

International Sales Transactions – A Series of Simulated Negotiation and Drafting Exercises

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1. Introduction

I have been teaching courses on international trade law since 1991. When I was first asked to teach such a course, it extended over 2 weekly hours throughout a whole school year, i.e., two semesters (approximately 26 lectures). I therefore divided the course into two parts: the first one dealing with aspects of public international regulation of international trade (GATT, FTAs, Dumping, Subsidies and CVDs, Public Procurement etc.), and the second one with private international law. The second part was mostly devoted to various aspects of international sales transactions, and as a tool to teach this part I developed a series of simulated negotiation and drafting exercises. The series covers the following aspects of such transactions:

- Drafting an initial memorandum of agreement to cover the main components of the sales transaction;
- Allocation of costs and risk in connection with the long shipment: the use of the ICC INCOTERMS;
- The UN Convention on International Sales of Goods (CISG): the scope of application of the CISG; its substantive provisions; should one exclude it? Should one exclude some of its provisions?
- Modes of payment in international commerce; Letters of Credit;
- Allocation of performance risks: drafting a *Force Majeure* clause
- Settlement of Disputes: choosing between courts and arbitration; drafting exclusive jurisdiction clauses, arbitration and mediation clauses, and choice of law clauses.

These exercises have been very successful in the class room and much appreciated by my students over the last 16 years. They confront them with "real-world" problems, which they are very likely to meet in their legal or business practice, and require them to solve these problems by means of negotiation and drafting. This type of exercises is very different from the exercises they are used to in law school, which require them to analyze a legal problem and essentially write a judgment – thus implicitly suggesting that all problems should be solved by means of litigation. In international commerce, I explain to them, litigation is a bad option, due to the extensive costs, significant cultural problems and high level of uncertainty involved, and should only be used as a last resort. Instead, the transaction should be planned and structured in a way that minimizes the risk of a dispute that will require litigation, and when problems arise they should be solved by negotiation.

In the following paragraphs, I will briefly describe the five exercises that make up the series. As you will see, the series follows the same parties – a producer/seller in Israel and a buyer/downstream producer in Taiwan – as their business relationship and commercial negotiations develop, and the students get the opportunity to represent the

respective parties in one of these negotiations. The negotiations are conducted by a few students in front of the rest of the class. At the end, the class may direct questions to the negotiators and express their opinion on the way the negotiations were conducted. The whole exercise is then summarized by the professor, who uses it as a springboard to the subsequent lecture on the subject of the exercise.

2. First Exercise: Initial MOA & Allocation of Risks and Costs

The first exercise sets out the basic facts of the situation: Galilee Plastic Ltd. is a plastic factory owned by a Kibbutz in the Galilee that until now has been very successful in the domestic market. It has lately started to look into how to enter foreign markets. Saburu Motors Inc. is a big car producer in Taiwan working on its new revolutionary car named Fantasy, planned to be marketed around the world. Saburu is looking for good subcontractors to whom it can outsource some of the production, and Galilee Plastic Ltd. is trying to obtain a contract for the production of plastic parts for this new model. The Israeli company hopes to do the mass-production of certain components of the inside of the car doors and then ship these parts for assembly into the car in Saburu's plant in Taiwan. It will be a very big contract for Galilee Plastic Ltd. that will require substantial investments in machines and other production equipment in order to set up the proper production line.

A first meeting of the representatives of both of the parties has been set. The objective of the meeting is to try to reach a principal agreement on the main components of the future contract – in other words, basic principles on which later on a more detailed contract can be formulated. The parties do not know each other yet, so there is some suspicion in the air. The points that the parties would like to discuss are issues such as: payment and delivery terms, who will bear the risks of the sea freight, and what guarantees will Galilee Plastic receive in relation to the payment for its products and Saburu in relation to the quality of what it will receive.

The students participating in the exercise are appointed as lawyers of one of the parties. They are asked to prepare a draft agreement reflecting the opening position of their respective client on the most important issues. Each of them also receives an envelope with "secret facts", informing them about the essential interests of their respective clients. The students are asked to have clear views on which of their demands are absolutely essential for their clients, which ones would be nice to get, and which ones have only been introduced to the initial draft so that there will be something to take out as part of a compromise. They are also asked to prepare a negotiation strategy. Along with the task, they also receive a list of relevant reading material that will give them background knowledge on the topics involved and help them perform their missions.¹

This first exercise thus requires the students to think about all of the essential components of an international sales agreement, what the interests of the respective parties are in relation to these components and to negotiate an agreement that will meet

¹ The reading materials for the first exercise are: 1. Civ. App. 58/89 *Yardenia Insurance Company v. Rice Growers Cooperative Mills*, P.D. 46(2)613. (A judgment of the Israeli Supreme Court) (Hebrew).

2. Jan Ramberg, *Guide to Incoterms 2000 : Understanding and Practical Use* (Paris: ICC, 1999).

3. C.M. Schmitthoff, *Schmitthoff's Export Trade - The Law and Practice of International Trade* (9th ed.) (London: Steven & Sons, 1990), pp. 9-12, 16-43.

these interests. The long-term nature of the contract, and the importance of the parts for Saburu, requires much thought to be put into how one designs proper mechanisms to ensure quality control, long term liability, and reasonable returns on the high investments required by Galilee Plastic. In addition, the secret facts of this exercise direct the students to give special attention to the question of allocation of costs and risk in connection with the long shipment. This is meant to prepare the way for the study of the INCOTERMS – the well-known international standard sale terms published by the International Chamber of Commerce. In the course of the negotiations on these terms, the parties – and the student audience – gradually reach the conclusion that the choice of terms is to a large extent an economic choice, since costs are costs, and the risk can be insured. Thus, the term chosen must be calculated into the price of the products.

3. The Second Exercise: The Convention on International Sales of Goods

The second exercise raises various issues in relation to the UN Convention on International Sale of Goods (CISG).² Many of the situations are connected to the story told in the first exercise and require analysis of the text of the CISG in order to reach the right conclusion. Often they require a practical approach in order to give the best advice to the party in question on how to act in order to secure his or her rights. A central issue that has to be resolved in one of the questions in this exercise is related to the sphere of application of the CISG, and it brings out the general arrangement of the CISG in this matter and contrasts it with the peculiar Israeli arrangement.³ The students are also asked to consider whether their client will be better off to exclude the application of the CISG, and if so, under what conditions. They should also consider whether it would be wiser to just exclude some of the CISG's provisions, which are less favorable for their client.

4. The Third Exercise: Letters of Credit

The third exercise introduces the students to documentary credits and their use in international commerce. It describes a situation where, before a final agreement has been signed, it has been agreed that Galilee Plastic Ltd. will start to supply plastic parts to Saburu Motors, so that the car production can start. It has been agreed that the payment for the goods will be done through an irrevocable letter of credit (LC) issued by the Taipei Bank of Commerce, at the request of Saburu, to the benefit of Galilee Plastic. The LC will be confirmed by Bank Leumi of Israel. According to the LC, the issuing bank will pay the agreed price within 60 days of the submission of an invoice, a consignment

² The reading material for the second exercise is: 1. The Sales Law (International Sale of Goods), 5760-1999 (the Israeli Law implementing the CISG) (Hebrew). 2. Arie Reich, "The Sales Law (International Sale of Goods), 5731-1971: A Need for Revision" 14 Bar Ilan Law Studies, 1997, p.127-177 (Hebrew). 3. Arie Reich, "Globalization and Law: The Future Impact of International Law on Israel's Commercial Law", 17 Bar Ilan Law Studies, 2001, p. 17-71.(Hebrew). 4. Civ. App. 3912/90 *Eximin, Belgian Corporation v. Textile and Footwear, Italstyle Ferrari Ltd.* P.D 47(4)64 (Judgment of the Israel Supreme Court) (Hebrew). 5. Civ. App. 132/85 *Amropa E.G. v. H.Sh.I. Hamegader – Steel Industries Ltd.* P.D. 41(4)477 (Judgment of the Israel Supreme Court) (Hebrew). 6. Civ. App. 306/85 *Dataalab Management Pty. Ltd. v. Polack International Ltd.* P.D. 43(2)309 (Judgment of the Israel Supreme Court) (Hebrew).

³ Unlike Article 1 of the CISG, which applies the convention according to the choice of law rules of Private International Law, Israel has adopted a "coercive" model of application, that was found in the CISG's predecessor – the Hague UNIDROIT conventions. According to this model, whenever an Israeli court has jurisdiction over an international sales contract dispute, it will always apply the CISG, regardless of the choice of law rules of Private International Law. The students will discover that this is the case as they go about to answer one of the questions in Exercise 2.

note and a clean bill of lading in relation to the goods. The seller has indeed delivered the goods to the shipping company and presented the required documents to the bank. However, when the goods arrive, before the end of the 60 day period, Saburu discovers that the plastic parts do not meet the required standards. Saburu immediately sends a fax informing Galilee Plastic that it considers this a breach of the contract and an act of fraud, since the parts are worthless for Saburu and it is absolutely clear that Galilee Plastic must have known that. Thus, Saburu writes, it is going to instruct its bank not to make the payment under the LC. Galilee Plastic immediately informs Saburu that it believes there has been a misunderstanding and that it will send one of its senior managers, along with its lawyer, to Taiwan in order to resolve the misunderstanding.

This exercise requires the students to cope with a crisis in the parties' relationship that may bring it to an end, unless the crisis is handled wisely. From a legal point of view they need to understand the principle of the autonomy of the LC, as well as the scope of the fraud exception, as a background to their discussion.⁴ I usually ask them to start the exercise with a pleading of the legal arguments of each party, which then the class is required to decide on as "temporary members of the jury" – just in order to make sure they understand the legal rules pertaining to LCs. After that, the parties are asked to go back to negotiations (based on the recognition that even though Saburu's case for getting an injunction against payment under the LC is very weak, it is in the long term interest of Galilee Plastic to keep its customer happy and to supply it with new goods for free that meet the agreed standards). Here, Saburu's representatives are expected to come up with a solution that will prevent the recurrence of this type of problems, while still relying on the documentary credit mechanism. Since banks handling documentary credits only deal with documents and not with goods, Saburu must translate its conformity requirements to documentary form. This can be done effectively, for example, by demanding an inspection certificate issued by a respectable and independent inspection firm. This document will be added to the list of documents required by the LC as a condition for payment.

5. The Fourth Exercise: Allocation of Performance Risks: Drafting a *Force Majeure* Clause

The fourth exercise raises the problem of how to allocate performance risks, in particular in long-term contracts.⁵ This allocation is partly done in *force majeure* clauses. Although these clauses tend to be a part of the standard "boiler plates" of international sales contracts, and often are overlooked by the parties, the aim of this exercise is to draw the students' attention to the importance of these clauses and to teach them that they may be wise to examine their wording. Eventualities such as strikes, lockouts, wars, acts of terror, embargoes, riots, obstacles in the water ways, and acts of nature, must be

⁴ This background, as well as other important information, the students can learn from the reading material to this exercise, which is as follows: 1. App. Pet. 646/84 *Shorab Industry and Trading Company v. Raymond Saba – Unex & Others* P.D. 38(4)693 (Decision of the Israeli Supreme Court) (Hebrew). 2. Civ. App. 182/82 *Gingette Ltd. v. Barclays Bank International Ltd. of London* P.D. 39(3)785 (Judgment of the Israeli Supreme Court) (Hebrew). 3. Civ. App. 151/89 *Bank Leumi LeIsrael v. Brinn and Sons Ltd.* P.D. 46(4)101 (Judgment of the Israeli Supreme Court) (Hebrew). 4. David Sassoon & Orly Shenkar, *Documentary Credits: Practical and Legal Aspects* (2nd ed.) (Schocken Publishers, 1996) pp. 40-60, 109-118 (Hebrew).

⁵ The reading material for this exercise is: 1. Convention on International Sale of Goods, Articles 79-80; 2. The Contract Law (Remedies for Breach of Contract), 5731-1971, Article 18. 3. *Schmitthoff's Export Trade* (9th ed.) pp. 180-184; 199-203.

considered, and a decision has to be taken to what extent, and under what conditions, they may excuse a party for non-performance. These decisions have to be translated, of course, into legal formulations that will cover all eventualities and reflect the agreements reached during the negotiations. The students are also required to consider what will happen when such eventuality occur, what will the rights of the injured party be in a case where the other party is excused, and to provide for continuous and full communication between the parties during such time. In the course of the negotiations, the students gradually reach the conclusion that a *force majeure* clause is much more than a "legal technicality", and may in fact affect central commercial interests of the respective parties.

6. The Fifth Exercise: Settlement of Disputes in International Commerce

The fifth and final exercise in this series deals with the issue of dispute settlement.⁶ The background facts describe the familiar situation where each party demands that the courts of its home country shall have exclusive jurisdiction over any dispute that may arise between the parties to the contract, and that the governing law shall likewise be that of its jurisdiction. The students are therefore required to consider the problems of submitting themselves and their contract to an unknown legal system with unknown judges, far away from home. They will try to negotiate a compromise between these two conflicting positions which both parties can live with. Such a compromise may lead to the submission to a third, neutral legal system, less unknown to the parties and with a good reputation. It may also lead to alternative dispute settlements mechanisms such as mediation and/or arbitration. The students will then be required to consider the advantages and disadvantages of state courts in relation to private courts (arbitration panels), of judicial resolution in relation to a mediated resolution, and of institutional arbitration in relation to ad hoc arbitration. These considerations and their negotiated outcome will have to be explained to the class. Here too, of course, they will have to be able to translate their negotiated agreement into a properly formulated contract clause that will be self-executing in case of a dispute, so that the parties won't have to litigate before a court somewhere in the world on the precise meaning of the clause or in order to get instructions on issues not covered by the clause. As in the previous exercises, this too will serve as an introduction and stimulant to my subsequent lectures on dispute settlement in international commerce that will cover topics such as: choice of the law of the contract, private international law rules on choice of forum, institutional arbitration and their relative advantages and rules of procedures, ad hoc arbitration and the UNCITRAL Arbitration Rules, the New York Convention on the Recognition and Enforcement of Arbitral Awards, etc.

7. Concluding Remarks

While each of the exercises described above are performed before the class by only 4-6 students (a team of 2-3 "lawyers" on each side), the entire class is required to read the exercise and its reading material before the class. This ensures that everyone is able to follow the negotiations and the subsequent lecture. This material is of course also part of what will be covered by the final exam.

⁶ The reading material for the fifth exercise is: 1. Civ. App. 362/82 *Menorah Insurance Company Ltd. v. The Ship Donar*, P.D. 38(2)505 (Judgment by the Israeli Supreme Court) (Hebrew). 2. App. Pet. 102/88 *Ma'adaney Avaz HaKesev v. Cent Or S.A.R.L.* P.D. 42(3)201 (Decision by the Israeli Supreme Court) (Hebrew). 3. *Schmitthoff's Export Trade* (10th ed.) pp. 472-496.

My experience has shown that these exercises are much appreciated by the students and are very helpful as an introduction to the subsequent lectures on the respective subjects. When I meet my students several years later, they still have fond memories from these negotiation exercises, which tend to be the part of the course they remember best.