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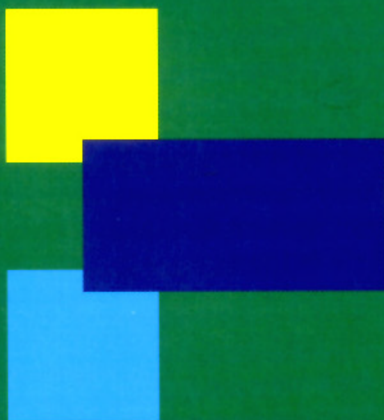

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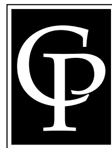
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ESSENTIAL INTERNATIONAL TRADE LAW

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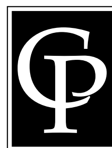

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Foreword

For some time now Australian governments at all levels have made the promotion of export their trade priority. From the Department of Foreign Affairs & Trade in Canberra to the smallest regional council, all now recognise that promoting export is essential to job and wealth creation and to increasing Australia's international competitiveness.

And the message from the business community in response to these government initiatives is clear too; training is essential. While business is quick to accept the attractions and potential rewards of international trade, most need to 're-tool' before they are prepared to make their first forays into international markets.

International trade requires new procedures and embraces new risks. Without familiarity of the basic ingredients of an international trade transaction, many businesses lack the confidence to take the first step.

Essential International Trade Law will be required reading both for businesses starting out in international trade, and for legal practitioners looking for some grounding in what is one of the most satisfying and intellectually rewarding areas of legal practice.

Geoff Farnsworth
President
Australian Institute of Export Ltd

Preface

This book is part of the Cavendish Essential Series. The books in the series constitute a unique publishing venture for Australia in that they are intended as a helpful revision aid for the hard-pressed student. They are not intended to be a substitute for the more detailed textbooks which are already listed in the current Cavendish catalogue.

Each book follows a prescribed format consisting of a checklist covering each of the areas in the chapter, and an expanded treatment of 'Essential' issues looking at examination topics in depth.

The authors are all Australian law academics who bring to their subjects a wealth of experience in academic and legal practice.

Professor David Barker
General Editor
Dean of the Faculty of Law,
University of Technology, Sydney

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Thanks and appreciation to Professor David Barker, who put me forward for the task of writing this book, and who continues to be an enormous inspiration to all law students, past and present, at the University of Technology, Sydney; Dr Iur Katrin Cutbush-Sabine, who lectured me in this subject and who has been involved in the genesis of this book; Blake Dawson Waldron for their support; and to all those who love and support me generally in my life.

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1 Introduction to International Trade Law

You should be familiar with the following areas:

- Scope of international trade law
- Importance of international trade law

The massive growth in international trade and the explosion of information technology are leading towards a world trading market and economic interdependence of the various nations. Perhaps this will eventually lead to a world government of sorts, with international trade being an arm of government. In the meantime, there is a complex myriad of treaties, laws, rules and guidelines for those involved with international trade to decipher. The importance of an understanding of the laws governing international trade transactions to a corporate and commercial legal practitioner cannot be understated.

The focus of this 'essential' international trade law text is to provide information relevant to law students and practitioners, and those engaging in, or wishing to engage in, trading relationships with persons and organisations in other countries.

Although many would consider it elementary that a business wishing to import materials from or export its products to overseas markets would first consider the legal exposure of doing so. However, studies conducted in the 1960s, 1970s and late 1990s in the United Kingdom, United States, and Australia, have found that most businesses involved in exporting did not seek legal advice before entering international sale contracts, did not consider what law would apply to such contracts, and did not consider the possible legal consequences if something went wrong. It is only when something goes wrong with a shipment, or one party finds itself in financial trouble and seeks to find ways out of contractual commitments, that the parties consider the legal aspects involved. For further discussion on this topic visit – www.agribusiness.asn.au/review/Perspectives/LegalExporting.htm.

'International trade law' covers an enormous scope of activities related to the agreement for sale of goods, the terms of their carriage, quality and quantity, insurance, and intellectual property issues. Those who attempt to comprehend the field as a whole have a difficult time, as similar terms are used to cover different areas. For example the terms International Business Law, International Business Transactions, International Commercial Law, International Sales Law, International Economic Law and International Finance Law are often used interchangeably. This book covers some of each of the above areas.

The first two chapters provide the reader with frameworks for understanding the organs, organisations, institutions, agreements, conventions, laws, and issues that arise in international trade law. The third chapter deals with the World Trade Organisation, with its background in the GATT, and the fourth chapter considers the major world trading blocs. The fifth chapter addresses competition aspects of international trade law, and the sixth chapter looks at the law governing private international traders of goods, including the governing law of trade contracts and the law relating to their transportation, payment, and passing of property, which are three major issues in international trade. Chapter 7 deals with disputes, and the final chapter deals with electronic commerce.

2 Frameworks for Understanding

You should be familiar with the following areas:

- Definition of international trade law
- Public and private international trade law
- Sources of international trade law
- International trade organisations

Defining international trade law

Breaking down the phrase into parts, '*inter*' is Latin for between, 'national' is nations, 'trade' is the exchange of goods, services, and technology for profit, and 'law' is the regulation of conduct. International trade law can therefore be defined as the regulation of the conduct of parties involved in the exchange of goods, services and technology between nations.

Motive for international trade

Economic theory suggests comparative advantage is the motive. Historically this occurred where countries had abundant supplies of different commodities. Behind the notion of comparative advantage is the presumption of value, that the commodity one country possesses is of value in another. Value is determined by demand in the market (unless it is undermined by cartelisation). It is often the case in the modern world that traders are trading in identical products. Components from countries A, B and C are combined in country D by a company owned in country E for sale in country F, making the whole notion of international competition rather artificial.

Public and private international trade law

International trade law is commonly described as 'public' and 'private'.

Public international trade law is the regulation of conduct in commerce between nations. 'States' is used to refer to national governments rather than the word 'governments' because some governments may change and the new government may not be recognised internationally.

Private international trade law is the regulation of conduct between private traders in different States. It generally does not encompass the trading activities of individual consumers, for example purchasing items whilst on holidays, but there has been a shift in perception.

The modern development is that the distinction between public and private international trade law has less meaning. We assume for example a World Trade Organisation (WTO) agreement is public but immediately it translates into private issues such as tariffs, dumping and taxes. Even in former times the division did not reflect the reality of the situation as it masked governments' involvement, and governments used the doctrine of sovereign immunity to protect their trading position. Take for example the East-India Company, the world's first multinational, which was founded by the Royal Charter of Elizabeth I in 1600.

Sources of international trade law

There are 7 main sources of international trade law, of varying levels of power. The hierarchy of source law is as follows:

Agreements between States

These are known as treaties, or conventions, and are the closest international equivalent to legislation in domestic legal systems. Treaties can be bilateral, meaning between two States, or multilateral, meaning between many States. The bilateral Treaties of Commerce and Navigation between England and other countries in the 19th century had a significant impact at the time, but are less prevalent today given the large number of multilateral treaties, except in specific areas of trade co-operation. Multilateral conventions are mostly developed through international organisations such as the United Nations (UN). A UN convention applies only to those States that have signed the

convention and ratified it, by enacting domestic legislation consistent with the convention and depositing an instrument of ratification with the Secretary-General. Once a convention is ratified it becomes part of a State's domestic law, and its application in that State will depend to a large extent on domestic jurisprudence (that is, on how it is applied and interpreted). If a State has not incorporated a convention into domestic law through ratification then it cannot be enforced in that State.

Treaties can impose legal obligations on the parties whereas declarations impose moral obligations. An international convention is the closest thing to international legislation. It will prevail over a domestic law where that State is party to the convention. International treaties and foreign laws do not operate within a State's territory unless that State allows it, and the State's laws do not apply outside its territory, unless the foreign State agrees to apply it. A State's territory is defined as its geographical boundary including the ocean, the sky, and the land below. While in theory the State's law applies to those persons and entities within its territory, in practice immunities are granted to persons such as diplomats and to entities such as ships.

The *Vienna Convention on the Law of Treaties* (1969) deals with the adoption and interpretation of treaties, as well as their entry into force. A treaty is concluded when its text is voted for by two-thirds of States who are present and voting. A State may adopt a treaty with specific reservations, unless this is prohibited in the treaty itself, or unless the reservations are generally incompatible with the object and purpose of the treaty. The Convention provides that a treaty is to be interpreted in good faith in accordance with the ordinary meaning given to its terms in the given context. The full text of the *Vienna Convention on the Law of Treaties* may be downloaded from www.austlii.edu.au/au/other/dfat/treaties/1974/2.html. It entered into force in Australia in 1980.

General practices between States

This includes trade customs and usages which have developed over time as standard in trading relationships. The body of *lex mercatoria* is the general principles of usages and customs among international traders. It developed from the law merchant, and is comprised of any general aspect of international trading which has been used, accepted and recognised by traders over a period of time. These are not fixed, and will depend on the practices between international traders at the time under consideration. They also vary from place to place. It is therefore very difficult to see *lex mercatoria* as a body of law for

international trade, for it is neither comprehensive nor of universal application. They fill an important role in international trade but are not in themselves a body of law. But if a broader view of *lex mercatoria* is adopted, reliance on any international instrument to govern a contractual relationship can be considered reliance on *lex mercatoria*, as opposed to relying on the trade laws of any one particular country. *Lex mercatoria* would then include activities by the International Institute for the Unification of Private Law (UNIDROIT), and the United Nations Commission on International Trade Law (UNCITRAL), and indeed each and every convention and agreement on international trade. Take for example Art 9(2) of the Vienna Convention (see p 74, below, for a full discussion), which provides that, unless expressed otherwise, customs and usages in a particular trade apply to the contract between the parties. Proving the usage regularly observed by and adopted by parties to contracts of a similar type in the particular trade concerned will be proof of *lex mercatoria*.

General recognised principles of law

These are principles of law recognised throughout national legal systems around the world. The procedures and legal principles held in common by the civil and common law systems fit into this category, such as good faith, *pact sunt servanda* (that the contract will be enforced according to its terms), and the obligation to mitigate damages.

However, the third general legal system, of Shari'a (Islam), is not included for some reason, despite the fact that nearly a quarter of the world's population falls within it. This is an area of International Trade Law that is not reflected at all as yet because the International Trade Laws were developed by non-Islamic States. In the 19th century Europe was dominant in setting the pattern of International Trade and the Islamic States accepted that. Arab traders used the Silk Road (from Shanghai to Egypt) and had their own trading arrangements, usually based in barter, which should of course be considered part of *lex mercatoria*.

A major underlying principle in international trade is good faith. The duty of good faith is basically a duty to act properly and in good conscience. It aligns with s 51AA of the *Trade Practices Act* 1974 (Cth) which provides that a corporation must not in trade or commerce engage in conduct which is unconscionable. In practice the duty of good faith provides Contracting Parties with a broad ground for opting out of the contract by ignoring individual terms and arguing

that there has been a breach of good faith which affects the whole of the contract such that it should be set aside.

Previously decided cases and academic writings

Whilst not a strict doctrine of precedent as in the common law systems, it is consistent with the objective of uniformity of interpretation that previous decisions be taken into account. Previous arbitral awards will be considered by arbitrators, and previous judicial decisions will be considered by national courts. The writings of leading academics is also considered of some importance as a form of expert commentary on the state of the law in a certain area.

Agreement between traders

This is known as the principle of party autonomy, that the traders should be free to contract on their own terms and to decide how disputes between them should be settled and according to what law. This principle is considered vital in international trade, however its application tends to be somewhat restricted. Any contract of sale, regardless of its terms, cannot exist independently of national law. This applies to whether a breach has occurred, whether the contract is capable of rescission, and remedies. Therefore the way the governing law of the contract is interpreted is important in determining the parties' risks.

There are occasions where courts have applied the law of their forum, the law with which they are most familiar, despite a clear choice of law clause to the contrary. For example in *Golden Acres Ltd v Queensland Estates Pty Ltd* (1969), the contract provided for Hong Kong law, but the Queensland court held that the parties could not exclude the application of Queensland law. Despite this, the judgment left open whether in the future the parties could rely on choice of law clauses. This resulted in a precedent which went both ways and provided no certainty.

In addition to the contractual terms agreed by the parties, the course of past dealings between traders may result in terms becoming part of an agreement between them. These past dealings, or trade 'usages' between the parties, may apply to the contractual relationship despite their not being incorporated into it in written form. Take for example a situation where traders routinely contract on the basis of the seller's standard terms and conditions of sale. If there is a contract in which an agreement was made over the telephone with no reference to the standard conditions, it can be shown that it was in the reasonable

contemplation of the parties that the contract incorporate the standard conditions in the same manner as in the other contracts, which contracts form a course of dealings between the parties.

Domestic law

The reality in many transactions is that if a particular issue is not settled by an international convention, a generally recognised practice or principle, or by a specific term in a trade contract, domestic law is applicable. The Federal government has the power to legislate with regard to trade and commerce under s 92 of the Australian Constitution. This is a highly litigated section, with some decisions finding monopoly being compatible with free trade, others finding it incompatible, and other decisions a mixture of the two. This is evident in *Clark King & Co Pty Ltd v Australian Wheat Board* (1978), for example, where wheat growers argued that the monopoly of the Wheat Board was unconstitutional. In addition to this state laws of procedure may apply to regulate the conduct of the litigation. For example, if the State court has power to order a freeze on the sale of goods, this can be applied notwithstanding the fact that the sale is governed by an international convention.

Dominant commercial organisations

Companies, often multi-national, who have a significant hold on the market for a particular product, commodity or service, can have a large say in how the market operates and under what conditions. The regulation of an industry can be determined by its main player, and it is difficult in an economic environment where the aim of businesses is to maximise profits for those with power not to use and abuse it. An example of market dominance is the sugar industry in Australia. Sugar is prohibited from being imported, and sugar prices are set by CSR in conjunction with the Queensland government.

Another example of dominance is exemplified in an English case involving the petroleum giant Esso. The case of *Esso v Marlin* (1976) involved the granting of a licence by Esso for the running of a petrol station. Esso had stipulated in the agreement delivery of set amounts of petrol at set intervals so that the petrol station would have to have a certain level of turnover in order to be able to accept the next fixed quantity delivery. Esso was able to determine such clauses as a result of the huge power imbalance between the parties. The licensee believed from negotiations that the petrol station would have a one-way street system to go in and out of the petrol station, but after the

contract had been signed the local authority decided against the one-way street system. This meant less business for the petrol station. Esso refused to renegotiate, and despite the licensee's attempts to work round the clock the contract was breached. In what was primarily a policy decision the court held that where a significant change occurs such as changes in building plans the terms of the contract are to be set aside and redrafted with the benefit of hindsight.

International trade organisations

Intergovernmental organisations (IGOs)

These organisations are created by two or more States to pursue common interests as an entity separate from its members. A 'charter' is formed, which states the objectives, functions, and structure of the organisation. Some examples include the UN and the European Union (EU). Other organisational types include economic communities, such as the Economic Community of West African States (ECOWAS), and free trade associations, such as the North American Free Trade Association (NAFTA). These are arrangements where the States involved agree to reduce or eliminate tariffs amongst themselves but maintain their own external tariffs.

Non-government organisations (NGOs)

These include non-profit and profit organisations. Non-profit organisations co-ordinate the interests of private national groups. Examples include the International Chamber of Commerce (ICC), the International Bar Association (IBA), the International Maritime Organisation (IMO) and the International Air Transport Association (IATA). Profit organisations are transnational corporations (TNCs), which have subsidiaries and joint ventures in several States.

3 World Trade Organisation

You should be familiar with the following areas:

- Background to the GATT
- The WTO Agreement
- Relationship between the GATT and WTO
- TRIPS Agreement
- GATS Agreement
- TRIMS Agreement

Background – GATT

Between 1929 and the end of the Second World War, international trading activities ground to a halt. The incredible increase in international trade since then is a result of political change due to the war, where the United States of America took over from Britain as the new leader in world trade. The US sought to reorganise the world, so as to avoid a new polarisation of uneven economic development such as was seen in the economic devastation of 1929.

The institutions to facilitate this reorganisation were to be:

(1) International Monetary Fund (IMF) to address balance of payments problems;

(2) World Bank to regulate international investment; and

(3) International Trade Organisation (ITO), to regulate international trade and dissolve trade barriers.

It is the third that is of relevance to the present study. The first step towards establishing the ITO was the completion of its charter in 1948, known as the Havana Charter. Meanwhile, negotiations were held between governments aimed at lowering customs tariffs and reducing discriminatory trade restrictions amongst themselves. The result of these negotiations was the signing by 25 governments in 1947 of a provisional international agreement to make binding commitments

with one another in relation to their trade policy, known as the General Agreement on Tariffs and Trade (GATT).

The central aim of the GATT was to reduce the protection of domestic industries to only one measure – the tariff, and then to negotiate the gradual reduction in tariffs. Mechanisms to achieve this included:

Restoration of most-favoured nation treatment

Each country agreed to grant one another treatment at least as favourable as they would grant any other country. That is, countries were to apply general treatment to the imports and exports of all other Contracting Parties.

National treatment

Contracting Parties agreed that imported goods from other Member States would be accorded no less favourable treatment with regards their sale and distribution than similar products produced domestically.

Elimination of quota restrictions on imports

Where a country imposes restrictions on the quantity of products imported, trade becomes dependent more on government policy than on market forces, and comprises a barrier to trade. The aim was to eliminate quota restrictions on the importation of certain goods. However some quota restrictions (QRs) were allowed under the GATT to safeguard domestic balance of payments, or for items such as agricultural produce, but these were to be administered in a non-discriminatory manner. This posed some problems for developing countries, who sought the right to use QRs to assist their economic development. Developing countries have very much relied on intergovernmental commodity agreements and compensating financial facilities to achieve stability. In 1964 the United Nations Conference on Trade and Development (UNCTAD) was established to consider specifically the trade and development problems of the developing countries. For further information visit www.unctad.org.

Elimination of preferential trading arrangements

Some countries, or groups of countries, had previously accorded to each other reciprocal preferential tariffs. Examples include the territories of the French Union, and Britain and the Commonwealth countries. These preferential tariffs were seen as a barrier to trade.

Despite the aim of the GATT to abolish trade preferences, the US favoured the creation of the European Community (EC) in 1957 by sponsoring the Treaty of Rome, to facilitate a greater economic harmonisation of Western Europe, which was seen as the bulwark against the eastern bloc during the Cold War. The eastern bloc responded with the creation of Comecon, which remained in place until 1989. Since then a number of the eastern bloc countries have become members of the EC.

Protection of domestic industries against export dumping

A trader may introduce products into a foreign country at a price well below the usual price charged for that product in the overseas market, so as to obtain market share, and force the domestic competitors out of the market. For 'dumping' to occur, the price charged must be less than the price charged in the trader's own country, or less than the price charged by the trader in other countries, or less than the cost of production in the country of origin.

Because of the severe damage this can do to the domestic industry, anti-dumping duties were allowed under the GATT to protect the domestic industry from this unfair competition, provided they were not applied merely to protect the domestic industry from competition. The amount of the anti-dumping duties imposed could be no more than the difference between the selling price and the price in the trader's domestic market.

State trading

State purchases and sales can act to protect domestic industry, and the GATT aimed to prevent discrimination by State trading. This posed problems for centrally planned economies, where most if not all purchases are made by State owned entities rather than private businesses, as is the case in market-based economies. Over the last 50 years the communist/socialist countries, such as China and the Soviet Union, have moved towards market economies. The remaining centrally planned economies were included in the GATT through agreements to purchase stated amounts of goods from market economies, so that a certain level of their trade became market-based,

and so that these State traders would effectively behave like private traders in that context.

Subsidies

This area was incorporated into the GATT in 1955. A subsidy is a payment made by a government to domestic producers, which reduces their net cost of production and enables them to charge more competitive prices for their goods. Government subsidies can present a serious barrier to imports. The GATT aimed for avoidance of subsidies generally, and reporting of subsidies where used. Export subsidies were allowed only on primary products.

Central role of the GATT in international trade

When it became evident that the ITO would never come into operation, which was in large part due to difficulties in ratification in the US Congress, the GATT became the central mechanism for regulating the conduct of international trade. The GATT did not pose as great a difficulty in the US Congress as the ITO did, because it was a trade agreement rather than a trade organisation, and its legal obligations were described as 'provisional', viewed as impermanent, and to be applied only where they were consistent with US domestic legislation. The reason the US difficulties resulted in stifling the development of the ITO was their overarching dominant position in world trade at the time. To an extent this remains the case today, with initiatives not having US support being unlikely to succeed.

The GATT had no formal institutional arrangements, for that was to be the role of the ITO. This is why we speak of GATT countries as 'Contracting Parties' and not 'members'. Perhaps the political flexibility of a 'non-institutional institution' is what made the GATT so effective. Decision-making was delegated to the Contracting Parties acting collectively, and stated in capital letters 'CONTRACTING PARTIES' to distinguish between reference to the various Contracting Parties acting individually. Despite the lack of an institution, the GATT had detailed rules in legal language, with rules for their application, interpretation, and enforcement. These rules were effective in the 1950s, mainly due to the normative pressure Contracting Parties placed on each other to comply with them. For a discussion on dispute settlement, refer to Chapter 7.

The GATT involved an annual meeting of the Contracting Parties and an executive committee, the Council of Representatives (which

met during interim periods to act with limited authority), and a Secretariat (which advised and assisted the Contracting Parties, undertook research and prepared reports).

GATT negotiations 1947–94

Over the years the Contracting Parties participated in a series of multitrade negotiations (MTNs) to update the GATT, and these are commonly referred to as 'rounds'. The negotiation rounds are based on most favoured nation (that every tariff concession by one State to another must similarly apply to the other Contracting States) and reciprocity (that concessions made by Contracting States should be reciprocated by others).

The rounds steadily became more complex and involved, and their duration expanded over time. The first rounds were completed each within a single year. The first round was held in Geneva, Switzerland in 1947, the second in Annecy, France in 1949, the third in Torquay, United Kingdom in 1951, and the fourth in Geneva in 1956. The fifth and sixth rounds were held in Geneva in 1960–62 (the 'Dillon' round) and 1962–67 (the 'Kennedy' round). The seventh round was held in Tokyo from 1973–79 and the most recent round, the Uruguay round, took place over 8 years from 1986–94. The reason the Uruguay round took 8 years is that it focused on several highly complex and controversial areas, including agricultural subsidies, services, and intellectual property.

As developing countries became involved with GATT, the United Nations Conference on Trade and Development (UNCTAD) was established in 1964 to consider the special needs of developing countries. It developed a Generalised System of Preferences, where good imported to developed countries from developing countries were given preferential duty treatment. It continues to operate, providing a vehicle for publicising trade issues of developing countries.

Relationship between GATT and WTO

The Uruguay Round of Multilateral Trade Negotiations from 1986–94 created the World Trade Organisation (WTO). Remembering the difficulties regarding the US Congress and the ITO, the US was here given assurance that it could review its membership if the dispute settlement procedures under the WTO were repeatedly unfavourable to the US.

The WTO is the realisation of the ITO planned after the Second World War, discussed at the beginning of this chapter.

The distinction between the GATT 1947 and the WTO is that the GATT was a network of international trade agreements and working bodies, whereas the WTO is an organisation to administer international trade agreements using GATT 1994 as its code of conduct. The latter is institutional while the former is not.

Current WTO membership

At 26 July 2001 there were 142 members of the WTO, including Australia, Austria, Belgium, Brazil, Canada, Chile, Czech Republic, Denmark, Egypt, European Community, France, Germany, Greece, Hong Kong, Hungary, India, Ireland, Italy, Japan, Korea, Malaysia, Mexico, Netherlands, New Zealand, Norway, Pakistan, Papua New Guinea, Peru, Philippines, Poland, Portugal, Singapore, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Turkey, United Kingdom, and the United States.

China and Taiwan are in the process of making accession bids, and are expected to become members of the WTO in the very near future. This has required them to enter access agreements with each of the existing WTO members on what they are willing to do to bring their trade policy in line with WTO standards.

The WTO Agreement

Known as the Marrakesh Agreement, but officially titled 'The Final Act Embodying the Results of the Uruguay Round of Multilateral

Trade Negotiations', the WTO Agreement contains a number of agreements reached during the course of the Uruguay Round.

Agreement Establishing the World Trade Organisation

It provides for an institutional framework encompassing the GATT, as modified by the Uruguay Round. The WTO has a legal personality and is based on general principles of international law. Its task is to administer the WTO Agreement, and other agreements not an integral part of the WTO. The hierarchical structure of the WTO includes a Ministerial Conference, a General Council (which acts as a Dispute Settlement Body), a Council for Trade in Goods, Council for Trade in Services, Council for TRIPS, other subsidiary bodies and committees, and the Secretariat.

General Agreement on Tariffs and Trade 1994

This agreement incorporates texts on the interpretation of a number of GATT articles, such as balance of payments provisions and procedures for review of customs unions or free trade areas.

Uruguay Round Protocol GATT 1994

Contains commitments reached on tariff and non-tariff measures negotiated in the Uruguay Round in areas such as agriculture and export subsidies. The concessions are staggered, with successive reductions at the beginning of each year over a four year period. A more flexible approach is adopted for less developed countries, depending on their trade, financial and developmental needs.

Agreement on Agriculture

There are four components of the Agreement: an Agreement on Agriculture itself, concessions and commitments members are to undertake, an Agreement on Sanitary and Phytosanitary Measures, and a Ministerial Decision concerning least developed and net food importing developing countries.

The Agreement establishes a long term agenda for the opening up of agriculture markets by commitments on market access, domestic support and export subsidies. In addition to a separate approach for developing and developed countries, the Agreement also distinguishes countries dependent on food imports.

The initial aim is to replace the multiplicity of non-tariff measures with tariffs (to make member agriculture policies more transparent), coupled with tariff rate reductions over six years (for developed countries) or 10 years (for developing countries). Export subsidies are also reduced over a six year period. Quotas are set at 3% of domestic consumption, raising to 5% during implementation. Where this results in a surge of imports members are allowed to apply additional duties, known as special safeguards.

The Agreement provided for further agricultural negotiations to commence in the fifth year of implementation. This occurred late in 1999, despite the failure of major attempts at Seattle to agree on the basis of the substantive new round of negotiations (already being described as the 'Millennium Round').

Agreement on Sanitary and Phytosanitary Measures

Sanitary and Phytosanitary (SPS) measures are regulations for food safety and animal and plant health. Governments have the right to take SPS measures, but they should not be applied to act as a barrier to trade. They should only apply to the extent they are necessary to protect human, animal or plant life or health. WTO members differ on their risk assessment in certain areas, depending on their view of the scientific evidence. The Agreement encourages WTO members to use international standards, guidelines and recommendations as a basis for assessing risk.

Agreement on Textiles and Clothing

The Agreement listed a number of textiles and clothing products then subject to bilateral quotas, agreed under the Multifibre Arrangement (MFA). WTO members could choose from the list in the categories of tops and yarns, fabrics, made up textile products, and clothing, to

bring within the GATT rules, to a percentage of their total textiles and clothing imports (starting with 16%).

Where movement of a product by a WTO member to come within the GATT rules resulted in an influx of imports, safeguard measures could be taken. A Textiles Monitory Body (TMB) was established to review such measures, as well as to generally oversee the implementation of the Agreement by members.

Agreement on Technical Barriers to Trade

This Agreement aims to prevent technical standards and testing and certification procedures from creating unnecessary trade barriers. Similar to the SPS Agreement, it is acknowledged that governments retain the right to take measures to protect human, animal or plant life or health or the environment, through requiring products to comply with certain processing, producing and packaging standards.

Agreement on Trade Related Aspects of Investment Measures (TRIMs)

The TRIMs Agreement lists investment measures which unduly restrict and distort trade. These include measures which restrict the volume of product an entity may import, or require the organisation to procure products locally. The Agreement requires measures to be disclosed, and eliminated over the implementation period.

Agreement on Subsidies and Countervailing Measures

The Agreement establishes three categories of subsidies – prohibited, actionable, and non-actionable. Prohibited subsidies are those contingent on export performance, or on the use of domestic over imported goods. Actionable subsidies are those which create 'adverse effects' and 'serious prejudice' to another WTO member. Non-actionable subsidies include assistance to industrial research and assistance to disadvantaged regions, for which a member may only seek a determination and recommendation on if the subsidy results in serious adverse effects to its domestic industry.

Agreement on Safeguards

A safeguard measure, as mentioned earlier in the chapter, is an action to protect a domestic industry from an unforeseen increase of imports of any product which is causing, or which is likely to cause, serious injury to the industry.

The duration of a measure should not exceed four years, unless there is a continued need for it, in which case it may continue up to a maximum of eight years. The WTO member would then have to wait at least two years before reintroducing the safeguard measure, if still necessary. The Agreement provides for a Safeguards Committee to oversee the Agreement, and to ensure commitments are being met.

General Agreement on Trade in Services (GATS)

The GATS includes basic obligations of the WTO members on trade in services, as well as commitments to liberalise trade in services over a period of time. This includes the removal of limitations on the number of service providers, or the number of service transactions. The GATS covers services such as international banking, consulting, construction projects, tourism, and education. Each WTO member must treat the services and service providers of other WTO members no less favourably than domestic services and service providers.

The GATS contains a number of annexes, dealing with issues such as free movement of service providers to provide services in another WTO member market (but not to the extent of requiring the granting of permanent residence) and access for foreign service providers to use public telecommunications services and networks. This would cover, for example, an airline wishing to operate out of another country, to enable it to send trained personnel to the foreign market to train up local staff, and to enable it to run a computerised reservations system using the foreign market's telecommunications networks.

The Council for Trade in Services is responsible for overseeing the functioning of the GATS. Multitrade negotiations are encouraged, as was done with goods, and greater participation of developing countries through access to technology, distribution channels and information networks. This is seen as a weakness in the GATS because it does not structure future reductions. Each reduction has to be negotiated, which opens up political pressure in each WTO member country on each occasion, whereas pre-agreed structured future reductions are easier to administer.

Agreement on Trade Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods (TRIPs)

Protection of intellectual property was regarded in the GATT as an acceptable obstacle to free trade. The World Intellectual Property Organisation (WIPO) was created in 1967/8 to promote the global protection of intellectual property rights, and to administer industrial property rights agreements. These agreements have included:

- Paris Convention for the Protection of Industrial Property (1967);
- Berne Convention for the Protection of Literary and Artistic Works (1971);
- International Convention for the Protection of the Rights of Performers, Producers of Phonograms and Broadcasting Organisations (1961), known as the Rome Convention;
- Treaty on Intellectual Property in Respect of Integrated Circuits, known as the IPIC Treaty; and
- Universal Copyright Convention.

The Paris and Berne Conventions dealt in vague terms with the volatile issue of enforcement, but did not contain appropriate methods for resolving disputes between States. Where provisions are incorporated from previous conventions such as the Paris, Berne, and Rome Conventions, the articles of those Conventions are merely stated in an article of the TRIPS Agreement, rather than the provisions being written out in full. For example, Art 2 states 'Members shall comply with Art 1 through 12, and Art 19, of the Paris Convention (1967)'. The Agreement therefore needs to be read in conjunction with these other sources.

The Agreement establishes minimum international standards for the protection of intellectual property rights, and applies to all WTO members. 'Intellectual property' covers copyright and 'related rights', trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits and the protection of undisclosed information. The aim is to encourage development on a *quid pro quo* basis.

A Council for TRIPS oversees the functioning of the Agreement. The Agreement provides detailed rights, such as rental rights for authors and successors in title of computer programs and cinematographic works. The protection of geographical indications protects the public from being misled as to the origin of goods. The definition of patentable subject matter requires the work to be new, useful, and non-obvious. The term of protection of a work, other than a photographic work or a work of applied art, is 50 years from the

making of the work or its publication. This applies to works whose author is a corporation.

The enforcement procedures require effective and immediate action by members to seize infringing goods and devices. The procedures used must be fair and equitable and not unnecessarily complicated, lengthy or costly, and damages must be available. The defendant is to be given written notice disclosing the basis of the claims in sufficient detail. The parties to the procedures present evidence, and if one party unreasonably withholds relevant evidence, judgment can be passed on the basis of the evidence available with consideration of the allegedly withheld information. The remedies for breach of intellectual property rights under the TRIPS Agreement are injunctions and damages, but if these remedies are inconsistent with domestic law, compensation and declaratory judgments are provided for. Damages can be payable even where the infringer did not have actual or constructive knowledge of the infringement. If the claim fails, the applicant may be ordered to pay damages and the defendant's costs.

The Agreement applies a 'graduation rule' to developing countries so that as they develop economically they must graduate into the common GATT rules. Developed countries are to provide incentives to commercial entities to promote technology transfer to least developed countries to enable them to create a sound and viable technological base. Developed countries are, upon agreed terms, to co-operate in assisting the establishment of laws and procedures, infrastructures and training of personnel to apply the technology in less developed countries.

Computer programs are protected as literary works under the Berne Convention. Databases are also capable of being protected by copyright. Industrial designs are protected for a period of 10 years. Owners of protected designs would be able to prevent the manufacture, sale or importation of articles bearing or embodying a design which is a copy of the protected design.

The Agreement requires that 20 year patent protection be available for all inventions, whether of products or processes, in almost all fields of technology. Inventions may be excluded from patentability if their commercial exploitation is prohibited for reasons of public order or morality; otherwise, the permitted exclusions are for diagnostic, therapeutic and surgical methods, and for plants and (other than micro-organisms) animals and essentially biological processes for the production of plants or animals (other than microbiological processes).

Part III of the Agreement sets out the obligations of member governments to provide procedures and remedies under their domestic law to ensure that intellectual property rights can be effectively enforced, by foreign right holders as well as by their own nationals.

A difficulty in the present international intellectual property (IP) law is the placing of regulations on newly industrialised societies. Industrialisation in several countries has relied upon the use of other countries' technology. The United States and Switzerland made use of technology that was patented in Germany and the United Kingdom. Japan bought licences from the United States. Now China seeks to industrialise and yet there is international insistence that they comply with modern IP law when perhaps it would be fairer to allow them to have free run while they develop. At present IP is being used as a sword by those countries with a technological advantage.

Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)

The DSU established a systematic approach to the settlement of disputes between WTO members. The chapter on Dispute Settlement discusses the rules and procedures.

For more information on the WTO visit www.wto.org. The full text of the WTO Agreements may be downloaded at www.wto.org/english/docs_e/legal_e/final_e.htm.

Domestic application

International treaties do not automatically enter into force in Australia, despite having been agreed to by members of the government involved in negotiating them. It is necessary for appropriate legislation to be drafted, and existing legislation to be amended, except where the legislation already meets the treaty requirements, or they can be met by administrative action. It is only after the legislation is in place that the treaty may be ratified on behalf of Australia.

The Federal Government only has the power given to it under the heads of power in s 51 of the Australian Constitution. Residual power remains with the States. Therefore although the Australian government is a member of the WTO, the States are not, and the States have power to make laws which contravene Australia's WTO obligations. However, under s 51(xxix) of the Constitution, the Commonwealth Government has the power to legislate with respect to

external affairs, and in the landmark case of *Koowarta v Bjelke-Petersen* (1981) the High Court held that this external affairs power could be used to override the legislation of the States.

In practice, Australia's WTO obligations are applied domestically at a State and Federal level.

4 Trading Blocs

You should be familiar with the following areas:

- European Union (EU)
- North Atlantic Free Trade Agreement (NAFTA)
- The Common Market for the Southern Cone (Mercosur)
- Asia Pacific Economic Community (APEC)
- ASEAN Free Trade Area (AFTA)
- Andean Pact (ANCOM)
- Australia New Zealand Closer Economic Relations Trade Agreement (CER)

Countries form trading blocs to assist their domestic economies, and to improve their bargaining power with other countries. The six major trading blocs in the world today are the EU, NAFTA, Mercosur, APEC, ASEAN and ANCOM.

European Union

The European Economic Community (EEC) was created in 1965 by the *Treaty of Rome* (1957), with the aim to establish a common market with the alignment of economic and social policies, to promote harmony, stability, and an increased standard of living. The EEC was then referred to as the European Community (EC) and in 1993 was changed to the European Union (EU) under the *Treaty on European Union* (TEU), also known as the *Maastricht Treaty*. The EU is the most cohesive and comprehensive trading bloc in the world. It has made significant achievements in the removal of internal tariffs and quotas, the free movement of persons, services and capital, the customs union, rules on competition, dumping practices and social policy. It has become analogous to the Federal model used in Australia.

Each of the Member States surrendered sovereignty to the EU, and the EU law replaced national laws in specified areas. Where competence in a specified area is surrendered to the EU, international agreements on those areas cannot be entered into by the individual States. This is why, for example, the current membership of the WTO lists the European Union as a member and not the individual States. EU law takes supremacy over domestic laws. EU law can be directly applicable throughout the community, meaning that individuals can invoke it in their national courts. Directly applicable laws include non-discrimination, tariffs, quotas, competition, and State monopolies. GATT Rules, however, are not directly applicable, because they were intended to apply to governments and not individuals.

The organs of the EEC are the Council, the Commission, the Parliament, and the Court of Justice. The role of the Council is to co-ordinate economic policy, with legislative and financial power. The Commission proposes and drafts legislation, which is submitted to the Council for approval. The Council consults the Parliament before the new legislation is enacted. The European Court of Justice (ECJ) regulates the interpretation and application of the legislation.

Some provisions of the Treaty of Rome which are of relevance to the international trader include the free movement of goods and workers, service provision, and capital. Free movement of goods is achieved by the creation of a customs union, where tariffs and other barriers of trade are eliminated as between the Member States, and a common external tariff (CET) is imposed on goods entering the EU, regardless of their place of entry. As a result, trade within the community is fostered, while trade with non-Member States is reduced.

The EU competition rules are of great importance both to countries wishing to sell goods into the EU and to companies wishing to manufacture goods within the EU. The EU jargon for commercial entities is 'undertakings'. There are two main provisions of the Treaty of Rome which affect international business transactions within and outside of the EU.

Article 85 prohibits anti-competitive behaviour by competitors who co-operate to distort natural market conditions. This can occur, for example, where the major competitors agree to fix prices for their goods, where competitors agree to limit or control production, or to allocate various markets between themselves. It does not apply, however, where competitors co-operate their research and development efforts to develop a new or improved product.

Article 86 prohibits dominant undertakings from abusing their position of strength to distort competition in the relevant market for their goods. A dominant undertaking is one that can behave independently without taking into account its competitors, suppliers or customers. The 'relevant market' will depend on the characteristics and use of the goods in question. An 'abuse' of the dominant position occurs when production is unfairly controlled, unreasonable demands are required of purchasers, or excessively high or low prices are set (high to make excessive profits, or low to squeeze a small competitor out of the market). For more information on Articles 85 and 86, see p 56, below.

The Commission investigates complaints against companies, and has wide powers to search and seize documents. The matter is heard by the ECJ, and if a company is found guilty of anti-competitive conduct, heavy financial penalties can apply.

There are also two conventions relevant to international traders which are applicable in those EU countries that have ratified them. The first is the *Convention on Law Applicable to Contractual Obligations (Choice of Law)* (1980), which recognises the right of parties to decide upon the law to govern their contracts. The second is the *Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters* (1968), which allows the enforcement of a judgment by a court in one Member State in a court in another Member State.

There are also directives on the liability of companies, the classification and maintenance of share capital, and uniform accounting standards.

The Treaty of Rome is available at www.hri.org/docs/Rome57, general information about the EU and its institutions is available at http://europa.eu.int, and EU law may be searched at http://europa.eu.int/celex/htm/celex_en.htm.

NAFTA

The North Atlantic Free Trade Agreement is an agreement between the United States, Mexico and Canada to establish a free trade area, by:

(1) eliminating trade barriers in goods and services;

(2) promoting free competition;

(3) increasing investment opportunities;

(4) protecting and enforcing intellectual property rights; and

(5) creating a framework for further co-operation.

Two institutions have been established to facilitate administration of NAFTA. The Free Trade Commission is a supervisory body, and the Secretariat is an administrative support body.

Non-tariff restrictions (such as import licences and quotas) were to be removed, and it was agreed that taxes would not be imposed on exported goods unless the goods were subject to the same tax if consumed domestically. The principal objective in trade between the United States and Mexico is the elimination of import duties on goods that originate within North America. Mexico's use of drawbacks allow manufacturers to recoup import duties paid on Asian components in products for the United States, and Canadian markets provided large Asian manufacturers with an export platform in Mexico. Mexico had until 2001 to fully eliminate the drawback programme.

Given that duty free treatment and other benefits of the NAFTA provisions applied to goods originating in North America, rules were established to define origin. The basic origin rule is that the goods must either:

(i) be wholly produced within a NAFTA country, from NAFTA originating materials; or

(ii) be assembled from non-NAFTA components provided NAFTA components accounts for 50% of the net cost or 60% of the value of the finished product, and the components undergo sufficient processing to result in a change in tariff classification.

The NAFTA also incorporates emergency action safeguards, where a party may temporarily halt tariff reductions to protect an industry that is being seriously injured by surges in imports resulting from the tariff reductions. 'Emergency actions' can be of two kinds – against the imports of one other party, known as bilateral actions, or against the imports of all countries, known as global actions.

The NAFTA extends free trade commitments to cross-border trade in services by service providers of another NAFTA country. Each country is to afford service providers of another NAFTA country treatment equal to that it accords its own service providers. Service providers are not required to maintain an office in the other country in order to provide services within it. However, the provisions are of limited application, as they do not affect most air services, basic telecommunications, and social services. The NAFTA also provides for the removal of restrictions so that business people can readily obtain temporary entry to other NAFTA countries. Some restrictions will continue to be applied, however, given the ongoing problem of illegal immigration of Mexican citizens to the United States. There is an

annual limit of 5,500 Mexican professionals to be admitted into the United States.

With regard to free trade in financial services, Mexico agreed to permit financial institutions in the United States and Canada to establish wholly owned subsidiaries in Mexico, phased in by the year 2000.

The NAFTA addresses competition policy and monopoly concerns, recognising that prevention of anti-competitive conduct would further promote free trade relations. However, the NAFTA provisions in this regard are general, and vaguely drafted. This can be compared to the Structural Impediment Initiative discussions with Japan, and the specific undertakings of the US-EC anti-trust co-operation agreement of 1991. Similarly, in the area of anti-dumping, the United States managed to prevent Mexico's efforts at incorporating into NAFTA a modification of the US anti-dumping and countervailing duty laws. As it stands, each country reserves the right to apply their own laws in this area to imported goods.

The NAFTA involves a three stage dispute resolution process. The first stage is consultation, which is envisaged to be the primary means of settling disputes. If unsuccessful, the second stage involves a meeting of the Free Trade Commission to discuss the matter. If the problem remains unresolved, an arbitral panel of five expert members hears the matter, using a procedure similar to panel dispute resolution under GATT. If it is contended that the offending country has violated both its NAFTA obligations and its GATT obligations, the complaining party is able to choose either forum to resolve the dispute.

For further information and links on NAFTA, visit www.mexico-trade.com/nafta.html.

Mercosur

The Common Market of the Southern Cone (Mercosur) is a customs union which was established in 1995. The agreement to form a customs union was made in 1991 in the Treaty of Asuncion. The aim is to create a free trade zone, with free movement of goods, services, and factors of production such as labour and capital. Members are Brazil, Argentina, Paraguay and Uruguay, plus two associate members, Bolivia and Chile. It is expected South Africa will commence negotiations with Mercosur in 2001 for development of a South-South free trade area. After the EU and NAFTA, Mercosur is the third largest trading bloc in the world.

Mercosur, like other customs unions, applies a common external tariff, coupled with a reduction/elimination of customs duties and non-tariff restrictions within the union. Rules of origin apply to goods manufactured from materials originating in member countries, those with 60% content originating in member countries, and goods manufactured from foreign materials which, as a result of processing, result in a new tariff classification. Mercosur also provides for the settlement of disputes by direct negotiation, followed if necessary by reference of the dispute to the Common Market Group for recommendations based on advice of a panel of experts convened for that purpose. Members are also permitted to apply safeguard measures if a significant increase in the level of imports of a particular good damages, or threatens to damage, a member's market. Members have sought to curb inflation by pegging currency to the US dollar.

The text of the Mercosur Agreement may be viewed at www.mac.doc.gov/ola/mercosur/mgi/mercosus.htm and further information may be found at www.mercosur.org.

APEC

The Asia Pacific Economic Community (APEC) is a trading bloc founded in 1989, comprising 21 Member States in the Asia-Pacific region, including Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Singapore, Taiwan, Thailand and the USA.

For the first five years of its existence, APEC operated as a forum for economic discussions and consultations, but there were few concrete outcomes. This was largely because of requirements placed on ASEAN members participating in APEC. In 1994 the 'Bogor targets' were agreed, with 18 member countries agreeing to work towards a free trade and investment zone (by 2010 for developed members, and 2020 for developing members), with elimination of tariffs and most non-tariff barriers among member countries.

Application of concessions since has been by open regionalism and concerted unilateralism. 'Open regionalism' involves trade concessions applying generally and not only to other member countries, and 'concerted unilateralism' involves member countries setting and applying their own measures rather than measures set by the union and applied to all member countries. These concepts have been both applauded and criticised.

Since 1994 a number of APEC agreements have been concluded. The Osaka Action Plan, adopted in 1995, concerned trade and investment liberalisation, business facilitation and economic and technical co-operation. The Manila Action Plan for APEC (MAPA), adopted in 1996, compiled members' action plans to achieve the Bogor targets. Further agreements were made in 1997 and 1998, with discussions focusing on economic recovery from financial crisis, with an objective of skills development to improve the social wellbeing of the people. Work in 1999 involved competition regulatory reform and work on an APEC Food System, as well as support for a new round of WTO trade negotiations. The 2000 meeting in Brunei focused on the development of small and medium enterprises (SMEs), and the involvement in APEC activities of the business/private sector.

In addition to formal and informal ministerial meetings, there are a number of APEC committees and sub-committees, on subjects such as trade and investment, energy and environment, e-commerce, intellectual property, tourism and telecommunications.

For further information visit www.apecsec.org.sg.

ASEAN

The Association of Southeast Asian Nations (ASEAN) is a regional economic group formed by the 1967 Bangkok Declaration. Current members are Brunei, Indonesia, Laos, Myanmar, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. The Foreign Ministers of ASEAN Member States meet annually in a different member state each year. A Secretariat was formed in 1976 to co-ordinate administration, and various committees have been established in areas such as banking, finance, food, trade, and transport.

Rather than focusing on tariff reduction, ASEAN Member States have created preferential tariffs for goods originating in other Member States, negotiated bilaterally or multilaterally. This applies to commodities such as rice and crude oil. The governments of Member States undertake joint development of industrial projects that are then afforded monopoly production rights in ASEAN Member States, and high tariff preferences. ASEAN has also encouraged private business entities to form 'clubs' to reduce trade barriers between Member States in areas of industry and commerce.

ASEAN enters trade negotiations on behalf of its Member States with other countries and other trading blocs, whilst at the same time the individual Member States may also negotiate with trade partners

bilaterally. This can be compared to the EU, where the States have delegated complete control in certain areas to the EU and the individual States are not allowed to negotiate individually in these areas.

The current focus is the creation of the ASEAN Free Trade Area (AFTA). The AFTA agreement involves the founding members of AFTA, with implementation currently taking place, for reductions in import duties on 85% of goods in an inclusion list in 2000, 90% in 2001, and 100% by 2002. In late 2000, however, a protocol was agreed which allows ASEAN members to suspend tariff reduction commitments in the face of 'real difficulties', to allow some flexibility, with newer members having more time to comply. For further information on AFTA visit www.moc.go.th/thai/dbe/AFTA-NET.html.

Andean Pact (ANCOM)

The Andean Pact (ANCOM) was formed in 1969. In 1989, following the Ica declaration, then members (Bolivia, Columbia and Venezuela) agreed to accelerate liberalisation of trade among Member States, with a free trade area being created in 1991. The following year Ecuador and Peru joined ANCOM, and there was a shift from being a free trade area to a customs union. Since then member countries have worked to support their small domestic markets through the promotion of industrial development by regional import substitution. In October 2000 they adopted a new intellectual property rights system, in line with the WTO TRIPS Agreement (see p 21, above, for more information on TRIPS).

CER

Australia and New Zealand have had preferential trading arrangements with one another for many years, to the point that it is often remarked that New Zealand is an Australian State. Australia and New Zealand were part of the British Commonwealth until the 1960s, when Britain entered the EEC (refer above to discussion under the European Union) and the Commonwealth preferential scheme was disbanded. At this time, Australia and New Zealand entered a bilateral preferential trading agreement, with agreed items traded between the two countries being granted reduced rates of duty.

In 1982 a more comprehensive free trade agreement was entered, namely the *Australia and New Zealand Closer Economic Relations Trade*

Agreement (CER), which entered into force the following year, and has been considered globally to be the most 'free' trading agreement in existence.

Article 3 of the CER applies Rules of Origin to goods originating in a Member State which are traded between them. Goods are considered to have originated in a Member State if the goods are:

(1) raw materials from that State;

(2) manufactured from raw materials in that State;

(3) manufactured from raw materials sourced from another Member State;

(4) manufactured from 'determined manufactured raw materials' (DMRMs), which are raw materials not available in the free trade area which by necessity have to be sourced from overseas; or

(5) partly manufactured in that State: where the last manufacture process was in that State, and at least 50% of the 'factory cost' of the finished goods originates from that State or another Member State. Factory cost is determined by adding the cost of raw materials, labour, factory overheads, and inner packaging containers.

Goods which were traded free of tariffs prior to the CER will remain tariff free, and on other goods, tariffs were to be reduced and progressively eliminated (Art 4). The same applied to quota restrictions (Art 5), export subsidies and export incentives (Art 9). The CER also contains provisions on government purchasing, specifically that preference should not be shown by Member States to domestic suppliers (by tender or otherwise) to government.

Where goods are imported for use in manufacture, and government assistance in one country enables its producers to purchase those imports at less cost than producers in the other country, the manufactured goods (known as 'intermediate goods') have a competitive advantage, and a 'prejudicial intermediate goods' situation arises. Under Art 14, if this cannot be resolved by negotiation between the two countries, the prejudiced country may introduce an import tariff to balance out the assistance.

A 1988 a *Protocol to the Australia New Zealand Closer Economic Relations Trade Agreement on Acceleration of Free Trade in Goods* was agreed, incorporating into the CER an agreement to eliminate all tariffs and quotas by 1 July 1990. This has been accomplished, and further reviews of the CER have since taken place. The CER now also covers services, and addresses non-tariff measures. The aim is to harmonise customs and quarantine administrative procedures, to eliminate

technical barriers to trade, and to have mutual recognition of standards and occupations.

An online guide to the CER may be downloaded from www.dfat.gov.au/geo/new_zealand/anz_cer?sellcer.html.

CARICOM

The Caribbean Community (CARICOM) includes member countries such as Bahamas, Barbados, Grenada, Jamaica, Trinidad and Tobago. The aim is economic integration through a common market regime, and economic strength through co-ordinated foreign policies and co-operation. The Treaty Establishing CARICOM, which entered into force in 1973, provides for a Conference of Heads of Government (to set policy and conclude treaties), and a Common Market Council.

A detailed discussion of the Treaty provisions is available at www.sice.oas.org/summary/carianx.asp.

Cairns Group

Although not officially a trading bloc, the Cairns Group is a coalition of 18 agriculture exporting countries, with the joint aim of having agriculture on the multilateral trade agenda. The Cairns Group was established in 1986 on Australia's initiative, and comprises Australia, Argentina, Austria, Bolivia, Brazil, Canada, Chile, Columbia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand and Uruguay.

As a result of the Cairns Group's efforts, negotiations on agriculture were included in the Uruguay Round, and there is now a WTO Agreement on Agriculture (refer to p 18, above). The Cairns Group is now focusing on lowering tariffs and eliminating export subsidies and subsidies to domestic agriculture industries.

OECD

Also not a trading bloc, but often confused as one, is the Organisation for Economic Co-operation and Development (OECD). It is a vehicle for the co-ordination of economic policy amongst industrialised market based economies, so as to maximise economic development. It is mentioned here for the benefit of those readers who had previously thought of the OECD as a trading bloc.

The future of trading blocs

It is evident that the move is towards various countries forming economic free trade areas, with some countries being members of more than one trading bloc. It is anticipated that the future will involve a global free trade area. Since 1995 there have been AFTA/CER talks to reduce barriers to trade and investment between members of CER and ASEAN, and the aim is for a free trade area between members of AFTA and CER by 2005. Similarly there is a General Collaboration Agreement between CER and Mercosur countries. In 1999 discussions were held for an agreement to merge Mercosur and the Andean Pact into one South American Free Trade Area. Provided NAFTA is able to form alliances with Mercosur, we may in the future see NAFTA and the EU forming a cohesive group. If this were accomplished, it is likely APEC would then fold into that. This appears to be why the Asian nations have formed ASEAN, to retain some form of control.

5 Competition

You should be familiar with the following areas:

- Conceptual approaches to competition
- Why competition needs to be regulated
- How business action can impact on competition
- Anti-competitive practices such as collusion, price discrimination, dumping, misuse of substantial market power, exclusive dealing, resale price maintenance, refusal to supply, restraint of trade clauses, and in some cases, mergers and acquisitions

Conceptual approaches to competition

There are two principal schools of thought. The Chicago School sees the primary goal of competition as efficiency in the use of resources. Generally competition is good because it encourages corporations to be more efficient. Practices such as collusion are discouraged because they enable corporations to price according to profit targets rather than market forces, which results in a less efficient use of resources. The Competition School similarly views competition as useful in achieving an efficient use of resources. However not only are measures to eliminate monopolies and oligopolies supported but also competition measures which aim to achieve social ends.

Need for regulation of competition

In pure economic theory, competition should not need to be regulated because market forces should operate so that competitive entities flourish while the uncompetitive go out of business. In practice this is not the case, owing to differences in the size and power of businesses competing in a market, and different conditions applying to local and foreign players.

For example, a small but competitive locally owned business may be pushed out of the market when a large foreign competitor enters. This may simply be due to legitimate economies of scale making the foreign competitor's products more competitive, or it may be due to the large competitor being able to sell their products in the local market at below cost over a period of time until the small competitor goes out of business. The latter reason would not be due to legitimate competitive forces and would hinder competition, as once the large corporation has pushed competitors out of the market, it has a monopoly and is able to raise prices without constraint.

In Australia the Federal Government has power to make laws with respect to corporations under s 51(xx) of the Australian Constitution, and power to make laws with respect to trade and commerce under s 51(I). Section 122 of the Constitution extends the power to territories. The Commonwealth has exercised its power in the enactment of the *Trade Practices Act* 1974 (Cth) (TPA). The TPA is a broad piece of legislation covering many areas of trade practices, and we are concerned here only with provisions relating to competition.

The Australian Competition and Consumer Commission (ACCC) is an independent statutory authority which administers both the TPA and the *Prices Surveillance Act* 1983 (Cth). It is the ACCC and not a court that decides through an authorisation process on the balancing of reduced competition and increased efficiency. As a result of early difficulties where different regulatory restrictions applied across States and business types, the *Competition Policy Reform Act* 1995 (Cth) was introduced to achieve uniform competition policies throughout Australia.

The basic rule of competition law is that practices which have, or are likely to have, a substantial lessening of competition in a market are prohibited.

'Substantial', like many key legal terms, is difficult to define. It has been described as real, of substance, not necessarily large, 'not insubstantial or minimal' (*Cool & Sons v O'Brien Glass Industries* (1981)), and 'a greater rather than lesser degree of lessening' (*Dandy Power Equipment v Mercury Marine* (1982)).

The 'market' is defined according to product, product level, function, geographical boundaries, and substitute products. For example, the market in *Davids Holdings v Attorney-General* (1994) was the supply of grocery products by independent wholesalers to independent retailers in Queensland and northern NSW.

There are many practices which can have a negative impact on competition in a market, including collusion between competitors, cartelisation, price fixing, price discrimination, boycotts, dumping, abuse of a dominant market position, exclusive dealing, resale price maintenance, a refusal to supply, restraint of trade clauses, and mergers and acquisitions.

Collusion

Collusion, or conspiracy, is concerted action by traders designed to prevent other competitors engaging in competition. Conspiracy can be between traders at the same level in a market, such as between retailers ('horizontal' collusion), or it can be between traders at different levels of a market, such as between a retailer, wholesaler, manufacturer and supplier ('vertical' collusion).

Where certain corporations engage in concerted action over time, their association is described as a cartel. Cartels generally exist where the main competitors in a market or market segment are members, so that collectively they can increase the market price without fear of loss of demand for their products. Cartels are primarily motivated by profit, and the higher the price charged by the major competitors in a market, the greater profitability.

Section 45 of the TPA describes such practices as 'contracts arrangements or understandings having the purpose or being likely to have the effect of substantially lessening competition in the relevant market'. Legal practitioners faced with an issue of collusion should consider firstly whether there is a contract, agreement or understanding made between two or more parties. Secondly, to consider the 'market' for the goods or services in question, and thirdly consider whether the agreement had the subjective purpose of or is likely to substantially lessen competition in that market.

A 'contract' is defined according to ordinary contract law principles as to something which is legally enforceable (*Hughes v Western Australian Cricket Association* (1986)).

An 'arrangement' is not as formal and precise as a contract but requires a meeting of the minds of the parties involved and gives rise to common expectations (*Trade Practices Commission v Nicholas Enterprises* (1979)) but not necessarily mutual commitments (*Morphett Arms Hotel v Trade Practices Commission* (1980)).

An 'understanding' is similar to an arrangement but is more informal and imprecise. Mutuality of obligations is not necessary (*Top*

Performance Motors v Ira Berk (Queensland) (1975)), however in some judgments 'understandings' have been equated to 'arrangements'.

The 'relevant market' is determined by an analysis of the structure of the markets in which the corporation sells the subject goods. Relevant considerations include: (i) availability of substitutes in close competition; (ii) geographical area; (iii) the ease with which buyers can change suppliers; (iv) market entry barriers; (v) technical characteristics; and (vi) market function.

Three examples of collusive practices are market splitting, boycotts and price fixing.

Market splitting

This, also known as market sharing, occurs where two or more competitors agree to divide a market between themselves. The competitors may agree not to compete in a particular segment of the market, so the other may dominate that segment. This has an anti-competitive effect because each competitor is effectively in a monopoly (or at least dominant) situation in their market segment. The result is that customers may be faced with higher prices than the company could charge in a competitive market. A market can be split up according to target markets or geographical areas.

In *Gallagher v Pioneer Concrete* (1993) a concrete manufacturer alleged that lorry owner drivers of concrete trucks to worksites had divided the market between themselves according to a rotation system. This enabled the drivers to have stable and equal incomes without the need for vigorous competition. However it also substantially removed the incentive for any one driver to be more efficient, innovative and price competitive than the others.

In *Australian Competition and Consumer Commission v Roche Vitamins Australia Pty Ltd* (2001) three major vitamin companies entered into arrangements with respect to the supply of animal vitamins A and E and pre-mix containing these two vitamins, one of which was the allocation of tenders between the three companies. The conduct was a manifestation of arrangements made by the overseas parent companies, in what effectively amounted to a worldwide price fixing conspiracy. The two other companies would lodge tenders less attractive than the company for whom it had agreed would be allocated that tender. The Federal Court held that the companies had colluded on how the marked would be divided up among them, and imposed penalties totalling AUS$26 million.

Boycotts

Boycotts occur where a corporation refuses to deal with another corporation. Primary boycotts involve agreements between two parties not to deal with a third party in order to affect that third party or cause it to respond in a certain way. Secondary boycotts involve agreements between two parties not to deal with a third party in order to affect the third party's dealing with a fourth party.

Section 45(2) of the TPA prohibits boycott agreements, describing them as 'exclusionary provisions'. There are two requirements for an agreement to be considered an exclusionary provision under the TPA. The first is that the arrangement was made between competitors, and the second is that it had the purpose of preventing, restricting or limiting the supply or acquisition of goods and services from particular persons or in particular circumstances.

Legal practitioners faced with an issue of boycotts need only consider whether there is a contract, agreement or understanding between two or more competitors that contains an exclusionary provision as defined in s 4D of the TPA. There is no requirement that the boycott agreement is likely to substantially lessen competition in that market. The mere existence of the agreement contravenes the Act.

In *ASX Operations v Pont Data Australia* (1991), ASXO (owned by the Australian Stock Exchange, ASX) supplied Pont Data with stock market information but also competed with it for the provision of information to the market. ASXO added terms to the sale agreement restricting the resale of the information only to licensees, and requiring Pont Data to provide details of who they sold the information to.

In *News Ltd v Australian Rugby Football League* (1996) the Australian Rugby League's response to a proposed new entrant into the rugby competition market, Super League, was to have clubs sign five year agreements committing themselves to be loyal to the League's competition. At first instance it was held that the clubs were not in competition and that, as the agreements in each case were between the League and a club, no inference of collusion between the clubs could be drawn. On appeal it was held the potential entry of News into the market for organising rugby league competitions created a likely choice for clubs; that each club understood the other clubs were entering identical contracts and each contract contained an exclusionary provision, so s 45(2) had been contravened.

Where breach is established, the entire agreement is deemed void unless the breaching clauses can be severed. However, parties may apply to the ACCC for authorisation of a boycott agreement where the

public benefits of the agreement outweigh the negative effects on competition.

Price fixing

'Price fixing' refers to agreements between corporations to sell products at set prices. Whilst this introduces price stability to a market and ensures competition does not become so fierce that cost cutting affects safety in the workplace or in the products, it also tends to increase the parties' market power and excludes price competition between them.

Section 45 of the TPA prohibits price fixing, and s 45A further provides that it is not necessary to show a purpose or effect of likely substantial lessening of competition. Parties can however apply to the ACCC for authorisation, which will generally be granted in situations where there is a great imbalance of power between the competitors and their purchasers, for example a single purchaser in the market for a good or service with the power to force prices down. The fixing of prices in these markets enables the competitors to have a countervailing power. Generally, legal practitioners faced with an issue of price fixing therefore need only consider whether there is a contract, agreement or understanding between two or more competitors that fixes prices.

Trade Practices Commission v David Jones (Australia) (1986) concerned a horizontal price fixing agreement. The alleged agreement was between three retailers and a distributor to sell Sheridan towels and sheets at prices set by the distributor, with a view to curtailing the practice of discounting by manchester discounters. No direct evidence was presented as to what transpired at a meeting of the retailers and the distributor except from oral testimony. However the court considered the inference of an understanding could be made considering the similar pricing structures adopted by the alleged parties soon after their meeting, stating this showed 'a concurrence of time, character, direction and result'.

In *Australian Competition and Consumer Commission v Tyco Australia Pty Ltd* (2001), allegations were brought against over 20 companies and 38 individuals, in relation to alleged price fixing in the market for installation of fire protection systems (such as sprinklers and alarms) in Queensland. The competitors had held regular meetings during which they would agree on prices to charge and prices at which tenders would be submitted.

It is important not to mistake *parallel pricing* for price fixing. In markets where there is high elasticity of demand, small differences in price between brands have a large effect. Consumers do not differentiate between brands, so that they simply purchase the lowest priced product available. When one competitor is observed to have reduced its price, for the other competitors to make sales they must follow suit. This parallel pricing can give rise to an inference of collusion. That inference can be negated by a credible explanation of the parallel conduct (*Trade Practices Commission v Nicholas Enterprises (No 2)* (1979)).

This is also what occurred in *Trade Practices Commission v Email* (1980), where two kilowatt hour meter manufacturers who had identical price lists and identical tenders explained this as being due only to commercial considerations. The larger of the two manufacturers, Email, considered itself a price leader and published price lists so authorities (their main customers) would know they were treated equally. It knew the authorities required there to be at least two manufacturers of meters, and believed that the smaller manufacturer could not remain in business over a period of time if they priced higher than Email. By sending them their price lists it enabled the price leadership situation to operate quickly.

There is an exception to the application of the 'no collusion' rule, which is liner shipping. In Part X of the *Trade Practices Act* 1974 (Cth) Part X provides liner shipping companies with exemptions so they may collaborate to provide joint scheduled shipping services for Australian shippers. In December 1999 the Productivity Commission reported on its review of Part X. The Commission found that Part X is a low cost, adequate level of regulation of competition in the liner shipping market which is both compatible with international regulatory regimes, and supportive of the interests of Australian shippers. The Productivity Commission recommends a further review of Part X in 2005. The Government has accepted their recommendations.

Misuse of substantial market power

The behaviour of competitors of a corporation with substantial market power often has little bearing on that corporation's business. Section 46 of the TPA deals with the misuse of this power by corporations for the purpose of damaging or eliminating a competitor or preventing

entry into the market of new competitors. The aim is to protect the interests of consumers.

Market power is determined under s 46(3) as the degree to which a corporation is affected by the actions of competitors, suppliers and retailers in the market for their products. Market power is power to raise prices and to exclude competitors. Similar to s 45, relevant considerations include barriers of entry to the market, differentiation of products within the market, volume and size of competitors, and market share. Considerations in *Arnotts v Trade Practices Commission* (1990) included their 65% market share, high establishment costs for a new competitor, difficulties faced in obtaining supermarket shelf space, brand loyalty, and its 'price leader' position. For there to be a misuse of market power the activity undertaken must be one that would not have been undertaken had there been competitive conditions in the market (*Dowling v Dalgety Australia* (1992)).

Market share is evidence of market power, but does not in itself establish market power. Similarly damage to consumers by the action of a dominant organisation is not necessarily the result of a misuse of power. A dominant organisation may simply be exercising an existing contractual right. There must therefore be a link between the market power and the activity alleged to be a misuse of it. For example, in *Natwest Australia Bank v Boral General Strapping Systems* (1992) French J held there was no link between Boral's refusal to supply and market power and therefore no cause of action. He used the example of the hiring of an arsonist to burn down a competitor's factory. This may be the act of a dominant organisation and it is obviously anti-competitive, but the act is not dependant on market power.

Leveraging

Leveraging occurs where a corporation uses its power in a particular market as leverage in another market. In Q*ueensland Wire Industries v BHP* (1989) BHP, knowing that purchasers bought posts and wire for rural fencing in a single transaction, refused to supply Y-bar (which is used to make posts) to Queensland Wire so that it could not offer posts as well as wire for sale. BHP had a wholly owned subsidiary in competition with Queensland Wire in the rural fencing market. BHP was the sole producer of Y-bar and had there been another competitor Queensland Wire could have purchased Y-bar from, BHP would not have refused to supply them. Given the exceedingly high barriers of entry to the steel market, Queensland Wire would be unable to offer

fence posts as well as wire to purchasers wanting a single transaction. It was held that BHP had misused its dominant power in the steel market.

Predatory pricing

Like dumping, the aim of predatory pricing is to force competitors from the market. Charging very low prices is unprofitable for the competitor charging them but it is all the more damaging on competitors, who are forced to lower their prices to maintain sales or risk going out of business. The charging of a lower price than competitors is not itself anti-competitive; it can be due to the competitiveness and efficiency of the corporation that it is able to get the product to the market at a lower price. Over time this will force competitors to become more efficient in their use of resources so as to be price competitors or to leave the market.

In *Trade Practice Commission v CSBP & Farmers* (1980) a reduction of AUS$34.10 per tonne for urea by Farmers was considered not to be predatory pricing because the price reduction was a response to an announcement by a competitor that it would sell at a price AUS$33.70 less than what Farmers had been charging.

In *Eastern Express v General Newspapers* (1991) it was held that an analysis of whether predatory pricing has occurred requires an examination of the price-cutter's costs moreso than the market price for the products. In that case the price cuts did not make the newspaper unprofitable and without other evidence of an anti-competitive purpose the claim was not made out.

Price discrimination

Price discrimination prohibits sellers treating similar buyers of goods differently through pricing, where this may have the likely effect of substantially lessening competition in the market for those goods. This includes discounts, allowances, rebates and credits.

Until 1995 s 49 of the TPA dealt with price discrimination. The *Competition Policy Reform Act* 1995 repealed s 49. However, price discrimination is still covered by other provisions in Part IV of the TPA, such as ss 45, 46 and 47.

Exclusive dealing

Section 47 of the TPA deals with 'exclusive dealing'. It defines (s 47(2)–(9)) and prohibits (s 47(1)) exclusive dealing.

Purchase restrictions

Section 47(2) states that both restrictions on a purchaser from purchasing from competitors of a supplier, and requirements for the purchase of minimum quantities, fall within the definition of exclusive dealing. For example, *O'Brien Glass Industries v Cool & Sons* (1983) concerned the giving of discounts by a glass manufacturer to retailers who agreed to purchase windscreens almost exclusively from them. This practice, which inhibited retailers from purchasing windscreens from competitors, was held to substantially lessen competition. Similarly in *Eastern Express v General Newspapers* (1991) an agreement between a newspaper publisher with real estate agents to exclusively advertise in their newspaper was held to substantially lessen competition.

Refusal to supply

Section 47(3) covers refusal to supply goods and services to a purchaser as being exclusive dealing. In *Mark Lyons v Bursill Sportsgear* (1987) a supplier of ski boots refused to supply boots to a purchaser who would not agree to resell them to specified outlets. However in *Dowling v Dalgety Australia* (1992) an agreement between auctioneers who owned a saleyard to not allow any other auctioneer to use the saleyards was not sufficient to substantially lessen competition, because auction sales were just one of many mechanisms for sale of cattle.

Resale restrictions

Section 47(4) covers restrictions on a seller from supplying their goods or services to a purchaser's competitors. In *Stationers Supply v The Victorian Authorised Newsagents Association and Others* (1993) it was alleged that the newsagent association required the stationers to supply exclusively to them. On the balance of the evidence it was held not to be for the purpose of substantially lessening competition.

Section 47(5) covers the refusal to acquire goods from a supplier where the supplier will not agree to the condition specified in s 47(4).

Conditional supply

Section 47(6) covers the supply of goods or services on the condition that the purchaser acquires specific other goods or services from a specific source. In *Castlemaine Tooheys v Williams and Hodgkins Transport* (1986) a beer supplier required pubs to purchase the transportation service as well as the goods. It was held not to infringe the section because the transportation provider was an agent of the beer supplier and not a third party. In *Trade Practices Commission v Tapeda and Another* (1994) purchasers of motor vehicles could only obtain an increased trade-in price on their vehicle if the new vehicle was financed through a specified third party.

Section 47(7) covers a refusal to supply where the purchaser will not agree to the condition specified in s 47(6).

Sections 47(8) and 47(9) cover exclusive arrangements in connection with leases and licences and are outside the scope of this book.

Legal practitioners faced with an issue of exclusive dealing should consider firstly whether the action concerned falls within one of the definitions of exclusive dealing, as described above. Secondly, consider the 'market' for the goods or services in question, and thirdly consider whether the practice has the purpose or likely effect of substantially lessening competition in that market.

Take for example the case of *Dandy Power Equipment v Mercury Marine* (1982), where a dealer in outboard marine motors who acquired a franchise in Chrysler motors in addition to their Mercury motors franchise had their Mercury motors franchise terminated.

Firstly, did this fall within the definition of exclusive dealing? Yes. The termination of the franchise was argued to be a refusal to supply unless the dealer agreed not to sell Chrysler motors, which is a defined form of exclusive dealing.

Secondly, what was the 'market' for the goods in question? The market was twofold. The first was the wholesale market, where Mercury sold motors to dealers, and the second was the retail market, where the dealers sold motors to the public.

Thirdly, was there likely to be a substantial lessening of competition? No. It was held regarding the wholesale market that the price competition effects of the supply of both brand motors would be slight. Regarding the retail market, given the small number of motors sold by the dealer to the public it was unlikely non-supply of the Mercury brand would have any anti-competitive effect on the market. As there was no likely substantial lessening of competition the case was not made out.

The exception to the rule that the conduct must have the purpose or likely effect of substantially lessening competition is *third line forcing*, which refers to the supply of goods or services on the condition that the purchaser also purchase goods or services from a specified third party (often a company owned by the seller), and/or a refusal to supply if the purchaser does not agree to that condition. This practice is prohibited whether or not it has a substantial effect on competition.

Note however that exemption can be obtained through notification under s 93 of the TPA or authorisation through s 88(8). Immunity from prosecution for third line forcing under s 93 becomes effective 14 days after notification is given unless the ACCC gives notification within the 14 days that they intend to evaluate the notified practice and make a determination on it. Immunity from prosecution under s 88(8) becomes effective when the ACCC approves an application by a corporation to engage in the exclusive dealing specified. Approval is granted where the ACCC considers the public benefit resulting from the practice is likely to outweigh the detriment caused by the lessening of competition.

Resale price maintenance

Resale price maintenance (defined in s 96(3) of the TPA) refers to the sale of goods where the purchaser agrees not to resell the goods at a price lower than that specified by the seller, or a refusal to supply the goods to purchasers who will not agree to the resale price requirement. For example in *Trade Practices Commission v Bata Shoe Co (Australia) (No 1)* (1980), Woolworths would not agree to the resale price specified by Bata, and Bata refused to supply the shoes to them. Section 48 of the TPA prohibits resale price maintenance. Resale price maintenance does not cover recommended retail prices (s 97 of the TPA).

In *Trade Practices Commission v Penfolds Wines* (1992) Penfolds competed in the supply of wine to the retail market with a wine wholesaler to whom they also wholesaled wine. The wholesaler refused to resell the wine at prices specified by Penfolds and Penfolds withdrew its discounts to that wholesaler so it would have to increase its prices.

In *Trade Practices Commission v Sony (Australia)* (1989) Sony required dealers to resell Sony merchandise at specified prices, and where dealers refused to do so, supplies were withheld and threatened to be cut off altogether. Making it known that goods would not be supplied

unless the purchaser agrees to adhere to minimum prices for resale is a breach of s 96(3)(a) of the TPA.

There is an exemption in s 98(2) where a supplier has recently provided goods to a purchaser at below their cost for the purpose of introducing them to the products and attracting them to make routine purchases of them. Exemption can also be obtained through authorisation under s 88(8A) where it can be shown the resale price maintenance will benefit the public.

Restraint of trade

Restraint of trade clauses typically are included in contracts for the sale of businesses, to restrain the vendor from engaging in activities which may lessen the value of the business being purchased. For example, if a vendor of a delicatessen were to sell his or her business (including goodwill) and then set up a similar store three doors down, this would lessen the value of the business being sold because many loyal customers would choose to deal from the vendor at the new store.

Some degree of restraint of trade is inevitable in commercial contracts, but a public policy principle prohibits unreasonable restraint of trade. Section 45 of the TPA directly prohibits restraint of trade agreements which substantially lessen competition. A restraint of trade clause is void unless it can be shown: (i) there is a legitimate interest to be protected; (ii) the clause is reasonable as between the parties; and (iii) the clause is in the public interest.

Legitimate interest

The courts recognise the protection of goodwill, client base, and confidential information as being legitimate interests worthy of protection. Section 51(2)(b), (d) and (e) of the TPA allow the regulation of restrictions as to future work of employees, partners, and the protection of goodwill according to common law.

Reasonableness

The following considerations are taken into account in assessing reasonableness:

(1) Duration – the longer the restraint of trade clause is to apply the more likely it will be considered unreasonable. For example if a trained engineer was restricted from working as an engineer for 20 years, this would mean a large part of the engineer's working life

would be foregone. In *Nordenfelt v The Maxim Nordenfelt Guns and Ammunition* (1894) the period of a restraint of trade clause was 25 years.

(2) Extent – the more extensive the restraint of trade clause the more likely it is to be considered unreasonable. For example if a vendor of a business selling lollies was restricted from establishing a new business selling goods of any sort, edible or otherwise, this would be unreasonable.

(3) Geographical area – the broader the geographical area covered by the restraint of trade clause, the more likely it is to be considered unreasonable. This assessment will very much depend on the market for the goods. For example, the market for an icecream shop would be the local area in which the store is located, and a restraint of trade clause prohibiting someone from setting up an icecream shop anywhere in the country would clearly be unreasonable. On the other hand, the market for large machinery may be global, and a complete restriction may not by itself be considered unreasonable (depending on the time period). This is what occurred in the *Nordenfelt* case, above.

These factors need to be considered as a whole. Courts are less likely to intervene where a party has itself agreed to the restraint of trade clause than where an organisation has agreed to it on another's behalf, for example by a club on behalf of its members.

Public policy

Once the defender of a restraint of trade agreement establishes reasonableness, the burden of proof shifts to the challenger to prove the agreement to be against public interest. Generally companies are able to bypass the prohibitions in the TPA if they can show that the conduct would result in more benefit to the public than compliance with the TPA would.

There have been few cases where a restraint of trade clause has been struck down on the grounds of public policy. A restraint of trade clause which resulted in a monopoly situation was held invalid (*Attorney-General v Adelaide Steamship Co* (1913)). The standard of public policy is the standard of the day (*Nordenfelt* (1894)), and the current economic situation including labour shortages is taken into account (*Lindner v Murdock's Garage* (1950)). A specific ground needs to be established. The area of the public in the market for the goods or services the subject of the restraint of trade clause are those whose interests should be considered and not economic impact generally.

The void parts of a restraint of trade agreement can be severed from the contract, provided what is left can stand alone. A court will not rewrite the clause. This has resulted in the use of ladder clauses, where several levels of restraint are stipulated in the restraint of trade clause, so that if the more restrictive ones are struck down the most restrictive of the remainder will apply. Provided a ladder clause is worded carefully it will not be held void for uncertainty and a restraint of some level will be enforced.

A restraint of trade clause cannot be challenged by a third party. This means that a restraint of trade clause which is highly anti-competitive, if accepted by the parties, cannot be interfered with.

In *Australian Capital Territory v Munday* (2000), the restraint of trade doctrine was held to have no operation in respect of commercial arrangements between the operator of a rubbish dump ('tip') and a salvage company, which restricted access to other users. The tip operator had given the exclusive right to salvage materials from the tip to the salvage company, to encourage the salvage of recyclable materials. This was challenged by a person who scavenged for goods for himself and for resale at trash and treasure markets. It was held that persons who used the tip did not come there to trade their rubbish, but to dump it, and so restraint of trade had no application to the contract terms of the salvage agreement.

Mergers and acquisitions

Section 50 of the TPA prohibits a person or corporation from acquiring directly or indirectly the assets or shares of a body corporate if the acquisition would have the effect or likely effect of substantially lessening competition in a market. (Note that in cases between 1977 and early 1993 a stricter test applied, namely whether the merged entity would result in or strengthen a position of control or dominance in the market.)

Section 50(3) lists matters which are taken into account in determining whether a proposed merger would substantially lessen competition in a market, although the list is not exhaustive. For example the list does not include efficiency as a matter to be taken into account when in practice it has been considered (*Re Queensland Independent Wholesalers* (1994)). As to 'directly or indirectly', a direct acquisition refers to a purchase of shares or assets by the competitor itself, and indirect acquisition refers to a purchase through an agent (often a subsidiary of the competitor).

The inclusion of the phrase 'directly or indirectly' has been said to add nothing to the construction of the section (Lockhart J in *Trade Practices Commission v Australian Iron & Steel* (1990)). The competitor must have a proprietary interest in the assets or shares. Where a wholly owned subsidiary buys the shares or assets there is no proprietary right in the parent company and the purchase does not fall within the section. However where the subsidiary makes the purchase as agent for or on behalf of the parent company the parent is considered the owner of the assets or shares.

In *Trade Practices Commission v Ansett Transport Industries (Operations)* (1978) Ansett wished to acquire shares in Avis Rent-A-Car. Avis was found to have a 43–46% share in the market and to have the preferred position of an airport franchisee, however the level of competition in the market was such that Avis did not have a dominant position in the market.

Section 50A deals with mergers and acquisitions occurring outside Australia which result in a foreign corporation having a controlling interest in an Australian corporation such that there is likely to be a substantial lessening of competition in a market which cannot be justified on public benefit grounds.

As with other types of anti-competitive conduct, corporations can apply to the ACCC for authorisation. Pursuant to s 90(9) of the TPA, the ACCC will authorise the merger or acquisition where the public benefit will outweigh its anti-competitive effects. A merger is of public benefit where the economies of scope and scale created by the integration of production and distribution result in lower prices.

The approach to mergers by the ACCC is flexible, and where issues are raised parties are given an opportunity to refine their proposals so that the public can benefit and competition can be protected. The merger of Ampol and Caltex is a good example of this. The initial merger proposal raised serious issues of competition, considering the structure of the petroleum industry. There are high barriers to entry in the petroleum market and few sources of supply. Control is held by those involved in refining down the line to retail selling, and this has made it difficult for independent parties to compete. While a merger of two major players in the market would obviously have anti-competitive effects at all levels within the market and would enable the merged entity to charge higher prices, the corporations have made various undertakings to address the ACCC's concerns to enable the merger to go ahead.

Dumping

Dumping occurs where:

(1) the export price of the goods sold or to be sold is less than the prevailing price in the exporter's home market ('normal value');

(2) the industry is suffering or will suffer material injury; and

(3) there is a causal connection between the charging of less than normal value and the material injury.

This can occur where the goods have been subsidised in the foreign State, or where a trader is strong enough to absorb the losses until competitors are removed from the market, which is known as *predatory pricing*.

As more countries develop anti-dumping laws (including China in 1997) there is greater opportunity for companies affected to take action against parties responsible for dumping goods. Also dumping is becoming a weapon of choice as tariff levels continue to decline.

Under the Anti-dumping Agreement under the World Trade Organisation (WTO), countries may impose anti-dumping duties to counteract the effect of the dumping of goods. Anti-dumping measures are imposed on such goods with an aim to achieve a level playing field within a market. Measures taken include import duties and undertakings by the foreign trader to increase the sale price for the goods in the domestic market.

Normal value

Usually this will be the market price in the importer's domestic market. However, issues arise where the goods are sold by a State owned enterprise, or where different prices are charged where the goods are bought in bulk, or where the packaging and labelling requirements are different for import and export, or where the goods are simply not sold on the domestic market. The aim is to find 'like' goods, or to find the same goods sold in a similar country (described as a 'surrogate' country). If not, a 'cost to make and sell' calculation is made, with an amount added to allow for profit.

Materiality

Materiality is decided by considering the volume and price of dumped goods, the impact on the industry and the state of the industry (Art VIII). This test is broad.

The test of 'material injury' has been lowered, as a result of *Mullins Wheels Pty Ltd v Minister for Customs & Consumer Affairs* (1999). The case involved the importation of truck wheel rims exported from South Africa at dumping prices. The Federal Court considered that the finding of a causal link between dumping and material injury to be a practical exercise, to be undertaken in a common sense way, taking into account the purpose of the finding and the legal principle of causation. Unfortunately, the Court effectively equated economic causation with the legal principle of causation, when they have little relationship to each other.

Causation

Causation can be difficult to establish, as often there are many factors which affect industry economic performance, such as market and price trends, profitability, capacity utilisation. Inferences have to be drawn from relative directional movements, usually through trend analysis. Sometimes what looks like a trend is just a coincidence. It has been observed that where causation cannot be proved but it cannot be proved there was no causation, causation has been found.

Procedure for taking anti-dumping action in Australia

Where imports have been dumped on the Australian market such that material injury is caused or threatened to be caused to an Australian industry producing like goods, an application can be made to have dumping duties imposed.

The procedure is as follows:

(1) Industry player notices dumping and discusses matter with the Dumping Liaison Unit of the Australian Customs Service.

(2) An application is lodged with supporting information OR Minister commences anti-dumping action of its own volition.

(3) Customs has 20 days to determine whether there is reasonable evidence of dumping and of resulting material injury.

(4) An investigation is commenced (Day 1), if need be, and by direct contact and public notice Customs invites interested parties to respond to the claims made in the application.

(5) Submissions by interested parties must be lodged by Day 40 and must include a non-confidential summary of the information contained in the submission. The confidential version is held by Customs and the non-confidential version is placed on a public file.
(6) From Day 60 Customs may, where it has sufficient verified information, impose provisional measures in the form of securities. Customs must accompany the imposition of securities with a Preliminary Affirmative Determination.
(7) By Day 110 Customs must publish a Statement of Essential Facts on which it intends to base its report to the Minister.
(8) Parties have 20 days (usually Days 110–130) to lodge a response to the Statement of Essential Facts.
(9) Days 130–155 Customs reviews the evidence and finalises its report and recommendations to the Minister.
(10) The Minister makes a final finding on whether to impose anti-dumping measures (Day A1).
(11) Up to Day A30 an applicant may lodge an appeal to the Trade Measures Review Officer (TMRO), who is located in the Department of Industry Science and Resources.
(12) From Day A30–60 interested parties are given notice of appeal and may lodge submissions in response.
(13) The TMRO may either refuse the appeal or may recommend the Minister that the issue be remitted back to Customs for further investigation and report.

Lawyers are commonly involved at Day 110 on, preparing detailed submissions to Customs, and if there is an appeal.

This process is not without its criticisms. It has been criticised as being too short (155 days), especially the 40 days for submissions, because often a questionnaire sent to a non-English speaking trader has to be interpreted and it takes time to be returned. Often traders do not have proper records as to their course of trade (but as long as generally accepted record keeping processes are used they are accepted). Also, the TMRO is a employee of the Minister and so is not really independent, and usually the TMRO will call Customs to discuss the matter in making its decision whether to send the matter back. Further, whether there is dumping or not depends on the calculations – if pockets of the industry are looked at, dumping can be clear, but if a weighted average of prices are used then dumping is harder to show.

The *Trade Practices (Misuse of Trans-Tasman Market Power) Act* 1990 provides for the application of competition laws for goods originating from Australia and New Zealand, without anti-dumping measures being available.

EU competition law

EU competition law applies to foreign traders trading into the EU. The aim of competition law in the European Union is to maintain a single common market, rather than having large national companies directing the market, thus partitioning the common market along national lines. Some undertakings (the EU term for business entities) can have turnovers as large as the gross national product of some smaller States in the common market. European Community competition law aims to avoid dominance by these large entities, and to enable small and medium sized undertakings to compete, as it is in these smaller organisations that the best employment prospects are for the people of the common market States. The competition law compliments the notion of the free movement of goods within the common market.

The principal article is Art 3G of the *Treaty of Rome* (1957), which provides for the institution of a system to ensure competition in the common market is not distorted. Articles 85 and 86 provide detailed rules to achieve this objective.

Article 85 deals with collusion between a number of undertakings, such as cartels, which establish artificial prices. As with collusion under the TPA, collusion can be horizontal or vertical. It is necessary to show some form of collusion between undertakings (such as an agreement, a decision of an association, or a concerted practice) which may affect trade between Member States, with an object or effect of anti-competitive results.

Article 86 is usually concerned with the actions of a single undertaking, specifically the abuse or exploitation of a dominant position in a market. For an abuse of a dominant position to be made out it must be shown that a particular undertaking is in a dominant position in a relevant market, has abused that position, and that the abuse has affected trade between States in the European Union. A firm is in a dominant position if it can act independently of its customers and competitors – *United Brand Co (New Jersey) and United Brand Continental BV (Rotterdam, The Netherlands) v European Community Commission* (1978). Considerations include market share, the structure

of the undertaking, technical and commercial advantages, barriers of entry to the market, and the behaviour of the undertaking. The relevant market is defined along product, geographical, and temporal lines.

US competition law

The favoured term in the US is 'anti-trust' which basically means 'anti-competitive', that is, devices to prohibit restrictive international trade, practices that are exercised in another State but have an impact domestically.

The *Sherman Antitrust Act* 1890 declared trusts, conspiracy, and restraint of trade as illegal, punishable by a US$10 million fine in the case of a corporation, US$350,000 in the case of an individual and/or a three year prison sentence. In *Standard Oil Co of New Jersey v United States* (1910) the United States Supreme Court adopted a 'rule of reason' that contravention of the Act only occurred where the practices engaged in resulted in an unreasonable reduction in competition. The *Clayton Antitrust Act* 1914 dealt with exclusive dealing, interlocking directorships and price discrimination.

The Australian government has passed a *Foreign Antitrust Judgments (Restriction of Enforcement) Act* 1979 (Cth) so that United States anti-trust decisions cannot be enforced in Australia.

Allowed anti-competitive conduct

Not all anti-competitive conduct is disallowed. Some areas require control to maintain the viability of trade in that area. For example, commodity arrangements are made between primary producing countries to stabilise the supply and pricing of commodities such as bananas, coffee, cotton, iron ore, meat, sugar, tea and tin. The arrangements commonly include export quotas, fixed price agreements, and the development of a central body to stabilise supply by buying and selling commodities. Export controls are imposed to protect the domestic market, and are usually executed by way of export licenses. Export controls can also protect cultural property (heritage items) in their country of origin. It is anticipated that agriculture will be the primary issue in the upcoming 'Millennium Round' WTO negotiations.

6 International Trade Contracts

You should be familiar with the following areas:

- Agency, distribution agreements, franchising, licensing
- Law governing international trade contracts
- UNCITRAL
- UNIDROIT
- Taxation and customs
- International carriage of goods by sea, air, land, and multimodal carriage
- Payment by bills of exchange, letters of credit, and countertrade
- Passing of property

Selling goods internationally

The first question for a business wishing to sell its goods internationally is to decide on the most appropriate method. For example:

(1) Should sales simply be in response to direct orders from the overseas country, with international trade contracts filled domestically and then shipped overseas?

(2) Should a foreign sales agent be used to sell and distribute the goods on behalf of the company?

(3) Should the goods be sold at wholesale prices to a foreign distributor, who then resells them to buyers in the foreign market?

(4) Should a branch office or subsidiary be established in the foreign market?

(5) Should a joint venture be entered with a similar existing business in the foreign market?

(6) Should an acquisition be made of a similar existing business in the foreign market?

(7) Where the product is a system of doing business rather than merely a good or service, should the system be franchised?
(8) What steps should be taken to protect the intellectual property of the business, such as trademarks and designs?

Agency arrangements

An agent acts on behalf of a principal to establish trade contacts for the principal's goods and services in different markets. Both parties in an agency relationship have certain rights and obligations. The agent is obliged to look after the interests of the principal, to communicate necessary information, to comply with reasonable requests of the principal, to keep confidential information confidential, and to act in good faith. The principal is obliged to indemnify the agent for expenses incurred on the principal's behalf, and to pay the agent a commission. If the parties cannot agree as to remuneration the amount customarily earned by agents in that place is applied. This is difficult to pinpoint as there are large differences in remuneration of agents in different States and in markets for different goods, and it is all the more difficult if the product being marketed by the agent is innovative.

A key problem in agency agreements is the scope of the authority an agent has, and most often problems arise with regard to undertakings made by agents in the course of negotiations with third parties. The third party position is difficult where such undertakings are not performed by the principal, especially where the identity of the principal is not disclosed. Difficulties as to the correct forum in which to sue arise where the principal, agent and third party reside in different countries, for agency law differs across different legal systems.

Formally, the extent to which the agent can bind the principal depends on the terms of the contract between them. This will determine the scope of the agent's actual authority. However, the principal may also be legally bound by an agent's representations where although the agent did not have actual authority to make them, the agent had ostensible, or apparent, authority to do so. Ostensible authority is determined from the viewpoint of third parties, and may be inferred from the position the agent holds. For example, it is reasonable for a third party dealing with a person with a business title of 'Australasian Sales Manager' to conclude that person has authority to enter sales contracts for and on behalf of the company.

Generally for an agent to ensure exclusion of personal liability the agent should sign a contract with a third party followed by the words 'as agent for' and state the principal's name. An agent who signs a contract without qualification may still be excluded from personal liability where it is clear from the contractual provisions that he or she is acting as an agent in the transaction. If the agent acts for a disclosed but unidentified principal the agent may be sued as a co-principal.

Commonly large traders use agents to test a new market, and disputes arise where an agent builds a substantial market for a product over a two to three year period and then the principal decides to conduct trade in that market directly rather than through the agent. There is a vast difference in bargaining power between the parties and the agent requires some form of protection. For example in this situation the principal is required to pay the agent a pension. There is some conflict between the principle of freedom of contract and the protection of the weaker party, which to a large extent is the impetus behind domestic consumer legislation.

The *Convention on Agency in the International Sale of Goods*, produced by UNIDROIT in 1983, was drafted to complement the Vienna Convention (see p 74, below, for more on the Vienna Convention and p 70, below, for more on UNIDROIT). It is stated to apply where a principal and third party for whom the agent contracts have their place of business in different States and the agent's place of business is in a Contracting State to the Convention. It does not apply to agency agreements for stocks and commodity contracts. It contains similar provisions to the Vienna Convention with respect to interpretation and non-coverage.

In relation to the issue of ostensible authority, the Agency Convention provides under Art 14 that, where the conduct of a principal causes a third party reasonably and in good faith to believe that the agent has authority to act on behalf of the principal and is acting within the scope of its authority, the principal may not argue lack of authority on the part of the agent in defence to a claim by that third party against the principal. However, the principal may agree with a third party to exclude part or all of the Convention from applying to the relevant agency agreement.

Under Art 33(1), the Convention enters into force when it is ratified, approved, accepted or acceded to by 10 Member States. At the time of writing, the Convention had been acceded to by three Member States and ratified by a further two Member States. It therefore has not yet entered into force.

The full text of the Agency Convention may be downloaded from www.unidroit.org.

Distribution agreements

A distributor buys products and then resells them. A distribution agreement is a contract for the supply of goods over a certain period of time. The agreement defines the terms on which the goods are sold for resale by the distributor in the foreign market.

Often a distributor will want exclusive rights to distribute the specific goods into their market, that is, a clause that the manufacturer will only supply the product to it and not to any other distributor in that market, nor to an agent or otherwise selling into that market. If the agreement merely prevents the manufacturer entering other distribution agreements in that market, it is known as a *sole distribution agreement*. If the agreement also prevents the manufacturer itself selling into that market, it is known as an *exclusive distribution agreement*.

Distribution agreements typically include the following clauses:

(1) Goods – specifying the model or type of goods to be distributed by the distributor. Where there are a number of goods or models within a product range, it is useful for the agreement to incorporate a separate document such as a product list or sales catalogue.

(2) Price – it is unusual for a distribution agreement to include actual prices for the goods, unless such a clause is coupled with another clause providing for periodic review of the prices. Even this may be unrealistic, especially where the prices of finished goods fluctuate depending on the cost of raw materials from which they are made. It is more common for distribution agreements to refer to prices in comparison to some other market driven factor. For example, prices can be agreed at 10% below standard published wholesale prices for the seller, or, where the goods being distributed are commodities, at 5% less than the world spot price for the particular commodity at the time each order is placed.

(3) Territory – the geographical area in which the distributor may distribute the goods.

(4) Exclusivity – agreement by the seller not to sell directly to customers within the stated territory.

(5) Reciprocity – agreement that any indirect inquiries by consumers in the stated territory will be referred by the seller to the distributor, and agreement by the distributor to refer any indirect inquiries from consumers outside the stated territory to the company.

(6) Marketing – agreement as to minimum obligations of the distributor with respect to advertising the goods in the foreign market. This

may include a minimum advertising spend, or a stated number of advertisements per annum in stated newspapers or magazines. There may also be an agreement as to maximum intervals between which the distributor must visit nominated major buyers or the number of prospective buyers the distributor must approach each month.

(7) Database management – agreement that the distributor will maintain a record of customers and will provide access to such record to the seller upon request.

It is quite legal to enter exclusive distribution agreements. It is only where the agreement has an anti-competitive effect that there is a problem. Care should be taken with the following clauses, as they may breach competition law provisions in certain countries:

(a) agreement by the distributor not to buy from other sellers of similar products to those covered by the distribution agreement; and
(b) agreement as to the price at which the distributor will resell the goods within the foreign market.

If a seller is unsure, the best approach in Australia is to contact the Trade Practices Commission and notify it of the arrangement. If it makes no decision on point then the arrangement is acceptable. The best approach internationally is to seek legal advice in the overseas jurisdiction. For further information regarding anti-competitive agreements refer to Chapter 5 on competition.

Branch offices and subsidiaries

A *branch office* is an arm of the exporting company which is physically located in the foreign country, and a *subsidiary* is a separate and independent legal entity incorporated in the foreign country. Determining which is more appropriate for an exporting company will depend on the employment, taxation, investment and company laws in the foreign country.

A subsidiary may be partly or wholly owned by the exporting company, who is referred to as the 'parent' company. Where a number of subsidiaries are established in various countries, the exporting company becomes a multinational, or transnational, corporation. Although there are no international laws applicable to multinational companies, the *OECD Guidelines for Multinational Enterprises* express the collective expectations of OECD member governments as to the behaviour and activities of multinational enterprises. Although in principle a subsidiary is legally a separate entity to the parent

company, there are circumstances in which the 'corporate veil' is pierced, so that the subsidiary is treated as part of the parent company. The relevant circumstances include where the subsidiary is completely controlled by the parent company.

For example, in *James Hardie & Coy Pty Ltd v Desmond Putt* (1998) the plaintiff who sufferred asbestos related injuries as a result of working at James Hardie & Co Pty Ltd, New Zealand, succeeded in an action of negligence against two New South Wales companies, James Hardie & Coy Pty Ltd and James Hardie Industries Ltd (the Holding Company). Usually the acts of the New Zealand company would be legally separate from the acts of the New South Wales companies, but in this case the Court held that in this instance the corporate veil should be lifted. With subsidiaries being 95% owned by the parent company, and control being maintained by the parent company, the James Hardie group of companies was held to be conducted as one enterprise.

Joint ventures

An international joint venture is an undertaking by two or more companies with registered business addresses in different countries. The joint venture may be in relation to a specific project, or may be of an ongoing nature. In some countries where there are restrictions in the right of foreign enterprises to do business, a foreign enterprise may have no choice but to enter a joint venture with a domestic enterprise in the foreign country. The joint venture may be merely contractual, or may involve the formation of a company in which the joint venture partners have equity shareholdings.

Licensing

Where the product is a method of manufacturing in which there is some intellectual property right, such as a new technology, licences provide a means for the owner of the process to grant a foreign business the right to use that process for a period of time. The licensee typically pays royalties based on sales arising from use of that process. Typical licensed intellectual property rights include patents (ideas), copyright (art works), trademarks (names/logos), circuit layouts and designs.

Patents

A patent gives the patentee the exclusive right to market the invention for a set period of time. In Australia, s 67 of the *Patents Act* 1990 (Cth)

provides for a 20 year period. Where a patentee licenses use of the patent, the licensed right must be registered with the Register of Patents. The patentee can proceed against anyone who exploits the invention without permission.

Copyright

The copyright in a book, painting, film, piece of music or computer software is owned by the creator of the piece of work, except if the creator acted under commission or under a contract of employment, in which case the person commissioning the work or the employer owns the copyright. The copyright lasts for 50 years from the year in which the owner of the work dies.

The owner of copyright grants a licence for the licensee to copy the work. Typically the owner will enter a series of exclusive licences around the world for reproduction of their copyright work. Difficulties are created where the cost of reproduction in one licensed country is substantially lower than the cost of reproduction in another licensed country, such that it is economically feasible for the one country to transport the items for sale in the other country. This is known as *parallel importing*, and this practice is deemed an infringement of copyright under the *Copyright Act* 1968 (Cth).

Trademarks

A trademark is a distinctive sign used to distinguish a product from other products in the market. It can be a letter, word, name, number, signature, brand, heading, shape, colour or sound. Under the *Trade Marks Act* 1995 (Cth), a trademark must be registered to be protected. Registration lasts for 10 years, but can be renewed every 10 years indefinitely. The registered owner of a trademark may license its use.

The owner may proceed against any unauthorised use of the trademark, that is, where a substantially or deceptively similar sign is used. There is nothing to prevent parallel importation of legitimately marked goods under a licence from the owner of the trademark, except if there is a provision in the licence agreement providing that the licensee may not export trademarked goods into the owner's country.

But even this will only bind the licensee – it will not bind third parties who buy the trademarked products from the licensee and choose to export them to the owner of the trademark's country. This may occur where the retail price of the trademarked good in the foreign market plus the cost of carriage from the foreign market to the market of the trademark owner is less than the cost of production of the trademarked good in the place of business of the trademark owner.

Circuit layouts

A circuit layout is a blueprint for the production of an integrated circuit. The *Circuit Layouts Act* 1989 (Cth) provides the circuit layout creator the exclusive right for 10 years to exploit the layout by producing an integrated circuit from it. The right may be licensed, giving the licence holder the right to proceed against persons who copy the layout or produce integrated circuits from it.

Parallel importation of circuit layouts is permitted (unlike computer software generally, which comes within the *Copyright Act* 1986 (Cth) discussed above). Software incorporated into an integrated circuit which is parallel imported is not protected.

Designs

A design is a pattern, shape, or ornamentation which gives a distinctive appearance to a product. The *Designs Act* 1906 (Cth) provides that new designs may be registered. The owner of a design is the person who created it, unless they were employed or commissioned to do so, in which case the employer or person who commissioned the design is the owner of it.

Although each of the above measures have anti-competitive effects, the *Trade Practices Act* 1974 (Cth) exempts them from the competition provisions in that Act (readers refer to Chapter 5) on the basis that the public benefits from new and innovative products. They take time and cost money to research, develop, produce and market, so an initial period of protection is considered an incentive for the creator to develop an invention beyond the concept stage.

In each case, the usual remedy for a breach of a licence is in restraining further breach, and either damages or an account of profits made from the unlawful use of the intellectual property right concerned.

Franchising

Where the product is a system of doing business, rather than a good or service for sale, the developer of the system may enter a franchise agreement. A franchise agreement is a type of licensing agreement, under which the franchisor allows the franchisee to use the franchisor's business name, trademark, advertising slogan, shop layout, design of packaging, etc. The franchisor also provides assistance with marketing, business, and technical aspects of working the business system. Examples of franchises include McDonalds and Jim's Mowing. Given that a large number of new businesses fail to get

off the ground before the financial investment begins to show a return, entering a franchise arrangement can enable the new business to benefit from the goodwill created by other franchises in the chain.

In return for these benefits the franchisee agrees to conduct the business in accordance with the marketing plan and business system of the franchisor. The franchisee typically pays an initial fee and ongoing royalty payments based on sales. The difference between a franchise and a subsidiary is that the franchisee owns the franchised outlet, whereas a subsidiary is owned by the head company. Although the franchisee has ownership, the franchisor retains control. This is essential from a franchisor's viewpoint because consumers perceive each outlet of a franchise to be part of the one business, and a failure to adhere to the corporate image by one outlet can affect the reputation of other outlets in the chain.

In 2000, UNIDROIT published a *Guide to International Master Franchise Arrangements*. The Guide details international franchising through the use of a master franchise agreement between an oversees franchisor and a party in a country where the franchise is to be established. The domestic party effectively becomes a sub-franchisor, selling and operating franchises in that country. The sub-franchisor will be particularly concerned with the rights it is granted, how they can be exercised and how exclusive they are. The franchisor will be concerned with ensuring the integrity of the system, which can be done by training and assisting the sub-franchisor, and with removing any sub-franchisees who may bring the consumer perception of the franchise into disrepute.

The only regulation in Australia is for petrol station franchises, which are regulated by the *Petroleum Retail Marketing Franchise Act* 1980 (Cth). It deals with the formation and termination of franchise agreements relating to petrol stations. There is also a *Franchising Code of Practice*, which was produced by the Franchising Code Administration Council in 1993. It provides for a code of conduct and for dispute resolution by mutual negotiation, or if that fails, conciliation by a conciliator nominated by the Franchising Code Administration Council. Injunctive relief may be obtained from a court if irreparable damage would be suffered by a party without it.

International trade contracts

International trade contracts are used when selling directly to the buyers or distributors in an overseas country. Given that each country

has its own laws, the issue of what law governs an international trade contract is of major importance. Below are four options for establishing the governing law of an international sale contract.

Option 1 – Parties negotiate a complete contract

The parties may negotiate a complete contract, including 'material' terms such as price and quantity, and 'standard' terms such as governing law and jurisdiction. One would expect that each trader would be more comfortable with their domestic law rather than the foreign law of the other party, but it is not possible in an international trade contract to have two applicable laws at the one time. Often the party with superior bargaining power's standard terms and conditions will apply, which may include reference to that party's domestic law, or some law the party considers favourable to it.

In practice, this approach is rarely used, because the time and cost involved in negotiating a complete contract is not commercially feasible. International trade markets can move rather quickly, and, as discussed in Chapter 1, it is often not until something goes wrong that the legal aspect of the transaction is considered. It may, however, be feasible to negotiate a complete contract if it is a very large purchase, or a long term contract.

Option 2 – Parties' standard terms and conditions

Typically traders have standard terms and conditions printed on the reverse of their sale/purchase order form. The buyer will send a purchase order with its standard terms and conditions on the reverse. The seller responds with an acceptance of the offer and a copy of its standard terms and conditions on the reverse. While the material terms (such as the price, quality, delivery terms) of the buyer's order and seller's response may be identical, the standard terms and conditions may vary markedly.

In an atmosphere of time pressure to clinch a deal, traders often choose not to argue over the terms and conditions, but when disputes later arise, each party seeks to apply their standard terms and conditions over the other party's terms and conditions. There is often also dispute about terms and conditions agreed in correspondence between the parties leading up to the formation of the contract. This is known as a '*battle of forms*'. A court will generally look to the terms and conditions of the party whose offer was accepted. This could be the original offer or the last of a number of counter-offers. This is because a valid acceptance must include acceptance of all the terms of the offer,

which includes the offeror's standard terms and conditions. This approach is known as the '*last shot doctrine*'. There is an alternative approach, which is to consider the two different terms and conditions and allow reliance only on those terms and conditions which are not in conflict with one another. Terms which are inconsistent with one another are not able to be relied upon. This approach is known as the '*knock out doctrine*'.

Option 3 – Standard industry contracts

These are standard contracts used within a particular industry or trade, which are typically impartial and expert organisations, or by an association of the traders themselves in consultation with their lawyers. Standard forms of contract have been adopted in the trade of specific products, such as corn, oil seeds, cereals, timber, and coal. For example, the Grain and Feed Trade Association (GAFTA) has a number of published standard form contracts. The parties may use the GAFTA contract, which contains a governing law clause. Having standard contracts in a particular trade can also assist the smaller or weaker party to the international sale contract, because a party wishing to deviate from a standard clause is compelled to explain their reasons for the deviation.

Option 4 – An international law governing sales contracts

The aim here is to have a governing law which is international in character, rather than selecting a domestic law. Having an international law which the parties can choose to incorporate into their contract supports the growth of international trade as parties from disparate countries can comfortably enter contracts with one another without first having to research the law of the other party's country.

Harmonising, or creating international trade laws, has been the primary thrust of the work of the United Nations Commission on International Trade Law (UNCITRAL), which is discussed further below. The *United Nations Convention on the International Sale of Goods* 1980 (Vienna Convention) is one such law, which covers several (but not all) issues which may arise in an international sale of goods transaction. Another organisation which aims to have uniform approaches to international sales contracts is the International Institute for the Unification of Private Law (UNIDROIT). UNIDROIT, UNCITRAL and the Vienna Convention are discussed below. In the area of international shipping, efforts have been made to unify the law relating to the rights and liabilities of cargo carriers, including the

Hague Rules of 1924, the Hague-Visby Rules of 1968, the Hamburg Rules of 1978, and Incoterms 1990 and 2000. Each of these are dealt with in detail later in this chapter.

What if no law is selected by the parties? See pp 139–40, below.

UNIDROIT

The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organisation with 58 Member States. It has a General Assembly, Governing Council and Secretariat. The Governing Council established a working group of leading experts in contract law and international trade law from the major legal and socio-economic systems of the world. Representatives sat in a personal capacity and did not express the views of their governments. Successive drafts were circulated among a wider group of experts for advice. Where there were conflicting rules, the group decided which rule provided a fairer outcome between trade parties. The outcome of this work was the UNIDROIT Principles, which were published in 1994 and represent a broad consensus.

The UNIDROIT Principles are set out more in the style of a code than a statute, and are divided into chapters headed general rules, contract formation, validity, interpretation, content, performance, non-performance, hardship, termination, and damage.

The UNIDROIT Principles apply:

(1) where the parties have agreed in their contract that:
   (a) they are to apply; or
   (b) general principles of law, such as *lex mercatoria* are to apply (some see the UNIDROIT Principles as a codification of *lex mercatoria*); and

(2) where the judge or arbitrator, in its discretion, applies them to:
   (a) solve an issue which cannot be solved by the applicable law; or
   (b) interpret or supplement uniform international law instruments.

In practice the UNIDROIT Principles have been used as a guide in contractual negotiations, and for filling gaps in the coverage of issues by the Vienna Convention (see p 74, below, for more on the Vienna Convention).

Article 1.1 of the UNIDROIT Principles deals with the autonomy of the parties over their own affairs. Article 1.7 deals with good faith and Art 1.8 discusses openness to usages. Article 2.4(2)(a) raises an inference of irrevocability of an offer similar to that found in Art 16 of

the Vienna Convention. Article 2.21 provides a 'knockout' solution to the problem of battle of forms, meaning the contract is formed on those terms common in substance between the parties. Article 7.3.1(2) deals with fundamental breach, and the aggrieved party is entitled to compel performance, assisted if need be by the court. Whilst specific performance is discretionary under Art 28 of the Vienna Convention, the UNIDROIT Principles require the court to order specific performance unless one of a number of stated exceptions under Art 7.2.2 applies. For further information visit www.unidroit.org.

UNCITRAL

In the 1960's it was recognised that there were several active organisations trying to unify international trade law, and a body such as UNCITRAL could prevent duplication of efforts among the organisations. The primary objective of the United Nations Commission on International Trade Law (UNCITRAL) is the harmonisation and unification of the law relating to trade. UNCITRAL was created in 1966 to co-ordinate this process, by:

- facilitating co-operation;
- encouraging adoption of existing uniform laws and conventions;
- promoting codification of trade customs and practices;
- promoting uniform interpretation of uniform laws and conventions;
- disseminating information on new developments.

UNCITRAL meets annually, and working groups are established to deal with specific topics. Working groups aim to harmonise the law on particular topics by codifying uniform legal rules from existing trade customs and practices. The working group prepares a draft text of a convention or model law for the Commission to consider, revise, and adopt. The next step is a recommendation by the Commission to the United Nations General Assembly to convene a conference, where countries may choose to adopt the new law.

The main areas of work by UNCITRAL are as follows:

International sale of goods

- *Convention on the Limitation Period in the International Sale of Goods*, New York 1974, which established a four year limitation period, extended in certain circumstances to a maximum of 10 years, after

which claims under an international sale of goods contract are time barred.

- *United Nations Convention on Contracts for the International Sale of Goods*, Vienna, 1980 (the Vienna Convention).
- The *UNCITRAL Legal Guide on International Countertrade Transactions* was adopted in 1992 to identify the legal issues involved in countertrade transactions.

Transportation

- The *United Nations Convention on the Carriage of Goods by Sea* was adopted in 1978 and entered into force in Australia in 1992. It has come to be known as the 'Hamburg Rules'. It establishes a uniform law governing the carriage of goods by sea, setting out the rights and obligations of shippers, carriers and consignees.
- A *United Nations Convention on the Liability of Operators of Transport Terminals in International Trade* has been drafted, which establishes the rules for determining liability for the loss, damage or delay in delivery of goods whilst at a transport terminal. This Convention has not yet entered into force.

Construction and public procurement

- In 1988 the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* was published.
- In 1994 the *UNCITRAL Model Law on Procurement of Goods, Construction and Services* was adopted to promote transparency, fairness and objectivity in the procurement process.

Electronic commerce

An electronic bill of lading has been developed, which uses the Electronic Data Interchange (EDI). The *UNCITRAL Model Law on Electronic Commerce* was adopted in 1996, dealing with what constitutes an 'original' document, the writing requirement and electronic signatures.

International payments

- In 1987 a *Legal Guide on Electronic Funds Transfers* was published.
- In 1988 the *United Nations Convention on International Bills of Exchange and International Promissory Notes* was drafted to overcome the uncertainties of international payments. It has not yet officially come into force, but will apply if the parties incorporate it in their contract.
- In 1992 the *UNCITRAL Model Law on International Credit Transfers* was adopted.
- In 1995 the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* was adopted. These conventions are dealt with in more detail below.
- The *UNCITRAL Model Law on Cross-Border Insolvency* was adopted in 1997 to promote co-ordination by courts and insolvency administrators in situations where an insolvent debtor has assets in several States.

International commercial ADR

- The *UNCITRAL Conciliation Rules* were adopted in 1980 to establish the procedures by which disputes can be settled through conciliation between the parties.
- The *UNCITRAL Arbitration Rules* were adopted in 1976, which are suitable for both ad hoc arbitration and for arbitration administered by an institution.
- In 1982 UNCITRAL also adopted a set of non-binding Recommendations to assist arbitral institutions and other interested bodies with regard to arbitrations under the UNCITRAL Arbitration Rules.
- In 1985 UNCITRAL adopted the *UNCITRAL Model Law on International Commercial Arbitration*, which has been widely accepted.
- In 1996 the *UNCITRAL Notes on Organising Arbitral Proceedings* was created for use in both ad hoc arbitrations and for arbitration administered by an institution, suggesting matters the arbitral tribunal may wish to rule on in arbitral proceedings.

For more information on UNCITRAL, visit www.uncitral.org.

Vienna Convention

The *United Nations Convention on Contracts for the International Sale of Goods*, known also as the 'Vienna Convention', or as 'CISG', was signed by all 62 States at the conference in 1980. The text of the Vienna Convention is based on a 1950's draft by UNIDROIT and on two conventions on international contracts and sales in the 1970's. The aim was to bridge the legal ideological differences between the codified and the Anglo-Saxon systems of law. The text of the Convention (with annotations) is available at www.cisg.law.pace.edu/cisg/text/cisg-toc.html.

Article 1 states the sphere of application of the Vienna Convention. It applies to sale of goods contracts where the parties have their places of business in different Contracting States or where the applicable law is that of a Contracting State. Australia is party to the Vienna Convention, and therefore where an international trade contract is between an Australian trader and a trader from another country party to the Vienna Convention, it will apply. Australian States have also enacted the Vienna Convention as part of their sale of goods legislation (as the Commonwealth does not have power under the Constitution to enact such legislation). An example is the *Sale of Goods (Vienna Convention) Act* 1986 (NSW). This means that if an international trade contract is governed by NSW law, the Vienna Convention will apply, even if the other party to the contract is in a country which is not party to it.

Article 2 provides that the Convention covers commercial sale contracts only, and several other exceptions are listed. These exceptions include the sale of shares, electricity, ships, and aircraft. Importantly, Art 4 states that the Convention does not cover validity of the contract of sale or property in the goods. This means that those issues have to be addressed by the parties to the contract or in accordance with the law applicable by way of conflict of laws rules.

Article 6 allows the parties to exclude or modify the application of the Convention, giving them a degree of autonomy. Trading parties from States who are not party to the Convention may include a clause adopting the Convention as their choice of law so it will apply instead of either party's domestic law. Parties may opt out of the Vienna Convention through placing a choice of law clause in their contract of sale. The Convention can have restricted application where a party's Member State has made a reservation to a provision.

When experiencing difficulty in finding the answer to a particular issue within the Vienna Convention, there are three paths of enquiry you may follow:

Interpretation of Convention provisions

Is the issue regarding the meaning of a particular article? Where the wording of an article of the Convention needs interpreting, Art 7(1) states the court should consider:

(1) the international character of the Convention;

(2) the need to promote uniformity in its application; and

(3) the observance of good faith.

It is also valid to consider:

(4) the legislative history of the Convention (to consider discussions and negotiations in the drafting of its terms), which is found in the Secretariat Commentary;

(5) cases where the courts have previously interpreted that provision. This is a growing body of law which may be found in Case Law on Uncitral Texts (CLOUT), www.un.or.at/uncitral/en-index.htm.

Non-coverage

Is the issue regarding whether an article covers the issue? The Convention may govern the issue but the articles may not specifically address the exact point your issue concerns. Article 7(2) states the issue should be settled in conformity with the general principles on which the Convention is based, or in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law. General principles include uniformity and good faith, and Honnold has suggested others are the duty to communicate information needed by the other party, and the obligation to mitigate damages. General principles are also illustrated in past decisions on similar issues, in the UNIDROIT Principles, and in *lex mercatoria*. Arguments can be raised against the value of the UNIDROIT Principles and against the application of *lex mercatoria* in a day and age where trade practices vary enormously from trade region to trade region. The breadth of Art 7 therefore introduces an element of unpredictability.

There is also the mechanism of analogy, by considering other sections of the Convention and drawing an analogy to the situation in hand. Take for example a situation where a contract specified a set number of days for payment to be transferred and the payment was

made late because of a public holiday. An analogy can be drawn to Art 20 of the Convention, which deals with the time period for acceptance, allowing an extension of the period for acceptance in circumstances where the transmission is delayed due to a holiday.

Non-governance

This is where the Convention does not govern the issue, for example where the issue is as to the validity of the contract between the parties, competency of the parties, property in the goods, rights of third parties, or product liability. These may be addressed by specific clauses in the contract of sale but if they are not, the law of the forum State will be applied.

Article 8 adds complexity to the situation. It provides that conduct is to be interpreted in accordance with the intent of the parties, be that actual or according to the interpretation a reasonable person would have of the party's intention in the circumstances. Article 9 makes any usage agreed between the parties to be binding upon them. It is often the case in international trade that the parties have some matters which are not specifically stated in the contract. For example, a seller who ships apples may generally phone the buyer when the shipment actually arrives at the port of delivery. While the contract merely states that the buyer has the responsibility for taking delivery at that port, the phone call from the seller to the buyer is an agreed usage, so if the seller failed to call the buyer and the apples rotted, the seller would be accountable for its failure to notify the buyer.

With regard to the formation of the contract of sale, the Convention defines what constitutes an offer and what constitutes an acceptance. There is no requirement of consideration. Article 14 provides that an offer must be sufficiently definite, showing an intention of the offeror to be bound if the offeree accepts. It is possible for an offer to be valid without stating the contract price if the course of dealing between the parties would make this obvious. The offer can be made open for a fixed time, and the offeror cannot revoke the offer until this fixed time is passed (Art 16), or until a rejection of the offer is received (Art 17). If the acceptance contains any additional terms which materially alter the terms of the offer, this is not considered an acceptance but instead, a counter-offer, for the original offeror to accept (Art 19). The contract is formed when acceptance becomes effective (Art 23). The contract need not be in writing, but where a State requires evidence in writing that State may declare Art 11 not to apply to transactions conducted in that State.

Under the Vienna Convention, either party can avoid performance of the contract if there has been a fundamental breach by the other party (Art 25). This means a breach that substantially deprives the other party of what they expect under the contract, unless the breaching party could not have reasonably foreseen such a result. The avoiding party must give notice to the breaching party, or cannot avoid performance of the contract (Art 26). The avoiding party is entitled to specific performance of the contract provided the court where the matter is being heard would grant specific performance to a domestic contract in similar circumstances (Art 28).

Part 3, Chapter 2 (Arts 30–52) concern the obligations of the seller. The seller must make timely delivery of goods that conform to their contractual description, and hand over documents relating to the goods. If the seller fails to perform these obligations the buyer may:

(i) refuse delivery;

(ii) require delivery of substitute goods or require the seller to repair the goods;

(iii) set an additional reasonable time period for the seller to perform the contract, and if this is given, the buyer cannot resort to any other remedy during the extension period;

(iv) reduce the price;

(v) avoid the contract; and

(vi) seek damages and interest.

Part 3, Chapter 3 (Arts 53–65) concern the obligations of the buyer. The buyer must accept delivery of the goods and pay the contract price. If the buyer fails to perform these obligations the seller may:

(i) require payment and delivery;

(ii) set an additional reasonable time period for the buyer to perform the contract, and if this is given, the seller cannot resort to any other remedy during the extension period;

(iii) avoid the contract; and

(iv) seek damages and interest.

The Convention is widely accepted, and this is due to the fact that many countries were involved in drafting it. The Convention attempts to reconcile the different contractual legal principles adopted throughout various States.

There are two exceptions to these remedies for non-performance. The first is *dirty hands*, that is, a party whose actions caused the other party to breach the contract. The second is *force majeure*, where an unanticipated impediment beyond the control of the parties caused the breach to occur. Examples would include a natural disaster, an act of war, or industrial strike action. The parties may extend this by incorporating a *hardship* clause in the contract, which is a little broader than force majeure. A hardship clause tends to compel renegotiation between the parties if as a result of an event which was beyond the control of the parties a party would suffer severe financial hardship. This raises some difficulty considering the reason the parties contracted with each other in the first instance was that they considered it was the best deal available at the time. Obviously some hardships are merely part of the normal economic risk of business, so the parties should agree between themselves what events will amount to 'hardship' before the contract is entered.

The general remedy provided for in the Convention is damages. Where a party avoids the contract, both parties are released from their obligations, except those clauses that specify what is to occur if the contract is avoided.

Chapter 4 considers passing of risk, although this is not necessarily the same as passing of property. Risk for the goods passes to the buyer when the seller hands the goods over to the carrier at a specified place (Art 67). If the goods are onsold during transit, the risk passes to the new buyer from the time the contract is concluded, unless the original buyer knew the goods had been lost or damaged already (Art 68).

The Convention also provides for the preservation of the goods. If the goods are perishable, the seller should give notice to the buyer that the goods will be sold to another buyer. If the seller has to store the goods while the buyer delays in taking delivery, the seller can charge for the costs associated.

Trade terms

Trade terms pre-determine the obligations between the buyer and seller as to loading of the goods, transport costs and insurance. It is common that the more powerful negotiating party can dictate trade terms, yet it is paradoxical that it is the more powerful party that can often negotiate special rates for transportation and insurance. In

addition to this the powerful negotiating party can insist the goods be shipped only on ships designated by them.

The most common mode of transportation of goods internationally is via the sea. The standard trade terms 'CIF' and 'FOB' are of frequent and wide usage in the international shipping of goods, so it is important to understand their meaning. They were originally developed for the convenience of trade by ship merchants to define the responsibilities and liabilities of the parties for the goods at various stages in their transportation.

CIF stands for 'cost, insurance, freight'. The price of the goods in a CIF contract includes not only their sale price, but also the cost of transporting them to the buyer, and insuring them during transit. It makes sense for the seller to arrange transportation, given that most sellers regularly ship their goods, are familiar with local shipping customs and service providers, and would likely be able to arrange a better deal than the buyer. The buyer would be arranging a one-off shipping agreement in a foreign country.

The seller prepares an invoice detailing the goods, and bears the responsibility for their correct description. The seller also obtains a shipping contract and an insurance policy. These three documents, plus any other documents required by the exporting country, are presented to the buyer for payment before delivery takes place. The buyer is responsible for obtaining any required import licences, unless the contract provides otherwise. The buyer obtains rights against the goods on the strength of the documents (such as the right to sell the goods on to another buyer) and it has been argued that a CIF contract is effectively a contract for the sale of documents (see *Arnhold Karberg v Blythe, Green, Jourdain & Co* (1915)).

FOB stands for 'free on board'. This means that the buyer assumes responsibility and cost for transport and insurance of the goods. Once the goods are on board at the port of departure, the seller is free from any further liability for them, apart from their matching the description as stated in the contract for sale. The actual bill of lading is arranged by the seller, and endorsed to the buyer when the goods are on board the ship.

The problem with the traditional abbreviations of CIF and FOB was that they meant different things in different trade centres. In 1936 the International Chamber of Commerce (ICC) developed a set of standard rules of interpretation known as INCOTERMS to establish standard meanings for trade terms.

The ICC is a private organisation of semi-official standing which was established by business entities. Incoterms can be seen as a codification of *lex mercatoria*. UNCITRAL has recommended their use. In order for the Incoterms to apply, they must be expressly or impliedly incorporated into the contract.

The ICC periodically revises these standard rules as new circumstances arise, and the most recent revision is Incoterms 2000.

Incoterms vary according to which party delivers the goods, bears the cost of delivery, the responsibility for loss and damage to the goods, and arranges insurance and export documents. The trade terms are divided into four groups:

- E group – 'Ex' – The buyer takes delivery at the seller's premises (Ex Works – EXW).
- F group – 'Free' – The seller is free of further financial obligation once the goods are delivered to the carrier (Free Carrier – FCA), or to the port of exit (Free Alongside Ship – FAS), or once loaded onto the vessel (Free On Board – FOB).
- C group – 'Cost' – The seller covers the cost of freight (Cost and Freight – C & F), or insurance and freight (Cost Insurance Freight – CIF).
- D group – 'Delivered' – The buyer takes delivery on land at the port of entry (Delivered Ex Quay – DEQ), or on the vessel at the port of entry (Delivered Ex Ship – DES), with duty paid (Delivered Duty Paid – DDP) or unpaid (Delivered Duty Unpaid – DDU).

The two most common trade terms used are Cost Insurance Freight (CIF) and Free on Board (FOB).

CIF contracts under INCOTERMS 2000

The seller's obligations are:

(1) The goods must match their contractual description. This includes their packaging, and the time for shipment.

(2) The preparation of documents – the invoice, the shipping contract (known as a bill of lading), the insurance contract, export licences and customs formalities.

(3) The risk for the goods until they are on board the ship at the port of departure.

The buyer's obligations are:

(1) Notice to the seller of when and where the goods are to be delivered, and any information needed by the seller to prepare the documents.

(2) Acceptance of delivery of the goods and transport documents.
(3) Import licences.
(4) Payment of the contract price, as well as any duties, taxes, and other customs formalities during transit and at the port of arrival.

FOB contracts under INCOTERMS 2000

The seller's obligations are:

(1) The goods must match their contractual description.
(2) The preparation of an invoice (or its electronic equivalent, if the parties agree).
(3) Inform the buyer of any information needed by the buyer to prepare the insurance contract, and notice once the goods have been placed on board ship.
(4) Export licences and customs formalities.

The buyer's obligations are:

(1) Notice to the seller of the ship, the time, and port of departure.
(2) The shipping contract (bill of lading) and the insurance contract.
(3) Acceptance of delivery of the goods and transport documents.
(4) Import licences.
(5) Payment of the contract price, as well as any duties, taxes, and other customs formalities during transit and at the port of arrival.

It is important when negotiating a contract involving trade terms that both parties mean the same thing. For example, FAS can mean 'free alongside ship' or it could mean 'free arrival station'. In the first the seller needs only get the goods to the loading port, but in the second the seller must deliver to the buyer's depot.

International carriage of goods

Carriage of goods by sea

Prior to aeroplanes being a commercially feasible method for moving goods internationally, the only available method for carrying goods internationally from Australia was by sea. Historically England was the major shipping hub, and, combined with the fact that Australia was formerly an English colony, it is not surprising that Australia's shipping laws are closely aligned with those of the United Kingdom.

International rules

International attempts at harmonising rules applicable to carriage of goods by sea include the Hague Rules (1924), the Hague-Visby Rules (1968) and the Hamburg Rules (1978).

The Hague Rules, signed in 1924, aimed to protect cargo owners, and so defined the minimum level of liability that could not be contracted out by carriers of goods by sea. Over time the Hague Rules were much criticised, as there had been technical changes in the manner of transporting cargo which made the Rules difficult to apply, and the rules were viewed to unfairly favour carriers at the expense of cargo owners. The Hague-Visby Rules, drafted in 1968, aimed to address these criticisms by updating and expanding upon the Hague Rules. As with any international convention, the Rules have force only when implemented by domestic legislation in the signatory countries. Some countries have still not done this, such as the United States, and in those countries the Hague Rules still apply.

The Hague-Visby Rules apply automatically to bills of lading for goods, during the time of their transit. Where the contract is for the carriage of live animals, deck cargo, or if the goods are to be transported by inland waterway, or the documents of title are non-transferable, the Hague-Visby Rules will only apply if the parties choose to incorporate them into the contract. Otherwise, the common law will apply. Under the Hague-Visby Rules, the carrier is required to provide a seaworthy ship, which includes being adequate to sail and being adequate to carry cargo. The carrier is responsible for the careful loading and handling of the goods, and must not deviate from the most direct route except by act of God or to save life or property.

The *United Nations Convention on Carriage of Goods by Sea* (1978), known as the Hamburg Rules, came into force internationally in 1992. They apply to the carriage of goods by sea between two different States, where the port of loading or the port of arrival is a party to the Convention. Parties from non-Member States may expressly stipulate that the Hamburg Rules are to apply to the contract. The Hamburg Rules apply to all cargo, including deck cargo and live animals, and apply whether or not a bill of lading is used. Parties cannot contract out of the provisions of the Hamburg Rules; any attempt to do so is rendered void. The Rules apply during the time the carrier exercises the right of control and supervision of the goods. The distinction is drawn between the carrier and the actual carrier for the purposes of liability. A uniform test of liability is used, based on presumed fault. The carrier bears the burden of proof to show that all reasonable

measures were taken to avoid the occurrence of loss or damage to the goods in the carrier's control.

Some countries have adopted only the Hague Rules, others the Hague-Visby, and others the Hamburg Rules, which has fragmented these attempts at harmonisation. The Comite Maritime International in conjunction with UNCITRAL is currently working to develop an extensive new carriage regime, to supersede each of the existing international rules. If this is to succeed the new regime will have to be broadly recognised and adopted, otherwise there will merely be another set of rules to add to an already complicated area. For further information on the work of the CMI International Sub-Committee on Issues of Transport www.comitemaritime.org/news/nl2000.html.

Rules in force in Australia

Australia, in the *Carriage of Goods by Sea Act* 1991 (Cth), has adopted the Amended Hague Rules, which is a hybrid between the Hague-Visby Rules and the Hamburg Rules. Section 8 of the Act provides that the Amended Hague Rules have force of law in Australia.

Article 3(1) of the Rules provides that the carrier is bound before and at the beginning of the voyage to exercise due diligence to make the ship seaworthy, to properly man, equip and supply it, and to make the holds and cooling chambers in which cargo is carried fit and safe for the reception, carriage and preservation of the cargo. The carrier is obliged to properly load, handle, stow, carry, keep, care for and discharge the goods carried (Art 3(2)).

Article 3(6) relates to circumstances where the goods carried are lost or damaged. The consignee must give written notice of such loss or damage before taking delivery of them, or, if not apparent at that time, within three days of receipt, unless there has been a joint survey or inspection of the goods at the time of delivery. Legal proceedings must be brought within one year from the date of delivery, or the consignee loses the right to claim at all. The parties may agree to extend this period. This typically occurs where settlement negotiations are taking place between the parties which it is hoped will resolve the matter without having to commence formal legal proceedings. Where a time bar extension cannot be negotiated, the consignee must commence proceedings within time. If there is a claim by the carrier for indemnity from a third party, the carrier may bring this cross-claim at least three months after the one year period has expired (Art 3(6 bis)).

Under Art 4(5) the carrier's liability is limited to the greater of 666.67 SDR's per package or 2 SDR's per kilogram, unless the value of the goods was declared by the shipper and inserted in the bill of lading. An SDR is a standard drawing right, which is an internationally uniform unit of account defined by the International Monetary Fund. An SDR is usually worth about AUS$2. For the latest rates, visit www.imf.org/external/np/tre/sdr/sdr.htm.

However, a carrier may be able to not only limit its liability for loss or damage to the goods, but exclude it altogether. Under Art 4(1), the carrier is not liable where damage arises from unseaworthiness unless that loss or damage is caused by a want of due diligence on the carrier's part to meet its obligations under Art 3(1) discussed above. The carrier bears the burden of proving that it exercised due diligence. Under Art 4(2), the carrier is not liable where the loss or damage resulted from circumstances such as:

(1) a negligent act of the master or crew in the navigation or management of the ship;
(2) fire, war, strikes, riots, and acts of God or foreign rulers;
(3) perils of the sea;
(4) acts or omissions of the shipper or owner of the goods;
(5) latent defects, insufficient packaging or inadequate marks; and
(6) any other cause arising without fault or knowledge of the carrier.

The *Carriage of Goods by Sea Act* 1991 (Cth) may be downloaded from www.austlii.edu.au, and the full text of the Rules may be found at Schedule 1A to the Act.

Shipping documentation

Where goods which are the subject of a sale of goods transaction are reasonably small in size, such as a shipment of clothing, a *sea waybill* or a *bill of lading* is used as the contract of carriage. A sea waybill is a non-negotiable document, and is suitable for use where the goods are not intended to be onsold during transit. A bill of lading, on the other hand, serves several functions – the shipper regards the bill of lading as an invoice for the quantity and condition of the goods received, and as evidence of the shipping contract. When a bill of lading is endorsed to a third party, that third party would regard it as the contract of carriage, and any terms agreed between the seller and shipper which are not stated in it do not bind the third party. The bill of lading also serves the function of a document of title, in that the transfer of the bill of sale is the transfer of the right to demand delivery of the goods upon

their arrival. This means that the goods can be onsold while they are in transit, with the bill of lading being endorsed to intermediate buyers and ultimately to the final buyer, who presents the bill of lading at the discharge port to obtain release of the goods.

Major difficulties are created where the original bill of lading takes longer to change hands between various buyers than the goods take to arrive at the discharge port. Consequently the ultimate buyer does not have the original bill of lading to present to the master of the vessel carrying the goods, and a practice of such consignees providing masters will letters of indemnity (LOI) has developed. A LOI is basically a contract whereby the consignee agrees to indemnify the owners of the vessel against any claim made against it in the event the consignee was not actually the person entitled to delivery of the goods. It is typical that a LOI is guaranteed by a bank. Another difficulty with bills of lading is the practice of a number of original bills of lading being issued in respect of the same goods, with presentation of any one original being sufficient to obtain delivery. This provides the opportunity for fraud. For discussion on electronic bills of lading, refer to p 149, below.

When the cargo is initially delivered to the carrier, a 'mate's receipt' is issued. The bill of lading is not issued until the cargo is loaded on the vessel, where it is known as a 'shipped bill of lading', evidencing that the cargo is shipped on board. The person with possession of the mate's receipt is entitled to receive the bill of lading, unless some other person can prove ownership of the goods. The bill of lading is issued in triplicate, with one original remaining with the shipper, one being carried with the cargo, and one being sent to the consignee. The shipper may require the carrier to state information such as the weight or number of packages making up the consignment, but is obliged to indemnify the carrier in the event the information provided to the carrier is incorrect. Where weights and quantities are stated, this constitutes *prima facie* evidence of the quantity and weight of the goods shipped, unless the carrier adds words such as 'said to contain'. When the carrier issues the bill of lading, it is able to note on its face any qualifications as to the condition of the cargo when loaded. This is known as a 'claused' bill of lading. If this is not done, the bill of lading is known as a 'clean' bill of lading, and subsequent purchasers of the cargo while it is in transit are entitled to assume the cargo was shipped clean on board.

Other types of bills of lading are as follows:

- 'charterparty bill of lading' – a bill of lading which incorporates some or all of the terms of a charterparty. Charterparties are discussed below;

- 'container bill of lading' – a bill of lading issued to cover carriage of goods in a container, where for example the loaded container is carried by sea and then truck to an inland destination;
- 'house bill of lading' – a bill of lading issued by a freight forwarder. The freight forwarder combines, or consolidates, various consignments of goods into the one consignment. It is not, however, a document of title as a normal bill of lading is;
- 'through bill of lading' – a bill of lading in which either the sea voyage is broken into stages performed by different carriers, or the sea voyage is only part of the overall contract of carriage, such as where the goods are forwarded by truck to an inland destination. The terms and conditions applied to non-sea stages are typically the sea carriage terms and conditions.

Charterparties and contracts of affreightment

Where the goods are large enough to fill a whole ship, such as a shipment of coal, the trader will charter the ship using a *voyage charterparty* as the contract of carriage. Where the goods are large enough to fill a number of ships, a *contract of affreightment* (COA) is used. A COA is also used where the charterer wants to lock the carrier into fixed rates for a number of voyages.

A COA similarly specifies the responsibilities of the parties, as well as the quantity/volume of cargo to be carried, the number of voyages, and the period of time in which the voyages are to take place. Quantities are generally expressed +/- 10%. The COA need not specify the actual vessel to be used, but merely the tonnage capacity of the sort of vessel which would be suitable (known as the *deadweight*). The COA will provide for a period of time in which the vessel must arrive at the port of loading (*laycan*).

A charterparty provides a breakdown of who is responsible for navigation of the vessel, loading and discharging cargo, the time allowed for loading and discharging (*laytime*), the cost penalties if time is exceeded (*demurrage*), and liability for damage to cargo en route. Typically a standard form of charterparty is used (such as the Gencon form), which is supplemented by a number of terms specific to the contract, negotiated individually by the parties through their agents and brokers by telephone, telex and/or email. It is uncommon during negotiations for there to be any direct contact between the parties themselves.

Alternatively to a voyage charterparty, the trader may enter into a *time charterparty*, which is similar to the lease of a vehicle or property,

in that the time charterer has use of the vessel for trading for a specified period of time. An additional type of charterparty is a *demise charterparty*, under which the charterer takes legal possession of the vessel, and not merely a right of use of the vessel and its crew. The charterer is responsible for manning and maintaining the vessel during the period of the charter, and may sue in the vessel's name if the vessel is damaged by a third party's negligence. The demise charterer is referred to as a 'disponent owner'. Demise charters are much less common than time and voyage charterparties, and the remainder of this discussion focuses on the more common charterparties.

A time charterer may sub-charter the vessel to another party during the charter period. This may be a sub-time charter or a voyage charter. If a sub-time charter, the time charterer may itself sub-charter the vessel to a voyage charterer. This may be commercially feasible if, for example, the time charterer regularly carries a bulk cargo of a particular commodity from country A to country B; rather than having the vessel sail back from B to A empty, it may wish to enter a voyage charter with a party wishing to carry another bulk commodity from B to A. The result is that there is often a number of charterparty contracts relating to the one vessel at the one time. It is usual for brokers in these situations to minimise complication by negotiating sub-charterparties on the same standard terms as the head charter, known as negotiating 'back to back'.

For example, the 'Uljanik' owned by United Shipping Adriatic of Monrovia, was time chartered to Rondeau Bulk AG of Switzerland, who sub-time chartered the vessel to Hyundai Merchant Marine of Korea, who voyage chartered the vessel to Hi-Fert Pty Ltd of Australia, who used it to carry a bulk cargo of fertiliser to Australia in 1995. In addition to each of the charterparty contracts, when the bulk cargo of fertiliser was loaded and the bill of lading issued, an additional contract, between United Shipping Adriatic and Hi-Fert Pty Ltd, arose.

Whilst the contract of sale and the contract of carriage are separate, it is important to recognise that the effect of the bill of lading as a contract of carriage can differ. A bill of lading in the hands of a charterer is not a contract of carriage, because there is already a contract of carriage in existence between the parties, namely the charterparty. Take for example the carriage of goods under a FOB contract. A bill of lading is issued by the carrier to the shipper, and is a contract of carriage. If the shipper then indorses the bill of lading to a third party who is also the voyage charterer of the vessel, the bill of

lading ceases to be a contract of carriage. Another example is the carriage of goods under a CIF contract. The bill of lading issued by the carrier to a shipper who is also the voyage charterer of the vessel is not a contract of carriage. The voyage charterparty is. However, if the bill of lading is later indorsed to a third party receiver, it then becomes a contract of carriage between the carrier and the receiver.

In *Hi-Fert Pty Ltd v Kiukiang Maritime Carriers Pty Ltd* (2000) the Federal Court considered the situation where there is a contract of affreightment between a time charterer and a shipper, and a bill of lading is issued by the shipowner to an American shipper, which was later indorsed to Hi-Fert Pty Ltd. The 'Kiukiang Career' was owned by KMC, who time chartered it to WBC. WBC entered a contract of affreightment with Hi-Fert Pty Ltd. KMC argued that it was not liable to Hi-Fert in contract because the contract of carriage was not the bill of lading issued by it but the contract of affreightment Hi-Fert had with WBC. In that context, the bill of lading was only a receipt for the cargo. The Court held that the bill of lading did evidence the contract of carriage. The bill of lading incorporated the terms and conditions of the 'Governing Charterparty' which the Court held to be the time charterparty between KMC and WBC.

Packing

It is in the interest of parties to international sale transactions to ensure goods are suitably packaged. The goods typically will have value to the buyer above and beyond the price being paid for them. For example, the buyer may wish to use them in the manufacture of other products. Or the buyer may have arranged to resell them at a higher price. Great cost and inconvenience can be suffered where goods are damaged in transit as a result of being inadequately packaged and, where carriage is by sea, there can be considerable delay involved in having replacement goods delivered.

Some countries have packing legislation, restricting packaging materials which may be used. Wood is a good example. In Australia, wood may only be used for packing if it has been fumigated to the standards set by the Australian Quarantine Inspection Service (AQIS). For further information on AQIS visit the Department of Agriculture, Fisheries and Forestry (AFFA) website at www.affa.gov.au/outputs/quarantine.html.

Strict packaging and labelling requirements also apply to the carriage of dangerous goods, such as chemicals. The *International Maritime Dangerous Goods Code* (the IMDG Code) is a uniform

international code for the transport of dangerous goods by sea. It was drafted by the International Maritime Organisation (IMO) in 1965 to supplement the *International Convention for the Safety of Life at Sea*, 1960 (SOLAS). It has been revised a number of times since then to incorporate proposed changes by IMO members and changes to the United Nations Recommendations on the Transport of Dangerous Goods, which are made bi-annually. The most recent revision of the IMDG Code was adopted in May 2000. The full text of the IMDG Code is not freely available on the internet, but may be purchased in electronic form from www.imo.org.

Marine insurance

A marine insurance contract indemnifies the insured against loss and damage to cargo due to perils of the sea voyage. Which perils are covered depends on the terms of the policy. Marine insurance contracts contain the same features as most insurance contracts:

(1) Duty of good faith – this is the Latin maxim of *uberrimae fidei*, which means that the parties to the insurance contract must disclose to each other any information which is likely to affect the other's judgment of risk.

(2) Insurable interest – the insured must expect to acquire some benefit from the safe and timely carriage of the goods to their destination.

(3) Subrogation – the insurer indemnifies the insured (pays out the claim) and then has the right to sue in the place of the insured in order to recover the money from third parties.

(4) Double insurance – if the insured takes out two insurance policies over the same goods, the insured cannot recover twice. A claim is made against one of the insurers, and that insurer can then claim contribution from the second insurer.

Types of marine insurance policies

The main types of marine insurance policies are hull (insuring the hull and machinery of the vessel), cargo, and freight (insuring payment of freight). Of primary interest for present purposes is cargo insurance. There is great variety in cargo marine insurance contracts, depending on the focus of the insurable interest:

(i) Voyage policy – covers a particular voyage.

(ii) Time policy – covers a particular time period.

(iii) Valued policy – covers the goods to an agreed value.

(iv) Unvalued policy – covers the goods to a value that will be calculated by the cost of the property plus the expenses of shipping and insurance.

(v) Floating policy – covers several shipments of cargo over a period.

(vi) Open cover – covers shipments arranged on an ad hoc basis.

The insurance policy may be stated to apply 'warehouse to warehouse' but the requirement that the party claiming under the policy have an insurable interest remains, and therefore the insurance policy may not in practice actually cover the entire length of carriage.

Responsibility to take out marine insurance

The party responsible for insurance will depend on the terms of the contract. If a CIF contract, the seller arranges insurance, if FOB it is the buyer's responsibility.

Bearing in mind that the bill of lading for a particular shipment of goods may be bought and sold several times while it is at sea, it is important that the insurance policy is assignable. It is usual that a policy of marine insurance is assignable, unless provided otherwise in the policy. Assignment of the policy occurs at the same time as assignment of the subject matter (the cargo), usually effected by indorsement to subsequent buyers.

Institute Cargo Clauses

Where a seller is obliged to arrange insurance under a CIF contract, the seller is only required to take out minimal insurance. The most common form of insurance is the Institute Cargo Clauses A. The Institute Cargo Clauses are standard form clauses issued and periodically updated by the Institute of London Underwriters. In addition to Institute Cargo Clauses A, which is an 'all risks' insurance, there are Clauses B and C, which both cover specific risks. Despite its name, Clauses A do not cover literally 'all' risks. For example, they do not cover loss caused by:

(1) ordinary leakage, loss in weight or volume during transit;

(2) wilful misconduct by the assured;

(3) insufficient packaging of the goods;

(4) inherent vice in the nature of the goods;

(5) the insolvency of the carrier;

(6) the use of nuclear or atomic weapons;

(7) unseaworthiness of the vessel known to the assured at the time the goods were loaded on it; and

(8) acts of terrorism.

Therefore, depending on the risk assessment of cargo owners, additional insurance may be desirable.

Where Institute Cargo Clauses are used, liability by a cargo owner to make contributions in the *general average* are covered by the policy. A general average loss occurs where, for example, the vessel is in danger of foundering and the master jettisons cargo at sea. The owner whose cargo was jettisoned is entitled to claim a contribution from the owner of the vessel and from the owner of other cargo carried on it at the time of the general event. Another example of a general average loss is where expenditure is incurred as a result of the vessel entering a port of refuge in order to secure the safety of the vessel and cargo. Provided the step taken was successful in securing the safety of the cargo, and provided the step did not become necessary because of seaworthiness of the vessel or some other negligent act on behalf of the master, the shipowner is entitled to claim a contribution from the cargo owners.

Where numerous cargoes are carried on board the one vessel, the process of average adjusting can be complicated, and an average adjuster is appointed to calculate contributions. The definition of what amounts to a general average loss differs across various jurisdictions. The International Law Association attempted to rectify this situation in 1974 through the drafting of the York-Antwerp Rules, which may be adopted by the parties. If no adoption is made, adjustments in the general average are made in accordance with the law in force at the discharge port, or, if the vessel does not make it to the discharge port, general average is adjusted in accordance with the law in force at the nearest port to where the vessel foundered.

Indemnity under marine insurance policies

In practice, where a cargo owner suffers a loss to goods during transit, the cargo owner gives notice to the carrier of the loss, and claims under its policy of marine insurance. The marine insurer assesses whether the loss is covered by the policy, and if so, pays the claim.

Loss of cargo may be actual total loss (where the cargo is destroyed, or damaged to the point the goods are no longer of the kind insured), or constructive total loss (where the damage is such that the cargo has no commercial value, or the cost of preserving the cargo from actual total loss would exceed its recovery value). The usual

measure of indemnity for the insured is the value of the cargo at market value at the time of shipment plus the cost of insurance. In a CIF contract insurance is usually taken out at 110% of the market value. Where damage to the goods is partial rather than total, the insured may recover the value of the part of the shipment which is lost or damaged.

The measure of indemnity depends on the type of policy. If a valued policy, indemnity is at the agreed value of the goods. If an unvalued policy, indemnity is at the amount of the loss plus shipping and insurance expenses. If insurance is based on the *sound arrived value* of the goods, indemnity is based on the value the goods would have had if they had arrived undamaged, plus estimated profits which would have been earned from reselling them. If the loss is partial rather than total, and the policy is a valued policy, indemnity is in proportion to the loss of value. For example if the goods are worth 50% of their former value, the assured may recover 50% of the agreed value. If an unvalued policy, indemnity is in proportion to the loss of value.

When the claim is paid, the assured signs a *subrogation receipt*, which gives the insurer the right to sue in the assured's name against the party causing the loss or damage to the goods, usually the carrier.

Relevant legislation

As with most areas of shipping law, marine insurance law in Australia is modelled on English law. The *Marine Insurance Act* 1909 (Cth) was enacted in Australia just three years after the *Marine Insurance Act* 1906 (UK). The Act is subject to some exceptions, such as pleasure boats, which are covered by the *Insurance Contracts Act* 1984 (Cth), and insurance for carriage within inland waters, which are governed by the laws of the relevant State. Section 7 of the *Marine Insurance Act* defines a contract of marine insurance as 'a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against marine losses, that is to say, losses incident to marine adventure'. The Act has been criticised because if an insured fails to give full disclosure to the insurer, the insurer may avoid the policy and deny payment of a claim. Similarly, if there is breach of any warranty in the policy, the insurer may avoid the policy. In both cases, an insurer may avoid the policy even where the non-disclosure or breach of warranty has no bearing on the loss suffered. The Australian Law Reform Commission (ALRC) undertook a review of the Act recommending in its 2001 report that insurer's rights to

avoid marine insurance policies be limited to situations where the non-disclosure is material. A copy of the ALRC's report (ALRC 91) may be downloaded from www.austlii.edu.au/au/other/alrc/publi cations/ reports/91.

Freight

Freight is the contract price in a contract of carriage. It is earned by the carrier when the cargo is delivered to its destination, although this can be varied by the contract of carriage, so as to require payment of freight on shipment rather than delivery. This is referred to in the trade as freight prepaid, while the former is referred to as freight collect. It is common to see a bill of lading stating 'freight deemed earned on shipment', which means that freight is earned regardless of whether the goods end up being delivered to their destination. Where a bill of lading is marked 'freight collect', an intermediate buyer of the goods takes them on the basis that it will also have to pay freight when the goods arrive. If the buyer fails to pay the freight it does not stop the carrier seeking payment of the payment from the seller. It is then up to the seller to claim against the buyer for breach of the contract of sale.

Freight is typically payable by the shipper, the party who entered the contract with the carrier. In a FOB sale this is the buyer and in a CIF sale this is the seller. If you are unfamiliar with these acronyms, refer to the discussion of 'trade terms' at p 78, above. Freight is calculated by weight (a price per kilogram or tonne), by measurement (for example per 20′ shipping container), on an *ad valorem* basis (for example a price per AUS$1000 worth of goods carried), or by lump sum (for example for use of the whole ship or specific holds).

Freight rates for liner vessels, which operate regular scheduled services on particular major trade routes, are usually fixed by shipping conferences. A shipping conference is similar to a cartel. Usually such collusion in Australia would be in breach of the *Trade Practices Act* 1974 (Cth), however shipping conferences are exempted by virtue of Part X of the Act, a copy of which may be downloaded from www.austlii.edu.au. Part X was the subject of an inquiry by the Productivity Commission in 1999. The Final Report found that although conferences increase the potential for market power, they allow Australian exporters access to best possible prices from foreign liner carriers, and are an efficient way of meeting shippers' demands in terms of frequency and reliability of services. A copy of the Final Report is available at www.indcom.gov.au/inquiry/shipping /finalreport/index.html.

The *United Nations Convention on a Code of Conduct for Liner Conferences* (1972) was adopted in 1974 and entered into force generally in 1983. It was the result of difficulties experienced by new shipping lines, particularly those from developing countries, in gaining entry to existing conferences. The Code applies a 40:40:20 cargo sharing rule between the national shipping lines of the two Member States and foreign shipping lines. It applies to liner shipping by conferences operating between two countries who are party to it. Australia is not a party to the Convention. The full text of the Code may be downloaded from www.treaty.un. org/LibertyIMS::/Cmd= Request;Request= TREATYBYLOC;Form=none;VF_Volume=UNVOL 37;VF_File=00000316.

If the shipper arranges to load cargo of a certain weight, but loads less than this, the shipper is liable to pay *dead freight* to the carrier. The quantum of dead freight payable depends on whether the carrier is able to load other cargo to fill the space. If so, the freight earned from the carrier from the other cargo is deducted from the dead freight payable.

If the shipper instructs the carrier to carry the cargo to a destination other than that agreed in the contract of carriage, the shipper becomes liable to pay *back freight*. If the destination is further than the original destination, additional freight is paid, and if the destination is short of the original destination, the shipper remains liable to pay the original freight.

Where freight is not paid, the carrier is entitled to exercise a lien on the cargo for unpaid freight. This means the carrier is entitled to refuse to deliver the cargo until the freight has been paid, regardless of which party under the contract of sale is obliged to pay it. In practice where the seller was obliged to pay the freight and did not, the buyer, who wants release of the goods, pays the carrier the freight and then claims against the seller for breach of contract, damages being the amount of the freight paid.

Carriage of goods by air

A number of conventions regulate international carriage of goods by air. Each convention adds on to, or supplements, previous conventions. The main convention is the *Convention for the Unification of Certain Rules Relating to International Carriage by Air* (1929), otherwise known as the 'Warsaw Convention'. It aimed to provide a uniform code of rules to be observed by all parties to the Convention, which at the same time limited the liability of air carriers. It covers international carriage of passengers, baggage, and cargo. The transportation

document provided for an *air consignment note*, which serves a similar function to the bill of lading in shipping contracts, and detailed requirements were to be specified as a condition of limiting the air carrier's liability.

The Hague Protocol to the Convention, in 1955, simplified the documents of air carriage. It also further limited air carrier's liability for damage to goods to damage caused by wilful misconduct, excluding liability for damage caused through negligence. The *Guadalajara Convention* of 1961 supplemented the Warsaw Convention to cover cases where the carriage of goods was performed by a carrier other than the carrier entering the contract with the consignor. The actual carrier's liability was limited to damage occasioned by the acts and omissions of the carrier's servants or agents, whereas the contracting carrier was made vicariously liable for the acts and omissions of both the carrier's servants or agents and those of the actual carrier.

Since then there have been four further protocols, referred to as Montreal Protocols' No 1, 2, 3, and 4. Montreal Protocol No 4 limited air carrier liability for damage to goods to 17 SDR's per kilogram. An SDR is a standard drawing right, which is an internationally uniform unit of account defined by the International Monetary Fund. An SDR is usually worth about AUS$2. For the latest rates, visit www.imf.org/external/np/tre/sdr/sdr.htm.

The *Civil Aviation (Carrier's Liability) Act* 1959 (Cth) enacts in Australia the Warsaw Convention with Hague and Montreal Protocol 4 amendments. A copy of the Act may be downloaded from www.austlii.edu.au. The following is a discussion of the main provisions.

'International carriage' is defined as carriage where the place of departure and the place of destination are situated in the territories of two States who are party to the Convention (Art 1). Where carriage is performed by several successive carriers (such as where for example a cargo from Sydney to London is transhipped in Singapore) it is deemed, for the purposes of the Convention, to have been a single carriage operation (Art 1).

The standard document of carriage is an *air waybill* between the consignor (the sender) and the air carrier. It is not a negotiable document of title, as usually air carriage is too short for resale of the goods to take place during it. The carrier is to issue an air waybill for the cargo, or some other receipt for it (Art 4), made out in three originals (Art 7). The air waybill includes information such as the place of departure and destination, and the weight of the consignment

(Art 5). The consignor is responsible for the correctness of information relating to the cargo inserted on the air waybill by it or on its behalf, and, if incorrect, is obliged under Art 10 to indemnify the carrier against any damage suffered by it or a third person who relies on it.

On arrival of the cargo at the place of destination, the carrier gives notice of arrival to the consignee (Art 13). If the cargo is lost or damaged, both the consignor and consignee have the right to claim against the carrier for such loss or damage (Art 14). The carrier is *prima facie* liable for damage. If the event which caused the damage took place during the carriage by air, which includes when they are on the ground but within the aerodrome, the carrier is not liable if it can show that the loss or damage was the result of:

(1) inherent vice in the cargo;

(2) defective packaging;

(3) war; or

(4) an act of government/customs at the place of departure or destination.

As discussed on p 95, the carrier's liability is limited to 17 SDR's per kilogram. An exception to this limitation is where the consignor has made a special declaration of value of the cargo (Art 22). For example, let's say a package of 100kg of Chanel perfume is carried by air from France to Sydney, and arrives with damaged bottles and packaging. Assume no value was inserted in the air waybill, and the consignee claims for the full value of its loss, AUS$40,000. The carrier may seek to exclude its liability altogether on the basis the perfume was not properly packed for carriage, and, in case this cannot be proved, could argue in the alternative that liability should be limited to 17 SDR's per kilogram. The value of an SDR at the time of writing is AUS$2.17. Therefore liability may be limited to AUS$3,689 (17 x 2.17 x 100).

The kilogram limits are calculated based only on the weight of the lost or damaged packages, unless the value of the undamaged packages carried with the damaged packages is also affected. For example, if a consignment of canvas outdoor umbrellas with stands was subjected to water during carriage, such that the umbrellas arrived mouldy and unusable, the consignee could claim for the value of the umbrellas plus the value of the undamaged stands, because the consignee will be unable to sell the stands without the umbrellas.

The carrier does not have the freedom to contract for carriage of goods internationally on terms more favourable than that provided by the Convention. That is, the carrier cannot contract on the basis of no liability for loss or damage to the goods however caused. If the air waybill contains a provision such as this, the provision is null and void (Art 26). Of course the carrier does however retain the right to refuse to carry the goods altogether, as air carriers are not common carriers (such as some rail operators, who are unable to refuse to supply the service. Discussion of this topic is beyond the scope of this book).

A further *Montreal Convention* was signed in 1999 by 52 States, including Australia. It has not yet entered into force. It aims to supersede all previous conventions in the Warsaw system. It draws liability provisions from Montreal Protocol No 4. These provisions apply to delay as well as loss and damage to the goods. If a carrier can prove that it took all measures reasonably required to avoid damage caused by delay, it may avoid liability for delay.

In addition to the Conventions, the International Air Transport Association (IATA) have a standard form of air waybill. The conditions on the IATA air waybill provide that where no convention applies, the carrier's liability is limited to US$20 per kilogram. This occurs where the place of departure or destination is in a country which is not party to any convention in the Warsaw system.

Air cargo insurance

Given that the primary difference between air carriage and sea carriage is only in the gravity of the carrying vessel, and that marine insurance was in place for many years prior to the advent of aeroplanes, it is not surprising that air cargo insurance is commonly taken out in the marine insurance market. The Institute Air Cargo Clauses (1982) are modelled on the marine Institute Cargo Clauses. Similarly to Cargo Clauses A in marine insurance, Institute Air Cargo Clauses cover 'all risks' subject to stated exceptions, such as war and strikes, which are covered by Institute War Clauses (Air Cargo) and Institute Strikes Clauses (Air Cargo). Regular consignors of air cargo typically take out an annual policy covering all consignments by air during that period.

Alternatively, air cargo insurance can be provided under an air carrier's own policy, which is typically based on the Institute Air Cargo Clauses anyway. Insurance via the air waybill is suitable for persons who infrequently send cargo by air. A declared value may be

inserted into the air waybill, and in the event of loss or damage, the claim is paid at the declared sum. Where the carrier is also the insurer, there is no need for subrogation to take place.

Carriage of goods by land

Given that Australia is an island continent, it is impossible for international carriage of goods to take place by land. Therefore Australia has not become party to international conventions on international carriage of goods by rail or road. Such conventions are more applicable to countries sharing one continent, such as in Europe, Asia and the Middle East.

The *Convention Concerning the Contract for International Carriage of Goods by Rail* (CIM) was established in 1961. In 1980 it was incorporated into the *Convention Concerning International Carriage by Rail* (COTIF), to which CIM is annexed. COTIF is extensively applied in Europe. The contract of rail carriage is a through consignment note. The initial carrier is responsible for the goods even if other carriers are used. The CIM Rules are deemed to be incorporated into the contract of carriage if the goods enter at least two parties to COTIF. Where there are inconsistencies between the CIM Rules and the contract of carriage, the contract of carriage will apply where the term favours the sender and the CIM Rules will apply where the term favours the rail carrier. Liability is limited to 17 SDR's per kilogram. An SDR is a standard drawing right, which is an internationally uniform unit of account defined by the International Monetary Fund. An SDR is usually worth about AUS$2. For the latest rates, visit www.imf.org/external/np/tre/sdr/sdr.htm.

The *Convention on the Contract for International Carriage of Goods by Road* (CMR), concluded in 1956, applies where the country carriage commenced or the country of destination is a party to it. Liability is limited to 8.33 SDR's per kilogram. The CMR provides that if a vehicle containing goods is carried partly by sea, rail, inland waterway or air, without the goods being unloaded, the CMR applies to the whole of the carriage.

Domestic road and rail carriage are beyond the scope of this book, given that it is concerned with international trade law. However, where international carriage involves arranging a domestic road leg, it is important to note that if the road carriage terms and conditions include a provision that liability is limited to a specific sum, such a clause will be enforceable provided it is fair and reasonable for the

corporation to rely on it. In deciding what is fair and reasonable a court will consider all the circumstances, and in particular will look at:

(i) the strength of the bargaining positions of the parties;

(ii) whether the buyer received an inducement to agree to the term or had an opportunity of acquiring the goods or services under a contract that did not include that term; and

(iii) the buyer's knowledge of the existence and extent of the term.

For further reference see s 68A of the *Trade Practices Act* 1974 (Cth), a copy of which may be downloaded from www.austlii.edu.au.

Multimodal carriage of goods

'Multimodal' is simply 'many modes', meaning that the transportation of the goods involves a combination of sea, air, rail and road transportation. The large majority of transportation of internationally traded goods from Australia takes place by way of shipping, however in Europe road and rail transportation are most common.

The UNCTAD/ICC Rules for Multimodal Transport Documents were published in 1992, and can be incorporated into a contract of carriage. The Rules provide for a party who enters a multimodal transport contract (Multimodal Transport Operator (MTO)) and for a person who actually performs the carriage, in whole or in part. The MTO's responsibility covers the period from which it takes charge of the goods to the time of their delivery. The MTO is liable for any loss or damage to the goods unless it can show no fault or neglect on its part. There is a nine month limitation period from the time of delivery for the commencement of legal action in respect of loss or damage to goods.

Different conventions apply to each mode of transport, so effectively separate contracts need to be made to cover each mode of carriage, or an arrangement can be made whereby the first carrier acts as the consignor's agent and enters the other contracts itself. However CMR may apply if the goods remain loaded as per the first mode of transportation, for example in a shipping container which is transported by rail then sea then road, or in a truck which is then driven onto the ship. Difficulties arise in multimodal arrangements where the goods are damaged in transit but it is unclear at which stage the damage occurred.

In addition there is a *United Nations Convention on International Multimodal Transport of Goods* (1980), but it has not yet come into effect because it has not yet been ratified by the required 30 countries.

Customs

In Australia, the primary legislation for customs powers is the *Customs Act* 1901 (Cth) and the primary legislation for customs duties is the *Customs Tariff Act* 1995 (Cth). The government body administering customs is the Australian Customs Services. It is responsible for controlling the flow of objects into and out of Australia. This includes ensuring dangerous objects (such as guns and drugs) are not smuggled in, and valuable objects (such as Australian plants and animals) do not go out. Customs is also responsible for collecting revenue on dutiable goods.

Persons bringing objects in and taking objects out must declare those objects to Customs. Items below a nominal value may be brought in by travellers on a system of self-assessment and random checking. For objects imported or exported for trade purposes, a report must be provided to Customs, known as a customs entry. Customs will assume the entry is correct, and 95% of packaged cargo is brought in this way. This is known as the 'greenline'.

Under the 'amber line', customs randomly check 5% of packages, and if it is found that the customs entry contained an omission, or a false or misleading statement, the person is liable for duty plus a 200% penalty, and a possible criminal offence as well. When Customs check the goods, they are considered to be 'under the control of Customs', and during the time it takes for Customs to examine, count, measure, weigh or gauge them, they cannot be moved or interfered with except with Customs' authority.

On an international level, the Customs Co-operation Council was formed in 1950 to promote harmonisation of customs rules and procedures, so as to reduce transaction costs associated with international traders paying customs. It is now the World Customs Organisation, and is also involved in conciliating disputes regarding customs valuation, techniques, and nomenclature. Generally customs duty is applied at a rate of their customs value, usually at the contract price or market price. The rates are set out in classification rules.

To facilitate international trade, 'ATA carnets' are issued for temporary admission of goods such as commercial samples, goods required for international exhibitions, and laptop computers used for

business purposes. The 'TA' in ATA carnet stands for 'temporary admission', and is a temporary importation customs declaration issued by chambers of commerce or similar organisations in various countries. At the time of writing, the ATA Carnet was recognised in 47 countries including the United Kingdom, United States, and Australia. Further information on ATA Carnets, and details of State chambers of commerce in Australia, may be downloaded from www.austrade.gov.au/toolbar/publication/clients/The_ATA_Carnet %20_System.doc.

The *Convention on Nomenclature for Classification of Goods in Customs Tariffs* (1950) provided the divisions of goods and a means of describing them. The modern development from this is the *WTO Agreement on Implementation of Article VII of the GATT*, which concerns valuation rules, and sets out methods for valuing imported goods for customs purposes.

Each country has the power to set their own tariffs on goods, and their own rules and procedures for administering the customs function, subject to any international agreement they have entered into. For example, parties to the *United Nations Educational, Scientific and Cultural Organisation (UNESCO) Agreement on the Importation of Educational, Scientific and Cultural Materials*, undertook not to apply customs duties or other charges on goods brought into or out of their country which are educational, scientific or cultural in nature. For example, paintings to be exhibited, artefacts to be restored, or specimens to be examined.

In June 2001 *The Customs Legislation Amendment and Repeal (International Trade Modernisation) Bill* 2001 was passed through Parliament. It modernises Australia's cargo management systems through legislation of the Cargo Management Re-engineering project, which involved lengthy consultation with industry. The new systems allow for electronic customs entry, and for the one electronic document to allow for the generation of ancillary transport documents. This will save a great deal of the re-keying of information currently involved in international carriage operations, which results in high levels of errors in documentation. This will in turn reduce processing and handling costs.

For further information on Customs visit www.customs.gov.au.

Passing of property

The passing of property from the seller to the buyer in an international sale of goods transaction occurs at the time stipulated by the parties in the contract. Difficulties arise where this is not specified.

Romalpa (or retention of title) clauses enable the seller to retain property in the goods until such time as the buyer has fully paid for them. Two main issues arise:

The scope of the retention of title clause

The Romalpa clause can apply to the subject goods *in specie* or can be of general application to any goods delivered from the buyer to the seller where an amount remains outstanding. The name is derived from a landmark decision of Justice McCotter, *Romalpa Aluminium Ltd v Aluminium Industries* (1976), which involved the sale of aluminium. A clause in the contract of sale enabled Romalpa to retain full ownership of any materials delivered until all moneys were received. Romalpa sought to enforce the clause when Aluminium Industries went into receivership, and the issue arose as to whether the clause took priority over secured creditors, or whether it rated further down the list as an unsecured creditor. While previously the English position was that a charge over the goods had to be registered (so as to be fair to third party interests), it was held that the contractual clause was sufficient to create a primary right for payment.

The priority of the seller's claim to the goods

If a company goes into liquidation it is most likely there are a number of unpaid creditors, and the issue arises as to the seller's claim to the goods as compared to secured and unsecured creditors. The local laws regarding insolvency may also apply. Take for example the domestic law in Australia. The pecking order of creditors begins with mortgagees and other secured creditors, then unsecured creditors, and trade creditors appear quite a way down in the list. A retention of title clause may, however, assert their position at the top of the list, or to be more exact, exclude the particular goods from the list altogether.

A difficulty arises as to tracing. To what extent can the Romalpa clause be applied to goods which are used by the buyer in a manufacturing process, such as where grapes are used to make wine? If the clause is to apply such that the seller retains title in the goods even when they have been onsold to a third party, this creates a difficult situation for that third party who purchases the finished goods without knowledge of the title retention.

In *Associated Alloys Pty Limited v ACN 001 452 106 Pty Ltd (In Liquidation)* (2000), the High Court examined the effect of a retention of title clause which provided for the proceeds from the manufacture and sale of goods by a buyer to be held on trust for the seller. The part of the proceeds to be held on trust was equal in dollar terms to the amount owing by the buyer to the seller at the time of receipt of the proceeds. The majority of the Court held that a trust had been properly created in favour of the seller. From the time the trust is constituted the debt under the contract is discharged, so the seller's right shifts from one in contract (payment of contract price) to one in equity (performance of a trust).

Payment

There are three main methods of payment in international sale of goods transactions:

(1) direct payment – by telegraphic transfer or bankers' draft, either in advance, on delivery, or at an agreed time after delivery, such as 7 days or 30 days;

(2) payment under a bill of exchange (also known as a documentary collection) – the seller attaches the bill to the transit documents, the buyer makes payment and receives the documents it needs to obtain release of the cargo;

(3) payment under a letter of credit (also known as a documentary credit) – the buyer's bank opens the letter of credit. The seller ships the goods and presents the shipping documents at the buyer's bank in the seller's country. The buyer's bank checks the documents are correct, pays the seller, and sends the shipping documents to the buyer.

Note that a letter of credit is presented and paid in the seller's country, whereas a bill of exchange is presented and paid in the buyer's country.

Bills of exchange

A bill of exchange, or 'draft', is a negotiable instrument drawn by the seller (referred to as the 'drawer') on the buyer (the 'drawee'). It may be payable on demand ('at sight'), or at a stated period of credit (for example, 180 days). The bill of exchange is attached by the seller to the shipping documents, and is forwarded to a bank in the buyer's country with the seller's instructions. The buyer attends, examines the documents, and if a *sight bill*, pays the amount on its face, or if a *time bill*, signs to acknowledge an obligation to pay at the end of the stated

time period, referred to as the 'maturity date'. The buyer then obtains the shipping documents, which enable it to obtain release of the cargo.

A bill is negotiated where it is sold at a discount to a third party. That third party pays a lesser amount on the face and then, at maturity, obtains the value on the face of the bill. This suits the seller's cash flow, and it suits the third party, who is able to profit from the difference between what it bought the bill for and its face value. The third party is known as a 'holder in due course' provided the third party took the bill in good faith and for value, before maturity, and without notice of any defect in the title of the person negotiating it or of any dishonour of the bill. 'Dishonour' refers to non-payment by the buyer, in the case of a sight bill, or non-acceptance, in the case of a time bill.

The *Bills of Exchange Act* 1909 (Cth) deals with negotiable bills, payable to order or to bearer. A bill is payable to order where it is expressed to be payable to a particular person, and a bill is payable to bearer where it is expressed as such, or where the last indorsement was a blank indorsement. Section 22 of the Act provides that in order for acceptance of a bill by a drawee to be valid, it must at least be signed by the drawee, on the face of the bill, and it must not express that the drawee will perform its promise to pay by any other means than payment in money. Section 32 provides that a holder for value is a third party who gives valuable consideration for the bill, and s 34 provides for holders in due course, as discussed above. Under s 35, it is assumed that every holder is a holder in due course, unless proved otherwise. Section 43 provides that a holder in due course holds the bill free from any defect of title of prior parties, and may sue in the bill in his own name.

The Act also deals with foreign bills, as opposed to inland bills. Any bill which is not drawn and payable in Australasia is a foreign bill. If it is not evident on the face of the bill whether it is a foreign or inland bill, it is treated for the purposes of the Act as an inland bill. Section 77 provides that where a bill of exchange is drawn in one country and negotiated, accepted or payable in another, questions as to the validity of the bill, and acceptance are determined by the law of the place of issue, and questions as to dishonour are determined by the law of the place dishonour occurred.

Under s 53, where a bill is dishonoured by non-acceptance or by non-payment, notice of the dishonour must be given to the drawer and to each indorser, and s 54 provides that this notice must be given within a reasonable time of the bill being dishonoured. The usual procedure is that a dishonoured bill is 'noted and protested'. This

involves the drawing up of a statement of dishonour which is signed and dated by a notary public. It is essential in the case of foreign bills, as under s 56, if a bill is not noted and protested the drawer and indorsers are discharged from liability under the bill.

Internationally, the *Uniform Rules for Collections* (URC), issued by the International Chamber of Commerce apply where they are incorporated in the contract between the seller and the bank, typically appearing on the face of the seller's instructions. A 'collection' is defined as the handling by banks, on instructions received, of documents in order to obtain acceptance or payment. 'Documents' includes financial documents, such as bills of exchange, and commercial documents, such as bills of lading. Where there are commercial documents attached, this is referred to as a 'documentary collection'. Otherwise it is known as a 'clean collection'.

In 1931 the *Convention on the Unification of the Law Relating to Cheques (Uniform Law on Cheques)* was concluded, and entered into force in 1934. Additionally, the *United Nations Convention on International Bills of Exchange and International Promissory Notes* (1988) was developed to define the various parties involved in a bill of exchange, the rights and liabilities of holders, and the procedures on presentment for acceptance, dishonour by non-acceptance, and the holder's right of recourse. It applies where an international bill of exchange contains in heading and text 'International bill of exchange (UNCITRAL Convention)'.

Documentary letters of credit

This is by far the most common method of payment in international sale transactions. It suits the buyer and seller as both deal with a bank, which is more secure than merely relying on the other trader for payment.

There are several types of letters of credit the banks provide. The list below is arranged in order from the least secure to the most secure letter of credit:

(1) Revocable credit – the seller has no guarantee that the bank will pay, as the credit can be revoked at any time.

(2) Irrevocable unconfirmed credit – the correspondent bank is merely the agent of the issuing bank, so if the seller is not paid the seller has to sue the issuing bank in a foreign country.

(3) Confirmed credit – the correspondent bank confirms that payment will be made upon presentation of the documents.

Where a party has not elected whether the credit is to be revocable or irrevocable there is a presumption of irrevocability. A seller's bank will be more prepared to advance credit to the seller to bridge the gap between dispatch of the goods and receipt of payment if there is a retention of title clause in the underlying contract for sale.

Brokers of goods often arrange 'back-to-back' letters of credit. The broker will arrange purchase of the goods in one transaction and sale of the goods in another, both involving payment by letters of credit. Provided the documents required by each letter of credit are identical, the broker is able to assign the rights in the second credit to the issuing bank in the first, so effectively it is the buyer's credit that is used to finance the purchase.

In long term agreements the parties negotiate pro-rata payments for pro rata performance, so that payment is staggered over the course of the project or agreement.

The procedure for a letter of credit is:

(1) The seller and buyer agree to use this form of payment.

(2) The buyer asks their bank, the *issuing bank*, to open the credit.

(3) The issuing bank contacts their branch in the seller's country, or if the issuing bank does not have a branch, another bank in the seller's country, known as the *correspondent bank*.

(4) The relevant bank in the seller's country contacts the seller to advise that a letter of credit has been opened.

(5) The seller ships the goods, obtains the documents and presents them at the relevant bank in their country.

(6) The correspondent bank examines the documents within a reasonable time, and pays the seller. The time period for payment depends on the letter of credit – it can be payment on sight, or deferred payment.

(7) The correspondent bank sends the documents to the issuing bank and the issuing bank reimburses the correspondent bank.

The issuing bank will not always have a branch in the seller's country, and where another bank is presented with the documents, they are described as the *confirming bank*. The relationship between banks is regarded as an agency contract, however difficulties arise if the confirming bank pays against documents which the issuing bank deems as discrepant, or if the initial letter of credit was fraudulent. Generally if fraud occurs the issuing bank pays the confirming bank who then takes the matter up with the party who committed the fraud. In *Banco Santander v Bayfern* (1999) a confirming/negotiating bank

discounted a deferred payment credit without authority from the issuing bank and was held to bear the risk of fraud from the beneficiary which was discovered after discounting but before maturity.

A letter of credit forms a contract between the issuing bank and the buyer. The bank follows the instructions given by the buyer, and the buyer reimburses the issuing bank for sums paid by the correspondent bank to the seller. The buyer also pays the issuing bank a service fee or commission for processing the letter of credit. If the letter of credit is a confirmed credit, an additional contract is formed between the seller and the confirming bank.

A court will only interfere with the machinery of irrevocable obligations in exceptional circumstances. In *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* (1978) an English party entered three contracts of sale with guarantees made payable on demand by the bankers. They then considered the guarantees to be of too great a benefit to the Egyptian buyers and sought an injunction to stop the bank demanding payment. The decision was one of public policy for the protection of the banks in the interest of the reliability of the documentary credit, that any shortcomings in the terms of the initial contract should be resolved between the parties in the form of damages and not seek redress through interference with the credit transaction. This quarantining of the banks by the courts is rebuked by traders who argue banks have better inside knowledge.

Where disputes arise, there is some argument as to the law applicable to the letter of credit. In *Power Cuber International Ltd v National Bank of Kuwait SAK* (1981) a credit was issued in Kuwait but before it was paid the sales agent filed a claim in Kuwait for moneys owed, and a 'provisional attachment' applied to prevent further payments under the letter of credit. A suit in breach of contract was brought in England and the English court held the applicable law to be North Carolina as this was the place the letter of credit was physically situated. The provisional attachment only applied to the Kuwait branch of the bank and not to the branches, and the payment could be made in the English branch.

The *Uniform Customs and Practice for Documentary Credits*, known as the ICC Code, is a set of standardised rules on banking practice which are voluntarily accepted by banks around the world as a standard form for handling documentary credit transactions. It has also been recommended for use by UNCITRAL (see p 71, above, for more information on UNCITRAL). The UCP rules stipulate the basis for

which credit can be granted and specify the conditions under which a bank can make payment. There is a duty on banks to verify information, and payment typically occurs when the seller presents the letter of credit documents and a clean bill of lading.

Since 1993 the amended version of the rules, known as UCP 500, has been used. The buyer is described as the 'applicant' for the documentary letter of credit and the seller as the 'beneficiary'. If the seller's interests are transferred to another party that other party is described as a 'secondary beneficiary'. From the view of traders all stages of the documentary letter of credit form one transaction, but in fact the separate steps result in separate contracts. Article 3 of UCP 500 states that the documentary credit is separate from the underlying contract of sale. The contract of sale will contain a condition that a letter of credit be opened, and if the buyer fails to open a letter of credit this is a breach of contract. Alternatively, the letter of credit can be made a condition precedent to the sale contract, which means that the contract of sale does not come into existence until the buyer opens a letter of credit.

Article 4 states that the parties in a credit transaction deal in documents and not in goods, so effectively the parties are buying and selling documents irrespective of the subject matter of the underlying contract of sale. It is essential with letters of credit that documents presented strictly comply with the requirements set out in the letter of credit. The doctrine of strict compliance is regarded as a protection for the banks who are assumed to have no knowledge of the subject matter of the underlying contract of sale. For this reason the UCP 500 specifies requirements as to what documents correspondent banks may accept and what they may refuse. The bank has a duty to ensure the documents comply 'on their face', which means that the banks determine compliance solely on the basis of an examination of the documents themselves. The bank is not expected to assess their authenticity. In examining the documents, the bank must exercise reasonable care. Provided the correspondent bank pays under a letter of credit which appears on its face to be compliant, the correspondent bank is entitled to reimbursement from the issuing bank.

While the above procedure is illustrative of the payment method as between the buyer and seller, in practice it is most often the case that the goods in the underlying contract of sale will never be sighted by either the buyer or the seller, but go to third parties.

UCP 500 was envisaged for export commercial contracts so where it was used for standby letters of credit, adaptations had to be made.

A standby letter of credit is used to support payment of obligations upon the occurrence of a contingency. For example, it could be a financial standby, which comes into play if the buyer becomes insolvent. The *International Standby Practices* (ISP 98) has been developed for standby letters of credit and can be used for domestic and international transactions, if the parties agree for it to apply. ISP 98 contains 89 rules, covering the bank's obligations, presentation, examination of documents, notice of discrepancies, assignment of proceeds, cancellation, and standby letters of credit with more than one issuer (syndication). There are not major differences between ISP 98 and UCP 500, although the period for notice of dishonour is shorter (three days under ISP 98 and seven days under UCP 500). This means banks handling standby letters of credit must efficiently examine documents and notify the beneficiary of discrepancies.

In addition to the ICC initiatives, the United Nations has prepared an *UNCITRAL Model Law on International Credit Transfers* (1992), and a *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (1995).

Managing payment risk

Each of the payment methods described above has different levels of risk for the buyer and seller. Cash with order is the most risky method for the buyer, and open account has most risk for the seller. The Export Finance Insurance Corporation (EFIC) was established in Australia under the *Export Finance And Insurance Corporation Act* 1991 (Cth) to assist Australian exporters in managing the risk of payments not being received from export sale transactions. Section 7 of the Act states that the functions of EFIC are to:

(1) facilitate and encourage Australian export trade by providing insurance and financial services and products to persons involved in such trade;
(2) encourage banks and other financial institutions in Australia to finance export contracts;
(3) handle payments made by the government in relation to overseas aid projects that involve the making of payments under export contracts; and to
(4) provide information and advice regarding insurance and financial arrangements to Australian exporters.

A full copy of the Act may be downloaded from www.austlii.edu.au.

In practice, the major offering of EFIC is export credit insurance. In return for payment of a premium by the exporter, EFIC agrees to

indemnify a seller against non-payment by an overseas buyer under an export contract of sale. This cover is for 'commercial risks', and includes situations where the overseas buyer becomes insolvent and therefore unable to pay the contract price. EFIC typically provides cover to 90% of the value of the claim, meaning that the exporter bears 10% of the loss suffered. Policies can be specific (taken out to cover a specific export transaction) or comprehensive, which cover exports to approved overseas buyers up to a credit limit set by EFIC. For example, an exporter may sell hides and skins to three buyers in the Philippines, one of whom has a credit limit of AUS$1,600,000. This means that the exporter can have up to AUS$1,600,000 outstanding from the Filipino buyer at any one time and still be covered by insurance. As with all insurance policies, the exporter as insured has a duty to disclose to EFIC any circumstances known to it which affect the credit worthiness of the overseas buyer. This may result in a variation of the credit limit for that buyer.

Banks may be involved in bills of exchange by 'discounting'. This is where the bank pays the seller an amount less than the amount on the face of the bill of exchange, and then the bank recovers the full amount from the buyer at the date payment under the bill of exchange falls due. This suits the seller, who would rather get the money earlier, albeit a little less than the full amount. In the event the buyer does not pay at maturity, the bank may have recourse to the seller, unless the bill of exchange was discounted on a 'without recourse' basis. To facilitate such an arrangement, EFIC has in the past insured against the risk to the bank that a bill of exchange discounted to an exporter on a 'without recourse' basis is not paid by the overseas buyer.

EFIC also provides political risk cover to exporters. Political risk includes the risk that a law or administrative act by the government of the overseas buyer:

(1) prevents transfer of the payment from the buyer to the seller;
(2) prevents the goods being entered for import into the buyer's country;
(3) results in the cancellation of an import licence;
(4) results in delay or diversion of the voyage, or additional costs in storage, handling, transport; and
(5) in situations where the overseas buyer is the overseas government, results in payment not being made and not being able to be recovered.

It was not the intention in establishing EFIC to create a government lending instrumentality which competes with private banks. The aim is for banks to take up as much of the business as possible, with EFIC being used to manage risks which private banks assess as too great to be commercially feasible. For example, EFIC may support private banks lending money to Australian companies in relation to an overseas project involving the supply of Australian raw materials, goods, equipment and technology. This support may be through the provision of political risk insurance on the loans made, or by reinsuring a percentage of the bank's liabilities.

Currency issues

Just as supply and demand for particular goods varies, so does supply and demand for particular currencies, reflected in fluctuating exchange rates. Where fluctuations in exchange rates are marked, this can have a significant impact on the bottom line profits of international traders. Take for example an Australian trader who typically makes AUS$1000 profit on the sale of AUS$8,000 worth of goods domestically. A Thai buyer offers to pay the Australian seller 72,000 baht for equivalent goods. At an exchange rate of 8:1, this equates to AUS$9,000 and, after deducting additional freight and insurance costs, the Australian seller sees it is able to net AUS$1,500. This is AUS$500 more profit than the seller could make domestically. The seller ships the goods, and, 30 days later, receives payment of 72,000 baht. However, the exchange rate has dropped to 9:1, so the 72,000 baht is now worth only AUS$8,000. From this, the seller has to deduct freight and insurance costs, resulting in a net profit of only AUS$500, half what the seller could have made had it simply sold the goods domestically.

The seller in the above example may have been better off making the contract in a more stable currency, one in which there are likely to be only slight exchange rate fluctuations. One such currency is US dollars, and many international trade contracts are expressed in US dollars, even though neither party is from the United States. Many Australian companies operate US dollar accounts in addition to their Australian dollar accounts. The contract price may also be expressed in relation to some other benchmark, such as 4,500 SDR's. An SDR is a standard drawing right, which is an internationally uniform unit of account defined by the International Monetary Fund. An SDR is usually worth about AUS$2. For the latest rates, visit www.imf.org/external/np/tre/sdr/sdr.htm.

Alternatively, the Australian seller could have 'hedged' by selling the 72,000 baht today, for delivery in 30 days. Someone who expects the exchange rate for baht to rise, say from 8:1 to 7:1, will be willing to pay 8:1 now (AUS$9,000) for delivery of the 72,000 baht in 30 days, when that person expects AUS$9,000 worth will buy only 63,000 baht. This is known as a 'forward' foreign exchange transaction.

Hedging provides a degree of predicability for traders, and large traders with foreign exchange reserves are at a significant advantage as compared to smaller firms. In addition to this smaller traders are charged more for smaller transactions. In 1983 the currency market was freed up to allow traders to legitimately operate foreign current accounts. Commonly large traders now hold accounts in US dollars, francs, deutschmark, and yen, and they are able to finance transactions inhouse rather than through banks. Currently around 60% of international trade transactions are intra-company financed. This has resulted in a decline in demand for bank services in international documentary credit transactions, and the banks are now focusing on derivatives markets instead.

Countertrade

Countertrade involves a barter type arrangement, where payment is made in goods or services rather than in currency. For example, selling aluminium from country A in return for rice from country B, which can then be onsold by the party from country A to a party in country C for cash. Countertrade is often used where an international trader negotiates to sell goods into a developing economy where the currency is difficult to use on the world market, or when selling into a socialist economy where the government only allows payment for imported goods using domestic goods.

Countertrade returns parties back to an assessment of the underlying currency value of the goods being traded as a means of defining the value of goods being exchanged. Negotiation is had in quantity and quality rather than in market price. Alternatively a 'merged contract' can be used, which is basically two contracts for the sale and purchase of each commodity or good being countertraded, each stating a sum of money to be paid, and a further clause providing that the parties agree to deliver the goods and merely exchange the difference in the contract prices. This effectively creates a 'shadow price' for the products flowing in each direction.

An ingenious example of countertrade was that of Coca-Cola, who established a bottling plant in Kenya. Kenyan money was difficult to use on the world market so Coca-Cola bought a 20% interest in Paramount Pictures, and a film 'The Gods Must be Crazy' was filmed in Kenya with actors paid in Kenyan money. The film was then screened in countries like Australia and the proceeds converted into US dollars. Clearly to orchestrate this worldwide required a sizeable organisation.

Other forms of countertrade include compensation deals, where a foreign company builds an industrial plant and agrees to be paid by a percentage of production. French car manufacturer Renault entered into a countertrade agreement with Poland where Renault agreed to take payment for the establishment of an assembly plant in Poland by way of pork and poultry. The difficulty was that France, being a member of the European Union, had to comply with an EU agricultural policy which dictated quotas, so Renault had great difficulty offloading the pork and poultry elsewhere. It was used for staff meals at the assembly plant and before long, workers who were fed up with pork and poultry meals went on strike and Renault went from having a financial issue on their hands to an industrial relations issue!

The absence of a monetary exchange may remove the risk of currency fluctuations but this is replaced by the risk of a drop in the market for the goods received as payment. It is difficult to enter into a meaningful long term contract by way of countertrade, because this requires an educated guess at what will be the future value of the goods.

There is also some difficulty created by the absence of a monetary exchange in calculating customs duties and deciding damages where the goods traded are not as agreed. Poor quality is a common difficulty encountered by international sellers, and therefore when entering countertrade agreements it is important to specify the method by which damages are calculated. The agreed method should be incorporated as a clause in the contract of sale. Two workable methods are as follows. The first is by calculating the expectation loss by the party not in breach, which is the difference between the expected and actual value of the goods received. The second is by calculating the difference between the value of the goods provided by the non-breaching party and the actual value of the goods they received.

A variant on countertrading is compensation trading, or buy back transactions. This is where the buyer may make partial payment for

the goods provided through delivering back some of the resultant product. For example, a purchaser of hides and skins who makes partial payment through leather jackets produced from them. This arrangement is to be distinguished from industrial co-operation ventures, where a company invests overseas by providing equipment or building a factory and then buys goods produced in the factory.

The *UNCITRAL Legal Guide on International Countertrade Transactions* was adopted in 1992 to identify the legal issues involved in countertrade transactions. It discusses the approach parties can use to contracting, and deals with issues such as quality and quantity of goods, pricing, payment, third party involvement, security for performance, settlement of disputes, as well as financing and insurance considerations. A copy of the full text of the *Legal Guide on International Countertrade Transactions* may be downloaded from www.uncitral.org under 'Adopted Texts' and then 'International Sales of Goods and Related Transactions'.

Taxation

The rise in international trade has corresponded with a rise in tax legislation in various countries, each seeking to bring international businesses within their tax system. Taxation should be carefully considered at the time companies decide which method by which to establish a presence in a foreign market, because different arrangements have different tax consequences. For example, where licensing agreements are entered with foreign businesses, if tax is deductible at source, this may have significant cash flow consequences for the licensor, as it may prevent the licensor from minimising tax liability.

An importer or exporter who merely sells or buys goods into or out of a market will typically be outside the foreign country's taxation system, with the exception of taxes such as sales tax. However, where a foreign subsidiary or branch is established, such that the foreign company has a physical presence in that country, the foreign company is likely to be subject to taxation. Tax liabilities are determined by domestic legislation in each country.

To prevent situations where companies are required to pay taxation both at home and abroad, known as 'international double taxation', a number of countries have entered double taxation agreements, which typically provide that business profits are taxed in the home country unless the business has a 'permanent establishment'

in the foreign country. The interpretation of what constitutes a permanent establishment varies considerably, from establishment of a wholly owned subsidiary to merely having an agent present in a foreign country with the power to enter into contracts on behalf of the company.

Where companies who have paid tax on profits from an overseas branch in the overseas country are exempt from taxation on those profits in their home country, it is in their interest to shift profits to countries which have low rates of taxation. This may be achieved, for example, by selling goods from a high tax jurisdiction to a branch in a low tax jurisdiction at a price at which the company in the high tax jurisdiction does not make a profit. The branch in the low tax jurisdiction then resells the goods at normal market prices, with profits from the sale being taxed at its low rate. This is known as 'transfer pricing'.

An example of an international taxation agreement is the *OECD Model Tax Convention*, which was drafted in 1963 and has been periodically revised. The Convention:

(1) agrees which types of income are to be taxed in the home and foreign country; and
(2) agrees that where another OECD member has already taxed income, that income will be exempt from taxation in the income earner's home country.

Income from immovable property is to be taxed in the country in which the property is located (Art 6). This would apply, for example, to income from a farm. Income from business activities attributable to a permanent establishment in a country are to be taxed in that country (Art 7). Article 9 aims to avoid transfer pricing by making an adjustment in the profit of the branch in the low tax jurisdiction to reflect the diversion of profits to it.

Article 23 deals with methods for the elimination of double taxation. It provides that where a resident in an OECD country derives income which may be taxed in another OECD country, the first OECD country will exempt such income from tax, and will allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in the second OECD country. The first OECD country is, however, entitled to take the exempted income into consideration in determining the tax applicable on the remaining income.

The full text of the *OECD Model Tax Convention* may be downloaded from www.oecd.org under 'Taxation'. The OECD has also published *Transfer Pricing Guidelines for Multinational Enterprises*

and Tax Administrations, which may also be downloaded from the OECD website.

In countries where a goods and services tax (GST) or value added tax (VAT) apply, there are typically exceptions for exported goods. For example, in Australia the *A New Tax System (Goods and Services Tax) Act* 1999 (Cth) which applies a GST of 10% on sales of goods, excludes export sales from GST. In practice, this means that an Australian exporter of a finished good will pay GST on materials purchased to manufacture that finished good, and may claim back input tax credits for such GST paid when the goods are exported. A copy of the GST Act may be downloaded from www.austlii.edu.au.

Liability for breach of sales contract

Where a party to a contract fails to perform its part of the bargain, that party may be liable for damages the other party suffers as a result of that breach. The remedies for breach of sales contract depend on the applicable law. If a domestic sales contract which provides for New South Wales law to be the governing law of the contract, then the *Sale of Goods Act* 1923 (NSW) applies. Visit www.austlii.edu.au to read this Act. It will not be further discussed here as this is a book on international trade law. If an international sales contract which provides for the law in force in New South Wales to govern the contract, then the *Sale of Goods (Vienna Convention) Act* 1986 (NSW) applies. This gives force to the Vienna Convention in New South Wales. For a general discussion on the Vienna Convention, refer to p 74, above. There are two main remedies under the Vienna Convention – specific performance and damages.

In relation to specific performance, if a party fails to perform its obligations under the contract, the other party may require that party to do so (unless it has already resorted to a remedy which is inconsistent with this requirement). For example, if the goods delivered did not conform to the contract, the buyer may require the seller to deliver substitute goods, or to remedy the lack of conformity by repairing them, or may reduce the price in the same proportion as the value the goods delivered bore to the value of conforming goods at the time. The complaining party may fix an additional period of time for the other party to perform its obligations, during which period that party may not resort to any remedy for breach of contract. If the other party does not perform its obligations within the

additional time period, the complaining party may declare the contract avoided.

In relation to damages, the complaining party may claim a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach, provided such damage was foreseen (or ought to have been foreseen) by the breaching party as a consequence of a breach at the time the contract was concluded. For example, if the seller failed to deliver the goods, the buyer may purchase substitute goods, and is entitled to claim for the difference in price paid for the substitute goods, as well as any associated costs such as carriage of the goods where they were sourced from another country.

The complaining party has an obligation to take reasonable measures to mitigate its loss, including loss of profit, resulting from the breach. If the complaining party fails to do so, its damages may be reduced by the amount the loss should have been reduced. For example, if the goods delivered to the buyer did not conform to their contractual description, and the buyer makes a substitute purchase, the buyer should either return the non-conforming goods to the seller, or if this is not feasible, sell the non-conforming goods by way a salvage sale, with the proceeds going towards reducing the buyer's damages. If the buyer fails to do this and as a result the goods are no longer saleable (if perishable foodstuffs or obsolete equipment), the buyer's damages will be reduced by the amount the buyer could have got for the goods in a salvage sale.

The complaining party may be able to bring additional claims against the breaching party, such as a claim for breach of warranty, misrepresentation at common law, or misleading and deceptive conduct under s 52 of the *Trade Practices Act* 1974 (Cth).

Breach of warranty

Where a warranty is expressly incorporated into a contract (for example 'the seller warrants that it has title to the goods the subject of this sale') and there is a breach of that warranty, the complaining party may incorporate into its claim for breach of contract a breach of express warranty. In other contracts, warranties are implied into them to give the contract efficacy. For example, an implied warranty that the goods will be fit for the purpose for which they were purchased. If the goods were not so fit, the complaining party may claim for breach of implied warranty.

Negligent misrepresentation

Where a party makes a representation which is not incorporated into the contract of sale, and which the buyer relies upon, the buyer may claim for damages for negligent misrepresentation. For example, if the seller said that the car the buyer was purchasing was one of only 100 produced worldwide, and the buyer, relying on that representation, thinks the car is a good buy at the price it is being offered at and goes ahead with the purchase, and then finds out 100,000 of that model car was produced, which makes the car less rare and valuable, then the buyer may claim against the seller for negligent misrepresentation.

Section 52 of the Trade Practices Act 1974

This section simply provides that a corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive. The consequences of a failure to comply with this section is an entitlement for the affected party to claim for damages, under s 82 of the Act. For example, a seller of fertiliser sends an analysis report on the fertiliser to the buyer, showing a breakdown of its composition by weight. Rocks are not listed in the composition. The buyer gets the fertiliser, uses it on his crops, and finds large rock fragments in it. The analysis report was misleading and deceptive, in that it made the buyer believe there were no rocks in it, when in fact there were. It can be further misleading or deceptive conduct if the seller, hearing the buyer comment 'it's good to see there's no mention of rocks in this report' does not say anything to correct the buyer.

With the exception of claims for breach of contract under the Vienna Convention, the usual entitlement to damages is limited to those which directly flow from the breach. This would cover, for example, additional cartage costs (if the seller delivered the goods to the wrong outlet of the buyer) but would not cover consequential losses such as loss of profit (sales lost as a result of not having the goods at the correct outlet at the correct time) or economic loss (where the goods were components for the manufacture of other goods, and the factory production cannot continue until the goods arrive).

There is a general overriding principle that the parties are free to contract on whatever terms they wish. They have the freedom to allocate risk between them. For example, if I was selling a crane, I run the risk that it is not fit for the purpose of lifting steel chains. However, I could sell it at a lower price on the basis that the buyer gets the crane as is, working or not. The risk that the tractor is not fit for the purpose of lifting steel chains then falls on the buyer. This risk allocation has

formed part of the bargain struck between the parties, and will be enforceable.

The parties may also agree in their sales contract that if there is default by one party, that party will pay the other party damages in a fixed sum. This is known as a 'liquidated damages' clause. For example, a contract for the sale of certain machinery may provide for damages of AUS$1000 per day if delivery takes place after a specified date. This saves the buyer from having to go to court to assess damages payable by the seller for delay. Such a clause will be enforceable provided it is not found by a court to be a 'penalty', which is unenforceable. A liquidated damages provision becomes a penalty if the sum provided for is disproportionate to the true measure of damages.

In certain circumstances a breaching party may be able to exclude liability altogether. Two such circumstances are the occurrence of a force majeure event, or a frustrating event. *Force majeure* is discussed at p 78, above. The doctrine of frustration is often confused with force majeure. A contract becomes frustrated when the commercial aims of the parties to it are unable to be reached due to intervening circumstances which were not in existence at the time the contract was entered and, had they been, or had they been predicted, the parties would not have entered the contract. The frustrating event must occur after the contract is formed but before performance is due. For example, a contract of sale of certain paintings is frustrated if while in storage awaiting delivery they are destroyed by fire. A contract of sale for rubber is frustrated where the buyer's government introduces an embargo on importation of rubber. The legal effect of frustration is that the contract is terminated and the parties are discharged from performance of their contractual obligations.

Product liability

Where products the subject of an international contract of sale cause loss or damage, the designer, producer or distributor of the product may be liable in damages. The loss may be caused by a defect in the design of the product, the method of manufacture, or a failure to provide adequate safety information or instructions with the product. A defect occurs where a product's standard of safety is lower than can reasonably be expected.

There are three main models of product liability. The first is a strict liability model, under which a claimant need only prove that the loss

was suffered, without there being a requirement of fault on the part of the manufacturer. The second is a qualified liability model, under which the manufacturer's liability is qualified, for example only to circumstances where the manufacturer should have discovered the defect. The third model is the traditional fault-based system of liability.

International product liability is a difficult area, because the plaintiff has the right to choose where to commence an action. Commonly actions are commenced in the place where the loss occurred, but if the manufacturer does not have sufficient assets in that State against which judgment may be enforced, the plaintiff will often commence action in the manufacturer's State. Australian courts apply a tough test of jurisdiction. Where a foreign consumer suffers loss from an Australian product and commences action in an Australian court the court will not find it has jurisdiction unless the conduct complained of could be litigated if it occurred in Australia and that it was against the law in the plaintiff's State.

In addition to statutory regulations in this area a plaintiff may sue in contract or tort.

Contract

Where the Vienna Convention applies (refer to p 74, above, for more information), there is an implied term under Art 36 that the goods are reasonably fit for the purpose they were bought, and that they be of merchantable quality. The seller is not liable where the defect would have been obvious from a reasonable inspection of them. Also, pursuant to Art 6 of the Vienna Convention the parties are able to exclude the implied terms of reasonableness by incorporating a term to that effect in the contract of sale.

If the Vienna Convention does not apply there is less likelihood of success in suing in contract because of the doctrine of privity of contract.

Negligence

Where the Plaintiff can succeed in establishing loss directly related to a breach of a duty of care owed by the manufacturer of a product, the manufacturer may be liable in negligence for damages. Where the plaintiff has contributed to the loss damages are reduced proportionately. It may not be sufficient for the manufacturer to argue that the action was reasonable because it is standard in the industry concerned, however it is a good defence if the loss occurred as a result of the manufacturer's compliance with a statutory obligation.

Nuisance

Where the use of a defective product caused damage to some person other than the consumer of the product, the tort of nuisance may be used to ground liability. This is often used where the use of the product results in pollution which in turn causes damage.

Statutory provisions

In Australia the *Trade Practices Act* 1974 (Cth) (TPA) provides for damages under s 82 where the loss flows from misleading or deceptive conduct as defined in s 52. For example, where it was falsely represented that the product could be used to carry a weight greater than it could in fact carry. Under the TPA prescribed safety information can be required for the supply of certain goods, and where a defect is discovered in design, a product can be recalled.

In the US and the EU there are strict liability provisions for product liability. The manufacturer of a product can be held liable even where there has been no negligence on its part. In addition some courts in the US award exemplary damages against companies whose products are defective.

7 Dispute Settlement

You should be familiar with the following areas:

- Settlement of disputes between States under WTO
- Methods of dispute settlement for private traders, including negotiation, mediation, arbitration and litigation
- Resolving jurisdictional issues
- Enforcement of awards and judgments

Disputes between States

Background

In the 1950s the GATT disputes procedure developed from the 'nullification and impairment clause' in the proposed legal system for the ITO, which you will recall from Chapter 3 did not eventuate (see p 14, above). It dealt with government measures outside GATT which removed the commercial benefits expected to flow from tariff concessions. The clause applied to any action that 'nullified' or 'impaired' the objects of the agreement. Despite the GATT's appearance of being less formal than a legal system, it had coercive force. Once a judgment was passed, normative pressure was placed on the relevant government to alter its measures and if this failed, economic sanctions would be exacted.

Initially judgment was passed by the GATT Chairman, but from 1949 matters were delegated to subsidiary working groups, which became known as 'working parties'. These were negotiating bodies which included the disputing parties (known as the 'principals'), and neutral members to assist the principals to agree among themselves, by clarifying issues and discussing potential solutions. If the principals could not agree, the other members of the working party could not force a solution. The structure was similar to conciliation or mediation (refer to p 132, below).

This changed in 1950, when a working party on a dispute between Australia and Chile resulted in an adjudicated decision by the three

neutral members (making it similar to arbitration, refer to p 133, below, for more information on arbitration). Thereafter the Chairman suggested a single working party be appointed to deal with all legal complaints, to be known as a 'panel' (making the procedure similar to a court).

The panel procedure was far more orderly and legalised that the working party procedure. It involved submissions by the principals, after which the panel prepared a draft report, which was finalised after being discussed with the principals. The report was then submitted to the full membership of GATT (known as the 'Contracting Parties'). Interestingly, the panel appointed involved no representatives from major powers, and no representatives from the countries of the parties in dispute.

The panel procedure gained a reputation in the 1950s as being a highly effective instrument in applying GATT's very few coercive powers. This has been largely attributed to the high level of consensus amongst the Contracting Parties in the first decade of the GATT.

By 1960 the power balance amongst Contracting Parties in the GATT had changed quite dramatically. The three most important parties when GATT was formed were the US, UK, and France, but by 1960 they were the US, Japan and the EEC. Japan had experienced massive industrial growth in the 1950s. The European Economic Community (EEC) had been formed, and the five countries who were formerly individual GATT members now constituted a single, powerful bargaining force. European countries had not played a major role in GATT before this time, as the Organisation for European Economic Co-operation (OEEC), which was established in 1948 to give effect to the Marshall Plan, had acted to dismantle trade restrictions in Europe.

Additionally membership of developing countries had increased dramatically, and developing countries in GATT formed a caucus to negotiate benefits for themselves. They wanted strict enforcement of GATT obligations for developed countries and exemption from GATT obligations for themselves.

As a result of these shifts in membership, there was less consensus among the Contracting Parties. It has been suggested that the consensus in the early years may merely have been a reflection of the coercive power of the US, and the breakdown in consensus reflects the impact of the growing economic strength of other GATT countries, especially the EEC. In any event new forms of decision making and dispute resolution needed to be established. The initial approach was

to work out a pragmatic and practical solution applying the old structure as far as possible.

But by 1970 the legal structure in GATT was highly problematic. Some parties were being sanctioned for measures which several other Contracting Parties were also undertaking without similar sanctions. There had been a change in the attitude of Contracting Parties towards the disputes procedure. The fairness of the procedures was being questioned, and its legalised nature was seen to run counter to the co-operative style of negotiation traditional in the GATT.

In 1979 an *Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance* was adopted by the GATT, and in 1989 the *GATT Dispute Settlement Rules and Procedures* were adopted, to streamline procedures. Disputes proceeded through stages of notification, consultation, arbitration, panels and working parties, a report, and implementation of recommendations and rulings.

In 1992 an *Understanding on the Rules and Procedures Governing the Settlement of Disputes Under Articles 22 and 23 of GATT* was adopted, giving Contracting Parties an automatic right to a panel of three persons with relevant qualifications and experience. The agreement also provided for reference of a dispute to arbitration. Where a panel decision was made, it was automatically adopted unless a party notified the GATT Council of an appeal to the Standing Appellate Board. The preference was for specific performance rather than compensation and/or suspension of concessions. The agreement encompassed a 'legal system' type approach to dispute settlement, agreed to for a four year trial period.

WTO dispute settlement procedures

The Uruguay Round *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) provided for the establishment of an integrated dispute settlement system, largely based on the 1992 Understanding in the GATT discussed above. It extended the scope of dispute settlement to allow WTO members to make claims based on breach of any of the multilateral trade agreements annexed to the Agreement establishing the WTO. A Dispute Settlement Body (DSB) was established to exercise the authority of the General Council and the Councils and committees of the covered agreements.

WTO settlement rules stipulate that commercial conflicts are represented by governments. Private industry must persuade its government to represent its complaint as a possible infringement of any one of the GATT/WTO articles, and that the complaint has

significant trade ramifications so as to justify seeking consent from the WTO Dispute Settlement Panel to set up hearings between the parties, to investigate the complaint and to formulate a decision.

The overall aim of the settlement of contractual disputes is the maintenance of good relations between countries. Therefore there remains a preference for resolution of disputes by negotiation between the parties, assisted where necessary by a neutral third party. This is reflected in the procedure by which a dispute proceeds through a number of stages.

The first stage is *consultation*, which involves preliminary discussions between the parties to discuss their difference and see if they can settle it themselves. Consultations must begin within 30 days of a request by one WTO member to another, and if an agreement cannot be reached in another 30 days the complaining party may request the DSB to establish a panel. The panel helps the DSB make its decision on the dispute. It consists of three or five experts acting in their individual capacities, chosen from a list of experts in consultation with the countries in dispute, or rarely, by the WTO Director-General.

Once a panel is appointed, the procedure is:

(1) The parties make written submissions to the panel.

(2) The parties present their case orally at the first hearing.

(3) The parties make written rebuttals.

(4) The parties present oral arguments at the second hearing.

(5) The panel may consult experts or appoint an expert review group on specific issues.

(6) The panel provides their first draft (summarising facts and arguments) to the parties.

(7) The parties have two weeks to comment on the first draft.

(8) The panel provides their interim report (including findings and conclusions) to the parties.

(9) The parties have one week to request a review.

(10) The panel reviews their findings.

(11) The panel provides their final report to the parties.

(12) After three weeks the panel submits their final report to all WTO members.

(13) The final report becomes a ruling of the DSB, unless a consensus rejects it.

(14) The parties may appeal on points of law.

(15) An appeal is heard by three of the seven members of the Appellate Body (set up by the DSB). The members sit in their individual capacities for a four-year period.

(16) The DSB accepts the appeals report unless a consensus rejects it.

Steps 13 and 16 reflect the principle of *automaticity*, contained in the DSU. That is, the automatic adoption of the panel's or Appellate body's findings after a period of time has passed without the DSB determining otherwise. A dispute before the DSB takes approximately a year to settle, or 15 months if there is an appeal, although as the body of case law develops it is expected these time periods will expand.

A DSB ruling which includes a finding that the disputed trade measure does breach a WTO agreement or an obligation will typically contain recommendations as to how the measure may be altered be made to conform with WTO rules. The member in breach is expected to state its intention to comply with the ruling, and a time period over which this will be achieved. If the measure cannot be corrected promptly, the member in breach is expected to negotiate appropriate compensation, such as through allowing tariff reductions in other trade areas with the aggrieved member country. If agreement cannot be reached the aggrieved member may seek permission from the DSB to impose trade sanctions on the member in breach.

WTO dispute settlement and Australia

The government body which handles WTO disputes involving Australia is the Dispute Settlement and Enforcement Unit of the WTO Branch of the Trade Negotiations Division of the Department of Foreign Affairs & Trade (DFAT). If the Minister for Trade considers the matter to have significant trade ramifications then the Dispute Settlement and Enforcement Unit seeks consent from the WTO Dispute Settlement Body (DSB) to resolve the dispute through the WTO.

Some disputes involving Australia include:

(1) A claim by Australia against the EU, challenging EU subsidies on European pork, on the basis that they distorted the competitiveness of EU pork in overseas markets. During negotiations, the EU agreed to stop the subsidies, so the matter did not need to be referred through the formal settlement process.

(2) A claim by the US against Australia, challenging the grant of approximately $30 million by the Australian government to Howe and Company Pty Ltd, an Australian automotive leather manufacturer. A WTO ruling found that the grant was a subsidy

inconsistent with Australia's WTO obligations. A settlement agreement was reached, requiring Howe and Company Pty Ltd to repay a portion of the grant.

(3) A claim by Australia against the US in relation to a ban on prawn imports to the US from countries that did not have national programmes requiring prawn trawlers to use turtle exclusion devices. Australia does not have such a requirement on a national basis. A WTO ruling found that it was unreasonable for the US to require other countries to adopt turtle conservation regulations the same as theirs. The US varied the measure to allow importation of prawns provided the fishery concerned used turtle exclusion devices.

(4) A claim by Australia against the US in relation to quota restrictions on lamb imports to the United States. The quota restrictions were held to be in breach of US's WTO obligations. Australia is currently seeking enforcement of the decision against the US.

(5) A claim by Canada against Australia, challenging Australia's requirements for imported salmon, alleging they exceeded the international standard for food safety and acted as a barrier to potential exporters of salmon to Australia. A WTO ruling found some of the requirements to be allowed, and others were not.

In September 1999 the Commonwealth government introduced a domestic mechanism, the WTO Disputes Investigation and Enforcement Mechanism (DIEM), to facilitate access for all Australian exporters to Government assistance in taking advantage of Australia's WTO rights in other markets. If an exporter (or company wishing to export) considers that another WTO member government is not honouring their obligations under a WTO agreement, it may use the DIEM mechanism. A preliminary submission is made to the Department of Foreign Affairs and Trade (DFAT), setting out the specific measure adopted by the other WTO member government which is affecting that exporter's access to or competitiveness in that market. DFAT may then raise the matter with the other WTO member government and, if this does not resolve the dispute, follow the formal avenues of dispute settlement through the WTO as outlined above. DFAT aims to create a sort of partnership with the exporter, who is consulted throughout, and may be expected to meet some costs, such as market investigations and gathering of statistics.

A difficulty is that hearings over one trade area may affect negotiations between traders from the countries involved in other areas. In April 1999 the Australian government abandoned its WTO

challenge to Japan's decision to impose prohibitive tariffs of nearly 400% on rice, on the basis it could result in the loss of Japanese export markets in a range of other commodities, including wheat and coal. There are no measures currently available in Australia to industry if the government body refuses to take WTO proceedings.

Disputes between private traders and foreign States

Private traders who enter commercial contracts with foreign governments need to be very careful. The doctrine of sovereign State immunity may prevent domestic courts hearing claims against foreign sovereigns. The doctrine is historically based, from the days when the embodiment of the State was its king or queen, but it now applies to governments and government instrumentalities. In most countries, however, it is of restricted application, making governments immune from prosecution only for governmental acts of the State and not commercial activities of the State. When the State acts as a trader it is treated as one. This restriction applies in Australia, pursuant to the *Foreign States Immunities Act* 1985 (Cth). Sovereign immunity is rarely available as a defence in commercial proceedings in Australia. International traders need to be aware of the immunity application in the countries of their trading partners, as the restrictions vary. For example, the restricted doctrine of sovereign State immunity applies in China and Korea, but not in Japan. In some situations a government may not be immune from jurisdiction (the power of a court to hear a dispute) but may be immune from execution of a judgment against its assets in different countries.

Assuming the relevant government against whom a claim is made is not immune from prosecution, disputes may be heard by the International Court of Justice (ICJ), which is a United Nations organ made up of 15 judges from around the world. The private trader cannot itself bring an action before the ICJ, but must instead petition their domestic government to bring the matter to the ICJ on the private trader's behalf. The discretion of the domestic government is wide in deciding whether to take on the matter. It is therefore highly uncertain whether a trader doing business with a foreign sovereign will be able to have recourse against that foreign sovereign in the event it defaults on its contractual obligations.

Assuming the domestic government agrees to bring the matter before the ICJ on behalf of the private trader, the ICJ will consider international conventions applying between the States, recognised international customs, and analogous domestic judicial decisions of

those States. The ICJ may award injunctions and damages, and can enforce compliance through the UN Security Council.

Assuming the ICJ makes judgment in favour of the private trader's government, there is still no guarantee the trader will receive the damages awarded. This is up to the discretion of the domestic government.

It is advisable for a private trader faced with a dispute against a foreign State to use negotiation rather than litigation, especially given the laws under which the private trader would be litigating are written by their opponent. In practice, if negotiations fail a private trader may request the Department of Foreign Affairs and Trade to have the Australian ambassador in the country in question make representations to the foreign government. Often having such representations carries sufficient weight for the foreign State to engage in some form of compromise. A further alternative is to have an arbitration clause in the contract, with a further clause warranting that the party entering into the contract on behalf of the foreign State has authority to waive sovereign immunity and does so for the purposes of the contract. This may not be enforceable but does at least allow grounds for argument.

From a conceptual viewpoint the bringing of actions against foreign entities by the domestic government and not the private trader has difficulties in a modern world where companies are often not merely national, but multinational. Take for example a German bank which is 65% foreign owned. Having the German government represent the bank at the ICJ appears hypocritical, because the government may have different interests to the bank.

Note that whilst the resolution of disputes between States is known as 'dispute settlement', the resolution of disputes between private traders is known as 'dispute resolution'.

Disputes between private traders

Disputes between private traders are often the result of the great many factors in an international sale transaction that are beyond their control, such as changes in legislation, subsidies, exchange rate fluctuations, and new technologies which render the subject goods obsolete. Traders enter contracts for the international sale of goods and services for the purpose of doing business and making a profit. Extraneous factors can heavily impact upon anticipated profitability. A seller in a market where demand has rapidly increased, pushing the

market price up, may want to get out of a previously entered sales contract at a lower price. Similarly, a buyer in a market where demand for the goods has rapidly declined, making it unlikely they can be sold on at a profit, may want to find a way out of a contract entered when the market was stronger. This is especially the case where supply contracts are entered for five and ten year periods.

Take for example *Reardon Smith* (1976). In the 1960s a Japan shipbuilder contracted with parties worldwide to build 'super tankers'. Contracts were based on an assumption of fixed exchange rates. With the instability caused by the floating of the US dollar, the Japanese party sought to renegotiate payments to release them from their contractual obligations. They were successful in some of the contracts, but in others, the US buyers refused to renegotiate. Later, when there were massive changes in the oil market in terms of price, trading patterns, oil usage and transportation, these US buyers sought to get out of their contracts with the Japanese seller, who in turn refused to renegotiate.

Therefore it can be seen that a large majority of international trade disputes arise due to circumstances in the economic framework which are beyond the control of the parties. However when a dispute is aired through litigation, the parties rarely refer to such circumstances. Instead, they look to breach of contract and allegations of negligence. For example in the *Reardon Smith* case, the US buyers sought to avoid the contracts on the basis that the Japanese sellers were in breach of contract because they subcontracted the actual building of the tankers.

A difficulty is that contract terms are agreed against expectations of future developments, and if these developments fail to eventuate or other events supersede them, the contract is re-read by each party's solicitors with a desire to minimise their client's financial obligations through applying contractual terms with a different interpretation to that initially intended by the parties. It is for this reason that countries are increasingly encouraging a greater use of renegotiation, mediation and arbitration, which reinforces the duty of good faith in international trade, and encouraging parties to focus on the economic factors beyond their control and to resolve disputes in a reasonable and commercial manner.

Disputes between private traders raise a number of questions. Where should the dispute be settled? How should it be resolved – by mediation, arbitration, or litigation? What law should apply? How can any resulting agreement/award/judgment be enforced? Attempts have been made to resolve these difficulties through the creation of

international rules/conventions/definitions. For example, the Hague Rules, the *United Nations Model Law on Arbitration, and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*. However these are not of universal application, and countries who have not adopted them continue to apply domestic legislation.

Conciliation/mediation

The terms 'conciliation' and 'mediation' are synonymous. They describe a situation where a third party works with the disputing parties to reach a settlement. All parties to the dispute must agree to mediate for this method of dispute resolution to be used. Parties retain control of the outcome, so the third party has no power to force a solution on the parties. Mediation is commonly required in Asian countries before any formal process is used (for example, in Taiwan and Vietnam) or is at least required to be considered (for example, in Hong Kong and the Philippines).

Rules governing conciliation/mediation procedure

Parties to mediation can create their own rules for the procedure to be adopted, or choose to apply the rules devised by a mediation body. For example, the UNCITRAL Conciliation Rules and ICC Rules. The ICC Rules are at www.iccwbo.org/court/english/conciliation /all_topics.asp. In aid of less complexity, there are only 11 Articles in the ICC Conciliation Rules. They cover the establishment of the conciliation by request, response, and appointment of conciliator, confidentiality, costs, and the 'without prejudice' nature of the conciliation proceedings. Even if the contract includes reference to conciliation under the ICC Conciliation Rules, this does not oblige a party to mediate. The party requesting conciliation must apply to the Secretariat of the International Court of Arbitration (ICA) to do so. This has been done so the ICC ICA administers the arbitration. But there is nothing to stop parties incorporating the ICC Conciliation Rules, with the exception of Arts 1–4, allowing them to have a conciliation under ICC Rules without it being administered by it.

The UNCITRAL Conciliation Rules are at www.uncitral.org. They are similar to the ICC Rules, with an invitation and acceptance being made for conciliation. Article 5 provides for written statements describing the general nature of the dispute being sent to the conciliator and the other party. Article 7 specifically allows the

conciliator to go beyond listening and facilitating discussion, to making proposals for settlement of the dispute. Article 13 provides that the conciliator draws up terms of settlement for the parties to consider.

Note that where mediation is used between States in areas other than international trade it is called 'diplomacy'. That topic is beyond the scope of this book.

Arbitration

Arbitration is the preferred mechanism for the resolution of disputes between international traders, because of its privacy, relative speed, and enforceability. Treaties of Friendship, Commerce and Navigation include provisions which require courts in signatory countries to refuse jurisdiction to hear commercial disputes where a contract contains an arbitration clause.

Constitution of the arbitral tribunal

The parties agree to have an arbitrator, or a panel of arbitrators, decide their dispute. Arbitrators are frequently experts in the area of trade under dispute. Where a matter is to be heard by a single arbitrator, the parties nominate the arbitrator by agreement, and if agreement cannot be reached, the head of an arbitration body, such as the Court of Arbitration of the ICC, appoints one. If a panel of three arbitrators is to be used, typically each party nominates one arbitrator, and the two arbitrators appointed select a third, who chairs the arbitral tribunal.

Rules governing arbitration procedure

Similarly to mediation/conciliation, the parties can create their own rules, or choose to apply established arbitration rules, such as the ICC Rules of Arbitration or the UNCITRAL Rules of Arbitration. The parties may agree for the rules of an arbitration institution to apply, without agreeing that the institution is to also administer the dispute. Administration typically involves appointing arbitrators in default of agreement, receiving submissions, and providing a venue for the parties' oral submissions to be heard. It can facilitate the smooth running of an arbitration, but also adds to the cost. Where the parties agree not to have the arbitration administered it is known as an ad hoc arbitration.

UNCITRAL Arbitration Rules

The UNCITRAL Arbitration Rules were created in 1976, to be applied to ad hoc arbitrations. They provide for notice of arbitration to be given by the disputing party to other involved parties, representation of the parties, a panel of three arbitrators, a statement of claim and defence, evidence, an award and costs. The UNCITRAL Arbitration Rules impose strict time limits on the parties. See www.uncitral.org for the full text.

Under the UNCITRAL Arbitration Rules, the arbitral tribunal applies the law designated by the parties as applicable to the substance of the dispute. If the parties have not designated an applicable law, the arbitral tribunal applies the law determined by the conflict of law rules (see p 140, below).

ICC Arbitration Rules

The International Chamber of Commerce (ICC) Rules of Arbitration have been in place since 1923, and were most recently revised in 1988. Where the ICC Arbitration Rules apply, and ICC administers the arbitration, and the ICC Court of Arbitration appoints a single arbitrator in most cases, to save costs for the parties. The process involves a request for arbitration, an answer, a counterclaim (where applicable), payment of an advance, terms of reference, and an award within six months from the date of referral to arbitration. The text of the ICC Arbitration Rules is at www.iccwbo.org/court/english/arbitration/rules.asp.

The ICC also has a Pre-Arbitral Referee Procedure, which is designed for cases involving issues requiring immediate urgent resolution. This may be the case, for example, where there is a dispute about a cargo of pears which will be worthless if they rot before a solution is reached. The urgent issue is heard under a quick and summary procedure, and an order is issued soon after, or at most within 30 days of an application being made. The order is a holding measure only, and an order in a party's favour at this stage does not guarantee an order in the party's favour by the arbitral tribunal when the matter is fully heard. Often the order will be whatever is most practical at the time (for example, with the pear cargo, it is practical for the pears to be released to a party and on sold to a third party so that loss is minimised).

AAA Commercial Arbitration Rules

The American Arbitration Association (AAA) published the Commercial Arbitration Rules in 1985, under which a national panel of arbitrators was established, from which arbitrators are selected. These rules were combined with Commercial Mediation Rules in 2000 into a joint document titled 'Commercial Dispute Resolution Procedures'. There are 56 rules in the Commercial Arbitration Rules, covering appointment of arbitrators, conduct of proceedings, evidence, procedure and time periods for awards to be issued, and administrative expenses. The full text of the Rules is available at www.adr.org under 'Rules/Procedures' and then 'Commercial'.

London Court of International Arbitration Rules

Under the London Court of International Arbitration (LCIA) Rules, a party wishing to commence an arbitration makes a written request to the LCIA Court, setting out the nature of the dispute, and enclosing a copy of the arbitration agreement. The other party then puts on a written response, and the LCIA Court then appoints an arbitrator. The parties do not select the arbitrator, but the LCIA Court will take into account their preferences for criteria and method of selection.

The claimant then sends a written statement of case, or can elect to treat the request for arbitration as its statement of case. Similarly to litigation, there is then opportunity for defence, reply, counterclaim, defence and reply. Each statement has relevant documents referred to in it attached.

The Arbitral Tribunal holds a hearing with submissions, witnesses and experts, depending on the size and complexity of the dispute.

The LCIA Rules are at www.lcia-arbitration.com/rulecost /english.htm.

IBA Rules

The International Bar Association (IBA), formed in 1947, has rules of evidence to be applied in international commercial arbitration. These rules are a compromise between common law jurisprudence and civil law jurisprudence, while allowing for discovery of relevant documents to take place. The IBA also has Rules of Ethics for International Arbitrators, which are not binding on the parties unless they are adopted by agreement. They are intended to guide the conduct of international arbitrators, but are not intended to create grounds for suing them. The normal sanction for breach of the ethics rules is removal from office and disentitlement to remuneration for the arbitration.

LMAA Rules

The London Maritime Arbitrators' Association is an association of practising maritime arbitrators, founded in 1960, to encourage professional knowledge of London maritime arbitrators and to assist in speedy disposal of maritime disputes. There are three main avenues of arbitration through the LMAA, depending on the amount in dispute.

The Small Claims Procedure 1998 applies to disputes up to US$50,000, or larger disputes involving a single issue only. Arbitration is by a single arbitrator chosen by parties, or by the President of LMAA in default of agreement. There is generally no oral hearing, and an award is made within one month of all documents being received by the arbitrator. There is no right of appeal to the courts.

The FALCA Rules (Fast and Low Cost Arbitration) apply to disputes US$50,000–250,000. Arbitration is by a single arbitrator chosen by parties, or by the President of LMAA in default of agreement. Arbitration is on documents, without oral hearing unless in exceptional circumstances. An award is made no later than eight months after appointment of an arbitrator. There is no right of appeal to the courts.

The LMAA Terms (1997) apply for disputes above US$250,000. There are three arbitrators – one chosen by each party, two arbitrators choose third, or the President of LMAA choses the third in default of agreement. Arbitration is on documents and written and oral submissions. A preliminary meeting is held to narrow and settle issues where possible, and to agree on procedural and evidentiary matters.

Dealing with gaps in the rules

Where there are gaps in the arbitration rules selected, the governing law of the seat of arbitration applies, or if the parties have incorporated the UNCITRAL Model Law into their contract, it will apply.

UNCITRAL Model Law

The UNCITRAL Model Law on International Commercial Arbitration aimed to resolve the difficulty of some matters being referred to local courts. The Model Law was finalised in 1985, with the basic premise that the arbitration should be autonomous from local courts. A court may not intervene in an arbitration except where explicitly authorised

by the Model Law. The aim is to minimise litigation, and to provide time limits for arbitration so that it may be a time efficient mechanism for the resolution of disputes. If a party fails to make use of its rights during the stated time periods, it loses them. The agreement to arbitrate is specifically enforceable, and the court must order the parties to arbitrate unless the agreement to arbitrate is void or incapable of being applied.

Under the UNCITRAL Model Law, a party to arbitration may seek interim measures of protection from the arbitral tribunal. Any interim measures awarded by an arbitral tribunal bind only the parties to arbitration, so if an interim measure relates to a third party, an order must be sought from the court.

The UNCITRAL Model Law is legislated in Australia in the *International Arbitration Act* 1974 (Cth). A copy of this Act can be downloaded at www.austlii.edu.au.

Applicable law

It is important when selecting an arbitration clause to consider which law is to apply and where a matter would be litigated if a dispute arose out of the arbitral proceedings. There is variance amongst countries as to the enforceability of arbitration clauses. In the *L Schuler AG v Wickman Machine Tool Sales Ltd* (1974) case a contract between a German tool manufacturer and English sales agents included a clause providing for the exclusive settlement of disputes by arbitration in Germany. A dispute arose where the German party argued that the English party had not complied with the contract requirement of weekly or fortnightly visits to English car manufacturer clients, which enabled it to repudiate the contract. Arbitral proceedings in Germany resulted in an award in favour of the German party. Further arbitral proceedings in England confirmed this result. The disgruntled English party then commenced litigation in England. The High Court held that any contractual agreement limiting the operation of law is null and void, and that the court had power to hear the dispute. The court held that the failure to maintain the tight visiting schedule was merely a breach of warranty not a breach of an essential term, and therefore the German firm was not entitled to repudiate the contract.

Therefore, any arbitration agreement which purports to exclude the operation of law risks being rendered null and void by a court. It is wise to have a comprehensive dispute resolution clause, which provides for negotiation, and if negotiation is unsuccessful, mediation

or arbitration, and also stating an applicable law and jurisdiction in the event of litigation.

Arbitration in Australia

Arbitration of international trade disputes in Australia is relatively undeveloped. However there have been efforts. The Institute of Arbitrators Australia (IAA) was established in 1975 with its own set of arbitration rules. The Australian Centre for International Commercial Arbitration (ACICA) was established in 1985 but does not have its own rules. It merely administers arbitrations according to the rules selected or created by the parties. The Australian Commercial Dispute Centre (ACDC) was established in 1986 and the Sydney Maritime Arbitration Rules and Terms (SMART) were developed by a committee of Sydney maritime lawyers in 1991, a copy of which is available at http://uniserve.edu.au/law/pub/icl/adr/SMART.html.

Appeals

In principle the parties may agree to exclude the right of appeals from arbitration in their arbitration agreement. The benefit of doing this is that it caps the extent of dispute resolution proceedings.

There is no specific provision in the UNCITRAL Model Law which allows the parties to exclude appeal from arbitration. Article 34 of the UNCITRAL Model Law states an application for setting aside is the exclusive recourse against an arbitral award. An application is made to the Supreme Court in the State the award was made within three months of the date the award is received. The applicant must provide proof that either the arbitration agreement is invalid, that it was not given proper notice, that the award is outside the scope of submission to arbitration, or that the tribunal was wrongly composed.

There is interesting authority on point. In *American Diagnostics Inc v Gradipore Ltd* (1998) the decision of Leggatt LJ in *Arab African Energy Corporation Ltd v Oliprodukten Nederland BV* (1983) was distinguished. Leggatt LJ had considered an LCIA clause which provided first that any arbitral award is final and second that by submitting to arbitration the parties have undertaken to carry out the award without delay and have waived their right to appeal. Justice Giles in *American Diagnostics* said Leggatt's decision turned on the agreement to carry out the award without delay and not on the waiver. Therefore the appeal provision in the UNCITRAL Model Law will apply to the arbitration unless the agreement includes a statement that the award is final and an added

undertaking to carry out the award without delay, in which case curial review of the award is excluded.

Enforcement of arbitral awards

Arbitral awards are enforced through international conventions, such as the *New York Convention on Recognition and Enforcement of Foreign Arbitral Awards* 1958, the *Geneva Protocol on Arbitration Clauses* 1923, the *Geneva Convention on the Execution of Foreign Arbitral Awards* 1927, and where an award is to be enforced within the European Union, the *European Convention on the Mutual Recognition of Judgments* is used. If a country has ratified more than one of these Conventions, the New York Convention is applied.

The New York Convention covers both the enforcement of foreign arbitral awards and the enforcement of agreements to arbitrate disputes. Once the parties have formed an arbitral agreement, the courts of the Contracting State must refer them to arbitration unless the agreement is void or incapable of being performed. Arbitral tribunals are competent to determine whether they have jurisdiction to hear the dispute. A party who wishes to enforce a foreign arbitral award produces the original award to a court in the foreign State, along with the original agreement to arbitrate, and the court then accepts enforcement of it as if it were a decision of that court. The New York Convention is widely accepted and enforceability is considered a major benefit of arbitration over litigation.

Litigation

International trade contracts generally include a clause stating the law applicable to the contract and the courts who have power, or jurisdiction, to hear disputes arising from it. This will usually be the courts in the place of the applicable law, but need not be. The general rule is that the parties have the freedom to agree upon applicable law and forum between themselves.

Often a dissatisfied party will commence action in its domestic court and a foreign party will challenge the jurisdiction of the court to hear the dispute. A court applies conflict of laws rules to decide if it has jurisdiction, and if it so determines, the next step is to establish the applicable law.

A court will resolve questions of jurisdiction and applicable law by considering:

(i) Express contractual provision

If the parties have agreed in their contract that a particular court in a specified State will have jurisdiction to hear any disputes between them, that court *prima facie* has jurisdiction. The court selected may, however, refuse to accept jurisdiction, if it is considered to be an interference with judicial administration, or if the selected forum has no bearing on the contract. This is known as *forum non conveniens*. It is however not of uniform application in common law countries and is not applied in civil systems.

If the parties have chosen an international convention to apply, the court is assumed to know the rules of the convention. This is not always the case in practice, and the international trade lawyer often needs to be in a position to prove both the law and the facts to the forum court.

(ii) Vesting of rights doctrine

If the parties have not selected the applicable law, the court applies the law of the State where the rights of the parties became legally effective. According to this doctrine, the law of the place the contract was formed governs questions of validity and the law of the place the contract was performed governs questions of performance.

(iii) Most significant relationship

A court will also consider which State has the closest and most significant relationship with the parties and the substance of the contract. If the court is to apply the law of a foreign State, the onus of proving what that law is rests with the parties.

Additionally there is a *United Nations Convention on the Law Applicable to Contracts for the International Sale of Goods* (1985), which provides that where the parties have not chosen a law to apply to their contract of sale, the contract is governed by the law in the State where the seller has its place of business at the time of the conclusion of the contract. Exceptions to this rule include where negotiations took place, the contract was concluded, or performance takes place in another place, or where the contract was the result of a tender process, in which case the law of the State in which the buyer has its business at the time of the conclusion of the contract is applied (Art 8). There is a further exception, which is where, in the light of the circumstances as a whole, the contract is 'manifestly more closely connected with' a law other than the law of the buyer or seller's place of business.

Once issues of jurisdiction and applicable law are resolved the matter is litigated according to the legal procedures of the court

exercising jurisdiction, and according to the provisions of the applicable law.

Appeals

The right of appeal will depend on the legal procedure of the courts in the place the matter is heard. Legal systems vary markedly in this area. For example in France appeals are heard *de novo* (from the beginning) whereas in Australia appeals are only possible on specific issues, usually relating to law and procedure rather than fact.

Enforcement

It is one thing to achieve a positive result through litigation, it is another to enforce the court's decision. A party who seeks enforcement of a judgment of a legitimate court in a foreign State applies to a court in the foreign State for local recognition and enforcement of the court order. The hearing is called an *exequatur*. The court checks the formalistic requirements of the judgment (that there is not an appeal pending or a cross action) and considers whether its State is party to an agreement with the State in which the judgment was entered on mutual recognition of enforcement, and whether it would be in keeping with public policy for the judgment to be enforced. Once the judgment is endorsed through the foreign court it can be processed as if it were a judgment of that court.

There is no equivalent to the New York Convention (which enables enforcement of arbitral awards) for enforcement of court judgments. However, a new Hague Convention is currently in the drafting process. The Hague Conference on Private International Law, an IGO (see p 9, above) which meets two or three times each year to draft conventions on Private International Law, has established a Special Commission to establish an international framework for the grounding of jurisdiction (to discourage forum shopping), and for the recognition and timely enforcement of foreign civil judgments. The *Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters* (Brussels 1968 and Lugano 1988) which has been used successfully in the European Union, is being considered as a base. The Hague Conference previously drafted in 1971 a convention on recognition and enforcement (not jurisdiction) which was unsuccessful. There are 46 member countries of the Hague Conference. It is expected that when the Hague Convention on Jurisdiction, Recognition and Enforcement of Foreign Judgments is finalised and enters into force it will make court judgments as easy to enforce as the New York Convention does for arbitral awards.

Unfortunately several countries (including Australia) have enacted legislation prohibiting the enforcement of foreign judgments. The *Prohibition of Foreign Judgment Enforcement Act* 1984 (Cth), which was considered to be legitimate by way of the trade and commerce power in the Australian Constitution, applies such that where an Australian company has judgment entered against it in a foreign court that company can recover moneys paid from a local subsidiary of the foreign company. The *Foreign Judgments Act* 1991 (Cth) states specific grounds for refusal for recognition and enforcement, such as public policy, inconsistency with a previous judgment, and lack of notice of proceedings.

8 Electronic Commerce

You should be familiar with the following areas:

- Issues arising from use of email in trade communications
- Electronic contracts
- Website auctions
- Electronic bills of lading
- Payment by electronic means

Effect of electronic commerce on international trade

The major effect of the internet is its ability to bring together buyers and sellers in a global marketplace. Small businesses are able to sell products internationally, where they would previously not have had sufficient resources to make overseas buyers aware of their existence. Now, all it takes is a well prepared website.

E-commerce and trade communications

Where trade is conducted internationally, it has now become common practice to communicate by email rather than by phone. It is not often realised that emails can be required to be produced in court proceedings, just like any other document. In many jurisdictions, this applies not only to printed emails, but also those being stored on disks or on back-up tapes.

This is especially relevant where an incident occurs in an international sale transaction. If communication between various members of the buyer's company takes place by email, these may be accessed by the seller during the discovery process of litigation. If for example the matter relates to a buyer's claim for breach of contract because of non-conforming goods, and the buyer's email system contains an email from the Purchasing Manager to the Managing Director which says that the goods were sent back more because the company didn't really need them any more, but they are just relying

on a technical non-conformity which would not otherwise have affected the buyer's use of the goods, this email will significantly affect the buyer's position in the litigation.

Aside from the content of email communications, there are four major concerns regarding electronic communication:

(1) ensuring confidentiality (where necessary);

(2) ensuring that the person an email appears to have come from actually sent it ('authentication');

(3) ensuring the content of the email cannot be tampered with during transmission ('integrity'); and

(4) ensuring the sender cannot deny sending the email ('non-repudiation').

Email may be interfered with en-route in the same way documents sent by post may be interfered with. Once an email is 'sent' it passes from one computer to another until it reaches the computer of the recipient. The route each email follows is determined by 'router' computers, and depend on the amount of email traffic at the time. For example, an email sent from Melbourne to Sydney may bounce via the Philippines or the US. There is no technical barrier to prevent computers from scanning all the emails that pass through them en-route to their intended recipient. There are software programs that can search across emails for key words, and copy these to an electronic sub-folder, which can be viewed at any time by the user of that computer.

To prevent commercially sensitive information sent by email being intercepted, *encryption* can be used. Encryption has been used by national security and defence organisations for many years. It puts the information into code. The sender encodes the message and the authorised receiver decodes it. If intercepted en-route, it will be unintelligible. The encoding and decoding is performed with two 'keys', which are basically long sequences of numbers. The first key is a 'public' key, which can be made known generally. The second key is a 'private' key, which should only be known by an authorised person.

Let's take a practical example. She's Apples Pty Ltd wants to send a confidential trade offer to Apple Pies Ltd. The trader at She's Apples prepares the offer, then clicks on 'encryption' and 'Apple Pies Ltd' and the message is encoded in such a way that it can only be decoded with the 'private' key which has been previously been provided to Apple Pies Ltd. The 'private' key may be a sequence of 56 numbers, which Apple Pies Ltd will know as a password which the computer can translate into the number sequence.

The above example enables Apple Pies Ltd to receive the confidential trade offer, but Apples Ltd cannot be sure that the authorised person at She's Apples Pty Ltd sent it. This is where *digital signatures* come in. They work in reverse to the message encryption, where only my 'private key' can encode the information that makes up my digital signature in such a way that a 'public key' can decode it. If Apple Pies Ltd is able to use the public key on file for She's Apples Pty Ltd to decode it, Apple Pies Ltd will know it came from an authorised person from She's Apples Ltd.

International initiatives for electronic commerce regulation

As discussed at p 71, above, the United Nations Commission on International Trade Law (UNCITRAL) promotes harmony in international trade law. In the new area of e-commerce, UNCITRAL's aim is to avoid having multitudes of different electronic commerce legal regimes around the world. In 1996, UNCITRAL concluded a *Model Law on Electronic Commerce* to provide national law makers with a set of internationally accepted rules on electronic commerce to use when drafting their country's e-commerce legislation.

The Model Law is based on the principles of 'functional equivalence' and 'technology neutrality'. *Functional equivalence* means electronic documents and communications fill the same function as paper documents and communications. *Technology neutrality* means that no preference should be shown for one electronic communication technology over another, so that requirements should be sufficiently general to cover the technology generally. These principles are recognised in the US, the EU and Australia.

In addition to UNCITRAL's initiatives, electronic commerce will be a major area for consideration in the next round of WTO negotiations, and is expected to include issues of privacy, customs duties, modes of delivery, procurement, intellectual property, standards, and access to telecommunications networks. This round of negotiations is hoped to soon be launched. For further information on the WTO please refer to Chapter 3.

Australian initiatives

Australia is moving towards a single national approach to electronic commerce, with electronic contracts having the same force as paper contracts. The *Electronic Transactions Act* 1999 (Cth), which came into effect in 2000, was based on the UNCITRAL Model Law. Until 1 July

2001 the Act applied only to specific Commonwealth laws listed in the regulations (about 300 so far), and from 1 July 2001 it has applied to all laws of the Commonwealth, other than those specified. Specified acts are listed in the *Electronic Transactions Regulations* 2000, a copy of which may be downloaded from www.austlii.edu.au. At present it only applies at the Commonwealth level, but the States are currently in the process of enacting mirror legislation. The Victorian Act came into force in September 2000, and the New South Wales act will come into force on a date to be proclaimed.

Importantly, the *Electronic Transactions Act* 2000 provides that a transaction, commercial or otherwise, is not invalid merely because it took place partly or fully by electronic means of communication.

It also provides for the time and place of dispatch and receipt of an electronic communication. Unless otherwise agreed, the legal place in which dispatch occurs is where the sender has its place of business, and receipt occurs where the receiver has its place of business. If the sender or receiver has more than one place of business, dispatch or receipt is taken to have occurred in the place of business with the closest relationship to the underlying transaction to which the communication relates. If neither place of business has a close relationship, it is the principal place of business. If the sender or receiver has no place of business, it is the place in which the sender or receiver ordinarily resides.

The Act also provides legal recognition of electronic signatures and electronically provided documents. This allows documents that are being sent to a Commonwealth Government to be provided and signed electronically. Businesses can also record and retain business records electronically.

Commonwealth agencies have to accept electronic communications when a business or member of the public chooses to communicate in that way. This applies to the making of an application or declaration, the giving of a notification, and the lodging of a claim, return, or objection. However there must be compliance with any specific information technology requirements the relevant Commonwealth agency may have.

Exposure to foreign laws

The internet is perceived by many to be beyond the law, that anything can be posted and the user of the internet runs the risk that the information retrieved is incorrect, and that the person posting the information cannot be prosecuted.

However, courts in some countries are expanding the application of their laws to the internet. For example, a German born Australian, responsible for a website denying the Holocaust occurred, was arrested while travelling to Germany in 1999. In December 2000 a German court held that German law applied to foreigners who posted material on the internet in other countries if it can be accessed by internet users in Germany. Around the same time in France a judge ordered Yahoo, an internet company, to make it impossible for anybody in France to access any Yahoo website or service that constituted an apology of Nazism or a contesting of a Nazi crime. This was to be achieved by installing software to identify and block requests from users with French internet service providers, through voluntary declaration of nationality by users, and through blocking of searches with key words such as 'Hitler'.

Aside from the difficulty that this will also prevent French users from conducting legitimate study or research into Nazism over the internet, the message is that courts in some countries are showing a willingness to expand their jurisdiction to the internet. Those involved in international trade need to be aware of this when posting information on a company website.

For example, a claim has been brought in the Federal Court of Australia by a representative of a group of women whose doctor performed a surgical procedure for sealing fallopian tubes with a clip produced by an English manufacturer. The claim was for misleading and deceptive conduct on the part of the English manufacturer, in providing certain information. Some of the information referred to by the plaintiff had been posted on Femcare's website. The claim was brought under s 52 of the Australian *Trade Practices Act* 1974 (Cth), a provision it is likely the person posting the information on the website in England most likely had no knowledge of. For more information see *Bright v Femcare Ltd* (2000).

Electronic contracts

In many cases, the same underlying legal issues apply to paper based and internet based transactions. Tenders advertised and submitted on the internet are subject to the same legal requirements as tenders advertised in newspapers and submitted in hard copy form.

For example, the same issues of governing law and jurisdiction (where a dispute is heard) apply to international electronic contracts as to any international trade contract. If the parties do not choose the

governing law of the contract the rules of private international law apply the law of the place with the most real and substantial connection with the contract. This is difficult to establish in international e-commerce contracts where geography may be largely irrelevant. This reinforces the value of standard terms and conditions which clearly specify the governing law of the contract and the jurisdiction in which disputes will be resolved. These terms and conditions will apply if clearly posted on a company's website, preferably with a requirement for the user to click 'I Accept' before an on-line order form can be accessed. If a dispute arose as to whether the buyer viewed the terms and conditions prior to placing the electronic order, the seller could have its internet service provider generate an access log, which can show the computer from which the order was placed and the pages viewed prior to placement of the order. If on the other hand the order was placed by email, the ID number from the email can be easily ascertained and a website such as www.osilab.ch/services/dns-e.htm can be used to translate the ID number to a domain name, and then www.whois.net or www.domainsearch.com can be used to work out who owns the domain name, and therefore the source of the emailed order.

These technological methods of deciphering the origin of email or internet orders are useful in a dispute only where such evidence is admissible in the court in which the dispute is litigated. In selecting an applicable law and jurisdiction, it is important to choose a law in which electronic contracts are recognised and a jurisdiction in which electronic evidence is admissible in court. The legislation of each country will differ, and in many cases it will depend on whether 'writing' is defined to include electronic forms of writing. This is because many laws require agreements to be in writing and signed by both parties. For example the *Contract Law of the People's Republic of China*, which was adopted in March 1999, provides that writing may be in any form which is 'visually recorded'. As electronic contracts may be viewed visually, they are recognised under Chinese law. If a document is to be signed, it is sufficient that the court be satisfied that the electronic signature reliably identifies a person's approval to an electronic contract.

As with any transaction referable to the physical movement of goods, the potential remains for miscellaneous breaches of foreign legislation. This includes censorship laws, labelling requirements, restricted imports, and laws regarding misrepresentations. For

instance, a contract could call for the transport of alcohol through a country in which alcohol is banned.

Another area of potential concern is customs duties. Although there is a WTO declaration against the imposition of customs duties on electronic transactions, if the underlying transaction processed electronically is referable to a physical exportation or importation of goods, the same customs requirements will need to be met as if there were no electronic element involved.

Exposure to these laws can be minimised by requiring the foreign buyer to warrant that there are no legal impediments for entry, and use, of the contract goods in the buyer's country, coupled with an indemnity in favour of the seller in the event such legal impediments do exist.

Website auctions

Website auctions are becoming increasingly popular. They allow buyers and sellers to bid, counter-offer and execute transactions on-line, from anywhere in the world.

Typical auction websites allow bids to be tailored for specific requirements for delivery or payment, and have links to a forwarder offering ocean and air freight bookings, insurance, on-line consignment tracking, and document processing services. Adding on a freight forwarding service may be seen by the website auctioneer as an additional profit centre, but the site will not guarantee any performance by the forwarder. The forwarding will typically be sub-contracted out to a freight forwarder. In this way the website auctioneer's role becomes more of an agent or broker.

Most sites offer some proprietary security features. It will be critical to many companies to know how the site ensures that a member's commercially sensitive information is not accessible without authorisation. Even with security features, the website may make commercially sensitive information available. For example, competitors may be able to monitor the number or type of offers/bids made by a particular participant.

Electronic bills of lading

Internet technology offers an obvious solution to the age old problem of negotiable documents taking longer to pass hands than the passing of title to the goods being carried by sea (see page 85, above).

However, attempts in the 1980s to establish a system for electronic shipping documents were unsuccessful.

One attempt was Seadocs, devised by the International Association of Tanker Owners (Intertanko). It established a central registry of shipping documents. The paper bill of lading was deposited with the registry, who would receive electronic messages updating it of changes in ownership of the goods carried under it, then release the bill of lading to the consignee in time for it to be received before the goods arrived at the discharge port. Although it sped up the process of transferring the bill from buyer to buyer, there were industry concerns as to privacy, and the project did not pass trial stage. Another attempt was CARDIS, an American initiative which aimed to convert all users to an electronic system. It faced difficulties with the need for standard forms and systems.

In 1990 the Comite Maritime International (CMI) adopted *Rules for Electronic Bills of Lading*, which can be incorporated into a contract of carriage in the same way as INCOTERMS can (refer to p 79). The CMI Rules do not replace bill of lading terms and conditions. They are intended only to facilitate the use of an electronic regime for bills of lading. Existing legal principles otherwise apply. The rules adopt a public and private key system, where the person with the private key is entitled to control of the goods, and when the goods are negotiated, the shipper instructs the carrier to cancel the original private key and issue a new one to the buyer. To get around the writing requirement, the rules provide that the parties waive any right to raise a defence that the contract is not in writing. The full text of the *CMI Rules for Electronic Bills of Lading* may be downloaded from www.comitemaritime.org.

A more recent initiative in this area is the privately-run Bolero, which uses the *CMI Rules for Electronic Bills of Lading*, and the electronic data interchange (EDI) based SWIFT system. The SWIFT system has been used by banks for many years to process international payments between banks. Bolero operates between registered users exchanging encrypted EDI messages through a central registry, which contains details of shipping documents. The registered person at any time is the person entitled to control of the goods. When the goods are negotiated the registered person is updated, and when the goods arrive at the discharge port the carrier seeks instructions from Bolero as to whom the goods should be released. Bolero removes the need for consignees on negotiable bills to wait for original shipping documents to arrive, or to provide a letter of indemnity. However it does not remove the

responsibility of the carrier to release the goods to the person so entitled, and not to an unauthorised person who purports to be the true consignee. Issues being faced at present include carrier concern that they may not have insurance (P & I) cover when using Bolero, and concern regarding carriage where the Hague Rules apply, as paper bills of lading are still required. For more information, visit www.bolero.net.

There are three distinct levels of usage of electronic technology with bills of lading:

(1) Electronically generated bills of lading, which are then processed as a paper document from there on.

(2) Electronically generated bill of lading which is posted to a secure website, which the shipper can download and print out, which is then processed as a paper document from there on.

(3) Completely electronic bill of lading, which is issued electronically, negotiated electronically, and then presented electronically.

Although the technology exists for secure issue and negotiation of electronic bills of lading, a particular impediment has been the requirement in several legal systems for documents to be in writing and signed. A bill of lading signed by or on behalf of the carrier is evidence that the goods have indeed been shipped, a critical fact for potential purchasers of the cargo whilst it is at sea. The issue has been whether an electronic document meets the writing requirement, and whether an electronic signature is sufficient to meet a signature requirement. This situation is now changing, as countries enact legislation giving electronic documents and digital signatures the same legal force as paper documents and handwritten signatures.

However, issues remain, such as the requirement under Art 20(b) of UCP 500 (see p 108, above) that banks will accept documents which are electronically produced provided they are marked as original and appear to be signed. A computer generated negotiable bill of lading may be sent from carrier to shipper to print out, and may bear the carrier's signature on the bottom, but will only satisfy UCP 500 if it is also marked 'original' (*Glencore International Attorney-General v Bank of China* (1996)).

Electronic payment

Buyers who locate product information on a company's website can often enter their credit card details on the website, or by an email link

from the site. Processing these credit card transactions is little different in risk to credit card mail orders, fax orders, or telephone orders.

An alternative to electronic lodgement of credit card details is e-cash, or electronic 'coins'. In different denominations, each 'coin' consists of a digital message with a serial number which is provided with a private and public key in exchange for cash. This e-cash is, however, not legal tender, and therefore the terms of contract with the e-cash issuer are vitally important, as is the commercial stability (solvency) of the issuer.

More secure than e-cash are smart cards, or stored value cards. These work in the same manner as pre-paid phone cards, and have a similar appearance to cards used in automatic teller machines, with a digital chip rather than a magnetic strip. These stored value cards can either stand alone (so if lost the value on the card is also lost) or can be linked to a shadow bank account (in which loss of the card does not affect the balance in the account).

Although there are these electronic alternatives to payment in international trade, in practice where transactions involve large sums of money, international traders are continuing to use traditional methods of payment, such as letters of credit. For more information on these payment mechanisms, readers should refer to pp 103–09, above.

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