

International Business Law News

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From the Chair

By: Paula R. Johnson, Jostens, Inc.

Welcome to the 2003-2004 season of the MSBA International Business Law Section. As in previous years, we will be providing CLE opportunities and great speakers at our monthly Section luncheons. We are also hoping to provide several gatherings that is more social and networking in nature. Notices of these events will be sent by e-mail, if we have your address, so please update your profile with this information to stay current on Section activities.

Planning is already in the early stages for the Annual Spring Institute. Susanne Haas, the Institute Chair, is actively seeking Section members who would be willing to help with this event. If you have an interest in being involved, please feel free to contact her at Susanne.I.Haas@Honeywell.com. All ideas, suggestions and assistance are welcomed!!

Another key activity of the Section is the Newsletter. Jennifer Kalvestran, our Editor-in-Chief, is seeking articles of interest, so don't overlook this opportunity to be "published!" Feel free to contact her at jkalvestran@meagher.com.

In this issue of the Newsletter, we are pleased to feature an article of particular interest to International practitioners. While we all understand the relevance of Incoterms, and may be familiar with some of the changes embodied in Incoterms 2000, Deb Thompson has taken another look at these changes in light of UCC Article 2. This article is very timely for the Section, and we are privileged to be able to feature it. Mr. Frank Reynolds, President of International Projects, Inc. (Toledo, Ohio) and a member of the drafting committee for Incoterms 2000, writes a regular column for the *Journal of Commerce* (online). In a recent issue, he discusses her article regarding the Incoterms revisions and the potential dilemma of the UCC Article 2 revisions. In addition, Mr. John Simpson, past president of the American Association of Exporters and Importers (AAEI) and former Deputy Assistant Secretary for Trade Enforcement of the Treasury Department, has requested to present issues discussed within Ms. Thompson's article to the AAEI membership. AAEI has a large and diverse membership throughout the trade and trade services community. We extend our thanks to Deb for this great article!

Acquisition Of Italian On-going Business Within The Frame of Group To Group Cross-Border Acquisition Projects -Selected Issues-

By: Avv. Antonello Corrado and Caterina Mainieri, Pisano, De Vito, Maiano, Catucci & Corrado, Italy

The number of cross-border acquisitions has been rising for several years, and today this kind of operation represents one-third of the total number of acquisitions executed world-wide. Although the economic recession of the last few years has slowed down such growth, cross-border acquisitions still represent a relevant instrument by which companies are able to acquire market shares, eliminate competitors, restructure business organizations and cut unsustainable branches of their business. This article aims to highlight, from the perspective of Italian law, the main issues related to an acquisition project involving companies or on-going businesses located in different countries and jurisdictions (i.e. Cross-border Acquisitions Projects).

In addition to the problems normally associated with all kinds of acquisitions projects, Cross-Border Acquisitions Projects face some specific issues arising from the differences between the legal systems involved. These issues, if not adequately addressed, may lead to inconsistencies between contractual provisions contained in the Cross-Border acquisition contract and the provisions of the national legal systems that are invoked by the transaction.

In order to provide some guidelines for handling these issues, this article addresses the acquisition of an Italian On-going Business within the following framework, which may be considered the most common:

- (a) the Cross-border Acquisition Project involves multinational groups, in which one group (Group A) wishes to acquire from another group (Group B) a number of subsidiaries located in different jurisdictions (“the Target Companies”);
- (b) the Acquisition is negotiated between the Group Head Companies, or between the Territorial/Branch Head Companies of the Groups, which are competent in a specific region or business;
- (c) the Acquisition Agreement is a single contract usually, and hereinafter, referred to as the “Master Agreement”, the provisions of which are intended to apply to the acquisition of every Target Company;
- (d) the Acquisition is structured as share transfers, an asset transfer, or as a combination of the two; and/or
- (e) in Italy the Acquisition concerns the On-going Business of the Italian Target Company.

Although recourse to the Master Agreement is the appropriate way to proceed in group-to-group Cross-Border Acquisition Projects, the need to implement the Master Agreement in different jurisdictions may raise some delicate issues due to the overlapping of different legal systems. Some legal systems (such as in Italy) may require the application of some legal provisions which would supersede any contractual provisions found in the Master Agreement, including any “choice of governing law” provision. Therefore, the Master Agreement must be consistent with the local laws.

It is possible to overcome these issues by addressing during the negotiation and drafting of the Master Agreement the particularities of the local legal systems, in order to meet the compulsory requirements and to acknowledge any unavoidably-linked legal effects.

In reference to the Italian Law system, special issues arise out of the particular requirements provided by the Civil Code for the transfer of an On-going Business.

Transfer Of Assets or On-going Business Transfer

Before examining the above issues, it is essential to clarify that Italian law makes a clean-cut distinction between assets and On-going Business.

Assets are the tangible or intangible goods owned by a business enterprise, **individually considered**, while an On-going Business is the aggregate of assets and legal relationships organized for the running of the undertaker's business activity (Article 2555 of the Italian Civil Code - hereinafter Civil Code).² This distinction has some relevant practical consequences, particularly due to the different legal requirements provided by Italian law for the transfer of assets and the transfer of an On-going Business.

Whether the implementation of the Cross-Border Acquisition Project involves a transfer of assets or a transfer of an On-going Business should be verified on a case- by-case basis, regardless of the contract's heading and the express definition given by the parties. When the Acquisition Project transfers at least two of the following elements: (a) assets, (b) contracts, (c) employees, (d) public licences and authorizations, (e) know-how, and/or (f) list of clients and suppliers, the transfer should be considered an On-going Business transfer, and be dealt with accordingly.

In order to avoid delays and subsequent difficulties, some specific requirements set forth by Italian Law in relation to the transfer of the Ongoing Business³ should be considered in planning the Cross-Border Acquisition Project and in the negotiation of the Master Agreement. Particular attention should be paid to the following aspects:

- a) Formal requirements for the execution of the transfers;
- b) Effects on pending employment contracts; and
- c) Joint and several liability of the transferor and the transferee for certain debts.

Execution of the Transfer

Pursuant to Article 2556 of the Civil Code, the transfer of an On-going Business must be executed by means of a public deed, or a private deed with legalised signatures ("Deed of Transfer"). Article 2556 has a heavy impact on the Cross-Border Acquisition Project schedule, and should be kept in mind when planning the Project in order to assure that all of the local transactions are closed simultaneously.

First, Article 2556 requires the execution of an *ad hoc* Deed of Transfer of the Italian On-going Business. The *ad hoc* Deed of Transfer cannot be inconsistent with the provisions of the Master Agreement. To the contrary, it is advisable that the provisions of the Master Agreement applicable to the Italian Acquisition are reiterated in the Deed of Transfer as much as possible.

Moreover, the deed's public nature (also in the case of a private deed with legalised signatures) imposes strict formalities concerning signatory powers. The persons authorized to sign in the name and on behalf of the parties must give evidence of signatory power by means either of the appropriate corporate resolution or by means of a special proxy, the legalised copy of which must be delivered to the Notary.⁴

Whether executed by public deed or by a private deed with a legalized signature, the deed of transfer must be filed with the Registry of Companies within thirty days of the transfer. This guarantees public and general evidence of the transfer. Even if the fulfilment of this requirement does not impact the validity of the transfer itself, it is necessary to file the Deed of Transfer in order for the transfer to be effective vis-à-vis third parties. At least seven to ten days are required for the filing to take effect.

Effects on Employment Relationships

Two binding provisions of the Italian Civil Code greatly narrow the degree of flexibility granted to the parties with respect to the transfer of employees and the terms and conditions under which the transfer will be affected. Employment relationships are an area in which the Italian legal system offers ample protection to the employees and to the conservation

of their acquired rights. Consistent with this attitude, the transfer of the On-going Business is governed by two main provisions:

1. Article 2112 of the Italian Civil Code; and
2. Article 47, law of December 29th, 1990, no. 428 (as modified with Law Decree February 2nd, 2001, no.18, entered into force on July 1st, 2001 and hereinafter referred to as “Article 47 Law no. 428 1990”).⁵

Pursuant to Article 2112:

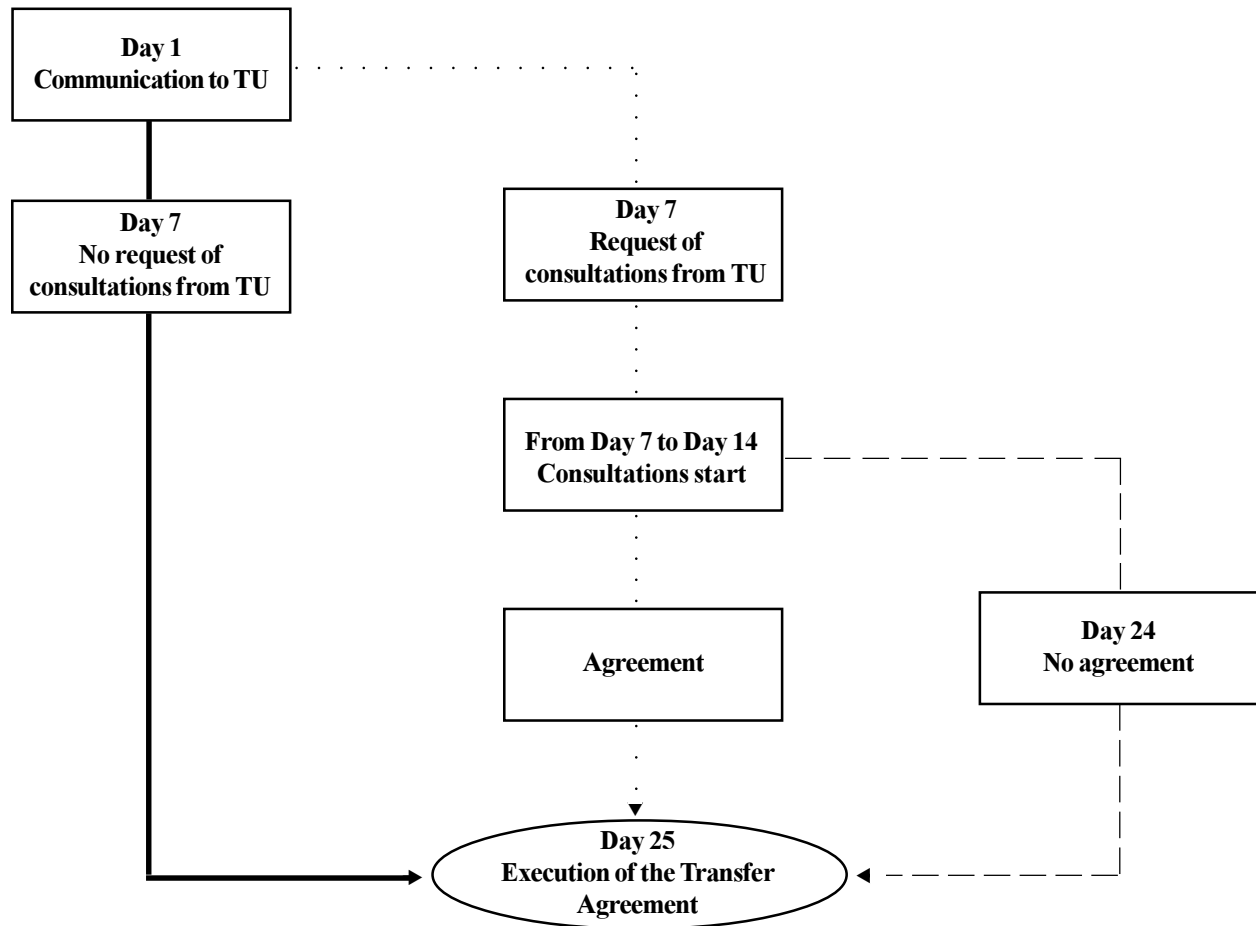
- in the case of the transfer of an On-going Business, the employment relationship continues with the transferee, and the employees retain all the personal rights that they have accrued prior to the transfer;
- transferor and transferee are jointly and severally liable for all the employees’ credits accrued prior to the transfer. But the employee can release the transferor from liability, provided that the waiver is formalized according to the special procedures set forth by Articles 410 and 411 of the Italian Civil Proceeding Code;⁶
- transferee is bound to apply to the employees the economical and contractual conditions established in the National Labor Collective Contracts (hereinafter “NLCC”) applicable to the transferor at the moment of the transfer, or the NLCC conditions applicable to the business of the transferee, provided that the latter guarantees economical and contractual treatment of the same level;
- the transfer of the On-going Business cannot, *per se*, serve as grounds for employee dismissals;
- should the transfer substantially affect the employee’s work conditions, the employee can legitimately resign during the three months following the transfer of the On-going Business.

Pursuant to Article 47 Law no. 428/1990:

- When the transferred On-going Business employs more than 15 employees, it is mandatory that the transferor and transferee give written notice regarding the transfer to the Trade Unions.
 - The notice must be given less than 25 days before the Deed of Transfer is executed, or before the first binding agreement regarding the transfer is reached between the parties.
 - The notice must provide all information concerning:
 - a) the proposed date of the transfer;
 - b) the reasons for the transfer of the On-going Business;
 - c) the legal, economic and social effects that the transfer will have on the employees;
 - d) the foreseen measures, if any, that will be taken with respect to the employees.
- Within 7 days from receipt of the above notice, the Trade Unions may, in writing, request a consultation with the parties to the transfer. If this occurs, the transferor and transferee must start joint consultations with the Trade Unions within 7 days of receiving the request.
- The consultation is aimed at settling any disagreements that may exist about the effects of the transfer on the employees’ rights, properly applying the provisions of Article 2112 Civil Code, and protecting the employees’ interests, individually and collectively.
- Any agreement reached with the Trade Union must be formalized in a report signed by all the parties involved. If no agreement is reached within ten days of consultation, the consultation is considered complete in any case and the On-going Business transfer can be legitimately executed.

- A final warning: the transferor and transferee commit “anti-trade union behaviour” if they do not give notice to the Trade Unions regarding the transfer, or if they refuse the requested consultations. Should this occur, the Trade Unions would have recourse under Article 28 of Law of May 20, no. 300, under which the Labour Judge can order that the procedure be immediately started.

As summarised below, the procedure for communication with the Trade Unions is such that, if the communication has been given and the consultation has been conducted upon the Trade Unions’ request, the transfer can be legitimately executed 25 days after the communication to the Trade Unions, regardless of whether or not an agreement has been reached:



Obviously, lacking agreement, Trade Unions are always free to act through the usual instruments granted to them in order to protect the employees’ rights (i.e. strikes or similar measures). Of course, this represents a strong deterrent to the execution of the transfer without having reached the prior consent of the Trade Unions.

In light of the above, the following matters should be taken into consideration in planning the Cross-Border Acquisition Project and in drafting the Master Agreement:

- (a) the scope of pre-closing due diligence, as far as Italian On-going Business is concerned, must duly cover the potential joint liability risk;
- (b) explicit representation and indemnification procedures regarding the employees' actual or potential credits during the pre-closing period should be included in the Master Agreement and in the *ad hoc* Italian deed of transfer;
- (c) the timetable of the Project must consider the conduct and completion of the activities noted in this section, with special regard given to the 25-day proceeding addressed in Article 47.

Joint and Several Liability for Commercial Debts and Tax Debts

In negotiating and drafting the Master Agreement, particular attention must be paid to the issue of the transfer of the On-going Business' liabilities. The Italian legal system provides some specific provisions concerning the commercial and fiscal liabilities of the On-going Business. These provisions apply, notwithstanding any agreement to the contrary that may be reached by the parties.

Commercial Liabilities

Regardless of any express agreement reached by the parties, pursuant to Article 2560 Civil Code, the parties are jointly and severally liable for the debts incurred prior to the transfer if they are recorded in the accounting books, and the creditors have not expressly released the transferor.

Debts for taxes

Pursuant to Article 14 Legislative Decree 18 December 1997, n. 472, the parties are jointly and severally liable for taxes and sanctions originating from violation of tax laws incurred in the two preceding years, and during the year the transfer of the On-going Business is executed. The parties are also jointly and severally liable for violations of tax laws that are noted during the same period of time, even if violated in preceding years. The transferee's liability accrues only for debts assessed until the date of transfer and is limited to the amount equal to the On-going Business' value.

Upon request, the Italian tax authority issues a certification of the amount resulting from violations or from debts assessed. The transferee is exempt from liability if: a) the certificate does not report notifications of violations or assessments of debts; or b) the certificate is not granted within 40 days from the request. No exemption is granted if the transfer is made with the purpose of fraudulently avoiding the payment of taxes.

Once again, the above issues may affect the timing of the Cross-border Acquisition Project and should therefore be carefully addressed in planning the Project and in preparing the agreements. In particular, in light of the above, is always opportune that:

- (a) the pre-closing due diligence of the Italian Ongoing Business covers the potential risks resulting from the debts that the parties do not intend to include in the transfer;
- (b) specific representations and indemnification procedures in favour of the transferee are included in the Master Agreement and in the *ad hoc* Italian deed of transfer; and
- (c) the timetable of the Project is coordinated with the time period in which the Italian tax authority must certify the amount resulting from violation of tax laws and from debts assessed by transferor.

Conclusion

The implementation of Cross-Border Acquisition Projects is now a frequent business scenario. Undoubtedly, it is also a challenging transaction in which the usual problems of a national merger are amplified by the co-existence and overlapping of several different legal systems, which must be considered and coordinated while designing the entire project. It is essential to know the laws of the involved countries, and to thoroughly analyze the consistency of the contractual provisions with the laws of those involved jurisdictions. These preventive measures will protect against *ex-post* re-

negotiation and subsequent revision of the contracts, which often prove to be more time-consuming and are never as effective as they would have been had the highlighted issues been addressed at the appropriate time.

Notes

¹ The transfer of assets is often chosen instead of a share transfer since it can be materially more advantageous from a tax point of view and can limit the transfer of liabilities, which would unavoidably pass from the seller to the buyer in a share transfer.

² An example of the interpretation of Article 2555 can be found in several decisions of the Court of Cassation, such as: “Transfer of On-going Business exists when the object of the transfer is a functional complex of assets suitable for the prosecution of a business activity” (*Court of Cassation, June 23rd, 2001, no. 8621*); “The peculiarity of the transfer of the On-going Business is the organization of the assets finalized to the run of the business” (*Court of Cassation, April 28th, 1998, no. 4319*).

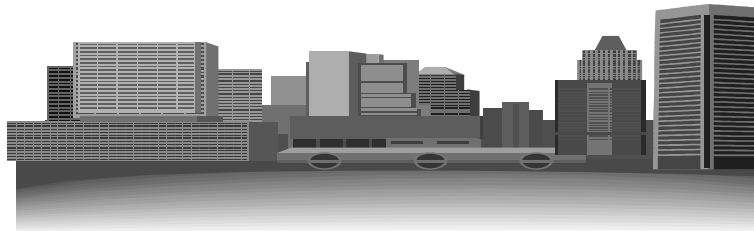
³ The On-going Business legal concept is not retracable in the Common Law legal systems.

⁴ The legalisation of the legal documents originating outside Italy must be made according to the Hague Convention of 1962, in the member countries of said Convention, or by the Italian Consulate.

⁵ Article 47 of Law 428/1990 accomplishes the European Directive 2001/23/CE, of March 12, 2001. Thus the provisions of Article 47 do not pertain to the Italian Legal system only. Similar laws can be found in the other European Member States’ legal systems.

⁶ According to Articles 410 and 411, the waiver must be formalized during a meeting fixed before the Local Labour Office. In the meeting the employee can be assisted and represented by the Trade Unions.

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Revised Incoterms

Changes for 2000 - and Beyond¹

By: Deb Thompson, Manager, Import/Export Compliance, Emerson Process Management

The International Chamber of Commerce (ICC) has updated Incoterms (international commercial terms¹), the official ICC rules for the interpretation of trade terms in sales contracts, which facilitate the conduct of international trade. When expressly referenced in a sales contract (“this contract to be governed by Incoterms 2000”), Incoterms clearly define the obligations of a buyer and seller with respect to the delivery of goods.²

The updates to Incoterms are made periodically, usually once a decade, to respond to changes and developments in international trade. The 2000 revision focuses on the spread of customs-free zones, the increased use of electronic communications, and revisions to transport practices. In addition, every definition has been revised to improve clarity and simplicity of the language.³ Before addressing the specific changes in the 2000 revision, it is important to revisit the scope and coverage of Incoterms. Although Incoterms specifically define the obligations of a buyer and seller with respect to the delivery of goods, they may not address all duties and obligations that the buyer and seller may wish to include in their contract of sale. To the extent that duties and obligations are not defined, provisions should be added to the sales contract as appropriate (*e.g.*, although documents prepared as a requirement of obligations created by Incoterms can convey title, Incoterms per se do **not** transfer title).⁴

The duties and obligations defined within Incoterms concern contracts of sale. Incoterms address delivery of goods or tangible items but not intangible items, such as software. Although there are important implications regarding contracts of carriage, insurance, and financing, Incoterms do not apply to the interpretation of contracts of this nature.⁵ It should also be noted that, to the extent possible, the ICC has attempted to harmonize expressions used throughout Incoterms with those same expressions as used in the 1980 UN Convention on Contracts for the International Sale of Goods (CISG).⁶

From an American perspective, confusion frequently arises in the use and understanding of certain terms because the nomenclature in Incoterms is the same as terms available within the Uniform Commercial Code (UCC) as defined in Article 2 §§ 2-319, 2-320, 2-321, and 2-322. Although now infrequently seen in contracts of sale, these “same” terms are also defined in the Revised American Foreign Trade Definitions – 1941.⁷ The definitions, along with their corresponding rights and obligations, differ under each set of rules. Perhaps the most notable term subject to confusion is FOB. Under the UCC, F.O.B. place of shipment obligates the seller to place goods into the possession of the carrier.⁸ Under the Revised American Foreign Trade Definitions – 1941, F.O.B. (named inland carrier at named inland point of departure) obligates the seller to arrange for loading of the goods on the conveyance for transportation.⁹ In contrast, Incoterms 2000 define FOB named port of shipment as available only for use with maritime and inland waterway transport (delivery when goods pass the ship’s rail) or, in other words, via ship.¹⁰ Express reference to the rules for interpretation is critical for understanding the rights and obligations of the parties.

The 1990 revision to Incoterms was a major structural overhaul of the 1980 version. Within each term, responsibilities of the seller and buyer were divided into ten categories. A1-A10 defined responsibilities of the seller while B1-B10 defined responsibilities of the buyer, with each category a mirror image of the other party’s responsibilities. As is often the case, the revision following a major overhaul will include a number of clean-up changes, particularly regarding inconsistencies in style and language. From the second draft of the final text version to publication, there were 214 changes to the A and B categories alone, not including prefatory statements of “The seller must” or the “The buyer must.” Although the majority of the changes are considered minor in substance, clarification of the language may revise the meaning or understanding of a term. It is therefore best to read the 2000 revision in its entirety.¹¹

Often overlooked, the Introduction section provides a wealth of information. It has been re-written and is clearer than the 1990 version. Section 6 covering Terminology has been added. Although the drafters of Incoterms 2000 have made great efforts to harmonize expressions, certain words retain different meanings, depending on the context in which they are used. “Shipper” and “delivery” are two such examples. Section 6 provides added clarity for interpretation.¹²

Sections A3 and B3 have been slightly relabeled as “Contracts of carriage and insurance.” Frequently the expression “No obligation” will appear in both the buyer’s and the seller’s section. This does not mean that a contract and payment for carriage or obtaining insurance does not or should not occur. Incoterms address only those obligations that the buyer and seller owe one another. As such, the expression “No obligation” within a term reflects that there is no specific obligation owed to the other party in this regard.¹³ The buyer and seller should determine separately the contract for carriage and insurance requirements and address them elsewhere in the contract of sale.

Incoterms are structurally divided into four categories for ease of use: The “E” term (Ex works), whereby the seller makes goods available to the buyer at seller’s own premises; “F”-terms (FCA, FAS, and FOB), whereby the seller delivers the goods to a carrier appointed by the buyer; “C”-terms (CFR, CIF, CPT, and CIP), where the seller contracts for carriage but does not assume the risk of loss for damage to the goods, or additional costs for events occurring after shipment and dispatch; and “D”-terms (DAF, DES, DEQ, DDU, and DDP), whereby the seller must bear all costs and risks to bring the goods to the agreed place of destination.¹⁴

Each term contains a preamble. With the exception of Ex works (EXW), the preamble will recommend the use or non-use of a term for a particular mode of transport. Unfortunately, perhaps the biggest mistake buyers and sellers make in the use of Incoterms is the selection of the incorrect term for the transaction contemplated. In doing so, the seller may find itself in a position in which it is unable to fulfill its obligation to tender the appropriate documents. The 2000 revision recognizes a particular difficulty associated with selection between the use of FCA and FOB and, as a consequence, added a warning in the preamble of FOB that if the goods are not intended to pass a ship’s rail, FCA should be used.¹⁵ To emphasize the point further, a “Mode of Transport Chart” is included that delineates the terms available for use by their intended transportation mode.¹⁶

Any mode of transport		
Group E	EXW	Ex Works (... named place)
Group F	FCA	Free Carrier (... named place)
Group C	CPT	Carriage Paid To (... named place of destination)
	CIP	Carriage and insurance Paid To (... named place of destination)
Group D	DAF	Delivered At Frontier (... named place)
	DDU	Delivered Duty Unpaid (... named place of destination)
	DDP	Delivered Duty Paid (... named place of destination)
Maritime and inland waterway transport only		
Group F	FAS	Free Alongside Ship (... named port of shipment)
	FOB	Free On Board (... named port of shipment)
Group C	CFR	Cost and Freight (... named port of destination)
	CIF	Cost, Insurance and Freight (... named port of destination)
Group D	DES	Delivered Ex Ship (... named port of destination)
	DEQ	Delivered Ex Quay (... named port of destination)

If ocean or inland waterway shipment is not the expected mode of transport, six Incoterms are inappropriate for use, including the ever popular FOB.

Incoterms 2000 do not substantially change the Ex works term, however a few points are worth reviewing. A seller's obligation to a buyer is at a minimum with use of the Ex works term. The seller needs only to place the goods at the disposal of the buyer at an agreed-upon place – usually the seller's premises. There is no obligation on the seller's part to load the goods on the vehicle for transportation.¹⁷ Although most sellers will, in fact, provide for or assist in loading, this obligation is clearly excluded under Ex works. Agreements regarding loading and any associated costs and risks should be addressed separately in the contract of sale.

More importantly, Ex works places responsibility for obtaining export authorization on the buyer at its own risk and expense, and Ex works is the only term within Incoterms 2000 that tasks the buyer with export clearance.¹⁸ A word of caution is warranted regarding export authorization or export licensing. U.S. export control laws contain certain rules that do not allow a foreign party to be the U.S. Principal Party in Interest (USPPI) (formerly known as the exporter of record) in certain instances. The USPPI is the party responsible to the U.S. Government for effecting the export from U.S. Customs' territory and must be shown on the Shipper's Export Declaration (SED). This includes the responsibility to obtain the appropriate export license or export authorization.¹⁹ But, under the Foreign Trade Statistics Regulations, a U.S. forwarding or other agent may effect the export from U.S. Customs' territory ("routed export transaction") on behalf of a foreign principal party in interest with certain information and assistance by the USPPI.²⁰

Additionally, there are sellers that, because of the nature of the goods (i.e., military items controlled under the International Traffic in Arms Regulations,²¹ dual-use controlled items under the jurisdiction of the Export Administration Regulations,²² etc.) or company policy, may wish to control the export licensing process, thereby assuring an appropriate and expected result. In these circumstances, Ex works should not be chosen to govern the delivery of the goods. Incoterms 2000 has made a substantial change to FCA in category A4-B4, "Delivery" obligations of the buyer and seller. Delivery in the 1990 revision covered multiple possible transportation methods, each with its own conditions depending on various circumstances.²³ The entire section has been rewritten and reorganized. The buyer is obligated to arrange for the main carriage, which means that delivery will occur either at the seller's premises when the carrier arrives to pick up the goods, or when the seller brings the goods to a buyer-designated carrier. If the carrier is to pick up goods at the seller's premises, delivery occurs once the goods have been loaded on the means of transport provided by the carrier. If the seller is required to provide the goods to some other named place, delivery occurs when the goods are placed at the disposal of the carrier or other buyer-nominated person. In this situation, the seller is not required to unload the goods at the agreed place.²⁴

The rule has adopted a common-sense approach of determining who controls the personnel and equipment to handle loading and unloading, regardless of the mode of transportation selected. By doing so, the drafters have made FCA far more user-friendly and versatile, while resolving previous confusion regarding costs incurred with the various modes of transportation.²⁵

For those buyers and sellers that frequently use ocean shipment, a substantial change has occurred to the FAS term. Prior to the 2000 revision, the buyer was obligated to obtain, at its own risk and expense, any necessary export license and carry out all necessary customs formalities.²⁶ The buyer could request assistance from the seller, and in so doing the seller would then be obligated to render whatever assistance possible, even though the buyer had ultimate responsibility.²⁷ Category A2-B2 covering "Licenses, authorizations and formalities" has been modified to require that the seller now arrange for the necessary export authorization or license.²⁸

A similar change has occurred in the DEQ term. Previous Incoterms obligated the seller, at its own risk and expense, to obtain the export and import licenses or authorizations, as well as carry out all customs formalities necessary for exportation and importation of the goods. If necessary, the seller was also to carry out any necessary formalities for the goods in transit through other countries.²⁹ Category A2-B2 "Licenses, authorizations and formalities" has been modified so that the seller is responsible for obtaining, at its own risk and expense, any export authorization and to carry out any customs formalities necessary for the exportation of the goods, while the buyer is now responsible for the corresponding requirements on the import side.³⁰

The changes to clearance obligations of FAS and DEQ are common-sense changes. From an exporting perspective, it is probable that the exporter (seller) will have more familiarity with export control laws. Similarly, importers (buyers) will

have more familiarity with their inbound customs rules and procedures. Governments, in general, would prefer to have accountability rest with a person or legal entity within their jurisdiction.³¹

Up to this point, although the changes to Incoterms 2000 are numerous, there are few major substantial changes. Incoterms have generally been intended as rules for interpretation of international commercial terms to be used in contracts of sale where goods are sold for delivery across borders of different countries. It is now recognized that Incoterms are sometimes used in domestic contracts. Incoterms 2000 acknowledges domestic usage and has aided with this application by modifying categories A2-B2 and any other provision dealing with export and import by rendering them not applicable.³²

This acknowledgement in Incoterms 2000 primarily recognizes the peculiarities of customs unions. This is most prevalent in Europe as evidenced by the advent of the European Union and subsequent efforts by the European Union to make border crossings transparent. Although goods may traverse borders, they may not be subject to duty or other import and export formalities within the customs union. Incoterms therefore recognizes the existence of customs unions and other customs-free zones, and has modified categories A2-B2 and A6-B6 clauses to include the phrase “where applicable.” It is the intent to maximize usage of the various Incoterms even within customs unions and customs-free zones.³³

Recognition of domestic usage of Incoterms may likely become increasingly more significant within the United States. A rewrite of UCC Article 2 was approved by the National Conference of Commissioners of Uniform State Law (NCCUSL) in August of 2002, and on May 13, 2003, the America Law Institute (ALI) also approved the proposed amendments.³⁴ Article 2, §§ 2-319 through 2-322 (trade terms), as well as related §§ 2-323 through 2-325, have been deleted as “inconsistent with modern commercial practices.”³⁵

Review of the UCC revisions’ proposed comments and reporter’s notes of the various annual drafts and discussion drafts sheds little light on the rationale behind the deletion. One reporter’s note indicates that the UCC sections were “woefully outdated” and did not “reflect modern practice.”³⁶ Conspicuously absent is a recommendation of an alternative if or when UCC Articles §§ 2-319 through 2-322 are no longer available.

Many buyers and sellers have relied on the UCC to govern interpretation of their trade terms on domestic transactions in goods. Although confusion can and does occur regarding the defined obligations of the buyer and seller between Incoterms and UCC, there was often little confusion that the appropriate UCC state equivalent statute would govern domestic transactions when state law was chosen to govern the contract. Now that the proposed amendments have been approved, the buyer and seller may soon be in a position in which they are unable to rely upon the UCC terms.

Since the UCC is a model code, the public will have to wait to see the reaction of the various states. Three natural possibilities exist with respect to UCC §§ 2-319 through 2-322:

- 1) the state adopts the revised model code as is;
- 2) the state rejects the model code and retains its existing §§ 2-319 through 2-322 equivalent; or
- 3) the state rejects wholesale deletion of §§ 2-319 through 2-322 equivalent, but modifies its existing law.

If states do not react with uniformity, choice of law negotiations between contracting parties will take on new significance with respect to delivery of goods.

For argument’s sake, presume the entire country adopts the revised model code. In this event, the UCC will no longer explicitly provide for interpretation of trade terms, thus leaving two remaining rules for interpretation – Incoterms and the Revised American Foreign Trade Definitions – 1941. Since there is a difference in updates, it is likely that the preferred choice will be Incoterms. Although use of Incoterms in domestic transactions are permissible,³⁷ Incoterms are primarily structured for international trade. Accordingly, modification of the interpretation rules will be necessary to accommodate such domestic transactions and assure a complete understanding between the parties. There are a number of approaches possible. Which direction is taken will depend on the choice of the parties.

Before attempting to reconcile UCC § 2-319³⁸ to Incoterms FCA (... named place), some generalities are worth keeping in mind. Incoterms generally do not deal with the consequences of breach or exemption from liability. One must look to other contractual terms and the law chosen to govern the contract.³⁹ The focus of Incoterms is on the seller’s delivery obligation with the belief that the distribution of functions and costs would not pose a difficulty where the parties have

a continuing commercial relationship or course of dealing. Application of the division of functions, costs, and risks can be applied for new commercial relationships or if contracts are made through brokers.⁴⁰ Incoterms look to the CISG for meaning with terms such as course of dealing and usage of trade.⁴¹ Lastly, the “F”-terms, like the “C”-terms in Incoterms, are shipment contracts, not destination contracts.⁴²

Picture a situation where contracting parties applied UCC F.O.B. seller’s factory as a contract term. If UCC § 2-319 is legislated out of existence, the parties may choose Incoterms 2000 to govern the contract of sale. A logical choice for a replacement term would be FCA (FCA seller’s factory, Anywhere, State, U.S.A.). Incoterms should always specify a named geographic location. If the geographic location of the factory is not included with the term, then it should be noted within the definitions applicable to the contract. Presume further that this situation involves a domestic contract only and that the choice of law incorporates the UCC model code. In its simplest form, the following term modifications_or clarifications would be required to Incoterms FCA (... named place):

- A2/B2 Licenses, authorizations and formalities: Not applicable
- A6/B6 Division of costs, Bullet 2 for A6, Bullet 3 for B6: Not applicable
- B9 Inspection of goods: Not applicable
- A10 Other obligations, paragraph 1: Not applicable
- B10 Other obligations, paragraph 1: Possible modification: “The buyer must pay all costs and charges incurred by seller in rendering his assistance in contracting for carriage in accordance with A3 a).”

Such modifications would remove that language that is exclusively applicable to international contracts for sale.

Although these modifications would essentially produce a term for domestic use, they may not be reflective of what is required or expected by the parties. It should be noted that Incoterms differ from UCC in a number of respects, such as: coverage of the term, contract for carriage, delivery, taking of delivery, and risk of loss.

For example, a comparison of some of the key areas of Incoterms FCA and UCC F.O.B. show the following:

FCA	(... named place) on date or within period agreed		UCC F.O.B. § 2-319 a named place (F.A.S. omitted)		
Deliver to:	Seller’s premises	Any other place	Deliver to:	Place of shipment (§ 2-319(1)(a) (see also § 2-504)	Place of destination (§ 2-319(1)(b) (see also § 2-503)
	If not specified & several points available - seller may select			Delivery is complete when tender of delivery:	
Carrier (nominated by buyer)	Delivery is complete when:		Carrier	Seller puts in possession of carrier (§ 2-504(a)) Seller promptly notifies buyer of shipment (§ 2-504(c))	Seller transports goods to destination (§ 2-319(1)(b))
	Seller loads (on means of transport by carrier)	Seller places at disposal of carrier (not unloaded)			
Other person (acting on behalf of buyer)	Seller loads (on means of transport by carrier)	Seller places at disposal of carrier (not unloaded)	Other		1) Seller puts & holds conforming goods at buyer's disposition & 2) Notifies buyer (manner, time & place per Agreement & § 2-503) (§ 2-503(1)) and tender documents as required (§ 2-503(3)) (See also Documents below)

	Seller loads (on means of transport by other) Other person	Seller places at disposal of other (not unloaded)	Other person (bailee) possesses & goods delivered without being moved		<ul style="list-style-type: none"> • Tender negotiable document of title; or • Procure acknowledgement by bailee of buyer's right of possession (§ 2-503(4)(a))
					Sufficient unless: buyer seasonably objects (§ 2-503(4)(b))
None specified:			+ F.O.B. vessel (§ 2-319(1)(c))	Different Incoterm - see FOB (...named port of shipment)	
Carrier – by seller		Seller places at disposal of carrier (not unloaded)	+ F.O.B. car or other vehicle (§ 2-319(1)(c))	Seller loads (§ 2-319(1)(c)) Buyer - seasonably gives needed instructions (§ 2-319(3))	Seller loads (§ 2-319(1)(c)) Buyer – seasonably gives needed instructions (§ 2-319(3))
Seller's transport		Not unloaded			
Contract for: carriage:	Seller – no obligation Buyer contracts	Seller - no obligation Buyer contracts	Contract for carriage:	Seller makes usual terms (§ 2-504(a)) & conform to express terms; see also additional comments §2-504, cmt. 2))	
However,					
1) if buyer requests, or	Seller <u>may</u> contract (usual terms) If decline, notify buyer	Seller <u>may</u> contract (usual terms) If decline, notify buyer			
2) if commercial practice & buyer does not give instructions to the contrary in due time	Seller <u>may</u> contract (usual terms) If decline, notify buyer	Seller <u>may</u> contract (usual terms) If decline, notify buyer			

Risk of loss:	Seller – until delivered above (if seller contracts for carriage, ROL to buyer) Buyer – after delivered above (& below, if applicable)	Seller - until delivered above (if seller contracts for carriage, ROL to buyer) Buyer - after delivered above (& below, if applicable)	Risk of loss:	Seller - to in possession of carrier (§ 2-319(1)(a)) Buyer - after shipment duly delivered (§ 2-509(1)(a))	To buyer when goods tendered in possession of carrier & enables buyer to take delivery (§ 2-509(1)(b))
And	From agreed date or expiry of any agreed date		Goods in possession of bailee	Buyer upon receipt of negotiable title of goods (§ 2-509(2)(a)); acknowledgement by bailee of buyer's right to possession (§ 2-509(2)(b)), or buyer's receipt of written direction to deliver (§ 2-509(2)(c))	
Buyer fails to nominate carrier/other person:	Buyer	Buyer	Bailee fails to honor non-negotiable document of title		Seller (for reasonable time so buyer can present document/direction) (§ 2-503(4)(b))
(or) carrier/ party fails to take goods into its charge at agreed time	Buyer	Buyer	(or) bailee fails to obey direction		Seller (for reasonable time so buyer can present document/direction) (§2-503(4)(b))
(or) buyer fails to give appropriate notice (e.g., name of party designated, mode of transport, etc. - See B7)	Buyer	Buyer	+F.O.B. car/	Seller (loading) other vehicle (§ 2-319(1)(c))	Seller (loading)
			By carrier (no particular destination)	Seller (delivery to carrier) Buyer - when duly tendered (§ 2-509(1)(b))	

			Any other case not covered	If seller is merchant, to buyer upon receipt of goods (§ 2-509(3)) If seller not merchant, to buyer on tender of delivery (§ 2-509(3))	
Division of Expenses:	Seller - all costs until delivered; proof of delivery Buyer – all costs from time delivered, contract for carriage, buyer requested transport document, (& below if applicable)	Seller - all costs until delivered; proof of delivery Buyer - all costs from time delivered, contract for carriage, buyer requested transport document, (& below if applicable)	Division of Expenses:	Seller (cost of putting in possession of carrier) (§ 2-319(1)(a))	Seller transport to named place (§ 2-319(1)(b))
Buyer fails to nominate carrier/ other person; or Buyer's nominated party fails to take goods at agreed time	Buyer Buyer	Buyer Buyer			
Buyer fails to give notice (see ROL) but only if goods duly appropriated to contract (identified)	Buyer	Buyer			
Documents:	Seller provides usual proof of delivery (POD)	Seller provides usual proof of delivery (POD)	Documents:	Obtain, promptly deliver in due form any document necessary for buyer to obtain possession of goods	Where contract requires, tender all documents in due form (§ 2-503(5)(a))
	If POD not transport document & buyer requests, seller must render every assistance to obtain transport document for contract of carriage	If POD not transport document & buyer requests, seller must render every assistance to obtain transport document for contract of carriage		(or) per Agreement, (or) usage of trade (§ 2-504(b))	

The “no obligation” portion of the contract for carriage under FCA is perhaps more clear when the term refers to FCA seller’s premises. When the named place is other than the seller’s premises, the seller is obligated to arrange for pre-carriage to the named place (including the risk and cost associated with arrival that named place). Typically, in an international transaction, that other named place is the terminal of buyer-appointed main carrier or forwarder located within the U.S. But if the term is used in a domestic-only transaction, it is likely there will not be a split of pre-carriage and main carriage (most shipments are door-to-door). Thus, for locations other than the seller’s premises, FCA in a domestic contract is likely to become a delivery term.⁴³

If the UCC terms disappear, then the parties, in order to ensure that their transaction proceeds smoothly and according to expectations, must determine what modifications will be required to the delivery term selected and which set of rules will govern the interpretation of the trade term.

Although Incoterms are a logical alternate choice, and they are available for domestic contracts of sale, the UCC is incorporated in much of the law that governs domestic contracts for the sale of goods. By its own definition, Incoterms look to the underlying choice of law to govern breach of contract, remedies available, and the like.⁴⁴ Given the differences in the terms between Incoterms and UCC, unless express terms or modifications are made to adapt the Incoterm selected to a (now existing) UCC term, confusion will likely arise in the underlying associated provisions.

Another possible alternative to Incoterms would be to dust off the American Foreign Trade Definitions – 1941, which were originally created by a joint committee of the Chamber of Commerce of the United States of America (now The United States Chamber of Commerce⁴⁵), the National Council of American Importers, Inc. (now the American Association of Exporters and Importers⁴⁶), and the National Foreign Trade Council, Inc. (NFTC⁴⁷). The American Foreign Trade Definitions – 1941 might be an appropriate set of American rules for the interpretation of trade terms in domestic sales contracts, although an update may be needed to reflect current commercial practices.

Even if contracting parties are willing to adopt an alternative set of rules to govern their trade terms and make the necessary modifications to the existing interpretation rules, which would capture their intent on a go-forward basis, a further issue stands yet unresolved. The approved Article 2 revisions do not propose, recommend, or mandate an alternative set of trade terms. Wholesale adoption of the Article 2 revisions would leave existing and ongoing contracts without a valid trade term. At best, existing contracts would need to be revised or renegotiated to reflect the appropriate meaning of a then-defunct term. At worst, there would be no valid meaning to the term, and disputes would likely arise as to the intent and expectations of the parties.

Should the UCC trade terms disappear, as will almost certainly be the case under the approved amendments to the UCC, perhaps the best alternative would be to create an entirely new set of American rules for the interpretation of trade terms in domestic sales contracts. Ideally, this new set would draw from and be in harmony with Incoterms concepts. The drafters of UCC would be able to reference them in their commentary section pertaining to the deletion of F.O.B/F.A.S. terms as a recommended alternative for existing and new contracts of sale. Buyers and sellers could then refer to one set of terms and rules of interpretation for domestic contracts, which would be compatible with both the underlying concepts of UCC and Incoterms. Incoterms would thus be left to govern only the interpretation of international trade terms – its primary function, and one that Incoterms does well.

Notes

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² International Chamber of Commerce, *INCOTERMS 2000* at 6 (ICC Publishing, Inc.) (1999).

³ Maria Livanos Cattai, *Foreward to INCOTERMS 2000* at 4 (ICC Publishing, Inc.) (1999).

⁴ *Id.* at 4.

⁵ International Chamber of Commerce, *supra* note 1, at 5.

⁶ *Id.* at 5.

⁷ *Id.* at 9.

⁸ Chamber of Commerce of the United States of America, et al., *REVISED AMERICAN FOREIGN TRADE DEFINITIONS – 1941* (issued by the National Foreign Trade Council, Inc.) (1941).

⁹ UNIFORM COMMERCIAL CODE § 2-319 (2003).

¹⁰ Chamber of Commerce of the United States of America, et al., *supra* note 6, at 4.

¹¹ International Chamber of Commerce, *supra* note 1, at 23.

¹² Frank Reynolds, *INCOTERMS FOR AMERICANS 5* (1999).

¹³ International Chamber of Commerce, *supra* note 1, at 9-11.

¹⁴ *Id.* at 19.

¹⁵ *Id.* at 7, 8.

¹⁶ *Id.* at 22.

¹⁷ *Id.* at 23.

¹⁸ *Id.* at 12.

¹⁹ *Id.* at 28, 29.

²⁰ 65 F.R. 42565-75 (July 10, 2000).

²¹ 15 CFR 30.4(c)(1).

²² 22 CFR 120-130.

²³ 15 CFR 730-774.

²⁴ International Chamber of Commerce, *INCOTERMS 1990* at 26 (ICC Publishing S.A.) (1990).

²⁵ International Chamber of Commerce, *supra* note 1, at 34.

²⁶ Reynolds, *supra* note 11, at 6.

²⁷ International Chamber of Commerce, *supra* note 22, at 33.

²⁸ *Id.* at 32.

²⁹ International Chamber of Commerce, *supra* note 1, at 42.

³⁰ International Chamber of Commerce, *supra* note 22, at 80.

³¹ International Chamber of Commerce, *supra* note 1, at 106-107.

³² Reynolds, *supra* note 11, at 7.

³³ International Chamber of Commerce, *supra* note 1, at 6.

³⁴ *Id.* at 21.

³⁵ National Conference of Commissioners on Uniform State Laws, *UCC2/2A Now Final* (visited July 24, 2003), <<http://www.nccusl.org/nccusl/DesktopModules/NewsDisplay.aspx?ItemID=52>>.

³⁶ The American Law Institute and National Conference of Commissioners on Uniform State Laws, *PROPOSED AMENDMENTS TO UNIFORM COMMERCIAL CODE ARTICLE 2 – SALES, July 26 – August 2, 2002*, at 73-76.

³⁷ The American Law Institute and National Conference of Commissioners on Uniform State Laws, *DRAFT FOR DISCUSSION ONLY, REVISION OF UNIFORM COMMERCIAL CODE ARTICLE 2 – SALES, December, 1999* at 58.

³⁸ *Id.*, at 21.

³⁹ UNIFORM COMMERCIAL CODE § 2-319 (2003).

⁴⁰ International Chamber of Commerce, *supra* note 1, at 6.

⁴¹ *Id.*, at 11.

⁴² *Id.*, at 9.

⁴³ *Id.*, at 14.

⁴⁴ Telephone Conversation with Frank Reynolds, President of International Projects, Inc. (Aug. 25, 2003).

⁴⁵ International Chamber of Commerce, *supra* note 1, at 6.

⁴⁶ The United States Chamber of Commerce (visited Aug. 1, 2003) <<http://www.uschamber.com/default>>.

⁴⁷ Telephone Conversation with John Simpson, President of American Association of Exports and Importers (Aug. 15, 2003).

⁴⁸ National Foreign Trade Council (visited Aug. 1, 2003) <<http://www.nftc.org/default.asp?Mode=DirectoryDisplay&id=1&category=A11>>.

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From the Editor *By: Jennifer Kalvestran, Meagher & Geer, PLLP*

I would like to express my gratitude and appreciation to those who contributed to this edition of *International Business Law News*. I would also like to take this time to welcome my new co-editor, Dorothy Jaworski of Meagher & Geer. We are interested in working with other members of the section. Please contact us if you would like to contribute an article to a future edition of the newsletter, or if you have any comments about this edition of the newsletter. We can be reached at:

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