

contractual considerations that should be negotiated to address the chief concerns unique to countertrade are set out.

### **A) Separation of Contracts**

One of the least understood aspects of a counterpurchase transaction is the importance of the two linked, but separate, commercial undertakings. There are a number of good reasons for the use of two separate contracts.

One of the most crucial reasons is that bankers, in most instances, will insist that the first agreement be free of any conditions related to counterpurchase. They will also look at the borrower on his independent ability to repay the loan and will not normally provide credit where the ability to repay the loan is conditional upon the performance of a third party, or upon sales of the counterpurchased goods. Two contracts allow greater flexibility in the performance of contract stipulations. For example, even though an exporter receives payment for his goods over a two-year period, he may have up to five years to fulfill his countertrade commitment.

Another reason is that two contracts ensure that payment for deliveries under the commercial contract is not encumbered by the obligation to accept counterdeliveries. As well, export risk insurance and financing from export agencies such as the Export Development Corporation are not available when payment is called for in goods. Finally, if a trading house is engaged to undertake the countertrade obligation, the terms and conditions of the primary contract will remain secret under separate contracts.

### **B) Pricing**

Always quote one price only, which includes your countertrade costs, while indicating the possibility of a slight price reduction if countertrade is not involved. In East European countries, negotiations take place at the lower level of management while the final decisions are rendered at much higher levels. Some exporters have found that, after committing themselves to a final price and thinking they had an agreement, a more senior level of management insisted that countertrade be incorporated in the transaction.

### **C) Transfer Clause**

The freedom for the exporter to transfer his countertrade obligation to a third-party intermediary of his own choosing is important. This clause will allow the exporter to pass his countertrade obligation on to a trading house or other appropriate third party without the interference of the original purchaser. In order to have complete freedom in the selection of an intermediary, make sure that the wording allows for the transfer of the counterpurchase obligation to *any* third party.

### **D) Linkage Clause**

This condition facilitates access to a range of countertrade goods. When dealing with an East European country, it is very important to have the Foreign Trade Organization (FTO) mentioned in the countertrade agreement since it provides an address to contact. Normally, there is a requirement for counterpurchase from the same FTO that made the purchase from the Western supplier. They will reluctantly agree to allow counterpurchase from another FTO on the condition that a commission is paid to them. Great care should be utilized in the selection of countertrade goods when utilizing a trading house as your intermediary since it will have a bearing on service charges. For example, there will be a lower charge for easily marketable goods, a higher charge for more difficult

to market merchandise. It is preferable to work with a trading house prior to the final selection of goods.

### **E) Credit Clause**

This condition applies to transactions in which, despite serious efforts by the exporter, the countertrade goods cannot be delivered as agreed by the countertrade partner, or are of less-than acceptable standard. A credit clause allows the exporter to benefit from having attempted to source all available countertrade goods, thereby reducing the overall countertrade obligations according to an agreed formula.

### **F) Non-fulfillment Penalty**

An exporter, especially when dealing with East European countries, is usually faced with the requirement that a penalty payment be made if the countertrade commitment is not fulfilled. If an exporter wishes to continue exporting to an East European country, it is not advisable to abdicate the countertrade commitment by paying the penalty fee. This causes difficulties for the FTO manager since the fee earned will not accrue to the FTO account while revenues from exports do.

It is important to be aware that the payment of a penalty does not necessarily release a company from fulfillment of the countertrade obligation, since penalties are devised for non-performance within certain time periods. Some exporters have been known to pay as many as three penalties on the same counterpurchase contract. Therefore, the wording in the contract should stipulate that on payment of a penalty, the exporter is given final release from fulfillment of the countertrade commitment. It is also important that an arbitration clause be included in the contract stipulating the law that will prevail in the event of a dispute. Apparently, some East European countries are quite fair and have been known to rule in favour of the exporter.

Frequently, the FTO will require an unconditional guarantee from a Western Bank in the form of an irrevocable letter of credit (I.L.C.) for the total amount of the penalty. This guarantee has been called in the past even though the countertrade commitment has been fulfilled. To eliminate the difficulties associated with retrieving the funds an exporter, when paying for the counterpurchased goods, should have included as part of the I.L.C. documentation, a signed statement by the FTO that the counterpurchase commitment has been fulfilled.

### **G) Pricing of Countertrade Goods**

In transactions that involve a commitment to purchase, it is important to always include in the counterpurchase contract a "normal prevailing international price" stipulation. Usually, this entails a comparison of the prices paid to suppliers by other customers in Western markets for the same products. In the absence of such an agreement, an exporter may be compelled to accept counterdeliveries at grossly inflated prices. In addition, there are situations where the goods cannot be delivered. In such circumstances, an exporter can agree to accept lower quality goods on condition that there is a discount from the normal prevailing international price.

### **H) Fulfillment of Countertrade Commitment**

The exporter should attempt to negotiate as long a period as possible within which to purchase countertrade goods. This will afford the necessary time to locate customers and to reduce storage costs. East European countries are now attempting to have counterpurchase requirements met in a calendar year to generate more foreign