat consulted with practitioners and other experts in the field of international countertrade. In addition, it examined model contract forms, general contract conditions and individual contracts from various parts of the world. Such sources are too numerous to be acknowledged individually; however, recognition is hereby given to their contribution in the preparation of the Legal Guide.

4. The preparation of the Legal Guide was motivated by an awareness that parties engaging in countertrade may lack relevant legal knowledge and experience, and that as a result they may not find optimal contractual solutions to legal issues that may arise in countertrade transactions. Those issues arise in particular from the fact that countertrade transactions are composite transactions encompassing the supply of goods in two directions, that there is a contractual link between those supplies of goods and that countertrade transactions often contain commitments of parties to enter into future contracts. Contractual solutions are particularly important in this area because national legislations often do not contain provisions specific to countertrade. Legal difficulties in this area may adversely affect many parties from developing countries, as well as parties from industrially developed countries, in particular if they do not regularly engage in countertrade.

5. The Legal Guide seeks to assist parties negotiating international countertrade transactions by identifying the legal issues involved, discussing possible approaches to the solution of the issues and, where appropriate, suggesting solutions that the parties may wish to agree on. The discussion in the Guide takes into account disparities among national laws. It is hoped that one result of the Guide will be to promote the development of an international common understanding as to the identification and resolution of legal issues arising in connection with countertrade transactions.

6. The Legal Guide has been designed to be of use to persons involved at various levels in negotiating and drawing up contracts in international countertrade transactions. It is intended for use by lawyers as well as by participants in countertrade who do not have a legal background. The Guide is also intended to be of assistance to persons who have overall managerial responsibility, and who require a broad awareness of the structure of those transactions and the principal legal issues to be covered by them. It is emphasized, however, that the Legal Guide should not be regarded by the parties as a substitute for obtaining legal advice from competent advisers.

7. It should be noted that the various solutions discussed in the Legal Guide will not govern the relationship between

[a]Addendum 18 was not issued.

[1]Report of the United Nations Commission on International Trade Law on the work of its nineteenth session, *Official Records of the General Assembly, Forty-first Session, Supplement No. 17* (A/41/17), paras. 235-243.

[2]Report of the United Nations Commission on International Trade Law on the work of its twenty-second session, *Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17* (A/44/17), para. 249.

[3]Report of the United Nations Commission on International Trade Law on the work of its twenty-third session, *Official Records of the General Assembly, Forty-fifth Session, Supplement No. 17* (A/45/17), paras. 11-18 and annex I.

[4]Report of the Working Group on International Payments on the work of its twenty-third session (A/CN.9/357).

[[5]Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session, *Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17* (A/47/17), paras. 83-139.]

the parties unless they expressly agree upon such solutions, or unless the solutions result from provisions of the applicable law. In addition, the Legal Guide is not intended to be used for interpreting agreements or contracts in countertrade transactions.

B. Arrangement of the Guide

8. Chapter II defines the scope of the Legal Guide by describing transactions covered by it and by explaining the focus of the discussion and the types of issues addressed. Since a prevailing terminology has not developed in countertrade practice, particular notice should be taken of chapter II, section E, which sets out certain terms specific to countertrade that are used throughout the Guide.

9. Chapter III describes possible contracting approaches to structuring a countertrade transaction. Chapter III also sets out possible types of contract clauses that parties may use, depending on the contracting approach chosen. Those types of clauses are discussed in chapters IV to XV. The discussion in the Legal Guide is restricted to those types of clauses that are specific to or of special importance for countertrade transactions.

10. Some of the clauses discussed in the Legal Guide are essential for establishing a countertrade transaction. Other clauses discussed in the Guide, while not necessarily essential, may be useful in the context of the particular commercial circumstances. In view of the great variety of circumstances in which countertrade transactions are concluded, the Legal Guide does not contain a general suggestion as to the types of clauses that parties should agree upon. It is for the parties to each transaction to judge the extent to which the issues considered in the Guide are relevant to their transaction.

C. Recommendations in the Guide

[The following paragraph, except for the modifications in italics, appeared in document A/CN.9/332/Add.1, under the title "I. Introduction to Legal Guide".]

11. *Where appropriate, the Legal Guide contains* suggestions as to how certain issues in a countertrade transaction might be settled. Three levels of suggestion have been used. The highest level is indicated by expressions to the effect that the parties "should" take a particular course of action. *Such expressions are used sparingly in the Guide and only when a particular* course of action is a logical or legal necessity. An intermediate level is used when it is "advisable" or "desirable", but not logically or legally required, that the parties adopt a particular course of action. The lowest *level of suggestion is expressed by* formulations such as "the parties may wish to consider" or "the parties might wish to provide", or the agreement by the parties "might" contain a particular solution. The wording used for a particular suggestion may be, for drafting reasons, varied somewhat from that just indicated; however, it should be clear from the wording what level of suggestion is intended.

D. Illustrative provisions

[The following two paragraphs, except for the modification in italics, have been taken from document A/CN.9/WG.IV/WP.51/Add.7, para. 4.]

12. Some chapters of the Legal Guide contain one or more "illustrative provisions" set forth in footnotes. They are included in order to make issues discussed in the text of a chapter easier to understand. They also serve to illustrate how certain solutions discussed in the text might be structured. Illustrative provisions have not been included where an understanding of an issue and guidance to drafting is clearly obtainable from the text of the chapter, or where a provision cannot be drafted in isolation from the particular countertrade transaction.

13. It is emphasized that illustrative provisions should not necessarily be regarded as models for inclusion in particular agreements entered into by the parties. The precise content *and formulation of a clause may* vary with each countertrade transaction. In addition, there is usually more than one possible solution to an issue, even though only one of those possible solutions is presented in an illustrative provision. It is therefore important that parties who draft a provision based upon an illustrative provision carefully consider whether the provision fits harmoniously within their countertrade transaction.

[A/CN.9/362/Add.2]

II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE

CONTENTS

		Paragraphs
A.	Transactions covered	1-6
B.	Focus on issues specific to countertrade	7-8
C.	Governmental regulations	9-10
D.	Universal scope of Legal Guide	11
E.	Terminology	12-28
	1. Varieties of countertrade	13-17
	2. Parties to countertrade transaction	18-22
	3. Countertrade transaction and its elements	23-28

[*Editorial note:* The present draft chapter II is a revision of draft chapter III bearing the same title and published in document A/CN.9/332/Add.1. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.1 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.1 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

A. Transactions covered

1. [1] *Countertrade transactions covered by the Legal Guide are those transactions in which one party supplies goods, services, technology or other economic value to the second party, and, in return, the first party purchases from the second party an agreed amount of goods, services, technology or other economic value.* A distinctive feature of these transactions is the existence of a link between the *supplies* in the two directions in that the conclusion of the *supply contract or contracts in one direction* is conditioned upon the conclusion of the *supply contract or contracts* in the other direction. When the parties enter into contracts in opposite directions without expressing such a link between them, the contracts, as regards contractual rights and obligations of the parties, cannot be distinguished from straightforward independent transactions. Therefore, the Legal Guide deals only with transactions that express in a contractual form such a link between the contracts constituting the countertrade transaction.

2. [*new paragraph*] For the sake of simplicity, the Legal Guide refers only to "goods" as the subject-matter of countertrade transactions. However, the dicussion in the Guide on transaction, involving goods is generally applicable also to transactions involving services. The Guide can be used as a broad guidance also for transactions involving technology. In some instances the Guide makes particular reference to services or to technology.

3. [*new paragraph*] The Legal Guide discusses primarily countertrade transactions in which the goods are delivered across national boundaries. Countertrade transactions in domestic trade may have features that are not considered in the present Guide. Nevertheless, to the extent domestic transactions fall within the varieties of countertrade transactions described herein, the Legal Guide can be used by parties to those transactions.

4. [2] *Countertrade transactions take a variety of forms and display differing features depending upon the particular circumstances of the transaction.* The differences concern such matters as the contractual structure of the transaction *(i.e., the number and sequence of the component contracts), whether goods supplied in one direction are to be used in the production of goods to be supplied in the other direction, the manner of payment, and the number of parties involved in the transaction.*

[3] *

[4] *

5. [5] Another aspect of the variety of countertrade transactions is the degree of interest the parties may have in the different segments of a countertrade transaction. In *many* transactions one of the parties is interested *primarily* in the export of its *own* goods *rather than in acquiring goods from the other party.* In other transactions, the parties consider the supply of goods in the two directions as being in their mutual interest. There are also transactions in which, at the outset of the transaction, a party perceives a commitment to conclude future contracts as a concession to the other party, but subsequently comes to regard that commitment as a benefit. *

6. [*new paragraph*] In most instances, the dicussion in the Legal Guide is relevant generally to various types of countertrade. However, in some contexts the discussion indicates that it is only relevant to a particular type of countertrade.

B. Focus on issues specific to countertrade

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section C, paragraphs 24 to 26. Some of the substance of paragraphs 25 and 26 (A/CN.9/332/Add.1) was moved to draft chapter III, "Contracting approach" (A/CN.9/362/Add.3).]

7. [*new paragraph*] The Legal Guide focuses on the drawing up of contractual clauses that are specific to or of particular importance for international countertrade. Such clauses are contained in an agreement of the parties that establishes a link between the supply of goods in one direction and the supply of goods in the other direction. That agreement is, as explained below in paragraph 24, referred to in the Legal Guide as the "countertrade agreement".

8. [24] *As a rule, the Legal Guide does not deal with the content of the contracts for individual supplies of goods under a countertrade transaction since those* contracts generally resemble contracts concluded as discrete and independent transactions. In some cases, however, the content of a contract is affected by the fact that it forms part of a countertrade transaction. For example, when the proceeds of a contract in one direction are to be used to pay for the contract in the other direction, the two supply contracts may contain payment provisions particular to countertrade. *To the extent clauses specific to countertrade may be inserted in those contracts, the Legal Guide considers them.*

C. Governmental regulations

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section D, paragraphs 27 and 28.]

9. [27] In some countries countertrade is subject to governmental regulations. Such regulations, which may derive from international agreements, are closely linked with national economic policies and as a result vary from country to country and are likely to be changed more often than rules of contract law. Governmental regulations may promote or restrict countertrade in a variety of ways. For ex-

ample, it may be provided that certain types of imports must be paid for only through a countertrade arrangement, that state trading agencies are to explore the possibility of countertrade when negotiating certain types of contracts, that certain types of local products are prohibited from being offered in countertrade, or that *an exporter of goods and the foreign purchaser are not free to agree that the resulting payment claim will be settled in a way other than by transferring foreign currency to the exporter's account.* Other such rules may relate to exchange controls or to the authority of an administrative organ to approve a countertrade transaction. Some regulations may be specifically oriented to *countertrade*; others may be more general, but with an impact on countertrade (*e.g., competition law, export and import regulations, foreign exchange rules*). Some regulations are directed to one contracting party only and do not directly affect the content or the legal effect of the contract concluded by that party. In other instances the regulation may limit the parties' freedom of contract.

10. [28] The Legal Guide advises parties to take into account such governmental regulations. Since the regulations are disparate and are often changed, advice is given, where appropriate, in the form of a caveat rather than in any detailed discussion of the substance of the applicable regulations. *Further discussion on mandatory governmental regulations is contained in chapter XIV, "Choice of law", paragraphs ___ to ___.*

D. Universal scope of Legal Guide

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section E, paragraph 29.]

11. [29] *Private law questions involved in international countertrade transactions and the motives for engaging in countertrade do not reveal regional particularities. To the extent there exist regional differences in contract practices, they concern in particular the frequency of use of certain commercial types of countertrade and the elaborateness and refinement of contractual solutions. Consequently,* the Legal Guide treats the legal issues arising from countertrade at the universal level.

E. Terminology

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section B, paragraphs 8 to 23.]

12. [29] Terminology used in practice and in writings to describe countertrade transactions and the parties involved in them varies greatly. A prevailing terminology has not developed. The following paragraphs establish a terminology used in the Legal Guide for different varieties of countertrade transactions, parties and contracts in countertrade.

1. Varieties of countertrade

13. [*new paragraph*] The terms used in the Legal Guide to denote different types of countertrade are explained below. Countertrade transactions are distinguished in the Legal Guide on the basis of their commercial or technical features and their contractual structure. It should be noted that classifications other than the one explained below exist.

14. [10] *Barter.* In practice the term "barter" is used with different meanings. The term may refer, for example, to countertrade transactions in general, to an intergovernmental agreement addressing mutual trade in particular goods between identified partners, or to countertrade in which trans-border flow of currency is eliminated or reduced or where a single contract governs the mutual shipments of goods. The Legal Guide uses "barter" in a strict legal sense to refer to a contract involving a two-way exchange of specified goods in which the supply of goods in one direction replaces, entirely or partly, the monetary payment for the supply of goods in the other direction. Where there is a difference in value in the supply of goods in the two directions, the settlement of the difference may be in money or in other economic value.

15. [11] *Counter-purchase.* This term is used to refer to a transaction in which the parties, in connection with the conclusion of a purchase contract in one direction, enter into an agreement to conclude a sales contract in the other direction, i.e., a counter-purchase contract. Counter-purchase is distinguished from buy-back in that the goods supplied under the first purchase are not used in the production of the items sold in return.

16. [12] *Buy-back.* This term refers to a transaction in which one party supplies a production facility, and the parties agree that the supplier of the facility, or a person designated by the supplier, will buy *products resulting from that production facility.* The supplier of the facility often provides technology and training and sometimes component parts or materials to be used in the production.

17. [13] *Offset.* Transactions referred to in the Legal Guide as offsets normally involve the supply of goods of high value or technological sophistication *and may include the transfer of technology and know-how, promotion of investments and facilitating access to a particular market. Two types of offset transactions may be distinguished.* Under a "direct offset" *the parties agree to supply to each other goods that are technologically or commercially related (e.g., component parts or products that are marketed together). A direct offset can contain features of a buy-back transaction (i.e., transfer of production equipment and technology, and purchase by the transferor of the resulting products). The difference between such a direct offset and a buy-back transaction is that in a direct offset both parties commit themselves to purchase over a period of time goods from each other, whereas under a buy-back transaction the party that has supplied the production facility commits itself to purchase goods resulting from the production facility.* Such direct offsets are *sometimes* referred to as industrial participation or industrial cooperation. The expression "indirect offset" typically refers to a transaction where a governmental agency that procures, or approves the procurement of, goods of high value requires from the supplier that counter-purchases are made in the procuring country or that economic value is provided to the procuring country in the form of investment, technology or assistance in third

markets. The counter-export goods are not technologically related to the export goods (i.e., they are not components of the export goods, as in direct offset, and they are not resultant products of the facility provided under the export contract, as in buy-back). The governmental agency often stipulates guidelines for the offset, for example, as to the industrial sectors or regions that are to be assisted in such a way. However, within such guidelines, the party committed to counter-purchase or to providing such assistance is normally free to choose the contracting partners. *A countertrade transaction may involve elements of both direct and indirect offset transactions.*

2. Parties to countertrade transaction

18. [18] *Purchaser, supplier* or *party.* The Legal Guide frequently uses the term "purchaser", "supplier" or "party" to refer to parties purchasing and supplying goods in a countertrade transaction. *These terms are employed when the discussion in the Guide is relevant both to a situation in which contracts are to be concluded in a particular sequence (chapter III, "Contracting approach", paragaraphs 13 to 19) and to the situation in which the parties agree to conclude contracts in the two directions without stipulating a particular sequence of conclusion (chapter III, paragraphs 20 and 21). This* terminology *is also used when* the contracts for the supply of goods in the two directions are concluded concurrently. * When reference is made to a party who is committed to purchase or supply goods but has not yet done so, the Legal Guide may use the terms "party committed to purchase goods" and "party committed to supply goods" *to make it clear that a contract has not been concluded yet.*

19. [14] *Exporter* or *counter-importer.* The term "exporter" or "counter-importer" is used for the party who is—under the first contract to be concluded—the supplier, i.e., the exporter, of goods, and who has entered into a commitment with the other party to purchase, i.e., to counter-import, other goods in return. One or the other term is used depending on the context in which the party is mentioned. It should be noted that in some countertrade transactions the exporter and the counter-importer are the same party, while in others the exporter and counter-importer are different parties.

20. [15] *Importer* or *counter-exporter.* The term "importer" or "counter-exporter" is used for the party who is—under the first contract to be concluded—the purchaser, i.e., the importer, of goods, and who has entered into a commitment with the other party to supply, i.e., to counter-export, other goods in return. One or the other term is used depending on the context in which the party is mentioned. As in respect of the exporter and the counter-importer, in some countertrade transactions the same party is the importer and the counter-exporter. Sometimes, however, one party imports and another party counter-exports.

21. [16] In some writings *on countertrade* the term "exporter" is used to denote the party from an economically developed country, who often supplies goods of technological content that normally cannot be obtained in the other party's country. The term is used *in those writings* irrespective of whether the "exporter" supplies first and agrees to purchase later or whether the "exporter" makes an "advance purchase" from the other party in order to enable that other party to raise funds needed for a subsequent purchase of goods from the "exporter". The term "importer" is used in those writings to denote the party from a developing country. To underline that meaning, such writings may use terms such as "primary" or "western exporter" or "developing country importer".

22. [17] A distinction based on economic or regional considerations is not used in the present Legal Guide. One reason is that the guide covers both intraregional and interregional countertrade. Thus, distinctions used in discussions of interregional countertrade, in which the issues tend to be considered primarily from the perspective of one of the parties, would not be suitable since the Legal Guide advises both parties whatever may be their relative economic strength or background. Furthermore, terms based on the time sequence of the conclusion of contracts are more suitable since, for the purpose of discussing the contractual role and interests of parties, the question of primary significance is whether the party has already sold its goods and has promised to purchase goods from the other party, or whether the party, having purchased goods, has not sold its goods yet.

3. Countertrade transaction and its elements
[change of title]

23. [23] *Countertrade transaction.* This term is used to refer to the whole countertrade arrangement containing the related supply contracts *in the two directions* and any countertrade agreement. *The terms "countertrade agreement" and "supply contract" are explained below.*

24. [19] *Countertrade agreement. The countertrade agreement is the term used in the Legal Guide for the basic agreement which sets forth stipulations concerning the manner in which the countertrade transaction is to be implemented.* In practice, *agreements setting forth such stipulations are* referred to by a variety of names, such as "frame agreement", "countertrade protocol", "umbrella agreement", "memorandum of understanding", "letter of undertaking", or "counterpurchase agreement". *In many countertrade transactions the main purpose of the countertrade agreement is to set out* the commitment of the parties to enter into the future contracts required to fulfil the objective of the transaction ("countertrade commitment", see *the following paragraph*). In addition to the countertrade commitment, the countertrade agreement is likely to contain *clauses dealing with the terms of the contract to be concluded and clauses designed to support the fulfilment of the countertrade commitment; such clauses may address issues such as* the type, quality and quantity of the goods, price of the goods, time period of fulfilment of the countertrade commitment, payment, restriction on resale of goods, participation of third persons in the transaction, liquidated damages or penalties, security for performance, *failure to complete the countertrade transaction,* choice of law, and settlement of disputes. The countertrade agreement may be embodied in a discrete instrument or it may be included in a contract for the shipment of goods. When the parties agree simultaneously on the terms governing the supply of all the goods

in both directions, the countertrade agreement would contain a stipulation expressing the link between the concluded contracts and possibly other stipulations, but would not contain a countertrade commitment.

25. [20] *Countertrade commitment.* This term is used to refer to the commitment of the parties to enter into a future contract or contracts. Depending on the circumstances, those future contracts may relate only to the shipment in one direction or to the shipments in both directions. The degree to which the countertrade commitment is definite depends on the amount of detail contained in the countertrade agreement concerning the terms of the future contracts.

26. [22] *Supply contracts. This term is used to refer generically to contracts for the supply of goods in one or in both directions. It may be used where no clear criterion exists for distinguishing between the "exporter" and "importer", where the discussion does not make it necessary to take into account a particular sequence of conclusion of contracts between the parties, or where the context requires a general reference to a contract for the supply of goods in either direction.*

27. [21] *Export, import, counter-export,* and *counter-import contracts. When the Legal Guide discusses transactions in which the parties can be referred to as "exporter", "importer", "counter-exporter" or "counter-importer" (see above, paragraphs 19 and 20), the supply contracts forming part of the transaction* would be referred to by names consistent with the names of the parties, i.e., "export" or "import" contract for the first contract entered into, and "counter-export" or "counter-import" contract for the contract entered into subsequently. The contracts in each direction *might* be referred to in the singular even though there may be several such contracts on both sides of the countertrade transaction.

28. [*new paragraph*] *Goods.* The subject-matter of a transaction may include various types of merchandise (such as manufactured goods or raw materials), services (such as maintenance, repair, transport, construction, tourist services, consulting, training), transfer of technology, or in some cases, a combination of these elements. As mentioned above in paragraph 2, for the sake of brevity, the Legal Guide generally refers only to "goods" as the subject-matter of countertrade transactions.

[A/CN.9/362/Add.3]

III. CONTRACTING APPROACH

CONTENTS

		Paragraphs
A.	Structure of countertrade transactions	1-23
	1. Single contract	2-10
	(a) Barter contract	3-8
	(b) Merged contract	9-10
	2. Separate supply contracts	11-23
	(a) Export contract and countertrade agreement concluded simultaneously	13-19
	(b) Countertrade agreement concluded prior to conclusion of definite supply contracts	20-21
	(c) Export contract, counter-export contract and countertrade agreement concluded simultaneously	22-23
B.	Contents of countertrade agreement	24-42
	1. Countertrade agreement with countertrade commitment	29-39
	2. Countertrade agreement without countertrade commitment	40-42
C.	Insurance and financing considerations	43-55

[*Editorial note:* The present draft chapter III is a revision of the draft chapter bearing the same title and published in document A/CN.9/332/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.2 are in italics. An asterisk indicates the place where text has been deleted without adding new language. The whole section C is new.]

A. Structure of countertrade transaction
[change of title]

1. [1] A preliminary question the parties have to address is the contract structure of the countertrade transaction. The parties may embody the obligations in regard to the shipments of goods in the two directions in one contract or they may *embody* those obligations into separate contracts. *(For the discussion of the structure of the countertrade transaction and related insurance and financing considerations, see below, paragraphs 8 and 9, and section C.)*

1. Single contract

2. [2] Under a single-contract approach the parties conclude one contract for the *supply* of goods in the two directions. Such a single contract may take the form of a barter contract *(below, paragraphs 3 to 8)* or the form of a merged contract *(below, paragraphs 9 and 10).* *

(a) *Barter contract*

3. [3] As noted in chapter II, "Scope and terminology of Legal Guide", paragraph 14, the Legal Guide uses the term barter in its strict legal sense to refer to a transaction involving an exchange of goods for goods, so that the supply of goods in one direction entirely or partly replaces the monetary payment for the supply of goods in the other direction. In a barter contract there is no need for a countertrade commitment since the parties agree at the outset of the transaction on all the contract terms for the shipments in the two directions. If the goods to be supplied in one direction are agreed to be of the same value as the goods to be supplied in the other direction, no monetary payment would be made. If the values are agreed to be different, the difference may be settled by monetary payment *or by delivery of additional* goods. The parties may or may not express the value of the goods in monetary terms. If they do so, the attachment of a price to the goods serves to compare the value of the deliveries. The parties may have to express the value of shipments in monetary terms due to customs or other administrative requirements.

[5] *

4. [7] *Under a* barter contract the *quantity of* goods to be shipped in one direction is often measured by the *quantity of* goods to be shipped in the other direction, rather than in terms of the market price for each shipment. The absence of a price in a barter contract or the use of prices that do not reflect the market prices might cause a difficulty when non-conforming goods are delivered under a barter contract. If in such a case monetary compensation is regarded as the appropriate relief, the absence in the contract of a market price, or of any price at all, could lead to disagreement over the amount of the compensation *due.* The stipulation of a price other than the market price may also give rise to a difficulty in calculating customs duties when they are based on the market value of the goods.

5. [4] A factor that is often the main reason for using barter is that the use of barter eliminates or reduces the need for currency transfers. It may be noted, however, that the avoidance of currency transfers may also be achieved through the use of other contractual forms, namely, the parties may conclude separate sales contracts in each direction and agree to set off *their payment* claims *under the contract* (such setoff of mutual claims is discussed in chapter IX, "Payment", paragraphs ___ to ___).

6. [6] *A possible difficulty in a barter contract may be a risk that the party who has shipped goods does not receive the agreed goods from the other party.* Payment against the presentation of shipping documents or the opening of a documentary letter of credit, devices used with other types of contracts to address *an analogous risk in other types of contracts*, cannot be used in barter since neither delivery is payable in money. *One way of addressing this risk may be to agree that the deliveries are to be made simultaneously, to the extent it is practical for the parties to coordinate ther deliveries in this way. If simultaneous deliveries are agreed upon, the contract may clarify that, if one of the parties is not prepared to deliver on schedule, the other party would be entitled to withhold its delivery or to terminate the contract if the delay exceeds a specified period of time. The contract may also provide that the party who has breached its obligation to deliver at the agreed time must compensate the other party for loss arising from the delay or termination of the contract. The parties may address in the contract the question of which outlays or losses are to be compensated (e.g., warehousing costs, costs related to transportation, or a specified amount of overhead costs).*

7. [6] *The risk that the other party will not ship the agreed goods may also be* overcome by providing for *an independent guarantee to* assure the party who has shipped of compensation in the event that the other party fails to ship (the use of *guarantees for* this purpose is discussed in chapter XII, "Security for performance", paragraphs ___ and ___). *If a party finds it costly or is unable to provide such a guarantee, it may be agreed that that party is to deliver goods first.* Insurance might be another *possible means of limiting the risk* that affect the party who has shipped first and thus "prepaid" the goods to be delivered subsequently by the other party (see below, paragraph 52).

8. [*new paragraph*] If the *right of a party to receive goods in return for its delivery is not sufficiently secured, in particular by an* independent bank guarantee, *that party* may find it difficult to obtain financing for the transaction from a bank or from a governmental credit agency. The entity providing financing may be reluctant to provide financing *to the extent* the profitability of the transaction and the ability of the party seeking credit to repay the credit depends on an unsecured obligation to deliver goods of the agreed quality.

(b) *Merged contract*

9. [8] The term "merged contract" is used to describe the case in which the *two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The merged contract thus embodies* all

the terms covering the obligations of the parties to ship goods to each other and to pay for the goods they have received. *The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation.* If the parties agree to set off their claims for payment under a merged contract, the difference between a merged contract and a barter contract * would be diminished *in that in either case no transfer of money takes place or only the balance of the values of the deliveries in the two directions is transferred.* As in barter, there is no need in a merged contract for a countertrade commitment since the deliveries to be made in the two directions are covered by definite contract terms.

10. [9] *It appears that many legal systems are likely to give weight to a merger of the mutual obligations in determining the degree of interdependence between contract obligations for the deliveries of goods in the two directions. * Unless the parties provide in the contract that certain obligations regarding delivery in one direction are to be performed irrespective of non-performance of an obligation regarding delivery in the other direction,* the mutual obligations are likely to be considered interdependent. *The consequence of such interdependence would be* that *non-performance of an obligation such as* non-delivery, refusal to take delivery, or non-payment relating to a shipment in one direction *might* be invoked as a reason for suspending or refusing performance in the other direction. Furthermore, termination of an obligation in one direction, whether or not a party is responsible for the termination, may be interpreted as entitling a party to terminate an obligation in the other direction. *(Such interdependence of obligations may affect the ability of a party to insure the payment claim arising from its delivery of goods and to obtain financing for the delivery, see below, paragraph 51).* If the parties using a merged contract approach wish to keep the obligation to ship goods in one direction and the corresponding payment obligation independent from the obligations relating to the shipment in the other direction, they should use unambiguous language to that effect. *A related discussion of possible interdependence between the export contract and the countertrade agreement is contained below in paragraphs 17 to 19.* Further discussion on the question of interdependence of obligations is found in chapter XIII, "*Failure to complete countertrade transaction*", *paragraphs ___ to ___.*

2. *Separate supply contracts*
[change of title]

11. [10] When the parties use separate contracts for the shipments in the two directions, they would use one of the following approaches:

(a) the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently;

(b) the countertrade agreement is concluded prior to the conclusion of any definite supply contracts;

(c) the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between them are concluded simultaneously.

12. [11] The obligation to ship goods in a particular direction in a countertrade transaction may be fulfilled by two or more different contracts, which may involve different buyers and sellers. While such a situation affects the contractual structure of a given transaction, it does not affect the nature of the discussion in this chapter. Therefore, references in the singular to a supply contract, as well as to an export or counter-export contract, also cover the situation in which more than one contract is concluded for the shipment of goods in a particular direction.

(a) *Export contract and countertrade agreement concluded simultaneously*

13. [12] The parties often finalize a contract for the shipment in one direction (export contract) before they are able to reach agreement on the contract for the shipment in the other direction (counter-export contract). Parties using this contracting approach may face a broad range of issues specific to countertrade. In order to *ensure* conclusion of the counter-export contract, the parties conclude, simultaneously with the conclusion of the export contract, a countertrade agreement containing the commitment to conclude the counter-export contract. The primary purpose of the countertrade agreement in such cases is, in addition to stating the countertrade commitment, to outline the terms of the future contract and *to* establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated below in paragraphs *29 to 33.*

14. [13] The contents of the countertrade agreement would be influenced by the degree to which the parties are able to define the terms of the future contract. It is advisable that the countertrade agreement be as definite as possible concerning the terms of the future contract, in particular regarding the type, quality, quantity and price of the countertrade goods, in order to increase the likelihood that the countertrade commitment will be fulfilled. To the extent that the parties are not in a position to settle the terms of the counter-export contract in the countertrade agreement, they are advised to establish guidelines within which the terms are to be agreed upon and *to lay down* procedures for negotiation (for the discussion on *the* definiteness of the countertrade commitment see *chapter IV,* paragraphs *38 to 60). In any case, it is advisable to settle in the countertrade agreement the time period within which the countertrade commitment should be fulfilled (see chapter IV, paragraphs 7 to 20).*

15. [14] The content of the countertrade agreement would also be influenced by the degree of interest the parties have in the shipments in the two directions. In many cases the exporter is primarily interested in the conclusion of the export contract, and the countertrade commitment results primarily from a desire to secure the export contract. In other cases, the importer purchases goods from the exporter in order to enable the exporter to finance the counter-import. In yet other cases, each side is particularly interested in obtaining the goods being offered by the other

side. Because the interests of the parties vary in such a manner, the content of the countertrade agreement may vary from case to case with respect to issues such as sanctions for non-fulfilment of the countertrade commitment, payment mechanisms, procedures for concluding the future contract and for monitoring fulfilment of the countertrade commitment, and interdependence of obligations.

16. [15] The simultaneous conclusion of an export contract and a countertrade agreement is an approach frequently used in counter-purchase, buy-back or offset transactions. In the case of the counter-purchase transaction, the parties may not yet know what type of goods would be counter-exported. In the case of a buy-back, the parties may not be able to agree on such terms as price or quantity because of the long time period between the conclusion of the contract for the export of the production facility and the beginning of production of resultant products. In an offset transaction, the parties may not know what type of goods will be counter-exported or the identity of the counter-exporters.

17. [16] The use of this contracting approach raises the question whether to include the terms of the countertrade agreement in the export contract or to embody those terms in a separate instrument. The choice of the parties in this regard may have an effect on the degree to which the obligations stipulated in the export contract and the obligations set forth in the countertrade agreement are considered to be interdependent. When there is such interdependence, a delay in the fulfilment or non-fulfilment of the countertrade commitment may provide the importer with a justification for suspending payment of the amounts due under the export contract or for deducting corresponding damages from the payment due under the export contract. Similarly, the exporter may regard a delay in payment for the export contract as a ground for delaying fulfilment of the countertrade commitment. Furthermore, delayed payment under the counter-export contract might prompt the importer to delay payment under the export contract. *(Such interdependence of obligations may affect the ability of the exporter to insure its payment claim under the export contract and to obtain financing; see below, paragraphs 51 and 53.)*

18. [17] If the *export contract* and the countertrade *agreement* are embodied in separate *contractual instruments*, it appears that many legal systems would consider the two sets of obligations to be independent, except to the extent specific contract provisions establish interdependence. In other legal systems the export contract and the countertrade agreement may, despite the use of separate *instruments*, be considered to be interdependent on the ground that the obligations of the parties embodied in the two *instruments* form part of a single transaction. When the parties wish to avoid interdependence of obligations between the export contract and the countertrade agreement, or when they wish to limit interdependence to particular obligations, it is advisable that they embody the export contract and the countertrade agreement in separate *instruments*. When, despite the use of separate *instruments*, it is uncertain whether the obligations under the export contract and the countertrade agreement would be considered independent, it is advisable that the independence of the *two sets of* obligations be clearly expressed in the countertrade agreement.

19. [18] The parties may wish to establish, by express contract clauses, an interrelationship between particular obligations arising out of the export contract and out of the countertrade agreement, while keeping other obligations independent. The parties may, for example, agree that * *the* termination of the export contract permits the exporter to terminate the countertrade agreement, and that non-fulfilment of the countertrade commitment by the counter-importer entitles the counter-exporter to deduct an agreed amount as liquidated damages or penalty from payments due under the export contract. Further discussion on the question of interdependence is found in chapter XIII, *"Failure to complete countertrade transaction", paragraphs ___ to ___*.

(b) *Countertrade agreement concluded prior to conclusion of definite supply contracts*

20. [19] The conclusion of a countertrade agreement may be the first step in the transaction prior to the conclusion of any definite supply contracts in either direction. The aim of the countertrade agreement in such a case is to express the commitment of the parties to conclude supply contracts in the two directions and to establish procedures for concluding and implementing those contracts.

21. [19] In order to achieve the envisaged level of shipments in the two directions, it is advisable that the countertrade agreement be as definite as possible concerning the terms of the contracts to be concluded in the two directions *(see chapter IV, "Countertrade commitment", paragraphs 38 to 60)*. The parties may also wish to establish mechanisms for monitoring and recording the *progress made in achieving the agreed upon* level of trade *(chapter IV, paragraphs 61 to 74)* and to provide sanctions for a failure to fulfil the countertrade commitment *(chapter XI, "Liquidated damages and penalty clauses" and chapter XII, "Security for performance")*. The need for sanctions may be diminished if the parties agree that their countervailing claims for payment for the shipments in each direction will be set off rather than paid for individually (see chapter IX, "Payment", paragraphs ___ to ___). Such a payment mechanism would provide an incentive to both parties to order goods from each other and thereby attain the level of trade envisaged in the countertrade agreement. The incentive is derived from the fact that a party who has shipped goods will be stimulated to order goods from the other party in order to be compensated for its own deliveries. *Furthermore, the parties may wish to address in the countertrade agreement the question of independence of the contracts in the two directions (see chapter XIII, paragraphs ___)*. These and other issues that the parties may wish to address in a countertrade agreement entered into prior to the conclusion of any supply contract are set out below in paragraphs *29 to 39.*

(c) *Export contract, counter-export contract and countertrade agreement concluded simultaneously*

22. [20] When the parties simultaneously conclude a contract for the supply of goods in one direction and another contract for the supply of goods in the other direc-

tion, and there is no indication in the contracts that there is a relationship between them, the contracts would appear on their face to be independent of one another even if one party or both parties regarded the conclusion of one contract as a condition for the conclusion of the other contract. When, however, the parties wish to give contractual effect to an intention that the conclusion of one contract be conditioned upon the conclusion of the other, i.e., when they wish to structure the contracts in the two directions as a countertrade transaction, the parties should conclude a countertrade agreement expressing that relationship.

23. [21] This contracting approach raises a limited number of issues since it does not involve a countertrade commitment. The main issue in this contracting approach is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked by provisions in the countertrade agreement. There is no need to deal in the countertrade agreement with various issues related to the fulfilment of the countertrade commitment (in particular the type, quality, quantity or price of the countertrade goods, time schedules of fulfilment of countertrade commitment, security of performance or liquidated damages or penalties supporting the countertrade commitment). The issues that the parties may wish to address in a countertrade agreement concluded simultaneously with the definite supply contracts in the two directions are set out below in paragraphs *40 to 42.*

B. Contents of countertrade agreement

24. [*new paragraph*] Matters of particular importance for the structure and implementation for countertrade transactions are dealt with in the countertrade agreement. While the Legal Guide concentrates on issues to be addressed in the countertrade agreement, where necessary, reference is made in the Guide to drawing up a provision in a supply contract that is influenced by the fact that the contract is part of the countertrade transaction. The following subsections 1 and 2 provide an outline of a possible content of a countertrade agreement, depending upon whether or not the countertrade agreement includes a countertrade commitment.

25. [*new paragraph*] A countertrade agreement with a countertrade commitment is used when the parties envisage concluding in the future one or more counter-export contracts, or when the parties envisage concluding in the future supply contracts in the two directions (cases *(a)* and *(b)* referred to above in paragraph *11*). A countertrade agreement without a countertrade commitment is used when the parties have entered, at the outset of the transaction, into the contracts for the supply of goods in the two directions and there is therefore no need for a countertrade commitment (case *(c)* referred to above in paragraph *11*).

26. [*new paragraph*] The content of a countertrade agreement involving a countertrade commitment is usually more complex and gives rise to more negotiation and drafting difficulties than a countertrade agreement without a countertrade commitment. The reason for the complexity and difficulty is that usually the parties, at the time of agreeing that they will in the future conclude a supply contract, are usually not in a position to specify, with sufficient definiteness, all the terms of the future contract. Lack of definiteness may make it difficult for the parties to draw up a countertrade agreement that will provide a sufficient assurance that the negotiations for the conclusion of a supply contract, containing terms acceptable to both parties, will be successful. The question of the definiteness of the countertrade commitment is discussed in chapter IV, paragraphs *38 to 60.*

27. [*Based on para. 26 of draft chapter II, A/CN.9/332/Add.1*] Some of the issues listed below and discussed in the following chapters of the Legal Guide are essential in establishing a countertrade transaction that involves a countertrade commitment. For example, the parties would have to choose a contracting approach, express their commitment to engage in reciprocal trade, specify the extent of the commitment and the time frame within which the commitment should be fulfilled.

28. [*Based on para. 26 of draft chapter II, A/CN.9/332/Add.1*] Solutions to certain other issues listed below and dealt with in the Legal Guide, while not necessarily essential, would help to ensure proper implementation of the transaction. The parties will have to judge whether and to what extent various contractual issues discussed in the Legal Guide are relevant to the circumstances of the given case. Generally, it is advisable to settle in the countertrade agreement issues that the parties consider relevant since national legislations are likely not to have rules on issues specific to countertrade.

1. Countertrade agreement with countertrade commitment

29. [22] *Countertrade commitment.* The essential feature of a countertrade commitment is a stipulation by which the parties undertake to * conclude one or more supply contracts *in one or in the two directions.* In order to add definiteness to the commitment *and increase* the likelihood of its fulfilment, parties often include in the countertrade agreement provisions concerning terms of the anticipated *contract, sanctions* for the failure to conclude the *supply* contract, and other provisions to ensure the proper carrying out of the countertrade transaction. *Various aspects of the countertrade commitment are discussed in chapter IV.*

30. [23] *Type, quality and quantity of goods.* In order for the countertrade commitment to be meaningful, it is particularly important that the countertrade agreement be as specific as possible as to the type, quality and quantity of the countertrade goods. Clauses in the countertrade agreement addressing these issues are discussed in chapter V.

31. [24] *Pricing of goods.* Since the parties are often not in a position to set the price of the countertrade goods at the time the countertrade agreement is concluded, they may establish guidelines and procedures for setting the price at a later date. Such provisions help to prevent delays in the conclusion of supply contracts and provide pricing flexibility in long-term countertrade transactions. Issues relating to pricing clauses are addressed in chapter VI.

[25] *

32. [26] *Participation of third parties [change of heading].* The parties may wish to involve third *parties,* either as suppliers or purchasers, or both, of countertrade goods. In such cases *it is advisable that* the countertrade agreement contain provisions concerning participation by third *parties.* Those provisions could determine the manner in which *a* third *party* would be selected, *whether the third party is to become bound to fulfil the countertrade commitment* and the legal effect of the involvement of the third *party* on the obligations undertaken by the parties to the countertrade agreement. Issues to be dealt with in the countertrade agreement relating to participation of third *parties* are discussed in chapter VIII.

33. [27] *Payment.* When payments for the shipments in each direction are kept independent, no payment issues specific to countertrade are raised. However, when the parties wish to link the payments for the shipments in the two directions so that the proceeds of the contract in one direction are used to pay for the contract in the other direction, they would have to include in the countertrade agreement provisions on the manner in which payment is to be linked. A discussion of contractual aspects of various types of linked payment mechanisms is found in chapter IX.

34. [28] *Restrictions on resale of goods.* The freedom of a party to resell goods purchased in a countertrade transaction may sometimes be restricted by contractual agreement between the supplier and the purchaser of the goods. The purchaser may be restricted, *for example,* as to the territory of resale, * resale price or packaging. Clauses in the countertrade agreement concerning such *resale* restrictions, *as well as the question of the legality of such clauses,* are discussed in chapter X.

35. [29] *Liquidated damages and penalties.* In order to limit disagreements as to the extent of damages resulting from a breach of the countertrade commitment, the countertrade agreement may stipulate a sum of money, *specified as liquidated damages or a penalty,* due from a party upon failure to fulfil the commitment to purchase or make available countertrade goods. The use of such clauses in a countertrade agreement is addressed in chapter XI. *In paragraph ___ of that chapter it is pointed out that the use of a penalty, as opposed to liquidated damages, is not permitted in a number of legal systems.*

36. [30] *Security for performance.* The parties may use guarantees to support fulfilment of the countertrade commitment, as well as the proper performance of individual supply contracts concluded pursuant to the countertrade commitment. The use of guarantees to support the fulfilment of the countertrade commitment, or the obligation to pay under a liquidated damages or penalty clause, raises issues to be addressed in the countertrade agreement. In transactions in which the parties limit payments in cash by exchanging goods for goods or setting off countervailing payment claims, the countertrade agreement may stipulate the use of guarantees to cover liquidation of an imbalance in the flow of trade. Issues to be addressed in the countertrade agreement when the parties wish to use guarantees to support fulfilment of the countertrade commitment and liquidation of an imbalance in trade are discussed in chapter XII.

37. [31] *Failure to complete countertrade transaction. The parties may wish to deal in the countertrade agreement with various issues relating to the possibility of a failure to complete the transaction. These issues include possible release of a party from its obligations under the countertrade commitment, monetary compensation, exempting impediments and interrelationship of obligations.* Provisions of this type are examined in chapter XIII.

38. [32] *Choice of law. It is advisable that the parties* agree upon the law to be applied to the countertrade agreement *and* to the supply contracts. Provisions of this nature are discussed in chapter XIV.

39. [33] *Settlement of disputes. It is advisable that the parties address in the countertrade agreement the manner in which disputes are to be settled.* Chapter XV examines issues to be considered in preparing dispute settlement clauses.

2. Countertrade agreement without countertrade commitment

40. [34] When the parties simultaneously conclude separate contracts for the entire supply of goods in the two directions, there is no need for a countertrade agreement containing either a countertrade commitment to conclude future contracts, or clauses on the type, quality, quantity or price of the goods, liquidated damages or penalties to be paid for failure to conclude supply contracts, or guarantees to support the countertrade commitment.

41. [35] The primary purpose of the countertrade agreement in this case would be to establish a link between the contracts in the two directions, namely, that the conclusion of a contract in one direction is conditioned upon the conclusion of a contract in the other direction. The countertrade agreement may provide that a problem in the performance of one contract would have an effect on the obligation to perform the contractual obligations in the other direction (clauses establishing a link of this type are discussed in chapter XIII). The parties may also establish a link between the contracts by structuring payment for the two contracts in such a way that the proceeds of the shipment in one direction would be used to pay for the shipment in the other direction. Linked payment mechanisms of this type are discussed in chapter IX.

42. [36] In addition, the countertrade agreement may address issues such as restrictions on the resale of countertrade goods (chapter X), participation of third persons in the countertrade transaction (chapter VIII), choice of law (chapter XIV) and settlement of disputes (chapter XV).

C. Insurance and financing considerations

[*Editorial note:* the whole section C is new.]

43. Criteria and procedures relevant to obtaining export credit insurance or financing are largely the same for a contract forming part of a countertrade transaction as they are for a straightforward export transaction. Therefore, the

Legal Guide does not discuss comprehensively export credit insurance and financing. However, to the extent credit-insurance and financing considerations are relevant to the structure of countertrade transactions, this subsection discusses those considerations.

44. In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. In some countries such insurance schemes are run or supported by State owned entities. In addition, many private insurance companies engage in such insurance. Insurance coverage usually starts when the exporter ships the goods. If the exporter is to manufacture goods designed specifically for the buyer, some insurers might also be prepared to cover the risk that the buyer will fail to take delivery of the goods when they are manufactured and made ready for delivery.

45. Insurable commercial risks might include the insolvency of the importer, repudiation by the importer of the contract prior to the shipment of the goods, and refusal of the importer to take delivery of the goods. Insurable non-commercial risks might include import restrictions by the State of the importer; exchange control regulations in the importer's country that prevent payment to be made or prevent use of the agreed currency; cancellation of import licence that had been properly issued; war, civil insurrection or similar conditions in the buyer's country that prevent the performance of the contract; other causes that are outside the control of the exporter and importer and that arise from events outside the exporter's country.

46. Insurance cover may be negotiated for a specific transaction or, on a broader basis, for all contracts for a certain type of merchandise concluded over a specified period of time by the exporter or by a group of exporters. The latter approach, based on turnover of goods, has the advantage of spreading the risk over a number of contracts and thereby reducing the premium.

47. Several salient principles, which are related to principles found in insurance generally, may be noted with respect to export credit insurance. One principle is that export credit insurance is a risk sharing scheme. The insurer will typically assume only a portion of the non-payment risk, while the rest of the risk must be borne by the insured exporter. The insurable portion of the risk depends on the type of risk involved and, if the insurer is a State agency, on the extent to which the State wishes to stimulate exports. Another principle is that the exporter is obligated to inform the insurer, to the best of its knowledge, of all facts that may affect the degree of the non-payment risk. A further principle is that the insured exporter must take all steps in its power to ensure that the contract for the export of goods is validly concluded and that it remains valid and enforceable.

48. Yet another principle is that, if the importer fails to pay the insured claim or if the enforceability of the claim becomes doubtful, the exporter must take all steps to minimize loss and to secure or enforce the payment claim. The insurer will typically require that it be informed of any difficulty that has arisen or is imminent regarding payment to be made under the insured contract. In addition, the insurer will usually require that it be consulted about steps to be taken to secure or enforce the payment claim and that it be entitled to approve certain steps. The readiness of the insurer to provide insurance cover and the amount of the premium will depend on the security that the importer is ready to provide in support of its payment obligation. Such security may be, for example, an irrevocable documentary letter of credit, a bill of exchange or a promissory note, with a third party guaranteeing payment of the bill or note, or an independent bank guarantee.

49. The objective of securing the insured payment claim may be achieved in a countertrade transaction by linking the insured claim to the claim arising from the supply contract in the other direction. As discussed in chapter XIII, "Failure to complete countertrade transaction", paragraph ___, in some countertrade transactions it is agreed that the exporter, if the importer fails to make payment under the export contract, is entitled to take possession and sell the goods that are to be delivered by the importer (counter-exporter) to the exporter (counter-importer). The proceeds of the sale are used to cover the exporter's outstanding claim. Since such an arrangement may reduce the risk of non-payment under the export contract, it may be easier for the exporter to obtain insurance and financing for the export contract. When a bank has provided financing to the exporter, it may be agreed, in order to provide security to the bank for the financing provided to the exporter, that the bank itself is to obtain a security interest in the counter-export goods.

50. A further principle applicable to the export credit insurance is that the insurer must be satisfied that in the normal course of events, i.e. if the exporter meets its obligations under the export contract, the importer will have no reason to refuse to pay the amount due under the export contract. Insurers wish to avoid situations where payment under the insured contract may become dependent on an event that is extraneous to the insured contract and that may be difficult for the insurer to assess.

51. The principle referred to in the previous paragraph is relevant to the case when the insured export contract forms part of a countertrade transaction. The question may arise whether the payment obligation under the export contract depends only on the performance of the export contract or whether the importer can suspend or withhold payment because of a failure of the exporter to conclude or perform a supply contract in the other direction. A source of particular concern is the possibility that payment may be suspended or withheld even if the exporter (counter-importer) claimed that the reason for the failure to conclude or perform a counter-import contract was one for which the exporter was not responsible. For example, the exporter may refuse to conclude a counter-import contract because the quality or the price of the offered countertrade goods is not acceptable in light of what was stipulated in the countertrade agreement. The possibility of such disagreement over the responsibility for non-fulfilment of the countertrade commitment is increased when the parties to the countertrade transaction have not included in the countertrade agreement definite terms of the contract to be concluded (see chapter IV, "Countertrade commitment",

paragraph 39). In a further example, the exporter may refuse to take delivery of the countertrade goods if the tendered goods do not conform to the agreed standards of quality. In order to avoid the possibility that the insured payment claim might be brought into question in such a situation, the insurer will usually require that steps be taken to make that payment claim independent from any disagreement concerning conclusion or performance of the contract in the other direction. Such independence can be established by using the separate-contract approach and by including in the countertrade agreement specific provisions indicating the independence of obligations (for a discussion on how the parties may wish to deal in the countertrade agreement with the relationship between their obligations, see chapter XIII, "Failure to complete countertrade transaction", paragraphs ___ to ___).

52. In the case of a barter contract, the party *who is to deliver goods* first is subject to the risk that the other party will fail to deliver its goods in return (see above, paragraphs 6 and 7). Some private insurers and, in some cases, governmental insurance agencies may be prepared to insure that risk. The case covered by such insurance would usually be limited to the bankruptcy of the party who failed to deliver and to certain political risks such as governmental restrictions or prohibitions that prevent the fulfilment of the contract. Insurance cover may be easier to obtain if the other party provides sufficient security for its obligation to deliver goods. Such security may be provided in the form of an independent bank guarantee. Another possible security may be an agreement giving the party who has delivered goods a right to take possession of the goods to be delivered in the other direction (see above, paragraph 49).

53. Parties often require financing in order to be able to carry out the transaction. The ability of a party to insure its credit risk is an important factor in the consideration by the financial institution whether to grant the requested financing. Financing may be in the form of a supplier credit or a buyer credit.

54. In the case of a supplier credit, the exporter delivers goods to the importer under a deferred payment arrangement and, in order to enable the exporter to enter into such an arrangement, a bank in the exporter's country provides financing to the exporter. Such financing may be, for example, in the form of a loan to the exporter or in the form of an undertaking by the bank that the bank will purchase the bills of exchange or promissory notes signed by the buyer in favour of the exporter. By purchasing the bills or notes, the bank, as the endorsee, would become the creditor of the foreign buyer. If no discounting of bills or notes takes place, the bank may require the exporter to assign the payment claim under the export contract to the bank. In addition, the bank may require the exporter to assign to it the benefits of the credit insurance policy. Such an assignment is often combined with an undertaking by the insurer to the effect that, if the buyer fails to pay under the export contract, and the failure falls within the risks covered by the insurance policy, the insurer will reimburse the bank. By becoming the beneficiary of the insurance policy, the bank is exposed to the risk that the exporter would breach the export contract and as a result the buyer would justifiedly fail to pay under the export contract. In such a case the bank would have recourse only to the exporter. The bank is also exposed to the risk that the reason for the buyer's failure constitutes a risk that is not covered by the insurance policy. In order to ameliorate the position of the bank, and in order to make it easier for exporters to obtain financing, some export credit insurers might be prepared, against a fee payable by the exporter, to issue to the bank providing financing to the exporter an unconditional guarantee supporting the bank's repayment claim against the exporter.

55. Under a buyer credit, the exporter arranges for a bank in the exporter's country to provide financing to the importer for the purchase of goods from the exporter. The bank in the exporter's country typically provides financing to a bank in the importer's country, which in turn extends financing to the importer. The bank in the exporter's country receives from the export credit insurer an undertaking whereby the insurer agrees to reimburse the bank if the buyer or its bank fail to repay the credit. Such an undertaking is issued on the application of the exporter and against payment by the exporter of an agreed premium. In case of failure by the buyer or its bank to repay the credit, the insurer who has reimbursed the bank that gave the credit has recourse to the exporter only if the exporter has failed to perform the obligations under the contract for the export of goods.

[A/CN.9/362/Add.4]

IV. COUNTERTRADE COMMITMENT

CONTENTS

		Paragraphs
A.	General remarks	1-2
B.	Extent of countertrade commitment	3-6
C.	Time period for fulfilment of countertrade commitment	7-20
	1. Length of fulfilment period	7-12
	2. Extension of fulfilment period	13-16
	3. Subperiods within fulfilment period	17-20

		Paragraphs
D.	Defining eligible supply contract	21-30
	1. By type of goods	22-25
	2. By geographical origin	26-27
	3. By identity of supplier	28
	4. By identity of purchaser	29
	5. Non-conforming purchases	30
E.	Rate of fulfilment credit	31-34
F.	Stage when commitment fulfilled	35-37
G.	Defining terms of future supply contracts	38-60
	1. Terms of future supply contracts	38-56
	(a) Standards or guidelines	44-46
	(b) Determination of contract term by third person	47-54
	(c) Determination of contract term by contract party	55-56
	2. Negotiation procedures	57-60
H.	Monitoring and recording fulfilment of countertrade commitment	61-74
	1. Exchange of information	62-64
	2. Confirmation of fulfilment of countertrade commitment	65-67
	3. Evidence accounts	68-74

[*Editorial note:* The present draft chapter IV incorporates revised draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8, revised paragraphs 26 and 27 from draft chapter V, "Type, quality and quantity of goods" as it appeared in A/CN.9/332/Add.4, and revised section C of draft chapter III, "Contracting approach", as it appeared in A/CN.9/332/Add.2. The revisions of paragraphs are in italics. The note in square brackets at the beginning of some paragraphs indicates that those paragraphs are new. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [*new paragraph*] A countertrade commitment, a commitment to conclude a future contract, is an essential feature present in two types of countertrade transactions. The first type is when the parties at the outset of the transaction finalize a contract in one direction (export contract) and then commit themselves to conclude a counter-export contract (see chapter III, paragraphs 13 to 19); the second type is when the parties commit themselves at the outset of the transaction to conclude a series of supply contracts in the two directions (see chapter III, paragraphs 20 and 21). The term countertrade commitment is explained in chapter II, paragraph 25.

2. [*new paragraph*] The degree to which parties may commit themselves to enter into a future contract may range from a "firm" commitment to enter into a supply contract to a more limited "serious intention" type of commitment (referred to also as "best efforts" or "good faith" commitments). Under a firm countertrade commitment, the parties undertake to conclude a contract in accordance with the terms set out in the countertrade agreement, without retaining a discretionary right to refuse to conclude a contract. Under a serious-intention type of commitment, the undertaking is limited to an obligation to negotiate in good faith, with a party retaining the right to refuse to enter into a contract if none of the contract offers is acceptable to it. Under the latter commitment, any sanctions for failing to comply with the commitment can apply only in the limited cases when the party fails to participate in negotiations or does not negotiate in good faith. The Legal Guide focuses on firm countertrade commitments. It does not deal with serious-intention type of commitments since such commitments do not provide sufficient assurance to the parties that the objectives of the countertrade transaction will be achieved.

B. Extent of countertrade commitment

3. [*new paragraph*] The extent of a countertrade commitment is frequently expressed in a monetary value. In counter-purchase, buy-back or indirect offset transactions, in which the parties conclude first a supply contract in one direction (export contract) (see chapter III, paragraphs ___), the extent of the countertrade commitment is often expressed as a percentage of the value of the goods delivered under the export contract. In countertrade transactions in which the parties conclude the countertrade agreement prior to concluding an unspecified number of contracts in the two directions (see chapter III, paragraphs 20 and 21), the extent of the purchases to be made in the two directions is often defined by an absolute monetary amount. Sometimes, however, the countertrade commitment is quantified by reference to a specific quantity of a given type of goods. It should be noted that the extent of the countertrade commitment may be subject to governmental regulations.

4. [*new paragraph*] In countertrade transactions with successive deliveries (e.g., buy-back transactions), in long-term transactions, or in transactions where the counter-exporter's financing costs are uncertain at the time of the conclusion of the countertrade agreement (e.g., because of a floating-rate credit arrangement), clauses are sometimes found providing for an increase or a decrease of the countertrade commitment depending upon movement in prices of the goods in question or in financing costs. In the

case of capital goods, it may be agreed that the commitment will be increased in proportion to expenses for spare parts or technical assistance.

5. [*from A/CN.9/332/Add.4, para. 26*] When the purchaser has made prior purchases from the supplier of a given type of goods, the provisions in the countertrade agreement regarding quantity may contain a concept often referred to as "additionality". According to this *concept*, only those purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment. The parties would normally be able to establish the threshold of additionality by agreeing on the quantity that is to be regarded as the usual or traditional purchase. When the parties do not identify the type of goods in the countertrade agreement, they may include a general stipulation that if the goods ultimately selected are of a type that the purchaser is already buying, only those purchases above existing levels would be counted towards fulfilment of the countertrade commitment.

6. [*from A/CN.9/332/Add.4, para. 27*] Where the arrangement allows the purchaser to choose from a number of eligible suppliers other than the party to whom the countertrade commitment is owed (e.g., in an indirect offset transaction), the additionality threshold would not be based on previous trade volume between the parties to the countertrade agreement, but on the trade volume with the suppliers selected or on the volume of previous purchases by the committed party in the suppliers' country. *In defining the additionality threshold, the parties may, for example, agree on an amount of purchases that is to be considered as the usual or traditional amount of purchases, which would not be counted towards fulfilment of the countertrade commitment. The parties may also stipulate that purchases from specified types of suppliers or from certain specified suppliers, or purchases from those suppliers that do not exceed an agreed amount, are to be regarded as the usual or traditional purchases. In some cases, the parties may wish to apply an additionality threshold only to certain types of goods. The parties may provide in the countertrade agreement that the party committed to purchase can count its purchases towards the fulfilment of the countertrade commitment after it has been established in an agreed manner that purchases agreed to be regarded as usual or traditional have been made.*

C. Time period for fulfilment of countertrade commitment

[*The present section C incorporates, with modifications in italics, paragraphs 17 to 30 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in document A/CN.9/332/Add.8.*]

1. Length of fulfilment period

7. The parties should specify in the countertrade agreement the length of time to be allowed for fulfilment of the countertrade commitment (hereinafter referred to as the "fulfilment period"). The countertrade agreement may determine the length of the fulfilment period by stipulating that the fulfilment period is to commence upon a fixed date and to expire on a fixed date.

8. Another method is to make the commencement of the fulfilment period contingent upon an event specified in the countertrade agreement and to set the length of the fulfilment period. Such an approach may be desirable in a variety of circumstances. For example, when the conclusion of the countertrade agreement precedes the entry into force of the export contract, the parties may agree that the fulfilment period will not begin until the export contract has entered into force. When there is uncertainty at the time of the conclusion of the countertrade agreement about the availability of countertrade goods or about the ability of the purchaser to utilize or market them, the parties may agree that the fulfilment period will commence upon the completion of certain preparatory activities (e.g., identification of goods, inspection by purchaser, certification of the technical capability of the factory producing the goods, agreement with a third-party purchaser or completion of joint marketing research). Where the exporter wishes to ensure that performance of the export contract is at an advanced stage or completed before performance of the countertrade commitment commences, the parties may stipulate in the countertrade agreement that commencement of the fulfilment period is to be triggered by an event in the performance of the export contract such as the opening of the letter of credit, delivery of a specified portion of the goods or payment. In a buy-back transaction, an appropriate moment might be the beginning of production of buy-back products by the facility supplied under the export contract. In order to avoid uncertainty as to whether the conditions for commencement of the fulfilment period have been met, it is advisable that the countertrade agreement state those conditions and the related obligations of the parties as precisely as possible.

9. In determining the length of the fulfilment period the parties should consider a number of factors. One factor is the size and type of the transaction being contemplated. For example, where the countertrade commitment is large and involves a series of shipments, more time would normally be needed for fulfilment of the countertrade commitment than if the transaction were relatively small. Where the countertrade agreement defines the countertrade goods in broad terms, it may be that a longer fulfilment period would be needed in order to allow time for identifying suitable countertrade goods. The quality of the countertrade goods may affect the length of the fulfilment period. The better the quality, the more likely it will be that the purchaser will either be able to market or use them in-house, thus allowing a shorter fulfilment period.

10. In some cases, the length of the fulfilment period is set so that it extends beyond the date when payment is due under the export contract. Such an approach would allow the exporter time to fulfil the countertrade commitment after payment under the export contract is due. In such a case it is in the interest of the importer to include in the countertrade agreement effective sanctions for breach of the countertrade commitment.

11. The parties may agree that the fulfilment period for the shipment in one direction is to be of the same length as the fulfilment period for the shipment in the other direc-

tion. Such an approach may be appropriate when no particular importance is attached to the order of the shipments in the two directions (e.g., countertrade carried out within the framework of a setoff account (chapter IX, "Payment", paragraphs ___) or an evidence account (paragraphs *68 to 74* below)). Such an approach may also be appropriate in a counter-purchase transaction in which the counter-importer is prepared to begin fulfilling the countertrade commitment without waiting to be paid under the export contract.

12. The fulfilment period should be of a sufficient length to take into account difficulties the supplier may encounter in making the countertrade goods available. If the goods are not made available in time, the purchaser could object to the exercise by the supplier of remedies for non-fulfilment of the countertrade commitment by claiming that non-fulfilment was due to unavailability of the goods. If the purchaser is entitled to select the goods from a list of eligible countertrade goods, the length of time needed to make available each of the different goods listed should be taken into account calculating the length of the fulfilment period.

2. Extension of fulfilment period

13. The parties may require more time to fulfil the countertrade commitment than provided by the countertrade agreement. For example, a purchaser may encounter unanticipated difficulties in utilizing or reselling the goods to be purchased. A supplier may have difficulties in making agreed upon goods available on schedule.

14. The law applicable to the countertrade agreement may provide for an extension of the time allowed for the performance of a party's contractual obligations in the event that the possibility of performance is affected by circumstances beyond the control of that party. The parties may wish to include in the countertrade agreement clauses addressing such situations (see chapter XIII, paragraphs ___, for a discussion of exemption * clauses).

15. The countertrade agreement may provide that *the parties will negotiate an extension* if the party seeking an extension has made *reasonable* efforts to fulfil the commitment. *Alternatively, the parties might agree that, if the party made reasonable efforts to fulfil the commitment, that party would be entitled to an appropriate extension of the fulfilment period. It may be left to the parties to agree on the new fulfilment period. The countertrade agreement might* indicate how the purchaser could demonstrate *reasonable* efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show *that it had made reasonable offers to* potential suppliers *to purchase goods, or that it had contacted a reasonable number of* potential suppliers in search of suitable countertrade goods, *or that potential suppliers had indicated that they would be willing to enter into supply contracts some time after the expiry of the fulfilment period. Evidence of such reasonable, but unsuccessful, efforts are sometimes in practice referred to as "negative files".* The countertrade agreement may also provide that a supplier who was unable to make goods available due to circumstances specified in the countertrade agreement would be entitled to an extension. Such circumstances may include, for example, lateness of the purchaser's order or changes in the purchaser's specifications. The parties may agree that a party could request an extension of the fulfilment period only if that party had fulfilled a portion of the countertrade commitment.

16. If the fulfilment of the countertrade commitment is supported by a guarantee, it is advisable that the parties provide that the period of the guarantee should be extended to cover an extension of the fulfilment period (see chapter XII, "Security for performance", paragraphs ___).

3. Subperiods within fulfilment period

17. Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods. For example, a five-year fulfilment period could be divided into five annual subperiods, with a specified portion of the total commitment to be fulfilled during each subperiod. Such an approach assists the parties in planning delivery and marketing of the countertrade goods, and helps to ensure that fulfilment does not fall so far behind that the parties would be unable at the latter stages of the fulfilment period to fulfil the outstanding countertrade commitment.

18. The countertrade agreement may allow flexibility in dealing with shortfalls in the fulfilment of the commitment assigned to individual subperiods by permitting the carry-over of all or a portion of a shortfall to the next subperiod. In such a case, the purchaser would have, in the following subperiod, to fulfil the portion of the commitment allocated to that subperiod, as well as to fulfil the portion of the commitment carried over from the preceding period. The portion not carried over would be subject to sanctions for failure to fulfil the countertrade commitment (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance"). Such flexibility would allow the purchaser to adjust the quantity to be purchased in a given subperiod in response to circumstances such as short term market fluctuations. However, a high degree of flexibility might adversely affect the interests of the supplier if the proceeds of sales in each subperiod are to be used for payments under the supply contract in the other direction.

19. To address the possibility that the fulfilment achieved in a given subperiod exceeds the required level, the parties may agree that some or all of the extra purchases would be credited to the commitment due in the following subperiod. Alternatively, the parties may agree that the excess fulfilment in one subperiod would not affect the level of the commitment due in the following subperiod.

20. The parties may wish to set deadlines within the fulfilment period for completion of different actions *that precede* fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, *selecting goods from a list of possible countertrade goods*, placing orders, shipping goods or opening letters of credit.

D. Defining eligible supply contracts

[*The present section D incorporates, with the addition of two new paragraphs, paragraphs 2 to 9 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.*]

21. The parties normally define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts") by indicating in the countertrade agreement the type of goods to be purchased under those future supply contracts. In some cases, the parties include in the countertrade agreement additional criteria relating to the geographical origin of the goods, the identity of the supplier, or the identity of the purchaser. When the parties are not in a position to indicate the type of goods in the countertrade agreement, some of these criteria may be included for the purpose of defining eligible supply contracts.

1. By type of goods

22. When the parties define the contracts eligible to be counted towards fulfilment by indicating the type of goods to be purchased, it is advisable that they do so with as much precision as possible. Precision is particularly advisable when the goods to be purchased exist in different varieties. (For a discussion of clauses in the countertrade agreement concerning the type of goods, see chapter VI, "Type, quality and quantity of goods", paragraphs *3 to 23.*)

23. Sometimes the parties provide in the countertrade agreement that, in addition to the purchase of the countertrade goods, other related items are to be counted towards fulfilment of the countertrade commitment. Such ancillary items may be, for example, purchase of samples and prototypes in the course of selecting the countertrade goods, local contracting of labour, local purchase of goods and services essential for carrying out a supply contract, unbilled activities by the purchaser in the supplier's country (e.g., recruitment of personnel, training programmes, secondment of staff and other forms of technical assistance), purchase from the supplier of transportation services, or performance by the purchaser of after-sales service on the countertrade goods. The countertrade agreement may provide that only a limited portion of the countertrade commitment may be fulfilled through such items.

24. When the purchaser has made prior purchases from the supplier, the countertrade agreement may provide that supply contracts must meet an "additionality" requirement in order to be counted towards fulfilment (see *above, paragraphs 5 and 6*).

25. [*new paragraph*] It should be noted that stipulations on eligibility of supply contracts based on the geographical origin of goods might conflict with mandatory rules of competition law and rules adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

2. By geographical origin

26. Eligibility of supply contracts may be defined by a stipulation that countertrade goods must be produced in a particular geographical area. Stipulations of this type are sometimes found in indirect offset transactions where the importer wishes to channel the counter-purchases to a particular region. Furthermore, the countertrade agreement may stipulate a required minimum level of local content. Such stipulations may provide that particular components of the goods must be locally produced or that the value of local components must constitute a certain percentage of the total value. Local content requirements are sometimes found in governmental regulations.

27. [*new paragraph*] As in the case referred to above in paragraph 25, stipulations requiring a party to purchase goods from identified suppliers might conflict with mandatory rules of competition law and provisions adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

3. By identity of supplier

28. The parties may agree that the exporter is to fulfil the countertrade commitment by purchasing goods from persons other than the importer. This is typically the case in indirect offset (see chapter II, paragraph *17*). In such cases, it is advisable that eligible supply contracts be defined by identifying the suppliers from whom the goods are to be purchased. The countertrade agreement may list eligible suppliers or may stipulate criteria to be observed by the purchaser in selecting a supplier. It may be provided, for example, that a selected supplier must be from a particular economic sector, be of a certain size, have a particular production programme, be located in a particular region, or be locally owned. Where several eligible suppliers are identified, the purchaser may be left free to distribute purchases among various suppliers or a particular structure of purchases from the identified suppliers may be stipulated. The identification of eligible suppliers does not necessarily mean that those suppliers have made a commitment to make countertrade goods available. In some cases the importer may provide an assurance that the eligible suppliers are prepared to negotiate the conclusion of a supply contract or *the importer may promise* to assist the purchaser in identifying a supplier who is willing to conclude a supply contract. (For a discussion of the participation of third persons as suppliers, see chapter VIII, paragraph ___.) The countertrade agreement may indicate the effect on the countertrade commitment if none of the eligible suppliers are prepared to conclude a supply contract.

4. By identity of purchaser

29. A restrictive element sometimes found in the definition of eligible supply contracts concerns the identity of the purchaser. For example, the countertrade agreement may provide that only purchases made by the party committed to purchase goods or by specified third persons (e.g., third persons from a particular country or geographical region) are to be counted towards fulfilment. For a discussion of restrictions on the participation of third persons as purchasers, see chapter VIII, paragraph ___.

5. Non-conforming purchases

30. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement would *nevertheless* be counted towards fulfilment of the countertrade commitment. For example, non-conforming purchases could be counted if the good faith efforts of the purchaser to locate suitable goods from the eligible suppliers or in the geographical regions or economic sectors identified in the countertrade agreement were unsuccessful. A provision of that type could call upon the purchaser to provide evidence of efforts to make purchases of the type required by the countertrade agreement (for a discussion of the analogous case of a party requesting an extension of the fulfilment period, see above, paragraphs *13 to 16*). It could be agreed that the specific prior consent of the party to whom the commitment is owed would be necessary for the purchases not meeting the eligibility requirements to be counted towards fulfilment. In order to foster efforts to comply with origin requirements, the countertrade agreement could limit the availability of an exception to the later stages of the fulfilment period. Furthermore, the parties may agree that purchases counted towards fulfilment that fall outside the eligibility provisions are to be counted at less than the full value of the purchases (see paragraphs *32 and 33* below).

E. Rate of fulfilment credit [change of title]

[*The present section E incorporates, with modifications in italics, paragraphs 13 to 16 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.*]

31. In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the amount deducted from the outstanding countertrade commitment is hereinafter referred to as "fulfilment credit"). Sometimes the parties agree that the fulfilment credit granted for a supply contract is to be an amount different *from* the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain *outlays not included in the cost of the goods themselves (e.g., transportation and insurance)* or to exclude from the fulfilment credit certain costs included in the purchase price. The supplier may agree to the crediting of such cost elements if, for example, they involve the purchase in the supplier's country of services related to the performance of the supply contract. *The rate of fulfilment credit might also be prescribed by mandatory provisions of law (chapter XIV, "Choice of law", paragraphs ___).*

32. The countertrade agreement may provide that purchases are to be credited towards fulfilment of the countertrade commitment at different rates depending upon the type of goods purchased. For example, fulfilment credit could be granted at the rate of 50 percent of the purchase value for one type of goods and 150 per cent for another, *or that investments or technology transfer will be credited at more than the capital contribution of the investment or the monetary value of the technology transfer (e.g., 150 per cent).* Such a variable rate of fulfilment credit *may be used in particular in indirect offset transactions, in which the exporter concludes contracts with third parties, and the importer* wishes to promote the purchase of certain types of goods. * In direct offset, as well as in buy-back, the countertrade agreement may provide that a certain amount of fulfilment credit will be granted for export sales, other than those to the counter-importer, generated by the production facility supplied by the exporter. Credit may also be granted for a percentage of the value of sales to buyers in the counter-exporter's country. *A variable rate of fulfilment credit might also be used in transactions in which the supply contracts are to be entered into between the parties to the countertrade agreement, in particular if the purchaser has a choice between several types of goods; in such a case the variable rate may serve as a stimulus to purchase a certain type of goods.*

33. The countertrade agreement may also provide for different rates of fulfilment credit depending upon the identity of the supplier, the geographical origin of the goods or the identity of the purchaser. The rationale behind such a provision is to steer the activities of the purchaser towards particular suppliers or regions, or to introduce the goods in certain markets.

34. The rate of fulfilment credit may also be made to vary according to the point of time when a purchase is made. Under a scheme of this type, the purchaser could fulfil the countertrade commitment by the purchase of a smaller quantity of goods if a supply contract was concluded at an early stage of the period for the fulfilment of the countertrade commitment. This approach is designed to give the purchaser an incentive for fulfilling the commitment earlier rather than later in the fulfilment period. In such a case it is particularly important that the countertrade agreement specify the point when fulfilment credit is to be given (e.g., when an order is placed or when payment is made).

F. Stage when commitment fulfilled

[*The present section F incorporates, with modifications in italics, paragraphs 10 to 12 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.*]

35. It is advisable that the countertrade agreement indicate the specific *action that must be taken* in order for the countertrade commitment to be fulfilled. The parties may choose between two basic approaches. Under one approach, the countertrade commitment is deemed to be fulfilled once a supply contract is concluded. In such cases, a breach of an obligation under the supply contract would be subject to remedies available under the supply contract. The parties may agree that, if the supply contract is not performed due to a reason imputable to one party, the amount of the unperformed contract could, at the option of the other party, be reinstated in the countertrade commitment.

36. Under the *second* approach, the commitment is deemed to be fulfilled at an agreed stage in the performance of the supply contract. For example, it may be agreed

that the commitment of the purchaser is fulfilled when the letter of credit is opened or when the funds have been transferred to the supplier and *that* the corresponding commitment of the supplier is fulfilled when the goods are delivered or placed at the disposal of the purchaser in the agreed manner. In such cases, in the event of a breach of the supply contract, the *aggrieved* party might be able to invoke remedies not only for breach of the supply contract, but also for breach of the countertrade agreement if the countertrade commitment remained unfulfilled. *A disadvantage of this second approach is that it is more complicated and uncertain than the first approach, under which fulfilment is deemed achieved simply upon the conclusion of a supply contract. The second approach might result in uncertainty when exempting impediments affect the ability of a party to take the steps necessary in the performance of a supply contract to achieve fulfilment of the countertrade commitment. In order to avoid this uncertainty, additional provisions would be required in the countertrade agreement on the effect of such impediments.*

37. The parties may wish to address the effect on the countertrade commitment of a failure to conclude or perform a supply contract. It may be agreed, for example, that when the reason for such a failure is imputable to one of the parties, the outstanding countertrade commitment of the other party may, at the option of that other party, be deemed fulfilled in the amount of the unaccepted contract offer or unperformed contract (see chapter XIII, "*Failure to complete countertrade transaction*", paragraph ___).

G. Defining terms of future supply contracts

[*The present section G is a restructured section C, paragraphs 37 to 61, of draft chapter III, "Contracting approach" as it appeared in A/CN.9/332/Add.2. Paragraphs 39 to 42 of the earlier section C, A/CN.9/332/Add.2, entitled "Negotiation procedures", have been included at the end of the present subsection 6.*]

1. Terms of future supply contracts

38. [*paragraph 43 in A/CN.9/332/Add.2*] Commitments to enter into supply contracts often do not stipulate in a definite manner *all* the terms of the contracts to be concluded. *Sometimes* the parties *have not decided yet on* the type of goods that will be the subject of the future supply contracts or what the terms of delivery will be. Even if the parties *are* able to set out in the countertrade agreement terms of the future supply contract, they sometimes forego doing so because they expect each party to live up to the commitment to conclude a future contract, though the terms of that contract may not be defined in great detail in the countertrade agreement.

39. [*new paragraph*] A lack of definiteness of the countertrade commitment may result in delays or uncertainties in negotiating a supply contract in view of the potentially broad scope of the negotiations. It is therefore advisable that the parties, to the extent feasible, include in the countertrade agreement the terms of the future contract or provide for means for subsequent determination of those terms (see paragraphs 44 to 56 below). In addition, the parties may wish to address in the countertrade agreement procedures to be followed in their negotiations (see paragraphs 57 to 60 below). This will facilitate negotiations, increase the likelihood that a supply contract will be concluded and increase the possibility that the party interested in the conclusion of the contract would be able to hold the other party responsible for refusing to conclude the contract. If, for example, the countertrade agreement specifies the goods that a party is committed to purchase, or at least contains a list of goods as a basis of negotiations, the counter-exporter may be able to show that the refusal of the counter-importer to purchase any goods constitutes a breach of the countertrade commmitment. If the goods are specified, it is also advisable to provide a mechanism for determining the price; this is particularly important when the countertrade goods are not of a standard type and it may be open to disagreement what is a fair market price.

40. [*paragraph 46 in A/CN.9/332/Add.2*] As the countertrade agreement becomes more definite *in specifying* the terms essential for the existence of an enforceable contract, the agreement approaches the point at which the parties have settled all the terms of the supply contract and postponed only the act of *concluding* the contract. *When the countertrade agreement embodies the essential terms of the future contract for the purchase of goods, in some legal systems the possibility exists that such a countertrade agreement could be relied upon as an enforceable sales contract. In order to avoid disagreements, it is advisable that the parties, when concluding a countertrade agreement that contains the essential terms of the contract to be concluded, stipulate clearly whether a separate contract is to be executed pursuant to the countertrade agreement.*

41. [*paragraph 47 in A/CN.9/332/Add.2*] Many legal systems contain rules to which the parties may resort in order to provide definiteness to a contract clause. For example, numerous legal systems provide a solution when the parties have not settled the price of the goods; the solution may be, for instance, that the price should be the one "generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned" (article 55 of the United Nations Convention on Contracts for the International Sale of Goods). Another example may be the rule on the quality of the goods to be delivered under the contract when the contract has not settled that issue; the rule in article 35(2)*(a)* of the above-mentioned Convention is that the goods should be "fit for the purposes for which goods of the same description would ordinarily be used". In some legal systems the parties may, within certain limits, resort to a court for the purpose of determining such a contract element. In other legal systems, however, the courts are not competent to intervene in this manner in a contractual relationship.

42. [*paragraph 48 in A/CN.9/332/Add.2*] Although such means for contract supplementation exist in many legal systems, they normally do not provide a solution in all cases of indefiniteness. The contract elements left indefinite in the countertrade agreement may not lend themselves to being made definite by reference to the applicable law. For example, if the parties have not agreed on the type of goods to be counter-exported, it would probably be impos-

sible to determine the type on the basis of the applicable law. Where the type of goods has been settled, the criteria provided in the applicable law concerning the price of the goods may not lead to a clear solution. Furthermore, such contract supplementation is subject to uncertainty arising out of divergencies among legal systems as to the techniques of supplementation, the role of the courts *or arbitral tribunals in determining the missing term,* the role of the parties, or as to the judicial control over the result of the supplementation. * As a result, the parties may wish to consider the contractual means discussed below for providing definiteness to a contract term left open in the countertrade agreement.

43. [*paragraph 49 in A/CN.9/332/Add.2*] The terms that are often left indefinite in the countertrade agreement and with respect to which contractual means for completing indefinite terms may be particularly useful are the type, quality, price and quantity of the countertrade goods. The contractual means that the parties may consider for completing any one or more of those terms are discussed in a general manner in subsections *(a)* through *(c)* below. In other parts of the Legal Guide, these contractual means will be referred to in specific contexts.

(a) *Standards or guidelines*

44. [*paragraph 50 in A/CN.9/332/Add.2*] The parties may wish to provide standards or guidelines to be used in determining particular contract terms. The use of a standard would allow the parties to determine a contract term by computation or by some other objective method not dependent upon the discretion of the parties. Examples of such standards include a formula, tariff, quotation, rate, index, statistic, or some other criterion not influenced by the will of either party. For example, the price of the countertrade goods may be determined by reference to the price at which goods of the same type are sold in a particular market or exchange, or the quality of the countertrade goods may be defined by reference to a particular national or international quality standard. Many legal systems recognize as valid a provision that the price or other contract term should be determined by reference to a standard.

45. [*paragraphs 50 and 45 in A/CN.9/332/Add.2*] Guidelines, on the other hand, set parameters within which a contract term is to be determined and involve a degree of latitude in arriving at a contract term. For example, the countertrade agreement may set a range within which the parties are to negotiate the price or it may be agreed that the price must be "reasonable" *(such price clauses are further discussed in chapter VII, "Pricing of goods", paragraphs ___). [The following text in italics has been taken from paragraph 45 of A/CN.9/332/Add.2:] Sometimes the parties are not in a position to be more definite about the terms of the anticipated supply contract than to provide that the contract terms should be fair or in accordance with the prevailing market conditions. Such provisions may be helpful when countertrade goods of a standard quality are agreed upon, thereby enabling a fair price to be ascertained. If, however, the type of countertrade goods is not settled or if the countertrade goods are products that do not have a standard price, such a "fair terms" commitment may not substantially enhance the position of the party interested in the conclusion of the contract. In such cases opinions may differ as to what contract terms are fair, thereby protracting the negotiations and making uncertain the success of a claim against the party refusing to conclude the contract.* If the type of goods has not been determined, the parties may agree on a list of goods on which the negotiations should focus or to which it should be limited (such lists are discussed in chapter VI, "Type, quality and quantity of goods"). As to other terms of the future contract, such as delivery, the parties may agree that the supply contract should be negotiated on the basis of prevailing market conditions. Where reference is made to market conditions, it is advisable that the parties refer to a specific market.

46. [*paragraph 52 in A/CN.9/332/Add.2*] Because of the discretion left to the parties, the inclusion of a guideline in the countertrade agreement for a particular term in the future contract does not ensure the finalization of that term. Nevertheless, a narrow range within which agreement should have been achieved, or clear guidelines limiting the latitude available to the negotiators, will not only make it more likely that a contract will be concluded but will also make it easier to show that a party refusing a given contract offer is in breach of the countertrade commitment.

(b) *Determination of contract term by third person*

47. [*paragraph 53 in A/CN.9/332/Add.2*] Sometimes the parties agree that a particular contract term will be determined by a third person. While such an approach provides a high degree of certainty that the term will be made definite, its infrequent use may be attributable to a reluctance by parties to relinquish their control over a contract term. When such a method is used, it is usually to determine the price of goods (see chapter *VII, paragraphs ___ and ___*). The parties might be willing to agree on such a method of determining a contract term if clear, *and preferably narrow,* guidelines are established within which the third person is to decide or if the third-person intervention is the last resort after other agreed mechanisms (e.g., negotiation, application of an agreed standard) have failed. If the parties do not wish to entrust the decision on a contract term to a third person, but still want the benefit of the opinion of a third person, it may be agreed that the determination by the third person will only be a recommendation.

48. [*paragraph 54 in A/CN.9/332/Add.2*] A number of legal systems recognize the right of the parties to entrust a third person with determining a contract term. In particular, reference by the parties to a third person for the determination of the price is a question frequently addressed in legal systems. There are, however, variations among the systems. For example, while some legal systems recognize that an arbitral tribunal or even a court may be entrusted with the determination of a contract term, others permit such a determination only if it is not performed as part of arbitral or judicial proceedings. Legal systems also differ as to the consequences of a failure by the parties to agree on the third person or of a failure by the third person to

act. Under some legal systems, the parties would have no recourse to a procedure for designating or replacing the person, and would have to accept the consequences of the contract term being left undetermined. In other systems, if the third person was to determine the price, the case may be treated as if the parties had agreed on a reasonable price. There are also differing approaches to the availability and extent of judicial review of a decision by a third person.

49. [*paragraph 55 in A/CN.9/332/Add.2*] The issues that the parties may wish to address in a stipulation empowering a third person to determine a contract term are discussed *in the following paragraphs.*

50. [*paragraph 56 in A/CN.9/332/Add.2*] *Person to request determination of term.* The parties may wish to address the question whether, at the time when the parties fail to agree on the term, either party would be entitled to request the third person to determine the term or whether the third person may act only upon the request of both parties.

51. [*paragraph 57 in A/CN.9/332/Add.2*] *The identity of the third person or the appointment procedure.* The parties may wish to name in the countertrade agreement the person who is to determine the contract term. In this case, the parties may also wish to provide an appointment procedure to be used in the event that the named person fails to act or is unable to act. If the parties do not wish to name the person who is to determine the contract term, it may be advisable for the parties to agree that they will appoint the third person at such time as they are unable themselves to reach agreement on the contract term. In such a case the parties may wish to agree on an appointment procedure, which is to become operative if the parties cannot reach agreement on the appointment of the third person.

52. [*paragraph 58 in A/CN.9/332/Add.2*] *Guidelines or standards to be observed by third person.* The parties are advised to delimit the mandate of the third person by providing guidelines or standards to be observed in determining the contract term. Such guidelines and standards are discussed generally above, paragraphs 50 to 52, and, as to price, in *chapter VII*, "Pricing of goods", *paragraphs ___ to ___*.

53. [*paragraph 59 in A/CN.9/332/Add.2*] *Nature of decision of third person.* The parties may agree that the decision by the third person would be binding as a contractual stipulation of the parties. Another approach may be to provide that the determination of the third person would be treated as a recommendation to be considered by the parties in good faith.

54. [*paragraph 60 in A/CN.9/332/Add.2*] *Procedure for challenging decision by the third person.* In some situations, for example, where the binding determination by the third person involves a question of particular economic significance, the parties might wish to provide an opportunity for the decision to be challenged by resort to another person, a panel of persons, or an institution. As to the nature of the decision on the challenge, it may be provided that the decision would bind the parties or only be a recommendation. The parties may wish to stipulate the mandate that would be given to the person deciding on the challenge (i.e., to uphold or reject the challenge, or to modify the challenged decision). The parties may wish to indicate how, in the event the challenged decision is set aside, the decision on the contract term is to be made (e.g., by the parties themselves or by the same or a different third person).

(c) *Determination of contract term by contract party*

55. [*paragraph 61 in A/CN.9/332/Add.2*] Sometimes the countertrade agreement leaves the determination of a contract term to one of the parties to the countertrade agreement. *Utmost caution is advisable in agreeing on such a solution, which leaves the determination of the contract term to a person who has an interest in the outcome of the determination.*

56. [*paragraph 61 in A/CN.9/332/Add.2*] *The parties should be aware that a clause empowering a contract party to determine a contract term is in many legal systems not enforceable. Where such a clause is recognized, it is subject to strict conditions.* If the subject of the determination is the price, a number of systems would recognize such a right given to a party if its exercise is limited by such standards as reasonableness, good faith or fairness. Some of these systems would construe *an agreement not expressly referring to such a standard as implicitly referring to it.* Other legal systems require the freedom to determine the price to be limited by a more definite standard *such as objectively ascertainable market prices, price averages or absolute limits stipulated by the parties. Analogous restrictions apply to the determination of terms such as the quantity of goods to be delivered under a contract or the time of contract performance.*

2. *Negotiation procedures*

57. [*paragraph 39 in A/CN.9/332/Add.2*] Countertrade agreements may set forth with varying degrees of procedural detail the manner in which negotiations are to be carried out. Specifying the negotiation procedures increases the probability that the negotiations will lead to a successful outcome. This would be particularly true where the nature of the negotiations is likely to be complicated, either because of the subject-matter of the eventual contracts or because of the number of persons who might be involved in those negotiations.

58. [*new paragraph*] Care should be taken to make negotiating procedures a part of a firm undertaking to conclude a supply contract. If the undertaking is limited to a mere obligation to negotiate, the parties, as noted above in paragraph 2, will have little assurance that the objectives of the transaction will be achieved. Even if negotiating procedures are combined with a firm countertrade commitment, such procedures alone do not ensure that negotiations will be successful. The most effective way to increase the likelihood of succeeding in the negotiations would be either to stipulate in the countertrade agreement the terms of the future contract or, if this is not possible, to agree on means

for providing definiteness to the countertrade commitment. Such means are discussed above, in particular in paragraphs 44 to 56.

59. [*paragraph 40 in A/CN.9/332/Add.2*] At a minimum, the countertrade agreement might provide that a party would be obligated to respond to contract proposals by the other party. More specific procedures would address issues such as: the party who is to submit a contract offer; questions to be covered by a contract offer; time periods for submitting it; the form, means or frequency of communication; the time period for reply; the time within which an agreement must be reached, and beyond which negotiations will be deemed to have failed. Furthermore, the parties may provide that in certain circumstances a party would be relieved of the duty to negotiate (e.g., when that party has made an offer meeting the agreed conditions and it has not been accepted, or, if the other party was to make the offer, when no such offer has been made).

60. [*paragraph 41 in A/CN.9/332/Add.2*] The stipulation of negotiation procedures such as those mentioned in the previous paragraph may * increase the possibility that a party who has not negotiated in good faith could be held responsible for the failure to conclude a contract. Such procedures could enable an aggrieved party to demonstrate, for example, that the other party refused to negotiate, imposed conditions to negotiate that the party could not properly impose, used unfair dilatory tactics, reopened discussion on issues already agreed upon, negotiated with other parties when it was improper to do so, or prematurely broke off negotiations.

H. Monitoring and recording fulfilment of countertrade commitment

[*The present section H incorporates, with some modifications in italics, paragraphs 31 to 44 of draft chapter VII, "Fulfilment of countertrade commitment", as it appeared in A/CN.9/332/Add.8.*]

61. The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment. Such arrangements may be particularly useful in long term countertrade transactions with multiple shipments in one or both directions.

1. Exchange of information

62. The parties may wish to establish procedures for exchange of information on progress in the fulfilment of the countertrade commitment. Such procedures may be useful, in particular, in "indirect offset" transactions (chapter II, *paragraph 17*), since the countertrade commitment is owed to a person who does not act as the supplier of the countertrade goods and the potential suppliers are, therefore, not parties to the countertrade agreement. A system of exchange of information may also be useful when the parties are engaged in a large volume of mutual trade, especially when only a part of that trade stems from the countertrade agreement.

63. The parties may include in the countertrade agreement guidelines concerning the contents, frequency and timing of the information to be exchanged. The required information could cover, for example, contracts that have been concluded *and* are eligible to be counted towards fulfilment (especially when concluded with a third person), shipments that have been made, payments effected in accordance with agreed upon procedures and purchases planned for an upcoming subperiod of the fulfilment period. Furthermore, the parties to the countertrade agreement sometimes find it useful to meet periodically to assess the progress that is being made towards fulfilment. Such meetings could be used to review the status of concluded contracts and those under negotiation and to consider possible modifications of the countertrade agreement. The countertrade agreement could address questions such as the frequency and location of meetings and the representation of the two sides.

64. In particularly complex transactions that require ongoing monitoring and coordination, the parties may wish to establish in the countertrade agreement a joint coordination committee. It is advisable that the parties address issues such as the frequency and location of meetings, representation of the two sides, the manner in which the results of the meetings will be reported and the mandate of the committee. The mandate of such a committee would typically be to assess progress in the implementation of the transaction, analyse difficulties and consider possible solutions, establish working groups for specific problems, and consider proposals to amend the countertrade agreement.

2. Confirmation of fulfilment of countertrade commitment

65. The parties may agree that the purchaser has a right to obtain from the party to whom the countertrade commitment is owed a written confirmation of the fulfilment of the countertrade commitment. Such a confirmation may take the form of a statement from the supplier (sometimes referred to as a "letter of release"). The parties may agree that the letter of release is a condition for payment under the supply contract concluded in fulfilment of the countertrade commitment (e.g., the letter of credit terms may specify that the letter of release is to be among the documents presented to the bank in order to obtain payment). Fulfilment of the countertrade commitment may also be *evidenced* by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

66. Written confirmation of fulfilment is intended to avoid disagreements, which may occur after a particular supply contract has been performed, as to whether the contract counts towards fulfilment of the countertrade commitment. Written confirmation may also be helpful to a party who wishes to demonstrate (e.g., in negotiating other countertrade agreements) a record of fulfilling countertrade commitments.

67. Where written confirmations are envisaged in a multiparty transaction (see chapter VIII, "Participation of

third *parties*", paragraphs ___ to ___), it is advisable that the countertrade agreement indicate whether the fulfilment of the commitment is to be confirmed by the supplier of the goods or by the party to whom the commitment is owed. Absent such an indication, a disagreement may arise between the purchaser and the party to whom the commitment is owed as to the significance of a statement by a third-party supplier that a supply contract fulfils the countertrade commitment, or of a clause in a supply contract with a third-party supplier to that effect.

3. *Evidence accounts*

68. The parties may agree that the *supply contracts in the two directions* are to be recorded in a ledger kept by themselves, by a bank or by a controlling authority. Such a ledger is referred to herein as an "evidence account", a term frequently used in practice. *Other terms used in practice include "record account" and "trade account".* An evidence account is not a payment mechanism. Rather, it is used only for recording the conclusion, performance and value of supply contracts, with financing and payment being arranged independently. With an evidence account, the parties undertake a countertrade commitment of a given value and then conclude supply contracts in the two directions without having to negotiate a countertrade commitment for each individual supply contract. Evidence accounts may accommodate multiple parties on one or both sides. An evidence account may be particularly useful in a long-term countertrade transaction to monitor the cumulative value of the purchases in the two directions and thereby to assist the parties in dealing with imbalances that may develop.

69. The use of an evidence account may be subject to governmental regulations. Such regulations may determine the manner in which an evidence account is to operate and require administration of the account by a controlling authority such as the central bank or foreign trade bank. An evidence account administered by a controlling authority may provide the purchaser access to a wider variety of countertrade goods and trading partners than might be available without an evidence account administered by the controlling authority. Government regulations may also require authorization of evidence accounts. It may be provided that such authorization would be given only for countertrade transactions exceeding a minimum turnover and to parties with an established presence in a given country. In some cases, an evidence account is authorized with the restriction that purchases by third parties will not be counted towards fulfilment of the countertrade commitment; such a restriction may be imposed when the motive for permitting an evidence account is to establish a long term trading relationship with a particular party. The countertrade goods may be limited to those agreed upon by the parties or those that the controlling authority has an interest in promoting.

70. When the parties are free to establish an evidence account, they may decide to administer the account themselves or to engage a bank or banks to do so. A variety of structures are possible depending on whether the account is administered by one or both of the parties or by one or two banks engaged by the parties. For example, parallel accounts could be established by a party or a bank on each side of the transaction in which supplies are credited and purchases are debited. Each parallel account could in turn consist of two ledgers, one listing contracts concluded in each direction and the other recording payments. If banks are to administer the evidence account, the parties may wish to use the banks that handle payment for the supply contracts.

71. The countertrade agreement should specify the documentation required for triggering entries in the evidence account (e.g., copies of contracts, evidence of letters of credit, or shipping documents). Such documentary requirements should be in line with the provisions in the countertrade agreement concerning the stage when the countertrade commitment is deemed fulfilled (see above, *paragraphs 35 to 37*). In order to minimize administrative burden, the parties may wish to align to the degree possible the documentary requirements for the evidence account with those of any governmental authority monitoring the countertrade transaction.

72. It is advisable that the parties address in the countertrade agreement deviations from the agreed upon ratio between the values of the shipments to be made in the two directions. *It may be agreed that, while the agreed upon ratio must be achieved upon the conclusion of the fulfilment period or at specified points in the fulfilment period, the values of the shipments may deviate from the agreed ratio during the fulfilment period or between the specified points in the fulfilment period.* The parties may further agree that deviations during the fulfilment period must remain within a specified range. For example, during the fulfilment period the value of the shipments in one direction should be not less than 60 and not more than 120 per cent of the value of the shipments in the other direction. It may be agreed that, *if a party fails to conclude the supply contracts necessary to achieve the agreed upon ratio, the other party is entitled to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction until the ratio is achieved (see also chapter XIII, "Failure to complete countertrade transaction", paragraph ___). A failure to achieve the agreed ratio may also be made* subject to sanctions (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance"). It is advisable to define in the countertrade agreement small deviations from the ratio that would be tolerated.

73. In order to minimize errors or discrepancies in the evidence account, *it is advisable for* the parties *to* agree to verify at fixed points of time the information entered in the account.

74. Where two banks are involved in administering the evidence account, the technical details of the account may be the subject of an interbank agreement. The countertrade parties have an interest in the contents of the interbank agreement, though they are not normally parties to it. It is therefore advisable that the parties consult with the banks to ensure that the evidence account established by the banks is acceptable to the parties.

[A/CN.9/362/Add.5]

V. GENERAL REMARKS ON DRAFTING

CONTENTS

		Paragraphs
A.	General remarks	1-9
B.	Language	10-12
C.	Parties to transaction	13-15
D.	Notifications	16-20
E.	Definitions	21-24

[*Editorial note:* The present draft chapter V is a revision of draft chapter IV bearing the same title and published as document A/CN.9/332/Add.3. Where the numbering of a paragraph has changed, the earlier paragraph number appears in square brackets at the beginning of the paragraph. The revisions of paragraphs that appeared in A/CN.9/332/Add.3 are in italics.]

A. General remarks

1. A countertrade transaction is usually the result of extensive written and oral communications between the parties. Each party may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts). Such a checklist could reduce the possibility of omissions or errors occurring in the steps taken prior to entering into the contracts. A party may also wish to consider seeking legal or technical advice in drawing up the contracts. While countertrade transactions can be expected to become routine for parties experienced in countertrade, even simple countertrade transactions may pose difficulties for newcomers to countertrade calling for legal or technical advice. For complex transactions, even experienced parties may require advice.

2. The process of establishing a countertrade transaction could be facilitated if the parties agree that, before a first draft of the countertrade agreement and any supply contract is prepared, negotiations on the main technical and commercial issues are to take place. Thereafter, one of the parties could be asked to submit a first draft reflecting the agreement reached during the negotiations. A first draft may then be discussed and elaborated, resulting in a preliminary set of contract documents, which, after review and finalization, will govern the relationship between the parties.

3. The legal rules applicable to the countertrade agreement may require that a countertrade agreement be in written form. Even when written form is not required, it is *recommended that* the parties express their agreement in writing to avoid later disputes as to what terms were actually agreed upon. If the parties decide that modifications of the countertrade agreement are to be in writing, it is advisable that this be stated in the countertrade agreement. *However, even if such a provision has been included in the countertrade agreement, there may be situations in which a modification can be made otherwise than in writing. A number of legal systems have rules, comparable to article 29(2) of the United Nations Sales Convention, according to which a party may be precluded by its conduct from asserting a contract provision that any modification or termination of the contract must be in writing to the extent that the other party has relied on that conduct.*

4. *It is desirable that* the parties clarify the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents which came about during the negotiations, on the other. The parties may wish to provide that those communications and draft documents are not part of the contract. They may further provide that those communications and draft documents cannot be used to interpret the contract, or, alternatively, that they may be used for this purpose to the extent permitted by the applicable law. Under the law applicable to the contract, oral exchanges, *statements and conduct of a party* and correspondence *may* be relevant to the interpretation of the contract even if they occur after the contract is entered into.

5. The parties should ensure that the contract terms as expressed in writing are unambiguous and will not give rise to disputes, and that the relationship between the various documents comprising the transaction is clearly established. Such precision may be of particular importance in countertrade transactions that are carried out over a long period and may have to be administered by persons who have not participated in the negotiations at the outset of the transaction (e.g. buy-back or offset transactions). Each party may find it useful to designate one person to be primarily responsible for supervising the preparation of the contract documents. It is advisable for that person to be a skilled draftsman familiar with international countertrade transactions. To the extent possible, it is advisable for that person to be present during important negotiations. Each party may find it useful to have the final contract documents scrutinized by a team having expertise in the subject-matter reflected in the documents in order to ensure accuracy and consistency of style and content.

6. The applicable legal rules may also contain rules on the interpretation of contracts and presumptions as to the meaning of certain expressions such as "reasonable price" (chapter VII, "Pricing of goods", paragraph 24), "trust" and "*compte fiduciaire*" (chapter IX, "Payment", paragraph 16), and "penalty" (chapter XI, "Liquidated damages and penalty clauses", paragraph ___). The parties are advised to select contract wording in light of the applicable law in order to ensure that the expressions used reflect the intended meaning. One approach is for the applicable law to be determined at a very early stage of the relationship between the parties (e.g., at the commencement of negotiations). The countertrade transaction may then be negotiated and drawn up taking that law into account. Another approach is for the parties to determine the applicable law only after negotiations have taken place on the main technical and commercial issues and have resulted in a measure of accord between the parties. They may thereafter review the first drafts relating to the transaction, which reflect that accord, in the light of the applicable law to ensure that the terms of the draft take account of that law. *The advisability of stipulating the law applicable to the countertrade agreement and the related supply contracts is discussed in chapter XIV.*

7. The parties should take into account the mandatory legal rules of an administrative, fiscal or other public nature in the country of each party that are relevant to the countertrade transaction. They should also take into account such mandatory legal rules in other countries when those rules are relevant to the transaction. Certain rules may concern the technical aspects of the countertrade agreement (e.g., safety standards for the countertrade goods or rules relating to environmental protection), and the terms of the countertrade agreement should not conflict with those rules. Other rules may concern export, import and foreign exchange restrictions (e.g., it may be provided that certain rights and obligations are not to arise until export or import licences, approvals for payments or for the use of particular payment mechanisms have been granted). Legal rules relating to taxation may be a factor, and the parties may wish to include in the countertrade agreement provisions dealing with liability for tax. *Mandatory provisions are also considered in chapter XIV, "Choice of law", paragraphs ___ to ___.*

8. The parties may wish to consider whether the countertrade agreement is to contain introductory recitals. The recitals may set forth representations made by one or both parties which induced the parties to enter into the agreement. The recitals may also *set out commercial objectives to be achieved through the transaction or describe the* context in which the countertrade agreement was entered into. The extent to which recitals are used in the interpretation of the terms of the agreement introduced by the recitals varies under different legal systems, and their impact on the interpretation may be uncertain. Accordingly, if the contents of recitals are intended to be significant in the interpretation or implementation of the countertrade agreement, it may be preferable to include those contents in the operative provisions of the countertrade agreement.

9. The parties may find it useful to examine standard forms of countertrade agreements, general conditions, standard clauses, or previously concluded countertrade agreements to facilitate the preparation of contract documents. Such an examination may clarify for the parties the issues that should be addressed in their negotiations. However, it is inadvisable to adopt provisions appearing in those documents without critical examination. Those provisions may, as a whole, reflect an undesirable balance of interests, or those provisions may not accurately reflect the terms agreed to by the parties. The parties may find it advisable to compare the approaches adopted in the forms, conditions or countertrade agreements examined by them with the approaches recommended in the present Legal Guide.

B. Language

10. The contracts constituting the countertrade transaction (i.e., the countertrade agreement and the individual supply contracts) may all be drawn up in only one language version (which may, but need not be, the language of either of the parties), or in the two languages of the parties where those languages differ, or the countertrade agreement may be drawn up in one language and the supply contracts in another language. Where the conclusion of the countertrade agreement precedes the conclusion of the supply contracts in the two directions (chapter III, "Contracting approach", paragraph 19), or where it precedes the conclusion of the counter-export contract (chapter III, paragraphs 12 to 18), it is advisable that the countertrade agreement specify the language of the contracts. The specification of the language before the commencement of negotiations on a supply contract may facilitate preparations of the parties for the negotiations and avoid a disagreement.

11. Drawing up a contract in only one language version will reduce conflicts of interpretation in regard to its provisions. Drawing up all the contracts constituting the countertrade transaction in the same language will reduce conflicts between two contracts of related content. On the other hand, each party may understand its rights and obligations more easily if one version of the contract is in its language. In addition, where extensive or complex working instructions to personnel of one or both parties are derived directly from the contract, it may be of particular importance that the contract is in the language in which the instructions are to be given. *The parties may decide that certain annexes to the countertrade agreement or a supply contract (e.g., those setting out technical specifications) will be drawn up in or translated into a particular language. If translations are envisaged, it is advisable to settle the question of who should bear the translation costs.* If only one language is to be used, the parties may wish to take the following factors into account in choosing that language: that it is advisable for the language chosen to be understood by the senior personnel of each party who will be implementing the contract; that it might be advisable for the contract to be in a language commonly used in international commerce; that the settlement of disputes is likely to be facilitated if the language chosen is the language in which proceedings would be conducted or if the language chosen is the language or one of the languages of the country of the applicable law.

12. If the parties do not draw up the contracts in a single language version, it is advisable to specify in the contracts which language version is to prevail in the event of a conflict between the two versions. For example, if the negotiations were conducted in one of the languages, the parties may wish to provide that the version in the language of the negotiations is to prevail. A provision that one of the language versions is to prevail might induce both parties to clarify as far as possible the prevailing language version. The parties may wish one language version to prevail in respect of certain segments of the transaction or in respect of certain contract documents (e.g. countertrade agreement or technical documents related to the countertrade agreement or a supply contract) and another language version in respect of the remainder of the contracts or documents. Where the parties provide that both language versions are to have equal status, the parties should attempt to provide guidelines for the settlement of a conflict between the two language versions. The parties may provide, for example, that the agreement is to be interpreted according to practices that the parties have established between themselves and usages regularly observed in international trade with respect to the agreement in question. The parties may also wish to provide that where a term of the contract in one language version is unclear, the corresponding term in the other language version may be used to clarify that term.

C. Parties to transaction

13. Where a contract involved in the transaction (the countertrade agreement or a supply contract) consists of several documents, the parties may wish to identify and describe themselves in a principal document designed to come first in logical sequence among the documents that incorporate that contract. The document should set forth, in a legally accurate form, the names of the parties, indicate their addresses, record the fact that the parties have entered into a contract, briefly describe the subject-matter of the contract, and be signed by the parties. It should also set forth the date on which, and the place where, the contract was signed, and the time when it is to enter into force. Subsequent reference in the contract to the parties may be facilitated if the principal document would specify that in the subsequent text and in the subordinate documents the parties would be referred to by agreed abbreviations or by expressions such as exporter, importer, counter-exporter, counter-importer, trading house. A party may have several addresses (e.g., the address of its head office, the address of a branch through which the contract was negotiated) and it may be preferable to specify in the document the address to which notifications directed to a party should be sent.

14. Parties to countertrade transactions are usually legal *persons*. In such cases the source of their legal status (e.g. incorporation under the laws of a particular country) may be set out in the contract. There may be limitations on the capacity of legal *persons* to enter into contracts. Therefore, unless satisfied of the other party's capacity to enter into the contract, each party may wish to require from the other some proof of that capacity. If a party to the contract is a legal *person*, the other party may wish to satisfy itself that the official of the *legal person* signing the contract has the authority to bind the *legal person. When a governmental agency is a party to the countertrade transaction, special authorization may be necessary for the conclusion of the countertrade agreement or the supply contract. Special authorization may also be required for a governmental agency to enter into an arbitration agreement and to include in that agreement a clause by which the agency agrees to carry out the award made by the arbitral tribunal.*

15. [*paragraph 14, last sentence*] If the contract is entered into by an agent on behalf of a principal, the name, address and status of the agent and of the principal may be identified, and evidence of authority from the principal enabling the agent to enter into the contract on its behalf may be annexed.

D. Notifications

16. [15] In a countertrade transaction a party frequently has to notify the other party of certain events or situations. Such notifications may be required, for example, to initiate negotiations for the conclusion of a supply contract, to facilitate cooperation in the performance of the contract, to enable the party to whom notification is given to take action, as the prerequisite to the exercise of a right, or as the means of exercising a right. The parties may wish to address and resolve in their contract certain issues which arise in connection with such notifications.

17. [16] In the interests of certainty, it is desirable to require that all notifications referred to in the countertrade transaction be given in writing, although in certain cases requiring immediate action the parties may wish to provide that notification can be given orally in person or by telephone, to be followed by confirmation in writing. The parties may wish to define "writing" (see paragraph 21 below) and to specify the acceptable means of conveying written notifications (e.g., surface mail, airmail, telex, telegraph, facsimile, electronic data interchange (EDI)). However, care should be taken not to so limit the means of notification that, if the means specified is not available, no valid notification could be given. The parties may also wish to specify the language in which notifications are to be given (e.g., the language of the contract).

18. [17] With regard to the time when a notification is to be effective, two approaches may be considered. One approach is to provide that a notification is effective upon its dispatch by the party giving the notification, or after the lapse of a fixed period of time after the dispatch. Alternatively, the parties may provide that a notice is effective only upon delivery of the notification to the party to whom it is given (see paragraph 21 below). Under the former approach, the risk of a failure to transmit or an error by the transmitting agency in transmission of the notification rests on the party to whom the notification is sent, while under the latter approach it rests on the party dispatching the notification. The parties may find it advantageous to select a means of transmitting the notification which provides proof of the dispatch or delivery, and of the time of dispatch or delivery. Another approach may be to require the party to whom the notification is given to acknowledge receiving the notification. It may be convenient for the

contract to contain a general provision to the effect that, unless otherwise specified, one or the other approach with respect to when a notification becomes effective (on dispatch or delivery) is to apply to notifications referred to in the contract. Exceptions to the general approach adopted may be appropriate for certain notifications.

19. [*new paragraph*] The parties may wish to specify the addresses of company departments or of representatives of the parties to which notifications should be sent. Different addressees might be specified for different kinds of notifications.

20. [18] The parties may wish to specify the legal consequences of a failure to notify. The parties may also wish to specify the consequences of a failure to respond to a notification that requires a response. For example, when the parties envisage a series of shipments *in one or in the two directions*, they may provide that if the supplier notifies the purchaser of a proposed shipment of a given quantity of the goods on a particular date, the purchaser is deemed to have agreed unless an objection is made.

E. Definitions

21. [19] *It is advisable* to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contract. Definitions are particularly useful in contracts between parties from different countries, even if they use the same language, because of the increased possibility that certain expressions or concepts may be used differently in the two countries. Definitions are also useful when the contracts are in two languages since they tend to reduce the likelihood of errors in translation. A definition ensures that the expression or concept defined is understood in the same sense whenever it is used in the agreement or the contract, and dispenses with the need to clarify the intended meaning of the expression or concept on each occasion that it is used. A definition is advisable if an expression which needs to be used is ambiguous. Such definitions are sometimes made subject to the qualification that the expressions defined bear the meanings assigned to them, "unless the context otherwise requires". Such a qualification takes into account the possibility that an expression which has been defined has inadvertently been used in a context in which it does not bear the meaning assigned to it in the definition. The preferable course is for the parties to scrutinize the contract carefully to ensure that the expressions defined bear the meanings assigned to them *wherever they occur.*

22. [20] Since a definition is usually intended to apply throughout an agreement or contract, a list of definitions may be included in the controlling document. Where, however, an expression that needs to be defined is used only in a particular provision or a particular section of the agreement or contract, it may be more convenient to include a definition in the provision or section in question.

23. [21] *Examples of expressions that parties may wish to define include* "countertrade agreement", "writing", "dispatch of notification", and "delivery of notification". The parties may wish to consider the following examples:

Countertrade agreement. "Countertrade agreement" consists of the following documents, and has that meaning in all the said documents: *(a)* the present document; *(b)* list of possible countertrade goods; *(c)* . . . .

Writing. "Writing" includes statements contained in a telex, telefax, telegram or other means of telecommunication which provides a record of the content of such statements.

Dispatch of a notification. "Dispatch of a notification" by a party occurs when it is properly addressed and conveyed to the appropriate entity for transmission by a mode authorized under the contract.

Delivery of a notification. "Delivery of a notification" to a party occurs when it is handed over to that party, or when it is left at an address of that party at which, under the contract, the notification may be left, irrespective of whether the notification is brought to the attention of the individual responsible to act on the notification.

24. [22] The parties may find it useful, when formulating their own definitions, to consider the descriptions contained in the present Guide of the various concepts commonly used in countertrade transactions. Those descriptions can be located by the use of the index to this Guide.

[A/CN.9/362/Add.6]

VI. TYPE, QUALITY AND QUANTITY OF GOODS

CONTENTS

		Paragraphs
A.	General remarks	1-2
B.	Type of goods	3-23
1.	General remarks	3-6
2.	List of possible goods	7-14
3.	Services	15
4.	Technology	16-23

		Paragraphs
C.	Quality of goods	24-32
	1. Specifying quality	25-28
	2. Pre-contractual quality control	29-32
	(a) Identity of inspector	30
	(b) Inspection procedures	31
	(c) Effect of inspector's finding	32
D.	Quantity of goods	33-39
E.	Modification of provisions on type, quality and quantity	40-41

[*Editorial note:* The present draft chapter VI is a revision of draft chapter V, "Type, quality and quantity of goods", published as document A/CN.9/332/Add.4. The note in square brackets at the beginning of each paragraph indicates either that the paragraph is new or it refers to the number under which the paragraph appeared in document A/CN.9/332/Add.4. The revisions of paragraphs that appeared in A/CN.9/332/Add.4 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [*new paragraph*] As noted in chapter II, paragraph 2, the discussion concerning "goods" in the Legal Guide is broadly applicable to services and technology. Where necessary, the present chapter makes reference to certain special issues concerning services and technology.

2. [1] The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. The more precise the countertrade agreement is with respect to the type of goods, the greater the possibility is of stipulating in the countertrade agreement the quantity and quality of the goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known. *

B. Type of goods

1. General remarks

3. [2] Various considerations may enter into the selection of the type of goods. The supplier would prefer that the goods be those that could easily be made available or those that the supplier wishes to introduce in a new market, while the purchaser would like to purchase goods that are needed or could be resold easily. The freedom of the parties to agree on the type of goods to be supplied in one or both directions may be affected by government regulations *dealing specifically with the types of goods that may be involved in countertrade transactions.* For example, in some countries government regulations exclude certain types of goods from being offered for purchase in a countertrade transaction if the price of the goods is not *paid in foreign currency to the the exporter's account.* * Government regulations may also provide that the import of certain types of goods is permitted only if the exporter agrees to purchase goods in return.

4. [3] The choice of the parties as to *the* type of goods may also be restricted by government regulations requiring that the countertrade goods must originate in the country, or in a particular region of the country, or must be purchased from a particular economic sector or group of suppliers. Such restrictions on origin and source are particularly likely to be encountered when the party requiring a countertrade commitment is a governmental entity. * Clauses in the countertrade agreement concerning origin and source restrictions are discussed in chapter IV, "Countertrade commitment", paragraphs 26 to 28, and chapter VIII, "Participation of third *parties*", paragraphs ___ to ___. *In addition to regulations specific to countertrade referred to in the previous two paragraphs, there may exist restrictions generally applicable to the export or the import of goods which could affect the freedom of the parties to select the types of goods to be traded under the countertrade transaction.*

5. [*new paragraph*] Parties may wish to be assured, prior to entering into the countertrade transaction, that, if the prescribed conditions are met, there are in principle no obstacles to obtaining the required export and import licences. Such an assurance, which may be given by a party to the transaction or by a third person, may be appropriate, for example, in countertrade transactions that require committing large portions of production capacity or disclosure of technological information. In such transactions the denial of a licence could pose greater difficulties than a similar denial in a simple sales transaction.

6. [*new paragraph*] If a governmental restriction on the export or import of goods is imposed after the parties have agreed on the type of goods, the parties would be impeded in the carrying out of the countertrade commitment or of a supply contract. Such impediments are discussed in chapter XIII, "Failure to complete countertrade transaction", paragraphs ___.

2. List of possible goods

7. [4] When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of possible

countertrade goods, the purchase of which would count towards fulfilment of the countertrade commitment. Where the countertrade agreement is concluded prior to the supply contracts pertaining to deliveries in both directions (chapter III, "Contracting approach", paragraphs 20 and 21), there may be two lists, one for each direction in which goods will be shipped. The product list may be attached to the countertrade agreement at the time of signature or may be agreed upon later.

8. [5] The countertrade agreement should be clear as to the nature and extent of the undertaking of the parties with respect to a list of possible countertrade goods. The supplier may undertake to make available all the types of goods on the list. In such a case the purchaser would be free to choose from among different types of goods appearing on the list, unless the countertrade agreement restricts the purchaser's choice. For example, there may be a limit on the number of different types of goods that may be purchased or there may be minimum or maximum levels set for the purchase of certain types of goods.

9. [6] The undertaking of the supplier as to availability may be limited to certain specified types of goods on the list. In such a case, the purchaser would be free to choose from among the goods that are identified in the countertrade agreement as being available. The possibility of purchasing any of the other types of goods, whose availability is not assured, would be left to subsequent negotiation.

10. [7] It may be agreed that the purchaser's commitment is to be reduced to the extent the supplier fails to make available those types of goods that are identified in the countertrade agreement as being available (see chapter XIII, "Failure to complete countertrade transaction", paragraphs ___). In addition, the supplier's commitment to make available goods appearing on a list may be supported by a liquidated damages or penalty clause (see chapter XI, "Liquidated damages and penalty clauses") or a guarantee (chapter XII, "Security for performance").

11. [8] When the supplier does not make an undertaking as to the availability of any particular type of goods appearing on the list, the determination of the types of goods actually available will occur in the course of the subsequent negotiations. If the supplier fails to make available any of the goods on the list, the purchaser would not be liable for the failure to fulfil the countertrade commitment (see chapter XIII, "Failure to complete countertrade transaction", paragraphs ___).

12. [9] The parties may wish to state in the countertrade agreement that the purchaser is obligated to supply within a specified time period the specifications necessary to establish accurately the purchaser's requirements with respect to the goods to be purchased and to enable the supplier to make a corresponding offer. The countertrade agreement may indicate that specifications will be provided by a third party (e.g., a trading house engaged to purchase the goods, or an end-user).

13. [10] Because countertrade agreements are often entered into for the purpose of developing new exports or new markets for existing exports, selection of the countertrade goods could be conditioned on a requirement that the goods be a non-traditional export of the supplier or, if they are a traditional export, that they be resold in a new market. Where the purchaser has made prior purchases from the supplier or has a prior commitment to purchase goods from the supplier, the countertrade agreement may stipulate that the purchase is to be of a new type of goods and must result in a level of sales higher than established levels in order to be counted towards fulfilment (see also *chapter IV,* paragraphs 5 and 6, concerning "additionality" as a factor in setting the *extent of the countertrade commitment*). It is advisable that the countertrade agreement define the requirements as to new products or markets, either by identifying products and markets considered new or identifying those not considered new.

14. [11] Establishing a procedure in the countertrade agreement for making decisions on the type of countertrade goods may be helpful, particularly in a long term countertrade transaction or one involving multiple parties. For example, the parties may wish to form a joint committee that would meet at regular intervals to identify countertrade goods and to monitor fulfilment of the countertrade commitment. Procedures established for identifying countertrade goods should be coordinated with deadlines in the fulfilment schedule. (See chapter IV, "Countertrade commitment", paragraphs 17 to 20; for a general discussion of negotiation, see chapter IV, paragraphs *56 to 60*). Such a joint committee might also be utilized to settle the price of the goods (see chapter VII, "Pricing of goods", paragraph ___).

3. Services

15. [*new paragraph*] When services are to be a subject-matter of a supply contract, it is advisable that the countertrade agreement be as specific as possible in describing them. Even if certain aspects of the envisaged service cannot be agreed upon at the time of entering into the countertrade agreement, the parties may facilitate subsequent negotiations and increase the likelihood of concluding the intended contract if they describe in the countertrade agreement those aspects of the service that they are in a position to agree on. The descriptions will depend on the type of the service envisaged. For example, if transport is the subject-matter of the future contract, the issues that the parties might be able to address in the countertrade agreement include the following: the routes, type of vehicles or vessels to be used, any special equipment that the carrier must have available, types of goods to be transported, special considerations concerning dangerous goods, any permits that may be necessary to effect the transport and the party responsible to obtain the permits. If maintenance of industrial equipment is the service in question, the countertrade agreement might, for example, outline certain of the elements of a maintenance programme, including the level of efficiency at which the equipment is to be maintained. Such elements could include, for example, periodic inspection of the equipment; maintenance manual and procedures; cleaning; adjustment and lubrication; replacement of defective or worn-out parts; the period

of time during which maintenance is to be provided; maintenance schedules; maintenance records; obligations of the parties with respect to unforeseen breakdowns and repairs; manner of calculating the price of the service.

4. Technology

16. [*new paragraph*] Countertrade transactions may involve the transfer of technological processes necessary for the manufacture of products or the transfer of knowledge and skills necessary to use particular industrial equipment. The communication of these processes, knowledge and skills is often referred to as the transfer of technology. When the transfer of technology is involved in a countertrade transaction, it is usually part of the export contract, i.e., the contract that is entered into at the outset of the countertrade transaction together with the countertrade agreement stipulating the conclusion of a counter-export contract. For example, export contracts in buy-back and indirect offset transactions include the transfer of technology. In some countertrade transactions, however, the countertrade agreement envisages technology to be transferred in connection with a supply contract to be concluded.

17. [*new paragraph*] The transfer of technology may occur in different ways. It may occur through the grant of licences to use industrial products or processes that are the subject of different forms of industrial property. Most legal systems provide for the registration, subject to certain conditions, of inventions of industrial products or processes which are thereby recognized and protected under the law relating to industrial property in force within the territory of the country in which the registration takes place. The owner of the industrial property obtains the exclusive right to exploit the products or processes that are the subject of the industrial property. A common form of industrial property protection consists of patents. Once a patent is granted, for a limited period determined by law, the invention that is the subject-matter of the patent can be exploited in the country that granted the patent only with the consent of the patent holder. A person can apply in more than one country for the grant of a patent. There exist international treaties according to which the registration of an invention with the designated international office provides national patent protection in the States members of the treaty; such treaties are, for example, the European Patent Convention of 1973 and the treaty establishing the African Intellectual Property Organization of 1962 and 1977. Most legal systems also recognize other forms of industrial property. For example, a distinctive sign used to identify goods and indicate their origin (e.g., as coming from a particular manufacturer) may be protected through registration as a trade mark. A protected trade mark cannot be used without the consent of the registered owner of the trade mark. The transfer of technology may occur in conjunction with a licence for the use of a trade mark. A patent holder or the owner of a trade mark may license the use of the patent or trade mark (i.e., permit, subject to the conditions of the licence, to use the subject-matter of the patent, or the trade mark, in return for remuneration). Some legal systems recognize additional forms of industrial property, such as utility models and industrial designs.

18. [*new paragraph*] When the purchaser requires a particular technology, it is advisable that the countertrade agreement contain as precise as possible a description of that technology. In some cases, however, the purchaser may prefer the obligations of the supplier of the technology to be defined primarily in terms of certain performance parameters to be achieved by the use of the technology (e.g., production of goods of a quantity and quality stipulated in the contract). In such cases, a general description of the technology may be sufficient for the countertrade agreement, and the supplier may be required to provide the detailed description upon the conclusion of the supply contract.

19. [*new paragraph*] Certain industrial processes may be known only to one or a few enterprises. These enterprises might not wish, or may have been unable, to protect the industrial processes through registration in accordance with the law relating to industrial property. They may, instead, keep this knowledge confidential. In such cases, the transfer of technology may occur through the supply of this knowledge (generally called "know-how"). Such transfer of know-how may be subject to conditions as to the maintenance of confidentiality by the party to whom the know-how has been transferred. The information and skills necessary for the operation and maintenance of a plant may be communicated through the training of personnel or through documentation. A given transaction may involve the transfer of technology through one or more of the methods described in this and the previous paragraph.

20. [*new paragraph*] The supplier of know-how will usually require the know-how to be kept confidential. Confidentiality may be required at two stages. Firstly, the supplier may provide some information relating to the know-how during negotiations for the conclusion of the countertrade agreement in order to enable the purchaser to decide whether it wishes to enter into a countertrade agreement, and to make proposals as to contract terms. The supplier will wish the purchaser to keep this know-how confidential. Secondly, when a supply contract is entered into pursuant to the countertrade agreement, the supplier will require the additional know-how supplied thereafter to be kept confidential. To achieve these results, it may be necessary under some legal systems for the parties, prior to the commencement of negotiations, to conclude an agreement under which the purchaser undertakes to maintain confidentiality with regard to know-how supplied during negotiations, and thereafter to include provisions on confidentiality in the countertrade agreement and in the supply contract. Under other legal systems, however, the obligation of the purchaser to maintain confidentiality results from the obligation of the parties to observe good faith during negotiations. The supplier may wish to consider whether it is necessary to supplement by an express stipulation any obligation to maintain confidentiality imposed by law.

21. [*new paragraph*] The extent to which contractual provisions may impose obligations as to confidentiality on the purchaser may be regulated by mandatory legal rules. Issues to be addressed by such contractual provisions may include clear identification of the know-how to be kept confidential, the duration of the confidentiality and the extent of permissible disclosure (e.g., disclosure being per-

missible in specified circumstances, or to specified persons). The parties might seek to provide that once the know-how to be kept confidential becomes available to the public, the obligation of confidentiality terminates, as does the obligation to pay royalties. The parties may also wish to provide, for example, that a person engaged by the purchaser to advise the purchaser in connection with the supply contract is to be allowed access to such of the know-how as is necessary for the exercise of the advisory functions. They may further wish to provide that if the countertrade agreement or the supply contract is terminated because of a failure on the part of the supplier, and the purchaser wishes to achieve the objective of the supply contract by engaging another supplier, the purchaser may disclose to the other supplier such part of the know-how as is necessary for achieving that objective. The purchaser may, however, be obligated to obtain from its adviser or the other supplier prior to the disclosure of the know-how an undertaking that the adviser or the other supplier will not disclose the know-how to others.

22. [*new paragraph*] An obligation of confidentiality may need to be imposed on the supplier of the technology, for example, when the purchaser is to have exclusive use of the technology, or when the supplier of the technology is to receive improvements to the technology made by the purchaser. In formulating a contractual provision for this purpose, the discussion in the previous two paragraphs may be useful.

23. [*new paragraph*] This Legal Guide does not deal comprehensively with contract negotiation relating to the licensing of industrial property, or the supply of know-how, since this subject is not specific to countertrade and has been dealt with in detail in publications issued by United Nations bodies.[1]

C. Quality of goods

24. [12] The question of quality of countertrade goods raises two main issues that the parties may wish to address in the countertrade agreement. The first involves specifying the level of quality that the goods must meet; the second involves establishing procedures to ascertain, before the conclusion of a supply contract, that goods being offered meet the specified level of quality (pre-contractual inspection). Agreement on both aspects of quality may help the parties to avoid disagreements over such questions as whether the party committed to purchase countertrade goods is obligated to purchase particular goods offered by the supplier or whether the goods are worth the price at which they are offered.

1. Specifying quality

25. [13] If the type of goods is not identified in the countertrade agreement, or is identified only by broad categories, precise statements of quality cannot be made. In such cases, the parties may only be able to state quality requirements in general terms such as "export", "prime" or "marketable" quality. When the type of goods is identified, it is advisable to be as precise as possible with respect to quality. *If the goods are commodities or semi-manufactured goods with standardized levels of quality (e.g., wire, steel sheets or petro-chemical products), it may be sufficient to use general statements of quality or descriptors of a particular grade of quality. In the case of manufactured goods, it is advisable to define the quality in a more specific way, for example, by referring to a quality standard, the purpose for which the goods must be fit, packaging, or safety and environmental requirements.*

26. [*new paragraph*] It should be noted that the quality of goods may be subject to standards of various kinds. There may be mandatory regulations prescribing certain measurable standards that goods must meet. In addition, the level of quality to be expected from goods may be a matter of trade usage in a particular market or industrial sector. Furthermore, quality standards may be enunciated in court decisions, for example, when a producer of a product is held liable for damage caused to the user of the product because in view of the court the design of the product was not safe. Moreover, there may exist non-mandatory quality standards or recommendations adopted by bodies such as trade associations, chambers of commerce or associations of users or consumers. Non-mandatory standards may also be established by governmental agencies entrusted with formulating and updating standards for commercial goods and services. Quality standards emanating from the foregoing sources may differ among countries or markets. Major differences may exist in particular with regard to consumer goods or services. In order to avoid disagreements, it is advisable that the countertrade agreement specify the standards that the countertrade goods must meet and, if the understanding of a quality standard may vary, it is advisable to link it to a particular country or market.

27. [*new paragraph*] When a particular type of service will be a subject-matter of a future supply contract, it is desirable that the countertrade agreement specify the quality standards to be observed in performing the service. If norms established by professional bodies are available, the quality of the service may be described by reference to those norms. Where such norms are not available, the countertrade agreement may stipulate that the service is to be effected in accordance with the standards that would be observed by a professional providing that kind of service. If professional standards differ, it is advisable that the parties specify the country whose professional standards should apply.

[1]The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in World Property Organization, *Licensing Guide for Developing Countries* (WIPO publication No. 620(*e*), 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in *Guidelines for Evaluation of Transfer of Technology Agreements*, United Nations Industrial Development Organization, Development and Transfer of Technology Series, No. 12 (ID/233, 1979), and in the *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry* (United Nations publication, Sales No. E.70.II.E.15). Other relevant publications are the *Handbook on the Acquisition of Technology by Developing Countries* (UNCTAD/TT/AS/5, 1978) and *Guide to Guarantee and Warranty Provisions in Transfer-of-Technology Transactions*, United Nations Industrial Development Organization (prepared jointly by the secretariats of the United Nations Industrial Development Organization and the International Center for Public Enterprises in Developing Countries) (ID/355, 1989). A manual on technology transfer is currently under preparation by the United Nations Industrial Development Organization.

28. [14] The parties may wish to address in the countertrade agreement, *i.e., prior to the conclusion of a supply contract,* the remedies of the purchaser in the event that goods delivered under supply contracts concluded subsequently do not meet quality standards stipulated in the countertrade agreement or in *the* individual supply contract. By including such provisions in the countertrade agreement, the parties could avoid negotiating the question of the purchaser's remedies each time a supply contract is concluded.

2. Pre-contractual quality control

29. [15] This section deals with pre-contractual quality control, i.e., quality control carried out before the conclusion of a supply contract by the party committed to purchase in order to establish whether the goods offered conform to the quality standards set in the countertrade agreement. *If several shipments of goods are intended, the parties may agree that pre-contractual quality control will be carried out on all goods intended to be the subject-matter of future supply contracts or only on some portions of those goods.* Pre-contractual quality control *is likely to reduce the possibility that,* after a supply contract is concluded, the goods are discovered not to meet the agreed quality standards. *It may be noted that a supply contract itself may provide for a quality inspection before the goods are shipped by the supplier ("pre-shipment inspection"). Such pre-shipment inspection, which relates to the performance of a concluded supply contract, is not specific to countertrade and is therefore not discussed in the Legal Guide.*

(a) *Identity of inspector*

30. [16] The pre-contractual quality control may be conducted by an inspector designated either by the party committed to purchase or by the parties jointly. When the inspector is to be designated jointly, the parties may wish to stipulate in the countertrade agreement criteria for the selection of the inspector. When the type of goods has been identified, the parties *are* in a better position to name the inspector since the subject-matter in which the inspector would need expertise *is* known to the parties.

(b) *Inspection procedures*

31. [17] *It is advisable that the* parties agree on various aspects of the inspection procedure such as: the location and time of inspection; *the time-frame for inspection; the manner of notifying the parties of the inspection results;* the mandate of an inspector to be designated jointly; whether, in the case of an inspector designated by the purchaser, the supplier will be informed of the inspector's mandate; the inspector's duty of confidentiality; deadlines for submission of the inspector's report; a requirement that reasons be stated for a finding that the goods are non-conforming; whether sampling and testing procedures customarily used in a particular trade suffice or whether ad hoc procedures need to be established; additional inspections or tests when the result of an inspection is contested (e.g., it may be agreed that a party could request a further inspection to be conducted by a second inspector, *that in the interest of finding a quick solution the second inspection should be carried out within short time-limits, that an experienced and independent quality arbitrator be engaged for this purpose,* and that the second inspection would be controlling); and cost of inspection.

(c) *Effect of inspector's finding*

32. [18] It may be agreed that the inspector's finding would be regarded as a statement of opinion on the basis of which the parties would consider what steps to take. Alternatively, it may be agreed that a finding by the inspector as to the quality of the goods would directly affect the contractual relationship of the parties. For example, it may be agreed that in the event that the inspector finds that the goods conform to the quality standard stipulated in the countertrade agreement, *and if the parties have agreed on the essential terms of a supply contract, the parties are deemed to have concluded the* supply contract. In the event of a negative finding, the supplier's offer to conclude a supply contract would be deemed not accepted and the rejection of the goods in question would not constitute a breach of the countertrade commitment. *The parties might agree that a negative finding and the rejection of the goods do not affect the extent of the countertrade commitment. Alternatively, it might be agreed that in the case of a negative finding, or in the case that two consecutive offers of the same type of goods are rejected as a result of a negative finding, the party committed to purchase would be released from the countertrade commitment up to the value of the goods refused (see also chapter XIII, "Failure to complete countertrade transaction", paragraph [6]).* Where the countertrade agreement envisages various levels of quality, it may be agreed that the inspector's finding as to quality would be used in a formula for determining the price of the goods.

D. Quantity of goods

33. [19] When the countertrade commitment refers to goods of one specified type, the quantity of goods to be purchased may be stipulated in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts *. When the parties express the countertrade commitment as a monetary amount, rather than as a quantity of goods to be purchased, they may wish to postpone determining the quantity until the conclusion of the supply contract. Such a postponement would allow fluctuations in the unit price of the goods to be taken into account. An increase in the unit price would mean a reduction in the quantity of goods to be purchased, while a drop in the unit price would mean an increase in the quantity to be purchased. When the countertrade commitment is expressed in terms of the number of units to be purchased, the parties may wish to stipulate a minimum monetary amount so that, in the event of a drop in the unit price, additional units would have to be purchased.

34. [20] When the countertrade agreement provides for several possible types of goods, the quantity of each type of goods that will be purchased may be left to be deter-

mined at the time of the conclusion of the supply contracts. The overall value of the purchases would have to be in conformity with the extent of the commitment set in the countertrade agreement. The countertrade agreement may specify the minimum and maximum percentages of the countertrade commitment that may be fulfilled by purchase of each type of goods.

35. [21] Where the parties are not in a position to determine quantity in the countertrade agreement, it may be useful for the countertrade agreement to set a deadline for agreement on quantity. The parties may refer to a specific date (e.g., 30 days before the close of a subperiod of the fulfilment period) or to an event in the contract in the other direction (e.g., in a buy-back transaction it may be agreed that quantity is to be determined upon the start-up of the plant delivered under the export contract).

36. [22] It may also be agreed that, at specified points in the period for the fulfilment of the countertrade commitment, a party committed to purchase would be obligated to provide an estimate of the quantities of goods expected to be purchased in the upcoming period of time. Similarly, a party committed to supply goods may agree to periodically provide an estimate of the quantity of goods expected to be made available. The parties may wish to agree on a permitted deviation between the estimated quantities and the quantities actually purchased or made available.

37. [23] When the proceeds of the export contract are to be used to pay for the counter-export contract, it is advisable that the parties ensure that the quantity purchased under the export contract is such that the proceeds of the export contract would cover payment for the counter-export contract. Payment mechanisms used in such cases are discussed in chapter IX.

38. [24] If the parties foresee the possibility of purchases of quantities beyond those stipulated in the countertrade agreement, they may wish to consider whether the purchaser's additional orders will be granted any preference over other potential buyers. A related issue is whether the additional quantities would be supplied on the same terms as the original quantities envisaged in the countertrade agreement.

39. [25] The parties may leave the quantity of goods to be determined on the basis of the purchaser's requirements. In such cases, the parties may wish to consider whether the supplier is to be the purchaser's single source for the goods and whether the purchases are to fall within a range specified in the countertrade agreement. The quantity of the goods may also be determined on the basis of the supplier's output of a given product. This approach may be used, for example, in a buy-back transaction. In this case too, the parties may wish to stipulate that the purchases are to fall within a range set in the countertrade agreement.

[Two paragraphs on "additionality", which appeared in the earlier draft chapter entitled "Type, quality and quantity of goods" (A/CN.9/332/Add.4, paragraphs 26 and 27), were moved to chapter IV, "Countertrade commitment" (A/CN.9/362/Add.4) paragraphs 5 and 6.]

E. Modification of provisions on type, quality and quantity

40. [28] A need for a review of provisions on type, quality or quantity of goods may arise due to the unavailability of goods specified in the countertrade agreement, the desire to place additional products on a list, a change in the commercial conditions underlying the transaction, a shift in the commercial objectives of the parties or a governmental regulation affecting the choice of countertrade goods. It could be agreed, particularly in long term transactions, that the parties would review the provisions on type, quality and quantity of goods either at regular intervals or in response to changes in circumstances stipulated in the countertrade agreement (e.g., a change beyond a certain threshold in the price of the goods). The review could be carried out within the framework of a mechanism for monitoring and coordinating fulfilment of the countertrade commitment (see *chapter IV, "Countertrade commitment", paragraphs 61 to 74*).

41. [29] In order to avoid a modification procedure, the parties may wish to provide that under certain conditions fulfilment credit would be earned by the purchase of goods other than those agreed upon in the countertrade agreement or appearing on a list of possible countertrade goods. For example, it might be required that the purchases in question meet an additionality test (*chapter IV, "Countertrade commitment", paragraphs 5 and 6*), or it may be stipulated that they would earn fulfilment credit at a reduced rate (for further discussion of clauses allowing non-conforming purchases to be counted toward fulfilment of the countertrade commitment, see *chapter IV, paragraph 30).*

[A/CN.9/362/Add.7]

VII. PRICING OF GOODS

CONTENTS

		Paragraphs
A.	General remarks	1-6
B.	Currency of price	7-10
C.	Determining price after conclusion of countertrade agreement	11-27
	1. Standards	11-20
	(a) Market prices for goods or *services* of standard quality	13
	(b) Production cost	14

		Paragraphs
	(c) Competitor's price	15-18
	(d) Most-favoured-customer clause	19
	(e) Use of more than one standard	20
2.	Negotiation	21-24
3.	Determination of price by third person	25-26
4.	Determination of price by one party	27
D.	Pricing of services	28-31
E.	Pricing of technology transfer	32-38
F.	Revision of price	39-52
1.	Reapplication of price clause	44
2.	Index clause	45-47
3.	Change in exchange rate of currency in which price is payable	48-52
	(a) Currency clause	48-50
	(b) Unit-of-account clause	51-52

[*Editorial note:* The present draft chapter VII is a revision of draft chapter VI, "Pricing of goods", published as document A/CN.9/332/Add.5. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.5 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.5 are in italics.]

A. General remarks

1. [1] It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future *supply contract.* When the parties are not able to set the price in the countertrade agreement, it is advisable to provide a method *according to which the price will be determined at the time the supply contract is to be concluded. When contracts are to be concluded in both directions, methods for price determination may be agreed for contracts in each of the two directions.* This chapter deals with methods for determining the price after the countertrade agreement has been concluded. *It also deals with certain questions encountered in the specific contexts of supplying services and the transfer of technology.* In addition, the chapter discusses the currency in which the price is expressed and revision of price.

2. [2] The parties may need to defer setting the price, for example, because the *specific* type of goods has not been identified at the time of the conclusion of the countertrade agreement or because there is to be a long interval between the conclusion of the countertrade agreement and the conclusion of a given supply contract. Such an interval may prompt the parties to defer setting the price because of the possibility of price fluctuation or of a change in the underlying economic conditions during the interval. In some cases, the parties may set the price of an initial shipment, but leave the determination of the price of subsequent shipments for a later time. Providing a method for determining the price may help the parties avoid differences over what the appropriate price should be, which may delay or prevent the conclusion of supply contracts. *Such differences may be compounded when a party expects a supply contract in one direction not to be profitable and wishes to offset the expected loss in setting the price for the contract in the other direction.*

3. [3] In a barter transaction, it may not be necessary to include a provision on price because the goods shipped in one direction constitute payment for the goods shipped in the other direction. Nevertheless, pricing issues may arise in a barter transaction if the parties decide to measure the relative value of their shipments in monetary terms, rather than merely in terms of volume and quality, or if the shipments are of different values and the imbalance is to be settled in money. Pricing would also be necessary when customs regulations require that goods entering a country indicate a monetary value.

4. [4] In setting the price of the countertrade goods, it is advisable that the parties specify whether or not the price includes costs ancillary to the costs of the goods themselves, such as transportation or insurance, testing, or customs duties and taxes. Some of the elements of the price may be indicated by using an appropriate trade term such as those defined in *INCOTERMS 1990* of the International Chamber of Commerce.

5. [5] The parties may wish to stipulate the point of time when the price is to be calculated, particularly in the case of goods whose price may fluctuate. When the countertrade transaction involves a single shipment or a number of shipments within a relatively short period of time, and the price is to be determined only once, a specified date may be agreed upon. In some cases, the price setting mechanism may be set in motion by an event such as the start-up of a plant under a buy-back transaction or the placing of an order. When multiple shipments are spread out over a longer period of time, several dates for determination of price may be agreed upon or the countertrade agreement may provide a mechanism for revision of the initial price.

6. [6] The parties should bear in mind that there may be mandatory rules that affect the level at which the price may be set. For example, if the price is set at a low level in relation to the market price, the goods may be subject to anti-dumping import *duty*.

B. Currency of price

7. [7] The currency in which the price is to be paid may involve certain risks arising from *the fluctuation in exchange rates* between that currency and other currencies. If the price is to be paid in the currency of the supplier's country, the purchaser bears the consequences of a change in the exchange rate between that currency and the currency of the purchaser's country. The supplier, however, will bear the consequences of a change in the exchange rate between the currency of the supplier's country and the currency of another country in which the supplier has to pay for equipment, materials or services needed in the production of the goods. If the price is to be paid in the currency of the purchaser's country, the supplier bears the consequences of a change in the exchange rate between this currency and the currency of the supplier's country. If the price is to be paid in the currency of a third country, each party bears the consequences of a change in the exchange rate between this currency and the currency of its respective country. Where a financing institution has granted the purchaser a loan for the purchase of the goods, the purchaser may prefer the price to be paid in the currency in which the loan is granted.

8. [8] In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties in force in the countries of the supplier and the purchaser, which may mandatorily govern this question. The parties should also take into account that under some legal systems the price in an international contract must be paid in the currency in which it is denominated, while other legal systems may permit, or even require, payments in the currency of the place of payment, even if the price is denominated in a *convertible* currency.

9. [9] The countertrade agreement may denominate the price in a currency that the parties consider to be stable or in a unit of account that is not a national currency, but provide that it is to be paid in another currency. The effects of such an approach are similar to those achieved by a currency clause (see *paragraphs 48 to 50* below), and restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. If this approach is used, it is advisable to agree in the countertrade agreement that the exchange rate is to be the one prevailing at a specified place on a specified date.

10. [10] It is not advisable for the contract to denominate the entire price in two or more currencies, and allow either the debtor or the creditor to decide in which currency the price is to be paid. Under such a clause, only the party having the choice is protected, and the choice may bring the party having the choice unjustified gains.

C. Determining price after conclusion of countertrade agreement

1. Standards

11. [11] The countertrade agreement may provide for a determination of the price through the use of a standard (see chapter *IV, "Countertrade commitment", paragraph 44*). Such a method provides a price at the time of the conclusion of the supply contract in an objective manner not influenced by the will of the parties.

12. [12] The parties may wish to include a procedure to apply in the event a standard they select proves to be unworkable (e.g., because a market price is not available as expected). For example, the parties may provide that the price is to be determined through the use of an alternate standard or that the price is to be determined by a third person.

(a) *Market prices for goods or* services *of standard quality* [title modified]

13. [13] When goods identified in the countertrade agreement are commodities or semi-finished products (e.g., grains, oil, metals, wool) for which prices are regularly reported, the parties may agree to link the price of the countertrade goods to the reported price. *Such a linkage to a standard price can also be used for determining the price of services if the service is standard and if there exists a reported price for the service. Such standard services may be, for example, transport; harvesting, cleaning, sorting or packing certain types of goods; or painting of standard surfaces such as ships.* Where the *price of goods or services is quoted* in several markets, the parties are advised to specify a particular market *or exchange* to which reference will be made. In order to protect against price fluctuations, the standard may call for an average of the prices reported at several agreed points of time (e.g., the prices reported on the first business day of the month for the six months preceding the date of the determination of the price).

(b) *Production cost*

14. [14] The parties may agree that the price is to be based on the supplier's cost of producing the goods, plus an amount to cover the supplier's overhead and profit. Such an approach may be selected when the exact cost of various inputs cannot be anticipated at the time the countertrade agreement is concluded. In order to limit the purchaser's risk of having to pay an excessive price, it is advisable that, where possible, the parties stipulate in the countertrade agreement the quantity of inputs (e.g., raw materials, energy and labour) that will be required for the production of one unit of the goods. The parties may also wish to stipulate that the supplier should maintain records reflecting production costs in accordance with forms and procedures required by the purchaser, and that the purchaser shall have access to those records. *This approach might be used when the contract to be concluded involves*

a technological solution that has not been fully developed yet and the exact cost of its development cannot be foreseen.

(c) *Competitor's price*

15. [15] The price may be determined on the basis of the price charged by an identified competitor producing the same type of goods as those that will be delivered under the supply contract. If the countertrade agreement does not identify the competitor, it may establish criteria for the selection of a competitor (e.g., geographical criteria or criteria related to the volume of production of the same type of goods). Because the competitor may sell a product at different prices in different geographical regions and markets, it is advisable that the countertrade agreement identify the market to which reference will be made. The price clause could also indicate how the price information will be obtained and the date as of which the competitor's price is to be determined. Furthermore, the parties may agree to exclude specially discounted prices charged to certain customers (preferential prices). For example, the standard may exclude prices charged for the goods when they are purchased by disaster relief organizations or by employees of the supplier.

16. [16] A competitor's price may not be relevant, without adjustments, if it is based on a significantly larger or smaller quantity than the quantity intended to be purchased under the countertrade agreement. A competitor's price may also not be appropriate if the competitor's goods are of a different quality, if the competitor's price is based on payment conditions (e.g., deferred payment) not being offered by the supplier of the countertrade goods, or if the amount of transportation costs or insurance and public charges contained in the competitor's price differs from what is to be included in the price of the countertrade goods. It is therefore advisable to stipulate that the standard should take into account only prices for shipments that are comparable in quantity, quality, delivery and payment conditions to the future supply contract, or that amounts should be added to or subtracted from the competitor's price in order to compensate for differences.

17. [17] The parties may agree that the price is to be determined on the basis of several competitors' prices. Such a clause may identify the competitors or it may provide that each of the parties is to obtain quotations from a specified number of competitors. If the competitors are not identified, it is advisable that a clause of this type specify the countries or regions from which the parties are to obtain the quotations. It is also advisable that the countertrade agreement indicate the manner in which the price is to be calculated (e.g., whether by calculating a mean or a median price). The parties may wish to specify the period of time during which the quotations are to be obtained. In doing so, the parties should take into account the length of time necessary to obtain the quotations as well as the need to base the calculation on current prices.

18. [18] When the party committed to purchase goods manufactures the same type of goods, the parties may agree that the price will be determined on the basis of the price charged by the purchaser or on the basis of the purchaser's own cost of manufacture. Such an approach might be used, for example, in a buy-back transaction in which a producer of a certain type of goods sells a facility that produces that type of goods and agrees to buy back the resultant products.

(d) *Most-favoured-customer clause*

19. [19] It may be agreed that the price of the countertrade goods will be based on the lowest price at which goods of the same type are supplied by the supplier to other customers. In some cases, the parties may restrict the clause to a limited category of customers (e.g., customers in a particular country or customers identified in the countertrade agreement). The parties may wish to indicate the means to be used to identify the most-favoured customer. For example, the supplier could be required to provide specified types of information indicating the prices charged by the supplier to other customers. It is also advisable to ensure that the most-favoured-customer price is relevant to the shipments to be made pursuant to the countertrade agreement (see above, paragraph 16). The parties may also wish to specify the date as of which the most-favoured-customer price is to be determined. The parties may wish to specify any specially discounted prices (preferential prices) offered by the supplier to certain customers that should not be taken into account (see above, paragraph 15). The scope of the most-favoured-customer clause may be broadened by agreeing that the price will be determined on the basis of the lowest price charged by the supplier or by other specified suppliers of the same type of goods.

(e) *Use of more than one standard*

20. [20] The countertrade agreement may provide that the price is to be determined by a formula involving two or more standards. For example, the price may be determined by averaging the prices derived from the selected standards. Another possibility is for the price derived from a particular standard to be compared with prices derived from one or more other standards. If the difference between the price derived from the selected standard and the prices from the comparator standards does not reach a specified threshold, the price derived from the selected standard would apply. If the difference exceeds a specified threshold, the final price would be, for example, the average of the price derived from the standards. Such techniques may be useful when it is desired to avoid the possibility that the price derived through the use of a single standard might not reflect the market value of a given product at the time the purchase is to be made.

2. Negotiation

21. [21] The parties may *stipulate in the countertrade agreement that the price to be paid under the future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement.* It is advisable that, to the degree possible, the parties agree on guidelines for the determination of the price. *(For a discussion on procedures for the negotiations, and on guidelines for the*

determination of the price, see chapter IV, "Countertrade commitment", paragraphs 44 to 46, and 57 to 60).

22. [22] *Guidelines for the determination of the price* may establish minimum and maximum limits within which the price is to be negotiated. In establishing such limits, the parties may use price standards of the type described above in paragraphs *11 to 20.* For example, it may be agreed that the price should not be more than 5 per cent higher or more than 5 per cent lower than the price charged by a competitor.

23. [23] Alternatively, guidelines may merely provide a reference price to be taken into account in negotiations. In formulating a guideline of this type, the parties may use price standards such as those described above in paragraphs *11 to 20.* For example, it may be agreed that the price will be negotiated taking into account the price of a particular competitor.

24. [24] A negotiation guideline may also take the form of a statement that the price of goods is to be "competitive", "reasonable", or at a "world market" level. Such a clause might be acceptable when the goods are of a standard quality. A guideline of this type may be made more precise by specifying, for example, whether the price should be based only on prices paid to the supplier by other buyers or should also be based on prices charged by other suppliers, the period of time the parties should refer to in determining what is a "competitive", "reasonable" or "world market" price, and, if there are variations in prices in different markets, which markets, types of buyers or geographical territories are referred to.

3. Determination of price by third person

25. [25] Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question). For a discussion of determination of contract terms by third persons, see chapter *IV, "Countertrade commitment"*, paragraphs *47 to 54.* Such an approach *may be used in combination with a clause on price setting by negotiation so that the determination of the price would be entrusted to a third person in the event that the parties failed to negotiate a price.*

26. [26] The countertrade agreement *should* delimit the mandate of the third person by providing guidelines of the type discussed with respect to negotiation (above, paragraphs *21 to 24*). The parties may wish to establish deadlines for referral of the matter to a third person, so that the price could be set in time to allow conclusion of contracts as planned.

4. Determination of price by one party

27. [27] Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement. *Utmost caution is advisable in agreeing on such a solution, since it leaves the determination of the price to a person who is interested in the outcome of the determination. In many legal systems an agreement of this type is not enforceable. (For further discussion, see chapter IV, "Countertrade commitment", paragraphs 55 and 56.)*

D. Pricing of services

28. [*new paragraph*] When the parties determine in the countertrade agreement a service as the subject-matter of the future supply contract (e.g., maintenance, repair, transport, construction services), it is advisable for the parties to settle in the countertrade agreement, to the extent possible, certain questions relating to the price of the services. By doing so, the parties may facilitate negotiations for the conclusion of the envisaged supply contract.

29. [*new paragraph*] Various approaches may be used in setting the price for services. One approach is to agree on unit rates for units of work processes involved. The units may be, for example, a quantity unit of the result (e.g., a square metre of paint work, kilometre of transport of goods, cubic metre of excavated material, hour of labour). This approach may be appropriate when the services in question are of a routine character or when the quantity of the services needed cannot be envisaged accurately at the time of entering into the countertrade agreement. If there is no provision for a revision of the unit price in the event of changes in unit costs, the risk of increases in costs and benefits arising out of decreases in costs are divided between the parties. The supplier bears the risk of an increase of the costs of materials and labour for each unit or receives the benefit of a decrease in those costs.

30. [*new paragraph*] Another approach is for the price to be expressed as a lump sum payable for the specified service. Under this method, the purchaser knows the total price of the service, and the supplier bears the risk of increases in the cost of the service and benefits if the cost turns out to be lower than anticipated. Since the lump-sum price may include an amount to compensate the supplier for bearing the risk of cost increases, the price may be higher in some cases than if the cost-reimbursable pricing method were used for the same service (see the following paragraph). In addition, the lump-sum pricing method requires a precise specification in the contract of the scope of the service. It might be advisable for the purchaser to address in the countertrade agreement the manner of monitoring the performance by the supplier to ensure that the contractor does not reduce its costs by using substandard materials or working methods.

31. [*new paragraph*] Yet another approach may be to stipulate that the supplier of the service is to be paid a fee to cover its overhead and profit, and that the supplier is to be compensated for its expenses on a cost-reimbursable basis. It is desirable for the countertrade agreement to specify clearly which costs are reimbursable and which are to be borne by the supplier out of its fees. Reimbursable expenses might be, for example, wages of personnel directly involved in the performance of the contract, routine items of materials or equipment used in performing the service, or costs incurred in employing specified types of subcontractors. Usually, the solution providing each party a better opportunity to foresee its costs is to enumerate the costs to be reimbursed and to provide that all other costs

are to be borne by the supplier; sometimes, however, the parties decide to enumerate the costs that are not reimbursable and provide that all other reasonable costs are to be reimbursed.

E. Pricing of technology transfer

32. [*new paragraph*] Sometimes the countertrade agreement envisages the future conclusion of a supply contract that includes the transfer of technology (see chapter VI, "Type, quality and quantity of goods", paragraphs *16 to 23*). In such cases, it is advisable for the parties, to the degree possible, to address in the countertrade agreement a variety of questions particular to the pricing of technology. Settling such questions in the countertrade agreement may facilitate finalization of the supply contract involving the transfer of technology. Those questions, discussed in the following paragraphs, are analysed in publications dealing with transfer of technology generally.[1]

33. [*new paragraph*] The two principal forms of pricing of technology transfers are the lump-sum payment or payment of royalties. In the lump-sum method, the total price is determined at the outset. Among the key questions raised by this method are the time of payment and whether it is to be paid in one payment or in instalments. Under the law of some countries, the use of the lump-sum method may be subject to certain conditions. These conditions may, for example, restrict the types of transfers (e.g., purchase of patent rights or specified types of technical services and assistance) or sectors in which the lump-sum method may be used; they may also prescribe the basis on which the lump sum is be calculated and require a special governmental authorization.

34. [*new paragraph*] If the royalty method is used, the price payable (i.e., the royalty) is fixed by reference to some economic result of the use of the transferred technology. The law of some countries mandates the use of the royalty method of payment in certain types of industrial property licenses or technology transfer agreements). The royalty is typically linked to the production, sales, or profits arising from the use of the technology. Where the volume of production is used as the reference factor, the royalty may be determined, for instance, as a fixed amount per unit or quantity (e.g., per ton or per litre) produced. The law of some countries restricts the freedom of parties to agree on royalties based on production. For example, it may be required that for certain types of licences or technology transfers royalties should be linked to sales volume.

35. [*new paragraph*] The linkage of royalties to sales has the advantage of not imposing on the transferee of the technology liability for payment of royalties for goods that have been produced but not sold. Parties wishing to use this approach must decide whether the royalty is to be based on the gross or on the net selling price. The latter method provides the possibility of excluding from the calculation of the royalty a number of items that are included in the sales price but which are unrelated to the technology or already have been a source of profit for the transferor. These might include, for example, packing expenses, taxes, transport and insurance costs, cost of raw materials, and the percentage of the price covering the royalties. The law of some countries may define the permissible range of elements that may be included in the net selling price. Furthermore, the parties may wish to stipulate that the royalty is to be based on the fair market price of the product. Such an approach may be used to guard against a diminution in the level of the economic return achieved by the transferor that would result were the transferee to sell the products in question at a low price to a party with whom the transferee had a special relationship. Various methods exist in turn for defining the fair market price. Other questions raised by the linking of royalties to sales include the point of time when the product is deemed sold and the time when the remittance of the royalty becomes due.

36. [*new paragraph*] Another basis for the calculation of royalties is to link royalties to profits obtained by the transferee from the exploitation of the technology transferred. Other approaches to the calculation of royalties include minimum royalty arrangements, in which a minimum payment is due irrespective of whether a given level of production, sales or profits has been achieved, decreasing royalty arrangements, in which the amount of the royalty decreases as production or sales increase, and maximum limits on the amount of royalties due. The use of certain of these arrangements may, in some cases, be mandated, and, in other cases, restricted, under the law of some countries. For example, in some countries, minimum royalty arrangements may not be permitted when royalties are linked to production, sales or profit, decreasing royalties might be mandated, and maximum royalty limits imposed for certain types of technology transfers. The attention of the parties should also be directed to the question of which of the parties is to be liable for payment of taxes on the royalties. It should be noted that the laws of some countries regulate this question (e.g., the parties may be required to stipulate in the contract for the transfer of technology who is to pay taxes).

37. [*new paragraph*] When considering whether to use the lump-sum or the royalty method, the parties should bear in mind, in addition to provisions of the applicable law, that each method of price calculation may have certain advantages and disadvantages in the light of the type of transaction and the economic circumstances involved. If, for example, royalties are payable over a long time, economic circumstances may change during this period affecting the volume of sales, and consequently the royalties payable; in a joint venture in which the transferor is a partner, it might be considered that a royalty linked to sales would be preferable to a lump-sum arrangement because of the added motivation provided to the transferor to develop sales. In some cases, it may be desirable to combine the two methods (e.g., an initial lump-sum payment followed by payment of royalties). The particular manner in which a royalty arrangement is structured would likewise have to reflect the economic circumstances and contractual obliga-

[1]The different methods of determining the price payable for technology are considered in detail in the *Licensing Guide for Developing Countries* (WIPO) and in *Guidelines for Evaluation of Transfer of Technology* (UNIDO); see footnote 1 in chap. VI, "Type, quality and quantity of goods".

tions involved. For example, if the licensor or technology transferor is to assist in sales of the products resulting from the transfer of the technology, caution might be advisable in applying a decreasing royalties arrangement since such an arrangement might have the unintended effect of discouraging the transferor from expending fully its efforts in the direction of increasing sales. Where royalties are to be paid, the parties would typically agree on a method of reporting the variable data (e.g., volume of production, sales or profits) which serve as the basis for calculating the royalty. Provision is usually made for the transferee to keep certain records and for the transferor to be given an opportunity to review those records.

38. [*new paragraph*] In negotiating the technology pricing clause, the question might arise whether any separate fees should be payable for specific technical services and assistance to be provided by the transferor of technology. Such services and assistance may include, for example, training programmes for the personnel of a patent or trademark licensee, technical experts furnished by the licensor or transferor, various technical services relating to the purchase of capital goods, and management, planning, research and development services. Some countries have provisions relating to that question.

F. Revision of price

39. [28] When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. It may be agreed that a revision would occur at specified points of time. Those points of time should be coordinated with the schedule for the fulfilment of the countertrade commitment (e.g., the revision is to take place four weeks prior to the commencement of a subperiod).

40. [29] Under another approach, it may be agreed that a revision would take place in response to specified changes in underlying economic conditions (e.g., an exchange rate fluctuation beyond a certain percentage from a reference rate in effect on the date the countertrade agreement was concluded or changes beyond an agreed threshold in specified components of production cost such as raw materials or labour). Contractual provisions concerning price revision due to a change in the value of the currency in which the price is to be paid are mandatorily regulated under some legal systems. The parties should, therefore, examine whether a clause which they intend to include in the countertrade agreement is permitted under the law of the country of each party.

41. [30] Yet another approach is to provide for a price revision at regular intervals (e.g., every six months), as well as for unscheduled revisions in response to specified changes in underlying economic conditions. In order to limit the frequency of price revision, it could be agreed that an unscheduled review could not take place within a specified period of time following a review, or within a specified period of time preceding a scheduled review. Yet another approach would be to set the price revision procedure in motion upon the delivery of a specified portion of the total quantity of goods to be purchased.

42. [31] The countertrade agreement might provide for the price revision clause to apply only in cases where its application would result in a revision exceeding a certain percentage of the price.

43. [32] When the countertrade agreement contains a price revision clause, the parties may wish to specify the shipments to which the revised price is to apply. It may be agreed, for example, that the applicable price for a given shipment is the price in effect on the date the goods are ordered or on the date the letter of credit is issued.

1. Reapplication of price clause

44. [33] The parties may stipulate in the countertrade agreement that the price is to be revised through the use of the same method as was employed to determine the initial price (standards (paragraphs 11 to 20), negotiation (paragraphs 21 and 24), determination of price by a third person (paragraphs 25 and 26) or determination of price by one party (paragraph 27)).

2. Index clause

45. [34] The purpose of index clauses is to revise the price of the countertrade goods by linking the price to the levels of the prices of certain goods or services prevailing on a certain date. *Usually the linkage is to the price of raw materials or services used in the production of the countertrade goods.* A change in the agreed indices automatically effects a change in the price. In formulating an index clause, it is advisable to use an algebraic formula to determine how changes in the specified indices are to be reflected in the price. Several indices, with different weightings given to each index, may be used in combination in the formula in order to reflect the proportion of different cost elements (e.g., materials or services) to the total cost of *the goods.* Different indices may be contained in a single formula to reflect the costs of different types of materials and services. When the sources of the same cost element (e.g., labour or energy) are in different countries, different indices may be found in a single formula for that cost element.

46. [35] Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g., they should be published at regular intervals). They should be reliable. Indices published by recognized bodies (*such as chambers of commerce,* or governmental or intergovernmental agencies), may be selected. The parties should exercise caution in using indices based on different currencies in a formula, as changes in the relationships between the currencies may affect the operation of the formula in unintended ways.

47. [36] In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a particular element of costs, the parties may wish to use an available index in respect of another element. It is advisable to choose an element whose price is likely to fluctuate in approximately the same proportions and at the same

times as the actual element to be used. For example, in cases where it is desired to provide an index for labour costs, a consumer price index or cost-of-living index is sometimes used if there is no wage index available.

3. Change in exchange rate of currency in which price is payable

(a) *Currency clause*

48. [37] Under a currency clause, the price to be paid is linked to an exchange rate between the currency in which the price is to be paid and a certain other currency (referred to as the "reference currency") determined at the time of entering into the countertrade agreement. If this rate of exchange has changed at the time of payment, the price to be paid is increased or decreased in such a way that the amount of the price in terms of the reference currency remains unchanged. For purposes of determining the applicable exchange rate, it may be desirable to adopt the time of actual payment, rather than the time when the payment falls due. If the latter time is adopted, the supplier may suffer a loss if the purchaser delays payment. Alternatively, the supplier may be given a choice between the exchange rate prevailing at the time when payment falls due or that prevailing at the time of actual payment. It is advisable to specify an exchange rate prevailing at a particular place.

49. [*new paragraph*] The intention of a currency clause is typically to stabilize the international purchasing power of the amount to be paid pursuant to the contract. Therefore, a currency clause may not operate as intended if the exchange rate between the currency in which the price is to be paid and the reference currency is set by administrative decisions independent of events taking place in the currency market.

50. [38] The reference currency should be stable. The insecurity arising from the potential instability of a single reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the currency in which the price is payable and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

(b) *Unit-of-account clause*

51. [39] If a unit-of-account clause is used, the price is denominated in a monetary unit of account composed of cumulative proportions of a number of selected currencies. In contrast to a clause in which several currencies are used (above, *paragraph 50*), the weighting given to each selected currency of which such a monetary unit of account is composed is usually not the same, and greater weight is given to currencies generally used in international trade. The unit of account may be one that is established by an intergovernmental institution or by agreement between two or more States and that specifies the selected currencies making up the unit and the relative weighting given to each currency (e.g., Special Drawing Right (SDR), European Currency Unit (ECU), or Unit of Account of the Preferential Trade Area for Eastern and Southern African States (UAPTA)). In choosing a unit of account, the parties should consider whether the relation between the currency in which the price is payable and the unit of account can be easily determined at the relevant times, i.e., at the time of entering into the supply contract and at the time of actual payment.

52. [40] The value of a unit of account composed of a basket of currencies is relatively stable, since the weakness of one currency of which the unit of account is composed is usually balanced by the strength of another currency. The use of such a unit of account will therefore give substantial protection against changes in exchange rates of the currency in which the price is payable in relation to other currencies.

[A/CN.9/362/Add.8]

VIII. PARTICIPATION OF THIRD PARTIES

CONTENTS

	Paragraphs
A. General remarks	1-3
B. Purchase of countertrade goods	4-40
1. Countertrade agreement	9-20
(a) Selection of third party	12-16
(b) Liability for fulfilment of countertrade commitment	17-20
2. Contractual relationship between party originally committed and third party	21-40
(a) Third party's commitment to purchase goods	21-29
(b) Third party's fee	30-36
(c) "Hold-harmless" clause	37
(d) Exclusivity of third party's mandate	38-40
C. Supply of countertrade goods	41-52
1. Selection of third party by party committed to purchase	45-46
2. Selection of third party by party committed to supply	47-52
D. Multi-party countertrade	53-58

[*Editorial note:* The present draft chapter VIII is a revision of draft chapter VIII, "Participation of third parties", published as document A/CN.9/WG.IV/WP.51/Add.1. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.1 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.1 are in italics. An asterisk indicates the place where text has been deleted without adding new language.

A. General remarks

1. [1] This chapter deals with cases in which a party, instead of itself purchasing or supplying goods in a particular direction, engages a third party to do so. Section B discusses the case in which a party originally committed to purchase goods engages a third party to make those purchases. Section C discusses the case in which a third party is designated to supply goods.

2. [1] This chapter also discusses cases in which a supplier of goods in one direction does not assume a commitment to purchase goods in the other direction, but instead a third-party purchaser assumes such a commitment from the outset of the transaction; such cases are dealt with in section D. Section D also discusses cases in which a purchaser of goods in one direction does not assume a commitment to supply goods in the other direction, but instead a third-party supplier assumes such a commitment from the outset.

[Some of the substance of paragraph 2 as it appeared in A/CN.9/WG.IV/WP.51/Add.1 was moved to paragraph 3.]

3. [3] Cases in which the party committed to purchase goods makes those purchases itself and then resells the goods are not within the subject-matter of this chapter, since those cases are not specific to countertrade. Various restrictions that may be placed on the resale of countertrade goods are discussed in chapter X.

B. Purchase of countertrade goods

4. [4] A party committed to purchase goods frequently cannot use the goods to be purchased, or lacks the marketing capacity or knowledge necessary to resell them. In these cases the party committed to purchase may wish to engage one or more third parties to make the purchases necessary to fulfil the commitment. The third party may be, for example, an end-user of the goods or a trading company specializing in the purchase and resale of certain types of goods.

5. [*new paragraph*] This section discusses only cases where the third party is to enter into a purchase contract with the supplier. Not discussed are cases in which the party committed to purchase engages a third person to perform the service of locating persons to whom the goods could be resold or the service of representing the committed party in the resale of the goods. Such services performed by a third person, which are not specific to countertrade, do not affect the rights and obligations of the parties under the countertrade agreement and are therefore not a matter to be addressed in that agreement.

6. [5] A third-party purchaser who agrees to become involved in the countertrade transaction makes a commitment to the party originally committed (i.e., only to the party who engages the third party) to purchase goods from the supplier within an agreed period of time. In some cases, the third party also makes a commitment to the supplier to enter into future contracts. Since the third party's commitment relates to the conclusion of future contracts, that commitment would address issues such as the type, quality, quantity and price of the goods to be the subject of the future contracts, period for fulfilment of the commitment, restrictions on resale of the goods, security for performance, liquidated damages or a penalty, and settlement of disputes. *While the third party's agreement to enter into a future contract with the supplier may address the same type of issues as are addressed in the countertrade agreement between the supplier and the party originally committed, the content of the solutions in the two agreements would not necessarily be the same. Different solutions might be adopted, for example, as to security for performance, liquidated damages or a penalty, the applicable law or the settlement of disputes.* (Implications of the commitment by the third party are discussed below in paragraphs *17 and 18*; the terms of the third party's commitment are discussed below in *paragraph 22*.)

7. [6] When a third-party purchaser is to be engaged, it is often the case that payment obligations under the supply contracts in each direction are to be settled independently. Such cases do not raise payment issues specific to countertrade. It may be agreed, however, to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", *paragraphs 68 and 76.*

8. [7] Sometimes the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser may have to assume in the future. Alternatively, a purchaser accumulating such excess fulfilment credit may be permitted to transfer the excess fulfilment credit to a third party (for a discussion of fulfilment credit, see chapter *IV, "Countertrade commitment", paragraphs 31 to 34*). The transfer of the fulfilment credit to a third party would entitle that third party to sell goods to the party who originally granted the fulfilment credit and to reduce any countertrade commitment by the amount of the transferred fulfilment credit. Such a transfer may involve the payment of a fee by the third party to the transferor of the fulfilment credit. In some countries, special regulations exist on the right of transfer of countertrade credit *(e.g., restricting the types of exports that can generate transferable credits, the types of parties to whom countertrade credit may be transferred, or the types of imports against which transferred credits may be applied).*

1. Countertrade agreement

9. [8] When the parties at the outset of the transaction foresee the possibility that the party committed to purchase will wish to engage a third-party purchaser, it is advisable to address that possibility in the countertrade agreement. *Provisions concerning a third-party purchaser are particularly advisable when, as described in the next paragraph, the parties might have differing expectations as to whether the purchaser is free to engage a third-party purchaser.*

10. [*new paragraph*] If the countertrade agreement does not address the participation of a third-party purchaser in the fulfilment of the countertrade commitment, the issue may arise between the parties as to whether the party originally committed to purchase is free to engage a third party to make the purchases. The solution to the issue would in many *national laws* be found in general principles of contract law, according to which a contract party is entitled to involve a third party in the performance of a contractual obligation without having to obtain the consent of the party entitled to the performance. Consent, however, would be required under those general principles if, in the circumstances of the case, the party entitled to the performance had a legitimate reason to insist that the obligation should be performed by the party originally committed. Such a legitimate reason might exist when, because of special properties or capabilities of the obligated party, the performance of the obligation by a third party would in some way diminish the value of the performance. For example, the supplier of countertrade goods might consider that, because of the reputation and existing resale network of the party committed to purchase, the resale of the goods by that party was essential for establishing a long-term place for the goods in the market or for maintaining the market image of the goods.

11. [9] The participation of third parties in the fulfilment of countertrade commitments may be subject to mandatory rules. Such rules may *make the participation of third parties subject to consent by the supplier,* impose guidelines as to the acceptability of third parties or require governmental authorization of third-party participation. A frequent reason for such restrictions is the desire to *ensure proper implementation of the countertrade transaction or to* prevent the marketing of the goods in traditional export markets of the State in question.

(a) *Selection of third party*

12. [10] Clauses in the countertrade agreement permitting the engagement of third parties may be formulated in such a way that the party originally committed to purchase goods is free to select the third party. In such clauses it is advisable to provide that notice of the engagement of a third party must be given to the supplier in advance of the purchases by the third party.

13. [11] Sometimes the countertrade agreement limits the freedom of the party originally committed to purchase goods to select the third party. Various types of limitations may be used. For example, the countertrade agreement may name the third party, list acceptable third parties, or stipulate the criteria to be followed in selecting the third party. Where the countertrade agreement names the third party or contains a short list of potential third parties, the countertrade agreement may provide for the selection of another party if the identified third parties are not in a position to purchase the goods.

14. [12] Another way of limiting the freedom to select a third party is to provide that the party originally committed to purchase goods is not permitted to engage a third party without the consent of the supplier. To expedite the designation of the third party, it may be agreed that the supplier will be deemed to have consented to the designation unless an objection is raised within a specified period of time. *The countertrade agreement may indicate* the type of information about a proposed third party that the party originally committed to purchase is obligated to furnish to the supplier (e.g., financial standing of the proposed third party and type and quantity of goods to be purchased). In order to limit the discretion of the supplier, the countertrade agreement may identify the types of objections that would be acceptable. Such acceptable objections might be, for example, that the proposed third party is already the supplier's trading partner, that the third party is selling goods produced by competitors of the supplier, or that the third party previously has failed to meet an obligation owed to the supplier or has been involved in a dispute with the supplier.

15. [13] The supplier may have various reasons for wishing to limit the freedom of the party originally committed to purchase in the selection of a third party. One category of reasons is aimed at preventing the selection of certain third parties. For example, restrictions may be designed to prevent sales to existing customers from being counted towards fulfilment of the countertrade commitment, to prevent the engagement of persons active in a particular market (e.g., because of existing distributorship agreements in the market or because of rules applicable to trade with that country), or to ensure that goods requiring special precautions in their use are not purchased by parties not trained to handle them. The other category of reasons is aimed at bringing about the selection of certain third parties. For example, a restriction may be designed to obtain the selection of a third party from a particular country or market or of a third party with experience in particular products or markets (e.g., because the supplier wishes to introduce the goods in a market).

16. [14] The parties should bear in mind, however, that a limitation on the purchaser's freedom to select a third party may have disadvantages. For example, the party originally committed to purchase goods might have to factor into the costs of the transaction the risk that the fee charged by the third party in connection with the purchase of the countertrade goods (see below, paragraphs *30 to 36*) might be higher than fees charged by other third parties or the risk that the third party will fail to make the purchases. The parties may agree that some of these risks will be assumed by the supplier who insists on the selection of a particular third party. For example, it may be agreed that the liability of the party originally committed under the liquidated damages or penalty clause would be reduced to the amount that that party could recover from the third party.

(b) *Liability for fulfilment of countertrade commitment*

17. [15] It is advisable for the parties to the countertrade agreement to *address in the countertrade agreement* the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment. The answer to that question depends on whether the third party has made a commitment to purchase goods only to the party engaging the third party or whether the third party has also made a commitment to the party who is to supply the goods (see above, *paragraph 6*).

18. [16] When the third party's commitment is made only to the party originally committed, the party originally committed remains liable to the supplier for its countertrade commitment even though the third party has been engaged. When, however, the third party makes the commitment both to the party originally committed and to the supplier, two approaches with respect to the commitment of the party originally committed may be considered. One approach is to stipulate in the countertrade agreement that the commitment of the party originally committed to purchase is to be maintained; in such a case, both the party originally committed and the third party will be liable to the supplier for the fulfilment of the commitment, and, ultimately, the party originally committed and the third party would settle the question of responsibility between themselves pursuant to their contract. Such an approach might be appropriate where the third party's commitment to the supplier to conclude future purchase contracts is not supported by the same guarantees as is the countertrade commitment of the party originally committed, or where the supplier has had no experience or has had unsatisfactory experience in dealing with the third party. The other approach is to stipulate that, upon the assumption of the commitment by the third party, the party originally committed will be released from the countertrade commitment, leaving only the third party liable to the supplier for the conclusion of future contracts. In order to implement such a substitution of the party liable to the supplier, the parties may agree on a transfer of the countertrade commitment from the party originally committed to the third party. The general contract law of most countries contains rules on transfers of contractual obligations that would be relevant to a transfer of a countertrade commitment. An alternative method of substituting the party liable to the supplier would be for the party originally committed and the supplier to agree to terminate their countertrade commitment at the moment the third party assumes a commitment to conclude future contracts with the supplier. To ensure that the original countertrade commitment is not terminated before the third party's commitment becomes effective, it is advisable to stipulate in the countertrade agreement that the termination would not take effect until the third party's commitment had become effective.

19. [17] As noted below in *paragraph 22,* third parties sometimes limit their commitment to a promise to exercise "best efforts" to make the purchases. *Where it is agreed that the countertrade commitment of the party originally committed is to be terminated when the third party commits itself to enter into a future contract with the supplier, it would be in the interest of the supplier to agree to such a replacement of the party committed to purchase only if the commitment of the third party is* a commitment to actually purchase goods rather than a "best efforts" type of commitment. If the third party were to make only a "best efforts" commitment, the supplier would have limited assurance that the conclusion of the supply contract would take place.

20. [18] Guarantees issued to support fulfilment of countertrade commitments are normally formulated in such a way that they cover only the obligation of the party originally committed. Therefore, if the supplier wishes to have the third party's commitment secured, it is advisable that the countertrade agreement require that the guarantee be modified or that a new guarantee be issued. It is also advisable that there be an indication of the consequences if the guarantee cannot be modified or an appropriate new guarantee cannot be procured.

2. Contractual relationship between party originally committed and third party

(a) *Third party's commitment to purchase goods*

21. [19] When the party originally committed to purchase intends to engage a third party to make the purchases, those two parties should reach an understanding as to the type of commitment to be made by the third party.

22. [20] Two types of commitment by third parties to parties originally committed are used in practice. One type is a promise that, subject to the terms of the engagement of the third party, the countertrade goods will actually be purchased. The other type of commitment is a promise by the third party that an effort will be made to purchase goods without an assurance that the effort will be successful. The third party may not be willing to make a full commitment because of uncertainty as to whether an end-user for the goods could be found or whether the purchase price of the goods would be competitive. Such a promise only to make an effort may be described by terms such as "serious intention", *"best endeavours"*, "best efforts", or "good-faith efforts" or by a clause to the effect that the third party will purchase the goods if an end-user for the goods can be found. If the third party fails to purchase the goods, it can exonerate itself from the consequences of the failure merely by showing a good faith effort to carry out its mandate. The party originally committed to purchase the goods may find the participation of the third party on a "best efforts" basis acceptable if there is reason to expect that the third party will fulfil the mandate (e.g., because of the third party's record or because the anticipated purchase and resale prices are likely to make the purchase commercially attractive).

23. [21] Sometimes the terms of the contract engaging the third party require the third party to make a commitment directly to the supplier to conclude future contracts (see above, paragraphs *6 and 17*).

24. [22] The terms under which the third party is engaged should be coordinated with the terms of the countertrade agreement. The need for coordination exists in particular with respect to the type, quality, quantity and

price of the countertrade goods. A problem may arise, for example, if the third party commits itself to purchase goods of a standard quality at a world market price, while the countertrade agreement specifies a different level of quality or price. In such a case, it may occur that the supplier makes available goods that conform to the countertrade agreement but that the third party is justified in refusing to purchase because the goods do not conform to the terms of the contract between the party originally committed and the third party. That would leave the party originally committed to purchase liable to the supplier for non-fulfilment of the countertrade commitment without the possibility of indemnification from the third party.

25. [23] Furthermore, a problem may arise when the countertrade agreement does not contain an assurance as to the availability of the goods but the third party, relying on its contract with the party originally committed, expects the goods to be made available. When such inconsistency exists, the party engaging the third party may be liable to the third party for a failure on the part of the supplier to make the goods available.

26. [24] When the countertrade agreement and the terms of the engagement of the third party both contain an assurance as to the availability of goods, the party originally committed may be liable to the third party for a failure by the supplier to make the goods available. In such a case, *the party originally committed would be interested in making the assurance of the availability of the goods subject to a liquidated damages or penalty clause or secured by a guarantee.*

27. [25] It is advisable for the contract by which the third party is engaged to reflect any restriction on the resale of goods set out in the countertrade agreement. Otherwise, the party originally committed to purchase may be liable for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement without the benefit of indemnification from the third party.

28. [26] In some cases, the party originally committed may wish to have an opportunity to make alternative arrangements to fulfil the countertrade commitment in the event that the third party fails to make the necessary purchases. This could be achieved by setting a deadline for purchases to be made by the third party that precedes the deadline for the fulfilment of the countertrade commitment that is binding upon the party originally committed. If the party originally committed wishes to have such an opportunity, it would be advisable, in negotiating the countertrade agreement, to ensure that the fulfilment period is of a sufficient length so as to allow the third party adequate time to make the purchases, *as well as to allow time for alternative arrangements to be made should* the third party fail to make those purchases.

29. [27] It is advisable to make it clear in the contract for the engagement of the third party whether it is up to the third party to carry out all aspects of the negotiation with the supplier relating to the conclusion of the future contract, or whether the party originally committed to purchase the goods should participate in some way in the conclusion or performance of the contract. It may be provided, for example, that the party originally committed to purchase must approve or at least be informed of a particular aspect of the purchase of the goods (e.g., the price or the destination of the goods).

(b) *Third party's fee*

30. [28] In return for the third party's commitment to purchase goods, the party originally committed may have to pay a fee to the third party. A fee, *to be agreed upon in the contract between the party originally committed and the third party,* is normally required when the price of goods to be purchased by the third party is not competitive and the resale of the goods would therefore not be profitable to the third party without the payment of a fee. Such a fee is referred to in practice by expressions such as "commission", "*disagio*", "subsidy", "discount", "premium", or "compensation". The amount of the fee would depend in particular on the *demand for the type of goods in question and on the* expected difference between the purchase price and the resale price of the goods. The amount of the fee may also be affected by the cost of any guarantee that the third party would have to procure to cover its liability either to the party originally committed or to the supplier, or to both, for a failure to make the necessary purchases.

31. [*new paragraph*] When a governmental agency is engaging a third party to purchase goods or when a governmental agency is being engaged to purchase goods, in some jurisdictions *mandatory restrictions apply to the payment of a fee by or to the governmental agency.*

32. [29] The fee may be calculated as a percentage of the price of the purchases to be effected by the third party or as an absolute amount per unit or quantity of goods. Sometimes a combination of the two methods is used. If the fee is calculated as a percentage of the price of the goods, it is advisable for the parties to be clear as to the amount on the basis of which the fee is to be calculated (e.g., whether any transport or insurance costs form part of that price).

33. [30] At the time the third party is engaged to conclude the future supply contracts, it may be difficult, due to price fluctuations, to predict the resale price. The parties may therefore provide for a variable fee, to be determined on the basis of the actual difference between the prices, increased by an agreed percentage or amount to cover the third party's costs. Depending upon the underlying commercial circumstances, the parties may wish to consider the possibility that the resale price might rise to a level at which the resale of the goods is profitable for the third party. If this possibility is taken into account, the third party would have to pay an amount to the party originally committed to purchase the goods corresponding to the extent to which the actual resale price increased above the anticipated resale price. Such an amount due from the third party is sometimes referred to as a "negative *disagio*".

34. [31] It is advisable to specify the point of time when the fee becomes due. It may be provided, for example, that the fee becomes due when the third party is engaged, upon the conclusion of the supply contract between the supplier and the third party, upon the opening of a letter of credit on

the instructions of the third party in favour of the supplier, or at the time of payment by the third party to the supplier. Sometimes it is agreed that specified percentages of the fee are payable at different points of time. For example, it may be agreed that a certain percentage of the fee is payable upon the engagement of the third party, a certain percentage upon the conclusion of the contract between the third party and the supplier, and the remainder upon payment by the third party for the goods. When the fee is to be paid subsequent to the conclusion of the contract between the party originally committed and the third party, the third party may request a bank guarantee to secure the obligation to pay the fee.

35. [32] It is advisable for the contract engaging the third party to stipulate whether the contractual relationship between the third party and the party originally committed would be affected by a termination or reduction of the countertrade commitment of the party originally committed. A termination or reduction of the countertrade commitment may result, for example, from the termination of the export contract (see chapter XIII, "*Failure to complete countertrade transaction*", paragraph ___). The third party may be interested in completing the purchase and earning the fee irrespective of the fate of the countertrade commitment of the party originally committed, particularly when expenses have been incurred in locating an end-user, when an end-user has been promised the goods or when the goods have actually been purchased and resold. The party engaging the third party, on the other hand, may be interested in being able to terminate the engagement of the third party in the event that the countertrade commitment is terminated.

36. [*new paragraph*] Sometimes it is agreed that the payment of the fee is to be shared by the party committed to purchase and the supplier. In such a case, the details concerning the sharing, including any limit to the costs to be borne by the supplier, should be dealt with in the countertrade agreement.

(c) *"Hold-harmless" clause*

37. [33] The party originally committed to purchase goods may be liable to the party to whom that commitment is owed when the third party fails to make the anticipated purchases (see above, paragraphs *17 and 18*). A party originally committed to purchase goods engaging a third party may therefore wish to include in its contract with the third party a "hold-harmless" clause. According to such a clause, the third party would have to indemnify the party originally committed to purchase for any liability to the supplier resulting from non-fulfilment of the countertrade commitment for reasons imputable to the third party. The parties may also stipulate that the "hold-harmless" clause would protect the party originally committed to purchase goods in the event of a violation by the third party of a restriction on the resale of the goods set out in the countertrade agreement and reflected in the contract engaging the third party. It may be agreed that the party originally committed to purchase the goods is to give the third party notice when a claim is raised that may result in the third party's liability under the "hold-harmless" clause.

(d) *Exclusivity of third party's mandate*

38. [34] It is advisable for the party originally committed and the third party to indicate in their contract whether the third party is to be the only party engaged or whether the party originally committed reserves the right to engage an additional third party for the purpose of fulfilling the same countertrade commitment. A third party could be given an exclusive mandate with respect to all the purchases to be made in fulfilment of the countertrade commitment or exclusivity could be given only with respect to a particular type of goods, a particular supplier, or a particular territory where the goods are to be purchased or resold.

39. [35] When the third party is given an exclusive mandate, the party originally committed may wish to reserve the right to declare the mandate as non-exclusive if by a specified time before the end of the fulfilment period the third party has not purchased an agreed quantity of goods.

40. [36] When the quantity of goods to be purchased is particularly large, it might be agreed that during a specified period of time the third party is *not permitted* to purchase the same type of goods from other sources. A rationale for such a restriction may be the desire to avoid a temporary oversupply in the market in which the third party plans to resell the goods, or a desire to compel the third party to concentrate its efforts on the fulfilment of the commitment in question.

C. Supply of countertrade goods

41. [37] Sometimes, a party who purchases goods in one direction does not supply goods in the other direction. Instead, one or more third parties are designated to supply the goods. There are two types of transactions in which such an approach may be used. One type is a transaction in which the party purchasing goods in one direction assumes a commitment for the supply of goods in the other direction, but because of difficulties in making the agreed goods available designates a third party to supply the agreed goods. The other type is an indirect offset transaction as described in chapter II, "Scope and terminology of Legal Guide", *paragraph 17*. In indirect offset transactions it is foreseen at the time of the conclusion of the export contract and of the countertrade agreement that the importer (often a governmental agency) will not counter-export goods and that the party committed to counter-import will have to locate third parties willing to supply goods. Those third parties are normally not bound by any commitment to conclude supply contracts with the counter-importer.

42. [38] In a transaction involving a third-party supplier, payment obligations under the supply contracts in the two directions are often settled independently. Payment in such a manner does not raise issues specific to countertrade. However, issues specific to countertrade do arise when the parties decide to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other

direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs *68, 75 and 76.*

43. [39] When the possibility exists that a third party may be involved in the supply of goods, it is advisable for the countertrade agreement to address the means by which the third party supplier is to be selected and the consequences of a failure by the third party to make the agreed goods available.

44. [40] Different approaches may be used for the selection of the third party supplier. One approach is for the countertrade agreement to name the third party. Another approach is for the countertrade agreement to stipulate that the third party supplier is to be agreed upon at a later date. Yet another approach is to leave the selection of the third party to one of the parties to the countertrade agreement.

1. Selection of third party by party committed to purchase

45. [41] It often occurs in offset transactions that the selection of the third party supplier is left to the party committed to purchase. That selection may be restricted by guidelines established in the countertrade agreement requiring the selection of suppliers from particular geographical regions or industrial sectors, or of suppliers of specific types of products or services. Such guidelines are referred to in *chapter IV, "Countertrade commitment," paragraph 28.*

46. [42] When the party committed to purchase is to select the third-party supplier, it is advisable to clarify in the countertrade agreement the effect of a failure by a potential third-party supplier to conclude a supply contract. When the selection is to be made from a large number of potential suppliers, it may be stipulated that the refusal by a potential third-party supplier would not result in a release from the commitment to purchase. When the third-party supplier is to be selected from a list of identified suppliers, it may be agreed that a refusal by all the suppliers on the list to conclude a supply contract in conformity with the terms of the countertrade agreement would release the party committed to purchase from its commitment. (For a further discussion of release from the countertrade commitment, see chapter XIII, "*Failure to complete countertrade transaction", section B.*)

2. Selection of third party by party committed to supply

47. [43] In some cases, the selection of third-party suppliers is left to the party who has a right under the countertrade agreement to supply goods. This may be the case when the party purchasing goods in one direction does not engage in the sale of goods that are to be supplied in the other direction (e.g., when a government agency purchases goods in an offset transaction), does not have goods of interest to the party committed to purchase, or is uncertain as to whether it will have suitable goods at the time the supply contract is to be concluded and therefore wishes to have the option of designating a third-party supplier.

48. [*new paragraph*] The party committed to supply may be left free to designate the third-party supplier. This may be the case, for example, if the countertrade goods are of a standard quality and readily available. Alternatively, the countertrade agreement may provide guidelines within which the party committed to supply goods may designate the third-party supplier or the countertrade agreement may list the potential third-party suppliers. The party committed to purchase may wish to include in the countertrade agreement a clause providing that purchasing from a third party should not cause additional costs to the party committed to purchase.

49. [44] When the selection of the third-party supplier is left to the party *originally committed to supply goods, the parties may provide in the countertrade agreement* that the third party must be in a position to make available goods that conform to the terms of the countertrade agreement. It *is advisable* for the countertrade agreement to be clear as to the consequences of a failure by the third party to make the agreed goods available. It may be agreed that such a failure would release the party committed to purchase from the countertrade commitment to the extent that the third party failed to make goods available, or it may be agreed that a new supplier would be selected. When the obligation of the party originally committed to supply is supported by a liquidated damages or penalty clause, or by a guarantee, it may be *clarified* that a failure by the third party to make the goods available would entitle the party committed to purchase to payment under the liquidated damages or penalty clause or under the guarantee. *

50. [*new paragraph*] It is advisable that the obligations assumed by the third party are coordinated with the obligations under the countertrade agreement of the party originally committed to supply. This is particularly important with respect to the obligations as to the quality, quantity or price of goods to be delivered, a guarantee of availability of goods, or liquidated damages or a penalty for a failure to make the goods available. The purpose of the coordination is to ensure that the goods offered by the third party to the party committed to purchase would be in accordance with the countertrade agreement. If, for example, the third party does not make available goods that meet the level of quality stipulated in the countertrade agreement and a supply contract is therefore not entered into, the party originally committed to supply would be liable under the countertrade agreement and the party committed to purchase may be released from the countertrade commitment.

51. [*new paragraph*] The contract between the party originally committed to supply and the third party may include a "hold-harmless" clause, whereby the third party agrees to indemnify the party originally committed to supply for the liquidated damages or a penalty that might have to be paid under the countertrade agreement as a result of a failure of the third party to make the agreed goods available.

52. [*new paragraph*] In some transactions, the party originally committed to supply and the third-party supplier agree that a commission will be paid by the third-party supplier to the party originally committed for the opportunity to market goods.

D. Multi-party countertrade

53. [45] There are three types of countertrade transactions that involve more than two parties but are distinct from the transactions covered in sections B and C of this chapter.

54. [46] One type is a tripartite transaction in which a party who supplies goods in one direction does not, at any point in the transaction, make a commitment to purchase goods in the other direction; instead, that commitment to purchase is assumed from the outset by a third party. By contrast, section B covers cases in which a party, after having assumed a commitment to purchase goods, engages a third party to make those purchases. A tripartite structure of this first type may be used, for example, in a buy-back transaction in which the exporter of the production facility does not wish to become involved in the purchase of the resultant products and there is a need, in order to secure financing, to have, at the outset, a third party committed to purchase those products. A tripartite transaction of this type may be initiated through the conclusion by the three parties of an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract for the supply of goods in one direction, while at the same time the third-party purchaser (counter-importer) and the counter-exporter enter into a commitment to conclude a future contract for the supply of goods in the other direction.

55. [47] A second type of multi-party transaction is a tripartite arrangement in which a party who purchases goods in one direction does not, at any point in the transaction, assume a commitment to supply goods in the other direction; instead, a third-party supplier assumes, at the outset, a commitment to supply goods. This type of tripartite transaction is distinct from *the* two types of transactions covered in section C: transactions in which a party, after having assumed a commitment to supply goods, designates a third party to supply those goods, and indirect offset transactions, in which the counter-importer makes a commitment to the importer to negotiate supply contracts with potential suppliers who have not made a commitment to conclude supply contracts with the counter-importer. One contractual approach for this type of tripartite transactions is for the three parties to conclude an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract in one direction simultaneously with the assumption by the third-party purchaser (counter-importer) and the counter-exporter of a commitment to conclude a future contract for the supply of goods in the other direction.

56. [48] In many cases, a feature of the tripartite transactions described in *the previous two* paragraphs is the linkage of payments for the supply contracts in the two directions. The use of such linked payment mechanisms is discussed in chapter IX, "Payment", *paragraphs 68, 75 and 76.*

57. [49] In a third type of multi-party transaction, the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties. Such a four-party countertrade transaction may be established when the parties to a contract for the supply of goods in one direction are not themselves in a position to conclude a supply contract in the other direction but are interested in the conclusion of such a supply contract. There may be interest in such an arrangement because the conclusion of the second supply contract would enable the parties to link payments for the contracts in the two directions so as to avoid or reduce cross-border currency transfers (linkage of payments in four-party transactions is discussed in chapter IX, "Payment", *paragraphs 69, 75 and 77*). Another reason for being interested in such an arrangement may be that the supply of goods in one direction is subject to a mandatory requirement of a purchase of goods in the other direction.

58. [*new paragraph*] It is advisable for the parties to consider at the outset of the transaction the question whether the failure to conclude or perform one of the supply contracts should have an effect on the obligation to conclude or perform another supply contract. This question is discussed in chapter XIII, "Failure to complete countertrade transaction", section E. For a discussion of interdependence between supply contracts when the parties have agreed on linked payments, see chapter IX, *paragraphs 72 and 73.*

[A/CN.9/362/Add.9]

IX. PAYMENT

CONTENTS

		Paragraphs
A.	General remarks	1-8
B.	Retention of funds by importer	9-13
C.	Blocking of funds	14-37
	1. General remarks	14-18
	2. Blocked accounts	19-30
	(a) Countertrade agreement	21-25
	(i) Location of account	21-22

	Paragraphs
(ii) Operation of blocked account	23-24
(iii) Other issues	25
(b) Blocked account agreement	26-30
(i) Parties	27
(ii) Transfer of funds into and out of account	28-29
(iii) Duration and closing of account	30
3. Crossed letters of credit	31-37
(a) Sequence of issuance	32-33
(b) Instructions for allocation of proceeds	34-36
(c) Expiry dates	37
D. Setoff of countervailing claims for payment	38-57
1. General remarks	38-44
2. Countertrade agreement	45-57
(a) Effecting credit and debit entries	45-48
(b) Calculation of entries	49-50
(c) Statements of account	51
(d) Periodic verification	52
(e) Limits on outstanding balance	53
(f) Settlement of *outstanding balance*	54-56
(g) Guarantee for payment of outstanding balance	57
E. Issues common to linked payment mechanisms	58-65
1. Currency or unit of account	58
2. Designation of banks	59
3. Interbank agreement	60-61
4. Transfer of unused or excess funds	62-63
5. Supplementary payments or deliveries	64
6. Bank commissions and charges	65
F. Payment aspects of multi-party countertrade transactions	66-77
1. General remarks	66-73
2. Blocking of funds in multi-party countertrade	74-77

[*Editorial note:* The present draft chapter is a revision of draft chapter IX, "Payment", published as document A/CN.9/332/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.6 are in italics.]

A. General remarks

1. [1] The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. [2] One reason the parties may have for linking payments is *the possibility* that it would be difficult for a party to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the shipment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (*below,* paragraphs *9 to 13*), blocking funds paid under the export contract through blocked accounts or crossed letters of credit to secure their availability to pay for the counter-export contract (below, paragraphs *14 to 37*), and setoff of countervailing claims for payment (below, paragraphs *38 to 57*).

3. [3] An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. [*new paragraph*] A characteristic of linked payment mechanisms is the security they provide to the party who has received goods first in that the funds to pay for those goods are not placed at the disposal of the party who has supplied those goods but are reserved to pay for goods subseqently to be supplied in the other direction. This fact may make it easier for that party to obtain a loan to finance its deliveries. The source of financing is often the bank that

is holding the funds to be used for paying subsequent deliveries or the bank that is administering a setoff of countervailing claims for payment.

5. [*new paragraph*] On the other hand, the party who is the first one to deliver goods, or who has delivered more goods than it has received, faces the risk that it will have to wait for an uncertain period of time before goods of the agreed quality are made available for purchase in return or, if such goods are not made available, that the proceeds from the deliveries that that party had made are released to pay for those deliveries. Because of this risk, a bank may be reluctant or unwilling to finance a delivery of goods if payment for those goods is to be deferred until the goods are purchased in return. As a result, in large-scale and long-term projects such as buy-back or indirect offset transactions it is less likely that a linked payment mechanism will be used.

6. [4] The parties may wish to consider the possibility *that hindrances might arise in carrying out the linked payments.* For example, a creditor of one of the countertrade parties *might obtain a court order to* seize proceeds of a supply *contract, the* bank holding the funds *might* become insolvent, or *a payment may be prevented because of supervening banking or foreign exchange regulations. Those cases* could result in the freezing of the payment mechanism until the claim against the countertrade party *was* adjudicated, *the bank became solvent or the regulations were lifted, as the case may be.* A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against *such external circumstances.* Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk *that such hindrances might arise.*

7. [5] It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

8. [*new paragraph*] It is advisable that the parties agree on the details of the linked payment mechanism in the countertrade agreement. Depending on the type of the payment mechanism chosen, individual supply contracts may have to contain clauses implementing the method of payment agreed upon in the countertrade agreement.

B. Retention of funds by importer

9. [6] Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

10. [7] A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "*trust*" in which the importer acts as the "*trustee*" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

11. [8] Furthermore, *a disagreement may arise over the type, quality or price of counter-export goods* if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods available. Retention of funds by the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

12. [9] An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds *are transferred to* the exporter.

13. [10] Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest *in favour of the exporter.* If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn *interest at the most favourable rate.*

C. Blocking of funds

1. General remarks

14. [11] When the exporter does not wish to leave the funds generated by the export contract under the control of

the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this *type:* blocked accounts and crossed letters of credit.

15. [12] When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

16. [13] When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

17. [14] A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

18. [15] The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

2. *Blocked accounts*

19. [16] Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "*trust*" account or "*compte fiduciaire*"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

20. [17] Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", below, paragraphs *26 to 30*). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

(a) *Countertrade agreement*

(i) *Location of account*

21. [18] The parties should consider stipulating in the countertrade agreement the location of the account, *by identifying* the bank, *by* indicating the country in which the account is to be opened or *by* providing some other criterion for the selection of the bank. The choice of possible locations of the account may be limited if the *national law* of the party whose shipment generated the funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

22. [19] When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted above in *paragraph 19,* a degree of protection may be available under some legal systems against claims of third persons.

(ii) *Operation of blocked account*

23. [20] It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

24. [21] The countertrade agreement may provide that payments into the account would be made through a letter

of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficiary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

(iii) *Other issues*

25. [22] It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see below, paragraphs *58 to 65*).

(b) *Blocked account agreement*

26. [23] The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and *by* the bank, as well as other provisions concerning the operation of the blocked account. The blocked account agreement would also address issues such as interest and bank charges, *and the manner in which trading parties may verify the accuracy of interest calculations and other actions taken by the bank in administering the account.* It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

(i) *Parties*

27. [24] The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some *national laws* require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer *is* distinct from the exporter and importer, the additional trading *party* may also be *party* to the blocked account agreement.

(ii) *Transfer of funds into and out of account*

28. [25] The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see above, paragraphs *23 and 24*) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to *its* instructions (see below, paragraphs *62 and 63*). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

29. [26] It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

(iii) *Duration and closing of account*

30. [27] In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate, *in addition to the passage of an agreed upon period of time,* circumstances in which the account would close. These could include an event such as *termination* of the export contract or of the countertrade agreement.

3. Crossed letters of credit

31. [28] Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see below, *paragraph 59*), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

(a) *Sequence of issuance*

32. [29] The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a sequence of issuance may be

an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

33. [30] In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

(b) *Instructions for allocation of proceeds*

34. [31] The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

35. [32] *Because of the linkage between the proceeds of the export letter of credit and the counter-export letter of credit the* choice as to the *method* of payment *of the export letter of credit* is limited to payment at sight or payment on a deferred basis. *Payment by a bill of exchange, the other option used in practice to defer payment of a letter of credit,* is incompatible with the linked payment objective of the crossed letters of credit. *When a bill of exchange is used for paying the beneficiary of the letter of credit, the bank obligated to pay would accept the bill drawn by the importer in favour of the beneficiary of the letter of credit. Such a bill gives the beneficiary the possibility to transfer the bill by endorsement to a third person.* If the *bill* were *endorsed* to a third person, the *bank that issued* the export letter of credit *and accepted the bill would be* obligated to pay the holder *of the bill* (and the importer would be obligated to reimburse the *bank that issued the export letter of credit*) independently of the *crossed-letter-of-credit payment scheme.* If the export letter of credit is payable at sight, the *bank issuing the export letter of credit* is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.

36. [33] It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

(c) *Expiry dates*

37. [34] It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

D. Setoff of countervailing claims for payment

1. General remarks

38. [35] The parties may agree that their mutual claims for payment based on shipments made in each direction would be set off. Under such an arrangement, *money is not actually paid; instead, the sum of claims arising from the deliveries in one direction are set off against the sum of claims arising from the deliveries in the other direction. If an outstanding balance arises in the values of the deliveries in the two directions, it can be settled by delivery of additional goods or by payment of money. In some States setoff arrangements are subject to governmental authorization.*

39. [36] A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. *This* section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

40. [37] A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law. Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of

shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an *outstanding balance* in the flow of trade.

41. [38] Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

42. [39] When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed below in paragraphs *60 and 61*).

43. [*new paragraph*] An agreement to set off claims arising from a trade relationship is in a number of national laws recognized as a distinct type of contract involving the two parties in the trade relationship and a third person who is to administer the recording of mutual claims. Terms used for such contracts include "*compte courant*", "*cuenta corriente*" or "*Kontokorrent*", although some of these terms are also used for accounts in which a bank holds funds of a client. Those national laws deal with issues such as obligations of the third person administering the setoff, the effect of the entry of a claim in the setoff account, the action necessary for the setoff of the countervailing claims to take effect, the possibility to dispute an individual claim or the balance of the countervailing claims, or the effect of insolvency or bankruptcy of a party on the individual entries in the setoff account.

44. [40] The Legal Guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

2. Countertrade agreement

(a) *Effecting credit and debit entries*

45. [41] The parties may wish to agree that entries in the account will be *triggered by presentation* of documents. The countertrade agreement should stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account).

46. [42] Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by *the customs authority* or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, below, *paragraph 53,* and settlement of *such balance,* below, paragraphs *54 to 56*) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

47. [43] In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the

purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the interbank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

48. [44] Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, *the stipulations in the countertrade agreement concerning the instructions to be given to the issuing banks should be aligned with the current revision of the Uniform Customs and Practice for Documentary Credits prepared by the International Chamber of Commerce, which banks customarily incorporate into their letter-of-credit forms.*

(b) *Calculation of entries*

49. [45] The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (below, *paragraph 58*). In addition, the parties may wish to address the question whether interest calculated on the amount of an *outstanding balance* would be registered in the setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

50. [46] In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will *not appear in the setoff account.* Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

(c) *Statements of account*

51. [47] *It is advisable to consider* the manner in which the participating bank or banks *will report* on the status of the setoff account *to the* trading parties *and to any other participating bank. Agreement on this issue is* particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.

(d) *Periodic verification*

52. [48] In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

(e) *Limits on outstanding balance*

53. [49] The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party *should* not exceed an agreed upon balance limit. In accordance with such a balance limit (sometimes referred to as a "*swing*"), debit and credit entries would not be entered in excess of the balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit, *or that an outstanding balance in excess of the limit is to be settled by transfer of money.* Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

(f) *Settlement of* outstanding balance [change of title]

54. [50] It is advisable that the parties agree in the countertrade agreement on the manner *of settling an outstanding balance in the values of the deliveries in the two directions that remains* at the conclusion of *subperiods of the fulfilment period or at the conclusion of the fulfilment period.*

55. [50] With respect to *an outstanding balance* remaining at the conclusion of *a subperiod,* it may be agreed that *the balance would be carried over to the next subperiod. Alternatively, it may be agreed that only a balance up to a specified limit would be carried over to the next subperiod, and that the balance in excess of the limit would have to be settled by cash or by* deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of *an outstanding balance that is* carried forward is to *prevent the accumulation of a high outstanding balance* that would be difficult to rectify by *the end* of the fulfilment period.

56. [51] *As to an outstanding balance* remaining at the conclusion of the fulfilment period, *it* may be agreed that *the balance* is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree *that the balance would be settled after the end of the*

fulfilment period by deliveries of goods within a fixed supplementary period. If an outstanding balance still remains after the conclusion of the supplementary period, *it may be stipulated that it is* to be settled by a currency transfer within an agreed period of time.

(g) *Guarantee for payment of outstanding balance*

57. [52] In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding *balance.* Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of *an outstanding balance* can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of an outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs *[38] to [45].*) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

E. Issues common to linked payment mechanisms

1. Currency or unit of account

58. [53] The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate *an outstanding debit balance* in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

2. Designation of banks

59. [54] The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

3. Interbank agreement

60. [55] Where *on each side of the countertrade transaction a bank is involved,* the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The interbank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. *While* the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

61. [56] The entry into force and *the* duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

4. Transfer of unused or excess funds

62. [57] It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

63. [58] A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the *outstanding* balance due under the counter-export will be paid at the time *the balance* becomes due.

5. *Supplementary payments or deliveries*

64. [59] The parties may anticipate that their shipments will not be of *equal* value or in the planned quantity so that the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

6. *Bank commissions and charges*

65. [60] It would be advisable for the parties to address in the countertrade agreement the question of payment of *bank* charges for operation of *the payment mechanism. In order* to simplify the operation of the payment arrangement, it may be agreed that *bank* commissions and charges will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the *bank* charges will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the charges of each bank will be paid by its respective client. *For example, it may be agreed that the charges for the issuance of a letter of credit will be* borne by the purchaser, while charges for negotiation and confirmation, if required, *will be* borne by the supplier. *Charges for extensions* or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.

F. Payment aspects of multi-party countertrade transactions

1. *General remarks*

66. [61] A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party *counter-importer or a third-party* counter-exporter is involved ("three-party countertrade"); in yet other cases, in addition to the exporter and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third *parties*", paragraphs ___ to ___). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

67. [62] If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two paragraphs, a party receiving goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

68. [63] In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

69. [64] In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

70. [65] Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where *no* cross-border transfer of currency *takes* place, payments would be made in local currency between parties on each side of the transaction.

71. [66] In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and *in* the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

72. [67] If one of the supply contracts in a multi-party countertrade transaction is not concluded or performed as envisaged, it will be impossible to use the proceeds of the contract between one pair of parties to pay for a contract between another pair of parties. In view of this interdependence of supply contracts, it is important that measures are taken that provide assurance to the parties that the

obligations under the transaction will be carried out as agreed. Accordingly, it is advisable that the obligations incumbent on each party are set out as clearly as possible, in particular the obligations concerning the quality of goods, the sequence of shipments, the manner and sequence of payments, and the instructions to be given to the participating banks. In order to increase the confidence of parties, the parties may agree to carry out, prior to the conclusion of the transaction, an inspection of goods to be delivered, to identify specifically the goods to be delivered, or to place the goods in the custody of a third person pending delivery. In order to facilitate coordination of the obligations of the parties, it is useful to address them in a single countertrade agreement entered into by all the participating parties. Where not all the parties to the multi-party transaction are parties to the countertrade agreement, it is advisable to include in the individual supply contracts terms concerning the linked payment mechanisms.

73. [*new paragraph*] In order to make the coordination of obligations of the parties to a multi-party countertrade transaction more effective, the parties may wish to stipulate at the outset of the transaction that certain terms of the countertrade agreement or of a supply contract can be modified only if all parties to the transaction agree to the modification. The modifications that should be subject to agreement of the participating parties are in particular those that concern the time of shipments, method of payment, quantity and quality of goods and price. In addition, the parties may wish to consider securing obligations under the transaction by agreeing on liquidated damages or penalties or on independent bank guarantees.

2. Blocking of funds in multi-party countertrade

74. [68] As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in above in paragraphs *14 to 37.*

75. [69] When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

76. [70] When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

77. [71] When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issuance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.

[A/CN.9/362/Add.10]

X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS

CONTENTS

		Paragraphs
A.	General remarks	1-8
B.	Duty to inform or consult	9-10
C.	Territorial and related restrictions	11-16
D.	Resale price	17-20
E.	Packaging and marking	21-22
F.	Application to third-party purchasers	23-24
G.	Review of restrictions	25-26

[*Editorial note:* The present draft chapter is a revision of draft chapter X, "Restrictions on resale of goods", published as document A/CN.9/WG.IV/WP.51/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.2 are in italics.]

A. General remarks

1. [1] Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of all or of a portion of the goods purchased pursuant to the countertrade commitment. The agreed restrictions may, for example, limit the territory where the purchaser may resell goods, set a minimum resale price, or prescribe packaging and marking of goods to be resold. Such restrictions may be applied to the resale of the goods within the country of the purchaser or to the re-export of the goods. A countertrade agreement or supply contract may contain a combination of different types of resale restrictions.

2. [2] Resale restrictions of this type are not particular to countertrade transactions. However, such restrictions are dealt with in the legal guide because they may take on a special importance in countertrade. Resale restrictions may be part of the strategy of a supplier of countertrade goods or of a government that has mandated countertrade when the purpose of requiring the countertrade commitment was to increase the volume of exports to a particular market or to develop new markets for the goods without affecting adversely existing markets for those goods.

3. [3] The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Such mandatory rules may be set forth in a statute and in various types of administrative regulations, *and interpreted by judicial decisions.* The mandatory rules of more than one country may apply. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices. For example, many legal systems provide that agreements restricting the right of resale are prohibited or may be invalidated if the supplier imposing the restriction has a dominant market position, if the restriction has the effect of limiting access to markets or otherwise unduly restraining competition or if the restriction has or may have other adverse effects on trade or economic development. Agreements setting a minimum price are prohibited outright in some legal systems. In other legal systems, minimum price agreements may be permitted only for certain types of goods (e.g., brand-name or luxury goods) or if specified conditions are met (e.g., the price-setting agreement is approved by the competent authority or it is shown that buyers have sufficient possibility to obtain the same or similar goods at prices not subject to a price-setting agreement).

4. [4] In negotiating a restriction on the resale of countertrade goods *it is useful to bear in mind that, depending on the commercial circumstances of the transaction, a restriction might* lower the price that the countertrade party purchasing and reselling countertrade goods will be able to offer to the countertrade party supplying the goods. Such *may be the* effect of a clause prohibiting the resale of the goods in the most attractive market, or of a clause requiring resale terms that result in additional costs to the party reselling the goods.

5. [5] When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction. Absent a provision in the countertrade agreement on resale restrictions, a demand that the purchase of countertrade goods be subject to a resale restriction may complicate negotiation of a supply contract and may make it difficult to attribute to one of the parties responsibility for a failure to conclude a supply contract. When it is possible that a third party will be engaged to make the purchases necessary to fulfil the countertrade commitment *and the third-party purchaser is to be subject to a resale restriction, it is advisable for the supplier to ensure that the third-party purchaser would be aware that its purchases are* subject to that restriction (see below, paragraphs *23 and 24*).

6. [6] The degree to which the countertrade agreement can be specific depends on factors such as whether the type of goods to be purchased has been identified, the nature of the restriction, or the length of time during which the supply contracts will be concluded, and the possibility of third parties being involved in the resale of the goods. In some cases it may be possible to formulate in the countertrade agreement the resale restriction clause that would apply to all purchases made pursuant to the countertrade agreement. In other cases the supplier may not have the necessary information at the time of the conclusion of the countertrade agreement to determine whether a resale restriction would be desirable, but would not wish to be precluded from raising the question of resale restrictions at a later stage. In such cases, the countertrade agreement may identify only the type or commercial purpose of a resale restriction being contemplated. For example, it may be agreed that the parties would negotiate a limitation of the territories in which the purchaser is permitted to resell goods in order to avoid sales of the goods in the supplier's existing markets.

7. [7] In some exceptional circumstances, the countertrade agreement may contain a stipulation that the purchaser may only use the goods in-house and may not resell them. Such a restriction may be imposed, for example, when the goods are supplied on preferential terms (e.g., in order to help the purchaser in a hardship situation) or when the supplier is under an obligation to restrict distribution of the goods because of their particularly sensitive nature or when the resale of the goods would entail disclosure of information that the supplier wishes to keep under its control.

8. [*new paragraph*] Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of

countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction. The purpose of such a restriction may be to enhance the purchaser's ability to resell the countertrade goods or to make the countertrade transaction more profitable for the purchaser. For example, the supplier of countertrade goods may agree not to sell the same type of goods to certain customers or in certain markets. The supplier of countertrade goods might also grant to the other countertrade party exclusive distributorship rights with respect to those goods. The parties might also agree that the supplier will not market the same type of goods at prices lower than those used in the countertrade transaction. Such restrictions applicable *to* the supplier might be stipulated when in the same transaction the purchaser has agreed to resale restrictions or they may be agreed upon when no resale restrictions have been agreed upon. The warning given in this chapter (above, paragraph 3) that various marketing restrictions may contravene mandatory rules on restrictive business practices is also applicable to marketing restrictions on the supplier of countertrade goods.

B. Duty to inform or consult

9. [8] The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods. Information of this kind may be useful to the supplier in monitoring compliance with resale restrictions binding upon the purchaser, in determining whether resale of the goods by the purchaser is achieving the goal of introducing the goods into new markets, in deciding whether to continue to offer those goods in countertrade transactions, in deciding whether the goal of opening new markets or the goal of increasing sales in traditional markets would be served by engaging in further countertrade transactions with the purchaser, or in planning its own marketing or production of the same or similar type of goods. Such an obligation to inform may be agreed upon also when the parties do not agree on a specific resale restriction, *for example,* because the type of goods to be purchased has not been specified at the time of the conclusion of the countertrade agreement.

10. [9] The countertrade agreement should be clear as to whether an obligation to inform or consult is limited to giving information or is intended to provide an opportunity for consultations between the purchaser and the supplier prior to the resale. It is advisable to stipulate the point of time when the supplier is to be informed. If the parties intend to allow for consultations prior to resale, it should be made clear that the purchaser must inform the supplier in sufficient time to allow consultations to take place.

C. Territorial and related restrictions

11. [10] The parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods under the countertrade agreement may resell the goods. A territorial restriction may be based on the supplier's desire, for example, to generate sales in new markets, to protect the supplier's existing markets, to ensure that the goods comply with the rules applicable in the markets in which they are to be resold, or to avoid violating restrictions arising from patents held by third persons or from licensing arrangements between third persons and the supplier for technology used to produce the countertrade goods. A further reason may be to prevent interference with exclusive distributorships granted by the party supplying goods under the countertrade agreement. If the supplier has granted an exclusive distributorship in a particular territory, it is inherent in such an arrangement that the supplier would be under a duty not to enter into contractual arrangements that undermine the exclusive distributorship. Sometimes exclusive distributorship agreements provide that the exclusive distributor is entitled to a commission if goods in question are sold in the restricted territory. In such cases the parties to the countertrade agreement might require the purchaser to pay a commission to the exclusive distributor.

12. [11] Identification of the territories where the goods may be resold can be done either by specifying the territories where the goods are not permitted to be resold or by specifying those territories where the goods are permitted to be resold. A provision specifying territories where the goods may be resold should make clear that resale is prohibited in territories that are not listed. The parties should pay attention to the need to use precise terminology. General expressions such as "Caribbean States", "Latin America", "Pacific region", *or "Europe"* may be interpreted differently and therefore may be inadequate. The territory in which the goods are permitted to be resold may also be limited to those territories in which after-sale service is available either from the purchaser or some other source. In drafting clauses concerning territories of resale, the parties should bear in mind that the right to resell in particular territories is distinct from the question whether the right to resell in those territories is exclusive or non-exclusive.

13. [12] In some cases, the countertrade agreement may provide that only a specified quantity of goods is permitted to be resold in particular territories or that only a specified quantity of goods is permitted to be resold without restriction as to territory. Such an approach may be motivated, for example, by the existence of governmental import quotas, by a desire to avoid oversupply in existing markets or by a desire to introduce the goods into new markets.

14. [13] When the countertrade transaction is likely to result in the resale of goods in markets in which the supplier usually does not sell, the supplier may wish to permit the resale of the goods only in territories in which the goods are covered by product liability insurance for claims arising from personal injury or property damage caused by the goods. It may be agreed that the party purchasing the goods under the countertrade agreement and reselling them is to obtain the insurance. Such insurance may be in the interest of the supplier because claims for damage resulting from the use of the goods may be made against the supplier. A clause permitting the resale of the goods only in territories in which the goods are covered by product liability insurance may be considered in particular when the products purchased under the countertrade transaction are

to be resold in a market where the standard of liability or the level of compensation awarded under product liability laws is considerably higher than in the markets in which the products are traditionally sold.

15. [14] Suppliers sometimes prohibit purchasers from selling to particular customers or classes of customers. Such restrictions may be motivated by a desire on the part of the supplier to retain certain customers for itself (e.g., bulk buyers). An aim of this type of restriction may be to prevent competition in the supply of the goods that might result in a lowering of the price. It should be noted that such resale restrictions may violate mandatory rules mentioned *above* (paragraph 3) prohibiting certain types of restrictive business practices. Another possible motivation for such restrictions may be the prevention of resale of goods of a sensitive or hazardous nature to certain buyers.

16. [15] The parties sometimes agree that the resale of goods requires the consent of the supplier. This approach might be taken, for example, when the nature of the goods requires a restriction on their transfer (e.g., hazardous substances or equipment whose use requires special training) or when the supplier contemplates granting exclusive distribution rights in the future and therefore wishes to retain the right to restrict the resale of the goods by the purchaser once those distributorships have been granted. The requirement of consent may be limited to specified territories or to specified classes of customers. The exercise by the supplier of the right to withhold consent may be made subject to objective criteria. It may be agreed, for example, that consent may be withheld only where the goods are to be resold in a market in which an exclusive distributorship has been established, or where existing sales of the goods in question by the supplier or its distributors have reached a specified threshold.

D. Resale price

17. [16] Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. As pointed out *above* in paragraph 3, the parties should bear in mind that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is permitted only in limited circumstances.

18. [17] The supplier may wish to set a minimum resale price when the goods to be supplied pursuant to the countertrade agreement are of such a quantity that their resale might destabilize or depress the price for goods of that type. While in many countertrade transactions the quantities of goods involved are such that they would not adversely affect the market price, there are countertrade transactions that result in an abrupt and large increase in the supply of goods of a particular type and that may therefore cause price instability. Minimum resale prices may also be intended to prevent sales at discount prices that might harm the image of a product.

19. [18] A minimum resale price may be stipulated in the countertrade agreement or it may be agreed that a minimum resale price is to be set at a time subsequent to the conclusion of the countertrade agreement (e.g., at the time of the conclusion of the supply contract or after a specified volume of the goods *has* been resold). In the case of a long term countertrade transaction, the parties may agree that a minimum resale price is to be set periodically. The countertrade agreement should be clear as to the charges and costs that are to form part of the stipulated minimum resale price (e.g., transportation costs, insurance premiums, or taxes). If the minimum price is to be set subsequent to the conclusion of the countertrade agreement, the parties may wish to link the determination of the minimum to an objective standard of the type used in setting a price for the goods as between the parties to the countertrade agreement. Such standards include the price quoted in a market of goods of the type in question, competitor's price or the price charged to the supplier's most favoured customer (see chapter VII, "Pricing of goods", paragraphs 11 to 20).

20. [19] The parties may not wish to set a specific minimum resale price in the countertrade agreement when the goods are of a standardized quality, such as commodities, that are sold in public markets because of the possibility that the market price may fall below a specific minimum resale price set in the countertrade agreement. A purchaser bound by a minimum resale price higher than the market price would find it difficult or impossible to resell the goods. In order to avoid such difficulties, the parties may wish to provide that the minimum resale price is to trace movements in the market price for the goods in question. This could be done by linking the determination of the minimum price to objective standards of the type referred to in the preceding paragraph.

E. Packaging and marking

21. [20] The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. Such requirements may obligate the purchaser to repackage or re-mark the goods or to resell the goods with their original packaging or marking. The question of packaging and marking may be important because a goal of many countertrade transactions is to introduce goods in non-traditional markets. The packaging and marking of the goods may be intended to affect the marketability of the goods in those markets, or to comply with legal rules governing packaging and marking. For example, the countertrade agreement may require that the goods be sold under the supplier's trade name, that the goods be sold in a particular form of packaging, that the packaging list the ingredients and composition of the goods, that the packaging indicate the origin of the goods, or that *the* packaging include instructions for use and that the instructions be in a particular form.

22. [21] The parties should ensure that any packaging or marking requirements in the countertrade agreement do not conflict with mandatory *provisions at the place* where the goods are to be resold. *For example, there may exist requirements as to marking the origin of goods, prohibitions to modify certain elements of markings or packaging, or requirements derived from consumer protection and environmental law.* Even when the countertrade agreement does not prescribe repackaging or re-marking, the purchaser may have to repackage or re-mark the goods when

packaging and marking of the goods by the supplier do not conform to the rules applicable in the country where the goods are to be resold.

F. Application to third-party purchasers

23. [22] When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in seeing that a resale restriction stipulated in the countertrade agreement will be observed by the third party. For that purpose, the supplier may wish to include in the countertrade agreement a provision obligating the party originally committed to purchase goods to incorporate the resale restriction in the contract through which the party originally committed engages the third party. Furthermore, it is advisable that the supplier include that resale restriction in the supply contract concluded with the third party or in the agreement with the third party by which the third party makes a commitment to the supplier to conclude a future supply contract (see chapter VIII, "Participation of third parties", paragraphs [15] and [16]). In this way the third party would be responsible directly to the supplier for compliance with the resale restriction.

24. [23] As noted in chapter VIII, "Participation of third parties", paragraph [25], the party originally committed to purchase may be liable under the countertrade agreement for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement. Therefore, the party originally committed would itself have an interest in reflecting in the contract with the third party any resale restriction set out in the countertrade agreement. Furthermore, the party originally committed to purchase goods may wish to include in its contract with the third party a "hold-harmless" clause committing the third party to indemnify the party originally committed to purchase for any liability to the supplier resulting from a violation by the third party of a resale restriction (for a discussion of "hold-harmless" clauses, see chapter VIII, paragraph [33]).

G. Review of restrictions

25. [24] Large-scale countertrade transactions often involve purchase and resale of goods over a long period of time during which the underlying commercial circumstances and interests of the parties may change significantly. The possibility of such changes may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions. A periodic review or a review upon the request of a party may be agreed upon. When the review is to be upon the request of a party, the countertrade agreement may identify the types of changes in the underlying circumstances that would entitle a party to a review. *Even in the absence of a review clause in the countertrade agreement, under some legal systems, in the event of major changes in the circumstances underlying the transaction the parties would be obligated to review the affected restriction.*

26. [25] The extent to which a review procedure is advisable would depend upon the nature of the resale restriction in question. For example, a restriction as to the territory or price of resale linked to a particular type of goods may entail a greater need for possible future modification than a restriction of a less stringent sort such as a requirement that the purchaser consult with the supplier prior to reselling the goods.

[A/CN.9/362/Add.11]

XI. LIQUIDATED DAMAGES AND PENALTY CLAUSES

CONTENTS

		Paragraphs
A.	General remarks	1-11
B.	Relationship of recovery of agreed sum to recovery of damages	12
C.	Effect of payment	13-16
D.	Amount of agreed sum	17-23
E.	Obtaining agreed sum	24-27
F.	Termination of countertrade commitment and clauses for payment of agreed sum	28-29

[*Editorial note:* The present draft chapter is a revision of draft chapter XI, "Liquidated damages and penalty clauses", published as document A/CN.9/WG.IV/WP.51/Add.3. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.3 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.3 are in italics.]

A. General remarks

1. [1] Liquidated damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation, *or a failure to perform it on time,* entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties establish their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or both.[1] *Sometimes, the parties agree that the obligation to pay liquidated damages or a penalty is to be secured by a guarantee (see below, paragraph 27).*

2. [2] This chapter focuses on liquidated damages and penalty clauses included in countertrade agreements to cover a failure to fulfil the countertrade *commitment. The* chapter does not address directly the use of liquidated damages or penalty clauses to support performance of supply contracts that form part of a countertrade transaction. Liquidated damages and penalty clauses are frequently used in sales contracts and other types of supply contracts, and the presence of such clauses in supply contracts that form part of a countertrade transaction does not raise issues specific to countertrade. Nevertheless, the discussion in this chapter of the general characteristics of liquidated damages and penalty clauses is relevant to the use of such clauses in supply contracts.

3. [*new paragraph*] Often the intention of the parties is for the clause to cover non-fulfilment of the countertrade commitment, i.e., that the beneficiary of the clause, by claiming the agreed sum in the case of breach of the countertrade commitment, would forsake fulfilment of the commitment. Sometimes the parties intend the clause to cover delay, i.e., that the countertrade commitment remains outstanding despite payment of the agreed sum (see below, paragraphs 13 to 16).

4. [3] *The obligation* to pay the agreed sum *arises when the committed party fails to take the action specified in the countertrade agreement as necessary to fulfil the countertrade commitment. As discussed in chapter IV,* paragraphs *35 and 36, that action may be either the conclusion of a supply contract or a specified action to be taken to perform the supply contract (e.g., opening the letter of credit or delivery of goods). If* the countertrade commitment *is to be fulfilled* upon *performance of* the supply contract, failure to *render the performance in question may give rise to* liability under *both* the liquidated damages or penalty clause in the countertrade agreement *as well as under the supply contract, a duplication of remedies the parties may wish to avoid (see chapter IV, paragraph 36).*

5. [4] The purchaser's commitment to purchase goods may be covered by a liquidated damages or penalty clause in the countertrade agreement, as may be the supplier's commitment to make goods available. *The clause may cover the whole or only a part of the countertrade commitment.* In many countertrade transactions it is only the party who has exported and is committed to counter-import whose commitment is covered by such a clause. That is because that party may be primarily interested in exporting its own goods and may not have the same degree of interest in purchasing goods in return. However, when the party committed to purchase has a particular interest in obtaining the goods, it may be agreed that the party committed to supply the goods would pay an agreed sum in the event that the party committed to supply fails to conclude a supply contract. When both the party committed to purchase and the party committed to supply have a strong interest in the future conclusion of a supply contract, it may be agreed that the commitments of both parties are to be subject to a liquidated damages or penalty clause.

6. [5] *When it is agreed at the time of conclusion of the countertrade agreement that a party should be entitled to monetary compensation if the other party fails to fulfil the countertrade commitment, an* agreement on *liquidated damages or a penalty* has certain advantages. Firstly, the sum constitutes agreed compensation for such a failure, thereby allowing the parties to avoid the difficulties and expenses that might be involved in proving the extent of resulting losses. Those expenses might be considerable, especially if the aggrieved party had to establish the losses in judicial or arbitral proceedings. Furthermore, the amount of damages that might be awarded in judicial or arbitral proceedings may be uncertain (see chapter XIII, "Failure to *complete* countertrade transaction", *paragraph 12*). An agreed sum is certain, and this certainty may be of benefit to both parties in assessing the risks to which they are subject under the countertrade agreement. Secondly, the agreed sum may serve as the limit to the liability for a failure to fulfil the countertrade commitment. The party whose commitment is covered by the clause is assisted by knowing in advance the maximum liability likely to be incurred in the event of its failure to fulfil the countertrade commitment (see, however, the discussion below in *paragraph 12,* as to the possibility of a claim for damages in excess of the agreed sum). *However, a liquidated damages or penalty clause may be a less attractive option when a purpose of the countertrade transaction is to avoid a transfer of currency.*

7. [6] Many legal systems have rules regulating liquidated damages and penalty clauses, and those rules will often restrict what the parties may achieve through those clauses. Under some legal systems, clauses fixing an agreed sum to stimulate performance are invalid, and the party who fails to perform is liable only for the damages recoverable under the general law. Those legal systems recognize only clauses by which the parties, at the time of contracting, fix an agreed sum payable as compensation for losses caused by a failure to perform. Under other legal

[1] Studies on the nature and operation of liquidated damages and penalty clauses in international contracts are contained in *Yearbook of the United Nations Commission on International Trade Law, volume X: 1979,* part two, I, C, and ibid., *volume XII: 1981,* part two, I, B, 1. "Uniform Rules on Contract Clauses for an Agreed Sum due upon Failure of Performance" (hereinafter referred to as "Uniform Rules") adopted by the Commission are set forth in the Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17* (A/38/17), annex I (also reproduced in *Yearbook of the United Nations Commission on International Trade Law, volume XIV: 1983,* part one, I, A). By its resolution A/RES/38/135 of 19 December 1983, the General Assembly recommended that States should, where appropriate, implement the Uniform Rules in the form of either a model law or a convention. The Uniform Rules may be used *by parties in drawing up* liquidated damages and penalty clauses.

systems, however, clauses fixing an agreed sum payable as compensation, or fixing an agreed sum to stimulate performance, or fixing a sum which has both those purposes, are in principle valid. The courts may have the power to reduce the agreed sum in specified circumstances, in particular if the amount is grossly excessive in the circumstances or if there has been part performance. The courts may also have the power to award additional damages when the actual damages exceed the agreed sum. In those legal systems the parties may not be permitted to derogate from the power of the court to reduce the agreed sum or to award additional damages.

8. [7] A committed party may fail to fulfil its countertrade commitment due to a permanent or temporary impediment for which it is not responsible (for a discussion of such impediments, see chapter XIII, "Failure to complete countertrade transaction", paragraphs *13 to 36*). The rule in many legal systems is that the agreed sum is not due if the failure to perform the obligation in question is caused by a permanent impediment for which the obligated party is not responsible. Such an approach is *consistent with the rule on exemption from liability for failure to perform found in* the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79 (see also Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance, article 5 (see note 1)). If an impediment prevents performance of an obligation only temporarily, according to a rule found in many legal systems, the time period for performance of the obligation is extended. In the case of temporary impediments, payment under the liquidated damages or penalty clause would be due only for the countertrade commitment remaining unfulfilled after the lapse of the extended fulfilment period. The countertrade agreement may maintain the applicability of those rules and may contain provisions defining exempting impediments and providing a rule for determining when an impediment is deemed permanent (see chapter XIII, "Failure to complete countertrade transaction", paragraphs *17 to 34*).

9. [8] Liquidated damages or penalty clauses should be distinguished from two other types of clauses, i.e. clauses limiting the amount recoverable as damages, and clauses providing alternative obligations. A clause limiting the amount recoverable as damages fixes a maximum amount payable if liability is proved. A plaintiff must prove the amount of its losses, and, if the amount falls below the maximum, only the amount proved is recoverable. In the case of liquidated damages or penalty clauses, the agreed sum is recoverable without proof of loss. A clause providing an alternative obligation gives the obligated party the option either of performing a specified obligation or paying an agreed sum. By exercising either option, the obligated party discharges the obligation. Under liquidated damages or penalty *clauses, the obligated party does not have the option of choosing between either performing the obligation or paying the agreed sum.* If there is any doubt as to whether *it is intended that* the committed party would have such an option, it is advisable that the question be settled in the clause.

10. [9] Clauses discussed in this chapter should also be distinguished from provisions in countertrade agreements establishing the obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing claims for payment are to be set off. Such payments to liquidate imbalances serve the function of payment for goods delivered in one direction that were not compensated by deliveries in the other direction. Furthermore, the amounts of such payments are not set in advance as is the case with liquidated damages or penalties. (For a discussion of clauses concerning the settlement of imbalances in barter, see chapter III, "Contracting approach", *paragraph 7*, and in setoff arrangements, see chapter IX, "Payment", paragraphs *54 to 57*.)

11. [10] As discussed in chapter VIII, "Participation of third parties", the countertrade party committed to purchase or to supply goods may have the right to engage a third party to fulfil that commitment. In some of those cases, it is agreed that the party originally committed is to remain liable for fulfilment of the countertrade commitment. When this is the case, the contract by which the third party is engaged may provide that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods. The purpose of payment of the agreed sum would be to indemnify the party originally committed for its liability for *a breach of* the countertrade commitment due to reasons imputable to the third party. The indemnification by the third party of the party originally committed could also take the form of a "hold-harmless" clause of the type discussed in chapter VIII, *paragraph 37.* Any commitment to conclude future supply contracts that is made by the third party directly to the countertrade party with whom those supply contracts are to be concluded may also be covered by a liquidated damages or penalty clause. (For a related discussion of the engagement of third parties, see chapter *VIII, paragraphs 6, 17 and 18* (third-party purchasers), and *paragraphs 49 to 51* (third-party suppliers)).

B. Relationship of recovery of agreed sum to recovery of damages

12. [11] Legal systems often regulate the relationship between the recovery of the agreed sum and the recovery of damages. Since one of the objectives of a liquidated damages or penalty clause is to avoid the difficulties of an inquiry into the extent of recoverable damages (see above, *paragraph 6*), under some legal systems the party to whom the agreed sum is owed is not permitted, in cases where recoverable damages under the rules relating to damages exceed the agreed sum, to waive the agreed sum and claim damages. Nor is the party owing the agreed sum permitted, in cases where the amount recoverable as damages is less than the agreed sum, to assert that that party should only be liable for damages. Under other legal systems, however, the party to whom the agreed sum is owed is permitted to prove that the losses exceed the agreed sum. In those legal systems the aggrieved party can, in addition to the agreed sum, recover damages to the extent that the loss exceeds the agreed sum, either unconditionally or subject to satisfying certain conditions (for example, that the failure of performance was negligent, or was committed with an intention to cause loss, or that there was an express agreement

that damages for the excess are to be recoverable). In view of such disparities among legal systems, and the differing perspectives from which a liquidated damages clause may be interpreted, it is advisable that the parties, to the extent permitted by the applicable law, settle in the clause the question whether the aggrieved party would be entitled to any damages beyond the agreed sum (Uniform Rules, article 7 (see note 1)). (For further discussion of monetary compensation for failure to fulfil the countertrade commitment, see chapter XIII, "Failure to complete countertrade transaction", paragraphs *11 and 12.*)

C. Effect of payment

13. [12] An important question for the parties to consider is whether, *by claiming the agreed sum, the beneficiary of the clause forsakes fulfilment of the underlying obligation.* Often the intention of parties *to countertrade transactions is that the beneficiary who, in the case of breach of the countertrade commitment, chooses to claim the agreed sum is precluded from also claiming fulfilment of the countertrade commitment.* However, since sometimes the parties intend that the agreed sum is to be payable for delay in fulfilment of the countertrade commitment, *in which case the countertrade commitment remains outstanding despite* payment of the agreed sum, it is advisable for the liquidated damages or penalty clause to contain a clear provision on the effect of payment of the agreed sum. *In the absence of* such a provision, the effect of payment would be determined by the applicable *law and on* the basis of circumstances that indicate the intent of the parties (e.g., the amount of the agreed sum) (Uniform Rules, article 6 (see note 1)).

14. [*new paragraph*] It should be noted that the nature of the obligation in question may determine whether performance could be enforced. In particular, performance of an obligation to provide services might be unenforceable under the laws of some States, thereby leaving compensation through monetary damages as the remedy.

15. [13] The parties may wish to provide for payment of an agreed sum for delay when it is particularly important for the countertrade commitment to be fulfilled by a specified date or for portions of the countertrade commitment to be fulfilled according to an agreed time schedule. The supplier may be interested in such a clause, for example, when the timely fulfilment of the countertrade commitment in one direction is essential for its ability to meet its payment obligations under the supply contract in the other direction. The purchaser may be interested in such a clause, for example, when a commitment has been made to resell the goods by a particular date. *The* amount of the agreed sum payable for delay *is further discussed* below *in section D.*

16. [14] The question of the effect of payment of an agreed sum would also arise when payment is due for a failure to fulfil the portion of a countertrade commitment allocated to a subperiod of the fulfilment period. In such cases it is advisable to make clear whether any payment is due under the liquidated damages or penalty clause for any unfulfilled portion of the countertrade commitment that is not carried over or that remains unfulfilled upon the expiry of the overall fulfilment period, or whether any payment is due for any unfulfilled portion of the countertrade commitment that is carried over from one subperiod to the next.

D. Amount of agreed sum

17. [15] The amount of the liquidated damages or penalty, *whether stipulated for non-fulfilment or for delayed fulfilment of the countertrade commitment,* may be expressed as an absolute amount or as a percentage of the value of the outstanding commitment. Calculating the amount on the basis of a percentage of the outstanding commitment has the advantage of automatically reducing the amount as the countertrade commitment is fulfilled. If there is *an independent* guarantee to secure payment of the agreed sum (see below, *paragraph 27), in view of its independent nature, any reduction of the amount that might become due would not result in an automatic reduction of the amount of the guarantee. Therefore, in order to keep the amount of the guarantee in line with the underlying obligation,* it is advisable for the terms of the guarantee to provide that any reduction in the *countertrade commitment* is to result, *upon presentation of agreed documents,* in a corresponding reduction in the amount of the guarantee (see chapter XII, "Security for performance", paragraphs *25 and 26). In the case of an accessory guarantee, a reduction in the underlying obligation would result in an automatic reduction of the amount owed under the guarantee (see chapter XII, paragraph 3).*

18. [19] When the clause for the payment of liquidated damages or a penalty covers delay, an agreed sum to be paid is often fixed by way of increments, a specified amount being due for a specified time unit of delay. In such cases it is advisable that a limit be placed on the cumulative amount of the increments. The parties may wish to address the possibility that the failure to fulfil the commitment would continue after the limit is reached. One approach would be to provide that the beneficiary of the liquidated damages or penalty clause is not entitled to recover either further increments in the liquidated damages or penalty, or damages for losses suffered as a result of non-fulfilment of the countertrade commitment after the date on which the limit was reached. Under another approach, after the limit is reached, the beneficiary of the liquidated damages or penalty clause is still entitled to claim fulfilment of the commitment. In this case the parties may agree that if the committed party fails to fulfil the countertrade commitment within an agreed period after the cumulative limit has been reached, the beneficiary of the liquidated damages or penalty clause is entitled to claim an additional agreed sum for non-fulfilment of the commitment. Under either approach it is advisable to provide that the beneficiary of the liquidated damages or penalty clause is entitled to terminate the countertrade commitment once the cumulative amount of the payments for delay is reached.

19. [16] Determining the appropriate amount for the agreed sum presents certain difficulties. In a long-term countertrade transaction, it may be difficult to estimate at the time of the conclusion of the countertrade agreement

the losses that may be suffered at the time of a breach of the countertrade commitment, and accordingly it may be difficult to quantify the amount of the agreed sum that would make it either truly compensatory, or adequate to stimulate performance. From the point of view of the beneficiary of the liquidated damages or penalty clause, the agreed sum should not be fixed at such a low level that the beneficiary will suffer serious uncompensated losses upon a failure of the other party to fulfil the countertrade commitment. Furthermore, a sum that is less than what the obligated party would save by failing to fulfil the countertrade commitment would not serve as a stimulus to fulfil properly and on time. Indeed, it may serve as a stimulus not to do so. [*the following sentence is a revision of the first sentence in paragraph 18 in A/CN.9/WG.IV/WP.51/Add.3*] The beneficiary of the clause may find it useful to have the agreed sum set at a level that provides both reasonable compensation and, to the extent permitted by the applicable law, a moderate pressure to fulfil the commitment.

20. [18] Excessive sums should be avoided, as they may deter some potential trading partners from entering into a countertrade agreement. Excessive sums may also make it more difficult to find a third party willing to become involved in the fulfilment of the countertrade commitment subject to a "hold-harmless" clause (see above, *paragraph 11*, as well as chapter VIII, "Participation of third parties", *paragraph 37*). An excessive sum may also have no special deterrent effect if it can be predicted that in all likelihood it will be declared invalid or reduced in legal proceedings (see above, *paragraph 7*). Furthermore, a party committed to purchase goods and requested to accept an agreed sum set at a particularly high level may as a counterbalance seek a lower price for the goods that party is to purchase, or that party may seek a higher sale price for its own goods.

21. [18] Where the applicable law only permits an agreed sum to serve as compensation, parties should attempt to estimate as accurately as possible the losses the purchaser is likely to suffer. [*the following sentence is a revision of paragraph 17 in A/CN.9/WG.IV/WP.51/Add.3*] *The* parties should bear in mind that, *under such laws,* the amount of the agreed sum *might* be viewed by a court as an important factor in determining whether the obligation to pay the agreed sum *was* intended to compensate for damages or to stimulate performance (see above, *paragraph 7*). Any records relating to the basis of the estimate and the calculations should be preserved as evidence that the sum was not fixed arbitrarily. In addition, the parties may wish to include a statement in the countertrade agreement that the amount set in the clause represents a good faith estimate of the damages that would be suffered as a result of *a breach* of the countertrade commitment.

22. [18] In determining what sum is reasonable *for an agreed sum to cover non-fulfilment of the countertrade commitment,* parties may consider such factors as the price the supplier would obtain in a substitute sale, the price the purchaser would have to pay in a substitute purchase, losses that might result from non-fulfilment of the countertrade commitment, the extent of the risk that the countertrade commitment will *not be fulfilled* and the fact that the sum should be substantial enough to induce performance.

23. [*new paragraph*] In determining what sum is reasonable for an agreed sum to cover delay in fulfilment of the countertrade commitment, parties may take into account circumstances that influenced the decision to include a liquidated damages or penalty clause in the countertrade agreement (see above, paragraph 15). For example, if the importer relies on timely counter-exports for repaying a bank loan, the basis for setting the amount of the agreed sum may be the financing costs that would have to be incurred as a result of late purchases under the countertrade agreement. If the counter-importer is to be the beneficiary of the liquidated damages or penalty clause, a relevant factor may be the consequences the counter-importer would face due to its inability to resell the countertrade goods by a particular date.

E. Obtaining agreed sum

24. [20] The parties may wish to provide that the aggrieved party loses the right to claim the agreed sum if a claim is not made within a specified period of time following the expiry of the fulfilment period (e.g., thirty days). The purpose of such a provision is to resolve questions of liability for *a failure to fulfil* the countertrade commitment within a reasonable period of time following the expiry of the fulfilment period. The period of time for making a demand should be sufficient to permit the parties to determine whether fulfilment of the countertrade commitment has taken place. This would be of particular importance where actions fulfilling the countertrade commitment might be taken shortly before the close of the fulfilment period or where supply contracts are to be concluded with persons other than the party to whom the commitment is owed.

25. [21] In the case of a fulfilment period divided into subperiods, it is advisable that the countertrade agreement indicate whether payment of the agreed sum is due following each subperiod in which there has been a failure to fulfil or only at the end of the entire fulfilment period. If payment is due following each subperiod, a period of time following the expiry of each subperiod could be provided during which payment of the agreed sum could be claimed (see the preceding paragraph).

26. [22] Legal proceedings that might be necessary to recover the agreed *sum entail* time and expense. The need to institute legal proceedings may be reduced if the countertrade agreement authorizes the beneficiary to deduct the agreed sum from funds of the other party in the hands of the beneficiary or *to set off the claim for the agreed sum against* funds due by the beneficiary to that party. For example, when it is agreed that the proceeds of the export contract are to be held to pay for the counter-export contract, it may be agreed that the counter-exporter may withhold an amount equivalent to the agreed sum if the counter-importer fails to honour its commitment to enter into a contract for the purchase of counter-export goods (see chapter IX, "Payment", paragraphs *12 and 62*). Where the beneficiary of the liquidated damages or penalty clause does not retain the proceeds

of a shipment in such a manner, the objective of securing payment of the agreed sum may be achieved by authorizing deduction from funds or claims that are unrelated to the countertrade transaction in question. It may be noted, however, that under some legal systems provisions authorizing deductions *and setoff* are regulated by mandatory rules. *One such rule found in the laws of a number of States is that a setoff is permitted only if the claims to be set off arose from the commercial relationship between the parties.* Furthermore, a deduction *or a setoff* might later be invalidated if the agreed sum deducted *or set off was held* by a court to be excessive, and was reduced.

27. [23] The beneficiary of the liquidated damages or penalty clause may wish to include a provision in the countertrade agreement requiring the other party to arrange for a financial institution to give a guarantee in respect of the agreed sum. The beneficiary could then claim the agreed sum from the financial institution according to the terms of the guarantee. *Such guarantees are typically of an independent nature, although the possibility of using an accessory guarantee is not excluded. For a discussion on independent guarantees, their distinction from accessory guarantees and on possible payment terms of guarantees, see* chapter XII, "Security for performance", *in particular paragraphs 3, 4 and 18.*

F. Termination of countertrade commitment and clauses for payment of agreed sum

28. [24] Parties may wish to provide that, where an agreed sum for delay is payable by way of increments with a limit on the cumulative amount recoverable (see above, *paragraph 18*), the countertrade commitment may not be terminated until the limit is reached on the ground of the failure to fulfil for which the agreed sum is provided.

29. [25] The parties may also wish to provide that termination after the limit is reached is not to affect any obligations to pay liquidated damages or penalties that became due prior to the termination. This would avoid the ambiguity that may result due to the rule in some legal systems that the termination of a contract affects obligations that became due prior to the termination of the contract. If, however, the countertrade commitment is terminated before the limit is reached (e.g., when the beneficiary of the liquidated damages or penalty clause terminates the countertrade commitment for a failure other than the one for which the agreed sum has been stipulated), the parties may wish to provide that the termination does not affect the right to recover an agreed sum due on the date of termination, but that no amount becomes due as the payment of an agreed sum after the termination.

[A/CN.9/362/Add.12]

XII. SECURITY FOR PERFORMANCE

CONTENTS

		Paragraphs
A.	General remarks	1-6
B.	Guarantee provisions in countertrade agreement	7-39
	1. Choice of guarantor	10-16
	2. Conditions for obtaining payment under the guarantee	17-22
	3. Amount of guarantee and reduction of amount	23-26
	4. Time of providing guarantee	27-30
	(a) At entry into force of countertrade agreement or shortly thereafter	27-28
	(b) Later in fulfilment period	29-30
	5. Duration of guarantee	31-36
	(a) Expiry date	31-33
	(b) Return of guarantee instrument	34
	(c) Extension	35-36
	6. Modification or termination of countertrade agreement	37-39
C.	Guarantee covering imbalance in trade	40-48
	1. Guarantee for shipment in one direction	43-47
	2. Mutual guarantees	48

[*Editorial note:* The present draft chapter is a revision of draft chapter XII, "Security for performance", published as document A/CN.9/332/Add.7. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.7 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.7 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [1] *This chapter* focuses on guarantees (also referred to in practice as "bonds" or "indemnities") in a countertrade transaction supporting the countertrade commitment. *Guarantees supporting the performance of individual supply contracts are not specifically addressed since they do not raise issues particular to countertrade. In a given countertrade transaction, guarantees may be used to* support the *obligation to* purchase goods, *the obligation to supply goods, or both these obligations.* Sometimes a guarantee supports the countertrade commitment by way of securing payment under a liquidated damages or penalty clause covering the countertrade commitment. Guarantees may also be used to support liquidation of imbalances in the flow of trade (below, paragraphs *40 to 48*).

2. [2] Requiring guarantees may have the general advantage of preventing parties who are unreliable or who do not have sufficient financial resources from participating in the countertrade transaction. Guarantor institutions generally make careful inquiries about a party whose obligations they are asked to guarantee, and will normally provide guarantees only when they have reasonable ground for believing that the party can successfully perform the obligation. This may be of particular advantage to importers or exporters who are otherwise unable to determine whether *a* proposed counter-party is reliable.

3. [3] Depending upon its terms, a guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor *is obligated* to pay *when the party to whom the underlying obligation is owed (the "beneficiary") presents to the guarantor the demand for payment and any additional document required under the terms of the guarantee. A required document may be, for example, a beneficiary's statement that the party* who procures the guarantee (the "principal") *is in breach of the underlying obligation, a beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person or entity stating that the breach of the underlying obligation has occurred. The third person or entity, designated in the guarantee or in accordance with the guarantee, may be, for instance, an expert, a supervisory body, an arbitral tribunal or a court. An independent guarantee assures the beneficiary that, upon presenting the demand and any required document, prompt payment will be made even if* there *remains* disagreement between the principal and the beneficiary as to whether the underlying obligation has been breached. *The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and any supporting document conform to the requirements specified in the guarantee. (For further discussion on possible payment conditions, see below, paragraph 18.) If the question arises whether the principal is entitled to the recovery of the amount paid on the ground that the underlying obligation had not been breached, that question would be determined in any subsequent proceedings between the principal and the beneficiary. Even though the* guarantor's obligation to pay *is* independent from the underlying obligation, the *payment claim by* the beneficiary under the guarantee may, *in exceptional circumstances,* be excluded under the law applicable to the guarantee, in particular when the claim by the beneficiary is fraudulent.

4. [4] Under an accessory guarantee, the guarantor must pay only when the principal is in fact in breach of the guaranteed obligation. Such accessory guarantees are referred to in national laws by terms such as "suretyship", "*cautionnement*", "*fianza*", and "*Bürgschaft*". The guarantor must, before paying a claim, ascertain whether the underlying obligation was breached in order to establish whether the claim is justified, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary.

5. [5] The discussion in *this chapter* is limited to independent guarantees, without thereby implying a preference for this type of guarantee. Generally, independent guarantees are used to support obligations set out in the countertrade agreement. While principals tend to prefer accessory guarantees, beneficiaries are normally reluctant to accept such guarantees because of the possible delays involved in obtaining payment. Moreover, guarantors, in particular banks, tend to prefer independent guarantees because they do not wish to investigate the performance of the underlying obligation. While the various legal regimes governing accessory guarantees are well established, independent guarantees, essentially a creation of banking and commercial practice, are not yet firmly established in all *national laws* and there is no uniformity as regards the extent to which independent guarantees are recognized.

6. [6] In some countries banks issue "stand-by letters of credit", which are the functional equivalent of independent guarantees. Accordingly, the discussion in the legal guide on guarantees for security for performance by the principal applies to stand-by letters of credit.

B. Guarantee provisions in countertrade agreement

7. [7] When the parties decide to use a guarantee to support the countertrade commitment, they should include in the countertrade agreement certain basic provisions concerning the issuance and terms of the guarantee. The parties may also wish to consider appending to the countertrade agreement a form of a guarantee to be followed by the issuer in establishing the guarantee. In formulating the terms of the future guarantee in the countertrade agreement, the parties should be sure that the agreed formulation would be accepted by the guarantor.

8. [8] Typically it is the party committed to purchase whose commitment is supported by a guarantee. *This* is because the primary objective of that party in agreeing to a countertrade commitment is to secure a sale *of its own goods,* rather than to obtain goods from the other party. When the party committed to purchase goods has a particular interest in obtaining the goods, the supplier's commitment to conclude a contract for the supply of the agreed goods may be supported by a guarantee. *As noted in paragraph 1, in* some cases the countertrade agreement may require both the purchaser and the supplier to obtain guarantees to support their commitments. When the parties to

the countertrade agreement foresee that a third person may assume the countertrade commitment, the parties may wish to consider whether the guarantee should be procured by the *third party or by the party originally committed* (see chapter VIII, "Participation of third *parties*").

9. [9] When the guarantee supports the principal's obligation under a liquidated damages or penalty clause, the question whether a payment under the guarantee would free the principal from liability for fulfilment of the countertrade commitment *or from liability for any damages beyond the amount of the guarantee* would be settled by the terms of the liquidated damages or penalty clause and the rules applicable to the clause (see chapter XI, "Liquidated damages and *penalty clauses", sections B and C*). When the guarantee does not support a liquidated damages or penalty clause and the parties intend, as is sometimes the case, that payment under the guarantee would have the effect of freeing the principal from the countertrade commitment or from liability for any damages exceeding the amount paid under the guarantee, they should state their intention in the countertrade agreement. Without a provision to this effect, it cannot be assumed that payment under the guarantee would free the principal from the countertrade commitment or from liability for damages. *It should further be noted that the fact that the obligation is supported by a guarantee does not give the obligated party the option of choosing between fulfilling the underlying contractual obligation and having the guarantee amount paid.*

1. Choice of guarantor

10. [10] The parties may wish to specify in the countertrade agreement a guarantor who would be acceptable to both parties. That would enable the beneficiary to be satisfied that the guarantee would be issued by a guarantor that had the necessary financial reserves and that was otherwise acceptable. The identification of the guarantor could be useful to both parties in that it would limit subsequent disagreements and enable the parties to know the cost of the guarantee at the outset.

11. [11] If the guarantor is not identified at the time of the conclusion of the countertrade agreement, the parties may provide, for example, that the guarantor *must* be a first class bank, be agreeable to the beneficiary or be an institution from the home country of one of the parties.

12. [12] A beneficiary may wish to have the guarantee issued by an institution in its home country because enforcement of a claim for payment against such an institution *might* be easier than against a foreign institution. However, requiring the use of a local guarantor *might* be disadvantageous to the extent that the principal *would be* prevented from using a guarantor with whom it has an established relationship and who *might* provide the same guarantee at a lower cost. *Furthermore, the guarantor in the beneficiary's country may require that reimbursement of any payment under the guarantee be secured by a bank acting in behalf of the principal, which may involve additional cost (see below, paragraph 14).*

13. [13] In some *States*, mandatory rules applicable to the beneficiary provide that a guarantee may be accepted only if it is issued by a financial institution in the country or a financial institution authorized to issue guarantees involving payment in a foreign currency or if the selection of the guarantor is approved by the competent authority.

14. [*new paragraph*] When the guarantee is to be issued by a bank in the beneficiary's country, that bank will often issue the guarantee only if reimbursement is secured through the issuance of a "counter-guarantee". The counter-guarantee entitles the bank issuing the guarantee to claim prompt reimbursement from the counter-guarantor in accordance with the terms of the counter-guarantee. The counter-guarantee would often be issued by the principal's bank that has instructed the guarantor to issue the guarantee.

15. [*new paragraph*] A similar requirement that payment be guaranteed by a bank in the beneficiary's country may apply when the security takes the form of a stand-by letter of credit. Such a requirement may be met by confirmation by a local bank of the stand-by letter of credit issued by a foreign bank. The confirming bank would obtain reimbursement from the issuing bank. Also a security in the form of a guarantee is sometimes confirmed by a bank in the beneficiary's country. In the case of both a confirmed stand-by letter of credit and a confirmed guarantee, the beneficiary has an option between claiming payment from the confirming bank or from the issuing bank.

16. [14] There have been instances where an undertaking to pay a sum of money, termed a "guarantee", supporting the countertrade commitment or the payment of related liquidated damages or penalties has been made by the party whose countertrade commitment is to be guaranteed. The effect of such a "guarantee" is that the party-guarantor promises to pay the other party under the terms of the guarantee without raising any defence that could not have been raised by a third-party guarantor, and that it is up to the party-guarantor to sue for reimbursement of the funds paid if it is claimed that the underlying obligation had not been breached. Such a guarantee might be acceptable to the beneficiary if the guarantee is independent from the underlying transaction and is issued by a trading party whose commercial integrity and financial adequacy are regarded by the beneficiary as being beyond doubt. However, it is not clear that such a guarantee gives the beneficiary legal rights in addition to those arising from the obligation being guaranteed.

2. Conditions for obtaining payment under the guarantee

17. [15] The countertrade agreement should clearly set forth the conditions that have to be fulfilled in order for the guarantor to be obligated to pay, in particular, as to any documents that have to be submitted in support of a claim for payment. *If there is a lack of clarity, there is a greater likelihood that* disputes *would* arise *due to* uncertainty as to whether the documents presented by the beneficiary conform to the terms of the guarantee.

18. [16] The terms of an independent guarantee may provide that a demand for payment alone would suffice, *with the possible additional requirement* that the demand

would have to be accompanied by the beneficiary's statement concerning the breach. A general declaration to that effect may be sufficient. Alternatively, the beneficiary may be required to state more details, such as the nature of the principal's breach, that the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid. In addition to the demand for payment, the beneficiary may be required to present *a document* issued by a third person relating to the default by the principal; *such a document may be, for example, a certificate of an independent expert,* an arbitral award or *a first-instance* court decision stating that the default has occurred. The guarantee may provide that the requirement of a third-person statement would *not apply* if the principal makes an admission of default in writing. In all these cases, the guarantor merely ascertains whether the documents conform on their face to the requirements of the guarantee and is not to inquire into the underlying transaction. In particular, the guarantor is not to investigate whether the statements contained in a document are founded.

19. [17] Sometimes the parties agree that the beneficiary must notify the principal of the intention to call the guarantee and that the claim cannot be made before the expiry of a specified period of time following the notice. The purpose of such a notice requirement is to provide an opportunity to the principal to cure a breach or to settle a disagreement. A corollary guarantee term would require the beneficiary to submit with the demand for payment documentary evidence that notice had been given to the principal.

20. [18] Where the guarantee supports the payment obligation under a liquidated damages or penalty clause, the parties may wish to stipulate that among the payment conditions would be a requirement that the beneficiary *must* provide a statement that payment under the liquidated damages or penalty clause *was* due.

21. [19] In addition to documentary conditions, a guarantee will usually specify requirements that do not pertain to the performance of the underlying obligation. Such requirements, which do not involve the presentation of a document, most frequently concern the time period within which a claim can be made, the amount of the guarantee, and the office of the guarantor where the claim is to be submitted.

22. [20] It is advisable that the countertrade agreement, in addition to setting out the agreement of the parties as to the guarantee, provide that the beneficiary is entitled to claim under the guarantee only if there is in fact a failure to fulfil the commitment. Such a provision might facilitate recovery by the principal of losses suffered in the event *that* a claim *is* paid without there having been a breach of the underlying obligation.

3. Amount of guarantee and reduction of amount

23. [21] The parties should agree on the amount of the guarantee, as well as the currency in which it is to be denominated and payable. The amount of the guarantee is expressed as a specified amount or as a percentage of the value of the outstanding commitment. If the guarantee is *to support* payment under a liquidated damages or penalty clause, the guarantee clause in the countertrade agreement may call for *the guarantee to cover* payment of the entire amount of the liquidated damages or penalty or *of* a portion thereof. The liquidated damages or penalty may itself be a certain percentage of the unfulfilled countertrade commitment. *(Concerning the amount of the liquidated damages or a penalty, see chapter XI, section D.)*

24. [22] In determining the amount of the guarantee, or of the liquidated damages or penalty covered by the guarantee, the parties would take into account factors such as the extent of the losses expected to be suffered in the event of non-fulfilment and the risk of failure to fulfil, as well as the limits which guarantors would usually observe in respect of similar contracts. Another factor may be the ease with which payment of a claim under the guarantee *could* be obtained. In this respect, the beneficiary generally has a trade-off to make. The closer the terms of the guarantee approach that of a simple demand guarantee and the easier it will be to obtain payment, the less willing the principal *might* be *to provide a* guarantee *covering* a high percentage of the countertrade commitment. On the other hand, if the documentary conditions are more difficult to meet when the principal has not breached the commitment (e.g., when an arbitral or court decision must be presented), the principal *might* be willing to agree on a higher amount for the guarantee.

25. [23] The parties may wish to include in the terms of the guarantee a mechanism to reduce the amount of the guarantee as fulfilment of the countertrade commitment progresses. Reduction of the guarantee amount would have the advantage of reducing the exposure under the guarantee and possibly the cost of the guarantee. If the guarantee secures payment of liquidated damages or a penalty, the provisions on the reduction of the guarantee should be consistent with any reduction mechanism for the sum of the liquidated damages or penalty.

26. [24] It is advisable that the reduction mechanism operate on the basis of the presentation to the guarantor of specified documents evidencing fulfilment of the countertrade commitment, without the guarantor being obligated to verify the degree to which the countertrade commitment has been fulfilled. These documents may include shipping documents, copies of supply contracts, purchase orders, letters of release or other documents recording fulfilment. The parties may also find it useful to stipulate the issuer of the documents and the party responsible for forwarding them to the guarantor. Where the fulfilment period is divided into subperiods, the parties may wish to provide that the guarantee will be reduced by the amount allocated for each subperiod and not claimed within the agreed period of time.

4. Time of providing guarantee

(a) *At entry into force of countertrade agreement or shortly thereafter*

27. [25] The parties are advised to agree on the point of time when the guarantee is to be issued. It may be agreed, for example, that the guarantee should be issued to the

beneficiary when the countertrade agreement enters into force or shortly thereafter (e.g., thirty days after entry into force of the countertrade agreement). The parties may obtain assurance that the guarantee would be procured at the agreed time by providing that the countertrade agreement would not enter into force without procurement of the guarantee or that the principal would be deemed to have breached the countertrade commitment if the guarantee was not procured within the agreed period of time.

28. [26] When a contract in one direction (export contract) is concluded together with the countertrade agreement, the parties could agree that the issuance of a guarantee supporting fulfilment of the countertrade commitment is a condition for the entry into force of the export contract. Such a provision would assure the importer of not being bound under the export contract before issuance of a guarantee to support the countertrade commitment.

(b) *Later in fulfilment period*

29. [27] The parties may agree that the guarantee *would only* have to be procured *at* a certain date later in the fulfilment period *if by that time* fulfilment of the commitment *was not yet* completed. The agreed date may be, for example, three months before the end of the fulfilment period or three months before the end of each yearly segment of a multi-year fulfilment schedule. This approach has the advantage that the amount of the guarantee could be calculated as a percentage of the then outstanding countertrade commitment. By making the amount of the guarantee dependent on the outstanding balance rather than on the entire countertrade commitment and by limiting the length of time during which a guarantee is in effect, the extent of exposure under the guarantee as well as the cost of the guarantee are likely to be reduced.

30. [28] Since such an approach exposes the beneficiary to the risk that the guarantee will not be procured, the parties may wish to agree on the beneficiary's rights in the event the guarantee is not procured as agreed. It may be agreed that the beneficiary would be permitted to regard the countertrade commitment as breached and to claim payment under a liquidated damages or penalty clause. Furthermore, it might be agreed that the beneficiary would be entitled to deduct the amount of the liquidated damages or penalty from any amounts becoming due under the export contract after the failure to procure the guarantee.

5. *Duration of guarantee*

(a) *Expiry date*

31. [29] It is advisable for the parties to agree *on the clause that should be included in the guarantee concerning* the length of time the guarantee is to remain in force. *It should be noted that, in view of the independence of the guarantee from the underlying countertrade agreement, the clause in the countertrade agreement concerning the period of validity of the guarantee will not determine the duration of the guarantee as specified in the guarantee. Guarantees usually contain* a fixed expiry date. *Another possibility would be* to provide for an open-ended guarantee that would terminate only when *the countertrade commitment was fulfilled* or the committed party *was* otherwise released from the commitment (see chapter *IV, "Countertrade commitment", paragraphs 35 to 37*). It should be noted that most guarantors *would* be willing to issue guarantees only if the expiry date is fixed. *It should also be noted that the laws of some States contain mandatory rules governing the validity period of guarantees.* *

32. [30] It is advisable that the expiry date of the guarantee fall after the end of the period for the fulfilment of the countertrade commitment. A period of time between expiry of the fulfilment period and expiry of the guarantee (e.g., thirty days) would allow the beneficiary to await the conclusion of supply contracts until the close of the fulfilment period without foregoing the possibility of claiming payment under the guarantee. Furthermore, the beneficiary, at its discretion, would be able to allow minor delays attributable to the principal in the fulfilment of the countertrade commitment without foregoing the possibility of claiming payment under the guarantee. At the same time, *if kept* relatively short, *the* interval would allow the liability of the guarantor to be resolved relatively soon after the alleged non-fulfilment of the countertrade commitment has taken place. The parties may also wish to apply such an approach in relation to guarantees covering subperiods of a fulfilment period.

33. [*new paragraph*] In the absence of a provision in the guarantee defining the effect of the expiry date, it is widely understood that a demand for payment, accompanied by any required documents, must be made before or on the expiry date, and that, accordingly, the guarantor is not obligated to pay any demand made after that date. However, according to the interpretation of courts of some jurisdictions, absent a provision to the contrary, the demand for payment can validly be made after the expiry date, provided that the contingency for which the guarantee had been given has occurred before or on the expiry date. Under such an interpretation, a demand for payment may be made either within a reasonable period of time after the expiry date or, according to some courts, even during a period of limitation or prescription.

[31] *

(b) *Return of guarantee instrument*

34. [32] *In some States* a guarantee may remain in force even after the expiry date if the guarantee instrument is not returned by the beneficiary. The countertrade agreement should therefore obligate the beneficiary to return the guarantee promptly upon fulfilment of the guaranteed obligation. However, the obligation to return the guarantee should be drafted so as not to imply that if the guarantee is not returned it remains in force even after the expiry date.

(c) *Extension*

35. [33] For various reasons, the time period for fulfilment of the countertrade commitment may be extended and as a result continue beyond the expiry date of the guarantee

(see chapter *IV, "Countertrade commitment", paragraphs 13 to 16*, concerning extension of the fulfilment period). The countertrade agreement might provide that, if the fulfilment period is extended, the principal would be obligated to arrange within a reasonable period of time a corresponding extension of the guarantee. Alternatively, the guarantee might provide for an automatic extension to cover any extension of the underlying fulfilment period agreed to by the parties. However, such a provision might not be acceptable to a guarantor who *did* not wish to be bound by a guarantee *the* duration *of which would depend* on an agreement to which the guarantor *was* not a party.

36. [34] With respect to the cost of extending the period of validity of the guarantee, the parties may wish to agree that the party responsible for the extension of the fulfilment period *would* be obligated to bear the costs of the extension of the guarantee period.

6. Modification or termination of countertrade agreement

37. [35] In *national laws* that recognize the agreement of the parties to establish an independent guarantee, an independent guarantee would remain in effect as stipulated regardless of changes in the underlying commitment. If the change in the underlying contract affects the possibility to obtain the documents *required to* support of the payment claim under the independent guarantee, it should be ensured that the change in the underlying contract *is* reflected by a corresponding modification of the guarantee terms.

38. [36] Under some *national laws* that do not fully recognize an independent guarantee, an alteration of the underlying commitment may result in the release of the guarantor; under other such *national laws*, the guarantee may be deemed to cover only the commitment of the principal existing at the date of issuance of the guarantee. With a view to avoiding undesired consequences, the parties may provide that the guarantee would remain in force despite modifications of the countertrade agreement.

39. [37] The modification of the countertrade agreement may extend the liability of the principal beyond the amount of the guarantee. The parties may wish to provide in the countertrade agreement that in those cases the principal would be obligated to ensure that the amount of the guarantee would be modified accordingly.

C. Guarantee for imbalance in trade

40. [38] The parties may agree that goods will be shipped in exchange for goods and that the shipments in each direction will not be paid for in money. This type of transaction may be based on a barter contract (see chapter III, "Contracting approach", paragraphs *3 to 8*) or on the setoff of countervailing claims for payment (see chapter IX, "Payment", *section D*). In such cases a supplier runs the risk that the value of its shipments may exceed the value of goods received from the other party and that this *imbalance* is not liquidated, either by supplies of goods or through payment in money. In order to address this risk, the parties may use guarantees to secure liquidation of an imbalance that may develop in the flow of trade. *It may be agreed that the imbalance should be liquidated at the end of the period for the fulfilment of the countertrade commitment or at specified points of time during that period.*

41. [39] The amount of the guarantee should be linked to the amount of the imbalance in the flow of trade, with an upper limit. This upper limit for the guarantee could be set at the level of imbalance permitted under the countertrade transaction. It may be agreed that the amount that could be claimed under the guarantee would cover less than the full extent of the imbalance (e.g., 80 per cent). The purpose of such an approach would be to discourage the calling of the guarantee except as a last resort. A beneficiary who *could not* recover the full amount of the imbalance by calling the guarantee would have a greater incentive to achieve the agreed balance in the flow of trade through ordering goods from the other party.

42. [*new paragraph*] When a third person holds information concerning the flow of the deliveries between the parties (e.g., the bank administering the setoff account), it can be stipulated in the guarantee that a demand for payment must be accompanied by a statement by that third person certifying the amount of the outstanding imbalance. Furthermore, the guarantee can stipulate that the guarantor is authorized to pay a demand only up to the amount of the certified imbalance.

1. Guarantee for shipment in one direction

43. [41] Where a particular sequence of shipments in the two directions is stipulated, the countertrade agreement may provide that the party scheduled to receive goods first must provide a guarantee supporting the obligation to ship goods in return. This guarantee would cover the risk taken by the party that ships first that the return shipment fails to take place by the agreed date or is not of the agreed value or quantity. When the first shipment is to take place in stages, it may be agreed that with each partial shipment a separate guarantee is to be provided corresponding to the value of that shipment; alternatively, *the parties and the guarantor may agree that the guaranteed amount will increase* upon the presentation of documents evidencing additional shipments.

44. [41] With respect to the timing of the issuance of the guarantee, the countertrade agreement may provide that the guarantee is to be handed over to the beneficiary in exchange for the shipping documents relating to the first delivery. Such a procedure would safeguard against the possibility that the party scheduled to ship first *would be given* the guarantee but *would then fail* to ship. In order to ensure that the beneficiary of the guarantee (the party that has shipped first) would not be in a position to claim payment under the guarantee once the principal (the party shipping second) has fulfilled its obligation to ship goods, the countertrade parties may agree that the beneficiary of the guarantee would obtain documents of title to the second shipment only upon surrender of the guarantee instrument.

45. [42] Guarantees may be used in a similar fashion in multi-party countertrade transactions. When the parties link deliveries in such a fashion that the importer, in exchange

for goods received from the exporter, ships goods to a third-party counter-importer, the third-party counter-importer pays the exporter (see chapter IX, "Payment", *paragraph 68*). The guarantee, provided by the importer, would support the obligation to counter-export after receiving the export goods. When the exporter is to be paid by the counter-importer upon shipment of the export goods, the counter-importer would be the beneficiary of the guarantee. Such a guarantee would cover the risk taken by the counter-importer in paying the exporter prior to receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon receipt of the counter-export goods, the exporter would be the beneficiary of the guarantee. Such a guarantee would cover the risk that the exporter, having shipped goods, failed to be paid by the counter-importer because the counter-export did not take place.

46. [43] A similar guarantee may be used when the exporter, instead of being paid by the importer, receives goods from a third-party counter-exporter, who in turn is paid by the importer (see chapter IX, *paragraph 68*). In this case, it may be agreed that the exporter would be given a guarantee covering the risk that, having shipped first, the exporter failed to be compensated by a shipment of goods from the counter-exporter.

47. [44] A guarantee may be employed in a similar fashion when both the counter-importer and the counter-exporter are separate parties from the exporter and the importer (see chapter IX, *paragraph 69*). It may be agreed that the importer must provide a guarantee to the exporter to support the importer's obligation to pay the price of the export goods. When the exporter is to receive payment from the counter-importer upon shipment of the export goods, the beneficiary would be the counter-importer. This would protect the counter-importer against the risk of paying the exporter without receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon shipment of the counter-export goods, the beneficiary of the guarantee would be the exporter. This would protect the exporter against the risk of shipping goods without being paid.

2. Mutual guarantees

48. [45] When the parties agree to exchange goods for goods, they may do so without stipulating a particular sequence in which the shipments in the two directions should take place. This is particularly likely when multiple shipments in each direction are envisaged. In such situations, both parties encounter the risk of an imbalance in the flow of trade which needs to be redressed either through the shipment of goods or through the payment of a sum of money. To address this risk, it may be agreed that each party is to provide a guarantee to secure liquidation of an imbalance in favour of the other party.

[A/CN.9/362/Add.13]

XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION

CONTENTS

		Paragraphs
A.	General remarks	1-5
B.	Remedies	6-12
	1. Release from part or all of countertrade commitment	6-10
	2. Monetary compensation	11-12
C.	Exempting impediments	13-36
	1. Legal consequences of exempting impediments	17-18
	2. Defining exempting impediments	19-34
	(a) General definition	20-22
	(b) General definition with list of exempting impediments	23-26
	(i) General definition with illustrative list	24
	(ii) General definition with exhaustive list	25
	(iii) General definition with list of exempting impediments whether or not they come within definition	26
	(c) Exhaustive list of exempting impediments without general definition	27
	(d) Possible exempting impediments	28-32
	(e) Exclusion of impediments	33-34
	3. Notification of impediments	35-36
D.	Effect on countertrade transaction of failure to conclude or perform supply contract	37-61
	1. Failure to conclude supply contract	43-48
	2. Termination of supply contract	49-55
	3. Failure to pay	56-60
	4. Failure to deliver goods	61

[*Editorial note*: The present draft chapter is a revision of draft chapter XIII, "Failure to complete countertrade transaction", published as document A/CN.9/WG.IV/WP.51/Add.4. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.4 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.4 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [1] This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). *The chapter* also discusses circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (section D). A further issue discussed in the present chapter is the effect of a failure to fulfil the countertrade commitment or of the failure to perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section E). Not discussed are remedies for non-performance of a supply contract concluded pursuant to the countertrade agreement, since such remedies are of a type available under contract law generally and do not raise issues specific to countertrade.

2. [*new paragraph*] The discussion in this chapter is set in the context of "firm" countertrade commitments, i.e., commitments in which a party undertakes to actually conclude a supply contract in accordance with the terms stipulated in the countertrade commitment. As noted in chapter IV, paragraph 2, the Legal Guide does not deal with countertrade commitments containing a lower degree of commitment (e.g., "best efforts" or "serious intention" types of commitment), under which the undertaking is limited to an obligation to negotiate in good faith without promising that a contract will actually be entered into.

3. [2] Failure by a party to fulfil its obligations under the countertrade transaction could have serious repercussions for the other party. The repercussions may be, for example, that a prospective supplier will not earn convertible funds planned to be used for the purchase of other goods, that a prospective supplier will be hampered in carrying out its plan to introduce countertrade goods into new markets, or that a prospective purchaser will not receive goods to be resold in order to pay for goods shipped in the other direction.

4. [3] It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National *laws* generally do not contain rules specifically tailored to countertrade, and general rules applicable to contractual obligations may not provide satisfactory answers when problems occur in fulfilling the countertrade commitment. The remedies that the parties might wish to address in the countertrade agreement include release from the countertrade commitment and liquidated damages or a penalty (see below, paragraphs 5 to 13). It is also advisable that the countertrade agreement define the circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (see below, paragraphs 14 to 37).

5. [4] The remedies for non-fulfilment of the countertrade commitment that the parties have decided to include in a countertrade agreement may not be appropriate in every circumstance. Therefore, while a party has the right to insist upon the remedies set forth in the countertrade agreement, the parties may find it desirable to negotiate in the light of the available remedies before resorting to the procedures available to enforce them (see discussion on negotiation in chapter XV, "Settlement of disputes", paragraphs *8 to 11*).

B. Remedies

1. Release from part or all of countertrade commitment

6. [5] There are various circumstances in which a party may be released from its obligations under the countertrade commitment. Such a release can result from a payment of liquidated damages or a penalty stipulated in the countertrade agreement for non-fulfilment of the countertrade commitment (*see chapter XI,* "Liquidated damages and penalty clauses", paragraph *[12]) or when the countertrade commitment is terminated after the payment of liquidated damages or a penalty covering delay have reached the agreed cumulative limit (see chapter XI, paragraph [19]).* A release of a party may also result when an action or omission by the other party causes the failure to fulfil the commitment (see paragraph 6 below). A further ground for a release may be the occurrence of circumstances that the applicable law or the countertrade agreement defines as exempting impediments (see paragraphs 14 to 37 below). Yet another situation in which a party may be released is when the supply contract in the other direction is terminated (see paragraph 48 below). A party may be released from all of the unfulfilled countertrade commitment or from only a portion thereof. If the circumstances that give rise to the release affect only a portion of the unfulfilled countertrade commitment, the remaining portion of the countertrade commitment remains in effect.

7. [6] *A party may be entitled, in accordance with legal rules generally applicable to the breach of a contractual obligation, to be released from the countertrade commitment if the other party fails to take the action necessary to fulfil the commitment. Nevertheless, the parties may wish to address in the countertrade agreement the question of the release from the countertrade commitment in order to establish a clear understanding as to the instances in which a party is to be released and as to the extent of release. This could take the form of a clause to the effect that,* if the party committed to supply breaches its obligation to make available a portion or all of the goods in accordance with the terms of the countertrade agreement, the party committed to purchase is released from an equivalent portion or all of the countertrade commitment. Similarly, the parties may wish to agree that, if the party committed to purchase breaches its obligation to purchase a portion or all of the goods made available in accordance with the terms of the countertrade agreement, the party committed to supply is released from an equivalent portion or all of the

countertrade commitment. When the parties so agree, they may wish to establish a notice requirement. Such a requirement might specify that the aggrieved party has to deliver a notice to the party in breach specifying the breach and informing the party in breach that the aggrieved party would be released from its obligations under the countertrade commitment to the extent that the breach was not remedied within a period of time specified in the notice or in the countertrade agreement. The period of time should be of a sufficient length to allow the remedying of the breach. The parties may wish to provide that the period of time commences to run from the date of the delivery of the notice. The parties may wish to consider whether it would be desirable to provide that, for the release to take effect, a second written notice would have to be delivered by the party claiming release.

8. [7] Sometimes the countertrade agreement sets subperiods within the fulfilment period in which specified portions of the countertrade commitment must be fulfilled (for a discussion of such subperiods, see chapter *IV, "Countertrade commitment"*, paragraphs *17 to 20*). Such schemes often provide that a committed party that fails to fulfil the commitment allocated to a given subperiod may carry over a portion of the unfulfilled commitment to the following subperiod and that the party in breach must pay liquidated damages or a penalty on the unfulfilled portion that is not carried over. In such cases it may be provided that the party in breach is to be given an additional period of time, after the expiry of the subperiod, to remedy the breach (see the preceding paragraph).

9. [8] It should be noted that, *as to the termination of contracts as a result of a breach,* some *national laws* contain special requirements. For example, it may be required that additional time be granted to remedy the breach, that notice of intent to terminate be given, or that judicial consent be given. *To the extent a countertrade agreement is regarded as governed by the rules applicable to contracts, those* requirements *would* be applicable.

10. [9] The countertrade agreement may provide that, if a release results from circumstances not attributable to either party (e.g., an exempting impediment), each party is to bear its own expenses and losses.

2. Monetary compensation

[10] *

[11] *

11. [12] It might be possible for the party who suffered loss as a result of a failure to fulfil a countertrade commitment to claim, on the basis of legal rules generally applicable to a breach of a contractual obligation, damages from the party who failed to fulfil the commitment. The problem of liability for failure to fulfil a countertrade commitment raises the question of pre-contractual liability. The answer to this question is often not clear in *national laws*, the approaches to the question differ under *the laws of* various *States*, and *in some States* the law of pre-contractual liability is undeveloped. A further source of uncertainty is the basis on which the extent of the damages would be calculated. If the important terms of the future supply contract (in particular type, quality and price of goods) are not sufficiently defined in the countertrade agreement, there would be an insufficient basis on which to calculate damages resulting from a failure to conclude that contract.

12. [*new paragraph*] If the parties agree that a party should obtain monetary compensation as a result of non-fulfilment of the countertrade commitment, they may, in order to avoid the uncertainties mentioned in the previous paragraph, include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalty clauses").

[12] *

C. Exempting impediments

13. [14] During the course of the period for fulfilment of the countertrade commitment, events may occur that impede a committed party to conclude an envisaged supply contract. An impediment may be of a legal nature, such as a change of regulations in the purchaser's or the supplier's country prohibiting the import or export of certain types of goods. An impediment may also be of a physical nature, such as a natural disaster preventing the production, transport or taking delivery of countertrade goods. Impediments may prevent fulfilment of the countertrade commitment permanently or only temporarily. The party who fails to fulfil its countertrade commitment due to an impediment may, subject to the applicable law and to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or be released altogether from the countertrade commitment, and be exonerated from liability to pay damages. Impediments that give rise to such an exemption are referred to in the Legal Guide as "exempting impediments".

14. [15] Many *national laws* contain rules concerning exempting impediments. *If an event impeding fulfilment of the countertrade commitment has the characteristics set forth in the applicable law (such as that the event was unforeseeable and unavoidable) the parties would be released from the commitment as a result of those rules.* However, those rules may lead to results that are incompatible with the circumstances and needs of international countertrade transactions or do not allocate the risk of occurrence of exempting impediments as desired by the parties. Therefore, the parties may wish to include in their countertrade agreement an exemption clause defining exempting impediments and specifying the legal consequences of those impediments. It is advisable for the parties to select terminology that is, in the light of the applicable law, consistent with their intentions (see *chapter V*, "General remarks on drafting", paragraph 6).

15. [16] In the negotiation of the clause in the countertrade agreement on exempting impediments, it is in the interest of each party to have included in the clause the types of exempting impediments that could affect the ability of that party to take the actions required to fulfil the countertrade commitment. For example, the party commit-

ted to purchase would be interested in covering impediments such as import restrictions and physical impediments to the taking of delivery or the use of the goods. The party committed to supply goods would be interested in covering impediments such as restrictions on goods permitted to be exported in countertrade transactions and other export restrictions and certain impediments affecting the ability to produce the goods. *Under* the generally accepted principle of freedom of contract, the parties have latitude to agree on which of the parties is to bear the risk that a particular type of event *that impedes* performance may occur. Accordingly, they *could* exclude from the list of exempting impediments events that would be treated as exempting impediments by the applicable law and to include other events that would not be so treated by the applicable law. *It should be noted, however, that some national laws establish mandatory limits to the freedom of a party to waive its right to rely on exempting impediments recognized under the law.*

16. [17] The treatment in various *national laws* of the subject of exemption differs with respect to the conceptual underpinnings of the subject and the terminology used. In relation to exemptions in the context of sales contracts, those differences have been bridged by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79.[1] The approach adopted in that Convention has been designed to take into account the particular circumstances and needs of international trade. The parties may find that approach to be a useful guide in formulating an exemption clause in a countertrade agreement. The discussion in this chapter of the legal consequences of exempting impediments and the definition of exempting impediments is based upon the approach taken in the Convention.

1. Legal consequences of exempting impediments

17. [18] The parties may wish to provide that, when fulfilment of the countertrade commitment is prevented by exempting impediments not exceeding a specified duration (e.g., 6 months), the fulfilment period would be extended for a period of time corresponding to the duration of the impediment. The purpose of such a provision would be to ensure that exempting impediments of a limited duration would not release the parties from the countertrade commitment. The parties may wish to stipulate in the countertrade agreement that, if an exempting impediment invoked by a party lasts longer than a specified duration, the other party may claim release from the countertrade commitment, or it may be agreed that either party may do so. The parties may wish to include in such a stipulation the obligation to engage in negotiations aimed at modifying the countertrade agreement in order to preserve the countertrade commitment.

18. [19] As discussed in chapter XI, "Liquidated damages and penalty clauses", *paragraph [7]*, in order to eliminate any uncertainty, the parties may wish to provide expressly that a party failing to fulfil the countertrade commitment due to an exempting impediment is exempt from the payment of liquidated damages or penalties, or of any damages that would otherwise be due under the applicable law.

2. Defining exempting impediments

19. [20] *While many national laws contain definitions of exempting impediments, the parties may wish, for reasons noted above in paragraph [15],* to include in the countertrade agreement a definition of exempting impediments. The parties may wish to adopt one of the following approaches: *(a)* providing only a general definition of exempting impediments; *(b)* combining a general definition with a list of exempting impediments; *(c)* providing only an exhaustive list of exempting impediments.

(a) *General definition*

20. [21] A general definition of exempting impediments would enable the parties to ensure that all events having the characteristics set forth in the definition would be considered as exempting impediments. The purpose of a general definition is also to exclude events that do not meet those characteristics. This approach would avoid the need to compile a list of exempting impediments, and would avoid the risk of omitting from the list events that the parties would have considered as exempting impediments. On the other hand, it could be difficult in some cases to determine whether or not a particular event was covered by the general definition.

21. [22] The parties may wish to *clarify in the definition that* fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see above, paragraphs 14 *and 15*), and not, for instance, only made inconvenient or more expensive. It should be noted, however, that a change in circumstances may occur that makes fulfilment of the countertrade commitment, while still physically possible, excessively costly, beyond what a party could be expected to have foreseen and to have to bear. Such an extreme change in circumstances may be regarded under the applicable law as an exempting impediment. In addition, the parties may wish to provide that the impediment must be beyond the control of the party failing to fulfil a countertrade commitment and that that party could not reasonably be expected to have taken the impediment into account at the time the countertrade agreement was entered into or to have avoided or overcome the impediment or its consequences *(this wording is modelled on article 79 of the United Nations Sales Convention).*

22. [23] Contractual clauses on exempting impediments sometimes merely list a number of exempting impediments and indicate that other similar events would also be considered as exempting impediments. In such a clause, the listed events serve as an indication whether an event not included in the list should be regarded as an exempting impediment. Nevertheless, inclusion of a general definition in the clause is likely to reduce uncertainty *as to* whether an event not included in the list should be regarded as an exempting impediment.

[1] *Official Records of the United Nations Conference on Contracts for the International Sale of Goods* (document A/CONF.97/18, annex 1); *Yearbook of the United Nations Commission on International Trade Law*, vol. XI:1980, part three, B.

(b) *General definition with list of exempting impediments*

23. [24] A general definition of exempting impediments might be followed by either an illustrative or exhaustive list of events that are to be regarded as exempting impediments. This approach would combine the flexibility afforded by a general definition with the certainty arising from the specification of exempting impediments.

(i) *General definition with illustrative list*

24. [25] Examples of exempting impediments to be included in an illustrative list may be chosen so as to clarify the scope of the general definition. Such an approach could give guidance as to the intended scope of the general definition and ensure that the events set forth in the list would be treated as exempting impediments if they meet the criteria set forth in the general definition.

(ii) *General definition with exhaustive list*

25. [26] A general definition of exempting impediments might be followed by an exhaustive list of events that are to be regarded as exempting impediments if *in a given case* they meet the criteria contained in *the definition*. An exhaustive list may be inadvisable unless the parties are certain that they can foresee and list all events which they would wish to be regarded as exempting impediments.

(iii) *General definition with list of exempting impediments whether or not they come within definition*

26. [27] A general definition of exempting impediments might be followed by a list of events that are to be regarded as exempting impediments whether or not they come within the general definition. This approach may be useful where parties choose a narrow general definition of exempting impediments, but wish certain events that do not fall within the scope of that definition to be regarded as exempting impediments. Since those events would constitute exempting impediments independently of the general definition, the remarks in paragraph 28 below, concerning safeguards that may be adopted when providing a list of exempting impediments without a general definition, are also applicable here.

(c) *Exhaustive list of exempting impediments without general definition*

27. [28] It is possible for an exemption clause simply to provide an exhaustive list of events that are to be considered exempting impediments, without a general definition. This approach has the disadvantage of not providing general criteria in a definition that the listed events must meet in order to be regarded as exempting impediments. Since such general criteria are not provided, it is advisable for the parties to describe the exempting impediments on the list as precisely as possible. The advantage of such precision is certainty as to the allocation of risk between the parties.

(d) *Possible exempting impediments*

28. [29] If the parties set forth in the exemption clause a list of events that are to be considered exempting impediments, with or without a general definition, they may wish to consider whether it is desirable to include events such as fire, explosion and trade embargo. Furthermore, the parties may wish to narrow the scope of the events listed below.

29. [30] *Natural disasters.* Natural disasters such as storms, cyclones, floods or sandstorms may be normal conditions at a particular time of the year at the relevant location. In such cases, the countertrade agreement contract might preclude a party from invoking them as exempting impediments if they were foreseeable and if effective counter-measures could have been taken (see paragraph 23 above).

30. [31] *War (whether declared or not), other military activity or civil unrest.* It may be difficult to determine when a war, other military activity or civil unrest can be considered as preventing performance of an obligation. For instance, hostilities may be taking place in the country of a party, but, if commercial activities by that party continue, the hostilities may not actually prevent a party from fulfilling the countertrade commitment. If the countertrade agreement does not contain a general definition of exempting impediments, it may be desirable to specify clearly when a war, other military activity or civil unrest is considered to prevent fulfilment of a countertrade commitment.

31. [32] *Strikes, boycotts, go-slows and occupation of factories or premises by workers.* The parties may wish to consider whether and the extent to which these events are to be considered as exempting impediments. On the one hand, such events could in a real sense prevent a party from fulfilling its commitment. On the other hand, the parties might consider that it would not be advisable for a party to be exempted from the consequences of a failure to fulfil a commitment when the failure resulted from the conduct of its own employees. In addition, it may be difficult to determine whether or not strikes by employees and other labour disputes are avoidable by a party, and what measures the party might reasonably be expected to take to avoid or to end the strike or dispute (e.g., meeting the strikers' demands). *

32. [33] *Shortages of raw materials needed in production.* The parties may wish to consider whether this is to be considered as an exempting impediment. They might, for example, consider that it is the obligation of a party to procure raw materials in time and, therefore, preclude a claim for an exemption if the raw materials had not been procured. In some cases, the party may fail to have the materials available on time due to a delay by its supplier. For those cases, however, it would be advisable for the party to ensure that the contract with its supplier of the materials provides for damages for failure to supply the materials.

(e) *Exclusion of impediments*

33. [34] Whichever approach to defining exempting impediments is adopted, the parties may wish further to clarify the scope of an exemption clause by expressly excluding some events. For example, the parties may wish to

exclude from exempting impediments events that occur after a breach of the countertrade commitment by a party and that, but for the breach, would not have prevented fulfilment of the commitment by that party.

34. [35] The parties may wish to consider whether certain acts of a State or of State organs are to be regarded as exempting impediments. A party may be required to secure a licence or other official approval for the conclusion of a supply contract. The countertrade agreement might provide that, if the licence or approval is refused by a State organ or if it is granted but later withdrawn, the party that was required to obtain the licence or approval cannot rely on the refusal or withdrawal as an exempting impediment. The parties might consider that it is equitable for the consequences of the absence of the licence or approval to be borne by the party that had the duty to obtain it, since that party undertook the countertrade commitment knowing of the necessity to obtain the licence or approval and the possibility of its being refused. Moreover, it might be difficult for the other party to determine whether the measures taken to obtain the licence or approval were reasonable (see paragraph 23 above). *The parties may wish to stipulate the circumstances in which the party who is required to obtain the licence could be exonerated by proving that the licence was refused or withdrawn for a reason not attributable to that party (for example, when after the conclusion of the countertrade agreement the Government imposed a licence requirement or changed its policy regarding granting or withdrawing licences).*

3. Notification of impediments

35. [36] It is desirable for the countertrade agreement to *clarify that* a party invoking an exempting impediment *must* give written notice of the impediment to the other party without undue delay after the party invoking the impediment *learned of the* occurrence of the impediment. This notification could facilitate the taking of measures by the other party to mitigate any loss. *Such an obligation of notification and mitigation of losses exists under the general principles of contract law of many national laws.* It may be required that the notice specify details of the impediment, together with evidence that the fulfilment of a countertrade commitment by the party is prevented or is likely to be prevented, and, if possible, the anticipated duration of the impediment. The party invoking the exempting impediment might also be required to continue to keep the other party informed of all circumstances that may be relevant for an ongoing appraisal of the impediment and its effects, and to notify the other party of the cessation of the impediment. It may be provided that a party who fails to notify the other party in time of the exempting impediment loses the right to invoke the exempting impediment. Alternatively, it may be provided that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the failure. The countertrade agreement might also provide that an exempting impediment, or certain types of exempting impediments, must be verified, for example, by a public authority, notary public, a consulate or chamber of commerce in the country where the impediment occurred.

36. [37] Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to consider *jointly* what measures to take in order to prevent or limit the effects of the impediment, and to prevent or mitigate any loss that may be caused by it. These measures might include renegotiation of the countertrade agreement (see paragraph 18 above).

D. Effect on countertrade transaction of failure to conclude or perform supply contract

37. [38] *A basic* feature of a countertrade transaction, *as noted in chapter II, paragraph 1,* is the link between the supplies of goods in the two directions in that the conclusion of the contract for the supply of goods in one direction is conditioned upon the conclusion of the contract for the supply of goods in the other *direction.* In view of this link, a question may arise whether a failure to conclude a supply contract or a failure to perform an existing supply contract in one direction should have an effect on the obligation to conclude a supply contract or to perform an existing supply contract in the other direction. For example, if in a counter-purchase transaction the export contract is terminated, the question may arise whether the exporter is entitled to be released from its obligations to purchase goods pursuant to the countertrade commitment. Similarly, if in a counter-purchase transaction the exporter fails to take the action necessary to fulfil the countertrade commitment, the question may arise whether the counter-exporter is entitled to suspend payment under the export contract or to terminate the export contract.

38. [*new paragraph*] Such questions of interdependence may arise also in multi-party countertrade transactions. For example, in a tripartite transaction involving the exporter, the importer who is also the counter-exporter, and a third-party purchaser, the question may arise whether the failure by the third party to purchase the goods entitles the importer to suspend payment for goods purchased from the exporter. In another example, in a four-party countertrade transaction, the question may arise whether the failure to conclude or perform a supply contract between one pair of parties entitles a party to the contract in the other direction to suspend performance of the contract or to terminate the contract. (Multi-party countertrade is described in chapter VIII, section D; for a discussion of linked payment mechanisms in multi-party countertrade, see chapter IX, section F.) The discussion in this section applies to countertrade transactions between two parties as well as to transactions involving more than two parties.

39. [*new paragraph*] While it is advisable, as discussed below, to include in the countertrade agreement provisions dealing with the interdependence of obligations, it is also advisable, when a problem arises in the completion of the transaction, for the parties to endeavour to find a negotiated solution. Negotiating a modification *of the* countertrade transaction is often preferable to a suspension or termination of the countertrade commitment or a supply contract.

40. [39] Many national *laws* contain general *rules that* provide an answer regarding interdependence of obligations incorporated in one contract. The general *principle is*

that non-performance by one party of its contractual obligations under a contract authorizes the other party not to perform its obligations under that contract, and that in some circumstances the other party is authorized to terminate the contract. Usually non-performance of one's own contract obligations *or* termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National *laws* normally do not provide a specific answer to the question of interdependence of obligations involved in various types of countertrade transactions and also do not clarify to what extent the above-mentioned general principles of contract law can be applied in a countertrade transaction.

41. [40] It is often suggested that the particular contract structure of the countertrade transaction is an important element in determining the interdependence of obligations in countertrade transactions. If *the contractual terms concerning the countertrade commitment or supply contracts in the two directions are embodied in one* contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (*see chapter III," Contracting approach", paragraphs 10, 17, 18*). If, however, separate contracts are *used, it has* been suggested that *under many national laws* the two sets of obligations would likely be regarded as independent, except to the extent specific contract provisions establish interdependence (the separate-contracts approach is discussed in *chapter III* paragraphs *11 to 23*). * On the other hand, it has been suggested that despite the use of separate contracts, the obligations in a countertrade transaction could be regarded as interdependent on the ground that those obligations embodied in separate contracts are commercially interrelated and thus form part of a single transaction.

42. [41] Because there is a dearth of judicial and arbitral decisions on the question of interdependence of obligations in countertrade transactions, generalizations cannot be made. The extent of interdependence will depend on the circumstances and contractual provisions of each case. In order to avoid disagreements as to whether a party is entitled to withhold fulfilment of its obligation as regards the supply of goods in one direction on the ground that the other party has failed to fulfil its obligation as regards the supply of goods in the other direction, the parties might wish to include in the countertrade agreement specific provisions indicating the extent of interdependence of obligations. Provisions determining the extent of interdependence of obligations may be included to address in particular the following problems in the fulfilment of the countertrade transaction: *(1)* failure to conclude a supply contract as stipulated in the countertrade agreement, *(2)* termination of a supply contract, *(3)* failure to meet a payment obligation under a supply contract, and *(4)* failure to deliver goods under a supply contract.

1. Failure to conclude supply contract

43. [42] In transactions in which the parties first conclude the supply contract in one direction (export contract) and leave the conclusion of the supply contract in the other direction (counter-export contract) to a later time (see chapter III, "Contracting approach", paragraphs *13 to 19*), the parties may wish to consider whether the failure of the exporter (counter-importer) to take an action necessary to fulfil the countertrade commitment should entitle the importer to suspend payment for the imported goods, or even to terminate the export contract. Such interdependence may be viewed favourably by an importer whose ability to meet payment obligations under the export contract depends on the proceeds of the counter-export contract to be concluded pursuant to the countertrade agreement.

44. [43] In considering whether to establish such interdependence between the countertrade commitment and the export contract, the parties may wish to take into account the possible amount of the counter-exporter's loss arising from the failure to fulfil the countertrade commitment and the possible amount of the exporter's loss arising from the suspension of payment under the export contract or from the termination of the export contract. It may not be desirable to allow a problem in the fulfilment of the countertrade commitment to disrupt the performance of the export contract. The parties may make such an assessment when the price to be paid under the export contract or the possible loss from the termination of the export contract is considerably higher than the possible loss from the failure by the counter-importer to fulfil the countertrade commitment. Furthermore, interdependence may not be desirable because of the possibility that the parties would disagree as to responsibility for the failure to conclude a supply contract. The possibility of suspension of payment under the export contract until the resolution of such a disagreement might introduce an unacceptable degree of uncertainty in the transaction. Moreover, the risk of non-payment under the export contract because of a problem in the fulfilment of the countertrade commitment may make it difficult for the exporter to find a financial institution to finance the export or to insure a non-payment risk. A reason for the financial institution's reluctance may be the fact that a possible difficulty the exporter may face in fulfilling the countertrade commitment is a circumstance extraneous to the export contract and difficult for the financial institution to assess. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to express in the countertrade agreement such independence of the export contract from the fulfilment of the countertrade commitment.

45. [44] However, in order to protect the interests of the counter-exporter, it may be appropriate to provide in the countertrade agreement for compensation of the loss expected to be suffered as a result of a failure to conclude the counter-export contract. The obligation to provide such compensation may be established by a liquidated damages or penalty clause in the countertrade agreement (see paragraphs 10 to 13 above, as well as chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance"). Furthermore, the countertrade agreement may grant the counter-exporter the right to deduct from payments due under the export contract the amount of liquidated damages or a penalty due for the failure to fulfil the countertrade commitment (see chapter IX, "Payment", *paragraphs 12 and 62*, and chapter XI, "Liquidated damages and penalty clauses", *paragraph 22*).

46. [45] In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", *paragraphs 20 and 21*), the parties may not find it useful to entitle a party to suspend performance of, or to terminate, a concluded supply contract in one direction in response to a failure by the other party to take an action necessary to conclude a supply contract in the other direction. In such transactions, the countertrade agreement often provides for the conclusion of a series of supply contracts in both of the two directions. Making the performance of contracts that have already been concluded in one direction dependent on the conclusion of contracts in the other direction may disrupt rather than stimulate orderly implementation of such a countertrade transaction. Accordingly, for reasons discussed above in paragraphs 39 to 41, the parties may wish to indicate expressly in the countertrade agreement that the obligations under the supply contracts in one direction are independent from the fulfilment of the countertrade commitment in the other direction.

47. [46] In some cases the countertrade agreement may provide that a failure by a party to conclude supply contracts in one direction entitles the other party to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction. Such an approach may be used in particular when it is agreed that during the course of the countertrade transaction the value of the goods supplied in one direction should not exceed the value of the goods supplied in the other direction by more than an agreed amount or percentage. This approach may be agreed upon when the parties stipulate that their mutual payment claims arising from the supply contracts in the two directions are to be set off and that the imbalance in the value of goods shipped in the two directions should not exceed an agreed limit (see chapter IX, "Payment", paragraphs *38 to 57*, in particular *paragraph 53*). In order to monitor the level of trade between the parties and to specify the situations in which a party is entitled to suspend conclusion of contracts or supplies of goods, the parties might agree that their mutual supplies of goods are to be recorded in an "evidence account" (see chapter *IV, "Countertrade commitment"*, paragraphs *68 to 74*).

48. [47] When the countertrade agreement provides that the countertrade commitment in one direction should not affect obligations under existing supply contracts in the other direction, the countertrade agreement may nevertheless establish sanctions for the failure to fulfil the countertrade commitment. For example, in transactions in which countervailing claims for payment for the supply of goods in the two directions are to be set off, the countertrade agreement may provide that a party that receives more goods than it ships is to liquidate the imbalance either through cash payments or through the shipment of additional goods (see chapter IX, "Payment", *paragraphs 53 to 56*). When the goods supplied in the two directions are to be paid for independently, the countertrade agreement may contain a liquidated damages or penalty clause or provide for the issuance of a bank guarantee or stand-by letter of credit covering non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

2. Termination of supply contract

49. [48] A supply contract may be terminated, for example, as a result of a breach of the contract by one party or as a result of an exempting impediment. For reasons discussed in paragraphs 39 to 41 above, the parties may wish to clarify in the countertrade agreement whether such a termination of a supply contract in one direction is to affect the obligations of the parties to conclude a future supply contract in the other direction or to perform an existing supply contract in the other direction. Various solutions can be considered:

(i) not to allow the termination of a supply contract in one direction to affect the *commitment to conclude* a supply contract in the other direction, or any obligations under an existing supply contract in the other direction;

(ii) to provide that termination of a supply contract in one direction is to release the parties from the countertrade commitment stipulating the conclusion of a supply contract in the other direction, but that, if a supply contract in the other direction has already been concluded, that supply contract is not to be affected;

(iii) to provide that termination of the supply contract in one direction is to result in the release from the countertrade commitment to conclude a supply contract in the other direction as well as in the termination of any existing supply contract in the other direction, unless specified actions for performance of the existing supply contract have already been taken (e.g., goods have been prepared for shipment or have been shipped).

50. [49] The solution under (i) may be appropriate in transactions in which the countertrade agreement provides for the conclusion of a series of supply contracts in both directions. In counter-purchase and buy-back transactions, it may also be appropriate to provide that the termination of a given counter-export contract should not affect the export contract. In these cases it may be possible for the parties to conclude a substitute supply contract for a terminated supply contract (see paragraph 54 below). Because of this possibility, as well as the possibility of exercising remedies available under the terminated supply contract, the parties may not wish that the termination of a given supply contract in one direction should affect the conclusion or performance of contracts in the other direction. *Furthermore, a possibility that the termination of the counter-export contract may affect the export contract may make it impossible for the exporter to obtain insurance cover for non-payment risk under the export contract. Inability to insure that risk may make it difficult or impossible for the exporter to obtain financing for the export contract (see chapter III, section C).*

51. [50] As to the possible effects of the termination of the export contract in a counter-purchase, buy-back or indirect offset transaction, the solution under (i) may be preferred by the importer (counter-exporter). An important objective of the importer for engaging in countertrade is often to find an outlet for its goods, and the need to find such an outlet would usually not be diminished by termi-

nation of the export contract. This solution may also be favoured by a third-party purchaser engaged by the exporter to fulfil the exporter's countertrade commitment; the third-party purchaser may be interested in the countertrade commitment remaining effective in order to be able to earn the fee agreed upon with the exporter or in order to recoup expenses incurred in anticipation of the purchase and resale of the countertrade goods (see chapter VIII, "Participation of third parties", *paragraph 35*). The exporter (counter-importer), on the other hand, is likely to favour solution (ii), in particular if the exporter does not expect a profit through the purchase and resale of the countertrade goods. In these types of transactions the exporter usually assumes a countertrade commitment in order to be able to export its own goods and would therefore not wish to remain subject to the countertrade commitment upon termination of the export contract, but at the same time would not wish to terminate existing counter-export contracts. In indirect offset transactions there is an additional reason for adopting the solution under (ii), namely, that the exporter (counter-importer) concludes counter-import contracts with third-party suppliers and it would be undesirable to terminate those contracts due to circumstances that do not concern those third parties.

52. [51] The question may arise whether, despite the release from the countertrade commitment, pursuant to the solution in (ii), of the party originally committed to purchase, a third-party purchaser engaged by the exporter (counter-importer) would continue to be entitled to receive a fee from the exporter (counter-importer) for purchases made from the counter-exporter after the release. As discussed in chapter VIII, "Participation of third parties", *paragraph 35*, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

53. [52] The solution under (iii) might be adopted when the parties consider that the countertrade transaction cannot proceed if a supply contract in one direction is terminated. This might be the case, for example, when the parties agree to link their payment obligations so that the proceeds of the supply contract in one direction would be used to pay for the supply contract in the other direction (chapter IX, "Payment"), or when, as in a direct offset transaction, the goods supplied by one party are to be incorporated in the goods to be supplied in the other direction. The solution under (iii) would also be indicated in buy-back transactions in which the possibility of fulfilling the countertrade commitment is contingent upon the performance of the export contract.

54. [53] When solution (ii) or (iii) is adopted, the parties may wish to clarify in the countertrade agreement that a party would be released from its obligations under the countertrade commitment or an existing counter-export contract on the basis of the termination of the export contract only if that party was not responsible for the termination of the export contract. The countertrade agreement may further provide that when one of the parties is responsible for the termination of the export contract (e.g., because of delivery of defective goods, because of *the* failure to obtain administrative approval for the contract, or because of the failure to obtain the issuance of a letter of credit), the other party has an option either of maintaining in effect the countertrade commitment or the counter-export contract or of being released from its obligations thereunder.

55. [54] Paragraphs 48 to 54, above, addressed the question whether a termination of a supply contract in one direction is to affect the obligations of the parties to conclude or perform a supply contract in the other direction. The parties may also wish to consider whether the termination of a supply contract in a given direction should obligate the parties to conclude a substitute supply contract in that same direction. An obligation to conclude a substitute supply contract may be considered appropriate in particular when the countertrade agreement provides for the conclusion of multiple supply contracts or when the countertrade agreement lists different types of countertrade goods.

3. Failure to pay

56. [55] In many countertrade transactions it is agreed that payment under the supply contract in one direction is to be made independently from payment under the supply contract in the other direction. For example, if under a counter-purchase or buy-back transaction the importer would delay its payments to the exporter, the exporter (counter-importer) would not be entitled to withhold payment under the counter-import contract or to set off its claim under the export contract against its payment obligation under the counter-import contract. Similarly, if the counter-importer would delay payment to the counter-exporter, the counter-exporter (importer) would not be entitled to withhold payment under the export contract or to set off the payment claims in the two directions. It is advisable that such agreement on independence of payment obligations be expressed in the countertrade agreement.

57. [56] It may be agreed, however, that, if a supplier has not been paid for goods delivered in one direction, that supplier is entitled to withhold payment for goods delivered in the other direction up to the amount of the outstanding claim or to set off the two countervailing claims.

58. [57] The advantage of independence of payment obligations is that the risk of non-payment under a supply contract in one direction is not increased by making the payment obligation under that contract dependent on the successful performance of a supply contract in the other direction. With such an approach, financing for a supply contract may be easier to obtain because the financing institution, in assessing the risk of non-payment, would not have to take into account circumstances extraneous to the supply contract to be financed (see also paragraph 43 above).

59. [58] The advantage of making the payment obligations interdependent is that of additional security to a party who does not receive payment for the goods it has supplied. If that party withholds payment or sets off the claims for payment under the supply contracts in the two directions, the result would be similar to a linked payment mechanism discussed in chapter IX, "Payment" (i.e., retention of funds, blocking of funds or setoff of countervailing claims for payment). The difference is that in the case discussed in this section the withholding of payment or setoff of claims is a fall-back right given to a party who does not

receive payment, whereas under the linked payment mechanisms discussed in chapter IX, the linkage of payments is the anticipated method of payment.

60. [59] When it is agreed that a party is entitled to withhold payment or to set off the two countervailing payment obligations, it is sometimes also stipulated that the party who delivered goods first (exporter) is entitled to take possession of the goods that are to be delivered by the other party (importer). Taking possession of the goods would enable the exporter, who is holding the outstanding claim, to obtain value and establish a payment obligation that could be set off against the outstanding claim. Such a stipulation is possible where the countertrade agreement specifies the goods that are to be counter-exported. In order to implement such an approach, it is advisable to identify clearly the goods and their location and to consider taking such additional measures as granting the exporter a security interest in those goods and giving the exporter an express right to claim their possession. A further measure may be for the countertrade parties to agree that the counter-exporter is to deposit the goods with a third person and to provide for the release of those goods to the counter-importer under specified conditions.

4. Failure to deliver goods

61. [60] The parties may wish to clarify in the countertrade agreement the consequences for the countertrade transaction of a failure to deliver, delayed delivery, or delivery of non-conforming goods under a supply contract in one direction. For delivery problems that result in the termination of a supply contract in one direction, the parties may wish to clarify in the countertrade agreement, as discussed in paragraphs 48 to 54 above, whether the termination is to affect the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. For delivery problems under a supply contract in one direction that do not result in termination of that supply contract, the parties may wish, for reasons explained in paragraphs 39 to 41 above, to provide expressly in the countertrade agreement that there should be no effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. Such an independence of the obligations with respect to the shipments in the two directions may not be appropriate in buy-back transactions in which the counter-export of goods is contingent upon the proper implementation of the export contract.

[A/CN.9/362/Add.14]

XIV. CHOICE OF LAW

CONTENTS

		Paragraphs
A.	General remarks	1-7
B.	Choice of applicable law	8-24
C.	Choosing *the same or different* national *laws* to govern countertrade agreement and supply contracts	25-29
D.	Mandatory legal rules of public nature	30-33

[*Editorial note:* The present draft chapter is a revision of draft chapter XIV, "Choice of law", published as document A/CN.9/WG.IV/WP.51/Add.5. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.5 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.5 are in italics.]

A. General remarks

1. [3] This chapter focuses on the choice by the parties to the countertrade transaction of the law applicable to the countertrade *agreement, the* supply contracts in the two directions, *and the contract by which a party committed to fulfil a countertrade commitment engages a third party to fulfil that commitment. The chapter considers also the question whether the countertrade agreement and the contracts forming part of the transaction should be made subject to a single national law or to different national laws (section C).* This chapter does not discuss the law applicable to other related arrangements in which a person who is not a party to the countertrade transaction is involved. Such other arrangements may include a guarantee supporting fulfilment of a countertrade commitment, an agreement between countertrade parties and their banks concerning linked payment arrangements, and an interbank agreement between banks involved in carrying out payment arrangements. Certain aspects of the law applicable to such arrangements are discussed in chapter XII, "Security for performance", paragraphs *[3], [5] and [13],* and chapter IX, "Payment", paragraphs *[4], [7], [16], [18], [19], [24] and [37].*

2. [1] Under the rules of private international law of many national *laws*, the parties are permitted by agreement to choose the applicable law, though under some of those *laws* there are certain restrictions on that *choice (rules* of private international law are *in some legal systems* referred to as "conflict of laws" or "choice of law" *rules).* If the parties do not choose the applicable law, the applicable law is determined by *the application of rules of private international law.*

3. [2] It should be noted that by choosing the applicable law the parties are not making a choice as to jurisdiction for settlement of any disputes. Issues relating to jurisdiction are discussed in chapter XV, "Settlement of disputes".

4. [4] Whatever be the law applicable to the countertrade agreement or the supply contracts, particular aspects of the countertrade transaction may be affected by mandatory legal rules of an administrative or other public nature in force in the countries of the parties *or* in the country where their obligations are to be performed. Those mandatory legal rules may regulate certain matters in the public interest, for example, international transfers of funds, the types of goods that may be traded in countertrade transactions, and restrictive business practices (see *below, section D).*

5. [5] In addition, the extent to which the parties may designate particular issues to be governed by the chosen law may be limited. For example, regardless of the choice by the parties, the law of the State where goods are situated may govern the transfer of ownership of those goods, and the law of the State in which the bank holding funds is located may govern disposition of the funds. The question of which *State's* procedural law is to govern arbitral or judicial proceedings for the settlement of disputes arising in connection with the countertrade transaction is discussed in chapter XV, "Settlement of disputes".

6. [6] *A sales contract forming part of the countertrade transaction may be subject to* the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). *According to its article 1, the* Convention applies to contracts of sale of goods *between parties whose places of business are in different States:* (a) *when the States are Contracting States, or* (b) *when the* rules of private international law lead to the application of the law of a Contracting State. *It should be noted that, even if the law of a State that is a party to the Convention is the applicable law, there is a divergence of opinion as to whether the Convention would apply to a countertrade agreement containing a commitment to conclude a supply contract in the future. However, uncertainty appears not to exist in the laws of some States as to the applicability of the Convention to a countertrade agreement that contains all the essential elements of the supply contract yet to be actually concluded. This is because, in those States (as noted in chapter IV, paragraph 40), a party refusing to honour such a commitment may be deemed to have consented to the actual contract of sale.*

7. [7] For a discussion of contract drafting in the light of *the* applicable law, see *chapter V,* "General remarks on drafting", paragraph 6.

B. Choice of applicable law

8. [8] It is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts. Such an identification of the applicable law is useful because it enables the parties to gear the actions they take to fulfil their contractual obligations, or the actions taken pursuant to their contractual rights, to the requirements found in the applicable law. If the parties do not choose the applicable law, the result provided by rules of private international law may not be satisfactory to the parties. For example, absent a contrary choice by the parties, sales contracts in a counter-purchase or offset transaction are likely to be, according to the rules of private international law, subject to the law of the seller. If in such a transaction the countertrade agreement is not subject, by the rules of private international law, to the same law as the sales contract to be concluded pursuant to that countertrade agreement, contractual terms common to both the countertrade agreement and the supply contract may not be given the same meaning (see below, *paragraph 25*).

9. [9] An express choice of the law applicable to the countertrade agreement and the supply contracts is advisable also to avoid uncertainty as to what law applies. Uncertainty in the absence of a choice of law may arise from two factors.

10. [10] First, the applicable law is determined by the application of rules of private international law of a national *law.* When a dispute arises concerning the countertrade agreement or a supply contract that is to be settled in judicial proceedings, the rules of private international law applied by the court settling the dispute will determine the applicable law. A court will apply the rules of private international law of its own country. If there is no exclusive jurisdiction clause agreed upon by the parties (see chapter XV, "Settlement of disputes", *paragraph [41]*), the courts of several countries may be competent to decide the dispute (e.g., the countries in which the parties to the dispute have their places of business or the country in which the obligation in question is to be performed). There may therefore be several possible systems of private international law that could determine the law applicable to the countertrade agreement or the supply contract. When disputes are to be settled in arbitral proceedings, the arbitral tribunal will determine what law is applicable, unless the parties have chosen the applicable law. *In some cases, the arbitral tribunal will* determine the applicable law according to the private international law rules that *the tribunal* considers appropriate; *in other cases, the arbitral tribunal will directly determine the applicable law that the tribunal considers appropriate for the case, without express reference to the rules of private international law. It may be difficult to predict on which criteria or rules the arbitral tribunal will rely in determining the applicable law.*

11. [11] The second factor producing uncertainty as to the applicable law is that, even if it is known which system of private international law will determine the applicable law to govern the countertrade agreement and the supply contracts, the *criteria and concepts used in* that system may be too general or vague to enable the parties

to predict with reasonable certainty which law will be determined to be applicable. This difficulty is compounded in the case of countertrade agreements because of possible uncertainty as to the legal nature of the countertrade agreement and the consequent uncertainty as to which rule of private international law should determine the applicable law.

12. [12] [*paragraph 13 as it appeared in A/CN.9/WG.IV/WP.51/Add.5 has been incorporated in the present paragraph*] The extent to which the parties are allowed to choose the applicable law will be determined by the *rules of private* international law being applied. Under some systems of private international law, the autonomy of the parties is limited and they are permitted to choose only a national *law* that has some connection with the contract, such as the *law* of the country of one of the parties or of the place of performance. *Such a limitation is sometimes referred to as the "nexus" rule. Under other systems of private international law, the parties are permitted to choose the applicable law to govern the countertrade agreement and the supply contracts without those restrictions.* Since a court that is to settle a dispute will apply the rules of private international law in force in its country, the parties should agree upon a choice of law that would be upheld by the rules of private international law in the countries whose courts might be competent to settle their disputes. If the parties are considering an exclusive jurisdiction clause, they should pay particular attention to whether courts in the contemplated jurisdiction would uphold their choice of law. *If a dispute is settled in arbitral proceedings, the law chosen by the parties will normally be applied by the arbitral tribunal. In order to avoid the application of a nexus rule, parties sometimes expressly stipulate in the choice-of-law clause that that rule should not apply. It should be noted that such a stipulation may have no effect inasmuch as the nexus rule is likely to be considered mandatory. The likelihood that such a stipulation would be upheld appears to be greater in arbitration proceedings.*

13. [14] When choosing the law to govern the countertrade agreement or the supply contracts, it is in general advisable for the parties to choose the law of a particular country. The rules of private international law of a country where legal proceedings may be instituted in the future may not recognize the validity of a choice of general principles of law or of principles common to several *countries* (e.g., of the countries of both parties). Even if such a choice would be valid, it may be difficult to identify principles of law that could resolve disputes of the type arising in connection with a countertrade agreement or a supply contract. Nevertheless, such a choice *might* be feasible in certain circumstances.

14. [*new paragraph*] When an international convention relevant to the countertrade transaction is in force in a State, it is widely accepted that the choice of the law of that State will include that international convention. Such a choice of a convention through the choice of the national law is expressly recognized in article 1*(b)* of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). Article 1*(b)* provides that the Convention applies to contracts of sale between parties whose places of business are in different States when the rules of private international law lead to the application of the law of a Contracting State.

15. [*new paragraph*] In some States it is recognized that parties can agree that their transaction should not be governed by a national law but by an international convention or by other rules of law such as an international legal text not having the force of an international treaty or a set of legal principles dealing with international trade. Other States, however, require the applicability of a national law, so that any international convention or other rules chosen by the parties will apply in so far as they do not contravene the mandatory provisions of the applicable national law.

16. [15] In many national *laws* a choice-of-law clause is interpreted as not to include the application of the rules of private international law of the chosen *national law* even if the clause does not expressly so provide. However, if that interpretation is not certain, the parties may wish to indicate in the clause that the substantive legal rules of the *national law* they have chosen are to apply. Otherwise, the choice of the *national law* may be interpreted as including the private international law rules of that *national law* and those rules might provide that the substantive rules of another *national law* are to apply.

17. [16] The parties may wish to choose as the applicable law the law of the country of one of the contracting parties. Alternatively, they may prefer to choose the law of a third country which is known to both parties and which deals in an appropriate manner with the legal issues arising from the countertrade agreement or from the supply contract. If the countertrade agreement or a supply contract provides for the jurisdiction of the courts of a particular country to settle disputes between the parties, the parties may wish to choose the law of that country as the applicable law. This could expedite judicial proceedings and make them less expensive, since a court will normally have less difficulty in ascertaining and applying its own law than the law of a different country.

18. [17] In the case of countries *that have two or more territorial units in which different laws are applicable* (as in some federal States), it is advisable to specify which one of those *laws* is to be applicable in order to avoid uncertainty.

19. [18] The parties may also wish to take the following factors into consideration in choosing the applicable law: *(a)* the parties' knowledge of, or possibility of gaining knowledge of, the law; *(b)* the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship between the parties (for example, the parties may wish that their countertrade commitment to enter into future contracts would be given effect under the chosen law); *(c)* the extent to which the law contains mandatory rules that would prevent the parties from settling by agreement questions that arise in their contractual relationship.

20. [19] Changes legislated in the law chosen by the parties to govern the countertrade agreement and the supply contract may or may not affect contracts in existence at the time those changes are made. If the parties wish that

only the legal rules in force at the time the countertrade agreement or supply contracts are entered into are to apply, it is advisable that they expressly so provide. However, parties should be aware that such a restriction will not be effective if the application of the changes in the legislation to existing contracts is mandatory.

21. [20] Different approaches are possible with respect to the drafting of a choice-of-law clause. One approach may be merely to provide that the *countertrade agreement or the* contract is to be governed by the chosen law. This approach may be sufficient if it is clear that the body chosen to settle disputes between the parties will apply the chosen law to all the issues that the parties desire to be regulated by it. A second approach may be to provide that the chosen law is to govern the *countertrade agreement or* contract in question, and also to include an illustrative list of the issues that are to be governed by that law *(e.g., formation of contract, or breach, termination, or invalidity of the countertrade agreement or contract).* This approach may be useful if the parties consider it desirable to ensure that the issues contained in the illustrative list in particular will be governed by the chosen law.

22. [21] Under *the private* international law of some countries a choice-of-law clause may be considered to be an agreement separate from the rest of the contract between the parties. Under those *laws,* the choice-of-law clause may remain valid even if the rest of the contract is invalid, unless the grounds for invalidity also extend to the choice-of-law clause. Where the contract is invalid but the choice-of-law clause remains valid, the formation, the lack of validity, and consequences of the invalidity of the contract will be governed by the chosen law.

23. [22] Under most systems of private international law the chosen law may govern the prescription of rights, while under some systems rules relating to prescription (limitation of actions) are of a procedural character and cannot be chosen by the parties in their contract; in those cases the procedural rules of the place where the legal proceedings are brought will apply. The Convention on the Limitation Period in the International Sale of Goods (New York, 1974) *as amended by the Protocol of 1980* provides in its article 3 that, unless the Convention provides otherwise, the Convention applies irrespective of the law which would otherwise be applicable by virtue of the rules of private international law. As discussed above in paragraph 6, it may be uncertain whether countertrade agreements committing the parties to the future conclusion of a sales contract fall within the scope of application of the United Nations Convention on Contracts for the International Sale of Goods. Similarly, it may be uncertain whether such countertrade agreements fall within the scope of application of the Convention on the Limitation Period in the International Sale of Goods.

24. [23] The parties may include in the countertrade agreement a choice-of-law clause that will designate the applicable law not only for the countertrade agreement but also for the future supply contracts to be concluded pursuant to the countertrade agreement. In this way the parties may settle in the countertrade agreement an issue that they would otherwise address in each supply contract.

C. Choosing *the same or different* national *laws* to govern countertrade agreement and supply contracts

[title changed]

25. [24] In making an express choice of the applicable law, the parties may wish to consider whether the countertrade agreement and any future supply contracts to be concluded in one direction or in both directions pursuant to that countertrade agreement should be made subject to a single national *law* or to different *national laws.* The application of a single *national law* may be desirable when the countertrade agreement stipulates terms of the future supply contracts and the parties wish to ensure that the legal meaning of terms stipulated in the countertrade agreement would remain the same when those terms are subsequently incorporated in a supply contract. Consistency of legal meaning may be desirable in particular with regard to terms concerning payment mechanisms (see chapter IX, "Payment", paragraph [16]), quality of the goods, and terms of delivery.

26. [25] If the parties have structured their obligations in such a way that their obligations arising from the supply contracts in the two directions are interrelated to a high degree, they may find it appropriate to subject all their mutual rights and obligations to a single national *law.* The obligations of the parties are closely interrelated, in particular, in barter transactions (see chapter III, "Contracting approach", paragraphs *3 to 8*) and in direct offset transactions (see chapter II, "Scope and terminology of Legal Guide", *paragraph 17*). The application of more than one *national law* to such transactions may lead to inconsistency between obligations of the parties.

27. [26] In the case of counter-purchase, buy-back and indirect offset transactions, the obligations of the parties arising, on the one hand, under the supply contract in one direction (export contract) and, on the other hand, under the countertrade agreement and the supply contract in the other direction (counter-export contract) are usually not interrelated to the same degree as the obligations are interrelated in barter or direct offset transactions. In these cases, no generally valid advice can be given as to whether it would be preferable for the parties to subject their obligations to one national *law* or to different national *laws.* In some of these cases, the parties may wish to subject all their obligations to one law. They may wish to do so since it may be simpler to administer the countertrade transaction and to obtain the necessary legal advice with a view to a single *national law* rather than to have to take into account more than one *national law.* There may, however, be situations in which the parties decide to subject the export contract to one law and the counter-export contract to another law. The parties might choose different laws when, on the one hand, there are special reasons for making one of the contracts subject to the law of a particular State and, on the other hand, the parties do not wish to subject the entire transaction to that law. Such special reasons concerning one of the contracts may be, for example, mandatory rules of a State of a party requiring certain types of contracts to be subject to the laws of that State, trade practice according to which one of the contracts is traditionally made subject to a particular *national law,* or the conclusion of the contracts by different sets of parties. If the parties

decide to subject the supply of goods in the two directions to different *national laws*, the parties may wish to consider, as noted above in *paragraph 25*, to subject the countertrade agreement and the supply contract to be concluded pursuant to it to the same law.

28. [27] When the party originally committed to purchase engages a third party to fulfil that commitment, the party originally committed and the third party may wish to subject the contract by which the third party is engaged to the law governing the countertrade agreement. Such a choice would help to ensure that terms found both in the countertrade agreement and the contract engaging the third party would be given the same meaning. (The need for coordination between the contract engaging a third party and the countertrade agreement is discussed in chapter VIII, "Participation of third parties", paragraphs *[22] to [25]*. Certain other aspects of the law applicable to participation by third parties are mentioned in paragraphs *[7], [9], [13] and [16]* of chapter VIII.)

29. [28] When the countertrade agreement is incorporated in an export contract (see chapter III, "Contracting approach", *paragraph 17*), a choice-of-law clause in the export contract would, absent a contrary provision, cover the clauses making up the countertrade agreement.

D. Mandatory legal rules of public nature

30. [29] In addition to the applicable law, mandatory rules of an administrative or other public nature in force in the countries of the parties and in other countries (e.g., the country of a third-party purchaser or of a third-party supplier or the country in which the proceeds of the supply in one direction are being held) may affect certain aspects of the countertrade transaction. These mandatory rules may be addressed to residents or citizens of the State that issued the rules, or to certain business activities being carried out or having an effect in the territory of the State. They may be enforced primarily by administrative officials. Their purpose is to ensure compliance with the economic, social, financial or foreign policy of the State. The parties should take these mandatory rules into account in drafting the countertrade agreement and the supply contracts. (Mandatory governmental regulations are also discussed in chapter II, "Scope and terminology of Legal Guide", *paragraphs 9 and 10.*)

31. [30] Such rules may be of a general nature, applicable to various types of commercial transactions, or they may be specific to countertrade. Rules of a general nature often relate to safety requirements, environmental protection, health and labour conditions, consumer protection, employment of local personnel, restrictive business practices (see chapter X, "Restrictions on resale of countertrade goods", paragraph 3), customs duties, taxes, and restrictions on exports, imports, transfer of technology and payment of foreign exchange.

32. [31] Mandatory rules specific to countertrade may provide, for example, that: *(a)* specified types of countertrade transactions require governmental approval; *(b)* importing of certain types of goods may be carried out only within the framework of specified forms of countertrade; *(c)* only certain types of goods are permitted to be offered in a countertrade transaction (see *chapter VI*, "Type, quality and quantity of goods", *paragraphs 3 and 40*); *(d)* goods purchased in fulfilment of a countertrade commitment must meet origin requirements (see *chapter VI, paragraph 4,* and *chapter IV, "Countertrade commitment", paragraph 26)*; *(e)* evidence accounts are permitted to be used only under specified conditions (see *chapter IV, "Countertrade commitment", paragraph 69)*; *(f)* the purchase of certain types of goods is to be credited towards the fulfilment of the countertrade commitment at specified rates (see *chapter IV, "Countertrade commitment", paragraphs 31 to 34*); *(g)* prior governmental authorization is required for linked payment arrangements restricting foreign currency payments into the country (see chapter IX, "Payment", paragraphs *[5] and [18]*); *(h)* specified financial institutions must be used for payment (see chapter IX, paragraphs *[24] and [37]*).

33. [32] The parties may wish to address in the countertrade agreement the possibility that fulfilment of the countertrade commitment would be impeded by the promulgation or modification of a mandatory rule after the conclusion of the countertrade agreement. Such clauses are discussed in chapter XIII, *"Failure to complete countertrade transaction", section D.*

[A/CN.9/362/Add.15]

XV. SETTLEMENT OF DISPUTES

CONTENTS

		Paragraphs
A.	General remarks	1-7
B.	Negotiation	8-11
C.	Conciliation	12-15
D.	Arbitration	16-41
	1. Scope of arbitration agreement and mandate of arbitral tribunal	18-23
	2. Type of arbitration and appropriate procedural rules	24-30

		Paragraphs
3.	Number of arbitrators	31-33
4.	Appointment of arbitrators	34
5.	Place of arbitration	35-39
6.	Language of proceedings	40-41
E.	Judicial proceedings	42-45
F.	Multi-contract and multi-party dispute settlement	46-53

[*Editorial note:* The present draft chapter is a revision of draft chapter XV, "Settlement of disputes", published as document A/CN.9/WG.IV/WP.51/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.6 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [1] Disputes may arise in a countertrade transaction with respect to the countertrade agreement, and with respect to the supply contracts concluded pursuant to the countertrade agreement. It is advisable that the parties agree on the manner in which any future disputes arising out of the countertrade agreement and the related supply contracts are to be settled.

2. [2] In general, it is desirable for the parties initially to attempt to settle their disputes through negotiation (*section B*). If negotiation is not successful, the parties might wish to refer their dispute to an independent conciliator, who is to make recommendations to the parties on how to settle the dispute (*section C*). If those methods of dispute settlement fail, there are basically two methods available of obtaining *a binding* decision: arbitration and judicial proceedings. Arbitration is a process by which parties refer disputes that might arise between them or that have already arisen *for decision* by an arbitral tribunal composed of one or more impartial persons (arbitrators) selected by them (*section D*). *Arbitral* proceedings may be initiated only on the basis of an arbitration agreement. In general, the parties are obligated to accept the decision of the arbitral tribunal (arbitral award) as final and binding. The arbitral award is usually enforceable in a manner similar to a court decision. In the absence of an arbitration agreement, disputes between the parties will have to be settled in judicial proceedings (*section E*).

3. [3] This chapter does not deal with procedures agreed upon by the parties for determining terms of a supply contract that have been left open in the countertrade agreement. Such methods include procedures to be observed by the parties in negotiating supply contract terms, standards and guidelines to be used in setting the terms, designation of a third person to determine a contract term, or authorizing one of the parties to determine a contract term within agreed parameters. Such methods are discussed generally in chapter *IV, "Countertrade commitment"*, paragraphs *38 to 60*, and with respect to specific types of contract terms in *chapter VI*, "Type, quality and quantity of goods", *paragraphs 25, 26, 34, 39, and chapter VII*, "Pricing of goods", paragraphs 11 *to 47*.

4. [4] The implementation of a countertrade transaction usually includes ongoing discussions between the parties that may permit many problems and misunderstandings to be resolved without recourse to dispute settlement proceedings. *If such discussions result in an amendment of the countertrade agreement or of a supply contract, it is advisable to express the agreement in writing (see chapter V, "General remarks on drafting", paragraphs 3 to 5).*

5. [5] When the parties embody all of their contractual obligations in the two directions in a single contract (see chapter III, "Contracting approach", paragraphs 2 *to 10*), a broadly worded dispute settlement clause in that contract would, *in the absence of* a contrary provision, govern all disputes arising from the contract. However, *usually the* parties embody their obligations in the two directions in more than one contract (see chapter III, paragraphs *11 to 23*). In multi-contract countertrade transactions, the parties may *consider it useful* to agree that all of the supply contracts, *a contract by which a third party is engaged to purchase or to supply goods,* as well as the countertrade agreement, are subject to one dispute settlement clause.

6. [5] When the countertrade agreement provides for the future conclusion of supply contracts, the parties may stipulate in the countertrade agreement that all of those contracts are to be subject to a particular method of dispute settlement. In this way the countertrade agreement may settle an issue that would otherwise be addressed in each supply contract.

7. [*new paragraph*] In some States restrictions exist as to the freedom of a State agency or some other entity of the State to conclude an arbitration agreement or to agree to the jurisdiction of a court of a foreign State. The right to enter into such dispute settlement clauses may be limited to certain types of transactions or to transactions with a foreign party, or such clauses may be subject to an authorization. It is advisable for the parties to investigate dispute settlement aspects in such cases in order to be assured that they are free to enter into a binding dispute settlement clause.

B. Negotiation

8. [6] The most satisfactory method of settling *a dispute between parties* is usually *reaching an amicable settlement of the dispute by* negotiation between the parties. An ami-

cable *settlement may* avoid disruption of *the* business relationship *between the parties.* In addition, it may save the parties the considerable cost and *the greater* amount of time that are normally required for the settlement of disputes by other means. Furthermore, negotiation may be a particularly attractive approach in long-term countertrade transactions in which the countertrade agreement indicates the terms of the future supply contracts in a general rather than in a specific manner.

9. [7] Even though the parties may wish to attempt to settle their disputes through negotiation before invoking other means of dispute settlement, it may not be desirable for the dispute settlement clause to prevent a party from *resorting to* other means of settlement until a period of time allotted for negotiation has expired. If the clause stipulates that other dispute settlement proceedings may not be initiated during the negotiation period, it is advisable to permit a party to initiate other proceedings even before the expiry of that period in certain cases, e.g., where a party states in the course of negotiations that it is not prepared to negotiate any longer, or where the initiation of arbitral or judicial proceedings before the expiry of the negotiation period is needed in order to prevent the loss or prescription of a right. It is advisable to require a settlement reached through negotiation to be reduced to writing.

10. [8] Since the outcome of a dispute between two parties to a countertrade transaction might affect the interests of *another party to the countertrade transaction*, it might be *agreed* that the *party not* directly involved in a dispute *should* be permitted to participate in the negotiations. Such a situation may arise when a third party is engaged to purchase countertrade goods and the dispute occurs between the third party and the supplier. In this case the party originally committed to purchase goods may be liable for payment of an agreed sum in the event that the intended purchase by the third party fails to take place and the countertrade commitment is not fulfilled. Similarly, a party committed to supply who engages a third-party supplier may *have an interest* in the outcome of the dispute between the third-party supplier and the purchaser. The right to such participation in the negotiation of a settlement may be limited to the case in which the party that engages the third party remains liable for the fulfilment of the countertrade commitment. *In the case of a multi-party countertrade transaction, it may be agreed that all parties to the transaction would participate in the negotiations.*

11. [9] In long-term countertrade transactions, the parties may establish a joint committee to coordinate and monitor implementation of the countertrade transaction (see chapter *IV, "Countertrade commitment", paragraph 64*). Such *a committee* may permit the parties to detect possible sources of difficulties and disputes at an early stage and may be *an* appropriate *vehicle* for settling disputes through negotiation.

C. Conciliation

12. [10] If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceedings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator respected by both parties. In contrast to an arbitrator or judge, the conciliator does not decide a dispute; rather, the conciliator assists the parties in reaching an agreed settlement, often by proposing solutions for their consideration.

13. [11] Conciliation is non-adversarial *and confidential. The* parties are more likely to preserve the good business relationship that exists between them than in arbitral or judicial proceedings. Conciliation may even improve the relationship between the parties, since the scope of the conciliation and the ultimate agreement of the parties may go beyond the strict confines of the dispute that gave rise to the conciliation. Conciliation may also permit the participation in the settlement of the dispute of parties that are not directly involved in the dispute but who have an interest in the outcome of the dispute. On the other hand, a potential disadvantage of conciliation is that, if the conciliation were to fail, the money and time spent on it *would be* wasted. * It is advisable that, before initiating conciliation, the parties consider carefully whether there exists a real likelihood of reaching a settlement.

14. [12] If the parties provide for conciliation, they will have to settle a number of issues for the conciliation to be effective. It is not feasible to settle all of those issues in the body of the countertrade agreement; rather, the parties may incorporate into their agreement by reference a set of conciliation rules prepared by an international organization, such as the UNCITRAL Conciliation Rules.[1]

15. [13] *It is often advisable to commence conciliation proceedings before resorting to arbitral or judicial proceedings. If during conciliation proceedings arbitral or judicial proceedings have been initiated, the parties* might still find it useful to continue with the conciliation. *Conciliation may also be initiated after the commencement of arbitral or judicial proceedings.*

D. Arbitration

16. [14] There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions. Arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the

[1]Report of the United Nations Commission on International Trade Law on the work of its thirteenth session (1980), *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 106 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XI: 1980, part one, II, A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations Publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads: "Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules has been recommended by the United Nations General Assembly in its resolution 35/52 of 4 December 1980.

countertrade agreement *or a related contract.* The parties can choose as arbitrators persons who have expert knowledge of the subject-matter in dispute. The parties may choose the place where the arbitral proceedings are to be conducted. They may also choose the language or languages to be used in the arbitral proceedings. In addition, the parties can choose the *applicable law, and* that choice will almost always be respected by the arbitral tribunal; the same is not always true of judicial proceedings (see chapter XIV, "Choice of law", *paragraph 12*). Where parties agree to arbitration, neither party submits to the courts of the country of the other party. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Arbitral proceedings tend to be more expeditious and *may be* less costly than judicial proceedings. It may be noted, however, that some *States* provide for summary judicial proceedings *for disputes involving a sum of money that does not exceed* a certain amount. *Under some national laws, an arbitral tribunal may have more latitude than a court to grant to the claimant the remedy of specific performance.* Finally, as a result of international conventions that assist in the recognition and enforcement of foreign arbitral awards, those awards are frequently recognized and enforced more easily than foreign judicial decisions. *One* such convention to which many States are parties is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).[2]

17. [15] On the other hand, an arbitral award may be set aside in judicial proceedings. The initiation of those proceedings will delay the final settlement of the dispute. However, under many legal systems, an arbitral award may be set aside only on a limited number of grounds, for example that the arbitral tribunal lacked authority to decide the dispute, that a party could not present its case in the arbitral proceedings, that the rules applicable to the appointment of arbitrators or to the arbitral procedure were not complied with, or that the award was contrary to public policy. It may also be noted that, in some *States*, it is not possible for parties to preclude courts from settling certain types of disputes. *In addition, a court may award and enforce to a broader extent than an arbitral tribunal provisional measures of protection or injunctions.*

1. Scope of arbitration agreement and mandate of arbitral tribunal

18. [16] In general, arbitral proceedings may be conducted only on the basis of an agreement by the parties to arbitrate. The agreement may be reflected either in an arbitration clause included in the countertrade agreement or *a related* contract, or in a separate arbitration agreement concluded by the parties before or after a dispute has arisen. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction. However, under some legal systems, an agreement to arbitrate is procedurally and substantively effective only if it is concluded *or confirmed* after a dispute has arisen.

19. [17] The arbitration agreement should indicate what disputes are to be settled by arbitration. For example, the arbitration clause may stipulate that all disputes arising out of or relating to the countertrade agreement or the breach, termination or invalidity thereof are to be settled by arbitration. In some cases, the parties may wish to exclude from that wide grant of jurisdiction certain disputes that they do not wish to be settled by arbitration.

20. [18] If permitted under the law applicable to the arbitral proceedings, the parties may wish to authorize the arbitral tribunal to order interim measures pending the final settlement of a dispute. However, under some legal systems arbitral tribunals are not empowered to order interim measures. Under other legal systems where interim measures of protection can be ordered by an arbitral tribunal, they cannot be enforced; in those cases it may be preferable for the parties to rely on a court to order interim measures. Under many legal systems a court may order interim measures even if the dispute is to be or has been submitted to arbitration.

21. [19] It is desirable for the arbitration agreement to obligate the parties to implement arbitral decisions, including decisions ordering interim measures. The advantage of including such an obligation in the agreement is that under some legal systems, where an arbitral award is not enforceable in the country of a party, a failure by the party to implement an award when obligated to do so by the agreement might be treated in judicial proceedings as a failure by the party to perform a contractual obligation.

22. [20] If judicial proceedings are instituted in respect of a dispute that is covered by a valid arbitration agreement, upon a timely request the court will normally refer the dispute to arbitration. However, the court may retain the authority to order interim measures and will normally be entitled to control certain aspects of arbitral proceedings (e.g., to decide on a challenge to arbitrators) and to set aside arbitral awards on certain grounds (see above, *paragraph 17*).

23. [21] Parties that are considering authorizing the arbitral tribunal to decide disputes *ex aequo et bono* or to act as *amiable compositeur* should bear in mind that arbitrators are not permitted to do so under some legal systems. In addition, such authorizations may be interpreted in different ways and lead to legal insecurity. For example, the terms might be interpreted as authorizing the arbitral tribunal to be guided either only by principles of fairness, justice or equity, or, in addition, by those provisions of the *applicable law regarded* in the legal system of that law as fundamental. If the parties wish to authorize the arbitral tribunal to decide disputes without applying all legal rules of a *State, they* may wish to specify the standards or rules according to which the arbitral tribunal is to decide the substance of the dispute. *Moreover, in* order to avoid any misunderstanding, the parties may wish to make it clear that the arbitral tribunal is to decide in accordance with the terms of the *supply* contract *or the countertrade agreement* and the relevant usages of trade applicable to the transaction.

[2]United Nations, *Treaty Series*, vol. 330, p. 38, No. 4739 (1959).

2. *Type of arbitration and appropriate procedural rules*

24. [22] The parties are able to select the type of arbitration that best suits their needs. It is desirable that they agree on appropriate rules to govern their arbitral proceedings. There is a wide range of arbitration systems available, with varying degrees of involvement of permanent bodies (e.g., arbitration institutions, courts of arbitration, professional or trade associations and chambers of commerce) or third persons (e.g., presidents of courts of arbitration or of chambers of commerce). At one end of the spectrum is the pure ad hoc type of arbitration, which does not involve a permanent body or third person in any way. This means, in practical terms, that no outside help is available (except, perhaps, from a national court) if, for example, difficulties are encountered in the appointment or challenge of an arbitrator. Moreover, any necessary administrative arrangements have to be made by the parties or the arbitrators themselves. At the other end of the spectrum there are arbitrations fully administered and supervised by a permanent body, which may review terms of reference and the draft award and may revise the form of the award and make recommendations as to its substance.

25. [23] Between these two types of arbitration there is a considerable variety of arbitration systems, all of which involve an appointing authority but differ as to the administrative services that they provide. The essential, although not necessarily exclusive, function of an appointing authority is to compose or assist in composing the arbitral tribunal (e.g., by appointing the arbitrators, deciding on challenges of an arbitrator or replacing an arbitrator). Administrative or logistical services, which may be offered as a package or separately, could include the following: forwarding written communications of a party or the arbitrators; assisting the arbitral tribunal in establishing and notifying the date, time and place of hearings and other meetings; providing, or arranging for, meeting rooms for hearings or deliberations of the arbitral tribunal; arranging for stenographic transcripts of hearings and for interpretation during hearings and possibly translation of documents; assisting in filing or registering the arbitral award, when required; holding deposits and administering accounts relating to fees and expenses; and providing other secretarial or clerical assistance.

26. [24] Unless the parties opt for pure ad hoc arbitration, they may wish to agree on the body or person to perform the functions that they require. Among the factors worthwhile considering in selecting an appropriate body or person are the following: willingness to perform the required functions; competence, in particular in respect of international matters; appropriateness of fees measured against the extent of services requested; seat or residence of the body or person and possible restriction of its services to a particular geographic area. The latter point should be viewed in conjunction with the probable or agreed place of arbitration (see below, *paragraphs 35 to 39*). However, certain functions (e.g., appointment) need not necessarily be performed at the place of arbitration, and certain arbitral institutions are prepared to provide services in countries other than those where they are located.

27. [25] In most cases, the arbitral proceedings will be governed by the *procedural* law of the State where the proceedings take place. Many States have laws regulating various aspects of arbitral proceedings. Some provisions of these laws are mandatory; others are non-mandatory. In selecting the place of arbitration, the parties may wish to consider the extent to which the law of a place under consideration recognizes the special needs and features of international commercial arbitration and, in particular, whether it is sufficiently liberal to allow the parties to tailor the procedural rules to meet their particular needs and wishes while at the same time ensuring that the proceedings are fair and efficient. A recent trend in this direction, discernible from modern legislation in some States, is being enhanced and fortified by the UNCITRAL Model Law on International Commercial Arbitration.[3] The UNCITRAL Model Law is becoming increasingly accepted by States of different regions and different legal and economic systems.

28. [26] Since the procedural rules in the arbitration laws of some States are not necessarily suited to the particular features and needs of international commercial arbitration, and since, in any case, those laws do not contain rules settling all procedural questions that may arise in relation to arbitral proceedings, the parties may wish to adopt a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution, and may refuse to administer a case if the parties have modified provisions of those rules that the institution regards as fundamental to its arbitration system. Most arbitral institutions, however, offer a choice of two or sometimes more sets of rules and *often* allow the parties to modify any of the rules. If the parties are not required by an institution to use a particular set of arbitration rules or to choose among specified sets of rules, or if they choose ad hoc arbitration, they are free to choose a set of rules themselves. In selecting a set of procedural rules, the parties may wish to consider its suitability for international cases and the acceptability of the procedures contained in them.

29. [27] Of the many arbitration rules promulgated by international organizations or arbitral institutions, the UNCITRAL Arbitration Rules[4] deserve particular mention. These Rules have proven to be acceptable in the various

[3]Report of the United Nations Commission on International Trade Law on the work of its eighteenth session (1985), *Official Records of the General Assembly, Fortieth Session, Supplement No. 17* (A/40/17), para. 332 and annex I (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XVI: 1985, part three, I (United Nations publication, Sales No. E.87.V.4)). The United Nations General Assembly, in its resolution 40/72 of 11 December 1985, recommended "that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice".

[4]Report of the United Nations Commission on International Trade Law on the work of its ninth session (1976), *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), para. 57 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. VII: 1976, part one, II, A (United Nations publication, Sales No. E.77.V.6)). The use of the UNCITRAL Arbitration Rules has been recommended by the United Nations General Assembly in its resolution 31/98 of 15 December 1976.

legal and economic systems and are widely known and used in all parts of the world. Parties may use them in pure ad hoc arbitrations as well as in arbitrations involving an appointing authority with or without the provision of additional administrative services. A considerable number of arbitration institutions in all regions of the world have either adopted these Rules as their own institutional rules for international cases or have offered to act as appointing authority in conjunction with the use of those Rules. Most of them will provide administrative services in cases conducted under the UNCITRAL Arbitration Rules.

30. [28] Where a model clause accompanies the arbitration rules to govern arbitrations under the countertrade agreement or is suggested by an arbitral institution, adoption of that clause by the parties may help to enhance the certainty and effectiveness of the arbitration agreement. Some model clauses, such as the one accompanying the UNCITRAL Arbitration Rules, invite the parties to settle certain practical matters by agreement. These include the involvement of an appointing authority, as well as the number of arbitrators (see below, paragraphs *31 to 33*), the appointment of arbitrators (see below, *paragraph 34*), the place of arbitration (see below, paragraphs *35 to 39*) and the language or languages to be used in the arbitral proceedings (see below, paragraphs *40 and 41*).[5] [*new footnote*]

3. Number of arbitrators

31. [29] The parties may wish to specify in the arbitration clause the number of arbitrators who are to comprise the arbitral tribunal. If the parties fail to do so, the chosen arbitration rules or, in some cases, the law applicable to the arbitral proceedings will either specify that number or the manner by which it is to be determined. Agreement by the parties on the number of arbitrators will enable the parties to ensure that the number conforms to their particular needs and wishes, and will provide certainty in respect of that aspect of the appointment process. However, parties should be aware that some national laws restrict their freedom to agree upon the number of arbitrators by, for example, prohibiting an even number of arbitrators.

32. [30] Other than the possible legal restriction just referred to, the considerations that may be relevant to the question of the number of arbitrators are essentially of a practical nature. In order to ensure the efficient functioning of the arbitral proceedings and the taking of decisions, it is usually desirable to specify an uneven number, i.e., one or three, although in practice parties sometimes specify two-member panels, coupled with a mechanism for *involving* a third arbitrator, "umpire" or "referee", to overcome any impasse between the two.

33. [31] As to whether one or three arbitrators should be specified, the parties may wish to consider that arbitral proceedings conducted by a sole arbitrator are generally less costly and tend to be more expeditious than proceedings where the fees of three arbitrators have to be paid and where three time schedules have to be accommodated. On the other hand, three arbitrators may bring a wider range of expertise and background to the proceedings. Since the desirable expertise and background can be of different types, different methods of appointing the arbitrators may be envisaged.

4. Appointment of arbitrators

34. [32] On the one hand, in an international case, each party may want to have one arbitrator of its choice who would be familiar with the economic and legal environment in which that party operates. Therefore, the parties might agree on a method by which each party appoints one arbitrator and the third arbitrator is chosen by the two thus appointed or by an appointing authority. On the other hand, in complex disputes involving legal, technical and economic issues, it may be of considerable advantage to have arbitrators with different qualifications and expertise in the relevant fields. Where parties attach particular importance to this aspect, they may wish to entrust an appointing authority with the appointment of all three arbitrators and, possibly, specify the qualifications or expertise required of the arbitrators.

5. Place of arbitration

35. [33] The parties may wish to specify in the arbitration agreement the place where the proceedings are to be held and where the arbitral award is to be issued. The selection of an appropriate place of arbitration may be crucial to the functioning of the arbitral process and to the enforceability of the arbitral award. The following considerations may be relevant to the selection of the place of arbitration.

36. [34] Firstly, the parties may consider it desirable to choose a place of arbitration such that an award issued in that place would be enforceable in the countries where the parties have their places of business or substantial assets. In many States, foreign awards are readily enforceable only by virtue of multilateral or bilateral treaties, and often only on the basis of reciprocity. In some States enforcement is available on the basis of legislation providing for the reciprocal enforcement of awards made in certain other States. The parties may thus wish to choose a place of arbitration in a State that is in such a treaty relationship, or has reciprocal legislative arrangements, with the States where enforcement might later be sought.

37. [35] Secondly, the parties may consider it desirable to choose a place where the arbitration law provides a suitable legal framework for international cases. Some arbitration laws might be inappropriate because, for example,

[5] [*new footnote*] The following clause is recommended in the UNCITRAL Arbitration Rules: "Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force.

Note — Parties may wish to consider adding:

(a) The appointing authority shall be ... (name of institution or person);

(b) The number of arbitrators shall be ... (one or three);

(c) The place of arbitration shall be ... (town or country);

(d) The language(s) to be used in the arbitral proceedings shall be ...".

they unduly restrict the autonomy of the parties or fail to provide a comprehensive procedural framework to ensure efficient and fair proceedings.

38. [36] Considerations of a more practical nature include the following: the convenience of the parties and other persons involved in the proceedings; the availability of necessary facilities, including meeting rooms, support services and communication facilities; the availability of administrative services of an arbitral institution or chamber of commerce, if so desired by the parties; relevant costs and expenses, including expenses for travel, accommodation, meeting rooms and support services; the ability of the parties' counsel to represent the parties without the need to retain local lawyers. Another relevant consideration is that it may be advantageous for the arbitral proceedings to be held in a place which is near to the subject-matter in dispute.

39. [37] Yet other considerations often lead parties to agree on a place other than in the States where they have their places of business. For example, the parties may select a third State because each party may have misgivings about arbitrating in the other party's country; a party in whose State the proceedings are conducted might be thought by the other party to benefit from a familiar legal and psychological environment and from other circumstances facilitating the presentation of the case.

6. Language of proceedings

40. [38] The parties may also wish to specify the language to be used in the arbitral proceedings. The choice of the language may influence the efficiency with which the proceedings are conducted and the cost of the proceedings. Whenever possible, it is desirable to specify a single language, such as the language in which the *documents related to the transaction are* written. When more than one language is specified, the costs of translation and interpretation from one language to the other are usually considered to be part of the costs of arbitration and apportioned in the same way as the other costs of arbitration.

41. [39] The parties may wish to specify the types of documents or communications that must be submitted in or translated into the specified language. They may, for example, require the written pleadings, oral testimony at a hearing, and any award, decision or other communication of the arbitral tribunal to be in the specified language. The tribunal may be given the discretion to decide whether and to what extent documentary evidence should be translated. Such discretion may be appropriate in view of the fact that documents submitted by the parties may be voluminous and that only a part of a document may be relevant to a dispute.

E. Judicial proceedings

42. [40] Disputes that are not settled through negotiation or conciliation will, if the parties do not agree to arbitration, have to be settled in judicial proceedings. Courts of two or more countries may be competent to decide a given dispute between the parties, and in some cases the manner in which a dispute is decided *depends* upon which court decides the dispute. For example, the validity and effect of a choice by the parties of the applicable law will depend upon the rules of private international law in the country of the court deciding the dispute (see chapter XIV, "Choice of law", *paragraph 12*).

43. [41] The uncertainties that arise when more than one court is competent to decide a dispute may be reduced by an exclusive jurisdiction clause, obligating the parties to submit disputes that arise between them to a specified court in a specified place in a specified country. However, the parties should bear in mind that, under many legal systems, a clause conferring exclusive jurisdiction on a court is valid only if the selected court *would, in the absence of the choice-of-jurisdiction clause, have authority* to decide the *type of dispute that is* submitted to it under the clause. Therefore, in selecting a court, the parties should ascertain that the court is legally competent to decide the types of disputes that are to be submitted to it. It is advisable for the clause to specify a court in the selected country, rather than to refer simply to *"a competent court"* in that country, in order to avoid questions as to which court was to decide a given dispute. The clause may stipulate the types of disputes that are subject to it in a manner similar to the specification in an arbitration agreement (see above, *paragraph 19*).

44. [42] In referring disputes to the courts of a particular State, the parties should bear in mind the extent to which a judicial decision made in that State would be enforceable in the countries of the parties, or in any other country in which enforcement may be sought (see above, *paragraph 36*).

45. [43] While an exclusive jurisdiction clause may reduce uncertainties with respect to matters such as the *applicable law* and the enforceability of a decision, and may facilitate the multi-party settlement of disputes (see below, paragraphs *50 to 53*), it may also have certain disadvantages. If a court in the country of one of the parties is given exclusive jurisdiction, and the exclusive jurisdiction clause is invalid under the law of the country of the selected court, but valid under the law of the country of the other party, difficulties may arise in initiating judicial proceedings in either of the countries. Difficulties connected with initiating judicial proceedings may be magnified if the parties confer exclusive jurisdiction on a court in a third country.

F. Multi-contract and multi-party dispute settlement

46. [44] Countertrade transactions often involve several contracts in the two directions, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court. If disputes are to be settled judicially, the parties may wish to confer exclusive jurisdiction on a particular court (see above, paragraphs *43 to 45*). If the parties opt for arbitration or conciliation, they may wish to agree that the arbitral tribunal or conciliator appointed to settle the first dispute that arises will also be

appointed to settle any subsequent disputes that may arise in the countertrade transaction.

47. [45] The selection of a single body to settle disputes would be useful when the disputes to be resolved raise similar questions of fact or law. This may promote economy and efficiency in dispute settlement, facilitate consolidation of dispute settlement proceedings, and lessen the possibility of inconsistent decisions. Even if disputes that may arise under the countertrade transaction do not all raise similar questions of law or fact, the selection of a single dispute settlement body may be advantageous because it may allow the parties to reduce the cost of legal advice and facilitate administration of the transaction.

48. [46] There may, however, be circumstances in which the parties agree to the submission of disputes under a given supply contract to a particular dispute settlement body, but decide to submit disputes under other contracts to a different body. Such circumstances may exist, for example, when it is customary in the practice of the parties or in the trade, or it is required by mandatory rules, that a particular supply contract be submitted to a particular dispute settlement method or body, and the parties do not wish to submit the other contracts in the transaction to that same method or body.

49. [47] The possibility of disputes under more than one contract involving similar questions of fact or law may exist in a number of situations. One such situation is when the subject-matter of the supply contracts in one direction is related to the subject-matter of the supply contracts in the other direction. This may be the case in a buy-back transaction in which, for example, a dispute as to the quality of the counter-export goods manufactured by equipment supplied under the export contract is related to a dispute as to the quality of that equipment. Similarly, in a direct offset transaction, in which the goods supplied in one direction are incorporated into the goods supplied in the other direction, a dispute as to the quality or timeliness of delivery of the goods in one direction may be related to a dispute as to the quality or timeliness of delivery of the goods in the other direction. Another situation in which related disputes may arise is when the countertrade agreement establishes a linked payment mechanism through which proceeds generated by the shipment of goods in one direction are to be used to pay for the shipment of goods in the other direction (see chapter IX, "Payment"). For example, when the importer, in accordance with the countertrade agreement, retains the proceeds of the export contract, a dispute as to the responsibility for a failure to conclude a counter-export contract may lead to a related dispute concerning the transfer of proceeds of the export contract to the exporter. When the countertrade agreement provides for the setoff of payment claims for supply contracts concluded in the two directions, a dispute as to settlement of imbalances may involve questions of fact or law pertaining to supply contracts in either direction. Yet another situation in which related disputes may arise is when the countertrade agreement provides that a problem in the conclusion or performance of supply contracts in one direction is to have an effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction (see chapter XIII, "Failure to complete countertrade transaction", paragraphs *[38] to [60]*).

50. [48] Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods *(see above, paragraph 10)*. For example, when there is a dispute between the counter-exporter and the *party originally committed to purchase* as to whether liquidated damages are payable for a failure to purchase goods, a third-party purchaser engaged by the *party originally committed* to purchase those goods would have an interest in the dispute if a "hold-harmless" clause has been agreed upon between the third-party purchaser and the *party originally committed to purchase* (see chapter VIII, "Participation of third parties", paragraph [33]). Similarly, the *party originally committed to purchase* would be interested in the outcome of a dispute between a third-party purchaser and the counter-exporter if the *party originally committed to purchase* remains liable for the fulfilment of the countertrade commitment despite the engagement of the third-party purchaser. A further example of a multi-party dispute would be when both the party originally committed to purchase and the third-party purchaser are liable to the supplier for the fulfilment of the countertrade commitment and the supplier decides to pursue a claim against both of them.

51. [49] In the types of cases referred to in the preceding paragraph, it may be desirable to settle all related issues in the same dispute settlement proceedings. This could prevent inconsistent decisions, facilitate the taking of evidence, and reduce costs. However, multi-party proceedings tend to be more complicated and less manageable, and a party may find it more difficult to plan and present its case in such proceedings.

52. [49] Many legal systems provide a means for disputes involving several parties to be settled in the same multi-party judicial proceedings. In order to enable disputes involving several parties to be settled in multi-party judicial proceedings, it may be desirable for related contracts to contain a clause conferring exclusive jurisdiction on a court that has the power to conduct multi-party proceedings (see above, paragraphs *43 to 45*). *

53. [*new paragraph*] Multi-party arbitration proceedings are usually possible only if all the participating parties conclude an arbitration agreement submitting their dispute to the same panel of arbitrators. The parties may wish to conclude such a multi-party arbitration agreement at the outset of the transaction, or they may decide to do so after the dispute has arisen when the matters at issue indicate the usefulness of a multi-party arbitration. In some States, after a dispute has arisen, courts are able to assist the parties to implement the multi-party arbitration agreement by deciding procedural issues on which the parties cannot agree (e.g., the question whether an issue is covered by the multi-party arbitration clause, appointment of a single arbitral tribunal, or determination of the place of arbitration). There are also some States in which courts may, under certain conditions, order consolidation of two or more arbitral proceedings into a single arbitration even if not all the parties involved have agreed on the submission of the dispute to a single panel of arbitrators. However, it may be doubtful whether an award rendered in proceedings consolidated by a court order would be enforceable against a party that had not consented to those proceedings.

[A/CN.9/362/Add.16]

DRAFT ILLUSTRATIVE PROVISIONS

CONTENTS

		Page
Introduction		185
Chapter VI.	Type, quality and quantity of goods	185
Chapter VII.	Pricing of goods	185
Chapter VIII.	Participation of third parties	186
Chapter X.	Restrictions on resale of goods	186
Chapter XI.	Liquidated damages and penalty clauses	187
Chapter XIII.	Failure to complete countertrade transaction	187
Chapter XIV.	Choice of law	188
Chapter XV.	Settlement of disputes	188

Introduction

1. The Working Group on International Payments decided that the Legal Guide should include a limited number of illustrative provisions (A/CN.9/357, paras. 93 and 94). The Working Group expressed support for the selection made in document A/CN.9/WG.IV/WP.51//Add.7 of the issues to which illustrative provisions should be added. The present document contains a revision of illustrative provisions published in document A/CN.9/WG.IV/WP.51//Add.7.

2. It is suggested that the illustrative provisions be included in the Legal Guide as footnotes.

3. As noted in document A/CN.9/WG.IV/WP.51//Add.7, paragraph 2, the preparation of the illustrative provisions has been influenced by the following considerations. Firstly, the draft Legal Guide discusses possible contractual solutions in such a way that the reader can derive from the draft chapters guidance to drafting clauses for a countertrade agreement. Secondly, illustrative provisions must of necessity be drafted in a general manner and may therefore not take into account the actual circumstances in a given countertrade transaction. These considerations reduce the number of illustrative provisions that can usefully be added to the Legal Guide.

4. In the Working Group it was suggested that in each illustrative provision reference should be made to the warning set out in chapter I, "Introduction", paragraph 13, that illustrative provisions should not necessarily be regarded as appropriate models for inclusion in individual agreements (A/CN.9/357, para. 93). In order to implement the suggestion, it is proposed that the following title be given to each set of illustrative provisions placed at the end of a given chapter: *"Illustrative provisions to chapter .. (care should be taken in using them, see 'Introduction', paragraph 13)".*

Chapter VI. Type, quality and quantity of goods

[*Editorial note:* The following footnote to paragraph 25, except for the modifications in italics, appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter V, Type, quality and quantity of goods, Footnote to paragraph 13".]

Footnote to paragraph 25

Assuming that *"Y Company" is committed to purchase goods from "X Company"*, the clause *in the countertrade agreement may contain the following elements:*

> *"When X Company makes, pursuant to the countertrade agreement, an offer for the conclusion of a supply contract, the goods offered for purchase must:*
>
> *(a)* be fit for the purposes for which goods of the same description would ordinarily be used;
>
> *(b)* be fit for any particular purpose expressly or impliedly made known to X Company at the time of the conclusion of the countertrade agreement;
>
> *(c)* possess qualities *consistent with those of the sample or model presented by X Company to Y Company;*
>
> *(d)* be contained or packaged in the manner usual for such goods or, where no such *usual manner has been established,* in a manner adequate to preserve and protect the goods."

(The clause is modelled on article 35 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)).

Chapter VII. Pricing of goods

[*Editorial note:* The following footnote to paragraph 48, except for the addition in italics, appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter VI, Pricing of goods, Footnote to paragraph 37".]

Footnote to paragraph 48

Assuming that the currency of payment is the Austrian schilling and that the reference currency is the Swiss franc, the clause may read as follows:

"If, on the date of actual payment, the exchange rate between the Austrian schilling and the Swiss franc is at variance from the exchange rate ... [specify exchange rate prevailing at a particular place] as it was on the date of conclusion of the countertrade agreement by more than ... [e.g, 5 per cent, or some other percentage specified by the parties], the price in Austrian schillings shall be increased or decreased so that that price, as converted into Swiss francs, would remain unchanged from the price as expressed in Swiss francs on the date of conclusion of the countertrade agreement." *(It should be noted that the foregoing clause may lead to an unintended and unsuitable result if the applicable exchange rate were to be set by an administrative decision independent of events in the currency market (see paragraph 49)).*

Chapter VIII. Participation of third parties

[*Editorial note:* The following footnotes to paragraphs 12, 18 and 23 are revisions of the footnotes to paragraphs 10, 16 and 21, which appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter VIII, Participation of third parties". The revisions are underlined. The footnote to paragraph 18, third sentence, is new.]

Footnote to paragraph 12

Assuming that "Y Company" is the party *originally* committed to purchase, the clause may read as follows:

"Y Company is authorized to engage a third-party purchaser to make the purchases necessary to fulfil the countertrade commitment." *(To this clause, the parties may add a stipulation discussed in paragraph 18 indicating whether or not, after the engagement of the third party, the party originally committed continues to be liable for the fulfilment of the countertrade commitment.)*

Footnote to paragraph 18, third sentence

[*new footnote*] Assuming that "Y Company" is the party originally committed to purchase and "X Company" is the supplier, the clause in the countertrade agreement may read as follows:

"The fact that Y Company engages a third party to make the purchases necessary to fulfil the countertrade commitment and that the third party makes a commitment to X Company to make those purchases does not release Y Company from liability for a failure to fulfil the countertrade commitment.

Footnote to paragraph 18, sixth sentence

Assuming that "Y Company" is the party *originally* committed to purchase, *and "X Company" is the supplier,* the clause *in the countertrade agreement* may read as follows:

"Y Company will be released from liability for fulfilment of the countertrade commitment *when, upon the engagement of a third-party purchaser by Y Company, the commitment of Y Company to purchase goods from X Company is transferred to the third-party purchaser. [The transfer includes the obligation to pay the liquidated damages in the case of a failure to make the purchases.] For such a transfer to be effective, Y Company, X Company and the third-party purchaser must agree to the transfer."*

Footnote to paragraph 18, seventh sentence

Assuming that "Y Company" is the party *originally* committed to purchase, *and "X Company" is the supplier,* the clause *in the countertrade agreement* may read as follows:

"Y Company undertakes to release X Company from liability for fulfilment of the countertrade commitment *when, upon the engagement of a third-party purchaser by Y Company, X Company and the third-party purchaser conclude an agreement whereby the third-party assumes a commitment to make* the purchases necessary to fulfil the countertrade commitment *of Y Company."*

If the foregoing provision is included in the countertrade agreement, the actual release of X Company from liability for fulfilment of the countertrade commitment *can be expressed in the following form:*

"X Company, *having agreed with Z Company (third-party purchaser) that Z Company assumes the commitment to make* the purchases necessary to fulfil the countertrade commitment *of Y Company, consents to the release of Y Company from the liability for the fulfilment of the countertrade commitment. The release of Y Company becomes effective when the agreement between X Company and Z Company becomes effective."*

Footnote to paragraph 23

Assuming that "Z Company" is the third-party purchaser, "Y Company" is the party originally committed to purchase, and "X Company" is the supplier, the clause *in the contract between Y Company and Z Company* may read as follows:

"Z Company *shall conclude with X Company an agreement in which Z Company will agree to* make the purchases necessary to fulfil the countertrade commitment set forth in the countertrade agreement between Y Company and X Company, a copy of which is attached to this contract. Z Company agrees to be bound by all the terms and conditions of that countertrade agreement, and in particular Z Company agrees to pay the liquidated damages stipulated in the countertrade agreement in the event Z Company fails to make the purchases necessary to fulfil the countertrade commitment."

Chapter X. Restrictions on resale of goods

[*Editorial note:* The following footnote to paragraph 10 appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter X, Restrictions on resale of goods, footnote to paragraph 9". No substantive change to the text of the footnote has been made.]

Footnote to paragraph 10

Assuming that "Y Company" is the party purchasing goods pursuant to the countertrade agreement and that "X Company" is the supplier, the clause may read as follows:

"Y Company must inform X Company

[*alternative A:*] of the resale of those goods; the information shall be given within ... days after the conclusion of the resale contract.

[*alternative B:*] of the negotiations for the resale of the countertrade goods; Y Company shall give X Company [... days] [sufficient time] to make any observations or suggestions on the intended resale, and Y Company shall refrain from concluding the resale contract under negotiation before the expiry of that time period.

The information to be given must indicate ... [include some or all of the following: country, region within a country, or city to which the countertrade goods are to be shipped; place of business of the person to whom the goods are being resold; resale price; whether the countertrade goods have been re-marked or repackaged prior to resale and, if so, what packaging or marking has been used.]"

Chapter XI. Liquidated damages and penalty clauses

[*Editorial note:* The following footnotes to paragraphs 6, 12 and 26 of draft chapter XI appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter XI, Liquidated damages and penalty clauses" as footnotes to paragraphs 5, 12 and 22. The modifications of the footnotes are in italics].

Footnote to paragraph 6

Assuming that "X Company" is the supplier, "Y Company" is the party committed to purchase, and the Austrian schilling *is* the currency of payment, the clause may read as follows:

[*For failure to purchase goods*]

"(1) If Y Company fails to make the purchases necessary to fulfil the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, Y Company will be obligated to pay to X Company an amount in Austrian schillings equivalent to ... *per cent* of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, Y Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

(2) To the extent that the failure by Y Company results from a failure by X Company to make goods available in conformity with this countertrade agreement, paragraph (1) will not apply."

[*For failure to supply goods*]

"(1) If X Company fails to make the goods available for the fulfilment of the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, X Company will be obligated to pay to Y Company an amount in Austrian schillings equivalent to ... per cent of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, X Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

(2) To the extent that the failure by X Company results from a failure by Y Company to fulfil its obligations under this countertrade agreement, paragraph (1) will not apply."

Footnote to paragraph 12 (provision that could be added to any liquidated damages or penalty clause)

"No damages are recoverable in addition to the agreed sum for the failure for which the agreed sum is payable."

Footnote to paragraph 26 (provision that could be added to any liquidated damages or penalty clause)

Assuming that "X Company" is the beneficiary of the clause and "Y Company" is the party obligated to pay the agreed sum, the stipulation may read as follows:

"If payment of the agreed sum becomes due in accordance with paragraph (1), *X Company* has the right to deduct *the agreed sum from funds of Y Company held by X Company or to set off the claim for the agreed sum against a countervailing claim by Y Company against X Company. [A deduction or setoff is permitted only if the funds held by X Company, or the claim by Y Company, arise from the following contracts ...]"*

Chapter XIII. Failure to complete countertrade transaction

[*Editorial note:* The following footnotes to paragraphs 7, 21, 23, 44 and 50 appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter XIII, Failure to complete countertrade transaction" as footnotes to paragraphs 6, 22, 24, 43 and 49. Slight editorial changes are in italics.]

Footnote to paragraph 7

Assuming *that* "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

"*If X* Company fails to accept a purchase order made by Y Company in accordance with this countertrade agreement [or a purchase order made by a third-party purchaser engaged by Y Company pursuant to this countertrade agreement], Y Company is entitled to declare the amount of the outstanding countertrade commitment reduced by the amount of the purchase order that was not accepted."

When it is agreed that Y Company must give an additional period to X Company, the following clause may be added to the previous one:

"In order to avail itself of the *right to declare* the outstanding countertrade commitment reduced, Y Company must give X Company written notice specifying that the failure to accept the purchase order constituted a breach of the countertrade commitment and that the

outstanding countertrade commitment will be reduced by the amount of the unaccepted purchase order if X Company does not make the goods available within the additional period of [e.g., 30*] days*."

Footnote to paragraph 21

Assuming *that* "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

"(1) [Y Company] [X Company] is exempt from the payment of damages, or of an agreed sum, in respect of a failure to fulfil its obligations under the countertrade agreement if that party proves that the failure was due to a physical or legal impediment beyond its control and that the party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the countertrade agreement or to have avoided or overcome it or its consequences.

(2) The period for the fulfilment of the countertrade commitment will be extended by a period of time corresponding to the duration of the impediment. If the impediment lasts longer than [e.g., six months], [the party against which the impediment is claimed] [either party] may terminate the countertrade agreement by written notice."

Footnote to paragraph 23

[*General definition of exempting impediment followed by illustrative or exhaustive list*]

"(1) [Same text as in para. (1) of the illustrative provision to *paragraph 21*]

(2) [*Illustrative list:*] The following are examples of events that are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1): . . . . [*Exhaustive list:*] Only the following events are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1)."

Footnote to paragraph 44

Assuming that "Y Company" is the exporter (counter-importer) and that "X Company" is the importer (counter-exporter), the clause would read as follows:

"A failure by Y Company to purchase goods pursuant to this countertrade agreement does not entitle X Company to suspend or withhold payment due by X Company to Y Company under the contract for the supply of . . . ."

Footnote to paragraph 50, first sentence

"If a contract for the supply of goods in one direction is terminated, neither party is entitled, irrespective of the cause for the termination, to suspend conclusion of contracts in the other direction or to suspend or withhold performance of obligations under concluded contracts in the other direction."

Footnote to paragraph 50, second sentence

"If a contract for the supply of goods by X Company to Y Company concluded pursuant to this countertrade agreement is terminated, neither party is entitled, irrespective of the cause for the termination, to suspend or withhold performance under the contract for the supply of goods by Y Company to X Company."

Chapter XIV. Choice of law

[*Editorial note:* The footnotes to paragraph 21 (to the second sentence and the fourth sentence) appeared in document A/CN.9/WG.IV/WP.51/Add.7 as footnotes to paragraph 20. The modifications in the text of the footnote to paragraph 21, second sentence, are in italics. The footnotes to paragraphs 15 and 24 are new.]

Footnote to paragraph 15

[*new footnote*] "This countertrade agreement as well as the contracts entered into pursuant to it are to be governed by the rules of (specify the set of rules such as the United Nations Convention on Contracts for the International Sale of Goods)."

Footnote to paragraph 21, second sentence (illustrative provision for the countertrade agreement and for a supply contract)

"*This . . . (specify countertrade agreement or supply contract) is to be governed by the* law of . . . (specify a country or a particular territorial unit) [as in force on . . . (specify date the countertrade agreement or the supply contract is entered *into)]. [This designation refers to the substantive law of (specify the same country or territorial unit as above) and not to its conflict-of-laws rules.*]"

Footnote to paragraph 21, fourth sentence (illustrative provision for the countertrade agreement and for a supply contract)

[Same as in footnote to *paragraph 21*, second sentence, with the addition, after the first sentence, of the following:] "The selected law governs in particular the formation of and validity of the contract and the consequences of its invalidity."

Footnote to paragraph 24

[*new footnote*] "This countertrade agreement is to be governed by the law of . . . (specify a country or a particular territorial unit) [as in force on . . . (specify date the countertrade agreement or the supply contract is entered into)]. The contracts concluded pursuant to this countertrade agreement are to be governed by (specify the same law as in the previous sentence or a different law). [The rules of private international law of . . . (specify the same country or territorial unit as in the previous two sentences) do not apply.]" (For the discussion of the question whether the same national law or different national laws should be chosen, see paragraphs 25 to 29.)

Chapter XV. Settlement of disputes

The model clauses recommended in the UNCITRAL Conciliation Rules and in the UNCITRAL Arbitration Rules are incorporated in footnotes to paragraphs 14 and 30 of chapter XV (A/CN.9/362/Add.15). In order to imple-

ment the decision of the Working Group on International Payments that the Legal Guide should indicate that there exist a number of different conciliation and arbitration rules (A/CN.9/357, para. 101), the following modifications are suggested to draft chapter XV (A/CN.9/362/Add.15):

In paragraph 14, last sentence, delete the words "prepared by an international organization" and add at the end of the paragraph the following sentence: "Other sets of conciliation rules have been prepared by various international and national organizations."

At the end of footnote 1, add the following sentence: "The use of other conciliation rules may also be appropriate in a given case."

In paragraph 30, second sentence, delete the words: "such as the one accompanying the UNCITRAL Arbitration Rules".

At the end of footnote 4, add the following sentence: "The use of other arbitration rules may also be appropriate in a given case."

At the beginning of footnote 5, add the following text: "A number of model arbitration clauses exist. Generally, it is advisable to use the model clause that pertains to the chosen arbitration rules."

[A/CN.9/362/Add.17]

CHAPTER SUMMARIES

The Working Group on International Payments decided that, in order to facilitate the use of the Legal Guide, each chapter should be preceded by a summary (A/CN.9/357, para. 15). In accordance with that decision, the present addendum contains summaries of chapters II to XV of the draft Legal Guide.

II. Scope and terminology of Legal Guide

Countertrade transactions covered by the Legal Guide are those transactions in which one party supplies goods, services, technology or other economic value to the second party, and, in return, the first party purchases from the second party an agreed amount of goods, services, technology or other economic value. A distinctive feature of these transactions is the existence of a link between the supply contracts in the two directions in that the conclusion of the supply contract or contracts in one direction is conditioned upon the conclusion of the supply contract or contracts in the other direction (paragraph 1). The discussion in the Guide on goods is generally applicable also to services, and can be used as a broad guidance also for transactions involving technology (paragraph 2). The focus of the Guide is on countertrade transactions in which the goods are delivered across national boundaries (paragraph 3).

Countertrade transactions take a variety of forms and display differing features. The discussion in the Legal Guide is relevant generally to all types of countertrade unless otherwise indicated (paragraphs 4 to 6).

The Guide focuses on the drawing up of contractual clauses that are specific to or of particular importance for international countertrade (paragraph 7). As a rule, it does not deal with the content of the contracts for individual supplies of goods under a countertrade transaction since those contracts generally resemble contracts concluded as discrete and independent transactions (paragraph 8).

In some countries, countertrade is subject to governmental regulations, which may promote or restrict countertrade in a variety of ways. In addition, various aspects of countertrade transactions are likely to be subject to regulations that are not specifically oriented to countertrade. Since the regulations are disparate and often changed, advice is given, where appropriate, in the form of a general warning that a matter being discussed may be subject to mandatory regulations (paragraphs 9 and 10). Private law questions involved in countertrade generally do not vary from region to region (paragraph 11).

Terminology used in countertrade varies, and no prevailing terminology has developed. The chapter establishes the terminology used in the Legal Guide for various types of countertrade transactions as well as for parties, contracts and subject-matters involved in a transaction (paragraphs 12 to 28).

The terms used for various types of countertrade are: "barter" (paragraph 14); "counter-purchase" (paragraph 15); "buy-back" (paragraph 16); "direct offset" and "indirect offset" (paragraph 17).

The terms used to denote parties to countertrade transactions are: "purchaser"; "supplier" or "party" (paragraph 18); "exporter" or "counter-importer" (paragraph 19); and "importer" or "counter-exporter" (paragraph 20).

The term "countertrade transaction" is used to refer to the whole countertrade arrangement (paragraph 23). The expressions for various contracts forming part of a countertrade transaction are: "countertrade agreement" (an agreement setting forth various stipulations on the manner in which the countertrade transaction is to be implemented (paragraph 24)); "countertrade commitment" (a commitment of the parties to enter into a future contract (paragraph 25)); "supply contracts" (paragraph 26); "export contract", "import contract", "counter-export contract" and "counter-import contract" (paragraph 27).

The use of the term "goods" is explained in paragraph 28.

III. Contracting approach

Parties may embody their obligations in regard to the shipments of goods in the two directions in a single contract or in separate contracts. A single contract may take the form of a barter contract, which is a contract involving an exchange of goods for goods, or the form of a "merged contract", an arrangement in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation (paragraphs 1 to 10).

When the shipments in the two directions are embodied in separate contracts, various contracting approaches are

used. Under one approach, the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently (paragraphs 11 to 19). This approach is used when the parties wish to finalize a contract for the shipment in one direction (export contract) before they are able to agree on the contract for the shipment in the other direction (counter-export contract). The purpose of the countertrade agreement in such a case is to express the commitment to conclude a counter-export contract or contracts and, to the extent possible, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under another approach, the countertrade agreement is concluded prior to the conclusion of any definite supply contracts. This approach is usually used when the parties wish to lay down a contractual framework within which a certain level of reciprocal trade should be generated over a period of time. The aim of the countertrade agreement in such a case is to express the commitment to conclude supply contracts in the two directions and, to the extent possible, to outline the terms of the future contracts and to establish procedures for concluding and carrying out those contracts (paragraphs 11, 12, 20 and 21). Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under yet another approach, the parties conclude simultaneously the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between those contracts (paragraphs 11, 12, 40 and 41). Since this approach does not require a commitment to conclude future contracts, this contracting approach raises a limited number of issues. The main issue to be addressed in the countertrade agreement is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked. Other possible issues are mentioned in paragraphs 41 and 42.

In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. Insurable risks include commercial and non-commercial risks. Among the principles on which the export-credit insurance is based, some are particularly relevant to countertrade transactions (paragraphs 43 to 51, in particular 49 to 52).

Parties often require financing in order to be able to carry out the transaction. An important factor in the consideration by the financial institution whether to grant financing is the ability of the party requesting financing to insure its risk that the payment claim arising from its delivery of goods will not be paid. Financing may be in the form of a supplier credit or a buyer credit (paragraphs 53 to 55).

IV. Countertrade commitment

A countertrade commitment is an undertaking to conclude a future contract or a series of supply contracts in one or in both directions (paragraph 1). A commitment may be a "firm" commitment or a more limited "best-efforts" type of commitment. The Legal Guide focuses on firm countertrade commitments (paragraph 2).

The extent of a countertrade commitment, i.e., the amount of goods to be purchased, may be expressed as an absolute monetary value, as a percentage of the value of the goods delivered, or as a number of units of a given type of goods (paragraphs 3 and 4). The countertrade agreement may provide that only the purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment ("additionality") (paragraphs 5 and 6).

The parties may specify in the countertrade agreement that the period for fulfilment of the countertrade commitment is to commence on a fixed date and to expire on a fixed date (paragraph 7), or that the fulfilment period of an agreed length is to commence when an event specified in the countertrade agreement takes place (paragraph 8). A number of factors are relevant in the determination of the length of the fulfilment period (paragraph 9 to 12). The fulfilment period may be extended in certain circumstances (paragraphs 13 to 16). Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods (paragraphs 17 to 20).

The parties should define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts"). Eligible supply contracts may be defined by specifying the type of goods to be purchased (paragraphs 21 to 25), by the geographical origin of the goods (paragraphs 26 and 27), by the identity or the type of the supplier (paragraph 28), or by the identity or type of purchaser (paragraph 29). It may be agreed that under certain circumstances non-conforming purchases will be counted towards fulfilment of the countertrade commitment (paragraph 30).

In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the deducted amount is referred to as "fulfilment credit"). Sometimes it is agreed that fulfilment credit will be granted at a rate higher or lower than the full purchase price, depending on the type of goods purchased, the identity of the supplier or the time when a purchase is made (paragraphs 31 to 34).

It is advisable that the countertrade agreement indicate the specific action that must be taken in order for the countertrade commitment to be fulfilled. The parties may agree either that fulfilment occurs upon the conclusion of a supply contract or upon the performance of a supply contract (paragraphs 35 to 37).

It is advisable that the parties include in the countertrade agreement, in as definite a manner as feasible, the terms of the future contract (paragraphs 38 to 43) or provide for means for subsequent determination of those terms. Those means include standards or guidelines to be used in determining a particular contract term (paragraphs 44 to 46), determination of a contract term by a third person (paragraphs 47 to 54), and determination of a contract term by a contract party (paragraphs 55 and 56). In addition, the countertrade agreement may provide for negotiation procedures for the conclusion of a supply contract (paragraphs 57 to 60).

The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment (paragraph 61). Such procedures include the exchange of information (paragraphs 62 to 64), the confirmation of fulfilment of a countertrade commitment (paragraphs 65 to 67), and "evidence accounts" (paragraphs 68 to 74).

V. General remarks on drafting

The parties may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts) (paragraphs 1 and 2). The applicable law may require that the contracts should be in writing; even if no such requirement exists, it is recommended that the contracts be in writing (paragraph 3).

In drawing up contracts that make up the countertrade transaction, the following matters should be taken into account: the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents, on the other hand (paragraph 4); designation of one person primarily responsible for supervising the preparation of the drafts (paragraph 5); provisions of the applicable law on the interpretation of contracts and presumptions on the meaning of certain expressions (paragraph 6); mandatory provisions (paragraph 7); introductory recitals (paragraph 8); use of standard forms, general conditions, standard clauses and previously concluded contracts (paragraph 9); use of one or more than one language for the contractual documents (paragraphs 10 to 12); identification and description of the parties in a principal document designed to come first in logical sequence amongst various documents (paragraph 13); the source of the legal status of parties that are legal persons, and any particular considerations when a party is a governmental agency (e.g., authorization for the conclusion of a contract or an arbitration agreement) (paragraph 14); the name, address, status and authority of any agents (paragraph 15).

It is desirable for the parties to consider the form that notifications under the countertrade transaction are to take and the means of transmittal (paragraph 16 and 17), the point of time when notifications are to be deemed effective (paragraph 18), addressees of notifications (paragraph 19), and the consequences of a failure to notify and of a failure to respond to a notification (paragraph 20).

It is advisable to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contracts (paragraphs 21 to 24).

VI. Type, quality and quantity of goods

The discussion concerning "goods" in the Legal Guide is broadly applicable also to services and technology (paragraph 1).

The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known (paragraph 2).

Various commercial considerations enter into the selection of the type of goods to be supplied under the countertrade transaction. The freedom of the parties to agree on the type of goods may be affected by government regulations (paragraphs 3 to 6).

When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of goods the purchase of which would count towards fulfilment of the countertrade commitment. If such a list is used, the parties may settle questions such as the availability of goods on the list, purchaser's duty to provide specifications and requirements, "additionality" and procedure for deciding on the type of goods (paragraphs 7 to 14). Services and technology as subject-matters of countertrade are discussed in paragraphs 15 to 23.

The question of quality of countertrade goods raises two main issues that the parties may address in the countertrade agreement: expressing the level of quality that the goods offered for purchase must possess (paragraphs 24 to 28), and the establishment of procedures to ascertain, before the conclusion of a supply contract, whether goods being offered meet the specified level of quality (paragraphs 29 to 32).

The quantity of goods to be purchased may be specified in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts. The quantity may be expressed as a monetary amount or as a number of units to be purchased, or the quantity may be left to be determined on the basis of the purchaser's requirements or the supplier's output (paragraphs 33 to 39).

Particularly in long-term transactions, it may be provided that, at regular intervals or in response to specified changes of circumstances, the parties will review the provisions in the countertrade agreement on the type, quality or quantity of goods. The parties may wish to stipulate in the countertrade agreement that under certain conditions fulfilment credit would be earned by the purchase of goods other than those stipulated in the countertrade agreement (paragraph 40 and 41).

VII. Pricing of goods

The chapter deals with methods for determining the price of goods that will be the subject-matter of the supply contract to be concluded pursuant to the countertrade commitment. It also deals with certain pricing questions encountered in the specific contexts of supplying services and the transfer of technology. In addition, it discusses the currency in which a price is expressed and the revision of a price.

It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future supply contract. When the parties are not able to do so, it is advisable to provide in the countertrade agreement a method for determining the price at the time the supply contract is to be concluded (paragraphs 1 to 6).

The currency in which the price is to be paid may involve risks arising from the fluctuation in exchange rates between that currency and other currencies. In stipulating the currency, the parties should take into consideration foreign exchange regulations. The parties may wish to denominate the price in a stable currency or in a unit of account (paragraphs 7 to 10).

The countertrade agreement may provide for a determination of the price through the use of a standard, a method that provides a price at the time of the conclusion of a

supply contract in a manner not influenced by the will of the parties. Possible price standards include: a reported market price for goods or services of standard quality; production cost of the goods; competitor's price; most-favoured-customer price (paragraphs 11 to 20).

The parties may stipulate in the countertrade agreement that the price to be paid under a future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement. It is advisable that, to the degree possible, the parties agree on guidelines for the negotiation of the price (paragraphs 21 to 24).

Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question) (paragraphs 25 and 26). Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement, a method with respect to which utmost caution is advisable (paragraph 27).

Prices for services may be set as rates for units of work processes or as a lump sum, or they may be set on a cost-reimbursable basis (paragraphs 28 to 31).

For setting the price for a technology transfer, the two principal forms are the lump-sum payment and payment of royalties (paragraphs 32 to 38).

When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. A revision may take place at specified points of time or in response to specified changes in the economic conditions (paragraphs 39 to 43). Possible methods of price revision include the reapplication of the method used to determine the original price (paragraph 44); an index clause, a method by which the price of the countertrade goods is made to depend on the levels of the prices of specified goods or services (paragraphs 45 to 47); a currency clause or a unit-of-account clause, whereby the price is linked to an exchange rate between the currency in which the price is to be paid and a stipulated other currency (paragraphs 48 to 52).

VIII. Participation of third parties

The chapter deals with cases in which a party committed to purchase or committed to supply goods, instead of itself purchasing or supplying goods, engages a third party to do so (sections B and C). Section D deals with "multi-party" transactions that are distinct from the cases discussed in sections B and C.

A party committed under a countertrade agreement to purchase goods (party "originally" committed to purchase goods) often engages a third party ("third-party purchaser") to make those purchases (paragraphs 4 to 7). When such participation of a third-party purchaser is envisaged, it is advisable to address in the countertrade agreement the question of the selection of the third-party purchaser and the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment (paragraphs 9 to 20). In addition, the party originally committed to purchase goods and the third-party purchaser should conclude a contract to deal with questions such as the nature of the commitment of the third party (a "firm" commitment or a "best-efforts" commitment, paragraph 22); fee payable to the third party (paragraphs 30 to 36); "hold-harmless" clause (paragraph 37); and the question whether the third party should have an exclusive or non-exclusive mandate to purchase and resell the goods (paragraphs 38 to 40).

Sometimes, the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser or a third party may assume in the future (paragraph 8).

The party committed to supply goods (party "originally" committed to supply) sometimes designates a third party ("third-party supplier") to supply the goods (paragraphs 41 to 44). When the participation of a third-party supplier is envisaged, it is advisable for the countertrade agreement to address the selection of the third party and the consequences of the failure by the third party to make the agreed goods available. In some transactions, the selection of the third-party supplier is left to the party committed to purchase goods (paragraphs 45 and 46). In other transactions, the selection is left to the party originally committed to supply goods (paragraphs 47 to 52).

As to "multi-party" countertrade transactions, three types are described in the chapter: *(a)* tripartite transaction that involves the exporter (who does not at any stage of the transaction assume a commitment to counter-import), the importer and the third-party counter-importer; *(b)* tripartite transaction that involves the exporter, the importer (who does not at any stage of the transaction assume a commitment to counter-export) and a third-party counter-exporter; and *(c)* four-party transaction in which the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties (paragraphs 53 to 58).

IX. Payment

Parties to a countertrade transaction may decide to link payments for the supply contracts in the two directions in such a way that the proceeds generated by the supply contract in one direction are to be used to pay for the supply contract in the other direction. This allows the transfer of funds between the parties to be avoided or reduced (paragraphs 1 to 8).

Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract) in order to generate funds to pay for the counter-export. In such a case, sometimes referred to as "advance purchase", it may be agreed that the proceeds of the export contract are to be retained by the importer until payment under the subsequent counter-export contract becomes due (paragraphs 9 to 13). When in an advance-purchase situation the proceeds generated by the export contract are not to be left under the control of the importer, the parties may agree on the use of a "blocked account" or of "crossed letters of credit" (paragraphs 14 to 18). Under a blocked-account method, the proceeds generated by the export contract are deposited in an account at an agreed bank, and the release of the money, intended as payment for the counter-export goods, is subject to agreed conditions (paragraphs 19 to 30). When crossed letters of credit are to be used, the funds payable under a letter of credit opened by the importer in favour of the exporter ("export letter of credit") are blocked in order

to be used to cover the letter of credit opened by the counter-importer in favour of the counter-exporter ("counter-export letter of credit") (paragraphs 31 to 37).

The parties may agree that their payment claims arising from the shipments made in the two directions would be set off. If an imbalance arises in the values of the deliveries, it can be settled by delivery of additional goods or by payment of money. In order to facilitate the setoff of claims, in particular in the case of multiple shipments, the parties may wish to use a record-keeping mechanism, which is referred to in the Guide as a "setoff account". A setoff account may be administered by the parties themselves or by a bank or banks (paragraphs 38 to 57).

Certain issues common to linked payment mechanisms (currency, designation of banks, interbank agreements, unused or excess funds, supplementary payments or deliveries, and bank charges) are discussed in paragraphs 58 to 65.

In the case of a "multi-party" countertrade transaction (i.e., "tripartite" or "four-party" countertrade; see chapter VIII), it might be agreed that the proceeds of the supply contract between one pair of parties will be used to pay for the supply contract between a different pair of parties. In a tripartite transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer; the counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a tripartite transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer, and the counter-importer (exporter) agrees that the payment claim under the export contract is discharged up to the value of the goods delivered to the counter-importer. In a four-party transaction, the exporter ships goods to the importer, and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter (paragraphs 66 to 73).

As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade (paragraphs 74 to 77).

X. Restrictions on resale of countertrade goods

Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of goods purchased pursuant to the countertrade commitment (paragraphs 1 and 2).

The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices (e.g., against agreements setting a minimum price) (paragraph 3).

When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction (paragraphs 4 to 7).

Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction (paragraph 8).

The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods (paragraphs 9 and 10).

Parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods may resell those goods (paragraphs 11 to 16).

Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. It should be noted that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is generally prohibited or permitted only in limited circumstances (paragraphs 17 to 20).

The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. The parties should ensure that any packaging or marking requirements do not conflict with mandatory provisions at the place where the goods are to be resold (paragraphs 21 and 22).

When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in the observation by the third party of resale restrictions stipulated in the countertrade agreement (paragraphs 23 and 24).

Changes in the underlying commercial circumstances may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions (paragraph 25 and 26).

XI. Liquidated-damages and penalty clauses

Liquidated-damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation, or a failure to perform it on time, entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties established their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or to do both (paragraph 1).

The chapter focuses on liquidated-damages and penalty clauses covering a failure to fulfil the countertrade commitment (paragraph 2). Such a failure may take the form of non-fulfilment or delayed fulfilment of the commitment (paragraphs 3 and 4). The clause may cover the purchaser's commitment to purchase goods or the supplier's commitment to make goods available (paragraphs 5 and 6).

Many national laws have provisions on liquidated-damages and penalty clauses. Those provisions include: a

mandatory restriction in some legal systems that clauses fixing an agreed sum to stimulate performance are invalid and that the party subject to such a clause is liable for a failure to perform only for the damages recoverable under the general law (paragraph 7); rules giving a power to the courts to reduce the amount of the agreed sum, or to award additional damages when the actual damage exceeds the agreed sum (paragraph 7); the rule that the agreed sum is not due if the party who failed to perform the obligation in question is not responsible for the failure (paragraph 8); other rules on the relationship between the recovery of the agreed sum and the recovery of damages (paragraph 12).

Liquidated-damages or penalty clauses should be distinguished from clauses limiting the amount recoverable as damages, clauses providing alternative obligations and clauses establishing an obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing payment claims are to be set off (paragraphs 9 and 10).

Where a party originally committed to purchase or to supply goods engages a third party to fulfil that commitment, it may be agreed that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods (paragraph 11).

An important question to consider is whether, by claiming the agreed sum, the beneficiary of the clause should be deemed to have forsaken fulfilment of the underlying obligation. Often the intention of the parties to countertrade transactions is that the beneficiary who chooses to claim the agreed sum is precluded from also claiming the fulfilment of the countertrade commitment. Sometimes, the parties intend that the agreed sum is to be payable for delay in fulfilment of the commitment, in which case the countertrade commitment remains outstanding despite payment of the agreed sum. It is advisable that the parties specify the effect of payment in the countertrade agreement (paragraphs 13 to 16).

The amount of liquidated damages or a penalty may be expressed as an absolute amount or as a percentage of the value of the outstanding countertrade commitment (paragraph 17). When the clause covers delay, an agreed sum is often fixed by way of increments, a specified amount being due for a specified time unit of delay (paragraph 18). Considerations relating to determining the appropriate amount of the agreed sum are discussed in paragraphs 19 to 23.

Issues related to obtaining the agreed sum that may be dealt with in the countertrade agreement include the following: a cut-off time for claiming the agreed sum (paragraph 24); payment of the agreed sum when the period for the fulfilment of the countertrade commitment is divided into subperiods (paragraph 25); a beneficiary's right to deduct the agreed sum from funds held by the beneficiary or a beneficiary's right to set off the claim to the agreed sum against a countervailing claim (paragraph 26); an independent guarantee to cover the obligation to pay the agreed sum (paragraph 27). The countertrade agreement may also address the possibility to terminate the countertrade commitment when the liquidated-damages or penalty clause covers delay (paragraph 28), and the effect of the termination of the countertrade commitment on the obligation to pay the agreed sum (paragraph 29).

XII. Security for performance

The parties to a countertrade transaction may agree to use a guarantee to cover the fulfilment of the countertrade commitment. A guarantee may be used for the obligation to purchase goods, the obligation to supply goods, or both those obligations (paragraph 1).

A guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor is obligated to pay when the beneficiary of the guarantee presents to the guarantor a demand for payment and any additional document required under the terms of the guarantee; such a document may be, for example, the beneficiary's statement that the party who procured the guarantee (the "principal") has breached the underlying obligation, the beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person stating that the breach of the underlying obligation has occurred. The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and the supporting documents conform to the requirements specified in the guarantee. Despite the independence of the guarantee from the underlying obligation, payment under the guarantee may exceptionally be refused, in particular when the payment claim is fraudulent (paragraph 3).

Under an accessory guarantee, the guarantor must, before paying a claim, ascertain whether the underlying obligation was breached, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary (paragraph 4).

The discussion in the chapter is limited to independent guarantees, without thereby implying a preference for this type of guarantee. The discussion in the chapter applies not only to securities in the form of guarantees but also to securities in the form of stand-by letters of credit, which are the functional equivalent of independent guarantees (paragraphs 5 and 6).

When a guarantee is to be used, the parties should include in the countertrade agreement provisions on questions such as: who is to procure the guarantee (paragraph 8); whether payment under the guarantee releases the principal from the countertrade commitment (paragraph 9); the identity of the guarantor or how a guarantor is to be chosen (paragraphs 10 to 16); the documents that the beneficiary would have to present for the guarantor to be obligated to pay (paragraphs 17 to 22); the amount of the guarantee and possibly a mechanism to reduce that amount as fulfilment of the countertrade commitment progresses (paragraphs 23 to 26); time when the guarantee is to be issued (paragraphs 27 to 30); expiry of the guarantee (paragraphs 31 to 33); return of the guarantee instrument (paragraph 34); obligation to procure an extension of the guarantee as a result of an extension of the period for the fulfilment of the countertrade commitment (paragraphs 35 and 36); modification of the underlying commitment and modification of the guarantee (paragraphs 37 to 39).

In transactions in which goods shipped in the two directions are not to be paid in money, guarantees may be used to secure the liquidation through cash payment of a possible imbalance in the flow of trade (paragraphs 40 to 48).

XIII. Failure to complete countertrade transaction

This chapter discusses remedies for non-fulfilment of the countertrade commitment (section B) and circumstances in which a party is exonerated from liability for a failure to fulfil the countertrade commitment (section C). Also discussed is the effect of a failure to conclude or perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section D). The discussion is set in the context of "firm" countertrade commitments (paragraphs 1 to 3).

It is advisable that countertrade agreements stipulate the remedies for a failure to fulfil the countertrade commitment since national laws generally do not contain rules specifically tailored to countertrade (paragraphs 4 and 5). Remedies to be considered are the release of a party from the countertrade commitment (paragraphs 6 to 10) or a monetary compensation, in particular in the form of liquidated damages or a penalty (paragraphs 11 and 12).

During the period for the fulfilment of the countertrade commitment, events of a legal or physical nature may occur that impede, permanently or temporarily, a committed party from concluding an envisaged supply contract. The party who fails to fulfil its commitment due to such an impediment may, according to the applicable law or according to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or may be released altogether from the commitment. Impediments that give rise to such an exemption are referred to as "exempting impediments" (paragraph 13).

Many national laws contain provisions concerning exempting impediments. However, since those provisions may lead to results that are incompatible with the needs of a given transaction, the parties may wish to include in the countertrade agreement a clause specifying the legal consequences of an exempting impediment (paragraphs 14 to 18) and a clause defining exempting impediments (paragraphs 19 to 34). The countertrade agreement may also contain a requirement that the party invoking an exempting impediment must give written notice of the impediment to the other party (paragraphs 35 and 36).

Since in a countertrade transaction the conclusion of a supply contract in one direction is conditioned upon the conclusion of a supply contract in the other direction, the question may arise whether a failure to conclude or perform a contract in one direction should have an effect on the obligation to conclude or perform a contract in the other direction. National laws normally do not provide a specific answer to the question of such interdependence of obligations in countertrade transactions. Therefore, in order to avoid uncertainty or disagreement, the parties may wish to include in the countertrade agreement clauses indicating the extent of the interdependence of obligations (paragraphs 37 to 42). Such clauses may address in particular the following problems in the completion of countertrade transactions: failure to conclude a supply contract as stipulated in the countertrade agreement (paragraphs 43 to 48), termination of a supply contract (paragraphs 49 to 55), failure to meet a payment obligation under a supply contract (paragraphs 56 to 60), failure to deliver goods under a supply contract (paragraph 61).

XIV. Choice of law

The chapter focuses on the choice by the parties to a countertrade transaction of the law applicable to the countertrade agreement, the supply contracts in the two directions, and the contract by which a party committed to fulfil a countertrade commitment engages a third party to fulfil that commitment. The chapter considers also the question whether the countertrade agreement and the contracts forming part of the transaction should be made subject to a single national law or to different national laws (paragraph 1).

Under the rules of "private international law" (or "conflict-of-laws" rules) of many States, parties are permitted to choose by agreement the applicable law, though under some of those laws there are restrictions on that choice. If the parties do not choose the applicable law, the applicable law is determined by the application of rules of private international law (paragraph 2). By choosing the applicable law, the parties do not make a choice as to jurisdiction (paragraph 3). Whatever the chosen law, particular aspects of the countertrade transaction may be affected by mandatory rules (paragraphs 4 and 30 to 33). The extent to which the parties may designate issues to be governed by the chosen law may be limited (paragraph 5). The relevance of the United Nations Sales Convention for a countertrade transaction is discussed in paragraph 6.

In order to avoid uncertainty as to what law applies, it is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts (paragraphs 8 to 11). The extent to which the parties are allowed to choose the applicable law is determined by the rules of private international law. Under some systems of private international law, the autonomy of parties is limited, and they are permitted to choose only a national law that has some connection with the contract (the "nexus" rule). Under most systems of private international law, parties are permitted to choose the applicable law without those restrictions (paragraph 12).

When choosing the applicable law, it is in general advisable to choose the law of a particular country (paragraphs 13 to 18). Parties may wish to take the following factors into consideration in choosing the applicable law: the parties' knowledge of, or possibility of gaining knowledge of, the law; the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship; the extent to which the law contains mandatory rules that would prevent the parties from settling by agreement questions that arise in their contractual relationship (paragraph 19). Further issues the parties may wish to bear in mind are: possible changes legislated in the law chosen by the parties (paragraph 20); approach to the drafting of the choice-of-law clause (paragraph 21); separateness of the choice-of-law clause from the rest of the contract (paragraph 22); applicability of the chosen law to the prescription of rights (limitations of actions) (paragraph 23); advisability of designating the applicable law not only for the countertrade agreement but also for the future supply contracts (paragraph 24).

In choosing the applicable law, the parties may wish to consider whether the countertrade agreement and the supply contracts should be made subject to a single national law or to different national laws (paragraphs 25 to 29).

XV. Settlement of disputes

It is advisable that the parties agree on the method by which future disputes arising out of the countertrade agreement and the related supply contracts would be settled. Dispute-settlement methods include negotiation, conciliation, arbitration and judicial proceedings (paragraphs 1 to 6). In some States, restrictions exist as to the freedom of a State agency to conclude an arbitration agreement or to agree to the jurisdiction of a court of a foreign State (paragraph 7).

Usually, the most satisfactory method of settling a dispute is through amicable settlement by negotiation between the parties (paragraphs 8 to 11).

If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceedings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator. If the parties provide for conciliation, they may settle relevant procedural issues by agreeing on a set of conciliation rules such as the UNCITRAL Conciliation Rules (paragraphs 12 to 15).

There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions (paragraphs 16 and 17). In general, arbitral proceedings may be conducted only if the parties agree thereto. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction (paragraphs 18 and 23). The parties are able to select the type of arbitration that best suits their needs (paragraphs 24 to 26).

The arbitral proceedings will normally be governed by the procedural law of the State where the proceedings take place. It is advisable for the parties to agree on a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution (paragraphs 27 to 29). Some arbitration rules contain a model arbitration clause that invite the parties to settle in the arbitration clause matters such as the involvement of an appointing authority and the number of arbitrators (paragraphs 30 to 34), the place of arbitration (paragraphs 35 to 39) and the language or languages to be used in the arbitral proceedings (paragraphs 40 and 41).

Disputes that are not settled through negotiation or conciliation can be settled, if the parties do not opt for arbitration, in judicial proceedings. Courts of two or more States may be competent to decide a given dispute. Parties may agree on a jurisdiction clause under which the parties are obligated to submit disputes to a specified court (paragraphs 42 to 45).

Countertrade transactions often involve several contracts, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court (paragraphs 46 to 49).

Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods. In such multi-party disputes, it may be desirable to settle all related issues in the same dispute settlement proceedings (paragraphs 50 to 53).