International contracts: Drafting considerations

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When drafting domestic contracts, lawyers need to have a good understanding of the client's business and the underlying transaction in order to properly allocate and mitigate attendant risks. But when the other party to the contract is located outside the United States and performance is a cross-border affair, the parties are likely subject to additional commercial risks and issues such as war, government instability, currency risk, export controls, shipping risks, and tariffs. Of course, lawyers should address these commercial issues in drafting the contract but must also pay attention to some basic legal concepts that, if not taken into consideration, can lead to problems for the client. This article sets forth a few considerations lawyers cannot ignore when drafting international contracts.

SHIPPING AND DELIVERY TERMS

Contracts involving the sale of goods typically use certain terms meant to define the time, place, and manner of delivery from a buyer to a seller such as FOB (free on board); FAS (free alongside); CIF (cost, insurance, and freight); and C&F (cost and freight). These terms serve as shorthand for describing and setting forth obligations of the parties in shipping and accepting delivery of the goods and defining when title and the risk of loss transfers from seller to buyer.

While these terms are commonly employed in sales contracts, they do not mean the same thing around the world. The Uniform

Commercial Code (UCC) defines these terms in a specific way not shared by the rest of the world. Under the UCC, FOB could be followed by a vessel at a named port of shipment. This means the seller bears the risk of loss and is responsible for delivering the goods onboard that vessel and the buyer is responsible for the goods thereafter.[1] However, FOB could also be followed by final destination and could be used to cover any mode of transportation, not just waterway shipment.

A more comprehensive compendium of shipping and delivery terms is the Incoterms 2020 Rules.[2] These rules more precisely define many more shipment and delivery possibilities. For those reasons, they are used throughout the world, especially in cross-border commercial contracts. For instance, under the Incoterms rules, FOB [named port of shipment] is used specifically to denote sea and inland waterway transport of cargo and means the seller bears the costs of delivering the goods to the named port of shipment, paying the vessel loading charges and export duties and taxes, and clearing export customs. The buyer arranges and bears all costs and risks of loss of goods after the seller delivers the goods on the ship nominated by the buyer at the named port.

Using the UCC shipment and delivery terms rather than the Incoterms rules may not only cause unnecessary confusion but, depending on the governing law of the contract, may shift and allocate costs and risk of loss to the parties in ways they did not intend. Thus, it is much more effective to use and expressly define the shipment and delivery terms pursuant to the Incoterms rules, which are recognized and used throughout the world in a uniform and coherent manner.

GOVERNING LAW

A very important question to be resolved when drafting international contracts — what law should govern it? — is often glossed over too quickly. This is important not only because it will determine how the contract will be interpreted but could also determine which terms are even part of the contract. In instances when parties are unable to agree on what law should govern a contract, a client may push to settle on a neutral jurisdiction such as England or Switzerland in order to compromise and finalize an agreement, thinking that will solve the issue and they can get on with the transaction. For several obvious and not-so-obvious reasons, that may not be a good idea.[3]

First, in most countries, parties to a contract are free to designate the law to be applied to their contract; that designation, so long as it is unambiguously worded, will generally be respected, with some exceptions. In Michigan, the Michigan Supreme Court defined those exceptions in *Chrysler Corp. v. Skyline Indus Servs., Inc.*, by adopting the approach laid out in the Restatement Conflicts of Law 2d, holding that a contractual choice-of-law provision will not be followed if either:

1. "the chosen state has no substantial relationship to the parties or the transaction and there is no ... reasonable basis" for that choice of law, or

2. the application of the chosen law "would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue" and which "would be the state of the applicable law in the absence of [a] choice of law by the parties."[4]

Although Michigan continues to adhere to the principles set forth in the Restatement Conflicts of Law 2d, many arbitration tribunals and the courts of most other countries do not follow its principles.[5] Therefore, depending on the jurisdiction of the court hearing the case, arbitrarily making the governing law of a contract the law of a neutral country creates a risk — the court may not honor the choice of law agreed to by the parties.

Second, if the parties agree to designate in their contract the governing law of a jurisdiction outside the United States, they may unwittingly incorporate other terms into their contract. This is because many countries, especially in civil law jurisdictions, have detailed commercial and civil codes which incorporate certain statutory terms into contracts, much like the UCC provides gap-fillers when these terms are not otherwise addressed.

Third, even when an international sales contract designates the law of a specific state or country to govern it, a court may interpret that provision to require application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) rather than the law of that jurisdiction. This is because the United States and nearly 100 other countries[6] have adopted and ratified the CISG as taking precedent over local law. Pursuant to the CISG, so long as the parties to an international sale of goods contract are located in different countries and both countries have signed the CISG, the CISG is to be applied as the governing law of the contract unless the contract expressly excludes it.[7] For example, if an agreement for the sale of goods between a party in Michigan and one in Ontario provided that Michigan laws govern the contract without expressly excluding the CISG, a Michigan court would apply the CISG, and not Michigan's UCC, in interpreting the contract[8] because the CISG, being part of U.S. federal law, preempts state contract law.

Lawyers should not be too anxious to exclude the CISG without considering the potential advantages it might have for the client since several of its gap-filling provisions are different from the UCC. For instance, absent a provision in the contract detailing the seller's recourse against a buyer who has not paid when due,[9] Section 2-703 of the UCC provides that the seller may stop delivery, sell the goods, and recover damages. In contrast, the CISG calls for more

limited seller remedies in that situation — it requires a fundamental breach before allowing the seller to cancel performance.[10] Such an application, therefore, would be more buyer friendly.

There are other important differences between the CISG and UCC,[11] but two are worth noting. One relates to contract formation and the so-called battle of the forms. Under UCC §2-207,[12] an offer is deemed accepted, and therefore a contract formed, even though it includes terms additional to or different from those in the offer[13] unless the offeree clearly indicates it is unwilling to proceed unless the offeror accepts the additional or different terms.[14] In contrast, Article 19 of the CISG states that any acceptance containing limitations or modifications to the original terms of the offer does not constitute an acceptance, but rather a rejection and a counter-offer.

A second significant difference relates to the parol evidence rule. Under Michigan law, the parol evidence rule holds that negotiations and extrinsic evidence preceding execution of a written contract are generally not admissible to interpret the meaning of a written contract.[15] The intent of the parties is to be found in the written contract.[16] However, the CISG does not follow the parol evidence rule. Article 8(3) of the CISG provides:

> In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

As a Michigan federal court noted, "given the wording of the [CISG], federal courts have determined that international sales agreements under the [CISG] are not subject to the parol evidence rule and are to be interpreted based on the 'subjective intent' of the parties based on their prior and subsequent statements and conduct."[17] Thus, if a party to a contract is concerned that its real intentions, expressed in negotiations, will not be adequately reflected in the four corners of a written contract, that party would benefit with the CISG because it would allow for introducing such extrinsic evidence in the event of a dispute.

In summary, it is important for drafters of international sales contracts to understand the CISG and how it differs from the UCC. Understandably, foreign parties are often unwilling to accept Michigan or other U.S. state law as the governing law of their contracts. For the same reason, U.S. lawyers need to be wary of accepting a foreign jurisdiction's law to govern the contract. Understanding the CISG and addressing its gap-filling defaults may not only help resolve a deadlock over governing law but, in certain situations, may benefit the client.

DISPUTE RESOLUTION

As with the governing law provision, the choice of jurisdiction and dispute resolution clause in an international contract is significant. Whether a court will hear a dispute just because two parties to a contract agreed to the jurisdiction of that court depends on several factors. Michigan courts, for example, generally enforce contractual forum selection clauses as provided in MCL 600.745(3).[18] However, Michigan law provides that even if the parties agree in a written contract that a court of another jurisdiction would exclusively resolve a dispute between them, a Michigan court could agree to take the case in any of the following instances:

(a) The court is required by statute to entertain the action.
(b) The plaintiff cannot secure effective relief in the other state for reasons other than delay in bringing the action.
(c) The other state would be a substantially less convenient place for the trial.
(d) The agreement as to the place of the action is obtained by misrepresentation, duress, abuse of economic power, or other unconscionable means.
(e) It would for some other reason be unfair or unreasonable to enforce the agreement.[19]

Many foreign jurisdictions apply similar principles with similar exceptions, which could lead to a surprise in the context of an international contract dispute where one party can pursue a lawsuit against the other in a jurisdiction not agreed upon by the parties.

An even more pressing concern is whether a judgment obtained in the chosen jurisdiction's courts will be enforceable against the other party. Obtaining a judgment from a Michigan court against a Chinese counterpart whose assets are only located in China is not worth much if the judgment is not enforced in China. The problem is exacerbated because there is no international treaty or convention to which the U.S. belongs regarding enforcement and recognition of foreign court judgments, and vice versa. Some foreign courts may recognize judgments from other jurisdictions on some notion of comity, but such a principle cannot be relied on; foreign judgments can often be challenged in domestic courts based on improper service of process, lack of jurisdiction, violation of public policy, or other grounds.

One effective strategy in mitigating these problems is for the parties to provide for arbitration. Often, when negotiating an international contract, it is easier for parties to agree on an arbitration clause than on a jurisdiction clause with a choice of forum. With international contracts, arbitration is also a more efficacious option because the U.S. and 168 other countries are signatories to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).[20] The U.S. is also a signatory to the 1975 Panama Inter-American Conven-

tion on International Commercial Arbitration (the Panama Convention)[21] with 18 other North and South American countries. These conventions encourage recognition and enforcement of international arbitration awards and agreements; each signatory pledges to recognize foreign awards in its domestic courts.[22] Underscoring this point, the U.S. Supreme Court has held that the general policy favoring arbitration "applies with special force in the field of international commerce."[23]

When drafting the arbitration provision in an international contract, using a short, canned arbitration clause may lead to uncertainty and delays in the proceedings. A custom arbitration clause is better. The drafter should specify the arbitration tribunal, the country in which the arbitration will take place (ensuring it is a signatory to the New York Convention), the procedural law and rules governing the proceedings, the number of arbitrators, how arbitrators will be selected, exclusivity of the arbitration as a dispute resolution mechanism, and the language of the proceeding.[24] Otherwise, the arbitration tribunal may decide those issues.

SCOPE OF DAMAGES AND LIMITATION OF LIABILITY

American lawyers usually spend some time negotiating the scope of damages and limitations of liability in domestic commercial contracts and whether liquidated damages should be used. UCC § 2-718(1) codifies the common law principle regarding liquidated damages, which provides that parties to a contract can agree to liquidated damages only to an amount reasonable in light of anticipated or actual harm caused by the breach; a term fixing unreasonably large liquidated damages is void as a penalty.[25] Additionally, under Michigan law, a party may contract against liability ordinary negligence, but may not insulate itself against liability for gross negligence or willful misconduct.[26]

Many foreign civil law jurisdictions, in contrast, recognize and enforce penalty clauses. In Switzerland, for example, a contractual penalty may be agreed to for the purpose of punishing one of the parties[27] even if the creditor has not suffered any loss or damage.[28] In many of these civil law jurisdictions, however, courts may use discretion to reduce penalties it considers excessive.[29]

As for general liability limitations and exclusions, many foreign jurisdictions have statutory rules on which types of damages are enforceable and which are not. German courts, for instance, have ruled that clauses in a party's standard terms and conditions that exclude or limit the liability of a party for a breach of fundamental contractual obligations are not enforceable.[30] Such obligations can include timely delivery, delivery of goods free from defects, and the obligation to provide the purchaser with information on proper use and maintenance of the goods.[31] German law also does not award punitive damages and, as a matter of law, its courts do not enforce foreign punitive damage awards even if the contract allows for it.

CISG Articles 74-76 require only that damages be foreseeable at the time the contract is executed, that losses be proved with reasonable certainty, and losses were not caused by the aggrieved party's failure to mitigate. Thus, recoverable damages are reduced if it is established that the aggrieved party failed to mitigate losses.[32]

CONCLUSION

By their very nature, international contracts are often more complex than domestic contracts due to special issues and risks inherent in dealing with foreign parties and cross-border transit of goods and services. Provisions that may be considered boilerplate in domestic contracts suddenly take on considerable significance in an international contract. This article touched on only some of the issues lawyers must address and not take for granted when drafting and negotiating international contracts.[33]

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ENDNOTES

1. MCL § 440.2319(1); MSA. § 19.2319(1).
2. The Incoterms 2020 Rules updated the Incoterms 2010 Rules.
3. Parties to a sales contract can also agree to have their contract governed by the CISG and/or the UNIDROIT Principles rather than the laws of any specific jurisdiction. See Christiana Fountoulakis, *The Parties' Choice of "Neutral Law" in International Sales Contracts*, at CISG-online at <https://cisg-online.org/files/commentFiles/Fountoulakis_EJLR_2005_303.pdf> [https://perma.cc/5C2B-74P5] (all websites cited in this article were accessed February 26, 2024).
4. *Chrysler Corp v Skyline Indus Servs, Inc*, 448 Mich 113, 120-123; 528 NW2d 698 (1995); see also *Hudson v Mathers*, 283 Mich App 91, 97; 770 NW2d 883 (2009).
5. For example, in the "Rome I Regulation" (i.e., Regulation (EC) No 593/2008[1] of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, *Official Journal of the European Union*. L (177)), which governs the choice of law in European Union member countries, "entitles the parties to choose the legal system of the country...they prefer, including the legal system of a country which does not have any substantial connection with the transaction or the parties." See also Gary Born and Cem Kalelioglu, *Choice-of-Law Agreements in International Contracts*, 50 Ga. J. Int'l Comp. L., 44, 78-84 (2021).
6. See *United Nations Convention on Contracts for the International Sale of Goods*, <https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&clang=_en> [https://perma.cc/D3AS-TFJD].
7. CISG Article 6.
8. *Business Mobility Sys, Inc. v Fibernetics Corp*, (WD Mich 2014) (quotation marks and citations omitted) states: "The CISG governs contracts for the sale of goods if the parties to the contract are located in different nations and both nations have signed the

CISG. Both the United States and Canada are signatory nations. Parties from different nations are free to designate a choice of law in their contract, or opt out of the CISG's application, but such an agreement must appear on the face of the contract and evince the parties' clear intent to opt out of the CISG. As incorporated federal law, the CISG governs the dispute so long as the parties have not elected to exclude its application. Accordingly, where the parties have not opted out of CISG application, there is no need to conduct a state choice of law analysis."

9. Also commonly referred to as an application of the "perfect tender rule." *See Capitol Dodge Sales, Inc v Northern Concrete Pipe, Inc*, 131 Mich App 149, 539; 346 NW2d 535 (quotation marks and citation omitted), interpreting UCC § 2–601 as providing that "the buyer may reject goods which fail in any respect to conform to the contract, creates a perfect tender rule replacing pre-code cases defining performance of a sales contract in terms of substantial compliance."

10. CISG, Articles 59, 61-65.

11. For a detailed comparison, see the presentation prepared by Pace University's Institute of International Commercial Law at <https://iicl.law.pace.edu/sites/default/files/bibliography/ucc-cisg_0.pdf> [https://perma.cc/U5LM-L856].

12. M.C.L. § 440.2207; M.S.A. § 19.2207.

13. *Ralph Shrader, Inc v Diamond Int'l Corp*, 833 F2d 1210, 1213 (6th Cir 1987).

14. *Challenge Machinery Co v Mattison Machine Works*, 138 Mich App 15; 359 NW2d 232 (1984).

15. *Brachman v Wheelock, Inc*, 343 Mich 230; 72 NW2d 246 (1955).

16. For exceptions to Michigan's parol evidence rule, see the discussion in Chapter 12, Michigan Contract Law, (ICLE) John Trentacosta and Vanessa Miller.

17. *Shuttle Packaging Systems, L.L.C. v. Tsonakis*, (WD Mich 2001).

18. *See, e.g., Turcheck v Amerifund Financial, Inc*, 272 Mich App 341;725 NW2d 684 (2006).

19. MCL 600.745(3)(a)-(e).

20. See 9 U.S.C. § 201, *et seq.*

21. See 9 U.S.C. § 301, *et seq.*

22. See *Scherk v Alberto–Culver Co*, 417 US 506, 520 n 15; 94 S Ct 2449; 41 LEd2d 270 (1974).

23. *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc*, 473 US 614, 631; 105 S Ct 3346; 87 LE2d 444 (1985).

24. See Nicholas C. Ulmer, *Drafting the International Arbitration Clause*, 20 International Lawyer 1335 (1986). See also International Bar Association, *IBA Guidelines for Drafting International Arbitration Clauses* (2010).

25. MCL 440.2718(1).

26. See *Universal Gym Equip, Inc v Vic Tanny Int'l, Inc*, 207 Mich App 364, 367–368; 526 NW2d 5 (1994), vacated in part on other grounds, 209 Mich App 511 (1994). See also, *Skotak v Vic Tanny Int'l, Inc*, 203 Mich App 616, 617-618; 513 NW2d 428 (1994); *Wagner v Regency Inn Corp*, 186 Mich App 158, 169; 463 NW2d 450 (1990).

27. Swiss Code of Obligations, Article 160(1).

28. Swiss Code of Obligations, Article 161(1).

29. Swiss Code of Obligations, Article 163(1); Austrian Civil Code, Section 1336(2); German Civil Code, Section 343.

30. Decision of the German Bundesgerichtshof, BGH I ZR 58/03, in NJW-RR 2006, 267.

31. Decision of the German Bundesgerichtshof, BGH X ZR 211/98, in NJW-RR 2001, 324, at 343.

32. Dr. Mohammed Zaheeruddin, *Claim for damages and their Requirements under the United Nations Convention on Contracts for International Sale of Goods*, 4 International Journal of Liberal Arts and Social Science 46 (2016).

33. A useful resource addressing many of the other issues to be considered in the context of international contracting is Legal Aspects of International Sourcing, Thomson Reuters (2015 Edition).

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