International Business Law

Negotiating, drafting and executing international commercial contracts

Handout No. 2
DRAFTING, NEGOTIATING AND CONCLUDING INTERNATIONAL CONTRACTS

WHY NEGOTIATE AND DRAFT A CONTRACT?

In domestic business relationships it is common for parties, when entering into a contractual relationship, not to discuss the legal aspects of their agreement, but to limit themselves to negotiating the basic contents of their deal. For example, in the case of a regular sale in a shop, the parties will agree upon the goods purchased and their price, and will take immediate delivery of the goods without discussing the legal obligations arising out of the deal. If any problem arises later (e.g., if the goods prove to be defective), the solution will be found in the rules of the applicable law governing the contract in question.

However, when contracts are more complicated or involve greater amounts of money, including most contracts between businessmen, parties will normally prefer to establish their own rules, to expressly define what their respective obligations are under the contract, while remaining within the framework of the applicable rules of law, which may, in various ways, limit their freedom (party autonomy), especially by dictating mandatory rules that the parties must, in any case, observe.

Where the law provides specific rules for a given contract such as a contract of sale, in principle the parties will only need to draft their own rules when the standard solutions provided by the law do not conform to their needs or do not answer issues they need to clarify. However, many contracts currently used - for example: distributorship, franchising, patent license, trademark license and transfer of technology - are not regulated by the law in most legal systems. Where this is the case, there is an additional reason for drafting detailed contracts: namely, to establish precise rules on the main issues of the contract in question.

When we shift from domestic to international contracts, the need for establishing specific contractual rules increases substantially because cross-border contracts are placed in a far less certain and foreseeable legal framework. If the parties have not made a clear choice of the applicable law, it may be difficult to determine in advance which law will govern the contract and, consequently, which rules will govern the obligations of the parties not expressly covered by the provisions of the contract.

1 This is at least the typical attitude in the context of civil law countries, where many contracts of common use are codified. In common law jurisdictions, on the contrary, the basic idea is that all the obligations of the parties should result from the provisions contained in the contract. This explains why the lawyers in common law countries tend to draft contracts that are far more detailed and exhaustive than those of civil law countries.
6.1.1 The trend towards self-sufficient contracts

Although parties should decide under which law the contract will be placed before drafting and negotiating a contract, it is not always possible to follow this practice.

Contracts are often drafted and negotiated before the applicable law has been chosen, because many negotiators consider this to be of secondary importance.

Moreover, parties frequently work out standard contracts for use in several potential future situations and in the (possible) context of different national laws, which implies that they cannot be construed in compliance with a specific domestic law.

Finally, many types of contracts frequently used in cross-border trade are not "codified" in domestic laws; consequently the drafters tend to cover the greatest possible number of issues in the contract itself. Many of these contracts (e.g., licensing agreements, distribution contracts, M&A agreements and turnkey contracts) circulate across national borders, and the standard clauses they contain tend to impose themselves in contractual practice, independently of the national law that will actually govern them.

This scenario explains why cross-border contracts tend to be drafted, as far as possible, as self-sufficient documents that are more and more independent from specific domestic laws. In other words, contracts used in international trade are tending to become increasingly similar and less closely linked to a given domestic legal system.

It should be clearly stated, however, that the idea of a self-sufficient contract which can "stand up" under any legal system is an impossible and illusory goal. Due to the variety of rules of the different legal systems, it is impossible to draft a contract that complies with all of them.

However, at the same time, it is possible to reduce the risk of conflict with the applicable rules of law by both drafting contracts that are as detailed and exhaustive as possible, and by choosing applicable rules of law from legal systems which have few mandatory rules or which have mandatory rules that conform to the expectations of international traders.

Therefore, it is very useful to devise contracts that are as self-sufficient as possible, bearing in mind that, whenever possible, one should, check their compliance with the rules of the applicable law in advance.

This trend towards self-sufficient and complete contracts, which has also been influenced by common law lawyers who tend to use this approach in their domestic deals is a positive one, provided that the drafting technique is applied in a reasonable way and without excess. It is important that a contract cover all important issues, but this does not justify the technique of "inflating" contracts by adding unnecessary clauses or by complicating matters that can be kept simple.

For inexperienced parties, there is a danger that lawyers, instead of helping them by "streamlining" the various issues and constructing a coherent and well-organized set of rules, may introduce unnecessary complications that do not answer the parties' actual needs.

This risk has become greater now that, due to the wide circulation of contracts in digital form, it is extremely easy to copy clauses from existing models.

Of course, when parties say that the contract must be short and simple, they underestimate the fact that this contradicts the need for completeness. A contract cannot be short and exhaustive at the same time. On the other hand, there should always be a fair compromise between completeness and reasonable length when deciding which issues a contract must cover.

If there is a close cooperation between the lawyer who drafts the contract and the businessman who signs it - because the two decide together which issues are relevant and which are not - the above risk will be significantly reduced.

6.1.2 Oral and written contracts

Many non-lawyers fail to understand the difference between an agreement by which the parties undertake certain obligations towards each other, and the written document, signed by the parties, which contains the terms of such agreement.

---

2 Because if the contract regulates all important issues that may give rise to disputes, there will be little space for the application of non-mandatory rules of the applicable law, which may vary from one legal system to the other. Of course, this drafting technique does not solve the problem of compliance with possible mandatory rules of the applicable law and will consequently be an appropriate solution where no mandatory rules exist.

3 Consequently, the general principles of lex mercatoria, while having the disadvantage of being rather vague, do have the advantage that the mandatory principles they contain - such as, for example, the prohibition of bribery and consequent nullity of the respective contracts - will rarely conflict with a reasonably drafted cross-border contract.

4 But if such a control is impossible (e.g., because the party s forced to accept the submission of the contract to a law the contents of which cannot be verified or where the verification would be far too expensive in relation to the importance of the deal), a well-drafted and exhaustive contract w i m any case reduce the risks.
Business people are therefore often convinced the written agreement signed by them is a binding contract and that whatever orally does not bind them, as can be seen in the following example.

**Example 6-1 | Appointing a foreign agent**

Mr Klaus Schmidt, director of the company Bio-Marmeladen Gmbh, a small German producer of organic food, meets at a fair in Paris Mr Jean Dupont, a French individual who is well placed in the business and who is interested in promoting in France the products manufactured by Bio-Marmeladen.

The parties do not sign any contract, but Mr Dupont regularly transmits orders of French customers to Bio-Marmeladen and the latter pays him a commission on the business transmitted.

When some disagreements arise with Mr Dupont, and the latter sends a letter to Mr Schmidt claiming his rights under the French rules on commercial agency, the latter consults a lawyer and discovers, against his expectations, that his company is bound by an agency contract to Mr Dupont.

Mr Schmidt thought, when entering into the relationship with Mr Dupont, that he had been very clever in not signing any contract, assuming that he would avoid having any obligation towards the agent. Fie now discovers that the fact of having appointed Mr Dupont for the promotion of his products and having agreed to remunerate his activity has been sufficient to create a legal relationship.

What is worse, he understands that he would have been much better off if he had negotiated and signed a written contract made with the assistance of a lawyer, because in such a context he might have inserted a number of clauses in his favour, such as a choice of forum clause and/or a clause providing for German law as the applicable law.

However, in the absence of contractual clauses to the contrary, the French agent will be able to bring a claim before his courts (under Article 5(1) of Regulation 44/2001 (supra, § 5.3.1.2)), which will apply French law (see above, § 2.5.2), which provides a much higher indemnity in case of termination.

This is a rather extreme example, since it presupposes that a businessman is unaware that a contractual relationship can come into being without a written agreement (although this situation is far less exceptional in practice than one would imagine).

A more realistic example would be a case in which a manufacturer entertains a continuing relationship with an importer who purchases and resells his products in a given country. In this case, it may not be clear if the importer is effectively a mere customer or if he should be considered to be a distributor, protected by the rules that may be applicable in his country to this contract.5

If there is no closer relationship, there are no problems. But where the continuing relationship with the importer would be qualified under the law of the distributor’s country as a distributorship contract, the fact of not having put such agreement in writing may entail considerable disadvantages for the exporter, as shown in the following example.

**Example 6-2 | Continuing relationship with a German importer**

For 20 years, a Brazilian manufacturer has been selling his products to a German company, which resells them on the German market. The German importer is de facto the sole importer of the products of the Brazilian supplier. Over the years, the company has organized a network of subdealers and has regularly increased the turnover. On the Brazilian company’s website, the German company is indicated as “General Agent for Germany.”

However, the parties never concluded a distribution contract.

When the Brazilian supplier decides to establish his own company in Germany for the distribution of its products and to replace the German distributor, he has to face the problem of terminating the relationship with the latter.

The supplier is convinced that the German company is simply a customer and that it is free to interrupt deliveries without any further obligation.

---

5 In fact, although not many countries have enacted specific laws protecting distributors, in many legal systems the courts recognize the distributor’s right to be granted a reasonable period of notice in case of termination and to recover damages if such period of notice is not granted.
On the contrary, the lawyers consulted by the supplier say that a distributorship relationship has been established and that the distributor is entitled to a reasonable term of notice and that, if the notice period is insufficient, damages for the loss of profit in the remaining period may be due to the distributor.

In this case, it would have been better to conclude a written contract, in which the parties could have agreed upon a reasonable notice period (the duration of which would, in principle, be recognized by the courts, while in the absence of such indication it is more difficult to determine what the correct notice period should be), and where other useful clauses could have been inserted, such as an arbitration or choice of forum clause.

All of this demonstrates that relying on oral agreements is dangerous. Whenever parties enter into relationships that could give rise to future problems, they should establish a written contract and specify all relevant issues in that context. This is not only useful for the purpose of clearly establishing the contents of their agreement, but may also be a device for checking whether all relevant issues have been considered.

6.1.3 Letters of intent and similar documents

A rather common practice in international trade, particularly in the context of complex dealings, is to sign documents that leave some ambiguity as to their binding character. These are presented under various names: letter of intent (LOI), memorandum of understanding (MOU), heads of agreement.

It should be said from the outset that in many cases the ambiguity is due to the more or less intentional desire of one party to bind the other party, without being bound itself. It has been rightly said that:

“Obscurities and ambiguities are not totally unintentional. [...] Each party, in other words, seems to be preoccupied by the concern of binding the other party not to re-discuss the parts of agreement recorded in the letter of intent, while at the same time preserving for itself the freedom to re-discuss said points. Thus, perhaps not always at a conscious level, each party appears to show a tendency to consider a letter of intent as binding only for the other party.”

It is impossible to determine the binding character of this type of document in general terms. This will depend very much upon the wording of the agreement and the applicable law.

Since a precise answer to these questions can only be given with respect to a particular case, and with reference to a specific legal system, I will limit myself to a general overview of some typical situations where the above problems arise.

6.1.3.1 Situations where letters of intent are used

The purpose of letters of intent varies substantially from case to case. It may be helpful to examine some typical situations frequently encountered in international trade.

First, there are a number of situations in which the non-binding nature of the document should be beyond dispute. This is the case, for example, when the negotiators simply wish to confirm their reciprocal interest in negotiating the contract, mainly because they need to show the party they represent that there are good reasons to continue such negotiation. Alternatively, a party may wish to obtain - in the course of negotiation - a non-binding declaration of interest from the other party, because it hopes that this might put the other party under moral pressure if it changes its mind. In this type of case, there should be little doubt about the non-binding nature of the document, although no certain conclusion can be drawn without considering the specific wording of the letter of intent and the applicable rules of law.

A less clear situation arises when the parties sign a document in which they sum up the results reached at a certain stage of the negotiations, distinguishing the issues agreed upon from those still to be negotiated. Agreements of this type may imply an understanding not to bring up for discussion the issues already agreed upon and, more

---


7 However the applicator of this concept is anything but easy, considering that most issues in a contract are connected. Therefore, it cannot be excluded that the negotiation of a new issue will also resolve old issues. In such a case, a renegotiation of the "old" issue, together with the connected new one, would certainly be justified.
generally, an obligation to conduct further negotiations in good faith. In fact, agreements of this kind may cause more confusion than create advantages for the parties, considering the difficulty of assessing which behavior conforms to good faith and which does not.

Another common situation arises in the context of contracts that are necessarily negotiated and concluded through subsequent steps.

If one considers an M&A contract for the acquisition of the shares of a company, normally the parties will sign a letter of intent when they have agreed on the basic aspects of the transaction and will postpone the conclusion of the agreement until a number of further steps have been taken.

A similar situation arises when the parties agree to establish a cooperation project involving the creation of a jointly owned company (joint venture). Here, the parties first need to agree upon the overall scheme and thereafter work out the details of the operation, which implies the creation of one or more companies, the drafting of contracts between the mother companies and the joint venture, obtaining government authorizations when necessary, etc.

In cases of this kind, the letter of intent or memorandum of understanding will normally be much more than a simple declaration of intent: it will be an agreement on the essential terms, which leaves open for further determination the terms that could not be defined at this stage.

Situations of this kind are very difficult to classify from a legal point of view.

In some jurisdictions, particularly those that do not accept the idea of an “agreement to agree”, the letter of intent will have little or no value: in others, it may give rise to a duty by the parties to continue and conclude in good faith the negotiations on the issues left open.

Example 6-3 | Contract with a Middle Eastern manufacturer

A US supplier of telecommunications systems and a Middle Eastern supplier of cables entered into an agreement whereby the parties undertook to negotiate in good faith the supply of cables to the US party if the latter succeeded in becoming prime contractor for a telecommunications expansion project. The agreement did not contain a choice-of-law clause.

The US supplier obtained the contract and became prime contractor, but the parties were unable to reach an agreement on the supply of cables.

When the dispute was submitted to arbitration, the question arose as to whether the undertaking to negotiate in good faith was valid and enforceable.

According to some legal systems (English law, Saudi law), the agreement should be considered non-enforceable, while under other laws (e.g., New York law, Unidroit Principles) the agreement would be valid.

The arbitral tribunal argued that, in determining the applicable law, it should prefer a legal system that would satisfy the expectations of the parties, i.e., a legal system under which the agreement would be considered valid. The tribunal decided in favour of New York law, after having ascertained that under such law the agreement would be enforceable. In addition, the arbitral tribunal emphasized that this result was in conformity with general principles of the law of international trade as expressed in the Unidroit Principles.

The above case shows how uncertain the solutions can be with respect to agreements that refer certain issues to further negotiation. Parties should, where possible, know in advance which legal system governs their agreement and make clear if and to what extent their agreement is effective under the applicable law. When this is not possible, arbitration will normally be the most appropriate solution in case of a dispute.

---

8 Of course, such a conclusion cannot be drawn without considering the specific wording of the contract and the applicable law, especially with regard to possible rules on pre-contractual liability: see infra, § 6.3.4.

9 See ICC case 8540/96, published on the Unilex website.

10 This is because arbitrators will have greater freedom when it comes to finding a solution that answers the reasonable expectations of the parties. In the above case, the arbitral tribunal was able to choose a legal system under which the agreement could be considered as valid (thus conforming to the likely expectations of the parties, since it is to be assumed that they entered into the agreement with the intent of performing it), while it is likely that a state court would have taken a more rigid approach.
In some jurisdictions, a letter of intent or memorandum of understanding leaving a number of issues open for further negotiation may be considered a binding contract, the details of which can be filled in by the competent courts on the request of one of the parties.

An interesting case, decided by an ICC arbitral tribunal in 1996, is described in the following example.

**Example 6-4 | Joint venture in Iran**

A Swedish manufacturer of trucks and an Iranian company signed a Memorandum of Understanding (MOU) concerning the supply to the Iranian party of trucks and respective spare parts, the organization by the purchaser of an after-sales service, the setting-up of a joint venture and a future cooperation in the assembly of trucks.

Thereafter, the supplier did not implement the MOU, failing to set up the joint venture.

In the dispute brought before the ICC arbitral tribunal, the Iranian party contended that the MOU did bind the parties, while the Swedish supplier sustained that such document did not bind them, since it had not agreed upon the specific contracts to be negotiated in the framework of such general scheme.

The arbitral tribunal decided as follows:

"Whereas the Arbitral Tribunal considers that when the parties agree upon general issues to be implemented by them at a later stage they cannot be released from the obligations to use their best efforts to ensure that such general issues become specific terms of contracts to be executed by the parties.

"The Arbitral Tribunal, having considered paragraph 2 of Article 5.4 of Unidroit 'Principles of International Commercial Contracts', rules that the general description of the parties' intentions to reach agreements on certain issues contained in the MOU obligates the parties to exert their best efforts in order to have such intentions become defined terms of contracts legally binding for each of them."

In the above case, the arbitral tribunal awarded damages to the Iranian party for the loss of the ability to enjoy the probable benefits of the two aborted projects.

**6.1.3.2 Advice to negotiators**

As shown in the above examples, it can be difficult to foresee the actual value of letters of intent and similar documents, since this depends on the specific wording and, most of all, on the rules of the applicable law, which vary substantially from country to country.

The problem is that in most cases the parties themselves wish to avoid clarity and to maintain a certain ambiguity with respect to the binding force of the document they are drafting.

Consequently, the first task of a negotiator is to understand what the party in question really wants. Does it want to be bound or not? Does it expect the other party to be bound or not?

Once it is clear where the ambiguity lies, in principle it is possible to redraft the clauses to avoid any possible misunderstanding thus, the parties can explicitly state that certain promises are not legally binding and that the other party cannot rely on them. Or, on the contrary, they can expressly state that certain undertakings are legally binding in all respects.

This kind of exercise can be useful to ensure a better understanding of what the parties really want, but where ambiguity is necessary to reach an agreement (because its very purpose is to hide an actual disagreement), it may be necessary to accept the risk of unclear wording. If this is the case, because no other solution is possible, the negotiator should try to minimize the risk by drafting clauses that are as close as possible to the expectations of his party and should, at the same time, check the effect of the clauses under the applicable law. In any case, the negotiator must be aware that his party is taking a risk against which it should be protected, for example, by choosing a resolution of disputes mechanism that may put his party in the best possible situation in case of a dispute.

---

PREPARING FOR THE NEGOTIATION OF AN INTERNATIONAL CONTRACT

As noted in previous chapters of this book, international contracts, unlike domestic contracts, are negotiated in a far less predictable legal framework, in which a great number of issues (applicable law, jurisdiction) may vary substantially from case to case.

This situation has a considerable impact on the negotiation stage of a contract, since the parties will need to investigate a number of issues in order to identify the legal framework within which the contract will be situated and, where necessary, to change this framework according to their specific needs.

Of course, the decision of how to approach these problems depends upon the particularities of each case and the preferences of the negotiators, which makes it difficult to set out precise rules. I will try to describe here the various steps that are normally appropriate, which does not mean that they should always be followed, since such a decision will depend upon the complexity and the particular circumstances of each contract.

6.2.1 Identifying the legal framework where the contract is to be situated

A first step to be taken is to identify, at least in general terms, the legal framework where the contract is to be situated, which will also determine the choice of applicable law.

The steps normally to be followed in this stage are the following:

(a) First, one should identify the rules that govern the type of contract in question within the potentially applicable legal systems (normally those of the countries of the parties), in order to verify if these rules conform to the expectations of those drafting the contract and whether there are mandatory rules that cannot be derogated contractually.

(b) It may also be appropriate to verify if there are other rules, such as currency regulations, antitrust rules, prescriptions regarding the products (with respect to security, labeling, rules on reservation of title, etc.), that may affect the contract in the legal systems at issue. Of course, it is impossible to say a priori which issues should be considered, since this depends on the subject matter of each contract and the special needs of the parties.

(c) The result of this inquiry should put the negotiator in a position to make a first assessment about the acceptability of the laws of the countries involved as possible governing laws of the contract. Of course, the choice of the applicable law will also depend on other considerations, but knowing what the impact of the possible alternatives is will certainly provide the negotiator with important elements for making a responsible choice.

(d) After having identified which law can be considered in the first instance as the most suitable with respect to the needs of the negotiator, one should verify to what extent the choice envisaged would actually be recognized and effective in the interested countries.

A problem not to be underestimated is the difficulty of obtaining information about foreign legal systems, especially those in certain countries. Where this is the case, negotiator should approach the problem realistically and look for other solutions, such as the choice of a neutral law and a satisfactory solution for the resolution of possible disputes, even where these may imply some risks.

6.2.2 Establishing a draft in view of the negotiation

While identifying the legal framework in which the contract is to be placed, the parties will normally begin to draw up the terms of the contract in order to have a draft to submit to the other party.

---

12 Where the contract is to be performed in a third country, the legal system of such country may also be relevant.
13 See especially § 2.9 on the actual options for the choice of the governing law.
14 This may give rise to serious problems if the law which is excluded by virtue of the choice of law (e.g., the law of the other party) contains internationally mandatory rules: supra. § 2.9.1.2.
6.2.2.1 The use of standard clauses or models

For those who draft international contracts, models are an essential tool for identifying the key issues of the contract in question and for obtaining useful hints about the possible solutions to consider. Since model contracts are normally the result of a comparison between several individual contracts, they generally offer a comprehensive view of the main issues of a particular type of contract and the respective solutions already vested in contractual clauses. While a good model is an essential basis for drafting an individual contract, it may become a dangerous tool if used “as such”, without adapting it to the specific circumstances of the case.

Parties should, whenever possible, draft their contracts with the assistance of a lawyer, who will have the responsibility of adapting the clauses to their specific needs and making sure that the solutions chosen are lawful and effective. This being said, it is common knowledge that many traders prefer drafting contracts by themselves, without the assistance of a lawyer, on the basis of the materials they are able to find. This tendency should be opposed by making the users aware of the dangers that arise when drafting international contracts without the advice of an expert. However, whatever attempts are made in this direction, the fact remains that many businessmen continue (and will continue) to negotiate and draft international contracts without any legal assistance. It follows that if this is the real-life situation, there is a clear need for good model contracts that can at least reduce the risk of bad drafting.

This is why ICC decided to prepare standard forms, which are not only intended to serve as a "model" for the lawyer who needs to draft a tailor-made agreement, but which can also be used as such by a businessman, together with a number of devices intended to reduce the risk of inappropriate manipulation of the contract text. This issue will be discussed later in § 71.2.3.

Another problem, which arises as a consequence of the growing availability of easy-to-copy model forms (especially after the introduction of personal computers and the internet), is the possible abuse of standard forms, including by lawyers. Since it has become so easy to obtain hundreds of well-drafted clauses, many drafters cannot resist the temptation to use this wealth of material in order to draw up extremely ponderous and comprehensive contracts, at the risk of forgetting the actual needs of the parties involved. Moreover, the technique of mixing clauses of different origin may cause the drafter to lose control over the contract as a whole and give rise to inconsistencies or insufficient coordination between the various clauses.

Another risk is that the negotiator may feel bound to the pre-established clauses because he does not want to take the responsibility of adapting them to the circumstances of the case, and may consequently refuse the requests of his client to look for alternative solutions that would better comply with his needs.

All of this means that model contracts and standard clauses must be used in the right way. They are certainly essential tools for preparing a good contract, but the negotiator must be able to use them appropriately without losing the necessary creativity for setting up a contract that truly matches the specific needs of the parties.

6.2.2.2 Identifying the most appropriate solutions and negotiation margins

While identifying the critical issues of the contract, the lawyer must determine, in close cooperation with his client, the contractual solutions most appropriate in the specific case.

This is a very delicate stage, where a close cooperation between the lawyer and the businessman is needed, since almost all issues are to be decided involve economic and commercial choices which affect the allocation of risks and charges between the parties, but which may have legal implications. This is because a certain solution may be unlawful and another not, or because one solution may be more or less onerous.

This means that a reasonable compromise must be found between the business needs of the party on the one hand and the legal requirements on the other. The lawyer must understand the needs of the businessman and look for solutions which can answer such needs without breaching the law, but the latter must accept that not all of the solutions he would prefer are legally acceptable.

In this context, the lawyer will try to work out reasonably unambiguous clauses, knowing that the agreement whose contractual provisions are too vague often hides a substantial disagreement, which may create problems during the performance of the contract. But here too, a certain degree of flexibility is required, because a too rigid attitude on this subject matter may cause difficulties in negotiation. In other words, a certain degree of ambiguity may be unavoidable.

---

15 Moreover, currently most small- and medium-sized undertakings normally copy their contracts from their competitors, who will, in turn, have done the same in the past. The resulting legal quality of such agreements is almost always catastrophic.

16 This tolerance towards the “do-it-yourself” approach is often criticized. It is said that by circulating ready-made models which can be used without the intervention of a lawyer, parties are induced to consider the lawyer’s role as superfluous. This is certainly true, at least to a certain extent, and all possible efforts should be made to inform the parties about the risks of drafting contracts without legal advice. However, one must also recognize that many companies will, at least with respect to “smaller” contracts, do the drafting by themselves using the materials they can find. Bearing this in mind, it is better to help the parties by giving them models of good quality, which will do less harm that the use of a bad text.
and a good lawyer should try to find the right balance in order to reach a compromise solution with the least possible risk. Finally, a very useful exercise during this preparation stage consists in working out alternative solutions on those issues where it is likely that the other party will not accept the proposed clauses. This is not only because it is important to have alternatives to propose in the course of the negotiation, but also because it is important to know in advance what the disadvantages are in terms of costs, risks, etc., of the various solutions.

6.3.1 The approach to negotiation
The negotiation of a contract implies by its very nature that the parties will discuss their respective positions and look for compromise solutions that reflect their respective bargaining power. However, it is not only the bargaining power that counts. The ability of the negotiator can also play an important role. It is therefore wrong to assume, as many small companies do, that negotiating with a stronger party is useless because the latter's requests will have to be accepted in any case. Of course, there are situations where there is almost no room for discussion (e.g., where a very big company asks for the application of its general conditions of purchase), but in many other cases the stronger party makes proposals which it is open to discuss, and it would be wrong to accept them before having at least tried to modify them.

Moreover, small companies often see themselves as weaker than they actually appear to be in the eyes of their counterpart. Finally, it can never be excluded that reasonable requests, when they are explained and presented in the right way, may be considered seriously by the other party, particularly in the context of long-term contracts where it is important to create a good spirit of cooperation and to maintain it during the life of the contract.

An important tool for strengthening the bargaining position of a party is to base the discussion on a draft worked out by that party and to continue the negotiation using the same document, thus giving the negotiator the advantage of discussing within a familiar context.  

---

17 This is not an absolute rule. There are situations in which it may be better for a party not to put its cards on the table and on the contrary, to wait for the first move of the other party. However, such a choice should be made consciously and not simply, because a party does not want to prepare a draft.
6.3.2 The role of the lawyer in the course of negotiation
We have already noted (§ 6.2.22) the importance of a close cooperation between the lawyer and the manager in preparing a draft contract. The same need for a joint approach exists during the negotiation stage, where the businessman needs to know from his lawyer if the alternative solutions discussed with his counterpart are legally feasible and, if not, what other solutions can be found.

It is therefore important that the lawyer be involved in the negotiation from the very beginning and that he actually knows the strengths and weaknesses of the deal his client is negotiating, so he can understand the importance of the issues in discussion.

The practice of involving the lawyer at the very end and asking him to give his advice on a contract that has already been negotiated is unacceptable. The lawyer involved at the end of the process will only be able to give some advice concerning a number of strictly legal clauses - such as the choice of law clause or the arbitration clause - but he will be unable to judge from a legal point of view whether the best possible solutions have been found for the other issues. This is because he does not know their context. If the lawyer does not know which type of risk the parties were expecting to cover with a given clause, he cannot say whether the clause is effective and to what extent.

This is why the lawyer should be involved in the negotiation of complex deals during the whole negotiation stage. Of course, his participation will be effective only if he is able and willing to understand the business needs of his client, and provided that he has the creativity needed to work out alternative solutions that may help overcome possible deadlocks.

This does not mean that the businessman must always be accompanied by his lawyer. In less important deals, where the participation of the lawyer at this stage would be too onerous, the non-lawyer will negotiate the contract prepared in advance with his lawyer and possibly wait to approve the final text after having verified the modifications with him. This is particularly the case when the lawyer has worked out a standard form with the client to be used in several circumstances, a typical situation with respect to agency or distribution agreements. Here the lawyer will mainly be involved in order to check if there are special problems with respect to the legal system of the other party, and to verify, if possible, whether modifications required by the counterpart are acceptable.

6.3.3 The recourse to local lawyers
Where there are no particular problems concerning the application of a foreign law (e.g., because the interested party is able to negotiate that the contract will be governed by its own law), there will normally be no need for involving foreign lawyers in the negotiation.

Where, on the contrary, the contract is to be governed by a law not known by the lawyer responsible for the drafting, this should, in principle, require the assistance of a lawyer from the country whose law is to be applied. This is in order to verify whether the solutions negotiated are fully valid and effective under such law.

However, it must be noted from the outset that such a solution is more difficult than one might think. In fact, in many cases the foreign lawyer will not understand the drafter/negotiator's point of view of and will consequently be unable to give the right advice.

There are several reasons for this. First, lawyers tend to reason within the framework of their own legal system and have difficulty in understanding questions that arise in a different context. Second, a lawyer who has not been closely involved in the negotiation and is not familiar with the underlying problems will be unable to identify the real legal issues and to work out alternatives that will provide a solution to the problems raised.

This does not mean that one should not request the advice of local lawyers, but rather that such advice will only be fully effective if the foreign lawyer has the necessary legal background - which mainly means the practice of assisting foreign companies - and if he can be closely involved in the negotiation so that he can appreciate the reasons why the legal issue on which he is being asked to give advice is important for the contract in question.

---

18 Some lawyers assume that they should only deal with strictly legal matters, but this is incorrect. A good business lawyer must also be able to understand business issues, because he would be unable to find the legal solution to the problem his client is facing.
If, on the contrary, the lawyer is simply asked to answer a purely legal question, which is not placed in the actual context of the negotiation, it is likely that his advice will be of little use, except that the negotiators may discharge their responsibility if something goes wrong.

6.3.4 Responsibility of the parties during negotiation

An important issue which arises when negotiations fail is that of determining if and to what extent the parties must respect certain obligations even in the period before conclusion of the contract.

The approach to this problem varies substantially from one legal system to another. Most civil law countries adopt the principle that during negotiations the parties must act in good faith, which means in particular that a party that interrupts negotiations in bad faith (e.g., after having given its counterpart a reasonable expectation that it would conclude the contract), or that carries out parallel negotiations without informing the other party, may be liable for damages. The precise conditions for such pre-contractual liability are not the same in all countries. Furthermore, as regards the recoverable damages, some legal systems limit the compensation to the so-called negative interest (i.e., the expenses sustained for the negotiation) while others also include the loss of profit or loss of a chance.

Common law countries tend to follow a more restrictive approach. In English law, for example, a traditional view seems to prevail whereby the parties have no obligations as to the conduct of the negotiation and are free to interrupt it and/or to carry out parallel negotiations with third parties until the contract is concluded. This practice, however, has been substantially mitigated in recent times.

Considering these differences, it is impossible to determine the extent of the parties’ liability during the negotiation stage without analyzing the legal system applicable in a specific case.

An attempt to set out uniform rules adapted to the needs of international trade has been made in the Unidroit Principles, which mainly follow the civil law approach, by stating the following rules:

Unidroit Principles - Article 2.1.15 | Negotiations in bad faith

(1) A party is free to negotiate and is not liable for a failure to reach an agreement.

(2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.

(3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.

This provision, after having stated in the first paragraph the general principle of freedom of negotiation, provides in the following paragraph that such freedom is not unlimited, but must be coordinated with the obligation to negotiate in good faith. As to the actual meaning of good faith in this context, the official commentary to Article 2.1.15 says that:

“A party's right freely to enter into negotiations and to decide on the terms to be negotiated is, however, not unlimited, and must not conflict with the principle of good faith and fair dealing laid down in Article 1.7. One particular instance of negotiating in bad faith which is expressly indicated in para. (3) of this article is that where a party enters into negotiations or continues to negotiate without any intention of concluding an agreement with the other party. Other instances occur when one party has deliberately or by negligence misled the other party as to the nature or terms of the proposed contract, either by misrepresenting facts, or by not disclosing facts which, given the nature of the parties and/or the contract, should have been disclosed ...”

Another article of the Unidroit Principles provides that parties who negotiate a contract are bound to respect a duty of confidentiality.
**Unidroit Principles - Article 2.1.16 | Duty of confidentiality**

Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party.

The above provisions can be very useful for arbitrators, in cases where they decide to apply these rules instead of domestic rules to a dispute involving pre-contractual liability. However, it should be noted that where the Unidroit Principles are incorporated by reference into the contract the parties have been negotiating (but have not managed to conclude), the rules on pre-contractual liability contained in the Principles should theoretically not be applicable (since they are part of the contract that has not been concluded) unless the parties have agreed in advance that the Principles will govern all of their future deals.

6.3.5 Agreed upon special rules for negotiation

In some cases, particularly when they are engaging in negotiations of substantial importance, the parties may agree in advance on the rules that are to govern the conduct of the negotiations.

The main issues to be considered in this context are the obligation to keep the information received confidential and the obligation not to deal with other parties.

6.3.5.1 Confidentiality agreements

A rather common practice is that of agreeing, before starting negotiations, that the parties shall maintain confidentiality and shall use only for the purpose of the negotiation all information received from the other party in the context of the negotiation.

This is especially the case when contracts are negotiated that imply by their very nature that the parties are exchanging confidential information, such as contracts for the acquisition of a company (where the purchaser must necessarily obtain the information necessary for evaluating the convenience of the deal and for determining the price), or transfer of technology agreements and know-how licenses (where the licensee cannot assess the suitability of the deal he is negotiating without obtaining minimum information about the proposed technology necessary for the evaluation).

One of the key issues when drafting confidentiality agreements is to define what the confidential information is. If the definition is too broad, the agreement may unreasonably limit the freedom of the receiving party. At the same time, a too-narrow definition may substantially deprive the agreement of its usefulness.

Confidentiality agreements drafted unilaterally by the disclosing party are often unbalanced and may dangerously limit the freedom of the receiving party as regards the future use of information it already had before signing the agreement. This is why parties tend to exclude from the confidentiality obligation information that is already known to the receiving party or that is not confidential in nature, although this approach may leave room for uncertainty, which can benefit the receiving party.

A possible compromise is to require that the confidential information be expressly identified as confidential. However, in this case the receiving party must have the opportunity to object to the confidential character of information that it deems to be non-confidential.

Considering the above problems, parties should take great care in drafting confidentiality agreements. A useful tool to which they can have recourse is the ICC Model Confidentiality Agreement, ICC Publication No. 664, published in Annex 9. § 9.7.

6.3.5.2 Undertaking not to deal with third parties and other clauses

Other possible clauses whereby the parties set up rules for future negotiations are those which limit their freedom to deal with other parties during the negotiation, or which provide for the reimbursement of certain expenses borne by one of the parties.

For example, the parties may agree not to enter into negotiations with others during a certain period or grant each other a right of first refusal.
In special situations, where a party has to bear substantial costs during the negotiations, e.g., for carrying out specific projects or investigations in view of the future contract, a reimbursement of such expenses (or part of them) in case of failure to conclude the contract may be agreed on.

**DRAFTING THE CONTRACT**

Drafting contracts is a very demanding task that requires specific skills. Lawyers who draft contracts are in a certain sense, required to act as “legislators” of the parties, since the contract is “the law of the parties”. The lawyers must be able to “translate” the agreement of the parties into clauses that leave the least possible space for ambiguity and that are fully enforceable.

**The trend towards common drafting standards**

We have seen (supra, § 6.1.1) that there is a general trend in international trade towards exhaustive and self-sufficient contracts. Drafting techniques and standard clauses tend to establish themselves across borders, which has led certain international contracts to become more and more similar to one another, independent of the national legal system that governs them. Thus, for instance, many M&A contracts and licensing agreements follow similar (mainly Anglo-American) drafting standards, whatever the applicable law chosen by the parties. 21

This trend towards uniformity favours the establishment of a common practice in international trade that can make the negotiation of international contracts easier and more effective.

At the same time, however, many international contracts are still drawn up in accordance with the domestic standards of one of the parties. This will especially be the case when a stronger party prepares a draft under its own law and according to the techniques commonly used in its country. This approach cannot be criticized as such, since the parties are free to decide how they want to draft their contracts, and once a contract is submitted to a given national law it is fairly normal that it be drafted in accordance with the common usage of such country.

Nevertheless, the establishment of common contractual standards acceptable to traders all over the world is certainly preferable, since it puts parties on an equal level and contributes to developing a sort of common language which makes communication and discussion easier between parties belonging to different legal systems. This is one of the reasons why ICC, when devising its model contracts, has tried, as far as possible, to set out clauses that are not linked to a particular legal system and that could become an international standard.

**The basic requirements of a well-drafted contract**

There are no absolute rules on how to draft a good contract, since this depends on the skill and experience of each individual. Nevertheless, it may be useful to state some general criteria that should be followed as much as possible.

First, the provisions of the contract should be clear and unambiguous for all those involved and not only for the parties who conclude it. When non-lawyers draft a contract, they often forget to mention issues that they take for granted, but which will not be at all obvious to a third party that may be called on in the future to decide a possible dispute. Consequently, a clause that may have a clear meaning when placed in the context known by the parties and discussed during the negotiations, may become ambiguous, if not quite incomprehensible, to a third party, or even to the parties themselves after a certain time.

It is therefore important that the clauses be drafted bearing in mind that they will be read by people not involved in the negotiation (judges, arbitrators), and that they resist a possible attempt by the lawyers to make them say the contrary of what the parties intended when concluding the agreement.

---

21 Some excesses in this direction may give rise to criticism, particularly when notions that are part of a given legal system are incorporated into contracts submitted to a national law under which they are unknown. For example, the reference to "representations" common to M&A agreements, characteristic of common law systems, may give rise to problems of interpretation if the contract is submitted to the law of a civil law country, where the term has no precise meaning.
## INCOTERMS® 2010 QUICK REFERENCE CHART

<table>
<thead>
<tr>
<th>INCOTERMS® 2010</th>
<th>Rules for any mode or modes of transport</th>
<th>Rules for sea and inland waterway transport</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ex Works (EXW)</strong></td>
<td>Free Carrier</td>
<td>Delivered at Terminal</td>
</tr>
<tr>
<td><strong>Free Carrier (FCA)</strong></td>
<td>Who Pays</td>
<td>Carriage &amp; Insurance Paid To</td>
</tr>
<tr>
<td><strong>Carriage Paid To</strong></td>
<td>Buyer</td>
<td>Delivered at Terminal</td>
</tr>
<tr>
<td><strong>Insurance Paid To</strong></td>
<td>Seller</td>
<td>Delivered at Duty Paid</td>
</tr>
<tr>
<td><strong>Paid To</strong></td>
<td>Buyer</td>
<td>Free Alongside Ship</td>
</tr>
<tr>
<td><strong>Delivered at Terminal</strong></td>
<td>Buyer</td>
<td>Free on Board</td>
</tr>
<tr>
<td><strong>Delivered at Place</strong></td>
<td>Buyer</td>
<td>Cost &amp; Freight</td>
</tr>
<tr>
<td><strong>Delivered at Duty Paid</strong></td>
<td>Buyer</td>
<td>Cost, Insurance &amp; Freight</td>
</tr>
<tr>
<td><strong>FAS</strong></td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td><strong>FOB</strong></td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td><strong>CFR</strong></td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td><strong>CIF</strong></td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
</tbody>
</table>

### SERVICES

- **Export Packing**
  - Buyer: Buyer
  - Seller: Buyer
- **Marking & Labeling**
  - Buyer: Buyer
  - Seller: Buyer
- **Block and Brace**
  - Buyer: Seller
  - Seller: Seller
- **Export Clearance** (License, EEI/AES)
  - Buyer: Buyer
  - Seller: Buyer
- **Freight Forwarder Documentation Fees**
  - Buyer: Buyer
  - Seller: Buyer
- **Inland Freight to Main Carrier**
  - Buyer: Buyer
  - Seller: Buyer
- **Vessel Loading Charges**
  - Buyer: Buyer
  - Seller: Buyer
- **Ocean Freight / Air Freight**
  - Buyer: Buyer
  - Seller: Buyer
- **Nominate Export Forwarder**
  - Buyer: Buyer
  - Seller: Buyer
- **Marine Insurance**
  - Buyer: Seller
  - Seller: Seller
- **Unload Main Carrier Charges**
  - Buyer: Buyer
  - Seller: Seller
- **Destination Terminal Charges**
  - Buyer: Buyer
  - Seller: Seller
- **Nominate On-Carrier**
  - Buyer: Buyer
  - Seller: Seller
- **Security Information Requirements**
  - Buyer: Buyer
  - Seller: Seller
- **Customs Broker Clearance Fees**
  - Buyer: Buyer
  - Seller: Buyer
- **Duty, Customs Fees, Taxes**
  - Buyer: Buyer
  - Seller: Buyer
- **Delivery to Buyer Destination**
  - Buyer: Buyer
  - Seller: Buyer
- **Delivering Carrier Unloading**
  - Buyer: Buyer
  - Seller: Buyer

### Notes:
1. Incoterms® 2010 do not deal with the parties' obligations for stowage within a container and therefore, where relevant, the parties should deal with this in the sales contract.
2. FCA Seller's Facility - Buyer pays inland freight; other FCA qualifiers. Seller arranges and loads pre-carryage carrier and pays inland freight to the "F" delivery place.
3. Incoterms® 2010 does not oblige the buyer nor must the seller to insure the goods, therefore this issue be addressed elsewhere in the sales contract.
4. Charges paid by Buyer or Seller depending on contract of carriage.
5. Charges paid by Seller if through Bill of Lading or door-to-door rate to Buyer’s destination.

*INCO®TERMS® IS A REGISTERED TRADEMARK OF THE INTERNATIONAL CHAMBER OF COMMERCE. THIS DOCUMENT IS NOT INTENDED AS LEGAL ADVICE BUT IS BEING PROVIDED FOR REFERENCE.*

USFRS SHOULD SEEK SPECIFIC GUIDANCE FROM INCO®TERMS® 2010 AVAILABLE THROUGH THE INTERNATIONAL CHAMBER OF COMMERCE AT [WWW.ICCBOOKS.COM](http://WWW.ICCBOOKS.COM)
<table>
<thead>
<tr>
<th>TYPE OF CONTRACT</th>
<th>DEFINITION</th>
<th>APPLICABLE INTERNATIONAL CONVENTIONS</th>
<th>COMMENTS</th>
</tr>
</thead>
</table>
| Contract for the Sale of Goods | Seller transfers or engages in the transfer of goods to a buyer who pays the agreed upon price | Hague Convention Relating to a Uniform Law on the International Sale of Goods (1964)  
United Nations Convention on Contracts for the International Sale of Goods ("Vienna Convention" or "CISG") (1980) | Often attached to a sales contract but is legally separate from a contract for the sale of goods  
Methods: road, rail, water, air or a combination of the above |
| Contract for the Transportation of Goods | Transporter contracts to deliver merchandise for a client who agrees to pay a fixed price | International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading (1924) and 1979 Protocol  
Convention Concerning International Carriage by Rail ("Berne Convention") (2010) | |
<table>
<thead>
<tr>
<th><strong>Distribution Contract</strong></th>
<th>Supplier agrees to provide goods to an intermediary distributor who will sell the products/services to third parties</th>
<th>Uniform Rules Concerning the Contract of International Carriage of Goods by Rail (Appendix B to Berne Convention) (2010)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financing Agreements</strong></td>
<td>Provides the credit terms between a lender and a borrower</td>
<td>Convention for the Unification of Certain Rules Relating to International Carriage by Air (“Warsaw Convention”) (1929)</td>
</tr>
<tr>
<td><strong>Employment Contract</strong></td>
<td>Contract in which an employer agrees to pay employee an agreed upon amount in exchange for an employee’s completion of specified services/acts</td>
<td>Convention for the Unification of Certain Rules for International Carriage by Air (“Montreal Convention”) (1999)</td>
</tr>
<tr>
<td><strong>Contract for the Transfer of Technology</strong></td>
<td>Contract where one party supplies technical know-how to the other in exchange for remuneration</td>
<td>Hague Convention on the Law Applicable to Agency (1978)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Includes: agency agreements, concession contracts, franchise contracts, etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Includes: contracts for the transfer of information, technical support contracts, cooperation or joint venture agreements, etc.</td>
</tr>
</tbody>
</table>