ESSENTIAL BUSINESS LAW

International Trade

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SERIES INTRODUCTION

In the last 15 years Businessmen and Managers have had to come to terms with a vast increase in the volume and complexity of laws affecting their activities. As a response to this there is a growing demand for courses, conferences and other literature, which explain these laws to those most directly affected by them. Many lawyers have helped to satisfy this demand but, in so doing, they have often presented the material as "lawyers' law."

Essential Business Law is a series of small books specifically designed to present some of the most important areas of business law to businessmen. The Series is not intended to be comprehensive, nor will it make instant lawyers. However it is hoped that by adding to its readers' understanding of the legal fabric of business, it will help to make them better businessmen.

International Trade begins with a look at general principles of contract applying to the export and import of goods. Subsequent chapters deal with carriage by sea, marine insurance and the financing of international trade. Problems posed by contact with foreign legal systems are examined in a final section on conflict of laws.

CONTENTS

CHAPTER ONE

INTRODUCTION

International trade can be considered as the life-blood of many nations and this is certainly the case with the United Kingdom. It is hardly surprising, therefore, that it has a good many important aspects. It is, among other things, significant economically, politically and sociologically as well as legally. Obviously, a book of this nature or size cannot cover all these features, nor can it deal with every detail of the law of international trade. What shall be done is to examine various essential elements of basic export transactions. Our main concern is with the case where a person in one country consigns goods overseas to a buyer in a foreign country. This will generally take place under one of the various types of contract for the international sale of goods, such as the c.i.f. or the f.o.b. contract (see Chapter 5). Payment under such contracts will not normally be by cash but under a system of credit arranged through the use of banking facilities (Chapter 6). The seller will normally be paid not when he delivers the goods to the buyer but when he tenders the documents representing those goods to the buyer's bank. Such documents should usually include a marine insurance policy, insuring the goods against risks to which they are subject whilst being carried overseas (Chapter 4), and a bill of lading. The bill of lading is a document of title, which means that the person in possession of it is normally the one entitled to demand possession of the goods themselves. It is also a receipt for the goods and is issued by the master of the ship onto which the goods have been loaded under a contract for their carriage agreed with the owner of the ship or a charterer to whom the vessel has been chartered (Chapter 3). Since the various contractual arrangements for the sale, carriage and insurance of the goods take place in an international environment, some contact with foreign laws and legal systems is inevitable and the final chapter of this book (Chapter 7) deals with some of the difficulties that may arise therefrom. It is convenient to begin, however, with a general discussion of the law of contract before considering the more specialised areas of it in international trade.

CHAPTER TWO

GENERAL PRINCIPLES OF CONTRACT

(1) *Formation and parties*

The relationships between the various parties involved in the export and import of goods are, in the main, based on contractual agreements. The essentials of a contract are, first, that the parties have agreed on certain terms which they intend to be legally binding on them. Secondly, the agreement must comply with any necessary legal formalities. Thus, a contract of marine insurance is inadmissible in evidence in court unless embodied in a marine insurance policy in accordance with the Marine Insurance Act 1906 (s. 22). Thirdly, English law requires an agreement to be supported by *consideration* in order to be legally enforceable. This means that one party to the contract is unable to demand that the other party perform his side of the bargain unless he himself provides something in return. The consideration he provides may take the form of a positive act, refraining to do something he is otherwise free to do or the making of a promise.

Finally, the rule of *privity of contract* provides that only the parties who have agreed to contract with each other will be bound by the contract or able to demand any benefits it confers (*Scruttons* v. *Midland Silicones* [1961]).

Although, where a contract emerges from a series of negotiations, it may not be entirely certain at what exact point in time an agreement is reached (particularly where some less basic terms remain to be settled), in most commercial situations it is clear that a contract has at some time been concluded and the courts are eager to give effect to the parties' overall intentions by enforcing it. In some situations, however, a different judicial policy may prevail and it then becomes important to look more closely at whether a contract can be said to have been concluded; for example, in cases where the rule of privity of contract is applicable.

Thus, it is usually the case where a person ships goods overseas that he agrees with the shipowner that he will not bring a claim for damages beyond a certain amount if his goods are lost or damaged due to the negligence of the shipowner, his immediate servants or third parties employed by him to handle the goods, such as stevedores. The stevedores agree with the shipowner to undertake the work of loading or unloading on the basis they will not be liable beyond the stated sum and fix their charges accordingly, these charges being reflected in the amount of freight the shipowner ultimately charges the shipper in the contract of carriage. It has recently been stated, in *The Eurymedon* [1974], that such arrangements are to be construed in their commercial context and that an overly technical analysis of them is to be avoided so that, in the example given, the stevedore should be able to claim the benefit of the limitation of liability agreed between the shipper and the shipowner even though on the face of it he is claiming the benefit of a term in a contract to which he is not a party.

One solution to the problem is to say that there is a separate contract between the shipper and the stevedore: to say that, when making his contract with the shipowner, the shipper makes an offer to the stevedore (to limit any claim for negligence), which offer the stevedore accepts either through the agency of the shipowner or personally on unloading the goods, the stevedore's consideration for the shipper's promise being the act of unloading the goods. It is clear that the shipper and the stevedore are acting on the basis of a limitation of liability. It is also clear that the stevedore can only claim the benefit of that limitation if he has a contract directly with the shipper. But it can be said that a stevedore hired by the shipowner is incapable of accepting the offer of a contract made by a shipper of whom he is in most cases unaware or that, even if there is an agreement, there is no contract until consideration is provided, so that the stevedore is not protected if he should damage the goods before he unloads them.

Therefore, although commercial contracts are generally to be interpreted with a view to their being enforced, there are potential problems where it is not yet clear that a contract has been concluded, in particular where judges may be influenced by a desire to reach a result on the basis of there being no concluded agreement. Thus, although the company shipping a cargo of machinery in *The Eurymedon* was bound to limit its claim against negligent stevedores, a private individual shipping his motor-car overseas was held not to be similarly bound in a subsequent case (*Herrick* v. *Leonard & Dingley* [1975]).

(2) *Other Parties*

There are further ways in which other parties may be affected by a contract. Before considering them, it should be noted that there are not necessarily only two parties to a contract anyway: a promise may be made by or to several persons, all of whom may incur various rights and obligations under the contract. We must now, however, consider three other situations.

First, a person may agree to act for another as his *agent*. A distinction must be made here between those persons (such as many importers) who act ostensibly as "agents" for others (such as overseas manufacturers) but in fact act on their own behalf, and true agents, such as brokers and shipmasters, whose main intention is to act on behalf of a *principal* and to affect his legal position. The relationship generally arises from an agreement between the principal and agent but may also exist: where the principal has represented that the agent is authorised to act on his behalf; where in a particular situation an agent has no actual authority but is exercising the sort of powers that agents placed in his position usually have; where the principal ratifies the agent's unauthorised acts; and in certain cases of overriding necessity.

So far as the principal and agent are concerned, the principal's obligations are to pay the agent his agreed commission or fee and to indemnify him against any liability he may incur whilst acting on his behalf. In addition, the agent will normally have a *lien* over any property of the principal's coming into his possession (*i.e.* a right to retain it until claims arising out of his agency are satisfied). The obligations of the agent are strict. He is (in the absence of authority to delegate the performance of his duties) personally bound to carry out his instructions with all due care and skill, to indemnify his principal against liability incurred by the latter due to his negligence and to act always in his principal's interest, in particular accounting to him for any benefits he derives from a transaction which it has not previously been agreed he should retain.

The prime consequence of the agent's carrying out his duties is that the principal and the third party with whom the agent has been in contact are brought into a direct contractual relationship and are, in consequence, directly liable to each other. The agent will only generally be liable to the third party where there is a separate, collateral contract between them, or where the agent expressly undertook to be personally liable (either in addition to, or instead of, his principal) or for breach of an implied warranty of authority. The last situation concerns those cases in which the agent has acted without authority and in which he is liable to the third party for having impliedly promised that he did have authority.

Another way in which a person may be directly affected by a contract to which he is not a party is by an *assignment*, a process whereby one party to a contract (the assignor) transfers the benefit of the contract to which he is entitled to a third party (the assignee), who then becomes able to enforce the other original party's obligation against him directly. Thus, the benefit of a marine insurance policy may be assigned (M.I.A., s. 50 (1)). In particular, negotiable instruments, such as *bills of exchange* (which are documentary substitutes for money), are assignable and the Bills of Lading Act 1855 makes special provisions for the transfer of rights and liabilities contained in *bills of lading*, which are documents of title to goods laden on board ship.

Finally, it may be noted that section 14 (2) of the Marine Insurance Act 1906 permits any person having an interest in the subject-matter of an insurance contract to insure on behalf and for the benefit of other persons with an interest as well as for his own benefit.

(3) *Vitiating Factors*

Even where there exists what appears to be a valid contract, there may be some defect which limits the right of one or other of the parties to enforce it.

For example, the contract may be void because the parties are so at cross-purposes that, although they appear to do so, they in fact fail to reach an agreement. This was the case in *Raffles* v. *Wichelhaus* [1864] where a seller failed to enforce a contract to sell cotton from a ship called the *Peerless* sailing in December, the buyer complaining that he intended to buy cotton from a *Peerless* sailing in October. The effect is similar where both parties are found to have reached an agreement but on the basis of a fundamental mistake of fact, as in *Couturier* v. *Hastie* [1856], where the parties contracted for the sale of a cargo of corn which, unbeknown to them, had already been lawfully sold by the master of the ship on which it was being carried to prevent its destruction by deterioration. If a contract has, however, been validly concluded but there is merely a mistake in the written record of it, as where a marine insurance policy does not accurately record the details, the court has jurisdiction to *rectify* the record in accordance with the contract as agreed.

Although there is no general rule requiring one contracting party to disclose facts known to himself but not to the other, there are some cases where the latter is able to avoid liability for the other's *non-disclosure*, for example, if an originally true statement is falsified by later events before the contract is concluded (*With* v. *O'Flanagan* [1936]). Of particular importance is the rule that, as a person wishing to take out an insurance policy is in a better position than the insurer to know all the relevant facts on which the insurance is to be based, he has an overriding obligation to disclose all the material facts which are or ought to be known to him (*e.g.* M.I.A., s. 18). It is more likely, however, that a contracting party will have to accept the consequences not of verbal inertia but of making a positive *misrepresentation*.

Generally speaking, this will be so where he falsely represents a fact material to the contract being negotiated and the other party relies on that misrepresentation. The person to whom the representation is made usually has a right to *rescind* the contract (*i.e.* to be restored to the position in which he was on entering the contract). The right to rescission is subject to limitations (*e.g.* where precise restitution is impossible or the court exercises its discretion under section 2 (2) of the Misrepresentation Act 1967 to award damages in lieu of rescission). If the person making the misrepresentation did so fraudulently, he may alternatively be sued in *deceit* and may be liable for all the damage directly flowing from his fraudulent inducement (*Doyle* v. *Olby* [1969]). If a representation is made negligently, the misrepresentor may be liable in damages for reasonably foreseeable losses ensuing, either under section 2 (1) of the Misrepresentation Act 1967 or in tort under the principle of *Hedley Byrne* v. *Heller* [1963]. This latter principle may render a person making a mis-statement liable to another even though they are not parties to a contract.

The remedies for misrepresentation provide important redress for an innocent party who has been induced thereby to enter into a contract. He may have a stronger remedy where the inducement is incorporated into the contract as one of its terms. The misrepresentor may, in that case, be liable for more than perhaps minimal loss flowing from the falsity of his statement, and for greater damages, if the consequence of the representation failing to prove true as a term of the contract is that he is liable for breach of contract and so bound to compensate the other party for his loss of expected profits (*Behn* v. *Burness* [1863]).

The remaining group of reasons affecting the validity of contracts concerns various aspects of illegality. For example, there are rules of law restricting gaming and wagering and a contract of marine insurance entered into by a person with no interest to be insured will be void (M.I.A., s. 4) and may render him liable to criminal penalities (Marine Insurance (Gambling Policies) Act 1909).

Apart from such clear instances of illegality, the courts have formulated certain principles of *public policy* to discourage conduct with potentially harmful consequences. Thus, they will not enforce contracts purporting to oust their jurisdiction (*Czarnikow* v. *Roth, Schmidt* [1922]), although a clause requiring the parties to submit a dispute to arbitration before resorting to the courts will be enforced as this facilitates the better resolution of disputes (*Scott* v. *Avery* [1856]). A contract to smuggle goods into a friendly country may not be enforced (*Foster* v. *Driscoll* [1928]), nor may contracts in restraint of trade. (An exclusive sales agreement may contravene the provisions of the Treaty of Rome.)

The effect of contravention of these various rules varies. Thus, a bill of lading not complying with the statutory requirement that it should declare that it was subject to the internationally agreed *Hague Rules* was held to be perfectly valid and enforceable (*Vita Food* v. *Unus Shipping* [1939]). And, although money paid under an illegal contract is generally not recoverable, it was held in *Oom* v. *Bruce* [1810] that an agent insuring goods on behalf of their Russian owner at a time when, unbeknown to himself or his insurer, Russia had declared war on England, could recover back the premium he had paid. On the other hand, one or both of the parties may not be able to enforce the contract at all, either in the sense of having the other party perform it or by being able successfully to sue for damages for breach. It is important in every case to look at the reasons for the relevant illegality and to see what effect that should have on the contract. Thus, if a statute prohibits overloading of a ship and punishes it by a fine, it does not necessarily follow that the shipowner cannot claim freight due from the owner of goods carried on board (*St. John Shipping* v. *Joseph Rank* [1956].

(4) *The Contents of the contract*

The majority of disputes in contract cases arise from some failure in performance of the agreement. It is important, therefore, to ascertain exactly what has been agreed by the parties. There are various rules for construing their meaning.

Fortunately for our purposes, most of the arrangements involved in international trade transactions are so complex that contracts are usually embodied in printed forms with standardised terms, the meaning of which is reasonably well understood. Moreover, there is a general rule of construction that extrinsic evidence is not admissible to contradict terms of a contract expressly set out in written form. In particular, evidence of the supposed intentions of the parties as deducible from negotiations leading up to the contract must be rejected, for their final agreement is taken to be as eventually written down.

In an imperfect world, however, problems will remain. For example, the main contractual document may incorporate some terms to be found in a second document and it may happen that some terms in the latter clearly conflict with similar ones in the former. The courts are always mindful of the fact that contracts are made to be performed and the overriding rule is always that they must strive to give effect to the intentions of the parties as ascertainable from the contract as a whole (*Adamastos* v. *Anglo-Saxon Petroleum* [1958]). Moreover, any term written onto a printed document must be given precedence over any inconsistent printed term. Busy businessmen do not make contracts for the sake of lawyers, who must so far as possible construe them in their commercial context (*Bunge* v. *Kruse* [1976]).

In many cases the contractual document does not contain all the terms of the agreement. (Some documents may even contain only a record of an agreement which may be contradicted, as is sometimes the case with bills of lading.) If the document is silent on a particular matter but it is clear that both parties must have thought that a particular term covering the matter was to have been implied, the court will recognise such an implied term if that is necessary for purposes of business efficacy (*The Moorcock* [1889]). That will also be the case where a term is implied by law (*e.g.* by the Sale of Goods Act 1893) or in cases where the parties have contracted on the basis of a well-known custom or trade usage. But a customary term will not be implied if it is inconsistent with an express term of the contract (*Les Affréteurs Réunis* v. *Leopold Walford* [1919]).

Just as it is in the interests of the parties to spell out their obligations in the contract, it is similarly to their personal advantage to restrict their individual liabilities. Hence it is common to find terms which closely define the circumstances in which one party undertakes to perform, outside of which he is not liable for non-performance (as where a shipper is not obliged to load a cargo in cases of "unavoidable hindrances": *The Angelia* [1973]).

Many disputes concern clauses purporting to exempt a party from liability to which he would otherwise be subject (*e.g.* an exclusion of liability for damage negligently caused). Although commercial men of similar bargaining strength may freely decide to include *exemption clauses* in their contract and to allocate risks and charges accordingly, the courts have demonstrated a persistent distaste for them and, where possible, tend to give them a construction which does not exclude liability. In particular, they will not be held to exclude liability for negligence unless this is clearly stated to be the intention (*Smith* v. *South Wales Switchgear* [1977]). A similar attitude is taken to *limitation clauses*, clauses limiting the liability of one party to a certain sum or requiring the other to bring any claim against him within a certain time limit. There is similar disapproval of *indemnity clauses*, clauses requiring one party (*e.g.* a consignor of goods) to indemnify the other party (*e.g.* the carrier) for liability he has incurred to a third party as a consequence of performing the contract.

Statutory restrictions on these varieties of clause have recently been enacted in the Unfair Contract Terms Act 1977, which requires most clauses in commercial contracts to be reasonable. However, section 26 of the Act exempts most contracts for the international sale of goods from its provisions, which also have a restricted application to contracts of insurance and of carriage of goods by sea and charterparties.

Contracting parties may make special provision for the remedies to be pursued on a breach of contract by providing that damages are to be of an agreed amount (*e.g.* a clause requiring payment of *demurrage* for detention of a ship in port beyond the agreed loading period: *Suisse Atlantique* case [1967]). In particular, there is nearly always a provision that disputes be submitted to *arbitration.*

As part of its overriding duty to give effect to the intentions of the parties, the court must, in any case in which an exemption or similar clause is potentially applicable, give effect to the clause and thereby, to the parties' agreed desires so far as they are ascertainable on the true construction of the clause (*Suisse Atlantique* case [1967]). In some cases, however, the courts have given expression to their dislike of such clauses by declaring that if the term he has breached is sufficiently *fundamental* (*e.g.* where the seller of mahogany attempts to deliver pine) or if the manner or consequences of the breach are particularly serious (*e.g.* delivery of a cargo to the wrong person: *Sze Hai Tong Bank* v. *Rambler Cycle Co.* [1959]) then the party at fault is so in breach of contract that he cannot claim the benefit of the exemption clause. The precise scope of the rules of *fundamental breach of contract* is not certain. It has long been settled, however, that the carrier of goods by sea normally loses the protection of such clauses if he unjustifiably deviates from the route agreed in the contract of carriage (*Thorley* v. *Orchis* [1907]) and he may similarly lose the benefit of a marine insurance policy (M.I.A., s. 46).

(5) *Discharge of the contract*

Contracts may come to an end for several reasons. In the great majority of cases it is because they have been performed according to the parties' original agreement. It may happen because of some substituted method of performance (such as a subsequent agreement to replace an obligation to pay in pounds by one to pay in dollars: *cf. Alan* v. *El Nasr* [1972]) or because through some external cause the contract is *frustrated*.

The commonest cause of disputes is that one party has failed to perform some or all of his obligations. The other party may have several options available to him. First, he may simply be entitled to terminate the contract (sometimes called "rescission") and not to perform his part of it. Secondly, he may sometimes be able to seek the remedy of *rescission* and to be put back into the position in which he was when the contract was made, by returning any defective performance he has received and recovering any money he has paid. Thirdly, he may be able to sue for damages as compensation for the loss he has suffered. In some cases, he may be able to force the other party to perform by suing for the sum that the other has agreed to pay or by claiming an equitable remedy.

The general rule is that where the effect of a breach of contract is so serious as to deprive the party not in breach (often called the "innocent party") substantially of the benefit for which he bargained, or where the manner of breach is such as to demonstrate that the party in breach (the "guilty party") intends no longer to be bound by the contract, then the innocent party has a choice. He may elect either to terminate the contract or to keep it in force; but in either event he can claim damages for the loss he suffers as a result of the breach (*Hong Kong Fir* v. *Kawasaki Kisen Kaisha* [1962]). Where the effects of the breach are less serious, the contract automatically remains in being and he can only sue for damages.

It is sometimes the case that terms of the contract fall into one of two classes of terms, known as *conditions* and *warranties*. The mere description of a term as a condition or a warranty is not conclusive (*Wickman* v. *Schuler* [1974]). For example the so-called "warranties" to be found in contracts of marine insurance are generally conditions in the present sense (M.I.A., s. 33). But if a term is in fact classifiable in one of these two ways, a breach of it has an automatic effect, independently of its consequences. Thus, a breach of warranty can only lead to an action for damages, whilst a breach of condition gives an additional option to terminate the contract, even if the innocent party has not been prejudiced by the breach (*Arcos* v. *Ronaasen* [1933]). A term may be classed as a condition or warranty either because the parties expressly agree to that effect, or by some rule of law (as with terms implied into contracts of sale by the Sale of Goods Act 1893) or because of its importance (*e.g.* a term in a charterparty as to the whereabouts of a ship: *Behn* v. *Burness* [1863]).