

The Mitigation Rule and Impacts of Overdue Payments in International Business¹

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ABSTRACT

Globalization has entered a new phase, in which the entire world is inextricably linked. Countless transnational trade is carried out every day, while numerous contracts are signed every day. However, trade frictions and trade disputes may cause various problems because buyers and sellers are in different countries, and may eventually damage the interests of one or both parties. An essential factor which prevents the capabilities of contractors is irregular and delays in payment.

Usually, if the buyer does not pay on time, it may also affect the seller's capital chain and even change the contractual relationship. Moreover, there may be additional fines and interest charges. Therefore, the objective of this paper is to explore the impacts of overdue payment and analyze how to protect the rights and avoid this kind of situations happen through the contract. And the article will explain the issue and use Dominance method to compare different standards, including The United Nations Convention on Contracts for the International Sale of Goods(CISG), Engineers Joint Contract Documents Committee(EJCDC), Consensus Docs and American Institute of Architects(AIA). At the meantime suggest, and the ideal solution will be given at the end of the article.

Key words: Late Payment, Compensation, Remedies, Financial Costs, Risks, Automatic Avoidance, Milestone Payment

INTRODUCTION

From hundreds or thousands of years ago till today, contractual relations are ubiquitous. The contract is an agreement concluded after the parties reached the deal by regular consultation, stipulating the obligations that must be fulfilled and the rights they should enjoy. Especially in the cross-border trade, CISG-compliant contracts are the basis for formal cooperation and the guarantee of rights. However, even under contractual constraints, there will still be various kinds of default or yet breach of contract, which may be caused by the buyer or the seller or even both parties. In fact, one of the most critical factors is overdue payment. According to the United

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Nations Convention on Contracts for the International Sale of Goods (CISG) Article 71, “Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach.”

Generally speaking, that overdue payment will lead a catastrophic effect on businesses for both buyer and contractor, especially for the buyer that the subsequent impact like has limited or even no cash reserves to rely on. While, for companies that are paid based on invoicing for given products or services, late payments are strapped to happen.

Casually regarding the receivables as “better late than never” could mean life or death to the trade. Because the two sides regularly negotiate deferred payment will affect the entire project process, for example, if the buyer does not pay or payment delay, the seller to ensure normal business activities and loans will bring additional costs. There are several reasons may cause the late payments. It could be as simple as someone forgets the payment date or the manager/accountant is not here when their approval is required to sign off on the invoice. More complicated reasons can be a puzzle, which includes any uncontrollable element or even a shift in direction for the overall system of what you are apart.

Therefore, the purpose of the research and analysis in this paper is to develop and answer the following questions in FIDIC, AIA, EJCDC, Consensus Docs and CISG:

- The impact of overdue payment on both parties
- How to handle or avoid the possible risks
- Primarily how to prevent the late payment in international trade
- And to analyze some of the provisions of the contract is how to regulate or constrain such behavior.

METHODOLOGY

While the study of this article, the author practices Dominance method as the principal methodology to definite and evaluate the problems and find the best way. The dominance method as one of the Multi-Attribute Decision Making (MADM) methods can be used to address issues that involve a finite and discrete set of alternative policies that have to be evaluated from conflicting objectives. The process indicates one or further alternatives that perform better or equal to all criteria matched to the other options. The dominance method bases the eliminating solely on the criteria rates. An alternative is dominated and hence eliminated from considerations if there is another alternative, which is better on one or more criteria and is equal to the remaining tests.

FEASIBLE ALTERNATIVES

Before any decision requiring the displacement of contract, the author concerned shall ensure that all feasible alternatives are explored to avoid new issues altogether. In the international sale of goods, in the event of a party default or expected default, the aggrieved party shall take reasonable measures to avoid the loss expansion; otherwise, it cannot get compensation for the avoidable losses. Consider the international business within different sectors and countries, and we will list and analysis some effective ways among the principal recommendations of actions as the alternative solutions for the risks. Because overdue payment, including the failure to pay the price as agreed within the time limit or as prescribed by law, which is a breach of contract and shall bear the corresponding liability for breach of contract which according to the provisions of the agreement or the provisions of laws and administrative regulations.

Table 1: Feasible Solutions Analysis

	Compensation	Suspend Performance of Contract	Take Reasonable Remedial Measures	Avoidance of Contract
Late Payment	Yes	The other person has the right to suspend performance of its obligations	Yes	The seller may claim the contract avoided under some specific circumstance
Financial Costs	Will increases May loss of profit	Will increases May loss of profit	Medium	Depends on the situation, could only be one side or maybe the both parties
Risks	Medium	High	Low	Very High

Before any decision requiring the solve the issues, the author concerned shall ensure that all feasible alternatives are explored in order to avoid the further problems altogether.

DEVELOPMENT OF OUTCOMES

In fact, the party in fault can be any of sides or both seller and buyer under the different background and situation. It means the risks can occur at any phase or most of the contracts, and how to choose one contract is critical for seller and buyer, especially for the international business.

I . Compensation

According to the Article 77 in CISG, "A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach." If one party fails to regard such actions, the party in breach may require a reduction in the costs in the amount by which the loss should have been mitigated.

Basically, in all contracts, there are specific provisions for compensation, including even compensation for damages other than loss of profits. Compensation is also the most direct way, usually not having too much impact on the contractual relationship between the two sides. And milestone payment is one of the solutions which payment is agreed by both sides before they sign the contract or after the first late payment.

II . Suspend Performance of Contract

Expect to default on one of the parties (overdue payment), and the other party has the right to suspend performance of obligations. Suspension of the performance of contractual obligations is a temporary remedy, not the termination of the contract, the contractual relationship between the parties did not end. How the development of the contractual relationship after suspending the performance of its obligations also depends on the further communication and negotiation between the two sides.

III. Take Reasonable Remedial Measures

Under the derogation rules, the injured party needs to take reasonable measures to reduce losses in the event of default by the other side. At the same time, derogation rules directly affect the number of damages. Impairment party damage is conducive to improving economic efficiency and avoidance of wastage, and impaired party impairment obligations can make it in the case of breach of contract, take reasonable measures to reduce losses. If the contract goods are highly seasoned goods, alternative transactions may not be possible or unnecessary. In a CISG case², the buyer could not pay on time. The seller, as a shoe factory, tried to resell the shoes made under the contract. However, the seller was unable to dispose of the contract because all the potential customers had finished stocking and the warehouse was full of goods. The court held that the seller had duly performed the derogation obligation and that expeditious resale was not conceivable under the circumstances of the case.

² Case No 17 U 146 /93 Appellate Court Düsseldorf, 14 January 1994, <http://cisgw3.law.pace.edu/cases/940114g1.html>.

IV. Avoidance of Contract

If before the date of performance of the contract, it is clear that one of the parties will be in breach of the contract, the other party may declare the contract avoided. Generally speaking, the injured party enjoys the right to terminate the contract in advance, which makes it possible for the contractual creditors to obtain the right to demand damages and to terminate the contract right in time before the actual performance of the contract period so that the interests of the creditors can be quickly remedied by law. If the other party provides a full performance bond, the victim may not exercise the right to terminate the contract. Only after the performance period expires and the other party still fails to perform the contract constitutes an actual fundamental breach of contract, can the aggrieved party terminate the contract.

SELECTION CRITERIA

In fact, the party in fault can be any of sides or both seller and buyer under the different background and situation. It means the risks can occur at any phase for most of the contracts, and how to choose one contract is critical for seller and buyer, especially for the international business. In another case³, because of the clothing that was the subject of the contract and which was seasonal and was not possible for the buyer to make up for the replacement of goods for retail sale if the seller delayed the delivery. Because the retailer needed to make a reservation a few months in advance; however, the seller stated on 29 March that was the end of the season, and the buyer cannot make up the goods at a reasonable price.

Therefore, it is critical to choose the best option that is a solid support which efficiently solves the overdue payments and also reduces the risks and financial costs, and we analyze the overall objectives and deliverables of the details from different perspectives to understand better what should be contained and considered. So, the following MADM analysis chart will ensure to understand it clearly.

³ ICC Arbitration Case No 8786 of January 1997, <http://cisgw3.law.pace.edu/cases/978786i1.html>.

Table 2: The MADM analyze about solving/making progress on the problem

	FIDIC vs. AIA	CD vs. FIDIC	EJCDC vs. AIA	CISG vs. CD	CISG vs. AIA
Financial Costs for buyer and seller	Worse	Better	Worse	Equal	Better
Compensation	Equal	Better	Worse	Better	Better
Risks and Title	Better	Equal	Worse	Equal	Worse
Avoidance of contract	Worse	Better	Equal	Equal	Better
Clear steps about solving Overdue Payments	Better	Worse	Worse	Better	Better
Dominance	No	No	No	Maybe	Yes

Based on all the terms what discussed and the analysis of Dominance, there are several suggestions are discussed in the above paragraph and the following parts will analysis all of these.

FINDINGS

Analysis and Comparison of the Alternatives

The following table will represent the comparison of all above four feasible alternatives through one of the compensatory multi-attributes decision analysis tools:

Attribute	Alternative	Value	Dimensional
Milestone Payments (CNY)	I	384,500	0.33
	II	342,500	0.45
	III	150,000	1.00
	IV	500,000	0.00
Late Payments (CNY)	I	750,000	1.00
	II	1,162,500	0.67
	III	937,500	0.85
	IV	2,000,000	0.00
Financial Costs (CNY)	I	560,000	1.00
	II	1,750,000	0.00
	III	928,900	0.69
	IV	1,202,600	0.49
Risks and Title %	I	0.55	0.50
	II	0.10	1.00
	III	0.18	0.79
	IV	1.00	0.00

Resource: International Sale Contract of HuaD, 2010

In this part, we study one compensatory model, non-dimensional Scaling for evaluating decision problem. However, there are two essential points are necessary to consider about:

- There must have the standard range of the non-dimensional values.
- All of the dimensionless attributes should match the same inclination concerning value.

Table 4: Non-Dimensional Scaling

Attribute	Alternatives			
	I	II	III	IV
Milestone Payments	0.33	0.45	1.00	0.00
Late Payments	1.00	0.67	0.85	0.00
Financial Costs	1.00	0.00	0.69	0.49
Risks and Title	0.50	1.00	0.79	0.00
Summary	2.83	2.12	3.33	0.49

Selection of the Preferred Alternative

Based on all up comparisons, Alternative three is the preferred alternative since the final data shown. Consequently, damage compensation rule is included in international legal documents and domestic laws. To mitigate damages in case of breach conforms with statutes of efficiency, good faith, fairness, and usually practice in the commercial transaction.

And sometimes the late payment of buyer will lead a significant impact on the seller, and some of the effects are even inconceivable and unacceptable. For example, in countries that enforce a mandatory foreign exchange settlement system, the seller may face a fine imposed by the international exchange administration if the buyer does not pay. In a CISG case⁴, because the Russian buyer did not make the payment as scheduled, according to the Ukrainian law, the Ukrainian seller was fined \$ 13,841 by the Bureau of National Budget. Because of the inability to sell foreign exchange after the clearance of the goods, and the seller counted the penalty as a loss and demanded Buyer compensation. The tribunal found that under Ukrainian law the seller could be exempted from the fines of the foreign exchange administration if the seller of Ukraine as the injured party brought a lawsuit or arbitration against the buyer's breach within 90 days from the date of customs clearance. The arbitral tribunal held that the seller did not actively defend its rights following the law and did not fit the requirements of Article 77 of the CISG that the injured party should take reasonable measures to reduce the loss, and the penalty loss could not be compensated.

Performance Monitoring and Post-evaluation of Results

Selected alternative is the best way to reduce the loss for both sides, but to better monitor and evaluate the result, it is necessary to compare and have a look at different statements. And we select the CISG as the baseline for comparison.

1. Compare with the baseline: CISG

In this article, the CISG will be used as the baseline for the international business contract, because the CISG is signed more than 32 countries and taking into account the uniform rules governing contracts for international sales of goods in different social, economic and legal systems, which will help to reduce the legal barriers to international trade and promote the development of international trade. There are a couple of terms that focus on late payments and compensation.

- “The seller is not deprived of any right he may have to claim damages by excising his right to other remedies.”

⁴ Arbitration Proceeding, 9 July 1999, <http://cisgw3.law.pace.edu/cases/990709u5.html>.

- “The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention.”

And this is just part of the clauses, but as we can see the CISG will help us to make a complete contract to avoid the risks, like late payment.

2. Compare with Consensus Docs

Consensus Docs form agreement established procurement and contract negotiation as an efficient usage of the project.

- “Payment, if any, for an adjustment shall be made in accordance with the term of Agreement.”
- “…… requiring corrective measures or remedial action. Such measure shall be the sole responsibility of Owner, and shall be performed in a manner minimizing any adverse effect upon the.”

3. Compare with AIA

- “The Architect may withhold a Certificate for Payment in whole or in part, to the extent reasonably necessary to protect the Owner…”
- “The Contractor shall promptly remedy damage and loss to property to in Sections…”

AIA A201-1997 increased the owner’s obligation to provide particular financial information, requiring the buyer to provide such information upon request at any time during the job. However, Consensus Docs obligates the buyer to present evidence of project financing only, as opposed to overall fiscal details, but the owner is compelled to do both before the work initiates and at any point after that upon written request of the contractor. And it is necessary to clearly state that both owner and contractor should contribute an agreement for the overdue payment.

CONCLUSIONS

According to the Article 71 in CISG: “Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach.” In conclusion, there are several ways to resolve the overdue payments, but the best way is damage compensation.

In the international sale of goods, in the case of a party default or expected breach of contract, the aggrieved party should practice reasonable measures to avoid the loss of expansion. The reason why derogation rules are widely accepted is that they have a complex and multiple nature

and require numerous reasons why the aggrieved party should take reasonable measures to mitigate it.

- Increase efficiency and avoid waste. Impairment party damage is conducive to improving economic efficiency and avoid waste. Assigning impaired parties impaired obligations can force them to take reasonable measures to mitigate losses in the event of a breach by the other side, and from a broader perspective, the waste of the entire social resources can be reduced.
- Fair trade and integrity. With an equitable point of view, it is unfair to require the defaulting party to assume liability for all the consequences of its breach, even if the aggrieved party could have acted proactively to avoid or minimize the loss. Whether it is fair trade or not that the principle of good faith requires the injured party considers the interests of the defaulting side, and to some extent, derogate from such selfless action. Such a derogation obligation is imposed on the aggrieved party, which, as a rule, is fair to both of the buyer and the seller because both sides may become potential defaulting parties.

Under the mitigation rules, the injured party needs to take reasonable measures to reduce losses in the event of default by the other side. It is true that what kind of standards are reasonable measures needs to be determined according to the specific circumstances of each case, whereas we can still consider it through some concrete solutions. However, the fundamental principle should be minimized as far as practicable due to overdue payment losses.

FOLLOW ON RESEARCH

During the entire process of working on this paper, we found that sometimes the negative impacts of overdue payments on both sides are more than we expected. However, there is more than one way to solve the late payments. And depends on the real situation, the solutions can be different. Although this essay explores reasonable mitigation, in practice there are still many changes in judgments about reasonable mitigation measures under different default conditions. Including derogation measures after the contract was invalidated, reasonable derogation measures without declaring the contract invalid, and more of the consequences of overdue payment. So, in case of better understanding and answer all of these, we need to do more study and research.

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