Countertrade Contracts in International Business

Cedric Guyot
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I. Introduction

Countertrade is one of the new fashionable words in international trade and finance, receiving new attention as a means for coping with financing, marketing or development problems that numerous countries are facing due to the international debt crisis. Complicating the drive for industrialization in developing countries have been, among other things, the high cost of imported energy due to the rapid rise in the cost of oil imports, a higher and higher external debt burden, the consequences of reduced market power, exchange regulations and non-convertibility of currencies, a need for technology and political instability due to regional wars or internal revolts.

Furthermore, economic development in a number of developing and nonmarket economy countries has been hampered by the incompatibility of their economic systems with those of the industrialized West. This incompatibility results mainly from the application of divergent economic and political theories to the marketplace and greater central government control over manufacturing and industrial developments. To promote the economic developments of the nonmarket and developing countries, and to solve their debt problems, which increases unemployment and low

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1. Articles on countertrade flourish in business, trade, law and financial reviews. For a general introduction to the forms of countertrade, their historical background, their advantages and disadvantages and selected legal issues, see Lochner, Guide to Countertrade and International Barter, 19 INT'L LAW. 725 (1985). A very useful bibliography can be found at Whisman, Countertrade: A Reading List, 19 INT'L LAW. 1013 (1985).

2. See, e.g., Focus, Countertrade: An Old Concept with a New Impact, 187 AMERICAN BANKER 13-45 (American Banker Special Survey, September 21, 1984); Ross, Giant Traders Grab the Best of Barter, 10 EURO-MONEY TRADE FIN. REP. (February 1984).
utilization of industrial production capacities, such countries are using countertrade as a tool in the international trade world. The solution is to impose various reciprocal conditions upon foreign trade when sluggish economic conditions affect the national trade balance, market access privileges and convertible currency transfer patterns.

Therefore countertrade is more often requested or even mandated by governmental formal (law or regulation) or informal (guidelines or recommendations) policy. Many countries apply most if not all of their export earnings for foreign debt payment and the remainder, if any, supports the continuation of industrialization programs. The lending of money by private banks to developing countries is also slowing sharply and jeopardizing the ability of developing nations to service interest payments and to sustain economic growth. To keep a fair economic level, these countries have to trade, to export and to attract investments and therefore promote long-term and medium-term trade through means such a countertrade. Countertrade is a means of fighting against the deterioration of trade balance.

Countertrade has been defined as the practice of linking imports of goods to exports to the country of the supplier, an exchange of products between two parties in lieu of the use of foreign exchange, a barter

3. The case of Malaysia clearly illustrates this: Malaysia is expected to have a deficit in trade of U.S. $5 billion in 1984. The interest burden of the foreign debt, now approaching U.S. $14.5 billion, plays a major part in its startling deficit. In order to offset lower commodity prices, Malaysia is taking steps to promote and increase countertrade. A Malayian Treasury Department Circular issued to all departments and agencies directs them to incorporate countertrade elements in their tender documents. The private sector is also being urged to follow suit. *Malaysia Takes Steps to Boost Countertrade*, J. COM. Oct. 15, 1984, at 3A; see, e.g., Birley, *Can't pay? will pay, but in Sultanas*. EUROMONEY, May 1983, at 187; Sender, *The Booming World of Countertrade*, DUN'S BUSINESS MONTH, January 1984, at 76.


arrangement with money as a modern form of compensation trading, or, more simply, trade without cash. Strictly, the word "countertrade" means a trade relation to oppose or to balance the effects of a contrary trade relation.

Trade analysts have also tried to assess the volume of countertrade in world trade. Their estimates vary widely from 1 percent to 30 percent. A survey which involved more than a hundred of the biggest exporting firms and several large banks of the United States was made in the fall of 1983 by the U.S. National Foreign Trade Council. Their survey revealed a sharp increase in countertrade in the 1980's. In 1972, only fifteen countries were involved in countertrade; most of these were East European countries, members of the CMEA. Seven years later, twenty-seven countries were requesting countertrade arrangements. Today, there are more than 88 countries that request some form of countertrade before agreeing to buy from exporters. Even if twenty-one of these countries (most of them West European countries), which are involved primarily in offset arrangements, are set aside as a special category of countertrade, the balance of sixty-seven nations now requesting countertrade reflects a 250 percent increase within the last four years.

One of the main international agreements being affected by the surge of countertrade is the General Agreement for Tariffs and Trades (GATT). While finding that countertrade does not, per se, contravene GATT rules,
GATT officials point out that "in some specific circumstances in which governmental measures require, stimulate, take the form of or react to countertrade, those measures could be inconsistent with obligation under GATT policies."17 Balancing trade between two countries is not expressly forbidden by GATT, but the language of GATT's articles condemns forced balancing of exports and imports when unilaterally imposed conditions on Trade Transaction as a violation of the duty of "nondiscriminatory treatment."18 But even if one finds violations of the GATT rules, there is the question of how a real violation of the GATT can be pursued and remedied.19 Also, the countries enacting regulations and forcing countertrade can cite for support of their decision Article XII of GATT which authorizes exceptions in the event of economic difficulties.20

Finally, countertrade also refers to the various methods of conducting reciprocal trade. Peter D. Ehrenhaft, an attorney specializing in international trade, concisely emphasized the three main rationales to achieve countertrade:

Countertrade may be the only way by which a seller will be able to sell his goods or services in a foreign market, as buyers claim they lack other feasible resources for paying what they acquire.

Countertrade may provide the best way to develop long-term association with foreign buyers; the latter then serve as local producers or distributors and, thus, help to lock in the original participants in the foreign market to the possible exclusion of other U.S. or Western competitors.

Countertrade may be the only way in which technology, thoroughly exploited in the West, can still be licensed for valuable consideration. It may also be the most feasible way for a licensor to be assured access to its licensee's operation for purposes of quality control.21

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17. 16 COUNTERTRADE OUTLOOK, April 23, 1984, citing a briefing paper made by Gary Banks, economist in the Economic Research and Analysis Unit of the GATT Secretariat. COUNTERTRADE OUTLOOK is a U.S. weekly intelligence release on international barter and related trade addressed to traders and exporters.

18. GATT, art. XVII, 1, 55 UNTS 187 (1947). GATT has been amended a number of times since 1967. The current version is contained in 4 GENERAL AGREEMENT ON TARIFF AND TRADE, BASIC INSTRUMENTS AND SELECTED DOCUMENTS (1969).


20. GATT, Art. XII 2(a)(i) and (ii), 55 UNTS 187 (1947). In analyzing this provision, A. Liebmann notes that the import restrictions may be imposed on a temporary basis to "safeguard" a country's "external financial position and its balance of payments." Such quotas may not "exceed those (measures) necessary to forestall the imminent threat of, or stop, a serious decline in monetary reserves" or "to achieve a reasonable rate of increase in reserves." In addition, the country invoking this exception is then required to relax its restrictions in proportion to the improvement in its balance of payments. Liebmann, supra note 19.

21. Ehrenhaft, Insuring U.S. Participants' Interests in Countertrade, SEMINAR ON COUN-
This article describes and analyzes the following countertrade contracts: barter, counterpurchase, offset and buy-back. In doing so, it identifies drafting problems and offers suggestions for the lawyer who may be involved with such contracts.

II. Barter

A. Notion

Barter, as a noncurrency transaction, is increasing in trade with Latin American and Southeast Asian countries due to the recent restrictions on international lending. Moreover, barter is also increasingly used for trade in commodities and agricultural products. Barter is the oldest form of trade, but today there is no longer instant performance with simultaneous reciprocal satisfaction. Contemporary barter agreements are successively performed contracts or reciprocal-supply contracts stretched over several years, generally for fungible goods like raw materials or agricultural products which more easily allow the determination of quantities.

This transaction for swapping goods is characterized by the fact that two persons or companies agree to exchange products and/or services: both parties accept each other's goods as payment. The transaction is contained in a single contract; there is no exchange of money between the parties in the transaction. Sometimes a small amount is paid in cash to cover special costs, or a down payment is made as a guarantee.

Difficult drafting problems are presented since a single instrument must cover both the deliveries and the counterdeliveries. The barter contract includes most of the standard provisions contained in a conventional

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22. On file with the author are 3 barter agreements, 10 counterpurchase contracts, 7 buy-back contracts and 2 cooperation arrangements with countertrade provisions.


24. Vogt, Barter of Agricultural Commodities Among Developing Countries, 2 COUNTERTRADE & BARTER Q. 21 (Summer 1984) [hereinafter cited as C.B.Q.].


26. For example, Ghana is to pay for import of linen, bicycles, food and cotton yarns from China with two thousand tons of cocoa. At the current cocoa price, this barter arrangement is worth about $4.8 million. Trade News, 17 EUROMONEY TRADE FIN. REP. 7 (Sept. 1984).
transnational trade contract, but some specific provisions need more attention.

B. CONTRACT CLAUSES

*Introductory clause.* This should provide that the two parties are entering into a two-way exchange of products and that the two deliveries are each in consideration of the other.\(^{27}\)

*The quality control and delivery provisions.* These are necessary because the delivery of two sets of products must be dealt with. The identification of the goods to be exchanged, the specification of quality standards, the delivery schedule,\(^{28}\) and the right of inspection must be emphasized. The quality of the bartered products must meet the standards agreed upon by the two parties involved.

*Bank guarantees.* Because there are usually no funds transferred in a barter arrangement, a standard letter of credit cannot be used to provide security. The barter contract should provide for parallel bank guarantees in the form of standby letters of credit, whereby the nondefaulting party may obtain payment in hard currency from the other party’s bank in the event of a default.\(^{29}\)

*Price.* Pure barter transactions involve no currency. The amounts of goods that flow in each direction are defined by the partners as equal in value. Partial barter involves a percentage of cash and the rest in goods. The amount and quantity are negotiated in terms of barrels, bales, tons, liters or other physical measurement. Negotiators may use what amounts to a shadow price in defining each product’s trading value in terms of the

\(^{27}\) Here, by way of example are provisions from two barter agreements—

B shall deliver to A, F.O.B. X, A’s total annual requirements, not to exceed . . . barrels, of naphtha meeting the following specifications (b’s quality of naphtha): . . .

A shall deliver to B, F.O.B. Y such quantities of naphtha meeting the following specifications (A’s quality of naphtha). For each barrel of A’s naphtha delivered to B by A hereunder, B shall deliver one barrel of B’s naphtha to A.

*Textes et Documents,* 8 D.P.C.I. 360 (1982).

A payment provision, set forth in each of two agreements closely linked by a special clause obviously creates a barter contract. Each agreement provides that “payment shall occur by 100 percent of product compensation represented by the transfer of product under the other agreement.”

*ACECO, le guide pratique de la compensation,* at 140 (1983).

\(^{28}\) The Soft Adjustment Clause is an interesting way to cope with surpluses, stockage or shipping problems in contracts involving large exchange of minerals, oil or agricultural products. This clause provides that upon request by one of the parties and in case of an imperative reason, the quantity during the delivery time can be modulated from maximum 10 percent up to maximum 10 percent down of the initially agreed delivery program.

\(^{29}\) Marks, *Counseling U.S. Clients in Countertrade Transactions,* *SEMINAR,* *supra* note 21, at 90.
other product. This shadow price, the value of the goods in a free market, is in the back of the mind of each negotiator as a common denominator to make the barter transaction workable.

**Contingency clause.** The chances of a full or partial default occurring are more frequent due to the presence of two sets of goods. The risk increases with the number of variables associated with the production, packaging, shipping and delivery of adequate quantity and quality in the time required. Certain provisions must be included to guarantee the quality and the delivery of both sets of goods.

**Escape clause.** This clause provides that in the event one party is determined (through arbitration or other means as provided in the contract) to have substantially breached its portion of the obligation, the nonbreaching party has the option to be paid in cash immediately according to a preagreed price in currency in lieu of being forced to wait for the delivery of the bartered product. In addition, the clause should provide for the termination of the obligation of the nonbreaching party so that if the breaching party is, later, in a position to perform, the nonbreaching party would be under no obligation to purchase the items.

C. **THE CASE OF CRUDE OIL EXPORTERS**

Barter in crude oil is the best known example of a convenient arrangement because the energy source is sought by all countries. Oil is now

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30. If the free market price of product A is 20 cents a pound and the price of product B is fifty cents a pound, the two products will be bartered at roughly 2.5 to 1 in quantity.

31. The U.S.—Jamaican Agreement creates a barter account: “Payment to the Commodity Credit Corp. (CCC) for the FAS value of the (milk product) delivered to and accepted by the Bauxite and Alumina Trading Co. Ltd. (BATCO) shall be paid for by delivery to CCC, . . . , of a quantity of Bauxite equivalent in total value to the total FAS value of the (milk product) delivered. CCC will establish a ‘barter account’ in which the value of exports of (milk product) will be applied against the value of bauxite delivered to CCC in accordance with part A of this agreement.” Barter Agreement between the U.S. and Jamaica, supra note 23, art. 12 (1).


—Detailed specification and description of goods.
—Guarantee of quality and quality control.
—Right of inspection.
—Right to neutral surveyor.
—Determination and settlement of claims, penalties in case of late delivery, delivery of nonconforming goods and failure to deliver.
—Force majeure.

33. “If and to the extent such imbalance (in deliveries) was caused by an occurrence provided for in the (Section dealing with Force Majeure and failure to perform), the owing party shall settle such imbalance by making payment (in currency) to the other party. . . .” *Textes et Documents*, Oil Exchange Agreement, 8 D.P.C.I. 360 (1982).
used as a "cash commodity" in international trade and, today, most of the European countries are engaged in oil barter as "purchasers." Some recent deals can clearly illustrate this new trend: Saudi Arabia acquired ten Boeing 747's which were paid for with a quantity of oil equal in value to the full purchase price of the airplanes. Krupp, the West German steel manufacturer, has sold steel products worth U.S. $80 million to Iran against payment in oil worth U.S. $100 million. Dessault, the French aerospace company, bartered Mirage 2000 aircraft worth U.S. $400 million for oil from Abu Dhabi.\(^{34}\)

European countries and Japan actively try to solicit barter transactions with oil instead of other products. They are doing this for three reasons. They need the oil as a strategic material within their country; the oil does not interfere with any of their domestic industry; and barter in turn fosters their exports to the oil supplier.\(^{35}\) To stabilize their national oil reserves, Western governments can seize the opportunity of a depressed oil market to put pressure on a country that is particularly in need of increasing its oil sales. Today, Iran is in this latter situation and actually "discounts" its oil in giving quantities than needed for the value of the bartered Western goods in order to attract goods urgently needed for its population and also to save currency to buy weapons on the world market.\(^{36}\)

On the other hand, because production of several oil producers has fallen sharply, at such times they are anxious to trade oil directly for imports to protect dwindling cash reserves and defend their official prices.\(^{37}\) For producer countries, oil bartering is a market tool when direct sales are decreasing due to new competition from offshore drilling. Oil countertrading clearly damages the cohesion of OPEC, although it should not be assumed that, in all cases, this constitutes breaches of OPEC's quota system.\(^{38}\) But, barter is clearly a good weapon for the industrialized countries, which can export valuable products and be paid in oil outside the OPEC regulated market.

Oil barter brings about several legal questions. The value of the goods exchanged may well not match their theoretical dollar value because the

\(^{34}\) Trade News, Euromoney Trade Fin. Rep., at 7 and 36 (February 1985); Int'l Trade Rep., Aug. 1984, at 221.

\(^{35}\) Martin, Corporate Experience in Oil Barter, Seminar on Countertrade, supra note 14 (Mr. Martin spoke as the Director, Westinghouse Trading Co.).

\(^{36}\) Greece, Iran $200 Million Barter Deal, J. Com., September 18, 1984, at 6A.

\(^{37}\) Libya and Algeria are forcing barter deals on trader to move their oil amid glut. Wall St. J., January 22, 1982, at 31.

\(^{38}\) "If the oil market continues its decline in 1985, then more oil barter deals can be expected." Ibrahim, Oil Traders Find They Have to Learn Some New Tricks, Wall St. J., March 11, 1985, at 32. In OPEC, 15 percent of oil production is bartered, and non-OPEC countries are largely bartering their crude oil to gain market powers, to increase oil production, and to maintain their levels of employment. Countertrading, Financial Times, February 7, 1985, at Sec. IV (a Financial Times Survey).
transactions are in the control of the national institutions, not the international credit system. The value of the received goods and the quantity of the bartered oil must be kept secret to avoid third-party claims for market disruption. In medium- and long-term contracts, a clause requiring regular review of quantities pursuant to change of oil prices would avoid surprise at the end of the transaction.

Three main documents are involved in an oil barter transaction: (1) a contract between the project or equipment supplier and the oil producer; (2) a contract between the project or equipment supplier and the oil taker (e.g., traders, other corporations, governments); and (3) a document of acknowledgment between the oil taker and the oil producer.

The proceeds from the oil sold by the oil taker have to be deposited in a special frozen account, called an escrow account before the entire deal is performed.\(^3\) This account is opened in a Western bank to avoid blockage of funds and will be in the name of the project or equipment supplier, which would draw down on the account in accordance with the terms of payment. The negotiating and drafting of the contract requires a group of specialists due to the complexity of the oil business. Oil barter involves important risks such as the fluctuation in the market price of crude during the term of the contracts and its high susceptibility to political problems. A contract termination by the oil taker could stop the flow of funds for the project supplier. On the other hand, if the oil producer stops shipment and the oil taker is left without the crude to fulfill a long-term commitment to the ultimate user of the oil, the project supplier that initiated the transaction could be caught in the middle.\(^4\) Finally, the oil taker is entitled to a commission for the service provided to the project supplier.

As seen in this barter problem, the technique has some advantages for both parties: a persuasive way to avoid financial issue in the producer country and a guarantee of payment and merchandisable materials for the Western country.\(^5\)

III. Counterpurchase

A. Notion

A counterpurchase contract has been defined as a transaction in which the seller provides the buyer with deliveries and contractually agrees to

\(^3\) An escrow account, or blocked funds, is a financial arrangement whereby an agreed bank holds funds as an agent for the other two parties and only releases those funds under certain specified circumstances. The funds are blocked until performance of the conditions. See, e.g., McVey, supra note 9, at 34.

\(^4\) Martin, supra note 35.

\(^5\) This is the reason for the swing away in barter contracts from manufactured and processed goods as the "currency" toward raw materials, minerals, and agricultural commodities: the greatest risk being nondelivery of the commodity by the second party.
purchase goods from the buyer equal to an agreed percentage of the original sale contract value.\textsuperscript{42} This countertrade transaction usually takes the form of a "contractual triangle" composed of three separate but related legal instruments that, when taken together, establish the terms and conditions of the deal:\textsuperscript{43} (1) the principal contract for a sale is a standard cash-for-goods transaction; (2) the counterpurchase contract sets the terms and conditions of the original seller's obligation to purchase goods from the buyer; and (3) a protocol that serves to link the two contracts is an instrument to agree under which both parties commit themselves to enter into their respective contract to purchase the other party's goods. This protocol is often included in the counterpurchase contract as a special provision.

This contractual arrangement builds a special mechanism where one party agrees to purchase goods from another upon the condition that the second agrees to purchase goods from the first.\textsuperscript{44} The two obligations should be viewed as distinct transactions with separate contracts and separate currency payment. Counterdeliveries in these transactions are generally not resultant nor related products to the goods delivered in the original sale, but are chosen from among a range of products offered in the counterpurchase contract by the foreign trade organization or the local companies.\textsuperscript{45} This contract is viewed then as a frame contract which will fix the obligation of the parties without any precision as for the goods. Thus, secondary sales contracts are not uncommon due to the new transactions with the owners of the various goods listed in the counterpurchase contract. The duration of the entire deal is only one to three or five years. The commitment for reciprocal purchase is stated in currency or as a percentage of the principal contract and varies from ten to a hundred percent.\textsuperscript{46}

Normally, the counterpurchase contract allows the Western company to assign its counterpurchase obligation to a third party, a trading house or another foreign buyer. If the Western company cannot find any products in the offered list that it can use in its own operations or that it can easily market through its organization, it often transfers its obligation to a trading

\textsuperscript{43.} Welt, \textit{supra} note 1, at 39.
\textsuperscript{44.} For the sake of clarity, the first party refers to the exporter in the principal contract becoming the buyer in the counterpurchase contract, and the second party refers to the importer in the principal contract becoming the seller in the counterpurchase contract.
\textsuperscript{45.} General Electric won a bidding war for a $150 million electric generator project in Romania against Hitachi and Siemens, not because of a major technological or cost advantage but because it agreed to market $150 million worth of Romanian product as a Counterpart. Yoffie, \textit{supra} note 1.
house which will dispose of the goods for a commission or a discount, called a "disagio."

B. Contract Clauses

Introductory clause. Such a clause is typically used as an opportunity to "tie" this contract with the principal contract or simply to point out that the contract is part of a countertrade agreement in referring to a protocol. The clause, already, raises the whole problem of dependence or independence of the contracts. 47

Countertrade clause. This is an acknowledgment of the obligation by the first party to purchase goods from the second party. The countertrade obligations are frequently measured in percentage referring to the total amount of the principal contract. 48 A mechanism should be included to adjust the obligation if there is a change of amount in the principal contract.

Period of time. The parties must agree upon a time schedule in which the first party is allowed to fulfill its counterpurchase obligation. Obviously, the longer, the better: one to three years is typical. The effective date of the contract is usually the same as in the principal contract. Two different obligations are current practice: either the first party has to perform during the total period at any time; or the first party agrees to purchase a specific amount each year or every six months. In this latter case, the obligation is spread out over the period of time. For that purpose, a multisupply clause will be drafted in the contract.

List of available goods. A list of goods from which to choose is always a better solution than specific and located goods because during the negotiation period the first party can already valuate its market ability to resell these goods or already contact traders specialized in certain types of products. 49


48. The obligation, in a counterpurchase contract, can be established both in percentage or in a specific amount, as in the following provision:

Company A, by itself, or through a third party, agrees to buy products or services in Country B—either during X years upon date of conclusion of the principal contract and for the following total amount . . . . FF—either 50 percent worth of the current value of the principal contract.

ACECO, supra note 27, at 130.

49. The most undesirable goods are finished products while the most desirable goods include raw, semiprocessed materials, ores, chemicals, agricultural or energy sources. The poor quality of counterpurchased finished products makes them unmarketable. Dizard, supra note 1, at 89.
Quality and quantity control. Obviously, the first party must try to avoid acceptance of inferior quality or nonmarketable goods. This provision therefore, must state that goods will not be accepted unless meeting the agreed specification or international market standards. If they do not, an option can be opened to the first party for a reduction in price or an alteration of purchase requirements. The quantity can be fixed in an exact quantity of specified items or in the percentage of various goods included in a global package expressed in hard currency.50

Right to inspect; right to neutral surveyor. It is in the interest of the first party to have the right to reject the goods in the event that the goods do not conform to the contract specification. As an alternative, the countertrade agreement should include a right of inspection by a neutral surveyor selected by both parties. There must be acceptance of a binding decision from the surveyor concerning the quality or quantity of the goods in question.51

Warranties. Due to the variety of the goods that may be included in a countertrade contract, the counterpurchase contract should provide that the warranties to be given in connection with each purchase will be those that are customary in Western markets for the goods involved. The provision might expressly state that the second party will warrant fitness, merchantability, conformity to samples, descriptions and proper packaging.52

Price. A prearranged price will most likely be established in hard currency. Prices under principal contract and counterpurchase contract should be fixed in the same currency to avoid the impact of exchange rate fluctuations. If the first party can select what goods to purchase over a period of time, the price will normally be expressed by a formula.53 A level of undetermination in the price is generally sought for successively performed contracts. In the frame contract, the price formula normally allows a future estimation at the time of purchase and an avoidance of contingency in world price changes. A "most favored customer" clause can be helpful to avoid later surprise in price differentials.

50. Park, Countertrade Requirements in East-West Transactions, 10 INT'L BUS. LAW. 122 (1982).
51. See, e.g., "Refusal of Control is considered as a refusal of performance that has for consequence the cancellation of the counterpurchase contract." Counterpurchase Contract between a French and a Yugoslavian Corporation, Article 11, in ACECO, supra note 27, at 133 (Annex 3A).
52. For example: "The counterpurchased products shall be of 'expert quality' and satisfy buyer standards or specifications." Counterpurchase contract in East Germany, ACECO, supra note 27, at 130 (Annex 2).
53. Pricing formulae can vary from "the acceptable international price at the time of purchase" to "the price of the product in X board of trade or exchange at time of purchase" or to "the competitive condition of world market at time of purchase."
Customer and territorial restrictions. The first party should obtain the consent of the second party that it can market the counterpurchased goods without restrictions as to geographic areas or potential purchasers. When dealing with a foreign trade organization, certain performed contracts prohibit the resale of products in countries where the foreign trade organization has already established a distribution system. Even if the contract is silent, it is advisable to expressly stipulate that the products may be resold worldwide. The right can be limited in time. To obtain freedom of market and customers for the counterpurchased goods, the protocol can be a solution. The first party should insist on the fact that the protocol expressly requires the second party or foreign trade organization of that country to grant non-exclusive distribution rights, over as wide a territory as possible, under each sale contract for the goods covered by that contract.

Multiple party clause. The problem of multiple party transaction raises a number of issues in case of nonperformance by one of the parties. The status of a third-party supplier of counterpurchased goods can be unclear. This case arises when the counterpurchased goods are not available directly from the second party. In CMEA countries, each foreign trade organization is specialized in certain goods and products. Agreement can be reached to obtain from a sister foreign trade organization counterpurchased goods more suitable to the first party.

The situation is more difficult in developing countries where the obligation of counterpurchase is generally requested by governmental regulations or decrees. In fact, the first party will have to choose the product from a limited list or will have to shop around to find a supplier in order to perform its duty. Naturally, this will raise administrative complications. The possibility to obtain products from a source than the second party has great advantages for the first party who can find the more merchantable products. But this first party must ensure that all its purchases from the third party are well settled vis-à-vis the second party. The end of the performance must be informed to the second party or the official department in charge of countertrade to avoid future problems.

55. Because those counterpurchased goods are more often difficult to market, any restriction concerning territorial distribution rights creates a more cumbersome way to do business. The classical problem of exclusive distribution right for sales contracts is at stake here. On the other hand, if market restrictions are present the first party should have a choice of goods as broad as possible. The following provision provides for the free choice of goods to counterpurchase due to a 100 percent counterpurchase obligation: "Company X commits itself to buy, directly or through third parties, Romanian made products specified by Common Agreements with Romanian export corporations." ACECO, supra note 27, at 127 (Annex I).
56. Marks, supra note 29, at 75.
57. For example: "The Company A will regularly and promptly notify the FTO, through
A second problem is raised by the so-called "transferability provision." This clause provides the first party with the right to assign its obligation under the counterpurchase contract to a third party. The second party can require that this will be allowed only with its permission. The principal issue involved is whether or not the first party will remain liable or secondarily liable for the performance of the contract. Separate contracts between brokers and the first party for resale of the goods on the world market does not bring any problems for the second party; since there is no substitution of person, the first party is still liable for breach of contract or default created by the third party. The third party is not a direct party to the counterpurchase contract but a distributor engaged in a separate contract with the first party. But the first party's principal problem is to avoid incurring greater liabilities to the distributor in the event of non-performance (e.g., default, delay, poor quality) by the second party of its supply obligation under the counterpurchase contract. The solution is more often found at the negotiation table.

On the other hand, if the counterpurchase contract is concluded directly between the third party and the second party and if there is no reserve regarding the first party liability, the latter is no longer liable to the second party.

But the first party may remain also jointly liable for the performance of the counterpurchase contract by special provision or by effect of the applicable law. The case is even more complicated when problems occur in the principal contract. The agreement between the first party and the third party is often a contract in which the third party assumes the counterpurchase obligation in consideration for a commission. What then is the relation between this subcontract and the principal contract?

When the principal contract is not concluded or cancelled, is the third party entitled to its commission? If the contract is not concluded, the third party seems to be not entitled to its commission because its own subcontract was suspended under the condition of the conclusion of the principal contract. If the principal contract has been concluded but not performed, the first party will stop paying any commission to the third party. But the third party has maybe already taken some steps to distribute the counterpurchased goods. It has, for example, been in frequent contact with the second party to perform the counterpurchase obligation. The solution is in the reading of the contract and the intent of both parties. Where the will of the parties does not converge, the two contracts, prin-

the Foreign Trade Bank, . . . . about the fulfillment of their obligations, that is, regarding contracts concluded with XYZ exporting organizations and regarding payment made pursuant to these contracts." Draft of an actual counterpurchase contract with Bulgaria, Art. 5, reprinted in Welt, supra note 1, at 216.

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Principal contracts and subcontracts, could be considered independent of each other.  

**Penalty clause.** The nonfulfillment of the obligation to counterpurchase is sanctioned by a penalty clause. This clause is generally at a rate of 5 percent to 20 percent of the contract value or of the unfulfilled portion. The rate is often negotiable, but sometimes provided by regulation.

A provision must specify that the payment of the penalty clause does extinguish the obligation to counterpurchase the goods. This is also an important issue to consider during negotiation of the contracts. Sometimes, the second party never intends to make the counterpurchased products available to the first party. So, with the payment of the penalty, the obligation of counterpurchase is extinguished. The clause is then treated as a price reduction of the principal contract.

Some multinational corporations prefer to pay the penalty in order to avoid the counterpurchase obligation. Obviously, the price of the goods in the principal contract includes the penalty to cover the costs. But the technique is generally not conducive to further trade relations. In addition, this is impossible to apply in case of mandated or requested counterpurchase by governmental policy.

In any event, the first party should be assured that once the penalty is paid, all of its obligations under the second agreement will terminate. It should be also specified that payment of a penalty by the first party does not affect the obligations of payment under the principal contract. Where the contract is silent to the result of payment of the penalty, the first party should stipulate a law, as the applicable law of the contract, which does not allow recovery of both penalty and principal. To avoid any trouble,

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59. As another "penalty technique," a principal contract with Romania even provides that the Romanian F.T.O. has the right to refuse the product delivered under this contract the day after the deadline foreseen for the conclusion of a counterpurchase contract.


61. The next example of a contract provision shows the critical question arising under a penalty clause. Indeed this provision does not extinguish the obligation to counterpurchase the goods:

If the above is entirely or partially not fulfilled within the agreed period, X . . . will pay, on the first demand of Y . . . , a penalty of 5 percent calculated on the value of the unfulfilled portion; without being released from the counterpurchase obligation to be performed within an additional time period forced by Y . . .

Fontaine, *supra* note 54, at 198.

62. Courts in various civilian law countries have also held that a certain percentage of penalty regarding the circumstances of the contract is considered improper and excessive in the trade law. Fontaine, *Les Clauses Pénale dans les Contrats Internationaux*, 8 D.P.C.I. 401 (1982). Common law jurisdictions continue to show hostility toward penalty clauses.
the agreement could just provide that the payment of penalty constitutes the sole remedy against the first party for any failure to purchase countertraded goods. Finally, the penalty clause is often independently covered by a first demand bank guarantee.

C. CROSS RELATIONSHIP BETWEEN THE TWO CONTRACTS

Preferably, the original contract does not refer to counterpurchase contracts and stipulates total payment in cash. In theory, each contract follows its own path but legally an important issue is raised: whether a difficulty arising in one of the contracts could influence performance of the other. Consistent with the intent of the parties, deliveries and counterdeliveries are part of one "deal" negotiated as a whole. Moreover, the amount to be purchased in the counterpurchased contract is stipulated in reference to the value of the principal contract; the effective date is the date of the principal contract; and the parties would not have concluded the counterpurchase agreement if the negotiation of the principal contract had failed.

The principal contract. The independence of the principal contract is necessary with no reference at all to any counterpurchase requirements. If the obligations of the counterpurchase contract are not properly performed, there are normally independent sanctions such as penalty clauses but the principal contract must not be affected. This independence of the principal contract is important for four main reasons:

(a) in order to obtain financing and credit risk guarantees from banks or export insurance credit from an insurer;
(b) greater flexibility in performance of contract stipulations because goods are different, deliveries are different and delays are different;
(c) the need to keep payment for the principal sale unencumbered by the conditions of the obligation to accept counterdeliveries. A Western company entering into a countertrade transaction under a single contract could place itself in the risky position of having to fulfill its counterpurchase obligation in order to receive payment for its export sale; and

E.g., 5 WILLINSTON ON CONTRACTS § 776 (1961).
In U.S. law, a strict penalty clause might be invalidated. In that case, the clause should be drafted as a liquidated damages provision, reciting the impossibility of determining actual damages. Hayward, Contracting for Countertrade: Recognizing and Avoiding the Pitfalls, SEMINAR, supra note 21, at 81.

63. Thomas B. McVey, Statement at the Seminar on Countertrade, supra note 14; P. VISHNY, GUIDE TO INTERNATIONAL COMMERCE LAW § 13.06 (1984).
(d) the opportunity to transfer the obligation of counterpurchase to a third party in keeping discretion over the principal contract.

Some standard contracts or even the negotiators themselves, require an express clause in the principal contract incorporating the counterpurchase contract by reference: "this contract is effective at the same date of the counterpurchase contract and both contracts are therefore linked." This opens the door for the foreign trade organization or the developing country's company to retain payment of the main contract if nonperformance of the counterpurchase obligations occurs.

When only percentages are expressed in the counterpurchase contract, then the possibility is left to the Western country proportionally to decrease its obligation when the foreign trade organization reduces its own purchases from the principal contract. This is a good system when both contracts or at least the principal contract is an installment contract, because if the foreign trade organization stops to buy, directly, due to the provision of counterpurchase obligations expressed in a percentage, then the obligation of the Western company will decrease proportionally.

The counterpurchase contract. On the other hand, the counterpurchase contract is not independent from the principal contract. With the counterpurchase contract, the intention of the foreign trade organization is to sell its products regardless of what may happen to the original contract. The first party will buy only if the original contract is performed, and thus it is essential to stipulate what will happen to the counterpurchase contract if the performance of the principal contract is disrupted.

It is strange, but logical, to conclude that for those parallel transactions a one-way contractual dependence is created for the global agreement. However, the "real" cross dependence of the two contracts is even more accurate if a protocol "links" the contracts. Great caution must be given to the provisions of each agreement to define the scope of the obligations and liabilities of the parties.

Such a protocol could also be the instrument to develop the consequences of nonperformance or any default stemmed from the principal contract over the counterpurchase contract. The contrary has to be

64. Marks, supra note 29, at 69.
65. "In connection with Contract No. . . . the seller, Company A, obligates himself in a period of . . . from the effective date of the contract, on his own or through other parties, to purchase for resale without any restrictions machinery or equipment of his choice from the export list of the indicated organizations XYZ, in the value of. . . ." Welt, supra note 1, at 216.
66. "The purpose of this protocol is to establish and to express the parties' mutual intent to (i) intensify their commercial relations and to (ii) buy from and sell to each other the products as listed in Appendix A and B attached hereto and made part herof." EEC Commission, Protocol for a Countertrade Transaction in Poland (19—).
avoided, in the interest of the Western party, for the reasons explained earlier. The counterpurchase contract must have its own sanctions for nonfulfillment without requiring a nonpayment of the principal contract until the counterpurchase obligation is performed. The Western party should better avoid that the local party takes the opportunity to set-off its debt for the principal contract with its receivables for the counterpurchase contract.

The Controversial Issue. The interdependence or independence of the two contracts in a counterpurchase transaction raises a controversial issue. The first theory expresses strict independence of the principal contract pursuant to the concept of contractual freedom. Clearly, the possibility is offered to the parties to draft and underwrite two different instruments or one single contract. The choice of the parties creates the law of the transaction. Indeed, the text of the contracts often states their agreement of the governing law between them. The intent of the parties can be to make two separate contracts unrelated in order to clarify their rights and duties and to obtain some bank guarantees and insurance coverage. But, if complete independence of the two contracts is established, the risk exists that the first party will have to perform the counterpurchase contract even if the principal contract is cancelled.

On the other hand, the interdependence of the two contracts in one single economical or legal agreement, even if there are two "instruments," can be sustained with the theory of common scheme and real intent of the parties at stake. The interpretation of the contract has to be done according to the reality of the intent of the parties rather than according


68. The following provision involves important and risky consequences for the first party in case of default:

In case of non-fulfillment by Company A of the obligation (to counterpurchase) the FTO has the right to deduct sum stated in clause . . . . from the Company A's invoices. Should for any reason the stated sum not be deducted by the FTO while paying Company A's invoices, the latter is to pay this sum at the first demand of the FTO.


70. Several U.S. authors emphasize the great danger of interdependence of the two contracts and urge businessmen to draft two clear separate instruments. They advise that the principal contract should not contain any reference to the counterpurchase contract. McVey, supra note 9; Grabow, supra note 47; Welt, supra note 1, at 40; Hayward, supra note 62, at 99.

71. Other systems in commercial contract law create separation of contracts representing the same deal and each contract will follow its own rules: the bill of exchange system or the irrevocable letter of credit are two good examples.

to the literal sense of the terms. Equality between the contractual parties and reciprocity of the advantages are expressed if the analysis of the reciprocal sale contract is made through the idea that one contract is done upon the condition that the other one is performed. The basis of the agreement is truly the condition: "I do purchase if you also agree to purchase from me." In this legal relation between the parties, there is reciprocity.

The setting of the agreement is done through one unique negotiation even if it results in two written contracts: export and import are obviously linked. One can sustain that the counterpurchase contract inevitably completes the principal contract and therefore makes up a common body. Any attempt to separate them or to make the principal contract independent and autonomous violates the intention of the contracting parties.73

Furthermore, the protocol often used for these countertrade contracts seems to establish an agreed linkage between the two contracts and obviously creates a potential cross reference between both contracts. It seems that with a protocol the intent of the parties to closely link the principal and counterpurchase contracts is clearly emphasized.74

D. THE FIRST INTERNATIONAL CASE ON COUNTERPURCHASE CONTRACT

The controversial linkage issue becomes even more complicated when third parties are involved. In 1982 a lawsuit was brought before a German Court of Appeals dealing with a counterpurchase contract.75 This decision seems to be the first one on that subject matter and the main issue was the notion of independence of the contracts and which circumstances should apply to clarify the question.

In 1977, a German steel company obtained a contract to deliver a turnkey plant in Iran to a state corporation. As a countertrade obligation, the German company committed itself to buy crude oil from a second state corporation for a hundred percent of the value of the turnkey plant. Thereafter, the German company entered into an agreement with a Belgian oil company to transfer the obligation to market the crude oil. The Belgian oil company committed itself to purchase the crude oil directly from the second Iranian state corporation. The oil company would also receive a

73. Id. at 181.
74. In U.S. law the notion of consideration in contract law can help this interpretation. Indeed if one considers that the consideration for one contract is the other contract and reciprocally because the deal is to compensate an import through an export, the linkage could be affirmed even without a special provision in the principal contract.
75. Oberlandesgericht, 17 U 151/81 December 1, 1982 (Dusseldorf) (the text of the decisions was obtained directly from one of the companies involved).

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discount (as specified in the agreement) from the German steel company for taking the counterpurchase obligation and because the price of the Iranian oil was higher than the average market price at that time.

In 1978 troubles occurred in Iran and the steel contract was not performed, but a certain quantity of oil was already purchased and shipped by the oil company. The counterpurchase contract was, therefore, in the performing stage. The German steel company refused then to pay the discount to the Belgian oil company which later filed an action before the German court to recover the discount and interest due. The German company alleged before the court that the counterpurchase contract and the principal contract were so clearly linked that the breaching of the principal contract lead to the cancellation of the counterpurchase contract. As a special argument on appeal, the German company alleged that the oil company had no right to the discount because the basis of the principal transaction had disappeared. The Belgian company alleged that the agreement between itself and the German company came into force when the counterpurchase contract was signed, and was not under condition that a turnkey plant contract be performed.

The court of appeals agreed with the analysis of the trial court and affirmed. The trial court had held, first, that the linkage between the two contracts was only implemented by the fact that they were signed together. Moreover, the oil contract did not refer at all to a breach of the principal contract, nor were there any provisions suggesting that the oil contract would come into force only when the turnkey plant contract was performed or when at least a down payment was made to start the process. Second, the Iranian parties involved never proved that the counterpurchase contract would be the consideration for the turnkey plant contracts. Third, the Belgian oil company directly started to buy crude oil in Iran expecting the discount from the German company because if no discount were paid, the deal was not profitable for the Belgian oil company. The Belgian oil company had no obligation to cancel its counterpurchase contract in order to exempt the German company from paying the discount, because nothing was specified about that duty in any of the contracts. Finally, no general obligation was forced upon the oil company to aggravate its own condition in taking the oil at an unprofitable price due to consequences from a different contract between two other parties.

The trial court clearly ruled that the provisions of the various contracts must show whether there is dependence or independence of those contracts, one vis-à-vis the other. The trial court further ruled that there is

normally independence if nothing is foreseen in those contracts unless the circumstances of the transaction or interest of the parties show the contrary. It also ordered payment of the discount in favor of the Belgian oil company.

In fact, the German steel company failed to show the interdependence of the principal contract and the counterpurchase contract because neither the contract nor the meetings between the parties nor the letter exchanged showed an intent to link the performance of both contracts. On appeal the German steel company emphasized the disappearance of the ground of the global transaction that would consequently cancel its obligation to pay the discount. The court of appeals refused to endorse that theory and distinguished between the closing of the deal and the performance of the deal.

Indeed, the German steel company would not have been compelled to pay the discount if the bidding was not accepted and the turnkey plant contract not signed. But, on the other hand, the counterpurchase contract between the Belgian company and the Iranian oil company, and the agreement between the German steel company and the Belgian oil company, did not refer at all to a condition of performance of the principal contract. So, the Belgian oil company could not have expected that its contract was under the condition that the principal contract would effectively be performed. (In fact, part of the crude oil was already shipped before the principal contract could even start to be implemented.) The court of appeals ruled that the performance of one contract cannot be the condition for the payment under another one unless specifically stipulated by the parties.

Finally, the court of appeals replied to the argument that the Belgian oil company acted in bad faith in asking payment of the discount because it had to assume the common risk of the transaction. This global agreement was a risky business for both parties, but nothing was foreseen in the contract in case of force majeure. So, the Belgian oil company had no duty to cancel its own contract to avoid extra expenses to the German steel company. The court of appeals held that there was no duty for a company to aggravate its own situation for the benefit of another party. Indeed, the Belgian oil company could not buy crude oil elsewhere at a profitable rate because the price increased drastically during that period. The "common risk sharing" failed also to convince the court of appeals that both contracts were interdependent.

E. The Case of Indonesia

In January 1982, Indonesia issued guidelines imposing a counterpurchase policy which was updated in April 1983 in the form of a directive.77


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This directive appears to be the first example of a mandatory countertrade policy enacted by a developing country to face balance of payment deficits and scarce hard currency reserves. The purpose of the directive, as set forth in its provisions, is to promote the export of and to diversify markets for Indonesian products.

Conditions. Mandated counterpurchase is limited to government contracts of at least U.S. $500,000. Private sector transactions are not affected. Also excluded from counterpurchase requirements are projects financed by multilateral development banks and projects involving country-to-country assistance, procurement of services from abroad (such as consultants) and joint venture projects with foreign parties.

The counterpurchase ratio is 100 percent and eligible products must be chosen from a list drawn up by the government.

Mechanism. Under this requirement, if a company's bid on a government tender is successful, the company must purchase agricultural or industrial goods with one or more Indonesian exporters to ratify its export obligation. A letter of undertaking will confirm the foreign company's commitment.

The exporter is allowed to have a third party carry out its export obligation by permission of the Department of Trade. To limit the possibility of Indonesian countertrade goods competing with regular export products on Indonesia's traditional markets, the foreign buyer must undertake to use or to resell the Indonesian goods in its home country, unless the Department of Trade authorizes otherwise. Exports to a third country are only permitted if the country concerned is a "new market" for the Indonesian product in question. This clearly puts a heavy burden on the foreign firm to find new markets for the products.

The counterpurchase of the goods must take place during the term of the contract for the government and within six months after receiving the award of the principal contract. In addition, the counterpurchase obligation must be completed before the end of the government contract.

It is also expressly stated that, in any event, the winner of the tender assumes full responsibility for the counterpurchase obligations unless a special release is issued by the Department of Trade. The penalty clause is very onerous, because if the winner of the tender, or the third party designated, has not fulfilled its export undertaking by completion of the government contract, it will be subject to a penalty of 50 percent of the value of the remainder of the goods not exported. The next years will show in commercial figures if this policy is fruitful, or not, for Indonesia.

78. Id. Art. 1-2, 4, 5, 6, 7.
79. Id. Art. 1-5, 7, 8, 14, 16; Art. IV-1.
80. The value of Indonesian contracts to February 1986 is worth approximately U.S. $765.
IV. Offset

A. Notion

Offset is an agreement in which the foreign purchaser, usually a government, requires the contractor to agree to purchase a predetermined level of components from subcontractors located within the purchasing nation, or to fulfill other portions of the private firm's international purchasing requirements from firms within that nation, or even to assist that nation in selling its unrelated products to third parties.81

Basically, it is a transaction in which an exporter transfers parts of the performance of its sales contract to suppliers located in the purchasing country. Offset is a regular component of large defense, aerospace or high-tech transactions.82 These arrangements usually combine domestic content, subcontracting, cooperation and technology-transfer requirements with long-term delay.

Such practices have been used by importing governments as a means of improving industrial development and domestic employment, as well as a tool to transfer technology.83 Offset is part of the countertrade arrangement in general but it is not a single or particular contract. It has to be analyzed as a global program, a group of contracts based on the same main purpose but with various typical obligations. The terms in individual subsequent contracts may vary substantially but the general purpose, from the buyer's point of view, is to take as many advantages as it can of a multimillion dollar transaction. Offset is a frame contract giving the intent of the parties and the general overview of the agreement; subsequent contracts will deal with the implementation of the offset program. In a broad sense, offset is a commitment by the seller to do something which has some positive impact on the economy of the purchaser country.

81. McVey, supra note 9, at 12.
82. Even European countries, Canada and Australia are using countertrade in offset contracts to develop their local employment and to improve aerospace and high-tech industry. Belgium, for instance, requires 100 percent compensation in offset contracts for new military and aerospace contracts. Certain requirements go as far as to ask a parallel contract in the seller country: parts made in Belgium are used for U.S. airplanes in the United States. Office Beige du Commerce Exterieur, Compensation, Informations 5 (April 1984).
83. A recent amendment to the U.S. Defense Production Act Amendment of 1984, Pub. L. No. 98-12, Title III, § 309, requires the President to submit a report within eighteen months on "the impact of offsets on the defense preparedness, industrial competitiveness, employment, and trade in the United States." The report should also examine "bilateral and multilateral negotiations of offset in international procurement and provide information on the types, terms, and magnitude of offsets."
In specialized contracts with sophisticated equipment and technology, the buyer does not want to be totally dependent on the seller. More and more, countries want to be able themselves to maintain, to repair and even to build their defense system, their aircraft fleet or their high-tech equipment. Because there are sometimes changes in the governmental policy or in the international official relationship, the old system of supply of military equipment in direct sales contracts is a risk for the nation. An indigenous defense industry and less dependence on sophisticated weapons are strong motivations to avoid future supply interruptions or maintenance deficiencies. In the aerospace and military industries, offset agreements are used as a competitive tool because at this high level of price and technology, the bidding contractor can afford those requirements to obtain a contract. Offset has spread in developing countries and become more elaborate as countries gain increased bargaining power and see other successful offset transactions in other parts of the world.

Specialists view offset programs as continuing to spread because the buyers will appreciate offset as a practical way of developing their industrial base and sellers will be driven by competitive pressures to continue to offer offsets. Another reason is that each of the parties secures long-term arrangements for its reciprocal interest. Today the buying leverage is an important tool for developing countries where the costs of industrialization are very high. Offset programs are a good answer for those countries which want to develop their economy. According to some U.S. governmental sources, the volume of offset activity exceeded U.S.

84. McDonnell Douglas sold some F18-Hornets to Spain. The contract allowed the manufacture, assembly or installation of twelve components of the F18 in Spain and also the final assembly of seventy-six of the eighty-four aircraft. This is intended to strengthen the Spanish industry in aerospace and eventually generate future exports. O'Sullivan, U.S. Military Efforts: Net Benefit or Cost?, 3 C.B.Q. 50 (1984).

85. Offset differs from the usual forms of countertrade in that (a) the purchaser of the company's product is more often a foreign government and the product sold is a sophisticated and high value item and (b) the fulfillment of bilateral trade obligations is stretched over a long period of time.


87. Offset requirements can amount to from 20 percent to 100 percent and even more. Last summer the contract between Bombardier of Montreal and the Belgian government for twenty-five hundred Land Rovers was a classical offset deal. But the offset requirement was reported to be worth at least six billion Belgian francs, 300 percent of the contract straight value. This, naturally, secured the order against any competitors. Four Belgian companies will benefit, some of them through subcontract work on a totally unrelated project where Bombardier is supplying some equipment to the Metro in Portland, Oregon. Hurst, Government Turns Blind Eyes as British Countertrading Blossoms, 3 C.B.Q. 54 (1984).


$15 billion during the period from 1975 to 1981. The U.S. Department of Defense estimated that this figure would double by 1988. The only restrictions on the further evolution of offset are the potential multilateral restrictions made by agreement between nations and by international organizations, but this is unlikely to happen because the governments are always the bidders and are taking real advantage from offset programs. The key elements are the costs and benefits to the participants and the balance between the bargaining position of the buyer and the degree of corporate competition.

B. THE OFFSET PROGRAM

The offset program will start with the statement of the good will of the multinational corporation to perform its countertrade duty. Although the terms of the offset on individual contracts may vary substantially, offsets can generally be grouped into the following types:

Coproduction. Overseas production based upon government-to-government agreement that permits a foreign government or producer to acquire the technical information and know-how to manufacture all or part of an item of the first party's equipment. These arrangements will include assembly, processing, and the manufacture of components or equipment in the buyer's country.

Direct licensed production. Overseas production of all or part of an item of the first party's equipment based upon the transfer of technical

91. A survey issued by the U.S. Treasury Department in 1983 showed that over one hundred forty-three offset contracts involving twenty-six U.S. aerospace and electronic firms and U.S. $9.5 billion in offset were required from January 1981 through mid-1983. The total amount of sales was U.S. $16.1 billion during the same period and the deals were made with twenty-two countries. U.S. Department of the Treasury, Offset/Coproduction Requirements in Aerospace and Electronics Trade (March 24, 1984). Another survey performed by the U.S. National Foreign Trade Council revealed that the percentage of exports involving countertrade was higher in the high-tech industries: 47 percent in aerospace and 20 percent in electronic and defense compared to an 8 percent general average for the major exporters. U.S. National Foreign Trade Council, Survey of Problems in U.S. Countertrade, reported at the Seminar on Countertrade, supra note 14.
92. In the U.S. aircraft industry, Northrop Corporation has elaborated a complicated strategy to deal with offset requirements. Northrop's apparent specialty is export promotion in helping to market the client's product. One offset program was launched in 1975 for Switzerland when the Swiss bought Northrop's F-5 fighters. Through the help of Northrop's international sales network, Swiss products worth U.S. $209 million were distributed around the world. In Saudi Arabia, where Northrop has extensive contracts, Northrop has helped increase to two hundred the number of Swiss companies that are now selling there, up from twenty-five at the start of the program. The assistance of Northrop was valued at 30 percent of the purchase price of the aircraft. Northrop's Skill in the Countertrade Game, Business Week, July 19, 1982, at 121.
93. Verzariu, supra note 68, at 43.
information and know-how under direct commercial arrangement between a manufacturer and a foreign government or producer.

Subcontractor production. Overseas production of a part or an item of the first party’s equipment. The subcontract does not involve license of technical information or know-how and is usually a direct commercial arrangement between the manufacturer and a foreign producer.

Overseas investment. Investment arising from the offset agreement, taking the form of capital invested to establish or expand a subsidiary or joint venture in the foreign country. Such operations may be commercial in nature or involve research and development programs.  

Technology transfer. Occurring as a result of an offset agreement, this may take the form of research and development conducted abroad, technical assistance provided to the subsidiary or joint ventures of overseas investment or other activities under direct commercial arrangement between the manufacturer and a foreign entity.

Counterpurchase. Purchase of goods and service from the buyer country as a condition of the offset program. These purchases may be made by the first party’s country, the first party itself, the first party’s suppliers or by third parties with whom the first party contractor acts as middleman. The purchase may involve products for defense or civil use.

These offsets have emerged in two forms: direct and indirect. With a direct offset transaction, the seller agrees to coproduce specific components of his products in the buying nation’s territory. There are several ways to execute a direct offset, the most common being through coproduction, direct license production and subcontractor production or maintenance agreements. Indirect offset is where the exporter agrees to assist the importing country in the development of its export or investment requirements unrelated to the principal contract.  

C. THE AUSTRALIAN OFFSETS PROGRAM POLICY

Since 1970 the Australian government has enforced a policy requiring foreign suppliers to offset all overseas military and civilian procurement where government funds are involved or where there is government in-

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94. A very recent, innovative requirement in offset programs has been created by Saudi Arabia which requests new investment inside its country. Saudi Arabia is asking that the bidding companies on the U.S. $3.95 billion AWAC System commit themselves to invest 35 percent of the contract value in high-technology projects inside Saudi Arabia. Saudi Arabia uses the size of the defense contracts as leverage to obtain foreign management and expertise that will help start an internal high-tech industry. Saudi officials actually want new operations to be set up through the joint venture technique. New Saudi Twist on Offset Requirements, Bus. Int’l, May 11, 1984, at 145.

95. Verzariu, supra note 88, at 8.
volvement in the purchasing decision. Commercial transactions devoid of official involvement are not affected by this policy. The offsets program has as its primary objectives the upgrading and the technological advancement of domestic manufacturing industries and as a secondary objective the creation of new employment. Under the policy overseas suppliers are required to transfer to local industries some technology comparable with that embodied in Australia’s purchase. There is a strong preference but no requirement that offsets be directly related to the initial procurement.

The notion of offset is broadly viewed and several possibilities are considered: component production; consulting; research and development work; subcontracting; procurement of unrelated items manufactured in Australia; and counterpurchase. Offsets are to be provided to value exceeding 30 percent of the contract value where the contract is Aust. $1 million or more. Offset can be required for various types of contracts for goods and/or services arranged with an overseas supplier. This concerns single order contracts, all orders placed under a period contract, extension to any contract, and lease or hire contracts. Offsets are not required where the imported goods or services are being purchased or based by a private enterprise in which there is no government financial interest or where the goods are of relatively low technological value. The offset program creates an interdepartmental committee to coordinate the offset activities and assigns the Department of Defense Support as the offsets authority.

Contracts between the overseas supplier and the Australian Department must incorporate a provision showing a “firm commitment” from the supplier and detailing the work which has been agreed as offset procurement. Moreover, there is an interesting obligation during performance of the contract: overseas suppliers or their local representatives are required to report quarterly the implementation of the offset duty to the offsets authority. In the notes accompanying the program, Australia insists, as factor to award the contract on the will of the supplier to enter into offset arrangements and on the technical worth and the monetary value of any proposals.

Australia is also open-minded regarding the form of the offset. Anything that will benefit the local industry appears acceptable (e.g., assembling, cooperation, transfer of technology, counterpurchase, research and development, and waiver of license fees). The 30 percent offset requirement is a minimum. There could thus be a higher contractual figure agreed upon by both parties. As an incentive for further agreement, offset achievement

in excess of the contracted figure will be recorded and applied as credit against future government purchase but there is no mention of the possibility to transfer that right to a third party. There are no provisions in the program about failure, breach of contract or penalty if the offset obligations are not or are partially performed. General Australian rules should therefore apply in that case. The Australian government is currently reviewing this program to update it to present world trends.97

V. Buy-Back

A. Notion

A buy-back contract is a long-term arrangement which involves the sale of plants, equipment or technology by one party to another and the payment for such sale in the form of products resulting from the plant, equipment or technology.98 The supplier of the know-how agrees to be partially or fully paid with the future output of the investment concerned.99 Buy-back agreements tend to be for larger arrangement and extend over longer terms than barter or counterpurchase contracts.

The essence of the buy-back contract is the agreement from the first party to market a portion of the project's output.100 Once production begins, a Western firm typically will take title to the agreed upon portion of the plant's output for either captive use or resale on the international market for its own account.101 Resulting products will be raw materials, semifinished or finished goods. Buy-back transactions have typical business features which differentiate them from other countertrade transactions.

First, the value of the transaction is much higher, often in the hundreds of millions of dollars. The financial risk increases because the Western company will, in fact, provide financing for the development of the plant

99. Levi Strauss wanted to expand European operation and Hungary wanted to build a blue jeans plant. Hungary bought some equipment and know-how from Levi Strauss who agreed to buy a share of the production as payment. The U.S. company now takes 60 percent of the plant's annual output, about U.S. $1 million pairs a year which are sold in Europe and Africa. Chesser, Barter Becomes Big Business in the World Trade, New York Times, July 26, 1981, at F15.
100. Verzariu, supra note 88, at 10.
101. "The Seller shall deliver to the Buyer for resale, primarily into EEC countries, over a period of eight years certain quantities of product (X) from the plant for a total purchase value of not more than (Y) million Pound Sterling to cover the hard currency expenditures for the equipment of the plant with parts for this equipment, technical documentation, license technological process, interest for credit facilities and advanced payment under Contract No. (Z)." Buy-Back Contract in the U.S.S.R., art. 2, Textes et Documents, 8 D.P.C.I. 365 (1982).
in contemplating a return from the output. Second, the period of product taken back can be relatively long, in the range of five to twenty years. Third, the value of the resulting product during the contract usually equals the value of the plant, technology or equipment (minus an initial currency down payment) plus an amount to cover interest expense during the period of buy-back. (But, negotiators must not forget that time alters those values year after year.)

For the second party the main advantage is the financing of import (delivery of equipment, access to know-how) and the overseas marketing, both of which are undertaken by the first party. This is a significant consideration for the enterprises of developing countries since few such countries have overseas market and enough hard currency to buy needed foreign equipment.

The first party, usually a Western multinational corporation, will benefit by having a new source of supply in that region and an advantage in a potential market. These arrangements are profitable because they guarantee a supply of raw material or finished products for a period of five to twenty years, in addition to the fact that they facilitate major sales of equipment and plant facilities. Buy-back contracts also allow Western companies to obtain manufactured products in countries where workers receive lower wages.

The resulting product is well known by the Western corporation and, in addition, is produced by its own technology. It is clearly in the interest of the first party to supply the most advanced technology since it will have to dispose of the output for captive use or for sales abroad.

Because buy-back is attractive for both partners, this type of transaction has been gaining ground these last years. In 1982, the U.S. International Trade Commission found that the majority of U.S. countertrade imports of chemicals and raw materials were results of buy-back transactions. This is also the preferred type of countertrade of the U.S.S.R. and of other East European countries.

102. See, e.g., Chesser, *Barter Becomes Big Business in World Trade*, New York Times, July 26, 1981, at F15; *Growing Worries over Buy-back Deals*, 130 CHEMICAL WEEK 40 (1982); Hairton, *Countertrade: Buying and Selling Chemicals in a Cash-short Market*, 133 CHEMICAL WEEK 32 (1985). Buy-back primarily used in Eastern Europe and the U.S.S.R. is, currently, widespread into the People's Republic of China. Newly industrialized countries and developing countries also use it as a means to obtain Western technology. Indeed, through a buy-back agreement, the country which receives plants, technology or equipment is provided with a supply of much needed production capacity of some raw materials or intermediate products, and with guaranteed exports. This type of countertrade agreement is useful for its economic development and for improvement of the national industry. Such a country can obtain sophisticated Western technology without causing a drain on its hard currency reserve. It secures the start of its production and limits its distribution costs.


104. For the OECD imports from East European countries under buy-back agreements rep-
Buy-back is often viewed as a special form of industrial cooperation.\textsuperscript{105} It is true that this arrangement is closely linked sometimes to cooperation arrangement: buy-back occurs in long-term industrial agreements for the acquisition of plants, the organization of industries, the transfer of technology or the exploitation of natural resources. But, buy-back is not similar to cooperation and remains a countertrade obligation. The essence of countertrade is the linkage between imports and exports. In buy-back, the main purpose of the developing country is to avoid as much as possible hard currency payment of the turnkey plant of the license agreement for technology.\textsuperscript{106}

The core of industrial cooperation is the community of interest based on the idea of equality and of reciprocal benefits.\textsuperscript{107} It is not impossible to conceive countertrade as part of a global industrial cooperation arrangement. The United Nations Commission for Europe, in defining industrial cooperation, insists on the criterion that the activities have to include a set of complementary or reciprocally matching operations. Cooperation means mutual benefit for the partners involved.\textsuperscript{108}

The United Nations Commission for Europe defined the new form of buy-back agreements in relation to cooperation agreements as:

\begin{quote}

a particular type of long-term industrial cooperation agreement between two or more partners from different countries which provides that one of the partners will deliver, usually on credit, some equipment, licenses and know-how for the construction of industrial installations and the other partner will deliver, over several years, products manufactured in these installations in payment for the imported equipment and technical know-how.\textsuperscript{109}
\end{quote}

The entire "operation" can become "cooperation" and countertrade is then part of the whole program.\textsuperscript{110} These notions are generally explained

\begin{itemize}
  \item \textsuperscript{105} Followed are two typical provisions of buy-back contracts:
  \begin{quote}
    \begin{itemize}
      \item Party B will supply advanced equipment valued, at U.S. $1 million, suitable for China's needs, to be installed in Party A's plant.
    \end{itemize}
  \end{quote}
  \item In order to insure repayment of principal and interest within five years, total sales generated over the five years must reach U.S. $.........
  \item Source: Business International Corporation.
  \item \textsuperscript{107} Previsani, Cooperation Industrielle et Compensation, 8 D.P.C.I. 213 (1982).
  \item \textsuperscript{108} The United Nations Economic Commission for Europe considers as industrial cooperation all operations which go beyond the simple purchase of sales of goods or services to create a community of interest for a certain time in order to achieve mutual advantages for the two parties. U.N. Doc. ECE/Trade/124. See also U.N.E.C.E., TC/B/490/Rev., at 3 (1975); U.N. Doc. E/ECE/844 (1973).
  \item \textsuperscript{109} Previsani, supra note 107, at 215.
  \item \textsuperscript{110} The following types of transactions are enumerated by the Commission as falling
\end{itemize}
in a frame contract or a program embodying all of the parties' rights and duties and stating the purposes and principles of the global operation. All the preceding contracts are annexed to the "mother" agreement and become part of the global arrangement.

These buy-back agreements which usually include licensing or transfer of technology necessary to operate the items purchased are considerably more complicated than those for the ordinary counterpurchase of goods or services. Furthermore, their long-term nature necessitates an "open contract" to cope with problems occurring during performance and to adapt the production to the evolution of techniques, market demands, prices or users' needs. Although this is true for all contracts for the acquisition of large industrial works, specific difficulties arise in connection with the buy-back aspect of the transaction mainly because the goods to be transferred to the first party are usually the resultant products from the plant or equipment that it supplies.

B. CONTRACT CLAUSES

Price. Since the buy-back obligation does not begin until the plant or equipment is built and operating, and since it usually extends over a long period of time, there are some particular difficulties in establishing the price.

Various price formulae have been suggested by a United Nations expert's group on international contracts:111 (a) product should be supplied at the market price plus appropriate commission; (b) each shipment needs a separate agreement on pricing through negotiation; (c) price will be fixed on the basis of the calculated price with an escalation clause which would go into force through negotiation if the deviation exceeds, for instance, 10 percent; and (d) periodic price determination could be agreed upon every three, six or twelve months. Another interesting method is to determine in the main contract an agreement on elements of the price. When one of the elements varies widely, a new price is either settled through agreement or automatically adjusted regarding the variation of the element.112

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112. "The parties hereby agree to accept as the price basis for (the product), the current
Quality and quantity provision. One of the most important problems in buy-back arrangements is to assure product quality because Eastern or developing countries' criteria do not always match Western standards. Therefore, the Western partner often insists upon quasi-absolute control over the quality in order to be able to use the products for its own facilities or to compete on the international market.

Agreements on the technical norms applicable to the product and their specification are a useful tool to avoid further discussion on quality. Western, Eastern or other norms have to be specified depending on the destination of the output. Before distributing the products, a quality control inspection must take place, done by the first party itself or by an independent expert. In any event, it should be stipulated that the first party has the right to reject products of bad quality and even to obtain payment in cash for the balance.

Delivery. Normally an annual production schedule is planned so that product purchases can be coordinated with production. The first party does not want surpluses, storage costs or shortage in supply. It needs also to be paid for the supplied equipment and technology. So delays should be subject to penalties for two reasons: security in payment and avoidance of the loss of competitiveness of "stale" or no longer current products.

Control. Because its own technology is at stake, technical responsibility increases for the Western supplier. A certain type of participation or control in the proper working and management of the factory is a safety
measure for the first party.\textsuperscript{116} The first party has a clear interest to give advice, to control the quality during the production process, to update the technology and to furnish spare parts. A certain idea of cooperation is necessary for the benefit of both parties.\textsuperscript{117}

A special committee can be created to manage the problems arising during performance of the contract, leaving day-to-day management totally to the second party. A consulting contract can otherwise be underway between the first and the second parties, leaving access to the factory to a representative of the first party at any time.

Because the sales are guaranteed under the buy-back contract, it is advisable to emphasize the second party's duty to maintain the machinery in good working order and to use its efforts to produce a competitive product. The first party could stipulate that, in case of necessity, the production of the plant will be managed by its own team.\textsuperscript{118}

The main purpose of a buy-back agreement being to acquire new technology, training programs for managers and workers are important even if a cost increase occurs because ultimately the Western supplier will benefit from better product quality.

\textit{Buy-back ratio}. The buy-back obligation can range from 10 percent to 100 percent. It can be only a percentage of the production when the second party wants to produce also for its local needs. The ratio has to be calculated regarding the price of the plant, equipment or technology transferred. In addition, the second party can sometimes ask for a higher ratio including the price plus a real counterpurchase obligation.

The lower the ratio, the longer the first party will have to wait to be fully paid. On the other hand, the first party could desire long-term guaranteed supply in taking the risk of a change in the resale price. This is a good argument during negotiation to obtain more control in the operation.

\textit{Transfer of title}. Another problem area which should be anticipated in the contract concerns the moment at which title to the machinery, technology or equipment delivered by the first party is transferred to the second party. Because the equipment is paid for by the product manufactured with the first party's know-how, it is important to fix which party

\textsuperscript{116} Difficulties currently met with know-how deliveries during the production process are insufficient maintenance, instruction manuals not followed, raw materials quality inadequate, spare parts inventory badly managed, corrective measures not promptly done and poor repairs due to the lack of knowledge. Rothey, \textit{Les Contrats de Buy-back}, 8 D.P.C.I. 188 (1982).

\textsuperscript{117} In a buy-back contract in China, Company A sent technical experts to install the equipment and train the workers of Company B. After a training program of approximately three months was completed, Company A maintained four technicians on the site but they had nothing to say in the management of the plant.

\textsuperscript{118} Rothey, \textit{supra} note 111.
is responsible for the maintenance, service and provision of spare parts for the equipment until it is fully paid for. The parties should agree on who is the owner of the equipment and who should bear the loss in case of damages to or destruction of the equipment by natural causes before the buy-back is completed.

**Mechanism of payment.** Contrary to the counterpurchase contract where the obligation is to buy or to implement another contract, in buy-back the output of the plant is the source of payment from the second party to the first party. Contrary to the barter contract where each set of goods is considered as payment for the other one, in buy-back only the resultant product represents payment for the plant or machinery. Payment can be direct or indirect. The first party, in the direct case, takes title to the products as payment, which means that the products are transferred or shipped directly to it. In its indirect case, the first party will purchase the products at a discount and resell them at a higher price to be paid for the purchase plus the delivery of the initial equipment.

In the latter the contractual commitment on the part of the first party is to purchase a certain quantity of products related to its initial delivery in order to be paid for it. These arrangements are incorporated into one contract, or into two separate contracts when they are close to a counterpurchase agreement. Existing contract examples reveal different payment systems:

(a) Equipment, know-how or technology are provided, cash free, in exchange for the output which the second party sells to the first party at a discount. Then, the first party markets the products and substantially increases the second party's price to recover the delivery of the equipment or know-how initially furnished and the purchase of the resultant product. Such contracts are only possible when there is no competition between the second party and the first party in marketing the product. In a partial buy-back, the second party is only selling in the local market and the first party must have total freedom in the international market.

(b) The Western company takes title of the resultant output at the completion of the manufacture without purchasing it and resells that output on the market to recover the costs of the equipment or technology. This is merely the exchange of technology against the resultant product. The equipment or know-how is paid for by transfer of the resultant product to the first party. A processing fee is often required

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by the second party to cover its costs other than the purchase of materials and equipment.

(c) Financing is given by a bank to construct the plant or to pay for the technology. The first party is then directly cleared in its account. The second party has received from a bank a loan to be repaid out of the output. To secure the sale, the second party imposes an obligation to purchase on the first party. The first party will then have the obligation to trade the product of the factory as the distributor of the second party.\(^{121}\)

(d) The first party agrees to sell machinery, equipment or technology to the second party. The first party is paid in currency but agrees also to purchase from the second party a predetermined amount of the resultant product. The second party is paid in currency.\(^{122}\) The deal is concluded with two different contracts and is therefore similar to a counterpurchase contract with the difference that the equipment delivered and the counterpurchase product are closely related.

C. The Case of the People's Republic of China

The purpose of countertrade under policies formulated by the People's Republic of China is to attract high technology and updated equipment to modernize Chinese industry.\(^{123}\) Given the Chinese economy's considerable industrial needs and limited hard currency earnings, China views countertrade as the best means for international business transactions.\(^{124}\) Because China is reluctant to permit any outflow of foreign currencies, acquisitions by existing Chinese factories of Western technology is to be paid for by exports derived from the refurbished factory's output. The most commonly used type of countertrade is the buy-back transaction, also called a compensation contract.\(^{125}\) Moreover, the foreign corporation benefits by having a new source of product in China, which has a large potential for extensive economic growth.\(^{126}\)

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121. F. John Carpenter, V.P. International Commodities Export Company, Statement at the Seminar on Countertrade, supra note 14.
125. Markscheid, supra note 119.
China's goal in promoting this countertrade technique is specific: to generate foreign exchange earnings by improving quality and quantity in production and by gaining greater access to foreign markets.\footnote{127} China perceives product buy-back deals not only as a means of acquiring know-how and equipment at a minimum net hard currency cost but also as a way of producing Western standard export production to enter the international market at a competitive level.\footnote{128} In August 1978, the Chinese State Council approved a resolution to set down broad and simple guidelines concerning buy-back contracts.\footnote{129} The guidelines did not establish formal rules on buy-back contracts but only set forth a general policy. In buy-back contracts, everything can be negotiated because the contract is the law between the parties. Three basic forms of buy-back contract exists in China:\footnote{130}

Assembling contracts. Under this arrangement, the Western party delivers component parts and all necessary items and specifications. The product is assembled in a Chinese factory. Most of the time the foreign partner has the exclusive right to the output of such production. The contract can also specify that the Chinese party will participate in the profits earned by the Western party from the sale of the assembled product.

Processing contracts. Under a processing agreement, raw materials are imported by the Western party and are processed by the Chinese factory following specification.\footnote{131} Another form of this contract involves the import of samples from abroad for processing. The Chinese party supplies the raw materials to produce the goods based on design and specifications provided by the Western party.

In both contracts, the Western party may deliver technology, machinery or equipment to do the work. The Chinese party also charges a contracting

\footnotemark[128] Dennis, supra note 123, at 67.  
\footnotemark[130] See generally Cohen and Nee, supra note 129; Torbert and Thomson, China's Joint Venture Law: A Preliminary Analysis, 12 VANDERBILT J. TRANSNAT'L L. 822 (1979). Compensation trade in China is a growing area; in 1980 approximately four hundred compensation contracts were signed (U.S. $112 million) and in 1982 approximately eight hundred sixty compensation contracts were signed (U.S. $700 million), 45 COUNTERTRADE OUTLOOK, November 19, 1984.  
\footnotemark[131] "Party B shall provide under this compensation trade arrangement party A with a complete set of equipment for processing product x and all the technical data. The sum total of the equipment party B provides with party A for making product x is 000 Japanese Yen. Party A shall pay party B by supplying 150 tons of product x within the year 1980, at price (decided) per ton, CIF Yokohama Harbour, totalling 000 Japanese Yen." Processing contract between a Japanese corporation and a Chinese factory reprinted in China Economic News, March 9, 1981, at 6.}
fee for its services and work. After manufacturing, the Western party accepts and sells abroad the finished product to be paid for the initial delivery of technology.

**Pure buy-back.** This arrangement involves a foreign investment in equipment or the sale of a plant where the repayment of the costs of importing capital equipment or technology is made with the resultant output or a related production. A buy-back contract differs from a joint venture because there are no capital investment and no management participation by the foreign corporation. However, some control or consulting requirements are often stipulated in the contract to improve the production of the Chinese factory. Technically buy-back is considered by the Chinese party as an installment loan with payment in goods instead of currency.

Chinese countertrade contains several characteristics.

(a) **Negotiation.** First, the Chinese will only purchase items that they recognize as urgently needed for their domestic economy. They request detailed information and expect the foreign firm to adapt equipment or plans to the particular needs of the Chinese market.

Numerous problems can arise during negotiation, and also during performance of the contract, such as: problems of admission; external control; difficulty to maintain production schedules; deficient quality of the product; and an insufficient transportation network. A deal with China, before becoming profitable, can be time- and money-consuming.

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132. In one of the largest buy-back deals in China, Container Transport International (CTI) struck a U.S. $110 million deal to build a container manufacturing plant and purchase its output as countertrade requirement. The plant, operated by the Guang-Zhou Shipyard Co., is committed to sell its entire output to CTI, whose principal business is leasing containers. CTI will purchase the containers at a reduced price for five years. This is planned to work out to a total of 50,000 containers. CTI has set careful standards for quality and material utilization and provides technical assistance to the plant but has declined to take any managerial role. The terms of the contract ensure that it is in the Chinese company's best interest to produce containers as efficiently as possible. Markscheid, *supra* note 119, at 51.


135. "1. Chinese Corporation X and Peking Light Industrial Import-Export Corp., together to be called Party A, and a Hong Kong company known as Party B, will cooperate for the above-mentioned purpose, according to the principle of equality and mutual benefit. 2. Party B will supply advanced equipment, valued at U.S. $1 million, suitable for China's needs, to be installed in Party A's plant."

Buy-back Contract in China, Art. 1, 2.

China, however, views business based on the principle of "equality and mutual benefit": a deal is working if both parties closely cooperate. The law governing the operation is the contract itself. The contract is the only instrument of reference. Careful drafting of the buy-back contract is imperative, therefore, because the Chinese are respectful of rules established by common agreement and also because the lack of a body of developed commercial or contractual law in China bars any effective recourse.  

(b) Control. The Chinese party is more often receptive to a quality control provision in the contract but will not allow any outside interference with the management of the Chinese factory. The foreign party can obtain a right to inspect the goods before accepting delivery but this control must take place in China. The foreign party is not able to raise a claim based on non-conformity once the goods are out of China.

A special organization, the Chinese Commodities Inspection Bureau, has the responsibility for inspection of all goods going into or out of China. In addition, the Chinese concern of promoting export is an incentive for better quality of products for export.

(c) Dispute settlement. The approach of dispute settlement is also totally different because the Chinese would rather avoid court or even arbitration. They favor conciliation, mediation or friendly negotiation. Going to court is perceived as a failure and a defeat. Generally, the provisions in a buy-back contract provide for renegotiation, even for delay in production, but rarely for penalty provisions because the penalty clauses would jeopardize the agreement by themselves and deteriorate the mutual good faith of the parties. Instead, statements are made showing a willingness to achieve good performance. An indemnity is sometimes foreseen as relief for loss or damages resulting from bad quality of the resultant product.

Finally, the Chinese prefer to keep countertrade transactions simple with a precise statement of the reciprocal obligations and an open door for further implementation of the details.

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137. Dennis, supra note 123, at 71.
138. Maher, supra note 133, at 240.
139. Art. VII of the U.S.-China Trade Agreement of July 1980 nevertheless recognizes arbitration as an acceptable mechanism and provides for arbitration in the United States or a third country as well as within China.
140. "Seller (Chinese party) hereby indemnifies buyers from any loan or damages caused by deviation of quality or specification. Discrepancies resulted by contingencies beyond human control will be settled by means of mutual negotiation." Agreement for Production of Metal Products in China, at 6, reprinted in Verzariu, supra note 1, at 187.
VI. Conclusion

Because countertrade is a recent trend, the contracts are evolving continuously and quickly, the legal issues are new, and the need to have provision coping with present or potential problems is increasing.

Countertrade is one of the rare areas which give the lawyer an opportunity to create law, to work with his legal imagination and reasoning, to structure transactions in respecting both parties’ requirements in an unexpected system of obligations, and to find ingenious tools to secure performance of the different obligations.

Economic and trade realities have caused governments to insist on particular reciprocal obligations in dealing with their imports. More and more corporations are facing these countertrade requirements. New, difficult problems arise for corporate executives, traders, bankers, and their legal counsel.

Therefore the traditional sales contract—“Goods for Cash”—must change in respect of specific national policies or pursuant to buyers’ leverage power. Parties thus must now adapt countertrade concepts to their traditional agreements.

Special provisions, or perhaps separate agreements, must be formed to solve the typical problems raised by these transactions. This aspect of countertrade is interesting to analyze, particularly the features of the contracts and the legal structure of the global argument.

Further, the general characteristic of international commerce is also changing due to the ideas of reciprocity and mutual benefit. Perhaps one shall see, through countertrade, new trends of customs and practice which will lead to a new trade environment.

Finally, “money” normally viewed as the only and best system of payment in international trade is overthrown in favor of other means of payment: in barter, each set of goods is the payment for the other; in buyback, the resultant product is transferred to the seller as payment for its delivery; in offset, the cash payment does not represent the exact value of the global transaction because the burdens placed upon the seller are indirectly remunerated; and in counterpurchase, payment is not sufficient and an obligation to purchase is part of the consideration.