Agribusiness Perspectives Papers 1999

Paper 26
ISSN 2209-6612

LEGAL ASPECTS OF EXPORTING: RISKS AND HOW TO REDUCE THEM

S.C. Williams
Graduate School of Management, University of Queensland

- Introduction
- What do these findings mean?
- The marketing textbook view
- The legal textbook view
- The international legal view
- The legal risks of exporting
- Discussion
- What should small exporters do?
- References
- Footnotes
- Table 1 - Legal Aspect of International Marketing
- Table 2 - Typical Problems with International Contracts

Introduction

Australian producers, manufacturers, processors, and service providers have been exporting successfully for more than two hundred years. They are part of a system of international trading activity and business conduct that has evolved over the centuries from the independent business dealings of many (mainly small) entrepreneurs . This has generated a set of agreed principles that have resulted in not only the creation and maintenance of an informal "international businessman's code" that governs the way business is done, but also forms the basis for much of the international law , public and private, that governs trade and stands ready to enforce compliance with the rules. Such principles include the keeping of promises, fair dealing, good faith, courtesy and communication. One might expect that exporters would be sure they had some understanding of the legal systems and environments they are dealing with, but research done by the author and others suggests otherwise.

The typical scenario for a small Australian producer exporting for the first time is the producer receiving a telephone call or fax from an overseas firm or agent asking if the producer is able to supply quantity *x* of product *y* to an overseas destination *z* for a price p (e.g. Cost, Insurance, Freight, or C.I.F.). The producer, often flattered by this unexpected overseas interest, contacts his/her bank and relevant exporting authorities for advice. The bank usually suggests a letter of credit transaction to guarantee payment on delivery, and the exporting authorities describe the required process and documentation needed for export. Various telephone and fax transactions take place between the exporter and importer, including exchanges of various documents (e.g. invoices, order forms, bills of sale). The required exports, transport, and insurance documentation is prepared, and the shipment takes place. If all goes well, subsequent orders may be received and much of the initial formality and dealing at arms' length may be dropped. Letters of credit may be dispensed with. The principals may meet and form a good personal relationship, or they may never meet, and the relationship remains company to company. Such relationships may continue uneventfully for many years.

In most cases, legal aspects are never considered. In a study of Queensland seafood exporters in 1997, the author (Williams , 1997) found that:

(a) most firms had no knowledge of the legal environments that applied to their international transactions;

(b) most firms were not concerned whether or not they had sound (low risk) contracts, or even whether or not the contracts were legally enforceable;

(c) most firms had no contact with lawyers in setting up their international trading activities or transactions; and

(d) most firms had not considered the possibilities of any adverse legal consequences arising from their trading activities, domestically or internationally.

These findings mirrored those of earlier studies (in the USA and the UK respectively) by Macaulay (1963) and Beale and Dugdale (1975). The 1997 study suggested that a number of factors may be operating to explain such behaviour, such as a general lack of knowledge of legal issues and risks, a general reliance on the 'international businessman's code', the use of letters of credit to secure payment (failure of payment was seen as the primary commercial risk, with other risks being seen as far less important), and the use of "the grapevine" determine whether or not the prospective trading partner was considered stable and trustworthy. Most reported that they had learned from hard experience that they were rewarded for overall results, and a dispute that ended in arbitration or the courts would most likely result in high costs and delays, and a significant loss of face. When the lawyers are called in, it is often too late to salvage the business relationship between the parties. Both firms have to suffer the embarrassment of having the details of their private dealings aired in public (Mueller , 1967) and both firms have to go through the perhaps now difficult exercise of finding new partners. There is therefore a great reluctance to admit the law to the process.

What do these findings mean?

In these apparently simple export transactions, legally-binding contracts (oral or written), recognized in both domestic and international law, have been made between the parties. Legally-binding agreements have been made with banks. This is so whether the parties are conscious of them or not. Both parties have exposed themselves to environments containing significant legal risks. Why are such legal aspects and consequences not considered (except superficially) by either party? 1

When one considers what is written in most academic textbooks on exporting and international marketing, and in most legal texts on international business and contracting, and what is happening in the area of international law governing trade, this is a most interesting question.

The marketing text book view

In most texts on exporting and international marketing, some 30-40 pages are devoted to the 'legal environment' and its importance for any firm engaged in overseas trade. Most texts (e.g. Jain , 1996) suggest the following:

1. Firms thinking of exporting should thoroughly research the legal environment of their target market(s) along with other important environments (such as social and political) well before exporting takes place.

2. This research information should be incorporated into a carefully-crafted legal strategy, where the firm takes a planned legal position with respect to its export operation (e.g. appropriate legal structures, appropriate terms in contracts, appropriate modes of financing, and arrangements for taxation).

3. Unless firms have their own legal resources they should seek the guidance of a legal practitioner expert in international trade issues.

4. Such legal planning should be regularly updated to take account of the rapidly-changing international legal situation and also in response to the changing needs of the firm (i.e. as it grows from a small, part-time exporter to a full-scale exporting business). Some legal issues raised in the texts as being important for management attention are presented in Tables 1 and 2.

TABLE 1 - Legal Aspect of International Marketing

1.	STRUCTURE (the legal entity desired/required)
2.	LOCATION (the location of the legal entity of business e.g. registered place)
3.	FINANCE/INVESTMENT
4.	TAX
5.	SHIPPING OF GOODS (requirements, documentation)
6.	CONTRACTS (form, content)
7.	DOCUMENTS (standard, modified, mandatory)
8.	REGULATION (specifications procedure for invoices, certificate of origin, packing lists, inspection, labeling, quarantine - for both home and host country)

9.	INTERNATIONAL AGREEMENTS (bilateral, multilateral)
10.	TRADEMARKS/BRAND NAMES (protection)
11.	INSURANCE
12.	CURRENCY TRANSACTIONS

TABLE 2 - Typical Problems with International Contracts

1.	UNCERTAINTY (gaps, ambiguities)
2.	WRONG TRANSLATIONS
3.	DIFFERENCES IN MEANING
4.	WRONG STRUCTURE
5.	FAILURE TO SPECIFY PROCEDURES (e.g. for resolving disputes)
6.	SUPERCISSION BY INTERNATIONAL TREATY

The legal textbook view

Macaulay (1977, p.508), noted that the classical (legal) model of contract:

"..starts with the assumption that entrepreneurs need to plan and deal with risk. They do so by carefully drafting contracts which they understand and agree to. In order to increase the chance that the contract will be performed and expectations honoured, the legal system defines when a contract is made, stands ready to interpret the language used by the parties, and fills any gaps in that language by applying norms reflecting the customs of the commercial community ... the classical model assumes that the rules of contract are central, significant, and necessary for economic transactions in a modern economy.."

He also noted that the law of contract:

1. provides a framework for business customs and provides a vocabulary as to what is "fair" or "the right thing";

2. keeps everyone reliable via the availability of legal remedies I.e. breaches will result in disagreeable sanctions (McNie l, 1980); and

3. reflects the wishes of society as a whole as to what is expected in a "normal" business relationship (e.g. fair dealing) (Friedman and Macaulay , 1967).

Carter and Harland (1996, p.14) suggest that businessmen who are informed of the law of contract (domestically or internationally) are in a better position to make decisions (and understand the consequences of decisions). They would better negotiate legal aspects such as *force majeure* (what happens if the ship or aircraft carrying the shipment is lost), hardship [where intervening factors have made it difficult for one party to deliver, or the other party to pay (a vital term if the product in question is perishable)], frustration (where performance of the contract becomes impossible[e.g. via legislation introducing a boycott], currency issues, time and place performance [does delivery on June 30 mean delivery on June 30 i.e. is it an essential term], and means of dispute resolution (whose law applies).

This picture of 'ideal commercial practice' that emerges from the legal texts differs sharply from the reality of simple export transactions outlined earlier. The classical theory of contract seems above the idea that businessmen may ignore legal considerations in their transactions (Lewis , 1982).

The international legal view

There is a well-established body of international public and private law governing trade in goods and services. Most countries are parties to a range of international trading agreements, and have passed appropriate matching domestic legislation to bring them into effect. There are many international bodies that work to provide traders with advice and model documents (e.g. contracts) to both reduce the workload,

minimize the number of disputes, and simplify dispute resolution should disputes occur. There are also many international forums for dispute resolution.

Each country has domestic laws that apply directly to both imports and exports.

Exporters have to comply with the export laws of their own country and the import laws of the target market. In addition, they must also abide by whatever international laws apply to their transactions, as well as any other domestic laws that reach out from home to affect their activities overseas (e.g. antitrust, foreign corrupt practices).

While dramatic differences may be found among the trading laws of nations , there is some common ground. Most countries are members of the World Trade Organization (WTO, successor to GATT, the General Agreement on Tariffs and Trade), and abide by its principles and rules. Most developed countries are also members of various organizations bodies of the United Nations, and subscribe to UN guidelines and rules, such as the Code of Restrictive Business Practices, and the Convention on the International Sale of Goods. 2

Most countries have laws supporting a system of tariff and non-tariff barriers to control imports and prevent disruption of domestic markets by foreign competition. Under the GATT (and now the WTO) there has been a concerted effort to eliminate such impediments to trade by reducing tariffs and converting covert non-tariff barriers and subsidies to overt tariffs and then progressively reducing them to low levels. In addition, most countries have their own laws protecting domestic firms from unfair international competitive practices such as dumping (selling a product overseas at prices lower in the home market). Most countries also have controls based on preventing the entry of disease or based on environmental concerns.

For example, a producer wishing to export food products to the United States faces a range of legal hurdles. These are:

1. Import quotas and licences

The item in question may be subject to a numerical quota that may be global (originating from anywhere), bilateral (originating from a particular country) to discretionary (changes according to the particular economic situation). Such quotas have been in place for many years, and apply to a wide range of products, from dairy foods to anchovies. Some of these quotas are blatantly for the protection of the farm vote. Others are the result of international commodity agreements. Still others are for national security or foreign policy reasons (e.g. the Cuba boycott). To obtain a share of the quota, an exporter may have to purchase a licence , often by public auction.

2. Non-tariff barriers

Most of these arise out of safety and health regulations, but may also include environmental concerns, consumer protection legislation, and product standards. Excessive use of "product standards" to inhibit imports resulted in the 1979 GATT Agreement on Technical Barriers to Trade (the Standards Code) which provides that imported products (e.g. processed foods) must be accorded the same treatment as the same product sourced domestically. Standards must not create unnecessary obstacles to trade, and must be related to a legitimate domestic objective (e.g. consumer health and safety) or environmental reasons (e.g. the recent import ban on Australian shrimp to the USA because Australian fishermen refused to fit turtle exclusion devices to their nets).

3. Tariff barriers

These, when added to the imported product, raise the price to a level which may make the import uncompetitive. In many cases, there is a cat and mouse game between the exporter and the importing country's customs agents as to which is the appropriate level of duty to apply. An exporter who is familiar with the importing country's tariffs can find legal ways of minimizing the duties paid and thus maximize returns (for example, setting up operation in an undeveloped country to take advantage of concessional tariff rates given by the USA (or other importer) to that country, or by exporting the product in a form that (legally) attracts minimal duty (i.e. as an ingredient, rather than a separate product). 3

The legal risks of exporting

As noted earlier, exporters expose themselves to various legal risks each time they export. These risks can be grouped under five headings:

1. Home country statute risk
2. Import country statute risk
3. Home country third-party risk
4. Import country third-party risk

5. International trade law risk

1. Home country statute risk

Here the exporter may run foul of home country laws and regulations directed at exporting. Such laws and regulations may include those relating to quarantine, export inspection, documentation, finance, charges, shipping, occupational health and safety, packaging, and the environment. They also include antitrust and foreign corrupt practices legislation (see earlier). An example would be failure to comply with airline packaging requirements, or misrepresentation of product, or export of a prohibited product or species.

2. Importing country statute risk

This includes all laws and regulations directed at controlling imports and regulating international trade. Such laws include quarantine, inspection, safety, documentation, and payment of appropriate duties and charges. They may be quite different to those of the exporters home country, in both form and effect. An example would be misrepresentation of product.

3. Home Country Third-Party Risk

Here is the risk associate with statutory or common-law claims brought by Australian claimants relating to such issues as injury caused by negligence, misrepresentation, or unconscionability that may adhere to the transaction. An example here would be where an employee was injured by a sharp edge or nail on a packing crate.

4. Importing Country Third-Party Risk

As above but relate to actions brought by overseas claimants. An example would be an action brought by a company in Japan against an Australian exporter for use of a Japanese registered trademark or brand name, or an outbreak of illness in Japan due to contamination of Australian products during processing in Australia.

5. International Trade Law Risk

Here are included factors such as appropriate jurisdiction, processes for dispute resolution, and claims for damages imposed on domestic traders by international courts. Such risks arise from the adoption of agreements such as the UN Convention for the International Sale of Goods (UN DOC. A/Conf 97/18 [1980]) by most countries. If the parties to an export transaction belong to countries which are signatories to this agreement, it automatically applies to all contracts between them. If a dispute arises that cannot be resolved by personal negotiation between the parties, the resolution of the dispute will be according to the Convention. The Convention will also apply for contracting parties whose countries are not parties to the Convention if they elect to have the Convention apply to their transactions (Benders , 1993). 4

The Convention covers:

1. The formation of the contract (e.g. Offer/Acceptance [Articles 14-29]).

2. Performance of the contract (the obligations of both parties [Articles 30-88]).

3. The rules with respect to the roles of member states (Articles 89-101).

Some interesting articles contained in the Convention of interest to exporters are:

Article 38

Article 38 - If the seller delivers non-conforming goods (to the specification), the buyer may reduce the price regardless of whether the price has been paid.

Article 52

Article 52 - If the seller delivers the goods before the date fixed, the buyer may take delivery or *refuse* to take delivery.

Article 71

Article 71 - A party may suspend the performance of his obligation (i.e. stop goods in transit or stop payment) if it becomes apparent that the other party will not be able to perform (or is not willing to perform) a substantial part of his obligation as a result of his creditworthiness or his *conduct* in performing the contract.

Article 78

Article 78 - If a party fails to pay the price or any other sum in arrears, the other party is entitled to *interest* on it.

Some other points arising from the operation of the Convention confirmed in court decisions are:

There is no need to have contracts in writing although some countries have declared they want this to be so (i.e. it is a proposed amendment).

Oral offers must be accepted immediately. Written offers will remain open for a 'reasonable' time (consistent with normal practice in the industry).

Firm offers need not be in writing.

Acceptance is effective when received but an offer cannot be revoked once acceptance has been dispatched.

A communication proposing additional terms in the exchange of forms is deemed a rejection and a counter-offer if these terms are "material" to the contract.

Price is a required term of contract but valid contracts can be made without reference to price. In these situations there is an implied price equal to the general market price.

Discussion

It is clear from the above that an exporter trading in ignorance of the law may suffer terribly at the hands of a contracting partner bent on litigation or sharp practice. It is important to know what might happen in a worst-case scenario. A knowledge of potential problem areas and liabilities is important. Exporters should know what the risks are.

While many exporters may go on for years without ever considering legal aspects and consequences, at some point there will be a dispute. Changes in the domestic and international legal environments are making such cavalier attitudes increasingly dangerous. For example, as more and more countries sign international legal agreements and as the body of international law becomes more and more established, there will be an expectation that increasing standardization and professionalism will apply to all international business transactions. More and more countries, companies, and law firms are embracing the UNIDROIT principles of Commercial Contracts (published 1994) in much the same way they are adopting International Standards Organization (ISO) quality benchmarks. The UNIDROIT Principles set general rules for international commercial contracts and their use is growing exponentially. They have a wide range of uses (Bonell , 1997):

As a checklist for important issues to be addressed in international trading;
As a model for contract provisions;
As the chosen law governing the contract;
As a basis for legal defence and claim (UNIDROIT principles are widely referred to in court cases);
As a source of expert opinion (e.g. in arbitration proceedings); and
as the basis for the commercial law of many countries (e.g. the Dutch Civil Code, the new Civil Code of the Russia Federation).
The UNIDROIT principles have the great advantage that they are accepted almost universally as "good" law. They are easy to read and understand, and are readily accessible on the internet.

What should small exporters do?

While most international marketing texts suggest detailed research of the legal environments of target markets and the formation of appropriate legal strategies, the texts are addressing their comments mainly to large players. Small exporters (particularly of agricultural products) simply do not have the resources or time to engage in such activities (Carter and Harland , 1996, p.15). On the other hand, there are some things that can be done to reduce the legal risks outlined earlier.

The first is that if a firm is serious about exporting, it should quickly establish a long-term stable, strong relationship with trading partners, and thus use the informal "international businessman's code" to full advantage. This can be done by making every effort to maximize the elements of communication, sincerity, professionalism, goodwill, respect and trust. This will in turn maximize the probability that disputes, if they arise, will be able to be resolved by amicable discussions between the parties. This strategy is particularly important for countries such as Japan where the personal relationship is all-important (Williams , 1995).

Second, a firm contemplating doing business overseas should consult a law firm with international trade and business expertise for advice. The value of the information received should far exceed the cost. Even if the firm does not ultimately apply the advice given, at least there will be an awareness of key areas that require management attention and where the pitfalls and risks may lie. This applies to both domestic and international spheres of law. The firm may also be made aware of the full range of options it has for engaging in international business, including areas such as finance and tax, and ways to minimize the cost of doing business overseas.

The third thing a firm can do is to access the UNIDROIT principles on internet sites such as http://www.agora.stm.it/...ish/principles/prince.h and note the contents. If both countries concerned are signatories to the UNCISG, then international law will apply to the contract. This

material may also be accessed on the net at http://www.cisg.law.pace.edu/cisg/text/treaty.html along with other links.

The increasing levels of professionalism seen in the conduct of international business means that exporters can no longer ignore legal issues. As noted earlier, some countries are moving to requirements for written contracts and more and more firms are adopting and expecting the application of UNIDROIT terms.

For a relatively small cost, small exporters can quickly obtain basic information on many key legal issues requiring their attention. This must be balanced against the potentially crippling cost of delays, fines and/or litigation. Ignorance of the law is still no excuse.

References

Adams , J. (1983), Non-contractual business dealings, *The New Law Journal* , 133 , pp.789-791.

Beale , H., and Dugdale, T. (1975), Contracts between businessmen: Planning and the use of contractual remedies, *British Journal of Law and Societ* y, 2 (1), pp.45-60.

Benders , B.J. (1993), Articles - C.I.S.C. Prepared for American Corporate Counsel Association Program for the UN Convention on Contracts for the International Sale of Goods. [http://www.kanekessler.c...es/kk-articles-cisg.ht]

Bonell , M.J. (1997), The UNIDROIT Principles in Practice - The experience of the first two years. [http//www.agora.stm.it/.../principles/pr-exper.h]

Carter , J.W., and Harland, D.J. (1996), *Contract Law in Australia* (3rd edn), Butterworths, Sydney.

Friedman , C.M., and Macaulay, S. (1967), Contract law and contract teaching - past, present, and future, *Wisconsin Law Review 1967* , pp.805-821.

Jain , S.C. (1996), *International Marketing* , Southeastern Publishing, p.297.

Lewis , R. (1982), Contracts between businessmen, *Journal of Law and Society,* 9 (2), pp.153-175.

Macaulay , S. (1963), Non-contractual relations in business - A preliminary study, *American Sociological Review* , 28 (1), pp.55-69.

Macaulay, S. (1977), Elegant Models, empirical pictures, and the complexities of contract, *Law and Society Review 1977* , p.507.

McNeil , I.R. (1980), The New Social Contract, Yale University Press, p.94.

Mueller , A. (1967), Contract remedies: Business fact and legal fantasy, *Wisconsin Law Review 1967* , pp.833-839.

Williams , S.C. (1995), Cross-cultural contextual differences in perceptions of seafood quality, *Asia-Pacific Journal of Quality Management* , 4 (1), pp.24-35.

Williams, S.C. (1997), Export of food products to Japan: Legal aspects and strategies. Paper presented at 5th International Trade Law Conference, Brisbane, 25 June 1997.

T.C.Beirne School of Law. The University of Queensland.

Footnotes

1 For a detailed discussion on this topic, see (Macaulay, 1963; Beale and Dugdale, 1975; Adams, 1983; and Williams, 1997).

2 The Convention for the International Sale of Goods arose from the Uniform Law on the International Sales of Goods (July 1, 1964, 834 UTS 107) and The Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (July 1, 1968, 834 UTS, 169). It provides a common framework for smoothing problems when trading parties come from different legal systems.

3 Things can go wrong, however. Some Australian exporters were recently caught by Taiwan customs in the act of labeling expensive lobster meat as cheaper spanner crab meat in order to avoid duty.

4 There is as yet no provision in the UNCISG for consignment sales. Here the local domestic law at the place of sale applies.

Date Created: 04 June 2005
Last Modified: (none)
Authorised By: Assoc. Prof. Bill Malcolm, Agriculture and Food Systems
Maintainer: Nanette Esparon, Agriculture and Food Systems
Email: webmaster@landfood.unimelb.edu.au