

*Draft chapter VI, "Pricing of goods"**Footnote to paragraph 37*

96. It was suggested to include in the illustrative provision, and in the accompanying text, a warning that the clause might not operate in the intended way if the exchange rate of the currency of payment and the reference currency was subject to administrative regulations.

*Draft chapter VIII, "Participation of third parties"**Footnote to paragraph 10*

97. The Working Group requested the Secretariat to revise the four illustrative provisions so as to ensure that the various scenarios for the involvement of a third-party purchaser discussed in the legal guide were illustrated.

Draft chapter XIII, "Failure to complete countertrade transaction"

98. No changes to the illustrative provisions were suggested.

*Draft chapter XIV, "Choice of law"**Footnotes to paragraph 20, second and fourth sentences*

99. It was suggested that an illustrative provision should be added to cover the situation in which the parties agreed

to settle the question of the law applicable to the various component contracts of a countertrade transaction by a single clause in the countertrade agreement. Such an approach might be used, in particular, when the countertrade agreement was concluded prior to the conclusion of the supply contracts in the two directions.

100. It was suggested that the illustrative provisions for chapter XIV should be expanded so as to reflect the discussion by the Working Group on the choice by the parties of international conventions and of non-legislative rules (see paragraph 81 above). As to the reference to international conventions, it was suggested that language illustrating the choice of an international convention, including the selection of the United Nations Sales Convention, could be added, either by expanding the existing illustrative provision or by including an additional provision.

*Draft chapter XV, "Settlement of disputes"**Footnotes to paragraphs 12 and 28*

101. It was suggested that the illustrative provisions should be broadened so as to indicate that a number of different conciliation and arbitration rules existed. Merely modifying the text of the relevant paragraphs in the legal guide to indicate that different rules were available was not considered sufficient if the illustrative provisions were not also modified.

**B. Working papers submitted to the Working Group on International Payments at its twenty-third session: draft chapters of legal guide on drawing up contracts in international countertrade transactions: sample chapters:* report of the Secretary-General
(A/CN.9/332/Add.8 and A/CN.9/WG.IV/WP.51 and Add.1-7)
[Original: English]**

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*The text contained herein is a first draft prepared by the Secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

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VII. FULFILMENT OF COUNTERTRADE COMMITMENT

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A. General remarks

1. The countertrade agreement should address several questions related to the fulfilment of the countertrade commitment. One question concerns the types of supply contracts that are eligible to be counted towards fulfilment (paragraphs 2 to 9 below). Another question is whether the countertrade commitment is fulfilled at the moment when the parties enter into a supply contract or at some subsequent point during the performance of the supply contract (paragraphs 10 to 12 below). A further question is whether an amount equivalent to the price payable under a supply contract, or a greater or lesser amount, is to be subtracted from the outstanding countertrade commitment (paragraphs 13 to 16 below). Yet another question concerns the period of time during which the countertrade commitment is to be fulfilled (paragraphs 17 to 30 below). The parties may also wish to establish procedures for monitoring and recording fulfilment (paragraphs 31 to 44 below).

B. Defining eligible supply contracts

2. 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*

3. 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 V, "Type, quality and quantity of goods", paragraphs 2 to 11.)

4. 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 labor, 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 programs, 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.

5. 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 toward fulfilment (see chapter V, paragraphs 26 and 27).

2. By geographical origin

6. 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.

3. By identity of supplier

7. 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 13). 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 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

8. 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

9. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement would 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 paragraphs 23 to 26 below). 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 14 and 15 below).

C. Stage when commitment fulfilled

10. It is advisable that the countertrade agreement indicate the specific events that must occur in order for the countertrade commitment to be fulfilled. The parties may chose 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.

11. Under the other 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 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 non-breaching 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.

12. 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, "Interdependence of obligations", paragraph —).

D. Amount of fulfilment credit

13. 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 than the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain costs (e.g., transportation and insurance) not included in the purchase price 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.

14. 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 per cent of the purchase value for one type of goods and 150 per cent for another. Such a variable rate of fulfilment credit could be desirable for a supplier who wishes to promote the purchase of certain types of goods. In an offset transaction, the countertrade agreement may provide 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). In direct offset, as well as in buy-back, the countertrade agreement may pro-

vide 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.

15. 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.

16. 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).

E. Time period for fulfilment of countertrade commitment

1. Length of fulfilment period

17. 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.

18. 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 fulfil-

ment 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.

19. 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.

20. 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.

21. 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 direction. 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 35 to 52) or an evidence account (paragraphs 38 to 44 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.

22. 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*

23. 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.

24. 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 — to —, for a discussion of exemption and hardship clauses).

25. The countertrade agreement may provide that an extension would be granted if the party seeking an extension has made good faith efforts to fulfil the commitment. It is advisable that such a provision indicate how the purchaser could demonstrate good faith efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show a certain number of contacts with potential suppliers in search of suitable countertrade goods. 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.

26. 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 33 and 34).

3. *Subperiods within fulfilment period*

27. 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.

28. 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.

29. 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.

30. The parties may wish to set deadlines within the fulfilment period for completion of different actions related to fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, placing orders, shipping goods or opening letters of credit.

F. Monitoring and recording fulfilment of countertrade commitment

31. 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

32. 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, "Introduction", paragraph 13), 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.

33. 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 that 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.

34. 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

35. 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 confirmed by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

36. 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.

37. 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

38. The parties may agree that their mutual shipments of goods 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. 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.

39. 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.

40. 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.

41. 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 require-

ments should be in line with the provisions in the countertrade agreement concerning the stage when the countertrade commitment is deemed fulfilled (see paragraphs 10 to 12 above). 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.

42. 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 is advisable to agree that during the fulfilment period the values of the shipments may deviate from the agreed ratio, with the agreed upon ratio to be achieved upon the conclusion of the fulfilment period or at 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 failure by a party to conclude the supply contracts necessary to achieve the agreed upon ratio may be 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.

43. In order to minimize errors or discrepancies in the evidence account, the parties may agree to verify at fixed points of time the information entered in the account.

44. 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/WG.IV/WP.51]

INTERNATIONAL COUNTERTRADE: DRAFT CHAPTERS OF LEGAL GUIDE ON DRAWING UP CONTRACTS IN INTERNATIONAL COUNTERTRADE TRANSACTIONS: REPORT OF THE SECRETARY-GENERAL

1. The Commission, at its nineteenth session (1986), in the context of its discussion of a note by the Secretariat entitled "Future work in the area of the new international economic order" (A/CN.9/277), considered its future work on the topic of countertrade. 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.¹

¹Report 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)*, 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 next 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 the following materials prepared by its secretariat: a proposed structure of the legal guide (A/CN.9/332, para. 6); an outline of the introductory chapter to the legal guide (A/CN.9/332/Add.1); draft chapter II, "Scope and terminology of legal guide" (A/CN.9/332/Add.1); draft chapter III, "Contracting approach" (A/CN.9/332/Add.2); draft chapter IV, "General remarks on drafting" (A/CN.9/332/Add.3); draft chapter V, "Type, quality and quantity of goods" (A/CN.9/332/Add.4); draft chapter VI, "Pricing of goods" (A/CN.9/332/Add.5); draft chapter IX, "Payment" (A/CN.9/332/Add.6); and draft chapter XII, "Security for performance" (A/CN.9/332/Add.7). Draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), was submitted to the Commission but was not considered by the Commission.²

5. 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).

6. The Commission decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them, together with draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), to the Working Group on International Payments. The Commission also decided that the Secretariat should redraft the chapters considered by it at its twenty-third session and the chapters to be submitted to the Working Group on International Payments in the light of the discussion at those sessions. The Commission also decided that the final text of the legal guide should be submitted to its twenty-fifth session, to be held in 1992 (A/45/17, paras. 17 and 18).

7. Addenda 1 to 6 to the present document contain draft chapters VIII, X, XI, XIII, XIV and XV, prepared pursuant to the above decision of the Commission. Addendum 7

contains sample draft illustrative provisions that may be used in drawing up a countertrade agreement; such illustrative provisions are expected to be set forth in footnotes to chapters of the final text of the legal guide. In preparing those draft chapters and sample draft illustrative provisions, the Secretariat has taken into account a broad range of relevant documents, contracts, books and articles. In addition, the Secretariat has benefited from the comments of an expert group that was convened by the Commission's secretariat at Vienna from 12 to 15 December 1989.

8. The Working Group may wish to consider the structure of these chapters, whether they cover the relevant issues, whether the statements made appropriately take into account the needs of countertrade practice and whether advice given is appropriate.

9. The proposed structure of the legal guide is as follows:

- I. Introduction to Legal Guide. This draft chapter, which will describe the origin, purpose, approach and structure of the legal guide, will be prepared for the twenty-fifth session of the Commission (an outline of this draft chapter is contained in A/CN.9/332/Add.1).
- II. Scope and terminology of Legal Guide (A/CN.9/332/Add.1)*
- III. Contracting approach (A/CN.9/332/Add.2)*
- IV. General remarks on drafting (A/CN.9/332/Add.3)*
- V. Type, quality and quantity of goods (A/CN.9/332/Add.4)*
- VI. Pricing of goods (A/CN.9/332/Add.5)*
- VII. Fulfilment of countertrade commitment. This draft chapter, contained in A/CN.9/332/Add.8, the Commission referred to the Working Group on International Payments.
- VIII. Participation of third parties (addendum 1 to the present document)
- IX. Payment (A/CN.9/332/Add.6)*
- X. Restrictions on resale of countertrade goods (addendum 2 to the present document)
- XI. Liquidated damages and penalty clauses (addendum 3 to the present document)
- XII. Security for performance (A/CN.9/332/Add.7)*
- XIII. Problems in completing countertrade transaction (addendum 4 to the present document)
- XIV. Choice of law (addendum 5 to the present document)
- XV. Settlement of disputes (addendum 6 to the present document).

²A summary of the discussion in the Commission on the draft chapters (A/CN.9/332/Add.1-7) is contained in annex I to the report of the Commission on the work of its twenty-third session (A/45/17).

*This draft chapter, submitted to the twenty-third session of the Commission (1990), will be revised in the light of the discussion at that session and any observations made at the twenty-third session of the Working Group on International Payments (1991), and will be submitted to the twenty-fifth session of the Commission in 1992.

[A/CN.9/WG.IV/WP.51/Add.1]

VIII. PARTICIPATION OF THIRD PARTIES

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A. General remarks

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. 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.

2. The Legal Guide does not discuss the case in which a party committed to purchase goods engages a third person only to locate persons to whom the goods could be resold or to represent the committed party in the resale of the goods. In such cases the third person does not purchase the goods in its own name. The use by the purchaser of such services by third persons is not discussed since the consent of the supplier is normally not required and such involvement of third persons therefore does not have to be addressed in the countertrade agreement.

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. Various restrictions that may be placed on the resale of countertrade goods are discussed in chapter X.

B. Purchase of countertrade goods

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. 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. (Implications of the commitment by the third party are discussed below in paragraphs 15 and 16; the terms of the third party's commitment are discussed below in paragraph 20.)

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 61 to 67.

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 VII, "Fulfilment of countertrade commitment", paragraphs 13 to 16). 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, the right of transfer of countertrade credit is regulated by law.

1. Countertrade agreement

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. Absent a provision authorizing the engagement of a third party, a disagreement may arise as to whether the party originally committed is entitled to engage a third party to fulfil the countertrade commitment. The party originally committed to purchase goods may consider that the commitment is not a personal obligation and that, even without the consent of the supplier, the commitment may be fulfilled by purchases made by a third party engaged by the party originally committed. The supplier, on the other hand, may take the position that the purchases must be made by the party originally committed to purchase the goods. The supplier may be prompted to take such a position, for example, by a belief that the resale of the goods by the party with whom the countertrade agreement has been concluded would establish a place for the goods in the market or maintain the market image of the goods.

9. The participation of third parties in the fulfilment of countertrade commitments may be subject to mandatory rules. Such rules may 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 prevent the marketing of the goods in traditional export markets of the State in question.

(a) Selection of third party

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.

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.

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. It is advisable to indicate in the countertrade agreement 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.

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).

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 paragraphs 28 to 31 below) 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

15. It is advisable for the parties to the countertrade agreement to consider 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 paragraph 5 above).

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.

17. As noted in paragraph 20 below, third parties sometimes limit their commitment to a promise to exercise "best efforts" to make the purchases. When the third party is to replace the party originally committed as the party liable to the supplier, it is advisable that the countertrade agreement stipulate that the commitment of the third party to the supplier should be 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.

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 origi-

nally 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*

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.

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 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).

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 paragraphs 5 and 15 above).

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.

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.

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, it would be in the interest of the party originally committed to obtain the agreement of the supplier to pay liquidated damages or a penalty or to provide a guarantee to support the assurance of the availability of the goods.

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.

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 the party originally committed to make alternative arrangements should the third party fail to make those purchases.

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*

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 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 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.

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).

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*".

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.

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 termina-

tion or reduction of the countertrade commitment may result, for example, from the termination of the export contract (see chapter XIII, "Problems in completing 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.

(c) *"Hold-harmless" clause*

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 paragraphs 15 and 16 above). 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*

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.

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.

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 to be 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

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 13. 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.

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 61 to 67.

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.

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.

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 VII, "Fulfilment of countertrade commitment," paragraph 7.

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, "Problems in completing countertrade transaction", paragraphs ____.)

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 (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.

44. When the selection of the third-party supplier is left to the party who is to supply goods under the countertrade agreement, it is advisable to provide that the third party must be in a position to make available goods that conform to the terms of the countertrade agreement. It is also 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 agreed 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. Alternatively, an obligation to pay liquidated damages or a penalty in case of a failure to make goods available, or to obtain a guarantee to cover such an eventuality, would be assumed by the third-party supplier.

D. Multi-party countertrade

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.

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 transac-

tion 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.

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 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 transaction 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.

48. In many cases, a feature of the tripartite transactions described in paragraphs 46 and 47 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 61 to 67.

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 61 to 67). 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.

[A/CN.9/WG.IV/WP.51/Add.2]

X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS

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A. General remarks

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. 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. 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. 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. In negotiating a restriction on the resale of countertrade goods the parties should be aware that such a restriction may 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 is likely to 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. 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, the supplier may wish to ensure that the third party is aware that the purchases made by the third party will be subject to that restriction (see paragraphs 22 and 23 below).

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. 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.

B. Duty to inform or consult

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 because the type of goods to be purchased has not been specified at the time of the conclusion of the countertrade agreement.

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

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.

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 "Western 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.

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.

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 pur-

chased 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.

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 in paragraph 3 above, 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.

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

16. Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. As pointed out in paragraph 3 above, 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.

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.

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 have 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 VI, "Pricing of goods", paragraphs 11 to 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

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 packaging include instructions for use and that the instructions be in a particular form.

21. The parties should ensure that any packaging or marking requirements in the countertrade agreement do not conflict with legal rules applicable where the goods are to be resold. 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

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.

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

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.

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/WG.IV/WP.51/Add.3]

XI. LIQUIDATED DAMAGES AND PENALTY CLAUSES

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A. General remarks

1. Liquidated damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation 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

¹Studies 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 to assist in resolving certain issues that arise in regard to liquidated damages and penalty clauses.*

2. This chapter focuses on liquidated damages and penalty clauses included in countertrade agreements to cover a failure to fulfil the countertrade commitment. Such a failure may take the form of non-fulfilment or delayed fulfilment of the countertrade commitment. This 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. Since liquidated damages or penalty clauses in countertrade agreements stipulate that the agreed sum is payable in case of a failure to fulfil the countertrade commitment, the obligation to pay the agreed sum is determined with reference to the provisions in the countertrade agreement stipulating the actions that must be taken in order to fulfil the countertrade commitment. For example, if the countertrade agreement provides that the countertrade commitment is to be deemed fulfilled upon the conclusion of a supply contract, failure to conclude the supply contract will result in liability under the liquidated damages or penalty clause in the countertrade agreement. If the countertrade commitment is to be fulfilled upon payment for the supply contract, failure to pay for the supply contract will result in liability under the liquidated damages or penalty clause in the countertrade agreement. (Concerning clauses in the countertrade agreement stipulating actions that must be taken in order to fulfil the countertrade commitment, see chapter VII, "Fulfilment of countertrade commitment", paragraphs 10 and 11.)

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. 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.

5. Agreement on a sum to be paid upon a failure to fulfil the countertrade commitment 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", paragraphs 12 and 13). 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 in paragraph 11, below, as to the possibility of a claim for damages in excess of the agreed sum).

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 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.

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 14 to 37). 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 followed 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 18 to 35).

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 in countertrade agreements, the parties do not usually intend that the committed party has the option of paying the agreed sum in place of fulfilling the countertrade commitment. If there is any doubt as to whether the committed party would have such an option, it is advisable that the question be settled in the clause.

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 6, and in setoff arrangements, see chapter IX, "Payment", paragraphs 50 to 52.)

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 non-fulfilment 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 33. 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, "Participation of third parties", paragraphs 5, 15 and 16 (third-party purchasers), and paragraph 44 (third-party suppliers).)

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

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 paragraph 5 above), 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 12 and 13.)

C. Effect of payment

12. An important question for the parties to consider is whether the payment of the agreed sum has the effect of releasing the obligated party from the countertrade commitment. Often the intention of the parties is that payment of the agreed sum terminates 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 and that the obligated party is not to be released from the countertrade commitment upon 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. Absent such a provision, the effect of payment would be determined by the applicable law. In some legal systems, absent an express provision by the parties on the effect of payment, a determination of the effect of payment may be made 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)).

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. (Concerning the amount of the agreed sum payable for delay, see paragraphs 18 and 19 below.)

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

15. The amount of the liquidated damages or penalty 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 a guarantee to secure payment of the agreed sum (see paragraph 23 below), it is advisable for the terms of the guarantee to provide that any reduction in the amount of the agreed sum is to result in a corresponding reduction in the amount of the guarantee (see chapter XII, "Security for performance", paragraphs 23 and 24).

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.

17. In setting the amount of the agreed sum, the parties should bear in mind that the amount of the agreed sum is likely to be viewed by a court as an important factor in determining whether the obligation to pay the agreed sum is intended to compensate for damages or to stimulate performance (see paragraph 6 above).

18. If the applicable law so permits, the beneficiary of the liquidated damages or penalty clause may find it useful for the countertrade agreement to fix an agreed sum at an amount that provides both reasonable compensation and a moderate pressure to fulfil the commitment. In determining what sum is reasonable, 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 remain unfulfilled and the fact that the sum should be substantial enough to induce performance. 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 paragraph 10 above, as well as chapter VIII, "Participation of third parties", paragraph 33). 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 paragraph 6 above). 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. Where the applicable law permits an agreed sum to serve only as compensation, parties should attempt to estimate as accurately as possible the losses the purchaser is likely to suffer. 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 non-fulfilment of the countertrade commitment.

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.

E. Obtaining agreed sum

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 non-fulfilment of 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.

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).

22. Legal proceedings that might be necessary to recover the agreed sum often 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 from 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 9 and 57). 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 are regulated by mandatory rules. Furthermore, a deduction might later be invalidated if the agreed sum deducted was later held by a court to be excessive, and was reduced.

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 (possible terms of a guarantee securing payment of the agreed sum are discussed in chapter XII, "Security for performance").

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

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 paragraph 19 above), 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.

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/WG.IV/WP.51/Add.4]

XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION*

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*A different title is used in the present addendum for draft chapter XIII than was used in the proposed structure of the legal guide (A/CN.9/WG.IV/WP.51, para. 9) and in some other draft chapters.

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A. General remarks

1. This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). It 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 therefore do not raise issues specific to countertrade.

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 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.

3. It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National legal systems 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 paragraphs 5 to 13 below). 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 paragraphs 14 to 37 below).

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 — to —).

B. Release from part or all of countertrade commitment

5. There are different 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 paragraph 10 below, as well as chapter XI, "Liquidated damages and penalty clauses", paragraph —). 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.

6. The parties may wish to agree 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.

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 VII, "Fulfilment of countertrade commitment", paragraphs 27 to 29). 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).

8. It should be noted that some legal systems contain special requirements for the termination of a contract as a result of a breach. 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. Were a release from a countertrade commitment to be interpreted as falling under those rules, such requirements might be applicable.

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.

C. Monetary compensation

10. The countertrade agreement may provide that a breach by a party of the countertrade commitment entitles the aggrieved party to receive from the party in breach an agreed sum as liquidated damages or a penalty (liquidated damages and penalty clauses are discussed in chapter XI). It is desir-

able that the countertrade agreement specify whether a party paying liquidated damages or a penalty is released from the obligations under the countertrade commitment (for a discussion of the effect of payment of liquidated damages or a penalty, see chapter XI, paragraphs — to —).

11. Liquidated damages and penalties should be distinguished from the obligation found in legal systems generally to pay damages as compensation for loss suffered due to a breach of a contractual obligation. Liquidated damages or a penalty involve an amount agreed upon at the time the contractual obligation is entered into and are payable by a party who failed to perform the obligation without proof of loss by the aggrieved party (chapter XI, paragraph —). By contrast, damages are assessed after the failure to perform a contractual obligation so as to compensate for the losses proved to have been suffered by the aggrieved party.

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 legal systems, the approaches to the question differ under various legal systems, and the law of pre-contractual liability is undeveloped in some countries. 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.

13. It is therefore advisable that the parties not leave the question of damages for non-fulfilment of the countertrade commitment to the applicable law. Instead, it is recommended that the parties include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalty clauses").

D. Exempting impediments

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. Such 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".

15. Many legal systems contain rules concerning exempting impediments. 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 IV, "General remarks on drafting", paragraph 6).

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 committed 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. It should be noted that, 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 impeding performance may occur. Accordingly, they would be free to 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.

17. The treatment in various legal systems 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 (sections 1 and 2 below, respectively) is based upon the approach taken in the Convention.

1. Legal consequences of exempting impediments

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 impedi-

ment. 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.

19. As discussed in chapter XI, "Liquidated damages and penalty clauses", paragraph —, 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

20. The parties may wish 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

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.

22. The parties may wish to include in the definition the stipulation that fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see paragraph 14 above), 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.

¹Official 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.

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 whether an event not included in the list should be regarded as an exempting impediment.

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

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*

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*

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 they meet the criteria contained in the general 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*

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*

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*

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.

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 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).

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.

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). In that connection, the parties may wish to provide that only strikes that do not arise from labour relations between the party and its employees (e.g., sympathy strikes) are to be regarded as exempting impediments.

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*

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.

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).

3. *Notification of impediments*

36. It is desirable for the countertrade agreement to obligate a party invoking an exempting impediment to give written notice of the impediment to the other party without undue delay after the party invoking the impediment learned or could reasonably have been expected to learn of the occurrence of the impediment. This notification could facilitate the taking of measures by the other party to mitigate any loss. 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.

37. Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to meet and consider 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).

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

38. A feature of a countertrade transaction 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 (see chapter II, "Scope and terminology of legal guide", paragraph 1). 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.

39. Many national legal systems contain general rules of contract law that provide an answer regarding interdependence of obligations incorporated in one contract. The general principle usually expressed in those rules 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 and termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National legal systems 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.

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 obligations in a countertrade transaction are merged into a single contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (the single-

contract approach is discussed in chapter III, "Contracting approach", paragraphs 2 to 9). If, however, separate contracts are used for the shipments in the two directions, it has been suggested that in many legal systems 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, "Contracting approach", paragraphs 10 to 21) [Note to the Working Group: paragraphs 9, and 16 to 18, of chapter III would have to be aligned with the present text.] 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.

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: (i) failure to conclude a supply contract as stipulated in the countertrade agreement, (ii) termination of a supply contract, (iii) failure to meet a payment obligation under a supply contract, and (iv) failure to deliver goods under a supply contract.

1. Failure to conclude supply contract

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 12 to 18), 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.

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 desir-

able 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.

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 9 and 57, and chapter XI, "Liquidated damages and penalty clauses", paragraph ___).

45. In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", paragraph 19), 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.

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 35 to 52, in particular paragraph 49). 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 VII, "Fulfilment of countertrade commitment", paragraphs 38 to 44).

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 49 to 51). 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

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 countertrade commitment stipulating the conclusion of 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).

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.

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 termination 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 32). 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.

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 32, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

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.

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 a 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.

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

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 counterpurchase 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.

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.

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).

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.

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

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 par-

ties 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/WG.IV/WP.51/Add.5]

XIV. CHOICE OF LAW

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A. General remarks

1. The legal rules that govern the contractual obligations of the parties involved in a countertrade transaction are referred to in the legal guide as the "applicable law". Under the rules of private international law of many national legal systems, the parties are permitted to choose the applicable law by agreement, though under some of those systems there are certain restrictions on that choice. (The term "private international law" refers to the body of rules of a State that determine which national legal system is to apply to a contractual relationship having an international character. In some legal systems, rules of private international law are 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 the rules of private international law.

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".

3. This chapter focuses on the choice by the parties to the countertrade transaction of the law applicable to the countertrade agreement and the supply contracts in the two directions. 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 arrange-

ments. 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.

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 and 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 section D, paragraphs 29 to 32 below).

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 national legal system'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. The question might arise as to the relevance to countertrade agreements of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). The Convention applies to contracts of sale of goods when the parties have their places of business in different

States and those States are parties to the Convention, or when the rules of private international law lead to the application of the law of a Contracting State (article 1). Countertrade agreements that commit the parties to the future conclusion of a sales contract are pre-contractual arrangements that often do not set out the contractual terms governing a sale of goods with the same degree of definiteness as would be necessary for a sales contract. There is a divergence of opinion as to whether pre-contractual arrangements fall within the scope of application of the Convention. However, when the countertrade agreement specifies all the essential terms of the supply contract to be concluded, the possibility exists that in some legal systems such an agreement would be regarded as a sales contract subject to the Convention (see chapter III, "Contracting approach", paragraph —). [*Note for the Working Group*: it is suggested that chapter III, paragraphs 43 to 48, contain a discussion of the implications of setting forth in the countertrade agreement the essential terms of the contract to be concluded. That discussion would note that, under some legal systems, when a countertrade agreement committing the parties to conclude a sales contract contains the essential terms of the contract to be concluded, the countertrade agreement may be regarded as a sales contract. The parties would be advised, when concluding a countertrade agreement that contains the essential terms of the future contract, to stipulate clearly whether a separate contract is to be executed pursuant to the countertrade agreement.]

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

B. Choice of applicable law

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 paragraph 24 below).

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. First, the applicable law is determined by the application of rules of private international law of a national legal

system. 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 —), 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. Usually, the arbitral tribunal will determine the applicable law according to the private international law rules that it considers appropriate. Since the arbitral tribunal may decide that the appropriate private law rules are not those of the place of arbitration, it may sometimes be difficult to predict which private international law rules the arbitral tribunal will consider to be appropriate.

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 rules of 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. The extent to which the parties are allowed to choose the applicable law will be determined by the rules of the system 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 legal system that has some connection with the contract, such as the legal system of the country of one of the parties or of the place of performance. 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.

13. 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. If a dispute is settled in arbitral proceedings, the law chosen by the parties will normally be applied by the arbitral tribunal.

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 legal systems (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 may be feasible in certain circumstances.

15. In many national legal systems a choice-of-law clause is interpreted as not to include the application of the rules of private international law of the chosen legal system 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 legal system they have chosen are to apply. Otherwise, the choice of the legal system may be interpreted as including the private international law rules of that legal system and those rules might provide that the substantive rules of another legal system are to apply.

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 exclusive 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.

17. In the case of countries where there are several legal systems applicable to contracts (as in some federal States), it is advisable to specify which one of those legal systems is to be applicable in order to avoid uncertainty.

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.

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.

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 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 contract in question (i.e., countertrade agreement or supply contract), and also to include an illustrative list of the issues that are to be governed by that law. 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.

21. Under the systems of private international law of some countries a choice-of-law clause may be considered to be agreement separate from the rest of the contract between the parties. Under those systems, 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.

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) 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 in paragraph 6 above, 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.

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 more than one national legal system to govern countertrade agreement and supply contracts

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 legal system or to different legal systems. The application of a single legal system 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.

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 legal system. The obligations of the parties are closely interrelated, in particular, in barter transactions (see chapter III, "Contracting approach", paragraphs 3 to 7) and in direct offset transactions (see chapter II, "Scope and terminology of Legal Guide", paragraph 13). The application of more than one legal system to such transactions may lead to inconsistency between obligations of the parties.

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 legal system or to different national legal systems. 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 legal system rather than to have to take into account more than one legal system. 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 legal system, 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 legal systems, the parties may wish to consider, as noted in paragraph 24 above, to subject the countertrade agreement and the supply contract to be concluded pursuant to it to the same law.

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.)

28. When the countertrade agreement is incorporated in an export contract (see chapter III, "Contracting approach", paragraph 16), 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

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 27 and 28.)

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.

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 V, "Type, quality and quantity of goods", paragraphs 2 and 28); (d) goods purchased in fulfilment of a countertrade commitment must meet origin requirements (see chapter V, paragraph 3, and chapter VII, "Fulfilment of countertrade commitment", paragraph 6); (e) evidence accounts are permitted to be used only under specified conditions (see chapter VII, paragraph 39); (f) the purchase of certain types of goods is to be cred-

ited towards the fulfilment of the countertrade commitment at specified rates (see chapter VII, paragraphs 13 to 16); (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).

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, "Problems in completing countertrade transaction", paragraphs ___ to ___.

[A/CN.9/WG.IV/WP.51/Add.6]

XV. SETTLEMENT OF DISPUTES

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A. General remarks

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. In general, it is desirable for the parties initially to attempt to settle their disputes through negotiation (see section B below). 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 (see section C below). If those methods of dispute settlement fail, there are basically two methods available of obtaining an enforceable 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 binding decision by an arbitral tribunal composed of one or more impartial persons (arbitrators) selected by them (see section D below). Generally, 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 (see section E below).

3. This chapter does not deal with procedures agreed upon by the parties for determining terms of a supply contract to be concluded 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 III, "Contracting approach", paragraphs 39 to 61, and with respect to specific types of contract terms in chapter V, "Type, quality and quantity of goods", paragraphs 13, 20, 25, and 27, chapter VI, "Pricing of goods", paragraphs 11 to 36, and chapter VII, "Fulfilment of countertrade commitment", paragraph 25.

4. The implementation of a countertrade transaction usually includes ongoing discussions between the parties that may permit many problems and misunderstanding to be resolved without recourse to dispute settlement proceedings. The parties may wish to require that, if a party intends to have recourse to dispute settlement proceedings other than negotiation, that party must notify the other party of that intention.

5. When the parties embody all of their contractual obligations in the two directions in a single contract (see chap-

ter III, "Contracting approach", paragraphs 2 to 9), a broadly worded dispute settlement clause in that contract would, absent a contrary provision, govern all disputes arising from the contract. However, it is usually the case that the parties embody their obligations in the two directions in more than one contract (see chapter III, paragraphs 10 to 21). In multi-contract countertrade transactions, the parties may wish to agree that all of the supply contracts, as well as the countertrade agreement, are subject to one dispute settlement clause. 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.

B. Negotiation

6. The most satisfactory method of settling disputes is usually by negotiation between the parties. An amicable settlement between the parties reached through negotiation may avoid disruption of their business relationship. In addition, it may save the parties the considerable cost and the generally 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.

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 initiating 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.

8. Since the outcome of a dispute between two parties to a countertrade transaction might affect the interests of a third party, it might be provided that a third party, though not directly involved in a dispute, may 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 be interested 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.

9. In long-term countertrade transactions, the parties may establish a joint committee to coordinate and monitor implementation of the countertrade transaction (see chapter VII, "Fulfilment of countertrade commitment", paragraph 34). Such committees may permit the parties to detect possible sources of difficulties and disputes at an early stage and may be appropriate vehicles for settling disputes through negotiation.

C. Conciliation

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.

11. Conciliation is non-adversarial. Consequently, 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 might have been wasted. That disadvantage might be reduced to some extent if the contract did not require the parties to attempt conciliation prior to initiating arbitral or judicial proceedings. It is advisable that, before initiating conciliation, the parties consider carefully whether there exists a real likelihood of reaching a settlement.

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

¹Report 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.

13. When the parties have referred a dispute to conciliation and arbitral or judicial proceedings are thereafter initiated, they might still find it useful to continue with the conciliation.

D. Arbitration

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 countertrade agreement. 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 law applicable to the contract in question, 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", paragraphs 12 and 13). 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, in some cases, less costly than judicial proceedings. It may be noted, however, that some legal systems provide for summary judicial proceedings for certain types of disputes (e.g. those involving a sum of money not exceeding a certain amount), although most disputes arising in countertrade transactions will not qualify for settlement under such proceedings. 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. On such convention to which many States are parties is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).²

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 legal systems, it is not possible for parties to preclude courts from settling certain types of disputes.

1. Scope of arbitration agreement and mandate of arbitral tribunal

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 arbitra-

tion clause included in the countertrade agreement or supply 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 after a dispute has arisen.

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.

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.

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.

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 paragraph 15 above).

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 law applicable to the contract regarded in the legal system of that law as fundamental. If the parties wish to authorize

²United Nations, *Treaties Series*, vol. 330, No. 4739 (1959), p. 38.

the arbitral tribunal to decide disputes without applying all legal rules of a State to the agreement, they may wish to specify the standards or rules according to which the arbitral tribunal is to decide the substance of the dispute. 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 contract and the relevant usages of trade applicable to the transaction.

2. *Type of arbitration and appropriate procedural rules*

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.

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.

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 ex-

tent 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 paragraphs 33 to 37 below). 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.

25. In most cases, the arbitral proceedings will be governed by the 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 (see paragraph 33 to 37 below), 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.

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 usually 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.

27. Of the many arbitration rules promulgated by international organizations or arbitral institutions, the UNCITRAL

³Report 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".

Arbitration Rules⁴ deserve particular mention. These Rules have proven to be acceptable in the various 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.

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 paragraphs 29 to 31 below), the appointment of arbitrators (see paragraph 32 below), the place of arbitration (see paragraphs 33 to 37 below) and the language or languages to be used in the arbitral proceedings (see paragraphs 38 and 39 below).

3. Number of arbitrators

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.

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 calling in a third arbitrator, "umpire" or "referee", to overcome any impasse between the two.

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

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

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.

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.

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, they unduly restrict the autonomy of the parties or fail to provide a comprehensive procedural framework to ensure efficient and fair proceedings.

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

⁴Report 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.

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.

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*

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 contract is 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.

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*

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 may depend 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", paragraphs 12 and 13).

41. The uncertainties that arise when more than one court is competent to decide a dispute may be reduced by an ex-

clusive 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 is competent to decide the types of disputes that are 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 paragraph 17 above).

42. In referring disputes to the courts of a particular State, the parties should bear in mind the extent to which 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 paragraph 34 above).

43. While an exclusive jurisdiction clause may reduce uncertainties with respect to matters such as the law applicable to the contract and the enforceability of a decision, and may facilitate the multi-party settlement of disputes (see paragraphs 48 and 49 below), 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*

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 paragraphs 41 to 43 above). 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.

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.

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.

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 perform-

ance 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).

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. For example, when there is a dispute between the counter-exporter and the counter-importer as to whether liquidated damages are payable for a failure to purchase goods, a third-party purchaser engaged by the counter-importer 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 counter-importer (see chapter VIII, "Participation of third parties", paragraph 33). Similarly, the counter-importer would be interested in the outcome of a dispute between a third-party purchaser and the counter-exporter if the counter-importer 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.

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. 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 paragraphs 41 to 43 above). It is more difficult to structure multi-party arbitration proceedings because, under most legal systems, all the participating parties have to agree to the submission of their disputes to the same panel of arbitrators.

[A/CN.9/WG.IV/WP.51/Add.7]

DRAFT ILLUSTRATIVE PROVISIONS

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Introduction

1. At the twenty-third session of the Commission (1990), it was suggested that illustrative contract provisions should be included in the legal guide in order to facilitate its use (A/45/17, annex I, para. 6). The present addendum has been prepared pursuant to that suggestion.

2. The preparation of the illustrative provisions contained in the present addendum has been influenced by the following considerations. Firstly, the draft chapters of the legal guide discuss 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.

3. The Working Group may wish to consider the advisability of including in the legal guide illustrative provisions such as the ones presented here.

4. If the Working Group decides that illustrative provisions should be included in the legal guide, it is suggested that they be presented in footnotes to the text of the legal guide, and that the following explanation be included in chapter I, "Introduction to Legal Guide":

“Illustrative provisions

“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.

“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 of a clause and language to be used in it is likely to 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.”

Chapter V. Type, quality and quantity of goods

Footnote to paragraph 13

Assuming that “X Company” is the supplier and “Y Company” is the party committed to purchase, the clause may read as follows:

“Goods offered for purchase under the countertrade agreement 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 the qualities which X Company has held out to Y Company as a sample or model;

“(d) be contained or packaged in the manner usual for such goods or, where there is no such manner, 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 VI. Pricing of goods

Footnote to paragraph 37

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.”

Chapter VIII. Participation of third parties

Footnote to paragraph 10

Assuming that “Y Company” is the party 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. In the event of such an engagement of a third party, Y Company remains liable for the fulfilment of the countertrade commitment."

Footnote to paragraph 16

Assuming that "Y Company" is the party committed to purchase, the clause may read as follows:

"Upon the engagement of a third-party purchaser, and upon the assumption by the third-party purchaser of the commitment to make the purchases necessary to fulfil the countertrade commitment as set forth in the countertrade agreement, Y Company will be released from liability for fulfilment of the countertrade commitment."

Footnote to paragraph 21

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 may read as follows:

"Z Company agrees 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."

The parties may wish to include the above provision in an agreement concluded by the party originally committed to purchase, by the third-party purchaser and by the supplier, in which the countertrade commitment is transferred to the third-party purchaser and the supplier consents to the transfer and to the release of the party originally committed from the countertrade commitment (see chapter VIII, paragraph 16). In such cases, the consent of the supplier to the release may be expressed in the following form:

"X Company consents to the assumption of the obligations under the countertrade agreement by Z Company and, when the assumption of those obligations becomes effective, to the release of Y Company from those obligations."

Chapter X. Restrictions on resale of countertrade goods

Footnote to paragraph 9

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. [*Both alternatives:*] 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

Footnote to paragraph 5

Assuming that "X Company" is the supplier, "Y Company" is the party committed to purchase, and the Austrian schilling 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 22 (provision that could be added to any liquidated damages or penalty clause)

"If payment of the agreed sum becomes due in accordance with paragraph (1), the party entitled to claim the

agreed sum has the right to deduct that sum, in whole or in part, from any payment due by that party to the party obligated to pay the agreed sum under [the following contracts only: . . .] [any contract between the parties].”

Chapter XIII. Failure to complete countertrade transaction

Footnote to paragraph 6

Assuming the “Y Company” is the party committed to purchase and that “X Company” is the supplier, the clause may read as follows:

[For release without additional period]

“If the 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.”

[For release with additional period]

“(1) [Same text as above]

“(2) In order to avail itself of the right in paragraph (1) 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 22

Assuming the “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 24

[General definition of exempting impediment followed by illustrative or exhaustive list]

“(1) [Same text as in para. (1) of the illustrative provision to paragraph 22]

“(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 43

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 49, 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 49, 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

Footnote to paragraph 20, second sentence (illustrative provision for the countertrade agreement and for a supply contract)

“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)] is to govern this . . . (specify countertrade agreement or supply contract). [The rules of private international law of . . . (specify the same country or territorial unit as above) do not apply.]”

Footnote to paragraph 20, fourth sentence (illustrative provision for the countertrade agreement and for a supply contract)

[Same as in footnote to paragraph 20, 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.”

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]**

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