

Invisible

in International Contracts and

Contractual literacy avoids unnecessary problems, builds a stronger foundation for business,

BY HELENA HAAPIO

Large organizations make hundreds of contracts each day. Contracting professionals know that the quality of contracts has a significant effect on both business performance and risk exposure. Some companies are still learning the hard way that getting contract terms wrong is expensive. Not all architects of business transactions are aware of the potential problems.

In everyday sales and purchasing transactions, time pressure often leads to gaps and unnoticed provisions in documents. People simply do not have the time to read all the standard conditions and click-wrap terms. It is easy to believe, mistakenly, that mouse clicks and fine print do not matter. This does not need to be a problem—more often than not, things work out as expected.

About the Author

HELENA HAAPIO is an international contract counsel with Lexpert, Ltd., in Helsinki, Finland. She works with large companies that market industrial goods, services, and business-to-business projects worldwide. Most of her work relates to combining quality and risk management with proactive planning and careful contracting in cross-border deals. Nothing herein is intended or should be taken as legal advice. Send comments on this article to cm@ncmahq.org.

Sometimes, however, problems do arise. What was inadvertently accepted—or left out—can cause major misunderstandings. The fine print may need to be read. Someone may accept a contract that creates unintended responsibilities or remedies that cannot be changed.

It is particularly easy—even for experienced people—to get into trouble when dealing with international commercial contracts. If an organization has been engaged in domestic dealings and starts selling or purchasing internationally, its basic assumptions may require a fresh appraisal. The contracting team must understand the commonly used words and phrases and avoid those ones that are often misused and misunderstood. People require new skills, and more attention needs to be paid to word choice, missing language, tacit assumptions, “self-evident” omitted items, and invisible terms.

It may be time for the contracting team to take a refresher course in “contractual literacy.”

Proving the Point

Example One: The Meaning of “Bimonthly”

“The meaning of ‘bimonthly’ is self-evident.”
—True or False?

You may say “true.” You may think you and your contracting partner fully agree, only to encounter a major misunderstanding later. What is self-evident for you and what you trust goes without saying may be understood quite differently from your original intention.

“Service fees shall be paid bimonthly,” means that service fees must be paid once every two months.

“Service fees shall be paid bimonthly,” means that service fees must be paid twice a month.”

Which alternative did you think was true? Technically, both answers are correct—it depends only on what authority or dictionary you rely on. For example, *The American Heritage Dictionary of the English Language* (4th edition) says that “bimonthly” means “happening every two months” or “happening twice a month; semi-monthly.” Looking at this dictionary, you can have it right either way.

In business reality, however, who is right and who is wrong is the wrong question! Businesses do not want to argue about when the service fees are payable. If the contract says fees are payable bimonthly, a simple and fast answer to exactly when and exactly how much each month is required, without having to dig into evidence

Terms

What to Do About Them

and secures contracting success.

about the original intention.

This example shows that if something seems to be self-evident, we might not pay as close attention—this is a dangerous habit. We may be working on autopilot, trusting that everybody shares our view, thereby allowing unnecessary misunderstandings to develop.

This should be avoided. Instead, we want to use words to provide the exact clarity of what we want to say. If we mean that we want to have the service fees paid twice a month, why not say so? For example, “Service fees shall be paid on the 1st and 15th of each month.” If we want to have the fees paid once every two months, we should say so—“Service fees shall be paid on the first day of every second month.”

Example Two: The Meaning of “Obligation to Consult”

“‘A’ shall consult ‘B’ before selling widgets to anyone else,” means that ‘A’ shall seek permission from ‘B’ for any proposed widget sale.

—True or False?

This may be true, but it also may be false. *The Oxford English Dictionary* (2nd edition) gives the word “consult” two meanings, namely “to ask the advice or opinion of” and “to seek permission or approval from (a person)

for a proposed action.” *The Oxford English Dictionary*, however, is not the only leading dictionary. It was actually the only dictionary that cited both meanings of the word consult. Most dictionaries only state that to consult means “to have regard to, to consider, to ask the advice or opinion of, to refer to”—nothing about seeking permission. Which dictionary, then, is the ultimate leading dictionary that provides the definitive answer for the word’s exact meaning?

It is easy to agree on one thing: No dictionary should ever determine the deal of the parties. If we want to agree to something important, we must make sure that we know what we are agreeing to do. Since dictionaries have different styles of definition, no individual work can be counted on to give the unique, “correct” meaning of a word.

In this case, the distinction could make all the difference when determining whether ‘A’ was in compliance. There is only one reasonable outcome for future dealings: We must avoid ambiguity and say what we mean. If we mean “seek permission,” we should say so. If we mean “ask advice,” we should say so.

Example Three: The Meaning of “Delivery”

“Delivery: CIF Tampa, Florida (Incoterms 2000), before May 1, 2004,” means that

the goods must arrive in Tampa before May 1, 2004.

—True or False?

False! If you did not agree otherwise, the supplier did what it was expected to do, when the supplier arranged and paid for the main carriage up to Tampa, and shipped the goods before May 1, 2004.

In accordance with Incoterms 2000, “CIF Tampa” means that the supplier has delivered the goods when the goods pass the ship’s rail at the port of shipment. C-terms, such as CIF, are *not* arrival terms; they are shipment terms. D-terms are arrival terms. If you mean arrival, you should use D-terms, for example, “DDU Tampa, FL (Incoterms 2000).”

The Incoterms provide standards you can use to facilitate trade and predictability. However, their correct use requires informed decisions as to which term is appropriate in a given situation. Although the Incoterms are widely used, they are not law. They do not necessarily apply to a certain transaction, unless the parties specifically incorporate them by making direct reference.

If a supplier does not know what delivery means, how can it deliver just-in-time? How can the people filling the order or obtaining transportation perform their jobs? Critical

hours are lost fighting these kinds of fires.

Misunderstandings often begin with a communication from the buyer. Is it clear? Does the supplier understand the date on the purchase order correctly? By changing purchase orders and labelling each date clearly, errors can be preempted. Simple changes can make valuable contributions to the bottom line.

Example Four: Liability After the Expiration of Warranty?

“The supplier’s liability for design faults ends at the end of the warranty period.”
—True or False?

The obvious answer is, “It depends.” Assume that a buyer has a contract with two gearbox suppliers, and that a design fault causes both suppliers’ gearboxes to fail. The buyer claims damages from both suppliers for the cost of repairing the gearboxes.

In both cases, the warranty period has already expired, and the suppliers deny liability. Neither supplier is liable for breach of contractual warranty because that warranty has expired. But, is that all? Despite the expiration of the contractual warranty, are there other grounds for liability?

Again, it depends on what the contract says. Most countries have their own contracts acts and domestic sale of goods acts, corresponding to U.S. state laws based on the Uniform Commercial Code. They contain provisions related to the quality of the supplied goods and provide implied warranties of some form (or liability for nonconformity). Where they apply, these provisions become part of the deal, unless the parties disclaim or limit them.

What if the gearboxes were not reasonably fit for their purpose? Supplier 1 may have to pay the repair costs, which can exceed the price of the gearboxes. Supplier 2, however, may have to pay nothing. One single sentence excluding implied warranties or statutory liability for nonconformity can make the difference. For a supplier

wishing to limit its liability, silence is not golden!

Example Five: Supplier’s Law or Buyer’s Law?

“In international sales, the buyer’s law governs the contract.”
—True or False?

Again, it depends on what the contract says in its choice of law provisions. The contract may state that the buyer’s law applies, in which case the statement is true. But, what if no such choice is made in the contract?

When the contract is silent, the choice of law depends on the principles of conflict of laws. Generally speaking, in the (unfortunate) absence-of-choice situation, the strongest default rule is that the supplier’s law applies. There are exceptions to this rule, however. The point here is this: Although we know that contracts should never be silent on this subject, our colleagues may not know this. When dealing on their own, they might leave this crucial issue unaddressed.

Sometimes, traders are not fully familiar with their own laws, either—as in the case with the United Nations Convention on Contracts for the International Sale of Goods (CISG, the Vienna Convention). CISG is now the “uniform international sales law” of more than 60 countries, including the United States (since 1988). Article 11 of CISG states that a contract of sale need not be concluded in or evidenced by writing and may be proved by any means, including witnesses.

This provision comes as a surprise to some traders, as do other provisions of CISG, including its notice requirements. Where it applies, the CISG must be dealt with by proper consideration or by express exclusion. If it is not excluded, and the contract falls within its scope, then—to the extent that the parties have not provided for other provisions in their contract—the provisions of the CISG form part of the contract.

Contractual Literacy

According to a variety of dictionaries, the word “literate” has two basic meanings: (1) someone who can read and write, and (2) a well-informed, educated person. Correspondingly, literacy means the condition or quality of being (1) literate, or (2) knowledgeable in a particular subject or field (e.g., computer literacy, cultural literacy, emotional literacy). The antonyms “illiteracy” and “illiterate” have an equally broad range of meanings.

If we define a “contractually literate” person as one who can read and write contracts, we should be able, in principle, to include every literate person in that category. Most people are able to read and write contracts—whether they are willing to do so, however, is another matter.

Experienced contracting professionals know that business people are reluctant to read lengthy documents—particularly if they do not fully perceive their effect on their business dealings. Here, we are not dealing with illiterate people in the traditional meaning of the word; we are dealing with “alliterate” people—those who have the ability to read and write but who may choose not to do so.

For contractual literacy, mere reading is obviously not enough. One must understand, as well. In addition to being willing and able to read and understand, there are two principal aspects to contractual literacy: (1) to read and understand what is specifically agreed upon, even the small print and often the more demanding task, and (2) to recognize and understand what is not specifically agreed upon but still becomes part of the deal (the invisible terms) and to act accordingly.

Further, contractual documents must be recognized and properly dealt with, even when there is no piece of paper with the word “contract” written on it. Appropriate attention must be paid to requests for proposals, quotations, purchase orders, confirmation letters, work scope definitions, and other documents, as well as to changes made to existing contracts and their attachments.

Experienced contracting professionals know that there are differences between domestic and international dealings, consumer and business transactions, and the like. They know that contracts must be tailored to the type of transactions they cover and the law that applies. Someone less well informed might be quite happy with any small print, any warranties and disclaimers, or any (or no) choice of law and dispute resolution forum. They may not have heard of the default rules, such as the CISG and they may not care, unless we do something about it. Here, the contracting professionals play a key role.

Success in international trade requires a basic understanding of the underlying laws and default rules (including the CISG). The contracting team must be particularly cautious about unaddressed items and other invisible aspects of contracts. No one should leave out something that is "self-evident" to them (but not to their trading partners).

Contracts must be reviewed with

extra care to establish where they are silent. Those points in which guesswork or default rules must not apply should be explicitly covered. All of this is possible, when the contracting team pays attention and acts accordingly.

Conclusion

Contracting is a process in which a wide range of people and functions are involved—a collaborative venture. It requires a knowledgeable and well-connected team. People involved in international dealings must master the ABCs of cross-border transactions and contracts. They must be contractually literate. They must identify and understand what exactly is being agreed upon. It may be just as important to notice things that are not in the contract—the invisible terms—as it is to understand the terms that have been specified.

Contracts are made with the aim of achieving business goals, and an appropriate balance must be struck between responding to business needs and risk management on one hand

and enabling and controlling on the other.

Contractually literate organizations do not allow default rules to write their contracts for them. They do not want to argue about notices not being timely or being too general under the applicable default rules, such as the CISG. Checklists, sample documents, and contract reviews can be developed and updated to design out failure points. Simple choices of words can help avoid misunderstandings.

By working together, business, contract, and legal professionals can help avoid unnecessary problems, build a stronger foundation for business, and secure contracting success. **CM**

Endnote

1. Dan Marshall, "HP Helps Deliver Just-In-Time," *Harvard Business Review*, Vol. 67: No. 5 (July-August 1989), p. 133, in connection with David N. Burt, "Managing Suppliers Up to Speed," *Harvard Business Review*, Vol. 67: No. 5 (July-August 1989), pp. 127-135.

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