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CISG Exclusion and Legal Efficiency

Lisa Spagnolo

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She presently coaches the Vis moot team, is a Fellow of the Institute of International Commercial Law, New York, has been a guest advisor to the International Commercial Contracts Committee International Section of the New York State Bar Association, is a member of the UNCITRAL Australian Liaison Committee at the Law Council of Australia, and is a Rapporteur for the CISG Advisory Council, edits the *Vindobona Journal of International Commercial Law and Arbitration*, and recently prepared a report commissioned by the Korea Legislation Research Institute. She has presented for the Australian Federal Attorney General's Department in Australia by invitation, and given papers in Asia, South America, Europe, and the USA.

She has three children, none of which have turned out to be lawyers.

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Foreword

The literature about the UN Convention on Contracts for the International Sale of Goods (the CISG) is already very extensive, but this excellent book manages to make a novel, and important, contribution. That is no small feat, and as a result, this book deserves to be widely read for that reason alone.

It is possible for the parties to an international sale transaction to contract out of the effect of the CISG, and contracting parties often do. Empirical surveys show that a majority of practicing lawyers who know about the CISG routinely advise their clients to contract out of its operation. The standard form contracts used in international commodity contracts all exclude the operation of the CISG. As a result, some iconoclastic writers have suggested that the huge literature on the CISG naïvely overlooks the fact that the Convention has little effect in practice. At the other end of the spectrum are those who focus their scholarship almost entirely on the CISG, as if it were the only instrument relevant to the international sale in goods. The truth lies somewhere between these two extremes: the CISG is neither all-important nor unimportant.

Dr Spagnolo's book bravely, and importantly, addresses the question of *why* people choose to contract out of the CISG when it would otherwise govern an international sale, and whether it is sensible to do so. After comparing the CISG's rules with those of English law and the American Uniform Commercial Code (UCC) in relation to several different aspects of contract formation and performance, as well as damages for breach, Dr Spagnolo asks the key question of which set of rules is more efficient. Her conclusion is that the CISG comes out of this comparison well, according to criteria of efficiency that she explains and justifies. At the very least, the CISG is not markedly *less* efficient than English law or the UCC.

Why, then, do lawyers and sophisticated traders so often exclude the effect of the CISG in favour of English law or the UCC? The answer to this important question forms the core of this book. Of course, different people have quite different reasons or multiple reasons for contracting out of the CISG, or for advising their clients to do so, but Dr Spagnolo demonstrates convincingly that the principal reason is, simply, unfamiliarity with the contents of the Convention, despite the fact that it has been existence for over 30 years. It is depressing, but illuminating, to see to what extent the exclusion of the CISG is a consequence of the "path dependence" of lawyers continuing

Foreword

to advise what they have always advised, without a thorough analysis of whether the CISG does (or even might), in fact, provide better outcomes for their clients.

It is not too much of an exaggeration to say that this book deals with one of the most important questions about the operation of the CISG, one that has not yet received the sustained attention that Dr Spagnolo gives to it. The extent of contracting out is the CISG's elephant in the room: ignored by some despite its size, but declared by others to be so large that it makes everything else irrelevant. This book boldly confronts the question of *why* this elephant sits in the CISG's room and argues that if we ask ourselves frankly about its real size and impact, we might choose a different response than the equally unhelpful alternatives of ignoring it or irrationally fearing it. That is a major contribution to our understanding of the operation of the CISG in practice.

Martin Davies
Tulane University, New Orleans
April 2014

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Preface

This book is bound to provoke. In some, it may confirm what they felt they always knew instinctively. In others, it may challenge their beliefs about what is occurring in practice, and/or why it is happening. Some will no doubt dismiss my conclusions.

My hope is that all who read it do so with an open mind, and that the reader enjoys the journey that took me years to complete just as much as I did. Those who know me know that I relish a challenge. So it is with this book. The questions I raise have always been controversial ones, and my aim has been to answer them in a considered way, making careful use of all available evidence, flawed as it may be. My persistent concern throughout is to analyse in a manner that prompts further thought.

In asking what has happened to the CISG in practice, I have attempted to go back in time to look at the reason for its creation, and to critique its historic aims. But the main purpose of this book is certainly not historical. I wanted to test how efficient the CISG really is in economic terms, not only as it stands on its own, but in comparison with alternative choices of law. Only then could the current lawyer practices in decision-making on choice of law and, in particular, opting out of the CISG, be analysed and justifiably critiqued.

While statistical studies are reviewed and analysed for trends using statistical methods, my purpose was to go behind the raw statistics to uncover verifiable trends and the reasons for those trends, and to predict their course into the future. Thus more recent studies are separated from earlier ones, and discernible changes between them are noted. In this way, certain conclusions could be drawn about what is affecting and what will in future affect the use or non-use of the CISG in practice.

The final purpose of this book has been to apply those conclusions to interpretive questions. Here, promotion of efficiency in trade is treated as a justifiable norm, and, using the examples of precontractual liability and waiver during litigation proceedings, I have suggested that, where there are competing doctrinal interpretations open to courts and tribunals, the best choice is the one that better promotes efficiency in trade, in light of earlier conclusions about exclusion trends and practices.

Preface

As anyone who has attempted to write a book knows, the end is really the beginning. So let me thank in advance all who take the time to read it, and welcome any comments you may have at lisa.spagnolo@monash.edu.

All sources are current to 28 February 2014.

Lisa Spagnolo
Melbourne
March 2014

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Publication

Parts of this book have been previously published as follows:

'*Iura Novit Curia* and the CISG: Resolution of the Faux Procedural Black Hole' in Ingeborg Schwenzer & Lisa Spagnolo (eds), *Towards Uniformity. The 2nd Annual MAA Schlechtriem CISG Conference* (Eleven International Publishing, 2011).

'Green Eggs & Ham: The CISG, Path Dependence, and the Behavioural Economics of Lawyers' Choices of Law in International Sales Contracts' (2010) 6 *Journal of Private International Law* 417.

'A Glimpse Through the Kaleidoscope: Choices of Law and the CISG' (2009) 13 *Vindobona Journal of International Commercial Law and Arbitration* 135.

'Rats in the Kaleidoscope: Rationality, Irrationality, and the Economics & Psychology of Opting In & Out of the CISG' (2009) 13 *Vindobona Journal of International Commercial Law and Arbitration* 157.

'Opening Pandora's Box: Good Faith & Precontractual Liability in the CISG' (2007) 21(2) *Temple International & Comparative Law Journal* 261.

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Acknowledgments

This book was written during a tumultuous time in my life, one filled with challenges, sorrow and joy. Throughout this remarkable time, it has been my one constant. There are many people to whom I am thankful, but none more so than the person who inspired and encouraged my journey into academia, Professor Jeff Waincymer. Jeff has been my mentor and instilled in me the confidence to aspire to things of which I once barely dreamed. I am grateful also to Dr Jeannie Paterson for her enthusiasm and advice, and for the Australian Postgraduate Award which enabled me to undertake this work. Lee Gordon-Brown from Monash Business Law & Taxation provided wonderful statistics tuition. My colleagues at the Monash Law School listened to my endless trials and tribulations, and did vast amounts of proofing, all of which made the road far less arduous. I feel privileged to work in such a generous faculty.

Thank you to Professors Ulrich Magnus and Martin Davies for their excellent and helpful insights as examiners of the work that became this book. The final stages were also enhanced by the tireless accuracy, dedication and humour of my fantastic assistants Lauren Peacock and Matthew Vethecan, and the wonderful editors at Kluwer International, including Lijntje Zandee, Series Editor Professor Ross Buckley, and the great editorial assistance of Srinivasan and Pritha.

I am indebted to my parents for everything I am. Although he did not live to see this book, my father Gianni's strength, courage and determination underpins my life and work. My mother Margaret has been an endless source of optimism and support, and an enormous influence. For their patience I thank David, Matthew, Kieran and Ellanya, and Naseef. It is impossible to forget the people in my life who kept me on the path with their love and support.

Finally, I thank my international colleagues. I am fortunate to have gained from them perspectives from all around the world, as well as wonderful friends. For me, that has been truly inspiring.

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CHAPTER 1

Introduction

§1.01 GENERAL

‘[T]he CISG can be viewed as an institutional arrangement that has evolved to reduce the transaction costs associated with international trade. If it is successful in doing so, it has the potential to create an enormous amount of value.’¹ The *Vienna Convention on Contracts for the International Sale of Goods* (CISG)² is the result of a major effort of many decades to harmonize the law relating to the international sale of goods. The basic rationale behind this movement was that a uniform sales law would lead to improved efficiency of cross-border sales and promote international trade.

In the austere times that follow the global financial crisis of 2008, questions regarding the value of law in improving efficiency in trade assume unprecedented importance. During previous worldwide depressions or serious recessions, trade was never as significant as it is today. In the current environment, the potential of the CISG is increasingly important.

However, the CISG cannot hope to attain its underlying efficiency aims if it is not applied in practice. In other words, the CISG must be a viable and desirable choice of law; otherwise, the effort to create it will have been futile. Exclusion of the CISG by commercial parties therefore could threaten attainment of its efficiency aims. The greater the rate of opt-outs, the less likely it is that the CISG will improve economic efficiency.

But *is* the CISG in fact efficient? And if so, *why* then do parties exclude it? My curiosity was peaked by the interrelationship between these two questions. Yet they are rarely discussed together in a comprehensive manner. Most authors do little more

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1. Kenneth Lehn, ‘The CISG: Perspectives from an Economist’, in Harry M. Flechtner, Ronald A. Brand and Mark S. Walter (eds), *Drafting Contracts Under the CISG* 261, 263 (Oxford 2008).
 2. Vienna Convention on Contracts for the International Sale of Goods, adopted 10 Apr. 1980, UN Doc A/CONF.97/18, opened for signature 11 Apr. 1980, 1489 UNTS 3 (entered into force 1 Jan. 1988) (‘CISG’).

than assert its efficiency. There are works on the broad efficiency of the CISG which do not touch on analysis of reasons for exclusions in any depth, and works regarding exclusions which do not ask the economic question. There are studies which examine rates and reasons for exclusion, but do not engage in economic or cross-disciplinary analysis. This book attempts to bring all these worlds together. It attempts to identify exactly what influences the frequency of use of the CISG in practice, and critiques the normative underpinning of the CISG to test whether it is indeed presently an efficient law, what factors affect its efficiency, and whether its efficiency can be improved.

The theory that I seek to test, which I believe is important for international business, is whether the CISG is an efficient choice of law for cross-border sales that is excluded for reasons that are actually unrelated to its substantive content. In other words, I have attempted to uncover the degree to which exclusions of the CISG are inefficient choices of law. This allows a critique of the extent to which opt-outs are suboptimal choices by lawyers, and even to predict the future direction of exclusions over time.

Thus I review the aims and applicability of the CISG, and examine both its substantive and non-substantive qualities, and compare these with two key competing and frequent choices of law for international sales – English and New York law. From an analysis of available empirical evidence regarding exclusion of the CISG in practice, the various factors which appear to influence lawyer choices to exclude the CISG are drawn. Choices to exclude the CISG are then analysed through various prisms to help explain influences behind lawyer opt-out decisions; behavioural economics, psychology, game theory, group dynamics and institutional behaviour.

From this come insights on choices of law in different jurisdictions, and concerning likely future changes in choices. I also suggest interpretative approaches sensitive to the CISG's economic aims can assist in enhancing its future efficiency, and give two examples.

By bringing together cross-disciplinary elements of empirical research, statistical analysis, economic and behavioural theory and doctrinal implications, this book attempts to present a uniquely contextual and realist insight into how and why harmonized international sales law is utilized in global trade.

Professor Schlechtriem once suggested that the CISG is a construction site.³ Perhaps this construction has stages of education, critique and development. The notions in this book originate at the critique stage, concerning the economic impact of the CISG, and how it currently functions in the real world, but then employs them to suggest the best paths for its future development within the global competitive market for law.

It has been stated that 'the future of the CISG rests in the hands of those using it: the business and legal communities'.⁴ I would add that the future of the CISG also rests in the hands of those not presently using it, or those infrequently doing so, and in

3. Peter Schlechtriem, *Interpretation, Gap-Filling and Further Development of the U.N. Sales Convention*, 16 Pace Int'l L. Rev. 279, 306 (2004).

4. Monica Killian, *CISG and the Problem with Common Law Jurisdictions*, 10(2) J. Transnat'l L. & Pol'y 217, 226 (2001).

courts, tribunals, and academics, who can promote interpretations that will enhance its comparative desirability and application in practice.

§1.02 SCOPE OF THIS WORK

The subject matter of this book is extremely wide. It spans international harmonized law, comparative law, law and economics, socio-legal issues, both procedural and substantive legal issues and international treaty obligations. It is therefore not possible to give an exhaustive account of the impact of all of these matters, but rather to use each to derive perspectives about the effect and development of the CISG.

When comparing the CISG with competing laws, English and US laws are used as the primary points of comparison in Chapter 4. It is true that this means that the efficiency of the CISG's substantive rules is measured against only common law alternatives. However, the reason for this selection is that these are frequently chosen as applicable law where the CISG is excluded; in the case of the US, often New York law is chosen.⁵ Nonetheless, where particularly relevant, some brief references in passing are made to domestic Swiss and German substantive rules within Chapter 4.

I have not attempted to duplicate empirical work previously undertaken, but instead drawn on existing empirical work for meta-analysis. At the time of writing, the Global Sales Law study was the most recent large-scale study.⁶ Due to its more recent nature, large size, and rather different design, analysis of the Global Sales Law study is therefore left until the end of Chapter 7, and it is primarily used to test some of the predictions made as a result of the earlier studies.

It is worthy of note that the CISG has partially achieved its aims by more indirect means. It has served as a model for law reform and development in numerous countries,⁷ and acted as a point of reference for the development of supranational principles such as the UNIDROIT Principles,⁸ PECL⁹ and more recently, the Draft

-
5. English, New York and Swiss law is preferred by survey respondents (other than the law of their home jurisdiction); Institute of European & Comparative Law, Oxford University and Clifford Chance LLP, *Civil Justice and Choice of Contract Law: A Business Survey* (2008) spreadsheet on file with the author ('Vogenauer and Hodges'). See Stefan Vogenauer, *Oxford Civil Justice Survey*, 15, 16, Questions 17.4 & 18, <http://denning.law.ox.ac.uk/iecl/pdfs/Oxford%20Civil%20Justice%20Survey%20-%20Summary%20of%20Results,%20Final.pdf> (accessed 28 Feb. 2014) and Stefan Vogenauer and Chris Hodges (eds), *Civil Justice Systems in Europe: Implications for Choice of Forum and Choice of Contract Law* (Hart 2011); School of International Arbitration at Queen Mary, University of London, *International Arbitration Survey: Choices in International Arbitration* (2010), 14, http://www.arbitrationonline.org/docs/2010_InternationalArbitrationSurveyReport.pdf (accessed 28 Feb. 2014) (after their own law, respondents preferred English (40%), New York (17%), or Swiss law (8%)).
 6. Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* (Oxford 2012). See Ch. 7 below, §7.03.
 7. Franco Ferrari (ed), *The CISG and Its Impact on National Legal Systems* (Sellier 2008); Jürgen Basedow, *Towards a Universal Doctrine of Breach of Contract: The Impact of the CISG*, 25 Int'l Rev. L. & Econ. 487 (2005).
 8. UNIDROIT *Principles of International Commercial Contracts* 2004, and most recently UNIDROIT *Principles of International Commercial Contracts* 2010, <http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf> (accessed 28 Feb. 2014) ('UNIDROIT Principles').

Common Frame of Reference and subsequent European Sales Law, the proposed CESL.¹⁰ It has also had a further effect on existing laws referred to as ‘interpretive assimilation’.¹¹ These aspects are not discussed here, since the purpose of this book is to examine the direct effect of the CISG within its own field of application. However, this should not be taken as suggesting that its influence by these less direct means has not had significant economic impact.

There are of course other aims of the CISG that are non-economic in nature. The Preamble states that development of trade is an ‘important element in promoting friendly relations among States.’¹² This relates to the idea that ‘countries are less likely to go to war with each other if they are trading partners’ and thus increases in international trade will bring about a reduction in hostilities between nations.¹³ This issue is not dealt with here, since it involves political rather than legal or economic aims.

§1.03 FUTURE RESEARCH

Empirical evidence is becoming increasingly available in relation to exclusions; however, there is virtually no evidence looking at the rate of opt-ins, which one study suggested might account for 10% of relevant choices.¹⁴ Attention should also be paid to the rate of exclusions and opt-ins within nations outside of Europe and the USA. The recent study by the Global Sales Law Project is one such survey,¹⁵ and it is suggested that follow-up international surveys to track trends should be conducted in future. It is also suggested that further large-scale nation-specific data from China, Australia and Canada is still of particular interest.

Data should also be collected in future, not only on preferences for or against the CISG (regarding which much data already exists),¹⁶ but on which alternative laws are

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9. Commission on European Contract Law, *Principles of European Contract Law*, Parts I and II (1999), and Part III (2003), <http://www.cisg.law.pace.edu/cisg/text/textef.html> (accessed 28 Feb. 2014) (‘Lando Principles’ or ‘PECL’).
 10. Christian von Bar and Eric Clive (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (Sellier 2009); Commission Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, COM (2011) 635 final (10 Nov. 2011), text adopted by EU Parliament: *European Parliament legislative resolution of 26 February 2014 on the proposal for a regulation of the European Parliament and of the Council on a Common European Sales Law* (COM(2011) 0635 – C7-0329/2011 – 2011/0284(COD)) (Ordinary legislative procedure: first reading), <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2014-0159> pending approval of the Council (accessed 28 Feb. 2014) (proposed Regulation ‘RCESL’; Annex I proposed ‘CESL’).
 11. Hiroo Sono, ‘The Diversity of Favor Contractus: The Impact of the CISG on Japan’s Civil Code and its Reform’, in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Towards Uniformity*, 165, §III.2 (Eleven 2011); Gilles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 *Vand. J. Transnat’l L.* 1511, 1519 (2006).
 12. CISG Preamble.
 13. See also Christopher Kee and Edgardo Muñoz, *In Defence of the CISG*, 14 *Deakin L. Rev.* 99 (2009). Aims of the CISG are discussed in Chs 2 and 3.
 14. Discussed in Ch. 6.
 15. See above n. 6.
 16. See Ch. 6.

preferred where the CISG is not, and why. Empirical work of this nature has been conducted for the preferences of European businesses,¹⁷ but not for lawyers themselves, nor for businesses or lawyers globally. This would help determine preferences amongst default rules.

Another area in which empirical evidence would provide helpful guidance is in the decision-making processes resulting in institutionalized choices of law inherent in standard forms promulgated by industry groups, as discussed in Chapters 6 and 7.

The importance of proper statistical methodology should be mentioned in relation to future research. If further studies are to inform rather than mislead, those involved will need to pay close attention to the implications of the design of their studies, in particular, the design of their questionnaires. It is also vital that researchers adhere to widely accepted statistical methods so that results are not over or understated, and some comments to that end have been included at relevant points in the present analysis.

<http://www.pbookshop.com>

17. See Vogenauer and Hodges, above n. 5.

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CHAPTER 2

Birth of the CISG: Its Applicability and Nature

§2.01 INTRODUCTION

In a book which concentrates on how often the CISG is utilized and why, it is worth first examining its creation, applicability, and nature in what is now a global market for law. The history of the CISG is by no means a novel discourse,¹ so the present chapter will only very briefly recall the policy aims which guided its drafters before turning to the circumstances under which it applies *ipso iure*. Essentially, this chapter sketches the context in which the CISG was brought to life, and when it takes effect, as the vital background to all other chapters.

§2.02 THE BIRTH OF THE CISG

The CISG was conceived shortly before the current global trade boom. It was created at the height of talk of the 'new international economic order'.² Socialist blocs still held sway, and their representatives were actively involved in the movement to create the CISG. It must have seemed like an ambitious project. Whilst drafters correctly anticipated global trade would grow, one suspects they never dreamt of the political changes and enormous seven-fold expansion of the global economy that would follow

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1. For a history of the CISG, see, Kazuaki Sono, 'The Vienna Sales Convention: History and Perspective', in Petar Šarčević and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures 1* (Oceana 1986); Peter Schlechtriem and Ingeborg Schwenzer, in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* 1, 1-3 (Oxford 3rd edn, 2010) (hereinafter '*Schlechtriem & Schwenzer* 3rd edn').
 2. See CISG Preamble. The idea of a 'new international economic order' inspired the creation of UNCITRAL not long before: Michael Bridge, 'Choice of Law Issues' in James J. Fawcett, Jonathan M. Harris and Michael Bridge (eds), *International Sale of Goods in the Conflict of Laws* 905, 912 [16.10] (Oxford 2005).

in the next three decades,³ such as the fall of socialism, the rise of Islam, the exponential economic growth of China, and the impact of computers and the Internet.

Harmonization of law, or more specifically, commercial law, was not a new idea. In the area of sales law, the movement began early in the century, and the world had already seen ULIS and ULF, the first drafts of which appeared in 1935.⁴ The drafters of the CISG learnt from that experience. One lesson was the vital importance of a wide participation from different legal systems and from all regions of the globe, something that the failed ULIS and ULF lacked.⁵ However, in the end, the fundamental aim of the CISG was the same as those earlier, less successful harmonization instruments.⁶ It grew from the long-held perception that could be traced back to Rabel; that the vast array of divergent national sales laws across the world, together with the uncertainties inherent in choice of law rules had long been a significant obstacle to international trade.⁷

Thus the aim of the CISG was, and still is, to provide a single uniform law for international trade in goods in order to reduce the perceived uncertainty and costs involved in cross-border as opposed to domestic trade, whereby business had to contend with multiple unfamiliar, diverse and sometimes inaccessible foreign sales laws.⁸ It was intended to be a neutral,⁹ internationally-recognized option. By comparison to choice of a foreign domestic law often unfamiliar to one or perhaps both parties, the CISG rules were to be easily accessible and relatively simple.¹⁰ The idea was to reduce barriers to international trade by reduction in transaction costs arising from

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3. Trade expanded seven-fold from 1980 to 2010: World Trade Organization, Time Series, <http://stat.wto.org/StatisticalProgram/WSDBViewData.aspx?Language=E> (accessed 28 Feb. 2014).
 4. The UNIDROIT 'Hague Sales Conventions', *Convention relating to a Uniform Law on the International Sale of Goods*, opened for signature 1 Jul. 1964, 834 UNTS 107 (entered into force 18 Aug. 1972) ('ULIS'); *Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods*, opened for signature 1 Jul. 1964, 834 UNTS 169 (entered into force 23 Aug. 1972) ('ULF').
 5. *Explanatory Note by the UNCITRAL Secretariat* 33, 33 [3] (2010), <http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf> (accessed 28 Feb. 2014); Peter Winship, 'The Scope of the Vienna Convention on International Sales Contracts' in Nina M. Galston and Hans Smit (eds), *International Sales* 1-1, 1-12, 1-15 (Bender 1984); Peter Schlechtriem and Ingeborg Schwenzer, in *Schlechtriem & Schwenzer* 3rd edn, above n. 1, Introduction, at 2-3; Bridge, above n. 2, at 911 [16.10].
 6. ULIS and ULF were ratified by only nine nations: Ulrich Magnus, 'Force Majeure and the CISG', in Petar Šarčević and Paul Volken (eds), *The International Sale of Goods Revisited* 1, 10 (Kluwer 2001).
 7. Ernst Rabel, *The Hague Conference on the Unification of Sales Law*, 1 Am. J. Comp. L. 58, 58 (1952); Jernej Sekolec, 'Digest of Case Law on the UN Sales Convention' in Franco Ferrari, Harry M. Flechtner and Ronald A. Brand (eds), *The Draft UNCITRAL Digest and Beyond* 1, 4 (Sellier 2004). Supporting diversity in contract laws: Sir Roy Goode, 'Contract and Commercial Law: The Logic and Limits of Harmonization', in F. Willem Grosheide and Ewoud Hondius (eds), *International Contract Law* 309, 319 (Intersentia 2004); Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 Pace Int'l L. Rev. 55, 56 (2003).
 8. The CISG was intended to 'contribute to the removal of legal barriers in international trade and promote the development of international trade': CISG Preamble.
 9. See Frank Diedrich, *Maintaining Uniformity in International Uniform Law via Autonomous Interpretation*, 8 Pace Int'l L. Rev. 303, 304 (1996); Christiana Fountoulakis, *The Parties' Choice of "Neutral Law" in International Sales Contracts*, 7 European J.L. Reform 303, 314 (2005).
 10. Sono, above n. 1, at 7; Christoph Brunner, *Force Majeure and Hardship in International Commercial Transactions* 17 (Kluwer 2009).

plural legal systems.¹¹ In essence, the CISG was intended to streamline efficient international trade.¹² Recently, many of these arguments were echoed in the debate over the introduction of a EU Directive or Regulation for a European Contract Law ‘for the removal of market barriers relating to diverging contract laws’ which create high legal costs arising from linguistic and legal divergences that raise obstacles ‘preventing businesses from grasping opportunities’ to engage in cross-border trade.¹³

It was anticipated that the CISG would reduce transaction costs by reducing the need to investigate a foreign law, decreasing the need to refer to choice of law rules, and by its design. Unlike domestic laws, the CISG was designed specifically for international trade, and therefore considered likely to further enhance efficiency in global trade. Given the long distances involved in many international transactions, unwinding a contract could entail far greater costs than for domestic transactions. Thus the notion of *favour contractus*, and the high hurdle of fundamental breach set for avoidance (or termination) of the transaction were thought the most suitable and efficient.¹⁴ Issues relating to efficiency of the CISG will be discussed further in Chapters 4 and 5.

In 1980 the text prepared by UNICITRAL¹⁵ was adopted¹⁶ and the newly formed CISG became a uniform international law for the sale of goods, driven by the policy norm that its establishment would reduce transaction costs and consequently increase trade.

The CISG has since attracted 80 signatories including the United States, China, Canada, Australia, Japan, South Korea, Brazil and almost all European countries,¹⁷ and has influenced many domestic law reforms around the globe, as well as international ‘soft law’ rules.¹⁸ Notably, the United Kingdom is not a Contracting State, and Japan, South Korea and Brazil only recently joined.¹⁹

It should be noted that the drafters did not suffer from the delusion that, in order to improve the efficiency of world trade, the CISG must apply to every transaction. Universalism had been a major criticism of ULF and of ULIS which was said to have an ‘excessive’ sphere of application.²⁰ However, they were mindful of significant obstacles that would stand in the way of the CISG having any real effect. They feared that courts

11. Jacob S. Ziegel, *Commentary on Party Autonomy and Statutory Regulation*, 6 J. Contract L. 123, 124, 127-128 (1993).

12. Mark Cantora, *The CISG after Medellín v. Texas*, 8 J. Int’l Bus. & L. 111, 111 (2009).

13. European Commission, *Green Paper from the Commission on Policy Options for Progress towards a European Contract Law for Consumers and Businesses*, COM(2010) 348 final, Brussels, 1 Jul. 2010, 3, 6, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0348:FIN:en:PDF> (accessed 28 Feb. 2014) (*‘Green Paper’*).

14. See Bertram Keller, ‘Favor Contractus: Reading the CISG in Favor of the Contract’, in Camilla B. Andersen and Ulrich G. Schroeter (eds), *Sharing International Commercial Law across National Boundaries* 247 (Wildy Simmonds & Hill 2008).

15. United Nations Commission on Trade Law (‘UNCITRAL’).

16. The CISG was adopted 10 Apr. 1980, UN Doc A/CONF.97/18.

17. *CISG Status*, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (accessed 28 Feb. 2014).

18. Notably, UNIDROIT Principles, PECL, DCFR and CESL.

19. *CISG Status*, above n. 17.

20. ULIS was applicable even where parties were from non-Contracting States unless excluded per Art. 3, an approach rejected in the CISG after careful study: Winship, above n. 5, at 1-11, 1-17;

would be too quick to find a contrary implicit choice of law;²¹ they knew that for it to succeed in having any real effect, it must operate as an ‘opt out’ regime, rather than an ‘opt in’ system.²² These were further lessons taken from ULIS and ULF.

Consequently, the CISG was made subject to the principle of party autonomy.²³ However, that same concept, as the drafters had suspected, also held the kernel for its potential downfall. It could only improve efficiency to the extent it was utilized in practice. If the CISG were never applied at all, its aims would ring hollow.

§2.03 HOW THE CISG BECOMES APPLICABLE

The CISG does not set out to cover all types of transactions. Some types of sales are expressly excluded, for example, *inter alia*, auctions and contracts for electricity, money, shares or, strangely with the benefit of hindsight, hovercraft!²⁴ In most cases, consumer contracts are excluded from the CISG, and contracts which preponderantly concern services are outside its sphere of applicability.²⁵

However, if the type of transaction falls within the CISG’s sphere, then its internal rules of applicability in Article 1 may override or substitute for otherwise relevant choice of law rules of the forum.²⁶ If so, the CISG may become applicable in the manner described below.

The view presented in this section of the effect of Article 1(1) is pertinent not only to the current explanation of the CISG’s applicability, but to further discussion in Chapter 10 regarding implicit exclusions.

[A] Both Parties from Contracting States: Article 1(1)(a)

The CISG applies by virtue of Article 1(1)(a) to a contract for the sale of goods between parties having their places of business in different Member States, described in the CISG as Contracting States. For simplicity, I will refer to such parties as ‘from’

Bridge, above n. 2, at 913-914 [16.12]-[16.15]; Peter Winship, *Private International Law and the U.N. Sales Convention*, 21 Cornell Int’l L.J. 487, 501 et seq. (1988) (hereinafter ‘*Private International Law*’).

21. UNCITRAL Yearbook [1971] Vol II, UN Doc A/CN.9/SER.A/1971/50, 55 [45]; UNCITRAL Secretariat, *Commentary on the Draft Convention*, UN Doc A/CONF.97/5 (14 Mar. 1979) 14, 17 Art. 5 [2] (hereinafter ‘*Secretariat Commentary*’), in Diplomatic Conference, Vienna, 10 Mar.-11 Apr. 1980, Vienna, 10 Mar.-11 Apr. 1980, UN Doc A/CONF.97/19 14, 15 (‘*Official Records*’), http://www.uncitral.org/pdf/a_conf.97_5-ocred.pdf (accessed 28 Feb. 2014).

22. Article V ULIS reservations could remove the obligation to apply it unless parties opted-in. A similar Australian proposal was soundly rejected: 1980 Diplomatic Conference, UN Doc A/CONF.97/C.2/SR.1 [40] et seq.; UN Doc A/CONF.97/C.2/SR.2 [6], <http://www.cisg.law.pace.edu/cisg/2dcommittee/articles/meeting1.html> and <http://www.cisg.law.pace.edu/cisg/2dcommittee/articles/meeting2.html> (accessed 28 Feb. 2014).

23. CISG Art. 6.

24. CISG Art. 2(b)-(f).

25. Unless the domestic purpose is not discernible: see, e.g., Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, above n. 1, Art. 2, at 51 [8] et seq.; Bridge, above n. 2, at 953 [16.84]; Court of Appeal (OLG) Stuttgart, Germany, 31 Mar. 2008, <http://cisgw3.law.pace.edu/cases/080331g1.html> (accessed 28 Feb. 2014).

26. Bridge, above n. 2, at 906 [16.02].

particular states, although of course, their place of business is the relevant factor.²⁷ Thus, for example, the CISG would govern contracts of sale between parties from the United States and Australia,²⁸ as both are Contracting States. It is irrelevant in this circumstance that the US has made a declaration under Article 95, since this has no effect on the operation of Article 1(1)(a).²⁹ Article 95 would be irrelevant even if both parties were from declaring States, since Article 1(1)(a) would still apply, and declaring States are still Contracting States for Article 1(1)(a) purposes.³⁰ Courts of the few Contracting States that have made a declaration pursuant to Article 95 are not bound by Article 1(1)(b), but continue to be bound by Article 1(1)(a).³¹ Indeed, as the number of CISG Contracting States has risen, Article 95 declarations are declining in importance, and resort to Article 1(1)(b) is slowly rendered redundant.³²

Where parties have purportedly agreed to exclude the CISG, it will nonetheless apply *prima facie*. As both parties are from Contracting States, it is the applicable law on its own terms. Notably, Article 1(1)(a) is the dominant test in Article 1(1).³³ Thus, in addition to satisfaction of relevant domestic validity requirements, an exclusion clause will need to satisfy Article 6 CISG to be effective in ending the applicability of the CISG.³⁴

The obligation to apply the CISG pursuant to Article 1(1)(a) of course only binds those courts located in Contracting States. Courts in other States and arbitral tribunals could nonetheless apply the CISG if the forum's rules of private international law refer to the law of a Contracting State, or such a law is determined applicable pursuant to relevant arbitral procedural rules.³⁵

27. CISG Art. 1(1)(a). On the need for awareness of the transaction's internationality pursuant to Art. 1(2): Franco Ferrari, 'The CISG's Sphere of Application' in Ferrari, Flechtner and Brand (eds), above n. 7, at 21, 31 et seq.

28. Provided this fact is apparent, CISG Art. 1(2).

29. Winship, above n. 5, at 1-29; Peter Schlechtriem, Ingeborg Schwenzer and Pascal Hachem, in *Slechtriem & Schwenzer*, 3rd edn, above n. 1, Art. 95, at 1190 [2]; Ulrich G. Schroeter, 'Backbone or Backward of the Convention? The CISG's Final Provisions' in Andersen and Schroeter (eds), above n. 14, at 425, 440; *Valero Marketing & Supply Company v. Greeni Oy*, 373 F Supp 2d 475, US District Court New Jersey, 15 Jun. 2005, <http://cisgw3.law.pace.edu/cases/050615u1.html> (accessed 28 Feb. 2014).

30. CISG Advisory Council, CISG-AC Opinion No. 15, Rapporteur: Prof. Dr Ulrich G. Schroeter, §2; Winship, above n. 5, at 1-32.

31. *Ibid.*, *Commentary* [3.10].

32. Michael Bridge, *The International Sale of Goods* 522 [10.57] (Oxford, 3rd edn, 2013); Bridge above n. 2, at 976-977 [16.128]; John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention*, 45-46 [47.6] (Kluwer, 4th edn, 2009); Schroeter, above n. 29, at 432.

33. Bridge above n. 2, at 915-916 [16.20].

34. *Ibid.*, at 966-967 [16.110].

35. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.18], [3.19]; Winship, above n. 5, at 1-30; Bridge above n. 2, at 917-918 [16.23]; Winship, *Private International Law*, above n. 20, at 520. Arbitral tribunals have greater flexibility in absence of an agreed choice: Art. 28(2) *UNCITRAL Model Law on International Commercial Arbitration 1985*, as amended in 2006, GA Res A/40/72, UN Doc A/40/17 annex I (11 Dec. 1985) and GA Res A/RES/61/33, UN Doc A/61/17 annex I (4 Dec. 2006) ('UNCITRAL Model Law'); ICC Rules of Arbitration, 11 (ICC 2011, effective 1 Jan. 2012); London Court of International Arbitration Rules 1998 Rules 14(2) and 22(1).

[B] One Party from a Non-contracting State: Article 1(1)(b)

Where Article 1(1)(a) is not satisfied, the CISG may otherwise apply through Article 1(1)(b) where the forum's choice of law rules refer to the law of a Contracting State. Application in this manner is more complex, and will vary depending on the forum. One must consider whether the forum is a court or arbitral tribunal, and if it is a court, whether it is located in a Contracting or non-contracting State. A further consideration is whether there is a relevant reservation to the CISG.³⁶

[1] Court in Article 95 Declaration Contracting State

The situation is different if the court seized of the matter is located in a Contracting State which has made an Article 95 declaration. In this instance, the Convention does not oblige the court to apply Article 1(1)(b), and only compels the court to apply the CISG when both parties are from Contracting States, that is, when Article 1(1)(a) is triggered. Thus a US court is not compelled by the Convention to apply the CISG to a contract between US and UK traders, since the US has made an Article 95 declaration, and Article 1(1)(a) is not satisfied. Were the US court to find US law (or specifically, the law of a US state) to be applicable pursuant to its own choice of law rules, then given the Article 95 declaration, it would apply the relevant domestic sales law.³⁷

However, contrary to some US and Chinese decisions,³⁸ this does not mean that a court in a declaration State is prohibited from applying the CISG unless Article 1(1)(a) is satisfied.³⁹ Nothing in Article 95 precludes the CISG's application in a declaring State

36. The CISG refers to declarations, although the effect is the same as a reservation: Art. 2(1)(d) *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 Jan. 1980).

37. That is, the Uniform Commercial Code Art. 2: Winship, above n. 5, 1-31; Franco Ferrari, *What Sources of Law for Contracts for the International Sale of Goods? Why One Has to Look beyond the CISG*, 25 *Int'l Rev. L. & Econ.* 314, 328 (2005).

38. *Impuls ID Internacional SL v. Psion-Teklogix Inc*, 234 F Supp 2d 1267, 1272, US District Court (SD Fla), 22 Nov. 2002, <http://cisgw3.law.pace.edu/cases/021122u1.html> (accessed 28 Feb. 2014) (hereinafter '*Impuls case*'); *Prime Start Ltd v. Maher Forest Products Ltd*, US District Court (WD Washington), 17 Jul. 2006, <http://cisgw3.law.pace.edu/cases/060717u1.html> (accessed 28 Feb. 2014) (hereinafter '*Prime Start case*'); *Princess d'Isenbourg et Cie Ltd. v. Kinder Caviar, Inc.*, US District Court (ED Kentucky), 22 Feb. 2011, <http://cisgw3.law.pace.edu/cases/110222u1.html> (accessed 28 Feb. 2014) ('*Princess case*'). These effectively hold that US courts can only apply the CISG through Art. 1(1)(a). See also Long, below n. 40, at 89 (citing a decision denying the parties' choice of CISG where Art. 1(1)(a) did not apply and a Chinese party was involved) ('*CI-ETAC Shanghai case*'). The opposite has also been upheld in China: Xiao Yongping and Long Weidi, *Contractual Party Autonomy in Chinese Private International Law*, 11 *Yearbook of Private Int'l L.* 193, 202-203, n. 57 (2009) (citing *Sanming Tsusho (Japan) Corp v. Fujian Zhangzhou Metals & Minerals Import & Export Co.*, (Xiajing Chuzi No. 124), Xiamen Intermediate People's Court, China, August 1994) (hereinafter '*Sanming Tsusho case*'). See also two further Chinese cases cited by CISG-AC Opinion No. 15, above n. 30, at n. 29.

39. See also Schlechtriem, Schwenzler and Hachem, above n. 29, Art. 95, at 1190 [2]; Gary F. Bell, *Why Singapore Should Withdraw Its [Article 95] Reservation*, 9 *Singapore Yearbook Int'l L.* 55, 65 (2005).

in such circumstances.⁴⁰ The forum is simply not *bound* to apply it by reason of the Convention. Nonetheless, the court has power to apply the CISG and may even have a duty to do so, derived not from the CISG, but from the forum's own choice of law rules.⁴¹

Thus, where Article 1(1)(a) is not satisfied, a court in a declaring State could apply the CISG, but is not obliged to do so pursuant to the Convention itself.⁴² One can easily envisage a situation where this could occur. For example, the parties might have explicitly 'opted into' the CISG. The fact that recognition of party autonomy might lead to the CISG has nothing to do with Article 1(1)(b). It depends entirely on the private international law of the forum.⁴³ At the choice of law level, its effectiveness will depend on any restrictions on party autonomy in the forum choice of law rules, and, where the CISG is chosen directly, the validity of selection of 'rules of law'.⁴⁴

If the forum's choice of law rules lead to the law of a non-declaring Contracting State, then the result would depend on how the forum resolves the following quandary. On the one hand, principles of private international law generally lead courts to apply 'foreign law' in the same manner in which a court in the foreign jurisdiction would apply it.⁴⁵ In this case, the 'home court' would apply the CISG. The complication with this view is that the CISG is not a foreign law for the forum court.⁴⁶ On the other hand, the court might 'adopt the line of reasoning that since its own legislature has deprived it of the possibility of applying the Convention pursuant to Article 1(1)(b), then it should only apply it when the requirements of Article 1(1)(a) are met'.⁴⁷

US courts and some Chinese decisions seem to have taken the latter approach, effectively treating the declaration as a mandatory rule of the forum State.⁴⁸ Most scholars argue the CISG can and should be applied in such circumstances, but others

40. Honnold, above n. 32, at 44 [47.6]; Bridge, above n. 32, at 520 n. 413 [10.55] (Honnold's observation was on a choice of law level, not on forum treaty obligations); Bell, above n. 39, at 65; Schroeter, above n. 29, at 441; Weidi Long, 'The Reach of the CISG in China: Declarations and Applicability to Hong Kong and Macao', in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Towards Uniformity* 83, 98 (Eleven 2011). Contra see US *Impuls*, *Prime Start*, *Princess* cases, and Chinese CIETAC *Shanghai* case, above n. 38.

41. Honnold, above n. 32, at 44 [47.6]; Schroeter, above n. 29, at 441; Ferrari, above n. 27, at 50.

42. CISG-AC Opinion No. 15, above n. 30, at §1, *Commentary* [3.7]; Malcolm Evans, in Cesare Massimo Bianca and Michael Joachim Bonell (eds), *Commentary on the International Sales Law*, Art. 95 654, 656 [3.4] (Giuffrè 1987); Bell, above n. 39, at 65.

43. Schroeter, above n. 29, at 441.

44. See, e.g., the effect of the Rome I Regulation, discussed below at n. 88.

45. Ronald H. Graveson, *Philosophical Aspects of the English Conflict of Laws*, 79 *Law Quarterly Rev.* 337, 341 (1962).

46. Since it is located in a Contracting State: Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, above n. 1, Art. 1, at 41 [32]; Bridge, above n. 2, at 916 [16.22]. This is discussed in detail below.

47. Evans, above n. 42, Art. 95, at 656 [3.3]. Contra Bridge, above n. 32, at 512 [10.55] (this result seems 'perverse').

48. See *Impuls*, *Prime Start*, *Princess* and CIETAC *Shanghai* cases, above n. 38. Contra *Sanming Tsusho* case, above n. 38; Long, above n. 40, at 89. Disapproving of the notion the Art. 95 declaration creates a 'mandatory rule' against opt-ins in China, see Xiao Yongping and Long Weidi, *Selected Topics on the Application of the CISG in China*, 20 *Pace Int'l L. Rev.* 61, 72, 81 (2008); Xiao and Long, above n. 38, at 202-203. See below n. 90, discussion of the effect of the 2012 PRC Supreme Court Interpretation I, Art. 9.

disagree.⁴⁹ The fault line between the views arises from differences about the interaction between choice of law rules and Article 1(1)(b) CISG. This leads to a nice question: how can a forum court, itself not bound by Article 1(1)(b), trigger or ‘arrive at’ the CISG by applying that very same provision but as the law of another State?⁵⁰ This question, itself turns on the role of Article 1(1)(b) – whether it amounts to a conflicts rule, an internal direction signalling demarcation between various domestic laws within a jurisdiction, or a precondition to application of the CISG.⁵¹ This will be further discussed below (in section §2.03[B][2]).

In the present context of a declaring State court applying the law of a non-declaring Contracting State, it is submitted that the declaration should be construed narrowly. Although the court is obviously under no duty to apply the Convention, the CISG is generally more apt for international transactions than non-CISG domestic sales law. After all, would it benefit the parties from the US and the UK in a case heard in a US court to have the domestic sales law of South Korea apply to their contract? This might well be the result under US choice of law rules if it the contract was substantially performed in South Korea.⁵² No doubt, for such a forum and parties, Korean law would be less accessible and its proof would involve higher costs due to the need for expert witnesses.

However, should the declaring State court’s choice of law rules refer to the law of another declaring State, it is unlikely that the CISG would be applied.⁵³ Thus if a US court is seized of a matter involving a UK and Chinese trader, and choice of law rules refer to Chinese law, China’s domestic sales law would apply, since China has also made an Article 95 declaration.

[2] Court in Non-declaration Contracting State

If the court is in a non-declaration Contracting State but, pursuant to Article 1(1)(b) concludes that its choice of law rules lead to the law of a declaring Contracting State, opinion is also divided. At first glance, it seems a somewhat similar quandary arises. Some consider that the forum should respect the declaration made by the State whose

49. Favours application of the CISG: Winship, above n. 5, at 1-32, 1-53; Peter Schlechtriem, in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 1, 36 [41] (Oxford 2nd edn, 2005); Honnold, above n. 32, at 44 [47.6]; Bridge, above n. 2, at 979 [16.134]; Evans, above n. 42, Art. 95, at 656-57 [3.3]-[3.4]; Schroeter, above n. 29, at 441; Bell, above n. 39, at 65; Schwenzer and Hachem, above n. 46, Art. 1, at 42 [37]; Long, above n. 40, at 89; Marco Torsello, *Reservations to International Uniform Commercial Law Conventions*, 5 Uniform L. Rev. 85, 108 (2000); Ferrari, above n. 27, at 50. Contra, Xiao and Long, above n. 48, at 67. See also Schlechtriem, Schwenzer and Hachem, above n. 29, Art. 95, at 1190 [2] (a declaration State court could apply the CISG to parties from non-Contracting States but generally does not).

50. Bridge, above n. 2, at 920-921 [16.27]-[16.29], 980-981 [16.136] (questioning whether the court applies the CISG as law of the other State, or as part of its own law).

51. *Ibid.*, at 968-969 [16.114]; Long, above n. 40, at 123.

52. Which might satisfy the US ‘center of gravity’ test, or its supposedly simplified version, the ‘most significant relationship’ test: *Brennan v. Carvel Corp*, 929 F 2d 801 (1st Cir. 1991), Court of Appeals, USA, 29 Mar. 1991.

53. Winship, above n. 5, at 1-53.

law applies, and thus not apply the CISG.⁵⁴ Notably, this view sees the forum as ‘not applying [its] own substantive law’ but the ‘substantive law of the state identified by the forum’s choice of law rules’.⁵⁵ In other words, it views CISG as (potentially) applicable as part of the domestic law of the other State. This school sits more comfortably with broader private international law, since it applies the ‘foreign law’ in the manner in which a court in that jurisdiction would apply it.⁵⁶ Naturally, such a ‘home court’, not being bound by Article 1(1)(b), would itself not be obliged to apply the CISG, although able to do so. The reasoning goes that this ‘private international law’ approach affords comity, and treats the decision of the foreign declaring State as an internal ‘allocation’ of cases to different areas of law.⁵⁷ It gives the widest possible meaning to the need, pursuant to international law, for courts in one Contracting State to respect reservations declared by other Contracting States.⁵⁸ It also discourages forum shopping.⁵⁹ This view has enjoyed the support of the majority of scholars,⁶⁰ and finds indirect support from the presumption in the Secretariat Commentary that the forum applies the CISG as part of the law of the other State.⁶¹

Yet the above majority opinion has almost been overtaken by more persuasive recent scholarship, including the recent CISG Advisory Council Opinion,⁶² which has highlighted a number of concerns arising from the above view. The first problem is one of public international law. A declaration of one Contracting State under Article 95 cannot bind another Contracting State.⁶³ Article 95 has no ‘*erga omnes*’ effect.⁶⁴ Some assert it was ‘conceived in order to allow the courts of reserving states (and only those

54. Jacob Ziegel, *The Scope of the Convention: Reaching out to Article One and Beyond*, 25 J.L. & Com. 59, 66 (2005-2006); Bell, above n. 39, at 64; Honnold, above n. 32, at 45 [47.6].

55. Bridge, above n. 2, at 919 [16.26], 920-921 [16.27]-[16.29].

56. Winship, *Private International Law*, above n. 20, at 525; Peter Schlechtriem, *Requirements of Application and Sphere of Applicability of the CISG*, 4 Victoria U. Wellington L. Rev. 781, 784 (2005); Bell, above n. 39, at 64; Bridge, above n. 2, at 922-923 [16.31]-[16.32].

57. Schwenzler and Hachem, above n. 46, Art. 1, at 42 [35]. See also Bridge, above n. 56.

58. *Vienna Convention on the Law of Treaties* Art. 21(1). See Bridge, above n. 2, at 974 [16.124].

59. Bell, above n. 39, at 64; Winship, above n. 5, at 1-27, 1-53.

60. Favouring application of non-CISG domestic law: Honnold, above n. 32, at 45-46 [47.6]; Winship, above n. 5, at 1-27, 1-53; Winship, *Private International Law*, above n. 20, at 525; Isaak Dore, *Choice of Law under the International Sales Convention: A U.S. Perspective*, 77 Am. J. Int'l L. 537, 538-39 (1983); Schlechtriem, above n. 56, at 784; Ziegel, above n. 54, at 66; Evans, above n. 42, Art. 95, at 357 [3.4]; Albert H. Kritzer, *Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods* 78 (Springer, 1st edn, 1989); Bell, above n. 39, at 64. See also authors cited in CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.16] n. 47.

61. *Secretariat, Commentary*, above n. 21, Art. 1 [7] (if forum conflict rules lead to ‘the law of a Contracting State’ the CISG should apply), in *Official Records*, above n. 21, 14, 15.

62. Favouring application of the CISG: CISG-AC Opinion No. 15, above n. 30, at §3, *Commentary* [3.12], [3.16]; Schroeter, above n. 29, at 445-447; Bridge, above n. 2, at 979-80 [16.135]; Bridge, above n. 32, at 521 [10.56]; Schwenzler and Hachem, above n. 46, Art. 1, at 43 [38]; Long, above n. 40, at 122; Ferrari, above n. 27, at 51-52; Torsello, above n. 49, at 108-109. See also Fritz Enderlein and Dietrich Maskow, *International Sales Law* Art. 95, 380, 381 [1]-[2] (Oceana 1992); Court of Appeal (OLG) Düsseldorf, Germany, 2 Jul. 1993, <http://cisgw3.law.pace.edu/cases/930702g1.html> (accessed 28 Feb. 2014).

63. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.5]; Schroeter, above n. 29, at 445-46; Bell, above n. 39, at 64; Enderlein and Maskow, above n. 62, Art. 95, at 381 [1]; Torsello, above n. 49, at 109; Ferrari, above n. 27, at 51-2; Bridge, above n. 2, at 980-81 [16.136].

64. Schroeter, above n. 29, at 446-47. See also Bridge, above n. 2, at 979 [16.135].

courts) to give preference to domestic law'.⁶⁵ The absence of words in Article 95 indicating a binding effect upon courts in other Contracting States, when contrasted with Articles 92-94 which do contain such words, seems to confirm this.⁶⁶ It must be admitted that Article 95 was a 'last minute' inclusion and therefore the omission of such wording may have been due more to oversight,⁶⁷ but a proposal that Article 95 declaring States be considered non-contracting States for the purposes of Article 1(1)(b) was in fact rejected.⁶⁸ Since a declaring State continues to enjoy the status of a Contracting State for the purposes of Article 1(1)(b), the forum remains bound to apply Article 1(1)(b).⁶⁹ When the forum is referred by its choice of law rules to the law of a declaring State, on this reading, the criterion in Article 1(1)(b) is satisfied, and the court is therefore obliged by international law to apply the CISG. Moreover, Article 1(1)(b) requires application of the 'Convention' which seems to indicate that the CISG per se is to be applied *ipso iure* in Contracting State courts,⁷⁰ not just on those occasions when it would be applied in a particular foreign jurisdiction. This view has now been endorsed by the CISG Advisory Council.⁷¹

In other words, on a literal reading of Article 1(1)(b), the provision only resorts to the private international law rules of the forum to determine whether or not the CISG applies per se, not the extent to which it should be applied or would be applied by a 'home court'. In that sense, the quandary facing a forum in a declaring Contracting State differs from the quandary facing a forum in a non-declaring State. In the first case, the forum's private international rules apply per se, but in the second, the controlling rule is found in Article 1(1)(b), which limits reference to those rules for limited purposes by framing them within parameters.

65. Torsello, above n. 49, at 108; Ferrari, above n. 37, at 328.

66. Contrasting Art. 95 wording with that of other reservations: CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.14]; Schroeter, above n. 29, at 440, 446-47; Bell, above n. 39, at 64; Schwenzler and Hachem, above n. 46, Art. 1, at 43 [38]; Bridge, above n. 2, at 974 [16.124], 974 [16.124], 980-81 [16.136]; Torsello, above n. 49, at 115. Singapore has attempted to assert Art. 95's effect: *Sole of Goods (United Nations Convention) Act* (Singapore, cap 283A, 1995) s. 3(2) (CISG applies only where Art. 1(1)(a) is satisfied). See also Germany's 'interpretive declaration': Schroeter, above n. 29, at 454. See UNCITRAL Yearbook Vol XXI (1990) 294; Art. 2 *VertragsG* [German Ratification Law for the CISG], *Bundesgesetzblatt* [German Federal Law Gazette] BGBI.II 586 (1989). These measures may bind national courts, but have no international effect: Bell, above n. 39, at n. 41.

67. Article 95 was inserted at the Plenary Conference after earlier rejection at the second committee: *Official Records*, at 229-230, 439; CISG-AC Opinion No. 15, above n. 30, *Commentary* [2.2], [3.15]; Winship, above n. 5, at 1-18, n. 34; Schlechtriem, Schwenzler and Hachem, above n. 29, Art. 95, at 1190 [1]; Schroeter, above n. 29, at 440 (it did not 'undergo extensive scrutiny').

68. The Czech proposal for Art. 95(2) was rejected: *Official Records*, at 170, 229-30, 439. Winship surmises it was too complex at the last minute: Winship, above n. 5, at 1-28.

69. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.12], [3.14]; Schroeter, above n. 29, at 446-47; Schlechtriem, Schwenzler and Hachem, above n. 29, Art. 95, at 1191 [3]; Bridge, above n. 32, at 521 [10.56]; Ferrari, above n. 27, at 52; Long, above n. 40, at 122-23; Torsello, above n. 49, at 108-109; Bridge, above n. 2, at 965 [16.109], 980-981 [16.136]. See, e.g., Court of Appeal (OLG) Düsseldorf, Germany, 2 Jul. 1993, above n. 62.

70. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.16]; Schroeter, above n. 29, at 446-447; Schwenzler and Hachem, above n. 46, Art. 1, at 43 [38].

71. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.16].

A number of comments should be made about the literal argument. First, it relies on the idea that the CISG, when applicable, is *not* to be applied as ‘part of the foreign domestic law’ of the jurisdiction referred to by choice of law rules. As between two Contracting States, the CISG is not ‘foreign law’ at all, and its applicability should not be determined in the same way as domestic foreign law. This is consistent with Article 7(1), which requires an international and uniform interpretation of the CISG. In fact, it is also consistent with Article 7(2), which leads to domestic law via private international law rules as the ultimate last resort for matters governed by the CISG but not expressly determined by it, following the failure of internal interpretive measures to fill internal gaps. Thus, there is never a need for a court applying Article 1(1)(b) to be concerned with the extent of the CISG’s application as perceived within a particular jurisdiction, since the CISG has an internal hierarchy to sort such matters out already, and to do so in an autonomous manner.

Yet a second comment will illustrate a flaw in this argument. It must be acknowledged that the argument side-steps an analogous problem. Should a court located in a Contracting State that has not made an Article 96 declaration ignore the formality requirements of the applicable State’s law if the forum’s choice of law rules determine an Article 96 declaration State’s law to be applicable? The answer to this question is not yet clear.⁷² It may well be preferable to construe such declarations narrowly, but in the present context, my concern is this; if the answer is no, can that position of observing an Article 96 declaration in another Contracting State be reconciled with the literal argument presented above, which essentially holds that an Article 95 declaration in one Contracting State should not affect the forum in another?

I think it can. One reason is that Article 95 concerns a provision which directs the courts of Contracting States to apply the CISG: Article 1(1). Article 1 effectively places a duty upon Contracting State courts to apply CISG in certain circumstances. Thus Article 1(1)(b), while directing resort to domestic private international law, remains the controlling provision for the sphere of application for forums in non-declaring Contracting States. Article 96, by contrast, limits the substantive scope of the CISG’s provisions, the application *in toto* of which is not otherwise in question. In this way it resembles Article 28, which retains the court’s discretion in orders of specific performance. There remains the contradiction, that an Article 96 declaration would then effectively bind courts of non-declaring Contracting States, and treats the CISG as part of the domestic law of a particular State. This is unsatisfactory, and the author does not advocate the above position in relation to Article 96.⁷³

72. Compare Bridge, above n. 2, at 982-84 [16.139]-[16.141]; Honnold, above n. 32, at 189-190 [129]; Enderlein and Maskow, above n. 62, Art. 95, at 383 [10]; Ferrari, above n. 37, at 333; Long, above n. 40, at 93 et seq.; *Forestal Guarani SA v. Daros International Inc*, 613 F 3d 395 (3rd Cir. 2010), Court of Appeals, USA, 21 Jul. 2010, <http://cisgw3.law.pace.edu/cases/100721u1.html> (accessed 28 Feb. 2014) (Art. 96 declaring State formality rules apply if forum conflict rules indicate that law).

73. Contra CISG-AC Opinion No. 15, above n. 30, at §6.1, *Commentary* [4.10] (a forum in a non-declaring Contracting State is *not bound* to apply the CISG Arts 11, 29 or Part II in disregard to the declaring State’s formality rules).

It is of course, for the Contracting State to define its own law. The literal argument does not deny this, but holds that each Contracting State did exactly that by adopting the CISG. It is submitted that in each case, the Contracting State has to some extent at least, altered its own choice of law rules by adopting provisions which in certain circumstances substitute for those rules.⁷⁴

There are those who would deny that Article 1(1)(b) was intended to alter private international law.⁷⁵ This may well be true, but its intent is to *facilitate* greater application of the CISG by effectively placing parameters around the reliance on private international law in circumstances where Article 1(1)(a) is irrelevant. Those parameters clearly ‘trigger’ the CISG’s application where the condition specified is satisfied, not the national law of the State that would be designated by the choice of law rules were they operating outside the Article 1(1)(b) framework. If this meaning is denied, then Article 1(1)(b) is redundant, since without it, the forum’s choice of law rules would apply in any event. Article 1(1) undoubtedly was intended to impact upon choice of law rules, as envisaged by Rabel,⁷⁶ and pursuant to the literal approach, at least displaces the forum’s choice of law rules where its own conditions are satisfied.

An interesting version of the literal argument has been advanced by Professor Bridge. In his view, the problem of ‘domestication’ of the CISG as part of the applicable domestic foreign law, and the associated issue of how one unlocks the CISG where Article 1(1)(b) does not apply in such a State can be resolved by the literal approach, by the added notion that it is the CISG as part of the *forum’s domestic law* that is being applied.⁷⁷ Where the forum is in a non-declaring State, this means the court is obliged under Article 1(1)(b) to apply the CISG, despite an Article 95 declaration in the jurisdiction indicated by the forum’s choice of law rules. Bridge’s solution characterizes the CISG in such a way that it is unnecessary for a forum in a non-declaring State to consider the issue of how the ‘home court’ would apply the CISG – the concern becomes redundant. The solution avoids the further risk that the forum might also consider the ‘home court’s’ choice of law rules,⁷⁸ raising the possibility of *renvoi*.⁷⁹

This is a sound solution to the problem of how the CISG becomes applicable when choice of law rules direct the court to the law of a declaring State. As Bridge points out, it need not offend the *Vienna Convention on the Law of Treaties 1969*, since the definition of ‘reservation’ in Article 2(1)(d) can be read as implying modification of treaty provisions ‘in their application to that State’. If the CISG is applied to relations between private parties as part of the forum’s law, it is ‘difficult to see’ how Article 1(1)(b) is being applied to the declaring State itself.⁸⁰ The view sits well with the notion

74. See also Bridge, above n. 2, at 921 [16.30].

75. Evans, above n. 42, Art. 95, at 657 [3.4] (Art. 1(1)(b) not intended to change ‘generally accepted principles of conflicts of law’). See also Long, above n. 40, at 123.

76. Ernst Rabel, *A Draft of an International Law of Sales*, 5 U. Chi. L. Rev. 543, 544 (1938).

77. Bridge, above n. 2, at 921-923, [16.30]-[16.32], 963 [16.104].

78. See *ibid.*, at 921 [16.30] (the text does not refer to the rules of private international law that might apply unless CISG is applied as part of the domestic law). Contra *Secretariat Commentary*, above n. 61. See also Winship, *Private International Law*, above n. 20, at 521-522.

79. See Winship, *Private International Law*, above n. 20, at 521-522 (presenting opposing views).

80. Bridge, above n. 32, at 522 [10.57] (even if at least one party is from a declaring State). Arguing it ‘doubtful’ that Art. 21 *Vienna Convention on the Law of Treaties* could apply to declarations

that Article 1(1)(b) operates to displace choice of law rules, but allows them to operate in a limited fashion within a controlled framework as a preliminary condition for the CISG's application when Article 1(1)(a) is unsatisfied. Further, it is submitted that such a view can comfortably co-exist with the suggested solution to the situation (discussed in section §2.03[B][1] above) where a court in a declaring State might choose to apply the CISG when its own choice of law rules lead to the law of a non-declaring State. This is because, in that case, the imperative requiring application of the CISG is primarily the forum's own choice of law rules.

Thus it is maintained that where the forum's own State has not made the declaration, the court is obliged to follow Article 1(1)(b). Where this leads to the law of a declaring State, the court should apply the CISG, since the other State's declaration has no effect upon the court's own obligation pursuant to Article 1(1)(b), which is to apply the Convention. Conversely, in the reverse scenario, where a forum in a declaring Contracting State finds the law of a non-declaring State applicable, the forum's own private international law is determinative, and would normally lead to the application of the CISG as part of the applicable law, although no obligation is imposed on the court by the Convention in this regard. However, for such a forum, if choice of law rules refer to the forum's own law, the CISG would not normally apply.

[3] *Court in Non-contracting State or Arbitral Tribunal*

Naturally, a forum located in a non-contracting State, or an arbitral tribunal for that matter, can never be bound to apply the CISG pursuant to Art. 1(1), but might do so pursuant to its own conflict rules or relevant arbitral procedure should these lead to application of the law of a Contracting State.⁸¹ It will then be likely to take heed of the Contracting State's declaration, if one exists, as an alteration to the way the CISG would be applied within the applicable foreign law by 'home courts', such that the CISG will not apply.⁸² On the other hand, if no declaration has been made by the Contracting State indicated by the choice of law rules, the CISG would be applied by the forum.⁸³

in private law treaties: Jürgen Basedow, *Uniform Private Law Conventions and the Law of Treaties*, 4 *Uniform L. Rev.* 731, 741 (2006).

81. CISG-AC Opinion No. 15, above n. 30, *Commentary* [3.18], [3.19]; Ferrari, above n. 37, at 316; Schwenger and Hachem, above n. 46, Art. 1, at 40 [31]; Winship, above n. 5, at 1-53; Honnold, above n. 32, at 45 [47.6].
82. Most consider the CISG not applicable 'by its own terms': Winship, above n. 5, at 1-53; Schlechtriem, above n. 56, at 784; *Nippon Systemware Kabushikigaisha v. O. Chiho Saibansho* [District Court] Tokyo, Japan, 19 Mar. 1998, <http://cisgw3.law.pace.edu/cases/980319j1.html> (accessed 28 Feb. 2014) (decided before Japan acceded); Bridge, above n. 2, at 922 [16.30], 974 [16.124], 965 [16.109] n. 221. Contra Ferrari, above n. 27, at 53; Torsello, above n. 49, at 108-109.
83. See Ferrari, above n. 37, at 317; Schwenger and Hachem, above n. 46, Art. 1, at 41 [32]. Contra Winship, *Private International Law*, above n. 20, at 524.

[C] Both Parties from a Non-contracting State

The CISG can also apply where neither party is from a Contracting State, but have agreed to apply the CISG. Perhaps unfortunately, the inclusion of a provision specifically authorizing opt-ins where the CISG would not otherwise apply was deliberately omitted from the CISG, since drafters felt that the validity of opt-ins would be determined by the limits of mandatory law.⁸⁴ Since the CISG is not otherwise applicable on its own terms, opt-ins may be specifically permitted, or conversely and more commonly, limited at the substantive level.⁸⁵

The parties' choice may also be restricted at the choice of law level. Such fetters seek to balance party autonomy with State interests.⁸⁶ For example, in Brazil, parties are generally not free to exercise autonomy in choice of law at all, unless arbitration is chosen.⁸⁷ The Rome I Regulation only permits choices of 'law'.⁸⁸ If the CISG is directly chosen by the parties in circumstances where it would otherwise not apply, then for this purpose it comprises an a-national 'rule of law', not a national 'law', and may be considered applicable only by means of substantive 'incorporation' into the contractual terms.⁸⁹ A similar position in China was apparently preserved in the new Chinese private international law.⁹⁰

84. UNCITRAL Yearbook [1972] Vol VIII, UN Doc A/CN.9/SEK.A/1977 25, 28 [48]-[51]. ULIS Art. 4 allowed opt in by parties not in different/Contracting States. The Working Group rejected this, anticipating later inclusion of general provisions on the CISG's relationship with national mandatory rules: UNCITRAL Yearbook [1971] Vol II, above n. 21, at 50, 55 [47]-[49].

85. See Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, above n. 1, Art. 6, at 117 [31].

86. Michael Whincop and Mary Keyes, *Putting the 'Private' Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 *Melbourne U.L. Rev.* 515, 518 (1997) (frequently State interests are assumed 'encoded' in choice of law rules).

87. In Brazil, the provision deeming *lex loci contractus* as governing law is widely construed prohibiting choice of law: *Lei de Introdução ao Código Civil Brasileiro 1942* [Introductory Law to the Civil Code], Decreto-Lei Nº 4657/1942 Art. 9.

88. *Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations* [2008] OJ L 177/6, Recital [13], Art. 3 ('Rome I Regulation'); European Commission, *Green Paper*, above n. 13, at 3; Symeon C. Symeonides, 'Party Autonomy in Rome I and II from a Comparative Perspective', in Katharina Boele-Woelki et al (eds), *Convergence and Divergence in Private International Law – Liber Amicorum Kurt Siehr* 513, 539-540 (Eleven 2010); Helmut Heiss, 'Party Autonomy', in Franco Ferrari and Stefan Leibler (eds), *Rome I Regulation: The Law Applicable to Contractual Obligations in Europe*, 1, 2 (Sellier, 2009).

89. See above n. 88.

90. Although it does not directly mention a-national law, PRC Supreme Peoples' Court 2012 Interpretation I, Art. 9 provides that where parties invoke international treaty not binding on PRC, the court can rely on the treaty provided it does not violate social public interests or mandatory PRC laws or regulations. It is unclear whether this endorses a conflicts rule allowing the treaty to be applied as applicable law, or simply incorporation into contractual terms as a matter of substantive autonomy, however the latter seems more likely. In any event, the CISG is not a 'treaty not yet binding' China (nor is UNIDROIT an 'international treaty'). Yet, by analogy with Art. 9, one might consider it likely a court would uphold supranational choice of law: *Interpretation of the Supreme People's Court on Select Issues Concerning the Application of the Act of the People's Republic of China on Application of Law in Foreign-Related Civil Relations (I)*, 28 Dec. 2012, effective 7 Jan. 2013 ('Interpretation I'); 中华人民共和国涉外民事关系法律适用法 *Zhōnghuá Rénmín Gònghéguó Shèwài Mínhì Guānxì Fǎlǚ Shìyòng Fǎ* [Act of the People's Republic of China on Application of Law in Civil Relationships with Foreign Contacts] adopted at the 17th

The forum might also apply the CISG where no choice has been made by the parties. If the court is in a non-declaring State it is bound to follow Article 1(1)(b), and thus might well apply the CISG if its private international law rules lead to the law of a Contracting State,⁹¹ depending on how it resolves the quandary described earlier (in section §2.03[B][2] above). If it is in a declaration State, or a non-contracting State, the outcome will depend on the choice of law rules of the forum per se (see sections §2.03[B][1] and §2.03[B][2] above).

The CISG might also apply when an arbitral tribunal deems it applicable. Even if parties did not refer to the CISG in the contract, and the CISG is not applicable due to Articles 1(1)(a) or (b), a tribunal may, if the arbitral procedural rules allow, choose the CISG as the appropriate or applicable law,⁹² or as evidence of international usages.⁹³

The CISG's application can come as a surprise to parties.⁹⁴ However, this is in keeping with its design. Its drafters recognized that an 'opt-in only' system would preclude any sort of widespread application,⁹⁵ and would therefore doom the CISG to failure in achieving any notable efficiency gains. Yet as mentioned earlier, 'opt-out' systems can also suffer a similar fate. Nonetheless, party autonomy was implemented as a cornerstone of the CISG.

§2.04 THE ENVIRONMENT OF PARTY AUTONOMY AND THE CISG AS SOFT LAW

As indicated in section §2.03, the CISG will automatically apply provided the contract is not one of those specifically excluded by Articles 2-3 and the criteria in either Article 1(1)(a) or Article 1(1)(b) are met. However, that is not the end of the story.

Those parties who consciously turn their minds to the issue can agree to derogate from or modify its provisions, or even exclude the application of the CISG altogether, pursuant to Article 6. A wide level of flexibility is available for parties to tailor the CISG to their own needs, or to choose another law. Naturally, the choice of law made by the parties will be potentially restricted by relevant validity requirements and choice of law rules, as discussed above.

sess. of the Standing Committee of the Eleventh National People's Congress, 28 Oct. 2010, in force 1 Apr. 2011, Arts 3 and 41; Weidi Long, *The Feasibility of Parties' Choice of the PICC in Sino-European Commercial Contracts*, 18 *Uniform L. Rev.* 163 (2003); Pietro Franzina and Renzo Cavalieri, *The 2012 'Interpretation' of the Supreme People's Court of China regarding the 2010 Act on Private International Law*, 27(4) *Diritto del Commercio Internazionale* 891, 899 (Giuffrè, 2013).

91. Schwenzler and Hachem, above n. 46, Art. 1, at 40 [31].

92. See above n. 35.

93. See Albert Kritzer, 'Scope, Interpretation and Resources', in Cornell International Law Journal (ed), *Review of the Convention on Contracts for the International Sale of Goods* 147, 153 (Sellier 1995); Fan Yang, *CISG in China and Beyond*, 40 *UCC L.J.* 373, 383 (2008). See 2011 ICC Rules of Arbitration, above n. 35, Art. 21(1); Xiao and Long, above n. 48, at 82-83.

94. Marco Torsello, *Substantive and Jurisdictional Aspects of International Contract Remedies*, 25 *Int'l Rev. L. & Econ.* 397, 399 (2005).

95. See rejected Australian proposal for reservation rendering the CISG an 'opt-in' system similar to Art. V ULIS: above n. 22.

However, these considerations aside, parties are essentially free to opt out of the CISG in circumstances where it would otherwise apply by default, or indeed, to opt into it in circumstances where it might not be applicable on its own terms, such as in electricity contracts, although the ability to opt in directly is often limited as mentioned above.

The CISG can therefore be characterized as a law essentially applicable by choice. In a sense, it owes its continuing relevance to choices of law made consciously or unconsciously by private individuals. Those choices may be made at the contractual or sometimes post-contractual stage.⁹⁶

The CISG is not a ‘soft law’ in the same way as the UNIDROIT Principles or the PECL, since it is adopted by Contracting States and applies by default when its preconditions are met. In the strict sense, it is a ‘hard law’ or ‘proper law’ which ‘imposes legally binding obligations’.⁹⁷ However, this quality of party autonomy means that the CISG can be accurately conceptualized as a soft law. This is not, of course, true in relation to its binding nature, but it is in the sense of its capacity to have a concrete *practical* effect in actually achieving its aim of efficiency gains.⁹⁸

Such a conceptualization highlights the importance of the CISG’s attractiveness to parties, and provides one key as to how its interpretive development is linked to economic effectiveness. Accomplishment of its aims is contingent upon its competitiveness as one choice of law amongst many at the contractual stage. Naturally it will not always be the right law for the transaction at hand. It may be a less efficient choice in particular circumstances, for certain types of transactions, or within particular industries. However, where it is an objectively suitable and efficient choice, rejection of the CISG reduces whatever efficiency gains might otherwise be achieved. The drafters of Article 6 were well aware of this.⁹⁹

Conscious *ex ante* choices at the negotiation and contracting stages are themselves highly complex. Furthermore, many parties do not consciously choose to have the CISG apply. The CISG often becomes applicable precisely because parties do not turn their mind to exclusion, or attempt to exclude, but unsuccessfully. It is conceded that the link between interpretation and attraction is by no means the entire picture in relation to conceptualizing the economic impact of the CISG. Nevertheless, many of the

96. Arguably, post-contractually choice may be subject to domestic law restrictions, though generally national laws allow choice: see Gary B. Born, *International Commercial Arbitration* 2247 (Kluwer 2009). See, e.g., Rome I Regulation Art. 3(2); Heiss, above n. 88, at 2; PRC Supreme Peoples’ Court, Interpretation I, above n. 90, at Art. 8 states Parties may choose or change their choice of law post-contractually, at any time until the end of the first instance hearing. Enabling choice of law, see 中华人民共和国合同法 Zhōnghuá Rénmín Gònghéguó Héttóng Fǎ [Contract Law of the People’s Republic of China (‘PRC’)] National People’s Congress, 15 Mar. 1999, Art. 126, http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383564.htm (accessed 28 Feb. 2014) and 中华人民共和国合同法 Zhōnghuá Rénmín Gònghéguó Mínfǎ Tōngzè [General Principles of the Civil Law of the PRC] National People’s Congress, 12 Apr. 1986, Art. 145.

97. Antonio Cassese, *International Law* 196-197 (Oxford 2nd edn, 2005).

98. Lisa Spagnolo, ‘The CISG as Soft Law & Choice of Law: Gōjū Ryū?’ in Larry DiMatteo (ed), *International Sales Law: A Global Challenge* 154 (Cambridge 2014).

99. It was recognized that Art. 6 might mean that the aim of uniform law would not be realized: UNCITRAL Yearbook [1971] Vol II, above n. 21, at 37, 44 [41].

advantages and disadvantages discussed in Chapters 4 and 5 also accrue where the CISG applies purely by default. Additionally, as will be discussed, the attractiveness of the CISG may have broader implications in terms of its efficiency.

Conscious choices to exclude can take place *ex ante* – up until the time of contracting – or *ex post*, since in most cases parties can exclude the CISG from application to their contract by modifying an earlier choice of law. The latter is another example of how the CISG operates as ‘soft law.’

It is submitted that the CISG’s nature as a quasi ‘soft’ law may hold significance for its effectiveness. In the same way as truly ‘soft’ law, the fate of the CISG in achieving its efficiency goals is actually in the hands of parties, lawyers, arbitrators and law firms, as much as it is in the hands of courts.

§2.05 CONCLUSION

This chapter gave an account of the basic rationale behind the movement to establish a uniform sales law. It established the circumstances in which the CISG might be able to achieve the end of improving efficiency in trade by examining when it applies to international sales transactions, and its position as a potential choice of law amongst many competing laws. Today, the aims of the CISG remain to improve the efficiency of international trade. However, the question next addressed is whether it is capable of doing so.

In Chapters 3 to 5, the normative value of the CISG is examined. Does the CISG fulfil any of the anticipated economic advantages envisaged by its drafters, or indeed any other economic gains not anticipated, or were its promises of economic efficiency simply an elaborate pipedream?

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CHAPTER 3

Economics and the CISG

§3.01 INTRODUCTION

It has been stated that CISG scholars have simply assumed the CISG's economic benefits are obvious but have failed to provide reasons for their conclusion.¹ This chapter and the following one seek to rectify this criticism. After all, efficiency was the normative justification for the CISG's creation. Is the CISG even capable of producing the improvements in efficiency envisaged by its drafters, or do those aims now ring hollow? Alternatively, does it produce efficiencies or economic pitfalls that were never even contemplated by its drafters?

This chapter assesses more closely the original aims of the CISG, and gives an overview of law and economics concepts that will be helpful in assessing the CISG's efficiency.

§3.02 EFFICIENCY OF LAW

Economic analysis of law seeks to assess the efficiency of law.² As the aim of the CISG was to reduce transaction costs, it is appropriate to expand briefly upon the meaning of efficiency of the law in a general sense before focussing on the CISG's provisions. The analysis in Chapters 4 and 5 will focus primarily on neoclassical rational-choice economic theory, which proceeds on the basis that perfectly competitive markets efficiently optimize expected utility. It assumes parties make rational choices through cost-benefit analyses, based on perfect information, and absent any market distortions from barriers to the free flow of resources such as information costs, transaction costs and externalities.³ Issues arising from behavioural economics, which draws on

1. Giles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 Vand. J. Transnat'l L. 1511, 1517 (2006).

2. Richard A. Posner, *Economic Analysis of Law*, 1-10 (Kluwer, 7th edn, 2007).

3. George J. Stigler, *The Theory of Price*, 43-74, 320-328 (Macmillan, 4th edn, 1987); Joseph E. Stiglitz, *Principles of Microeconomics*, 493-502 (Norton, 1st edn, 1993); Russell B. Korobkin and

cognitive psychology to relax the assumption of rational choice and perfect information, will be discussed separately in Chapter 7.

In neoclassical economics, a ‘Pareto-superior’ transaction is one in which at least one party is made better off while no party is made worse off.⁴ Pareto efficiency is achieved when no further reorganization or trade would result in at least one person being better off and no one being worse off than they are presently.⁵ This requirement of ‘unanimity’ is often considered too ‘fanatical’ for practical purposes.⁶ A less stringent measure of efficiency often substituted for Pareto efficiency is ‘Kaldor-Hicks efficiency’. While a transaction efficient in this sense may make some parties worse off, its overall benefits exceed its negative effects.⁷ Thus a move is considered efficient if the ‘winners win more than the losers lose’⁸ because in theory at least, the winners could compensate the losers and still be better off, regardless of whether compensation actually takes place or not.⁹ In other words, a transaction will be Kaldor-Hicks efficient if it increases overall welfare or exchange surplus, irrespective of its allocation. Unless otherwise indicated, I will rely upon this meaning of ‘efficiency’.

Coase Theorem holds that parties will bargain around initial resource allocations, so the initial allocation of property will not affect its ultimate use, since resources tend to gravitate toward their most valuable uses where voluntary exchanges (market conditions) are permitted.¹⁰ However, the most efficient allocation will arise when those who most highly value resources can freely acquire them, that is, when transactions are costless, and when parties hold full information.¹¹ Thus Coase hypothesizes that transaction costs create inefficiencies in the allocation and utilization of property rights.¹² Decisions of bargaining parties are said to be rationally controlled by the marginal costs and benefits of exchange transactions. Transaction costs create ‘friction’ in the efficient allocation of resources, thus their existence leads to inefficient allocation. Information asymmetries similarly distort efficient exchanges of resources, as do externalities. Thus the roles of information and transaction costs are both vital to efficient market outcomes.¹³ Such barriers to costless exchanges are conventionally thought to preclude the attainment of Pareto or Kaldor-Hicks efficiency, because they

Thomas S. Ulen, *Law and Behavioural Science*, 88 Cal. L. Rev. 1051, n. 104, 1055, 1060-1066 (2000). Information costs can be conceptualized as transaction costs: Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 Yale L.J. 1211, 1218 (1991).

4. Posner, above n. 2, at 12.
5. Calabresi, above n. 3, at 1215 n. 14; Posner, above n. 2, at 12.
6. Calabresi, above n. 3, at 1215 n. 14.
7. *Ibid.*, at 1221-1222; Posner, above n. 2, at 13.
8. Calabresi, above n. 3, at 1221.
9. Posner, above n. 2, at 13. Sometime this measure is referred to as ‘potential’ Pareto superior, because if the compensation occurred, a Pareto improvement is achieved: Calabresi, above n. 3, at 1221-1222.
10. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & Econ. 1, 1 (1960); Posner, above n. 2, at 7. The notion derives from Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Ward Lock first published 1776, 1812 ed reprint).
11. Coase, above n. 12, at 1; Joseph Farrell and Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 Rand J. Econ. 70, passim (1985).
12. Coase, above n. 12, at 1.
13. *Ibid.*, at 1; Kenneth J. Arrow, ‘The Organization of Economic Activity’, in Kenneth J. Arrow (ed), *Collected Papers of Kenneth J. Arrow Vol 2: General Equilibrium* 133, 142-148 (Harvard

result in an allocation behind rather than on the optimal utility frontier.¹⁴ This leads us to an important normative principle arising from the economic analysis of contract law; that the law should be structured in order to lower exchange costs so as to encourage exchanges thereby facilitating efficient resource allocation.¹⁵

Since the motivation behind exchanges is generally economic, ‘contracting parties may be assumed to desire a set of contract terms that will maximize the value of the exchange. It is true that each party is interested only in the value of the contract to it. However, the more efficiently the exchange is structured, the larger is the potential profit of the contract for the parties to divide between them’.¹⁶

Efficient contract laws are said to maximize the overall economic benefits from the contract after costs – in other words, in addition to improving social welfare more generally, maximization of net exchange surplus or gain is an important economic goal.

We can thus pinpoint other economic functions of contract law which may maximize net exchange surplus between parties: prevention of opportunistic behaviour by contractual parties; provision of efficient gap-filling default rules for incomplete contracts; the shifting of risk to the superior risk bearer; and reduction of the costs of contractual disputes.¹⁷ Contractual obligations must be enforceable to prevent parties from failing to perform or taking advantage of the non-simultaneous nature of performance to extract a better bargain. Without such legal backing, parties would engage in dampening self-protection measures such as up-front payment demands, excessive credit checks or deposits, or make do with sub-optimal but simultaneous trade.¹⁸ Adjudicative gap-filling *ex post* at the litigation stage can also maximize social welfare where it is cheaper than the cost of drafting express terms, particularly for unlikely contingent circumstances.¹⁹ Social welfare is maximized where contractual risks are borne by the party that is best able to foresee, assess, reduce, spread and/or eliminate the risk of that loss.²⁰

Contract law facilitates free enterprise and exchange in the economic system, and is the most obvious application of Coase Theorem. *Ex ante* contracting costs include search costs (information or learning costs), costs of negotiation, and costs involved in formal contract drafting, but other costs also exist, as discussed below.²¹ If we term these collectively as ‘transaction costs’ the implications of Coase Theorem are readily

1983); Posner, above n. 2, at 10; Farrell and Saloner, above n. 11, at 70; John Linarelli, *The Economics of Uniform Laws and Uniform Lawmaking*, 48 Wayne L. Rev. 1387, 1402 (2002-2003).

14. Proposing transaction or information cost reductions move the frontier outward rather than shift the current position closer to a static frontier: Calabresi, above n. 3, passim.

15. Michael Whincop and Mary Keyes, *Putting the ‘Private’ Back into Private International Law*, 21 Melbourne U.L. Rev. 515, 523 (1997).

16. Richard A. Posner and Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law*, 6 J. Legal Stud. 83, 89 (1977).

17. Posner, above n. 2, at 99 (adding the punishment of avoidable mistakes in the contracting process).

18. *Ibid.*, at 93-95.

19. *Ibid.*, at 95-97.

20. *Ibid.*, at 101-106.

21. Whincop and Keyes, above n. 15, at 531.

apparent. Reduced *ex ante* transaction costs at the stage of negotiation and drafting will reduce marginal costs and thus encourage parties to contract and improve efficient allocation of resources. Some argue this is the only purpose of contract law.²²

It has been proposed to this end that contract laws should provide a set of gap-filling or default rules applicable in the absence of derogation by the parties. A default rule is 'supplied by the state to complete an agreement that the parties leave incomplete'.²³ The 'intellectual heritage' of default rule theory can be traced to the Coase theorem.²⁴

To provide the most efficient outcomes, it has been argued that default rules should mimic what most parties themselves would have bargained for in a frictionless market, that is, had they possessed full information and faced no transaction costs. In other words, default rules are said to be efficient if they give parties 'what they wanted' and arguably 'should mimic the agreements contracting parties would reach were they costlessly to bargain out each detail of the transaction'.²⁵ Default rules conforming to this ideal are referred to as 'majoritarian' and are said to reduce transaction costs since parties can rely upon the default rules as gap-fillers rather than expend time, effort and cost of negotiating agreements and drafting similar contractual clauses themselves.²⁶ Additionally, by appealing to more parties than any alternative rule, a majoritarian default rule reduces total expenditure on the cost of opting out of the default rule. This minimizes the costs of contracting. The closer the default rules are to those that parties would have negotiated, the more parties can save on negotiation, and the more closely the result will mimic a frictionless market.²⁷ Thus majoritarian rules are generally

22. Mark Cantora, *The CISG after Medellín v. Texas*, 8 J. Int'l Bus. & L. 111, 120 (2009).

23. Whincop and Keyes, above n. 15, at 516. See also Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 87 (1989); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 Mich. L. Rev. 489, 516-526 (1989).

24. Frank H. Easterbrook and David R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1430 (1989); Whincop and Keyes, above n. 15, at 523.

25. Charles J. Goetz and Robert E. Scott, *The Mitigation Principle*, 69 Va L. Rev. 967, 971 (1983); Easterbrook and Fischel, above n. 24, at 1433; Posner and Rosenfield, above n. 16, at 88; Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541, 596, 597 (2003); Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 Int'l Rev. L. & Econ. 446, 447 (2005); Cantora, above n. 22, at 120. See also Ayres and Gertner, above n. 23, at 90, 93; Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535, 541 (1990).

26. Easterbrook and Fischel, above n. 24, at 1433; Schwartz and Scott, above n. 25, at 596; Russell Korobkin, 'Behavioral Economics, Contract Formation, and Contract Law', in Cass R. Sunstein (ed), *Behavioral Law and Economics*, 116, 138 (Cambridge, 2000); Gillette and Scott, above n. 25, at 447; Clayton P. Gillette and Franco Ferrari, *Warranties and "Lemons" under CISG Article 35(2)(a)*, 1 Internationales Handelsrecht 2, 3 (2010); Cantora, above n. 22, at 122. Also sometimes referred to as 'favoured default rules': see, e.g., Cuniberti, above n. 1, at 1526.

27. Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 Ga L. Rev. 363, 404 (2003); Schwartz and Scott, above n. 25, at 596; Gillette and Scott, above n. 25, at 447. But see Ian Ayres and Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 Yale L.J. 729, 733 (1992); Ayres and Gertner, above n. 23, passim. Contra Cuniberti, above n. 1, at 1527 (contending parties cannot rely on default rules until the clause for which the default rules substitute has been ascertained, but by that time, transaction costs to be 'saved' have already been incurred).

argued to be ‘efficient’ because they fit within the Coasian ideal.²⁸ However, other measures of the efficiency of default rules may mean that even non-majoritarian rules can be optimal. These will be discussed below in section §3.04, after an examination of the original economic aims of the CISG.

§3.03 ORIGINAL ECONOMIC AIMS

It was noted in Chapter 2 that the CISG was intended to reduce barriers to international trade arising from multiple foreign laws encountered in cross-border sales. The problems the CISG sought to overcome included both legal and linguistic divergence which might otherwise discourage trade through higher transaction costs and greater levels of legal uncertainty than those found in domestic trade. As mentioned earlier, these concerns are today being echoed in the debate over European Contract Law to remove market barriers and encourage business to engage in cross-border trade, which has led to the proposed CESL.²⁹

However, the exact nature of the economic gains sought by those who promoted the CISG is less than clear from the legislative record. It seems fair to say that the economic advantages sought pursuant to the goal of the first Working Group of ‘harmonization or unification of the law of the international sale of goods’,³⁰ took the form of fairly broad notions that were only rarely articulated in economic terms.

From inception, the assumption had been that unification would reduce obstacles to trade, and would therefore provide economic advantages that would increase the volume of trade. These notions did not bear repeating at each stage of drafting, but were apparent from the beginning. When UNCITRAL embarked on the process of reviewing ULIS and ULF to ultimately form the CISG, the Secretary General referred to the central underlying economic purpose of the project, stating:

the unification process is desirable *per se* only when there is an economic need and when unifying measures would have a beneficial effect on the development of international trade.³¹

Within the CISG’s text, express reference to the underlying economic aim of efficiency of international trade can be found in the Preamble. In relation to the CISG’s purpose it states:

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28. Whincop and Keyes, above n. 15, at 523. As parties do not negotiate default terms, pricing mechanisms arguably test the desirability of default rule properties: Easterbrook and Fischel, above n. 24, at 1429-1430.
 29. European Commission, *Green Paper from the Commission on Policy Options for Progress towards a European Contract Law for Consumers and Businesses*, COM(2010) 348 final, Brussels, 1 Jul. 2010, 3, 6, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0348:FIN:en:PDF> (hereinafter ‘*Green Paper*’). See proposed CESL, (referred to in Ch. 1, n. 10), text adopted by EU Parliament 26 Feb. 2014 for ‘Distance Contracts’, defined in Art. 2(p).
 30. *Report of the Working Group*, 1st sess, UN Doc A/CN.9/35/1970 [1] (5-16 Jan. 1970), in UNCITRAL Yearbook [1968-70] Vol I, UN Doc A/CN.9/SER.A/1970 177, 177 [1] (hereinafter ‘*Working Group, 1st sess*’).
 31. *Report of the Secretary-General*, UN GAOR, 21st sess, Annex 3 (Agenda Item 88), UN Doc A/6396, in UNCITRAL Yearbook Vol I, above n. 30, at 18, 41.

development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States

... the adoption of uniform rules ... would contribute to the removal of legal barriers in international trade and promote the development of international trade.³²

The Preamble shows that the CISG was intended as an instrument for the further development of international trade by economic means.³³ The text of the Preamble was drafted on the last day preceding the final plenary meeting, and adopted without substantive discussion.³⁴

This is not so surprising, given that the rationale for unification had already been so widely discussed since the 1920s. Further, it should be remembered that UNCITRAL itself was formed to promote ‘unification of the law of international trade’³⁵ on the basis that this would promote international trade. Prior to UNICTRAL’s creation, the UN General Assembly, had already resolved that:

divergencies arising from the laws of different States in matters relating to international trade constitute an obstacle to the development of world trade [and] ... it [was] desirable ... to explore the need for ... measures for the progressive unification and harmonization [because] ... [the] interests of all peoples ... demand the betterment of conditions favouring the extensive development of international trade.³⁶

This resolution was preceded by a background paper by the Hungarian delegation which noted that ‘the diversity of the rules of private international law applied by different States is a disturbing element’ that made international commercial activity ‘complicated and difficult’.³⁷ Alluding to the New Economic Order envisaged within UNCTAD principles which called for co-operation to improve conditions favourable for trade with developing countries, the paper stated ‘[i]t is beyond doubt that creation of such favourable conditions should cover the formulation ... of relevant ... international rules of law’.³⁸ The Hungarian paper was followed by a Secretariat brief on unification efforts already undertaken, which noted that the:

32. CISG Preamble.

33. See also Ingeborg Schwenzer and Pascal Hachem, in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)*, Preamble 13, 16 [2] (Oxford 3rd ed, 2010) (‘Schlechtriem & Schwenzer 3rd edn’).

34. See 1980 Diplomatic Conference, *Summary Records*, UN Doc A/CONF.97/SR.10 (10 Apr. 1980) [4]-[9]. See also Schwenzer and Hachem, in *Schlechtriem & Schwenzer* 3rd edn, above n. 33, at Preamble 13, 13 [1].

35. *Consideration of Steps to be Taken for Progressive Development*, GA Res 2102 (XX), UN GAOR, 21st sess, 1404th plen mtg, Agenda Item 88, (20 Dec. 1965), in *UNCITRAL Yearbook Vol I*, above n. 30, Part one, 18, 18.

36. *Ibid.*

37. *Background Paper by the Delegation of Hungary*, UN GAOR, 20th sess, Annexes, Agenda Item 92, UN Doc A/C.6/L.571, in *UNCITRAL Yearbook Vol I*, above n. 30, Part one, 5, 9 [40], [41].

38. *Ibid.*, at 11 [55], [56] (referring to General Principle Six of UNCTAD).

impetus for the unification of the law of international trade stems from the difficulties typically faced by those who engage in international commercial transactions as a result of the multiplicity of, and divergencies in national laws.³⁹

Unification of rules was seen as a solution consistent with the UNCTAD aim of ‘attainment of economic and social progress’.⁴⁰ In particular, the Secretariat concluded that action for ‘the purpose of removing or reducing legal obstacles to the flow of international trade’ was within the UN’s competence under the UN Charter.⁴¹ On the occasion of the UN General Assembly resolution for the creation of UNCITRAL the Columbian representative likewise stated:

[t]he removal of obstacles, including legal obstacles, to international trade was of special importance to the developing countries whose economies depended largely on their foreign trade, but it would also be to the advantage of the developed countries, whose trade would expand proportionately.⁴²

The Czech representative stated that ‘the smooth flow of international commerce depended in large part on the maintenance of a balance between sellers and buyers’,⁴³ but as one architect of the CISG put it, ultimate agreement on a fair balance was not difficult since every nation has both buyers and sellers.⁴⁴

A representative from Ghana asserted:

only harmonization on a world-wide scale would help reduce the obstacles of a legal nature hampering the flow of trade, while the unification of international trade law would help the developing countries ... to attain equality in their international trade.⁴⁵

Various delegates referred to the fact that ‘[c]urrently, international trade was hampered by a number of difficulties caused by the existence of different systems of law’.⁴⁶ Likewise, reference was made to the ‘legal barriers’ to trade created by the ‘lack of uniform rules’ by the representative of the USSR.⁴⁷ The French representative confirmed that goals were ‘economic’ and that unification could provide ‘economic

39. *Note by the Secretariat*, UN GAOR, 20th sess, Annexes, Agenda Item 92, UN Doc A/C.6/L.572, 13, 14 [6].

40. *Ibid.*, at 42 [214].

41. *Ibid.*, at 42 [214].

42. *Summary Record*, UN GAOR, 6th Comm, 21st sess, 948th mtg, Agenda Item 88 (6 Dec. 1966), in UNCITRAL Yearbook Vol I, above n. 30, at 47, 47 [1].

43. *Summary Record*, UN GAOR, 6th Comm, 21st sess, 947th mtg, Agenda Item 88 (5 Dec. 1966), in UNCITRAL Yearbook Vol I, above n. 30, at 45, 46 [6].

44. John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention* 7 [7] (Kluwer 4th ed 2009).

45. *Summary Record*, above n. 42, in UNCITRAL Yearbook Vol I, above n. 30, at 47, 48 [12].

46. *Summary Record*, UN GAOR, 6th Comm, 21st sess, 949th mtg, Agenda Item 88 (6 Dec. 1966), in UNCITRAL Yearbook Vol I, above n. 30, at 49, 49 [6]. Similarly, see, e.g., UNCITRAL Yearbook Vol I, above n. 30, at 57, 57 [7]-[8].

47. *Summary Record*, above n. 46, in UNCITRAL Yearbook Vol I, above n. 30, at 49, 49 [4].

advantages'.⁴⁸ Many spoke of the importance of developing the 'expansion of international trade'.⁴⁹ The committee reaffirmed its conviction that legal divergence was 'one of the obstacles' to this,⁵⁰ and therefore proposed that UNCITRAL be assigned the function (*inter alia*) of 'progressive harmonization and unification of the law of international trade'.⁵¹ The general assembly established UNCITRAL, echoing those sentiments in its terms of reference.⁵²

Upon its creation, representatives generally recognized that UNCITRAL's purpose was the elimination of 'barriers to the development of international trade' through the 'harmonization, progressive unification and modernization of international trade law' which they considered had 'an essential role to play in the development of countries' through the expansion of international commerce.⁵³ UNCTAD representatives commenting on the role of UNCITRAL, stressed the importance of 'stimulating trade, particularly that of the developing countries' in order to 'bridg[e] the gap between developing and developed countries'.⁵⁴

The economic effects of unification were clearly the CISG's primary purpose. The above remarks highlight the thought process that eventually brought the CISG to life: that inefficiencies or uncertainties inherent in the plurality of law per se led to *costs* which in turn discouraged trade.

However, as most of the views were painted with a rather broad brush, they do not give a good insight into exactly how the harmonization was expected to achieve expansion of trade or economic efficiencies. The closest to a more precise view on the specific types of economic effects anticipated by drafters is the Secretary General's brief which preceded the creation of UNCITRAL. It explains in more detail the impact of plural laws and choice of law uncertainties that those seeking to remove legal obstacles to international trade had in mind:

A single transaction involving multiple legal relationships (for example, a contract of sale, payment provisions, insurance, transportation, etc.) may be subject to divergent rules of different national laws, seldom known in all their particulars to all the parties directly involved. On questions of performance, interpretation and applications, the parties require adequate knowledge of the legal conditions governing the performance of the general obligations. In case of litigation, the courts or arbitral tribunals are faced with considerable difficulty in determining the law applicable to the different aspects of an international commercial transaction. Sometimes the parties include in the contract a stipulation concerning the law

48. *Summary Record*, above n. 42, in UNCITRAL Yearbook Vol I, above n. 30, at 47, 48 [15].

49. See, e.g., *Summary Record*, UN GAOR, 6th Comm, 21st sess, 951st mtg, Agenda Item 88 (8 Dec. 1966), in UNCITRAL Yearbook Vol I, above n. 30, at 56, 57 [33].

50. *Report of the Sixth Committee*, UN GAOR, 21st sess, Annexes (Agenda Item 88) UN Doc A/6594, in UNCITRAL Yearbook Vol I, above n. 30, at 58, 60 [10].

51. *Report of the Sixth Committee*, above n. 50, at 60.

52. Establishment of UNCITRAL, GA Res 2205 (XXI), GAOR 21st sess, Annexes, Agenda Item 88, UN Doc A/6396, Add 1 and 2, Preamble, [8]; *Report of [UNCITRAL] on the Work of its First Session (1968)*, GAOR, 23rd sess, Supp No 16, UN Doc A/7216, in UNCITRAL Yearbook Vol I, above n. 30, at 71.

53. *Report of UNCITRAL*, above n. 52, in UNCITRAL Yearbook Vol I, above n. 30, at 74 [22], [26].

54. *Report of the Trade and Development Board, UNCTAD*, GAOR, 23rd sess, Supp No 14, Agenda Item 9, UN Doc A/7214, in UNCITRAL Yearbook Vol I, above n. 30, at 87 [22], [26].

applicable to the various aspects of the transaction. However where such a clause is absent, the rules of private international law of the forum are held applicable, and the different national laws can give divergent solutions for the same problem.⁵⁵

It was on this basis that discussion of 'divergence in law' as an 'economic barrier to trade' took place in the lead up to UNCITRAL's creation and the CISG's birth. These phrases were used by drafters in later discussions, but the historical record shows that they were probably 'shorthand' for the search, information or learning costs at the negotiation, drafting, performance and litigation stages posed by divergent laws and unpredictable choice of law rules. It can therefore be surmised that rectification of these problems led to the formation of UNCITRAL, and became the goal of the CISG.

It is therefore little wonder that CISG drafters did not dwell on the benefits of its economic impact. The problem as well as its solution had already been identified long beforehand. What one does find in the *travaux préparatoires*, are copious references to the need to consider language, concepts and scope so as to avoid uncertainty, confusion and ambiguity, and the importance of using 'concrete' practical terminology, given the need for translation of the resulting text.⁵⁶ The need to avoid undue complexity in the remedial structure of the CISG received much attention.⁵⁷ The legislative history gives the impression that by the time the CISG was being drafted, the focus had shifted away from economic issues to technical drafting matters alone.

Yet this would misrepresent the aim of the drafters. Some of those directly involved in drafting the CISG, including Professors Honnold, Bonell⁵⁸ Schlechtriem, Ziegel, Michida and Maskow⁵⁹ firmly believed that economic concerns underpinned the entire exercise.

Honnold writes that the aim of the half-century of work culminating in the CISG was to 'free international commerce from a Babel of diverse domestic legal systems'.⁶⁰ Likewise, Professor Kazuaki Sono states that the CISG is the culmination of 'efforts to unwind such sophisticated localization of the law ... to eliminate

55. *Note by the Secretariat*, above n. 39, at 14 [6].

56. See, e.g., *Report of the Secretary-General*, UN Doc A/CN.9/WG.2/WP.8 [6] (13 Oct. 1971), in UNCITRAL Yearbook [1972] Vol III, UN Doc A/CN.9/SER.A/1972 31, 32 [6] ('*Secretary General Delivery Report*'). See also Honnold, above n. 44, at 15 [17].

57. See, eg, *Report of the Secretary-General*, UN Doc A/CN.9/WG.2/WP.19 (7 Dec. 1972), in UNCITRAL Yearbook [1973] Vol IV, UN Doc A/CN.9/SER.A/1973 36, 42 [45]-[46] ('*Secretary General Consolidation Report*').

58. Michael Joachim Bonell, in Cesare Massimo Bianca and Michael Joachim Bonell (eds), *Commentary on the International Sales Law* 3 [1.1] (Giuffrè 1987) (uniform law can 'take into account the fact that export or import transactions are often entered into by parties who do not possess equal bargaining power and who operate in quite different socio-economic contexts').

59. Fritz Enderlein and Dietrich Maskow, *International Sales Law* Preamble, 21 [5] (Oceana 1992) ('The idea that the unification of law would promote international trade, [as expressed within the Preamble] ("*removal of legal barriers*"), is the underlying motif of any efforts to achieve uniform laws in this field'). See also Amy H. Kastely, *Unification and Community*, 8 Nw J. Int'l L. & Bus. 574, 588 (1988) ('its main focus is on ... encouraging international trade').

60. John O. Honnold, *Documentary History of the Uniform Law for International Sales* 1 (Kluwer 1989) ('*Documentary History*').

unnecessary legal obstacles to the flow of trade'.⁶¹ Schlechtriem comments that the CISG was part of the political effort designed to bring about the 'step-by-step removal of the economic underdevelopment of developing countries'.⁶² Again, rarely are details about exactly how this was to be achieved by the CISG imparted in such opinions, although glimpses can be seen from time to time.

For example, Bonell mentions situations where parties cannot reach agreement, in which case a party will 'normally prefer to leave the question unresolved, rather than yield his own position'.⁶³ He states that divergence in national sales law has the 'obvious consequence' of '[s]erious prejudice to legal certainty'.⁶⁴ According to Bonell, the benefit offered by the CISG is that it offers a comparatively 'secure and balanced regulation' applicable by default.⁶⁵ This does not presume the transaction would not have proceeded without the CISG, but does anticipate greater certainty under the CISG by comparison with choice of law rules and plural domestic sales laws. In Ziegel's view, this was the primary aim of the CISG; to offer an 'easily ascertainable' substitute for the 'multiplicity of frequently uncertain choice of law' rules.⁶⁶ This benefit was also anticipated by Bonell as a significant purpose of the harmonized law, and he predicted that this improvement would be met 'with extreme favour', especially by those who do not possess superior bargaining power with which to insist on their preferred choice of law.⁶⁷

For Bonell, the CISG also has the potential to take on the role of a 'lingua franca' in negotiations, and 'allows the parties to avoid [the] dilemma' of having to choose between potentially unfamiliar and unfavourable foreign laws by providing an easily understandable and fair alternative.⁶⁸ Schlechtriem observes that removal of legal barriers to trade would occur because of linguistic accessibility and, after a 'certain familiarization period', the fact that such rules would become 'well-known to all those involved in international trade'.⁶⁹ This would effectively make it 'easier' and simpler to conclude trade in a world now geared towards 'speed and mass transactions'.⁷⁰ Ziegel too notes the CISG was intended as a "neutral" sales law where the parties were unwilling to accept the sales law of their respective countries as the law governing the transaction'.⁷¹ Again, the major benefit anticipated seems to be precontractual costs of negotiation including learning costs and reduced legal uncertainty.

61. Kazuaki Sono, 'The Vienna Sales Convention: History and Perspective' in Petar Šarčević and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* 1, 13 (Oceana 1986). Professor Sono was UNCITRAL Secretary General from 1980 to 1985.

62. Peter Schlechtriem, in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Preamble 12, 13 [4] (Oxford 2nd edn, 2005).

63. Bonell, above n. 58, at 14-15 [2.3].

64. *Ibid.*, at 3 [1.1].

65. *Ibid.*, at 14-15 [2.3].

66. Jacob S. Ziegel, *Commentary on Party Autonomy and Statutory Regulation*, 6 J. Contract L. 123, 124 (1993).

67. Bonell, above n. 58, at 15 [2.3]; at 9 [2.1.2].

68. *Ibid.*, at 15 [2.3].

69. Schlechtriem, above n. 62, at 14 [6].

70. *Ibid.*, at 14 [6].

71. Ziegel, above n. 66, at 124.

Schlechtriem mentions that '[o]nly a balanced sales law which is largely neutral in terms of economic policy can promote international trade' because even in developing countries, both buyers and sellers exist.⁷² What was required was a sales law that could function 'as a set of neutral rules' in order to promote legal certainty.⁷³ Thus Schlechtriem notes that balance between buyers and sellers is not simply a matter of fairness, but a necessary factor in ensuring that the CISG encourages international trade and assists in harmonization.⁷⁴ The idea of neutrality here takes on an economic twist; general acceptance and therefore standardization, certainty and efficiency are expressed by Schlechtriem to be contingent upon the quality of neutrality.

Honnold emphasizes that much of the CISG's design was influenced by the 'agreement' between drafters that its rules should prevent the high costs of reversing international contracts.⁷⁵ Professor Michida in 1979 notes the consequences of immediate cancellation of contracts by buyer or seller in places where inadequate communications, transportation or storage facilities exist.⁷⁶ In international transactions, he states, reshipment of rejected goods is particularly expensive, and wasteful, and thus a law which shifts responsibility for the goods to the buyer with a right to adequate compensation may be more cost-effective and efficient.⁷⁷ These views seem to indicate drafters were also concerned to minimize post-contractual costs in the design of the CISG, a matter dealt with further below.

There was much discussion on the need to reduce legal uncertainty. Take for example, the debate surrounding rules on applicability. It was argued that rejection of the universalist approach in ULIS would 'cause uncertainty as to the law applicable to the contract' and that reintroduction of choice of law rules would 'detract from unification, and would introduce ... such uncertainty that businessmen for whom [the CISG] was intended would often not know whether their contracts were covered by it'.⁷⁸ After a prototype of Article 1 CISG had been drafted, it was proposed that different nationalities of the parties be introduced as an additional criterion. However this was rejected as adding undue complexity, which would increase uncertainty.⁷⁹

To some degree, it also seems arguable that drafters understood the impact of the trade-offs between formal and substantive uniformity (discussed in Chapter 9). One can at times find references to the need to improve 'clarity' at the expense of 'scope', or to find a balance between the two.⁸⁰ For example, it was argued that the test for applicability needed to be simplified by comparison with ULIS 'to make it easier to be

72. Schlechtriem, above n. 62, at 13 [5].

73. *Ibid.*, at 13 [5].

74. *Ibid.*, at 13 [5].

75. Honnold, above n. 44, at 20-21 [27].

76. Sinichiro Michida, *Cancellation of Contract*, 27 *Am. J. Comp. L.* 279, 281 (1979).

77. *Ibid.*, at 280-81.

78. *Working Group, 1st sess*, above n. 30, in *UNCITRAL Yearbook Vol I*, above n. 30, at 177, 179 [15], [24].

79. *Report of Committee*, UN Doc A/32/17, Annex I [15], in *UNCITRAL Yearbook [1972] Vol VIII*, UN Doc A/CN.9/SER.A/1977 25, 26 [15].

80. *Working Group, 1st sess*, above n. 30, in *UNCITRAL Yearbook Vol I*, above n. 30, 181 [37]; *Working Paper prepared by the Secretariat, Working Group, 1st sess*, above n. 30, in *UNCITRAL Yearbook Vol I*, above n. 30, at 188, 192 [20].

applied in practice and enable merchants to keep in mind on what conditions [the CISG] would come into play to the exclusion of national laws' so as to 'reduce the number of uncertainties to rely on a limited set of criteria' even though this would result in a 'more restricted scope of the law'.⁸¹ There was also concern to balance the necessary degree of abstractness with the degree of complexity and concreteness expected by lawyers and merchants.⁸² In particular, drafters considered the suitability of 'reasonable person' tests for whether usages should be applicable to the contract in terms of whether various tests might cause doubt or uncertainty.⁸³ These observations seem to confirm that drafters felt that uniform law should reduce uncertainty for parties at the negotiation and drafting stages.

Post-contractual efficiency was also considered in the formulation of CISG solutions. Drafters noted that the potential option of *ipso facto* avoidance would rely on legal tests, and that this would lead to considerable uncertainty and vagueness in relationships between parties, except for perhaps commodity transactions where rapid fluctuations made such a solution viable. Instead, they opted for a requirement of declaration by notice of avoidance under Article 26 CISG, pursuant to which parties would have a clear understanding of their positions.⁸⁴ This was because it was thought for most transactions the certainty offered by a notice requirement outweighed the advantage of *ipso facto* prevention of price speculation.⁸⁵ A notice requirement was therefore considered more efficient for the majority of transactions, because it allowed the seller 'to act to prevent wastage, loss or expense to the goods when the buyer refuses to accept them on delivery'.⁸⁶ Notably, the rule chosen was 'majoritarian'. Similarly, drafters rejected the definition of 'fundamental breach' used in ULIS as too vague, and likely to cause confusion in the post-contractual relationship between parties.⁸⁷ Structurally, a single set of remedies was considered a less complex and more predictable approach, whereas a complex remedial structure would cause uncertainty and increased litigation if the same factual grounds invoked separate remedial provisions for both non-conformity and non-delivery.⁸⁸

81. *Working Group, 1st sess*, above n. 30, in UNCITRAL Yearbook Vol I, above n. 30, at 177, 201; *Note by the Secretary-General, A/CN.9/WG.2/WP.6* [87] (19 Nov. 1970), in UNCITRAL Yearbook [1971] Vol II, UN Doc A/CN.9/SER.A/1971 37, 49 [87] ('*Secretary General Analysis of Comments*'); *Report of the Working Group, 2nd sess*, UN Doc A/CN.9/52 [14] (7-18 Dec. 1970), in UNCITRAL Yearbook Vol II, *ibid.*, at 50, 52 [14] ('*Working Group, 2nd sess*').

82. *Working Group, 1st sess*, above n. 30, in UNCITRAL Yearbook Vol I, above n. 30, at 186 [114]; *Secretary General Delivery Report*, above n. 56, in UNCITRAL Yearbook Vol III, above n. 56, at 31, 33 [16] (ULIS was 'needlessly complex and abstract').

83. *Working Group, 2nd sess*, above n. 81, in UNCITRAL Yearbook Vol II, above n. 81, at 58 [75].

84. *Report of the Secretary-General*, UN Doc A/CN.9/WG.2/WP.9 (9 Dec. 1971), in UNCITRAL Yearbook Vol III, above n. 56, at 41, 43 [12] ('*Secretary General Ipso Facto Report*').

85. *Report of the Working Group, 3rd sess*, UN Doc A/CN.9/62 Adds 1 and 2, Annex I, [29] (24 Feb. and 3 & 21 Mar. 1972), in UNCITRAL Yearbook [1972] Vol III, above n. 56, at 77, 85 [29] ('*Working Group, 3rd sess*').

86. *Secretary General Consolidation Report*, above n. 57, in UNCITRAL Yearbook Vol IV, above n. 57, at 36, 41-42 [35]-[40]; *Secretary General Ipso Facto Report*, above n. 84, in UNCITRAL Yearbook Vol III, above n. 56, at 41, 43, 44 [12], [17].

87. *Secretary General Ipso Facto Report*, above n. 84, in UNCITRAL Yearbook Vol III, above n. 56, at 41, 47 [34].

88. *Secretary General Consolidation Report*, above n. 57, in UNCITRAL Yearbook Vol IV, above n. 57, at 36, 42 [45]-[46].

Even in the formative period of drafting, drafters sought to reduce or remove the need for judges to look to national (and hence potentially foreign) law for gap solving.⁸⁹ In determining how to express references to trade usages, drafters were concerned with the ease or difficulty of proof of usages in court, pursuant to different formulations.⁹⁰ The Working Groups were aware of the need to provide ‘clear guidelines that could assist in the application’ by judges of provisions dealing with concepts that might be unfamiliar to them, such as anticipatory breach in Articles 71-72 CISG.⁹¹ These examples demonstrate that the drafters also had an abiding concern regarding efficiency at the litigation stage.

Naturally, a serious matter for drafters was the widespread acceptance of the CISG. Following from ULIS and ULF, above all else, drafters knew that, regardless of the efficiency of the law, a politically rejected law would achieve no legal or economic benefits at all. Hence one finds references to the need to largely eliminate some matters from the CISG’s scope, such as property issues, in order to ensure its acceptability by potential Contracting States.⁹²

In stating that the aim was to reduce transaction costs, it seems its promoters believed the adoption of uniform sales law would reduce transaction costs at the negotiation and contracting stage by making it easier to agree on a choice of law and to draft contractual terms. Since neither party would need to familiarize themselves with a foreign law, information or learning costs would be removed for one or potentially both parties, and thus the CISG would decrease transaction costs.⁹³

The applicability rules in Article 1 CISG were designed to remove legal uncertainty about which law would apply under unpredictable choice of law rules of the forum seized of a dispute. Both reduction of legal uncertainty relating to choice of law rules and lowered negotiation and drafting costs can be classified as *ex ante* transaction cost savings.

It also seems the drafters were aware that the CISG could reduce litigation costs by providing an easily accessible and predictable law, both accessible and known in many jurisdictions. It was anticipated this would shorten proceedings and reduce the

89. *Working Group, 1st sess*, above n. 30, in UNICTRAL Yearbook Vol I, above n. 30, at 182 [37], [59].

90. *Secretary General Analysis of Comments*, above n. 81, in UNCITRAL Yearbook Vol II, above n. 81, at 37, 49 [87].

91. *Working Group, 3rd sess*, above n. 85, in UNCITRAL Yearbook Vol III, above n. 56, at 77, 89 [117].

92. *Working Paper prepared by the Secretariat*, above n. 78, in UNICTRAL Yearbook Vol I, above n. 30, at 188, 196 [52] (inclusion of property might ‘unduly delay completion of the work and jeopardize acceptance of the resulting legislation’). In the case of validity, an additional reason was that UNCITRAL was undertaking a separate project dealing with that issue: at 196 [52].

93. See generally in the context of private international law, Whincop and Keyes, above n. 15, at 531. On information or learning costs, see generally Arrow, above n. 13, at 142-149; Farrell and Saloner, above n. 11, at 70; Linarelli, above n. 13, at 1402; Larry Ribstein and Bruce Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. Legal Stud. 131, 138 (1996). Contra Sandeep Gopalan, *A Demander-Centric Approach to Regime Design in Transnational Commercial Law*, 39 Geo. J. Int’l L. 327, 336 (2008) (highlighting ‘learning externalities’ entailed by choice of CISG); Gillette and Scott, above n. 25, at 478.

need for expert witnesses etc.⁹⁴ This can be classified as an intended *ex post* efficiency. Notably, such an efficiency would arise irrespective of whether the parties had consciously chosen the applicable law to ensure the application of the CISG, or instead, found that the CISG applied by default.

A further intended *ex post* efficiency would arise from the substitution of Article 1 applicability rules in place of complex and unpredictable choice of law rules. This would produce *ex post* gains at the performance and litigation stages. It is clear from UNCITRAL's purpose and the inclusion of Article 1, that drafters intended to decrease this problem.⁹⁵

Furthermore, it is clearly evident that it was intended that the *ex post* costs of performing international contracts were to be lowered, since discussions preceding UNCITRAL's creation mention performance costs, and the intention to minimize them is apparent in the very design of the CISG itself.⁹⁶

§3.04 ECONOMICS BEYOND ORIGINAL AIMS

It is easy to see how the notion of allocative efficiency and the role of transaction costs fit with the aims of the CISG. The analysis above shows that drafters were sufficiently aware that a uniform law could reduce transaction costs, by resolving the problem of unfamiliarity and disadvantage with foreign law, and by reducing uncertainty in application of choice of law rules, both of which were considered 'barriers' to trade.⁹⁷ Thus it has been claimed that the CISG's 'very purpose' was to 'set forth uniform default rules which the parties could conveniently fall back on whenever the costs of making tailored rules is too high' with the added advantage of not being 'entirely foreign to anyone of the parties'.⁹⁸

In this section, law and economics theory is revisited to identify some issues that are relevant to an objective assessment of the CISG's efficiency which might go beyond the issues contemplated by drafters, and to clarify some which were considered by them. These concepts will be utilized in following chapters.

[A] *Ex Post Costs*

Although drafters apparently contemplated *ex post* costs to some degree, much of the attention given to the CISG's economic effect since then has focussed on its *ex ante*

94. Peter Schlechtriem, *Requirements of Application and Sphere of Applicability of the CISG*, 36 Victoria U. Wellington L. Rev. 781,793-94 (2005).

95. See above n. 55 and accompanying text.

96. See also mention of performance costs in antecedent discussions before the creation of UNCITRAL, above n. 43 and accompanying text.

97. See references to 'obstacles' to trade and 'stimulation' of trade, above nn 32, 36, 42, 45, 50, 53 and accompanying text; references to difficulties posed by plurality of laws and choice of law rules, above nn 37, 39, 46, 55 and accompanying text.

98. Marco Torsello, *Substantive and Jurisdictional Aspects of International Contract Remedies*, 25 Int'l Rev. L. & Econ. 397, 399 (2005).

effect.⁹⁹ As mentioned above, some have asserted the reduction of *ex ante* costs is the only aim of contract law.¹⁰⁰ To the contrary, it is submitted that, particularly in the field occupied by the CISG, there is another important function for contract law, in decreasing *ex post* costs. Cost reduction in performance and litigation phases, especially in an environment of plurality of potentially applicable laws, may bring significant efficiency gains.

The significance of *ex post* cost reduction is less obvious in Coasian terms. Being costs incurred after entry into a transaction, it is harder to see how their reduction might enhance efficient resource allocation in the sense of encouraging the free flow of trade in goods. Yet it is submitted that *anticipation* of such costs is still important at the *ex ante* stage, as a rational party will factor into the price of contracting any expected *ex post* costs. Thus their minimization affects net exchange value.

Performance *ex post* costs can also be conceptualized as the ‘overhead’ costs of doing international business. Simply performing contractual obligations comes at a cost, in part determined by the substantive design of applicable laws. Ascertaining the nature of those laws for the purposes of performance of contractual obligations, even if a dispute never arises, is also costly, particularly if a single company has a portfolio of contracts involving multiple applicable laws. A default law which can bring about reductions in the cost of managing performance obligations, can benefit businesses in the Kaldor-Hicks sense by reducing such overheads, thus maximizing exchange surpluses. Naturally, the efficiency gains of any single law depend not only on its design, but also on the ease of access to that law, and the number of recurrences of its use within a particular trading company’s portfolio of contracts.¹⁰¹

The nature of such costs and benefits at the *ex post* stages of performance and/or litigation are largely dealt with in Chapter 5 as non-substantive efficiency issues. Involvement of lawyers at the litigation or performance stages cannot be assumed to eliminate the costs of dealing with a plurality of foreign laws in a dispute, as will be discussed (below in Chapter 5), since legal costs will be incurred.¹⁰²

For now, it can be easily supposed that a party having encountered significant *ex post* problems in one international transaction may be less inclined to enter into them in the future. A party which would otherwise have engaged in international trade

99. See discussion in Ch. 5.

100. See above n. 22 and accompanying text.

101. But if parties do not consult or refer to applicable law in performing their obligations, arguably there are few efficiency gains in the choice of one law over another. This view, espoused by Cuniberti, is discussed further in Ch. 5, at §5.01.

102. Ayres and Gertner, above n. 23, at 93. European businesses recently surveyed on potential EU contract law harmonization considered one advantage to be a reduction in the need to consult local lawyers due to differences in legal systems: Institute of European & Comparative Law, Oxford University and Clifford Chance LLP, *Civil Justice and Choice of Contract Law: A Business Survey* (2008) spreadsheet on file with the author (‘Vogenauer and Hodges’). See Stefan Vogenauer, *Oxford Civil Justice Survey*, <http://denning.law.ox.ac.uk/iecl/pdfs/Oxford%20Civil%20Justice%20Survey%20-%20Summary%20of%20Results,%20Final.pdf> (accessed 28 Feb. 2014) and Stefan Vogenauer and Chris Hodges (eds), *Civil Justice Systems in Europe: Implications for Choice of Forum and Choice of Contract Law* (Hart 2011).

across many borders might instead refrain from any such trade, or limit its activities to only one or a few countries in anticipation of *ex post* difficulties and costs. Legal risks due to divergence of potentially applicable laws and the unpredictability of their application in foreign courts may cause parties to avoid engaging in otherwise profitable international business,¹⁰³ and an individual trader previously ‘burnt’ may refrain even beyond the extent warranted by a rational *ex ante* cost-benefit analysis.¹⁰⁴

International traders are often at higher risk as they tend to sink all their capital, equity and borrowings into the trade volume they opt for. One bad deal can break them. The volume of trade is accordingly affected by fear of opportunism and vastly higher performance and litigation costs. Anticipation of such costs can therefore act as a barrier or disincentive to trade. The nature of the barrier to a single transaction would be the anticipated *ex post* costs discounted by the probability that a dispute or performance issues will materialize. Thus expected *ex post* costs constitute transaction costs at the *ex ante* stage, and these impact upon future trades, hence reducing trade volumes and negatively affecting social welfare.

Studies have shown that in fact a proportion of businesses do shy away from international trade for fear of such complications. Although the global and European markets differ, it is interesting that the European Commission has noted that online transactions have not reached their full potential for this reason, based on empirical work which found 61% of businesses studied declined online transactions due to the jurisdiction of the consumer.¹⁰⁵ One might reasonably expect European businesses to be amongst those most likely to be accustomed to cross-border trade and variations in legal systems. Yet a recent survey revealed that 20% of European businesses surveyed were deterred from doing business in certain jurisdictions due to variations in legal systems, and 39% agreed these constituted a barrier to trade.¹⁰⁶ Only 16% considered that such differences had no financial impact on their business.¹⁰⁷ Small- to medium-sized businesses may have less capacity to deal with these costs.¹⁰⁸

103. Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 Va J. Int'l L. 743, 746 (1999).

104. The ‘availability heuristic’ is likely to be significant here, since problems experienced firsthand are likely to play a more prominent part in decision making processes than an objective assessment would warrant. For more discussion on psychological influences, see Ch. 7. See also Gillette, above n. 25, at 580-81.

105. European Commission, *Green Paper*, above n. 29, at 5 (citing data showing 61% of respondent businesses refuse offers for contracts with consumers online because they do not wish to trade in certain jurisdictions). A range of reasons could explain this, but it can reasonably be assumed divergent laws play a part. See also Francesco Parisi, *The Harmonization of Legal Warranties in European Law*, 52 Am. J. Comp. L. 403, 406 (2004) (‘exploitation of the opportunities offered by new communication technologies ... are at risk [due to] fragmented and heterogeneous consumer protection’).

106. The study of European businesses was conducted in 2008, yielding 103 responses: Vogenauer and Hodges, above n. 102, at 106, Question 46 (33%).

107. Vogenauer and Hodges, above n. 106, at Question 43. The vast majority of those surveyed viewed harmonization of European civil justice systems favourably (76%) and most saw advantages of lower costs and less need to consult local lawyers (36%, 33%), although 29% felt the need to master another legal system was a disadvantage: at Questions 44, 46.

108. European Commission, *Green Paper*, above n. 29, at 2, 7.

Far from ignoring *ex post* costs, the above discussion concluded that the CISG's drafters were aware of their significance, as demonstrated by the design features,¹⁰⁹ but this has received less attention in CISG literature, perhaps because costs at the performance and dispute stages are more subtle and complex in nature. Arguably, even if *ex post* savings are not anticipated by parties, they still represent efficiency gains in terms of social welfare by improving the value of the exchange, and in some instances, by reducing social costs (especially in litigation). Nonetheless, it is submitted that *ex post* costs are also an important component of the expected transaction costs in accordance with Coase Theorem when discounted by the probability of *ex post* events triggering those costs – that is, the chances of performance issues or litigation arising.

[B] Penalty Default Rules and Information Asymmetry

Minimization of *ex ante* transaction costs alone cannot explain all default rules. Unlike majoritarian default rules designed to replicate efficient market results, 'penalty' default rules do not attempt to provide parties with 'what they would have wanted.' Indeed, they may be designed to do exactly the opposite.¹¹⁰ Penalty default rules create incentives for at least one of the parties to expressly clarify their obligations by imposing a harsh penalty where parties remain silent, such as unenforceability.¹¹¹

It follows that penalty default rules raise transaction costs because they require at least one party to reveal information to the other. But their efficiency lies in the benefits flowing from forced clarification of obligations. As Ayres and Gertner have shown, the required disclosure enables parties to contract around the penalty default rule, and this entails *ex ante* transaction costs of disclosure and/or drafting, but will in fact be optimal where the cost of doing so compares favourably with the inefficiency of asymmetrical information or expense of gap filling by a court.¹¹² This means that a default rule disfavoured by the majority may nonetheless result in a 'larger set of more efficient contracts' because it discourages inefficient *ex post* gap filling by courts due to incomplete contracts,¹¹³ by shifting *ex ante* disclosure burdens to one party. Adjudicatory gap filling involves a social cost. However, even when societal interests are not at stake, such as where adjudication is not publicly subsidized, maximization of exchange value vis-à-vis the parties themselves can justify the penalty default approach. A penalty default should thus be chosen as a more efficient rule where it is

109. See above n. 55, and accompanying text. See also Ulrich G. Schroeter, in *Schlechtriem & Schwenzler* 3rd edn, above n. 33, Art. 25, 403 [9] (arguing drafters deliberately chose, on the basis of efficiency concerns, limitation of the availability of termination over a scheme enabling rejection of the goods at a lower threshold and demand for their re-export).

110. Ayres and Gertner, above n. 23, at 91, 101-104; Whincop and Keyes, above n. 15, at 524.

111. Ayres and Gertner, above n. 23, at 92-93, 97; Cuniberti, above n. 1, at 1526; Cantora, above n. 22, at 123.

112. Ayres and Gertner, above n. 23, at 93, 97. See also Marta Cenini and Francesco Parisi, 'An Economic Analysis of the CISG' in André Janssen and Olaf Meyer, *CISG Methodology* 151, 168 (Sellier 2009).

113. Ayres and Gertner, above n. 23, at 93, 97.

'cheaper for the parties to negotiate a term *ex ante* than for the courts to estimate *ex post* what parties would have wanted'.¹¹⁴

A good example is quantity in sale of goods. Unlike failure to agree on price, failure to specify quantity frequently results in invalidity.¹¹⁵ The difference is justified because it would be more difficult and expensive for a court to fill such a gap, but relatively easy for parties to agree upon it *ex ante*. Thus the harsh rule acts as a penalty default in the case of quantity. By contrast, it is easy for a court to gap fill in supplying a missing price by reference to a market or reasonable price.

Penalty default rules may be justified on the basis that they encourage efficient behaviour and value maximization.¹¹⁶ The additional information compelled by an efficient penalty default should enable more accurate pricing and allocation of risks and resources, as well as a reduction in effective cross-subsidization that takes place between high risk and low risk transactions in the absence of information.¹¹⁷ Penalty defaults can therefore reduce moral hazard, because relatively informed parties may otherwise engage in 'strategic incompleteness' whereby one party might withhold information in order to gain a larger slice of the contractual 'pie'.¹¹⁸ Such behaviour is a form of rent-seeking.¹¹⁹ Consequently, the bargain is not optimally efficient due to the asymmetry, so the 'pie' could be bigger, but the relatively informed party has a private incentive to prefer non-disclosure because they can acquire a larger private share or 'slice' of the smaller exchange gain.¹²⁰ In other words, the relatively informed party sacrifices the value of an efficient bargain in order to 'capture the cross-subsidization'.¹²¹ Penalty defaults can play a role in unwinding such 'strategic incompleteness' to improve efficiency both in terms of net exchange gains and social welfare.¹²² Issues relating to this are discussed below, and also in Chapter 5.

The moral hazard created by asymmetrical information can also be exacerbated by resort to rules for which the measure of sufficient behaviour is unverifiable. Indeterminate rules may lead to a party escaping the bargain by taking advantage of an unclear obligation.¹²³ Vagueness of legal rules can therefore similarly detract from their efficiency.¹²⁴

Cantora aptly notes that at the time the CISG was drafted, the majoritarian approach to default rules prevailed, and the alternative aims of penalty default rules under the Ayres-Gertner model had not yet been proposed. Cantora argues that it is not

114. Cenini and Parisi, above n. 112, 168.

115. Whincop and Keyes, above n. 15, 531; Ayres and Gertner, above n. 23, 95-96.

116. Whincop and Keyes, above n. 15, 524, 531.

117. *Ibid.*, at 524; Ayres and Gertner, above n. 23, 98.

118. Ayres and Gertner, above n. 23, 94, 98.

119. Victor Goldberg, *Readings in the Economics of Contract Law* (Cambridge University Press, 1989) 49 (defining rent-seeking as arising 'wherever parties have an incentive to expend real resources to capture something of value').

120. Ayres and Gertner, above n. 23, 94, 98.

121. *Ibid.*, 100 n. 59.

122. *Ibid.*, 94, 98, 101.

123. Gillette and Scott, above n. 25, at 456-57; Schwartz and Scott, above n. 25, at 607.

124. Schwartz and Scott, above n. 25, at 601-602.

clear whether the drafters ‘even took efficiency into account’.¹²⁵ In the above discussion I have contended that, to the contrary, they did take efficiency very much into account, although Cantora is correct that this rationale was often not entirely clear. As mentioned above, the drafters rarely mentioned economic effects directly, instead focussing on related issues such as clarity, practicality and ease of proof. Nonetheless, it is submitted that efficiency in trade was firmly the fundamental reason for the CISG’s creation.

[C] Least-Cost Avoiders

As mentioned above, another measure of the efficiency of a law is whether it shifts risks to the party best able to foresee, avoid or off-set the relevant risk.¹²⁶ Thus one party may be a superior risk bearer because they can insure against it more cheaply, because they can minimize loss from a particular risk by taking precautions before it arises, or due to their superior ability to mitigate a certain type of loss after it arises.¹²⁷ That superior capacity might simply relate to the relative physical proximity of a party to deal with practical matters and circumstances, a significant matter in international sales, or the superior capacity might arise from information asymmetries. Laws that shift tasks to parties best placed to deal with them most efficiently likewise have the effect of minimizing costs of performance and therefore can be characterized as efficient. Thus generally speaking, *ex ante*, both parties have an interest in shifting costs to the most efficient bearer of that risk: the ‘least-cost avoider’.¹²⁸ A law that does this reduces expected future costs and maximizes net joint exchange gains from the transaction.¹²⁹

The reduction of the propensity for moral hazard and the shifting of risks to least-cost avoiders are desirable because they improve exchange gains and social welfare. Viewed from the *ex ante* perspective, default rules that improve the available surpluses from a prospective contract should be preferred over those that do not. Since rules which allocate risk to the least-cost avoider increase exchange surpluses, they can be presumed to ‘replicate for the majority of commercial parties the legal rules that they would select for themselves’, that is, they are normally majoritarian in character.¹³⁰ They are therefore useful as signals of a substantively efficient default law.

125. Cantora, above n. 22, at 124 n. 73.

126. Generally on risk allocation and the ease with which one party or the other can affect the probability of a particular contingency arising; see, e.g., Posner and Rosenfield, above n. 16, at 90-91; George G. Triantis, ‘Unforeseen Contingencies - Risk Allocation in Contracts’ in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics* Vol III The Regulation of Contracts, Ch. IV General Contract Law, 100, 108 (Edward Elgar 2000).

127. Triantis, above n. 126, at 108; Posner and Rosenfield, above n. 16, at 90-91.

128. After the event naturally each would prefer to shift costs to the other, but *ex ante* both want to shift costs to the least-cost avoider: Goetz and Scott, above n. 25, at 971; Ayres and Gertner, above n. 23, at 89 n. 18; Posner and Rosenfield, above n. 16, at 90-91. See also Anthony T. Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. Legal Stud. 1, 1-7 (1978) (in context of mistake prevention and insurance).

129. Goetz and Scott, above n. 25, at 973.

130. See, e.g., Gillette and Ferrari, above n. 26, at 3, 6.

[D] Positive Externalities

However, default rules which raise *ex post* costs without net exchange surplus gains can also be efficient. The discouragement by penalty default rules of rent-seeking behaviour can affect wider social benefits derived from trade. More subtle than those contemplated by Ayres and Gertner, but nonetheless significant are gains at the litigation stage in terms of information costs for all parties. The precedent value of cases is an example. These could potentially influence the *ex ante* information search costs faced by third parties. In other words, it is possible to view the effect of litigation concerning default rules as a form of positive externality, which may be efficient in societal terms, particularly in circumstances where it carries a high value, such as when few precedent cases presently exist in a jurisdiction. These learning effects will be explored later in Chapter 10.

Additionally, as mentioned earlier, there may be social cost savings where litigation proceedings are streamlined. The CISG's effect in relation to choice of law rules is an example of this, since it may reduce the need for argument on this point not only to the benefit of the parties, but to the benefit of society in lowering demand for publicly subsidized court resources. This aspect is again discussed in Chapters 5 and 10.

However, little attention has been paid to the economic analysis of competition between legal systems.¹³¹ Part of the complexity in such an analysis lies in the layers of rules involved in such competition. Professors Whincop and Keyes rightly point out that this involves both substantive default rules and 'metadefault rules' because choice of law rules determine which system's default rules will apply to the contract.¹³² Some parties may in fact attach value to incompleteness of contractual choice of law, even where the costs of specifying a choice of law are low. This is because of the benefit of greater availability of information at the time when the delayed choice is made.¹³³ Therefore in some cases, a more incomplete contract coupled with *ex post* gap filling may be more efficient.¹³⁴ Unfortunately, as the factual matrix in dispute becomes clear, parties may be less able to agree on a choice of law.

[E] Network Effects

The notion of network effects only gained widespread currency in the 1980s.¹³⁵ Although CISG drafters could not have been aware of it at the time, the theory is one which holds particular importance for any modern economic assessment of the CISG.

131. Whincop and Keyes, above n. 15, at 516 n. 4. For a good example, see Ribstein, above n. 27.

132. *Ibid.*, at 530.

133. *Ibid.*, at 524, 536-37, 540-41.

134. See generally Gillette, above n. 25, at 538 (this assigns the job of determining the norms of the agreement to judges).

135. See, e.g., Michael L. Katz and Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 *Am. Econ. Rev.* 424 (1985); Farrell and Saloner, above n. 11; W. Brian Arthur, *Competing Technologies, Increasing Returns, and Lock-in by Historical Events*, 99 *The Economic Journal* 116 (1989) ('*Lock-in*').

As will be discussed in Chapters 5 and 7, 'network effects'¹³⁶ occur when a product increases in value simply by reason of its frequent use by others.

It will be submitted that this applies equally to laws in a competitive market for law, and thus the frequency with which a law is used is vital in any determination of the efficiency of the law itself. This will be developed further in Chapter 5.

§3.05 CONCLUSION

This chapter examined the limited original economic aims of its drafters. It then set out certain relevant economic concepts that will be helpful for the evaluation of the CISG's efficiency on an objective basis. It was concluded that the original aim of the CISG was to reduce transaction costs and increase trade in a number of ways. However, modern law and economics theory offers a wider basis upon which to test its efficiency.

Thus this book looks beyond the economic aims contemplated by its drafters, and will refer to relevant economic concepts in measuring efficiency, irrespective of whether the drafters took them into account. It is submitted that the extent to which the CISG is or is not efficient should be measured by its objective economic effect, not just the goals of those who undertook its drafting.

Efficient default rules are public goods, because they improve the reliability of transactions by lowering market distortions, correcting asymmetric information where it is efficient to do so, and encouraging efficient cost minimization and/or risk allocation.¹³⁷ Harmonized law has the potential to lower transaction costs in the form of negotiation and drafting costs, even in circumstances where efficient bargains were likely to occur anyway.¹³⁸ It remains to be seen whether this has been achieved under the CISG.

It is important to note that the analysis which follows does not adhere exclusively to a majoritarian approach, nor will it focus only on *ex ante* cost reduction. Maximization of the joint net exchange gains from bargains will be assumed to be a desirable localized outcome for parties. The value of *ex post* issues will be highlighted not only for their *ex ante* effect (as an anticipated cost affecting exchange value and volume of trade), but also for their wider implications in terms of maximizing social welfare gains. Therefore purely *ex post* efficiencies in the form of reduced costs at the performance costs and dispute stages for parties and society will also be considered.

The objective economic effectiveness of the CISG is difficult to assess because the CISG plays a number of different roles (substantive law per se, substitute for choice of

136. Farrell and Saloner, above n. 11, at 70; Katz and Shapiro, above n. 135, at 424; W. Brian Arthur, *Positive Feedbacks in the Economy*, 262 *Scientific American* 92 (1990), in W. Brian Arthur (ed), *Increasing Returns and Path Dependence in the Economy* 13 (University of Michigan Press 1994); Michael L. Katz and Carl Shapiro, *Systems Competition and Network Effects*, 8(2) *J. Econ. Perspectives* 93 (1994); S. J. Liebowitz and Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, 8 *J. Econ. Perspectives* 133, 135 (1994); Mark A. Lemley and David McGowan, *Legal Implications of Network Economic Effects*, 86 *Cal. L. Rev.* 479, 483 (1998).

137. See also Parisi, above n. 105, at 404 (discussing EU consumer protection measures).

138. *Ibid.*, at 405.

law rules, and as a model for usages)¹³⁹ for individual contracts at different points in time (*ex ante*, *ex post*). Further, a host of other influences may alter its effectiveness (discussed in Chapters 6 and 7).

This chapter has highlighted some important concepts that will underpin the assessment of the CISG's efficiency in following chapters. Specifically, it highlighted costs at the stages of negotiation, drafting, performance and litigation. Such costs can be categorized in accordance with whether they arise from the form and content of the rules themselves (substantive efficiency), or alternatively, whether they arise due to issues external to the substantive content of the rules, such as the frequency with which the rules are used (non-substantive efficiency). An assessment of the advantages and disadvantages of the CISG in relation to each of these two types of efficiencies follows in Chapters 4 and 5, respectively.

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139. Effects of the CISG as a domestic sales law model stand outside the scope of this book: see Ch. 1. However, even where not applicable *ipso iure*, the CISG is frequently applied to individual contracts *ex post* by adjudicators as a model of commercial usages or *lex mercatoria*, and indeed applied as 'appropriate' law absent agreed choice where arbitral tribunals are permitted such discretion: see Ch. 2, §2.03[B][3].

CHAPTER 4

The CISG and Efficiency: Substantive Advantages and Disadvantages

§4.01 INTRODUCTION

The effect of the CISG's substantive content or provisions is a highly important aspect of efficiency. After all, when choosing between competing laws, the first matter that arises in a lawyer's mind will be 'what are the features of the law that will impact upon my client's obligations?' and then 'are the qualities of its provisions favourable or unfavourable by comparison with other potential choices?'

Before beginning this analysis, it must be emphasized that there can be no such thing as a 'one size fits all' law. For particular clients, the CISG might not be the best choice. For particular transactions, the CISG might not be the best choice. That said, certain substantive features affect the relative suitability of the CISG as a choice of law.

In this chapter, the substantive features of the CISG are analysed in terms of their general efficiency, their relative effect on the buyer and seller, and their relative efficiency by comparison with competing choices of law.

§4.02 GENERAL 'EFFICIENCY' OF SUBSTANTIVE DESIGN FEATURES

The content of the CISG is obviously vital in terms of whether it is appropriate for a particular transaction. However, general observations must suffice for present purposes. It is submitted that, overall, the substantive content of the CISG is no worse – and in fact often very much better – suited to international sales than (often outmoded) national sales laws frequently oriented toward domestic trade.¹ Although it is not

1. The CISG was 'not designed to offer a superior sales regime' to national laws, but as a 'neutral' alternative: Jacob S. Ziegel, *Commentary on Party Autonomy and Statutory Regulation: Sale of Goods*, 6 J. Contract L. 123, 124, 127–28 (1993).

possible to analyse every aspect of the substantive features of the CISG, a few key substantive features are highlighted to facilitate analysis of its substantive value.

[A] Designed for International Sales – *Favor Contractus*

Unlike most domestic sales laws, the CISG was designed specifically for international sales. Perhaps a little facetiously, it can be said that some domestic sales laws need to be carbon-dated to determine their exact age, given that some were derived from earlier laws that arose in the wake of the industrial revolution.² Frequently they were drafted with domestic sales in mind, and therefore incorporate principles unsuited to international trade. An American Bar Association address warned that outdated laws ‘not based on harmonized or transparent standards ... increase commercial risks and transaction costs and may seriously hamper the activities of commercial entities’.³ By contrast, the CISG is a harmonized law designed to deal with the specific problems facing international sales.

Certain features reveal this design. The CISG contemplates the inherent long delays, high costs and serious difficulties in reversing international transactions. Far more than typically the case with domestic sales, international sale reversals are prohibitive given the extensive distances involved, cost of substitute deliveries, expense of re-shipping rejected goods and problems or sometimes impossibility of disposal of rejected goods in a foreign country.⁴ To promote efficiency in cross-border trade, the CISG aims to keep transactions on foot, and its provisions clearly reflect the general principle of *favor contractus*.⁵

2. The forerunner to the current *Sale of Goods Act 1979* (UK), is the *Sale of Goods Act 1893* (UK): Leonard S. Sealy, ‘The Contract of Sale of Goods’ in Anthony G. Guest (ed), *Benjamin’s Sale of Goods* 3, 4–8 (Sweet & Maxwell 5th edn, 2006) (‘*Benjamin’s Sale of Goods*’). From this Australian and New Zealand sales laws are derived: Kenneth Sutton, *Sales and Consumer Law in Australia and New Zealand* 3 (Law Book Co. 3rd ed, 1983). More modern laws in many jurisdictions have been modelled upon the CISG.
3. Hans Corell, ‘The Business Lawyer and International Law: Reflections on the Lawyers Role with respect to Teaching International Law, the Global Compact and International Trade Law’, American Bar Association, Santa Barbara, 17 Jan. 2004, 9, http://www.un.org/law/counsel/english/address_17_01_04.pdf (accessed 28 Feb. 2014).
4. See, e.g., Michael Bridge, ‘A Commentary on Articles 1–13 and 78’ in Franco Ferrari, Harry M. Flechtner and Ronald A. Brand (eds), *The Draft UNCITRAL Digest and Beyond* 235, 256 (Sellier 2004) (prematurely ending international sales as involving economic waste).
5. Michael Joachim Bonell, in Cesare Massimo Bianca and Michael Joachim Bonell (eds), *Commentary on the International Sales Law* Art. 7, 65, 81 [2.3.2.2] (Giuffrè 1987) (‘*Bianca & Bonell*’); Bertram Keller, ‘Favor Contractus: Reading the CISG in Favor of the Contract’ in Camilla B. Andersen and Ulrich G. Schroeter (eds), *Sharing International Commercial Law across National Boundaries* 247 (Wildy Simmonds & Hill 2008) (‘*Kritzer Festschrift*’); Hiroo Sono, ‘The Diversity of Favor Contractus: The Impact of the CISG on Japan’s Civil Code and its Reform’ in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Towards Uniformity* 165, §III.2 (Eleven 2011). See also, e.g., Handelsgericht [Commercial Court] (HG) Aargau, Switzerland, 5 Nov. 2002, §4(b)(a), (d)(aa) <http://cisgw3.law.pace.edu/cases/021105s1.html>; *Mitias v. Solidea Srl*, Tribunale di Forlì, Italy, 11 Dec. 2008 [3.2], <http://cisgw3.law.pace.edu/cases/081211i3.html>; District Court (LG) München, Germany, 27 Feb. 2002, <http://cisgw3.law.pace.edu/cases/020227g1.html> (avoidance as *ultima ratio*); Oberster Gerichtshof [Supreme Court] (OGH), Austria, 7 Sep. 2000, <http://cisgw3.law.pace.edu/cases/000907a3.html> (each accessed 28 Feb. 2014).

To this end, its design favours the remedies of price reduction and damages over a premature end to the contract.⁶ The availability of avoidance or termination is restricted to two serious circumstances: where the breach is fundamental, in the sense that it foreseeably and substantially deprives the innocent party of what they were entitled to expect under the contract; or alternatively, in cases of non-delivery, where the breaching party fails to deliver within an additional reasonable time (*Nachfrist*) period set by the innocent party, or declares it will not do so within the additional time.⁷

Thus unless timely delivery is an essential term, breaches might arguably be precluded from characterization as fundamental in circumstances where the seller makes a serious offer to cure a defect which will not cause unreasonable delay or inconvenience to the buyer.⁸ However, by agreement, parties can specify that certain breaches will be fundamental in nature.⁹

The right to remedies for non-conformity, and the more drastic right to avoid the contract cannot be exercised without timely notice to the breaching party.¹⁰

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6. CISG Arts 50, 74. On damages, see generally CISG Advisory Council, CISG-AC Opinion No 6, Rapporteur: Prof. John Y. Gotanda, §3; Peter Huber and Alastair Mullis, *The CISG: A New Textbook for Students and Practitioners* 279 (2007). On price reduction, see generally Erika Sondahl, *Understanding the Remedy of Price Reduction*, 7 *Vindobona J. Int'l Commercial L. & Arbitration* 255, 260 (2003); Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 2 Mar. 2005, <http://cisgw3.law.pace.edu/cases/050302g1.html>; *MCC-Marble Ceramic Center Inc v. Ceramica Nuova D'Agostino SpA*, US Circuit Court of Appeals (11th Cir), 29 Jun. 1998, <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/980629u1.html> ('MCC-Marble case') (each accessed 28 Feb. 2014).
 7. CISG Arts 25, 49(1)(a), 49(1)(b), 64(1)(a), 64(1)(b) & 63(1). See also Leonardo Graffi, *Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention*, 3 *Int'l Bus. L.J.* 338 (2003); Peter Huber, *CISG — The Structure of Remedies*, 71 *RabelsZ* 13, 16, 20–21 (2007); Court of Appeal (OLG) Düsseldorf, Germany, 24 Apr. 1997, <http://cisgw3.law.pace.edu/cases/970424g1.html>; Commercial Court (HG) Aargau, Switzerland, 26 Sep. 1997 §2F(2)(a), <http://cisgw3.law.pace.edu/cases/970926s1.html> (each accessed 28 Feb. 2014). The procedure for setting additional time is often referred to as a '*Nachfrist*'.
 8. CISG Advisory Council, CISG-AC Opinion No 5, 7 May 2005, Rapporteur: Prof. Dr Ingeborg Schwenzer, §3, *Commentary* [4.4]; Commercial Court (HG) Aargau, Switzerland, 5 Nov. 2002, above n. 5, at §4(b)(aa), (d)(aa); Court of Appeal (OLG) Koblenz, Germany, 31 Jan. 1997, <http://cisgw3.law.pace.edu/cases/970131g1.html> (each accessed 28 Feb. 2014); Robert Koch, 'The Concept of Fundamental Breach of Contract under the ... Goods (CISG)' in Pace International Law Review (ed), *Review of the Convention on Contracts for the International Sale of Goods 1998 (CISG)* 177, 254–5 (1999); John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention Art. 25*, 273 [181.1] (Kluwer 4th edn, 2009); Marco Torsello, *Substantive and Jurisdictional Aspects of International Contract Remedies*, 25 *Int'l Rev. L. & Econ.* 397, 403–404 (2005).
 9. Markus Müller-Chen, in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG) Art. 49*, 753 [14] (Oxford 3rd edn, 2010) ('*Schlechtriem & Schwenzer* 3rd edn').
 10. CISG Arts 26, 39. See further CISG Advisory Council, CISG-AC Opinion No 2, 7 Jun. 2004, Rapporteur: Prof. Eric E Bergsten; Ingeborg Schwenzer, *National Preconceptions that Endanger Uniformity*, 19 *Pace International Law Review* 103 (2007); *Mitias v. Solidea Srl*, Tribunale di Forlì, Italy, 11 Dec. 2008, above n. 5; Commercial Court (HG) Zürich, Switzerland, 26 Apr. 1995, §III(4), <http://cisgw3.law.pace.edu/cases/950426s1.html> (each accessed 28 Feb. 2014).

In keeping with this overall design, the emphasis is on performance of the contract.¹¹ If goods are merely non-conforming,¹² but not so seriously as to constitute a fundamental breach, then, unless modified by agreement, the CISG will not allow them to be rejected. Instead, it requires delivery to be taken and paid for, with any non-conformity leading to either a self-help unilateral price reduction, demand for performance or repair, or subsequent claim for damages.¹³

If the contract is avoided, there is an obligation to preserve the goods pending restitution, and to sell them where potential rapid deterioration makes this impracticable.¹⁴ Damages measured by reference to a substitute transaction and the right to restitution are both limited to cases where the contract is avoided.¹⁵

Given the general principle of preference for maintenance of the contract rather than termination, the CISG also contains innovations designed to facilitate performance despite problems that might arise. It contains a right to set extra (reasonable) time periods for performance where performance is late,¹⁶ and importantly, an opportunity for the seller to cure its own breach within reason.¹⁷

The efficiency of this approach will be analysed below. One problem with it is the potential for inconsistency regarding availability of the right to specific performance. Article 28 allows courts discretion to refuse an order for specific performance in circumstances where it would not do so pursuant to its own law. This was a compromise reached to accommodate disparate civil and common law propensities for ordering specific performance. The ‘gap’ allowing discretionary considerations at the jurisdictional level for specific performance is resolved in the PECL and UNIDROIT Principles.¹⁸

Nonetheless, the overall structure of the CISG favours maintenance of the original bargain, in most cases through self-help remedies. Performance is favoured, not

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11. This differs from common law whereby specific performance is available only if damages are inadequate. But see CISG Art. 28.
 12. The common law allows for rejection of goods that are non-conforming, unless (in the case of quantity) the variance is trivial (*de minimis non curat lex*), even if no loss is caused. However, this would not amount to fundamental breach under Art. 25 CISG. See Anthony G. Guest, ‘Performance of the Contract’ in Anthony G. Guest (ed), *Benjamin’s Sale of Goods* 409, 432–34 (Sweet & Maxwell 7th ed, 2006); Francis M. B. Reynolds, ‘Terms as to Description and Quality Implied by the Sale of Goods Act’ in Anthony G. Guest (ed), *Benjamin’s Sale of Goods* 535, at 546–48; Sir Guenter Treitel, ‘CIF Contracts’ in Anthony G. Guest (ed), *Benjamin’s Sale of Goods* 1457, at 1576 n. 14.
 13. CISG Arts 50, 47, 74.
 14. CISG Arts 85–88. See CISG Advisory Council, CISG-AC Opinion No 9, 15 Nov. 2008, Rapporteur: Prof. Michael Bridge, *Commentary* [2.7], [3.3]. At common law, after valid rejection buyer becomes bailee with duties of care: Reynolds, above n. 12, at 638; Ziegel, above n. 1, at 130.
 15. CISG Arts 75 & 76. See *Novia Handelsgesellschaft mbH v. AS Maseko*, Tallinna Ringkonnakohus [Circuit Court], Estonia, 19 Feb. 2004, CISG-online Case No 826, <http://www.globalsaleslaw.org/content/api/cisg/urteile/826.pdf>; CISG Advisory Council, CISG-AC Opinion No 8, 15 Nov. 2008, Rapporteur: Prof. John Y Gotanda; Ingeborg Schwenzer, in *Schlechtriem & Schwenzer* 3rd edn, above n. 9, Art. 76, at 1035.
 16. CISG Arts 47, 63.
 17. CISG Art. 37 (before delivery date); Art. 48 (seller can remedy own breaches at own expense if this does not cause unreasonable delays, expense or inconvenience for the buyer). See also, Commercial Court (HG) Aargau, Switzerland, 5 Nov. 2002, above n. 5, at §4(d)(aa).
 18. Torsello, above n. 8, at 404. See UNIDROIT Principles Art. 7.2.2; PECL Art. 9:102.

necessarily by forced performance of the original bargain, but by resort to remedies other than avoidance and restitution, such as price reduction, cure and damages.¹⁹

The substantive efficiency of the CISG's overarching design in terms of keeping the contract on foot is a matter overlooked in some analyses touching upon the efficiency of its rules. It is submitted that the design features of self-help remedies and restriction of avoidance will normally result in significantly lower *ex post* costs, both at the litigation and performance stages. In international trade, except where special circumstances or sector-specific arrangements apply, a default rule that limits the availability of termination of the contract and instead allows recourse to damages, price reduction, etc. is likely to be more efficient than a scheme which enables rejection of the goods at a lower threshold and then demands their re-export.²⁰ It is submitted that this design feature demonstrably increases net exchange gains for parties.

The *favor contractus* schema is also optimal from a societal viewpoint in this context, since it minimizes the cost of non-conformities by discouraging a complete unwinding of the contract. Instead, the party in the best physical and practical position to do so is required to deal with the goods in most cases. Both parties have avenues to try and resolve the problem, and an incentive to do so where this will minimize losses. After delivery, the buyer has an incentive to physically deal with the goods and claim a price reduction or damages. In other words, the CISG shifts costs to the least-cost avoider, and reduces the transaction costs of dispute settlement.

Thus parties are effectively encouraged to determine who is best placed to fix the problem if that can be done efficiently. If cure is likely to be efficient *ex post*, both have an incentive to reach an agreement to accommodate cure. Failing cure, unlike domestic settings, in most international sales the high cost of reversal makes it easier to determine the comparative advantage of parties in bearing risks *ex post*.²¹ Rather than default to a rule designed to reverse the transaction by re-shipping back, the CISG favours the cheaper option of the goods being dealt with by the party in possession of them. This reduces performance costs by comparison with reversal.

By providing a high threshold for termination, the CISG also reduces the potential for extraction of rent by opportunistic post-breach behaviour by the buyer.²² In this regard, it should be noted that the *favor contractus* principle relies on a 'substantial performance' requirement, inherent within the fundamental breach concept in Article 25 CISG, so that, relative to the 'perfect tender' requirement, moral hazard is shifted away from the buyer and toward the seller. This decreases the potential for inefficient strategic behaviour by the buyer, since termination is less available, but increases the potential for opportunistic underperformance by the seller.²³ However, it is submitted

19. Torsello, above n. 8, at 407.

20. Ulrich G. Schroeter, in *Schlechtriem & Schwenzler* 3rd edn, above n. 9, Art. 25, at 403 [9].

21. Normally, the opposite is true: George G. Triantis, 'Unforeseen Contingencies - Risk Allocation in Contracts' in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics* Vol III The Regulation of Contracts, Ch. IV General Contract Law, 100, 108 (Edward Elgar, 2000).

22. Catherine Piché, *The Convention on Contracts for the International Sale of Goods and the Uniform Commercial Code Remedies in Light of Remedial Principles Recognized under U.S. Law*, N.C. J. Int'l L. & Com. Reg. 519, 565 & passim (2002-2003).

23. Torsello, above n. 8, at 402-404.

that this allocation of risk for opportunistic behaviour is warranted in the circumstances of international trade, where reversal costs are high, particularly where appropriate remedies (in lieu of termination) to counteract the incentives upon the seller to underperform exist, such as price reduction, repair and damages. Furthermore, international trade involves a high degree of repeat business and associated disincentives for seller underperformance in any event.

The overall scheme should therefore be seen as an efficient default rule choice for international sales. The high threshold for termination reduces performance costs, decreases opportunism, and by shifting risks to the party most efficiently able to reduce costs, creates value by maximizing exchange gains to be divided between the parties in their terms of trade. Whilst this has been labelled a 'paternalist' rule,²⁴ it is submitted that in fact the rule does not reject majority preferences in seeking to optimize social benefits of trade. On the contrary, due to its comparative efficiency in minimizing economic waste,²⁵ and the ease with which the fundamental breach trigger can be adjusted by parties to suit their own circumstances, it probably represents a majoritarian default rule in the context of international trade.

Professors Cenini and Parisi, and Professor Katz reach similar views in their assessments of the efficiency of the CISG remedial regime. While Katz cautions that any assessment of remedies is only a 'second best' measure of efficiency by comparison with an *ex ante* approach,²⁶ he concludes that in the context of higher transport, communication, monitoring and dispute costs it was at least plausible that the CISG's 'restrictive approach to avoidance and more liberal approach to cure may make economic sense' as the drafters had hoped.²⁷ In his view, the CISG's focus on specific performance is an efficient design feature for international sales,²⁸ and restriction of the availability of termination within the CISG makes it more difficult for buyers to engage in opportunistic behaviour to extract modifications *ex post*, or to induce inefficient seller precautions against such buyer actions.²⁹ Thus he concludes it may make more economic sense in the international context to minimize rejection and termination remedies and correspondingly expand self-help remedies such as *Nachfrist* and cure.³⁰ This, he claims, may reduce seller incentives for strategic underperformance, minimize opportunistic buyer behaviour and deliver greater exchange surpluses, despite his observation that this could simultaneously potentially reduce predictability of outcomes.³¹ As Piché, Cenini and Parisi argue, self-help remedies are efficient because

24. See generally Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535, 576 (1990); Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 88 (1989).

25. Michael Bridge, 'Uniform and Harmonized Sales Law: Choice of Law Issues' in James J. Fawcett, Jonathan M. Harris and Michael Bridge (eds), *International Sale of Goods in the Conflict of Laws* 938-940, [16.57]-[16.60] (Oxford 2005).

26. Avery W. Katz, *Remedies for Breach of Contract Under the CISG*, 25 Int'l Rev. L. & Econ. 378, 380 (2005).

27. Katz, above n. 26, at 392.

28. *Ibid.*, at 383, 389.

29. *Ibid.*, at 392.

30. *Ibid.*, at 392.

31. *Ibid.*, at 392.

they reduce litigation costs.³² Like Katz, Cenini and Parisi conclude that in the context of international sales, the *favor contractus* structure of the CISG is efficiently superior.³³

Cenini and Parisi note that specific performance is considered a more precise remedy, given the difficulty courts have in accurately quantifying damages to match actual losses, and the risk of over or under compensation,³⁴ and therefore specific performance has long been considered a more efficient remedy by law and economics theorists who have argued that its availability should be expanded within common law remedial systems.³⁵

Recently Friehe and Tröger published a detailed analysis comparing the impact of two fundamentally different remedial institutions in sales law: regimes that make repair, replacement, price reduction and termination simultaneously available; and regimes that provide for a hierarchy of remedies, with primary rights to cure.³⁶ They argue that modern regimes such as the CISG, PECL and DCFR provide a sequenced set of remedies,³⁷ and that sequencing generally holds societal benefits in terms of reduced likelihood of opportunistic termination by buyers.³⁸ It will be recalled from the above discussion, that in the case of international sales, these benefits are likely to be further magnified due to high unwinding costs. Furthermore, they found that sequencing alters seller incentives to invest in quality, in that it disaggregates initial incentives from post-performance incentives, and that some societal benefits flowed from this disaggregation, although overall, investment levels remained the same under both regimes.³⁹

Thus the CISG preference for *favor contractus*, and emphasis on performance and specific performance is probably efficient in most situations governed by the CISG as the most accurate and precise method of compensation,⁴⁰ although this may not be so for goods that are yet to be manufactured at the time the contract is entered.⁴¹

[B] Formation and Formalities

Consideration is not required under the CISG. Provided formation requirements are met, agreement based on an intent to be bound is sufficient.⁴² Unless a declaration has

32. Marta Cenini and Francesco Parisi, 'An Economic Analysis of the CISG' in André Janssen and Olaf Meyer (eds), *CISG Methodology* 151, 155 (Sellier 2009); Piché, above n. 22, at 548.

33. Cenini and Parisi, above n. 32, at 155.

34. A heightened risk when markets do not exist or are limited: *ibid.*, at 157; Anthony T. Kronman, *Specific Performance*, 45 U. Chi. L. Rev. 351, 362 (1978); Alan Schwartz, *The Case for Specific Performance*, 89 Yale L.J. 271, 276 (1979).

35. Cenini and Parisi, above n. 32, at 155-57; Kronman, above n. 34, *passim*; Schwartz, above n. 34, at 277.

36. Tim Friehe and Tobias H. Tröger, *Sequencing of Remedies in Sales Law*, 33 Eur. J.L. & Econ. 159 (2012).

37. *Ibid.*, at 161-62 Table 1 (holding that the CISG falls into this category due to Art. 46).

38. *Ibid.*, at 183.

39. *Ibid.*, at 161, 183.

40. Generally Schwartz, above n. 34, at 277.

41. The CISG covers both existing goods and goods to be manufactured, so specific performance is sometimes a less efficient solution: Art. 3(1) CISG. *Contra* Cenini and Parisi, above n. 32, at 158.

42. 'Part II is silent on the need for "consideration" or a "causa": Michael Bridge, *The International Sale of Goods* 530 [11.02] (Oxford 3rd edn, 2013). It is submitted that the decision in *Geneva*

been made pursuant to Article 96, oral contracts will suffice under the CISG, as its provisions make it clear contracts need not be evidenced in writing. The CISG also removes the parol evidence rule.⁴³

In terms of formation, at least on its face, the CISG is relatively traditional: Articles 14-19. It requires a matching of offer and acceptance before a contract exists, yet a non-identical acceptance can result in a contract, provided that any changes are non-material, and no prompt objection to the discrepancies is forthcoming: Article 19(2). However, most key terms are classified as material, including dispute resolution clauses: Article 19(3). It is said, therefore, that the CISG adopts a modified 'last shot' approach to the 'battle of the forms'.⁴⁴

Yet perhaps surprisingly, the CISG seems to be evolving in relation to formation. While Article 19 apparently adopts a 'last shot' or 'mirror' approach, the CISG is now moving towards a more 'modern'⁴⁵ formation theory, that of the 'knock out'.⁴⁶

Pharmaceuticals Technology Corp v. Barr Laboratories, Inc., 201 F Supp 2d 236, US District Court (SD NY), 10 May 2002, <http://cisgw3.law.pace.edu/cases/020510u1.html>, was incorrect (regarding consideration).

43. CISG Arts 8(3), 11; CISG Advisory Council, CISG-AC Opinion No 3, 23 Oct. 2004, Rapporteur: Prof. Richard Hyland, §1. See also Huber and Mullis, above n. 6, at 13; Bridge, above n. 4, at 254; Harry M. Flechtner, 'Addressing Parol Evidence Issues in Contracts Governed by the CISG' in Harry M. Flechtner, Ronald A. Brand and Mark S. Walter (eds), *Drafting Contracts under the CISG* 257 (Oxford 2008) (Flechtner, Brand & Walter); Joseph Lookofsky, *Understanding the CISG* 43-44 (Kluwer 3rd ed, 2008); *MCC-Marble case*, above n. 6 (rejecting the incorrect position in *Beijing Metals and Minerals v. American Business Centre, Inc.*, US Circuit Court of Appeals (5th Cir), 15 Jun. 1993, <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/930615u1.html> (accessed 28 Feb. 2014)).
44. Cour de Cassation [Supreme Court], France, Cass civ 1er, 16 Jul. 1998, <http://cisgw3.law.pace.edu/cases/980716f1.html>; *Norfolk Southern Railway Company v. Power Source Supply, Inc.*, US District Court (WD Pa), 25 Jul. 2008, <http://cisgw3.law.pace.edu/cases/080725u1.html>; Court of Appeal (OLG) Köln, Germany, 24 May 2006, <http://cisgw3.law.pace.edu/cases/060524g1.html>; ICC Award No 8611, 23 Jan. 1997, <http://cisgw3.law.pace.edu/cases/978611i1.html> (each accessed 28 Feb. 2014). Contending the CISG adopts a 'last shot' theory of formation modified by Art. 19: Pilar Perales Viscasillas, "Battle of the Forms" under the 1980 United Nations Convention on Contracts for the International Sale of Goods, 10 Pace Int'l L. Rev. 97, 147-49 (1998); E. Allan Farnsworth, in *Bianca & Bonell*, above n. 5, Art. 19, at 175, 179 [2.5]; Fritz Enderlein and Dietrich Maskow, *International Sales Law* Art 19 97, 101 [10] (Oceana 1992); J. Clark Kelso, *The United Nations Convention on Contracts for the International Sale of Goods: Contract Formation and the Battle of Forms*, 21 Colum. J. Transnat'l L. 529, 554 (1983).
45. See Huber and Mullis, above n. 6, at 91, 100; Omri Ben-Shahar, *An Ex-Ante View of the Battle of the Forms*, 25 Int'l Rev. L. & Econ. 350, 356, 365 (2005).
46. Supporting a 'knock out' approach; Federal Supreme Court (BGH), Germany, 9 Jan. 2002, <http://cisgw3.law.pace.edu/cases/020109g1.html>; *ICT GmbH v. Princen Automatisering Oss BV*, Gerechtshof's Hertogenbosch [District Appeal Court], Netherlands, 19 Nov. 1996, <http://www.unilex.info/case.cfm?pid=1&do=case&id=329&step=Abstract>; CISG Advisory Council, CISG-AC Opinion No 13, Rapporteur: Prof. Sieg Eiselen, Commentary §10; Ulrich G. Schroeter, in *Schlechtriem & Schwenzer* 3rd edn, above n. 9, Art. 19, at 334, 350 [30]; Huber and Mullis, above n. 6, at 94; Honnold, above n. 8, Art. 19, at 252 [170.4]; Keller above n. 5, at 252; Lookofsky, above n. 43, at 60. *Contra* Pilar Perales Viscasillas, *Battle of the Forms and the Burden of Proof*, 6 Vindobona J. Int'l Commercial L. & Arbitration 217 (2002); Franco Ferrari in Stefan Kröll, Loukas Mistelis and Pilar Perales Viscasillas (eds), *UN Convention on Contracts for the International Sale of Goods* Art. 19, 279, 289 (Beck/Hart/Nomos 2011). See generally Ben-Shahar, above n. 45, passim ('reasonable shot' rule as the more efficient approach).

Under the last shot theory, where terms of offer and acceptance are mismatched, the acceptance normally prevails, since it is the ‘last shot’ before performance effectively accepts the counter-offer. In the ‘knock out’ theory, the terms common to both offer and acceptance form the basis of the contract, and any clashing terms are ‘knocked-out’ with the CISG filling in any lacunae.

While the ‘last shot’ view of the CISG was once strongly favoured, over time, cases and commentary have increasingly begun to endorse the ‘knock out’ view.⁴⁷ Often this is achieved by holding that, despite the existence of a clash, subsequent performance indicates their implicit intention to derogate from Article 19 pursuant to Article 6.⁴⁸ Past practices, the existence or indeed absence of declarations that a term is ‘to be a *conditio sine qua non* for the contract’s conclusion’, and subsequent conduct are all relevant in determining whether this is so.⁴⁹

The recent case of *Hanwha Corp v. Cedar Petrochemicals* illustrates the difficulties and dangers inherent in this process, particularly in jurisdictions which recognize the ‘knock out’ theory within their domestic contract law. It is submitted that the CISG applied *ipso iure* pursuant to Article 1(1)(a) simply because both businesses were in Contracting States. Yet the court relied upon an unfortunate mixture of business location and local knock out principles under the Uniform Commercial Code (UCC) to decide the CISG was applicable.⁵⁰ It then considered CISG formation, ironically adopting the traditional ‘mirror’ approach to Articles 14-19, to conclude no contract was formed because past practices demonstrated lack of intent to be bound until a choice of law had been agreed, and because each party had declared that no contract would be effected until their standard terms had been expressly accepted by the other.

On these facts, arguably, the same result would have ensued had a CISG ‘knock out’ view been adopted. First, it is possible that the steps taken of preparing a bill of lading and opening a letter of credit were sufficient performance to warrant application of the knock out rule under the CISG.⁵¹ However, given Article 8(3), the parties’ past practices and their clear statements regarding intent, it is submitted that this would have still led to the conclusion that no contract was concluded in this case, although by the correct path.

47. See above nn 44, 46.

48. See Amtsgericht [Petty District Court](AG) Kehl, Germany, 6 Oct. 1995, <http://cisgw3.law.pace.edu/cases/951006g1.html>. See also Schroeter, above n. 46, Art. 19, at 351 [41]; Huber and Mullis, above n. 6, at 94.

49. Schroeter, above n. 46, Art. 19, at 352-53 [42]-[46](emphasis in original).

50. *Hanwha Corporation v. Cedar Petrochemicals, Inc.*, US District Court (SD NY), 18 Jan. 2011, and Leandro Tripodi, *Editorial Comments*, <http://cisgw3.law.pace.edu/cases/110118u1.html> (accessed 28 Feb. 2014). In a summary judgment, the CISG was applied to formation issues despite attempts by both parties to opt out. The court utilized ‘knock out’ theory, but unfortunately did so pursuant to the domestic Uniform Commercial Code §2-207(b).

51. Ulrich Magnus, ‘Last Shot vs. Knock-out: Still Battle over Battle of Forms under the CISG’ in Ross Cranston, Jan Ramberg and Jacob Ziegel (eds), *Commercial Law Challenges in the 21st Century; Jan Hellner in memoriam* 185, 193-97 (Stockholm Centre for Commercial Law Juridiska institutionen 2007) 185, 193-97.

The issue is unresolved, and we might expect to see further gradual development over time.⁵² It is submitted that the ‘knock out’ theory is perhaps the better view where the conduct of the parties makes it clear they considered that a contract was in existence, leaving the only uncertainty as to which set of terms prevailed. It can be argued that, unless parties made it clear that no contract would arise other than on their own terms, the knock out rule should be applied in cases where the parties actually performed.⁵³ In the absence of a contrary stipulation, arguably the knock out rule more closely reflect the parties’ collective intent, and resolves uncertainty in a sensible and comprehensive way.

On the other hand, there is a strong counterargument that the ‘last shot’ rule is simple and easy to apply, since it enables parties themselves to quickly and efficiently ascertain their positions without time consuming and expensive term by term analysis by legal counsel. Indeed, some practitioners prefer to choose the CISG as a more certain alternative to a domestic sales law, *inter alia*, due to perceived absence of the knock out rule within the CISG.⁵⁴ The last shot method thus provides a high level of efficiency, particularly in reduced litigation costs, but may interfere severely with the accuracy of contract pricing.

Arguably, the knock out approach resolves uncertainty in a manner that more accurately reflects the bargain struck,⁵⁵ admittedly at the cost of the *ex post* advantages just mentioned. It is submitted that contract pricing is more accurate under the knock out rule. Pursuant to Article 8(2), one might reasonably conclude that, given neither party agreed to the other’s terms, both probably would reasonably have understood the bargain to consist of commonly sought terms, with residual gap-filling by default rules. Arguably, such an understanding means that Article 19 has been modified by Article 6, but only where the parties have gone ahead and performed the contract, thus manifesting a common belief a contract exists. If parties have not performed, the knock out view should not be applied to uphold a contract, since the basis for application of Article 6 would seem implausible.

The outcome suggested is arguably far closer to what the parties would have wanted, had they been asked for their preferred default rule in advance of the particular situation arising, than the alternative ‘all or nothing’ approach. It is therefore submitted as the more efficient rule because it is a ‘majoritarian’ solution to the problem. Further, the ‘last shot’ theory suffers from the ‘disadvantage of leading to practical outcomes which are random in nature and very difficult to foresee for the contracting parties’,⁵⁶ making accurate pricing impossible. In any event, as *Hanwha* shows, parties can always

52. Kaia Wildner, *Art. 19 CISG: The German Approach to the Battle of the Forms in International Contract Law*, 20 Pace Int’l L. Rev. 1, 30 (2008).

53. Magnus, above n. 51, at 193-97.

54. Burghard Piltz made this point during a debate at a conference: Global Challenges of International Sales Law Conference, 11-13 Nov. 2011, University of Florida, Gainesville, USA, where Prof Harry Flechtner also raised concerns about the effect of adoption of the ‘knock out’ rule within the CISG.

55. Similarly, see Wildner, above n. 52, at 28; Huber and Mullis, above n. 6, at 94; Honnold, above n. 8, Art. 19, at 252 [170.3].

56. Schroeter, above n. 46, Art. 19, at 349 [35].

make clear that there will be 'no deal' if specific terms are not accepted expressly, thereby bypassing the effect of any default knock out rule if they wish to do so.

It has been traditionally argued that the most efficient approach to formation is for courts to attempt to follow party intentions,⁵⁷ but inducement of efficient reliance has become the focus in relation to efficiency of formation rules,⁵⁸ concerning when a party undertakes reliance or 'relationship-specific investment' such that it would be better off if the contract is concluded, but worse off if it is not.⁵⁹ If the non-relying party is legally bound, it cannot exploit the other's reliance investment by seeking to extort a higher price or better terms.⁶⁰ Choice of an efficient level of reliance for the circumstances increases exchange gains for both parties, but achieving this may be an impossible task for default rules covering a wide range of transactions.⁶¹

However, Cenini and Parisi note that the Article 18 rule regarding silence as insufficient per se for acceptance is probably an appropriate choice in this regard due to its clarity.⁶² It is submitted that the best that can be achieved by default rules in relation to efficient reliance where international transactions are concerned is a good degree of clarity about when formation will occur, and that the timing roughly corresponds with what parties probably intended in most cases. It is submitted that this is indeed what is achieved by Articles 14-19, although it is contended that in some cases, the terms on which formation might be deemed to occur under the 'last shot' approach may not reflect the parties' collective intentions as closely as it might. To this end, it is submitted that although the 'last shot' interpretation is adequate in terms of efficient reliance, the 'knock out' approach presently evolving within the CISG probably offers a superior level of efficiency, since it more closely matches the parties' intent as a whole, thus providing the closest thing to a majoritarian approach as is possible where performance has occurred.

Similarly, it is contended that the removal of the parol evidence rule and any requirement of consideration is an appropriate choice in terms of encouragement of efficient reliance where parties from different legal systems are involved, since it encourages reliance at the point at which an agreement is understood by parties to exist, rather than on the basis of legal formalities of which not all parties will be aware.

[C] The Need for Notice

The CISG requires notice whenever there is a problem. The ability to rely upon non-conformity to seek remedies depends on the giving of timely notice: Article 39.⁶³ The ability to end the contract by avoidance likewise depends on notice: Article 26.

57. Cenini and Parisi, above n. 32, at 153.

58. Charles J. Goetz and Robert E. Scott, *Enforcing Promises*, 89 Yale L.J. 1261 (1980); Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 Stan. L. Rev. 481 (1996); Cenini and Parisi, above n. 32, at 153.

59. Cenini and Parisi, above n. 32, 153.

60. *Ibid.*, at 154.

61. See also, *ibid.*, at 154-55.

62. *Ibid.*, at 155.

63. Subject to the exceptions in CISG Arts 40, 44.

As mentioned earlier, the potential for *ipso facto* termination was considered too confusing for parties, and drafters considered that a requirement of declaration of avoidance by notice would provide both parties with clarity on their positions. As a design feature this holds particular importance in international trade between parties from potentially different legal backgrounds, where long distances are involved. Notice of avoidance would also enable the seller to re-sell or make other arrangements immediately, thus enabling the seller 'to act to prevent wastage, loss or expense to the goods when the buyer refuses to accept them on delivery'.⁶⁴ By adopting a notice requirement for avoidance, the CISG's solution therefore improves the chance that losses resulting from a terminated contract are minimized, in particular by the party that presumably might most efficiently avoid such a loss, the seller, who is thus the 'least-cost avoider' in most instances.

Notice of non-conformity likewise allows parties to determine the best way to resolve the deficiency in a timely and therefore efficient manner. It enables the seller to offer a cure to the problem pursuant to Article 48 CISG, rather than allow losses to grow unnecessarily. In many cases, the seller may be able to offer the most cost-effective solution. Notice of non-conformity is a vital aspect in ensuring such opportunities are not lost, so that the anticipated exchange surplus is preserved as far as possible, given that a problem has occurred. If cure by the seller is inefficient, then it is likely that the buyer can reject it on the basis of unreasonable inconvenience or delay, and moreover, the buyer retains the right to damages following a cure.⁶⁵

[D] Timing of Acceptance ('Receipt' versus 'Postal' Rule)

Communication of acceptance is effective once it reaches the offeror ('receipt rule'),⁶⁶ unless practices between the parties, usages or the offer itself indicate otherwise.⁶⁷ This differs somewhat from the historically important common law exceptions to the requirement of communication of acceptance, primarily the postal rule (or 'mail box' exception), whereby a theoretical 'meeting of minds' is deemed to occur when acceptance is posted.⁶⁸

The difference in approach holds less significance since the advent of internet communication which has reduced the postal rule's practical importance, even more than the phone or (almost extinct) fax machines. It is submitted, however, that nascent efforts regarding this new aspect of formation can be far more easily developed in the case of the CISG than at the uncoordinated domestic level. The UNCITRAL Model Law on Electronic Commerce will assist at the national level as it is slowly adopted and

64. *Report of the Secretary-General*, UN Doc A/CN.9/WG.2/WP.19 (7 Dec. 1972), in UNCITRAL Yearbook [1973] Vol IV, UN Doc A/CN.9/SER.A/1973 36, 41-42 [35]-[40]; *Report of the Secretary-General*, UN Doc A/CN.9/WG.2/WP.9 (9 Dec. 1971), in UNCITRAL Yearbook [1972] Vol III, UN Doc A/CN.9/SER.A/1972 41, 43, 44 [12], [17].

65. CISG Art. 48(1).

66. CISG Art. 18(2).

67. CISG Art. 18(3). See Perales Viscasillas, above n. 44, at 147-49.

68. John W. Carter, Elisabeth Peden and Gregory Tolhurst, *Contract Law in Australia* 72-73 (Butterworths 5th edn, 2007). See Cenini and Parisi, above n. 32, at 152.

implemented,⁶⁹ as will the *2005 Electronic Communications Convention*, should it eventually be more widely adopted. Indeed these were designed with, *inter alia*, the CISG in mind.⁷⁰ While not essential for the CISG's development,⁷¹ they offer useful guidance and demonstrate how harmonized law might more easily keep up with technological advances than fragmented domestic sales law.

In selecting the 'receipt rule', the CISG solution decreases incentives to rely on the offer too early, and increases the ability of the offeree to continue bargaining with others for longer,⁷² unless the circumstances invoke Article 16(2)(b). Cenini and Parisi conclude that the receipt rule is more efficient than the postal rule where parties have their businesses in different countries, because ultimately, it 'states more precisely when the contract is made for both parties'.⁷³

This assessment accords with the conclusion in the above section regarding the requirement of positive notice in the CISG, since the certainty afforded by such an approach fosters incentives for relationship-specific investment and cessation of other bargaining activity at a time when both are aware of the binding agreement, thereby reducing potentially wasteful costs and decreasing uncertainty. However, as mentioned, the practical difference between the rules is less significant with the proliferation of email.

[E] Warranties and Notice

The CISG provides warranties for non-conformity with express terms and for non-conformity with implied terms of fitness for purpose, sample, and packaging (Articles 35(1) and 35(2)), and other warranties relating to third party claims, including intellectual property rights (Articles 41 and 42). The seller is liable for non-conformity that exists when risk passes to the buyer: Article 36. The timing of risk for non-conformity will usually in practice be determined by an agreed selection of Incoterms, but if there is no such agreement, the CISG provides for the time at which goods are handed to the first carrier as a default rule: Article 67(1). There are competing views about the issue, and suitability of the rule in Article 67 for CIF contracts in particular has been questioned.⁷⁴

69. See UNCITRAL Model Law on Electronic Commerce (1996)(as amended 1998), http://www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf; *UN Convention on the Use of Electronic Communications in International Contracts*, adopted 23 Nov. 2005, GA Res 60/21. See generally CISG Advisory Council, CISG-AC Opinion No 1, 15 Aug. 2003, Rapporteur: Prof. Christina Ramberg.

70. See Petra Butler, 'The CISG and the United Nations Convention on the Use of Electronic Communications in International Contracts' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play 1* (Eleven 2012). See also, Luca G. Castellani, 'Foreword' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play*, vii, at ix.

71. Butler, above n. 70, at 15.

72. Cenini and Parisi, above n. 32, at 152.

73. Cenini and Parisi, above n. 32, at 152.

74. Michael Bridge, 'The Transfer of Risk under the UN Sales Convention 1980 (CISG)' in *Kritzer Festschrift*, above n. 5, 77, at 91.

The latter warranty for non-conformity will be lost if notice of breach is not given within reasonable time: Article 43(1). Likewise, the buyer must inspect the goods ‘within as short a period as practicable’ and give notice of breaches within a ‘reasonable time’ after the time at which the non-conformity was discovered or ought to have been discovered: Articles 38, 39. The maximum period is two years, although a much shorter time is usually considered ‘reasonable’ with perhaps the median period being one month depending on the nature of the goods.⁷⁵ The period can naturally be extended by agreement: Article 39(2).

These limitations on warranties do not apply at all if the seller was aware of the problem but did not disclose it to the buyer: Articles 40, 43(2). Although only of small practical importance, if the buyer has ‘reasonable excuse’ for failure to give notice, the limitations will only have a minimal effect, since the buyer can still reduce price under Article 50 or claim damages other than lost profits: Article 44.

The seller is, however, not liable for non-conformities and intellectual property claims where the buyer was aware of them when concluding the contract, or could not have been unaware of them at that time: Articles 35(3), 42(2)(a). Thus the CISG provides for a system of partial warranties.

In law and economics, a warranty is a seller’s promise ‘to assume specific responsibilities in case the quality or the performance of a purchased item does not conform to the [buyer’s] specifications and legitimate contractual expectations’.⁷⁶ The system design of partial warranties established within the CISG should be tested for its economic effect to determine whether they are efficient by comparison with alternative positions.

Warranties can relate to qualities that can be observed by the buyer (‘search properties’), durability or functionality that are only revealed over time (‘experience properties’), and some qualities which are incapable of verification (‘credence properties’).⁷⁷ Warranties perform the economic functions of insurance, signalling and provision of incentives.⁷⁸ The optimal warranty can be either a full or partial warranty, or no warranty at all, depending on the context. The factors which tend to make one rule more efficient than another are the comparative risk profiles of the parties, the existence of information asymmetry, and comparative ability to control risk.⁷⁹

For example, if information is symmetric and only exogenous risks exist (whereby neither buyer nor seller control risk of product failure),⁸⁰ then the warranty will carry no signalling or incentive effects, so the optimal level and duration of warranty will be determined by the relative risk aversion profiles of the parties.⁸¹ The

75. Ingeborg Schwenzer, *The Noble Month (Articles 38, 39 CISG) – The Story Behind the Scenery*, 7 *European J.L. Reform* 353, 353 (2005). See further below n. 170.

76. Francesco Parisi, *The Harmonization of Legal Warranties in European Law: An Economic Analysis*, 52 *Am. J. Comp. L.* 403, 407 (2004).

77. Klaus Wehrt, ‘Warranties’ in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics* Vol III, 179-195, 184 (Elgar 2000); Cenini and Parisi, above n. 32, at 158-59; *ibid.*, at 418-19.

78. Cenini and Parisi, above n. 32, at 159; Parisi, above n. 76, at 407.

79. Cenini and Parisi, above n. 32, at 159; Parisi, above n. 76, at 408.

80. Parisi, above n. 76, at 408.

81. Cenini and Parisi, above n. 32, at 160; *ibid.*, at 408.

party least risk averse is the best risk bearer in such a scenario, and where their risk profiles are identical, a partial warranty provides the optimal balance.

Similarly, if risk aversion profiles are identical, and risks are exogenous, but information asymmetry exists, then (*ceteris paribus*) the seller's warranty choice will provide quality signals to the less informed buyer, just as a buyer's selection of warranty will provide risk signals regarding potential for consequential loss to the less informed seller.⁸²

Finally, if risk is endogenous such that party behaviour can control risk, then the extent of the warranty will act as an incentive to invest in production and preservation of quality, and responsibility is most efficiently placed on the least-cost avoider of risk, that is, the party that can best minimize risk.⁸³

If both buyer and seller can equally affect risk, the best solution depends on whether blame for defects is clearly attributable by a court; if so, full warranties for seller-controlled risks are optimal, whereas if attribution is difficult, then the most efficient solution is a partial warranty as a 'second best' result, given that it aligns party interests in circumstances where no one warranty is optimal.⁸⁴

Given the potential combination of factors discussed above, full lifetime warranties are rarely optimal when all three functions of warranties are considered, particularly if the risk of non-conformity is controlled by the seller.⁸⁵ In most circumstances, adjustment of warranty level up or down will have inverse effects on two of the functions mentioned, so for example, increasing coverage will improve the buyer's insurance function, but decrease incentives for the buyer to disclose any risks.⁸⁶ Thus the functions reveal conflicting aims, and the optimal solution is normally a partial warranty.

CISG warranties are partial, since they relate to certain characteristics of the goods,⁸⁷ and are limited by the notice requirement and time limits for notice, although these limitations are qualified in some circumstances, such as seller knowledge.

It is submitted that the balance of liability within CISG warranties is likely to be efficient. Cenini and Parisi have argued the CISG selects an 'efficient level' of warranty since 'the risk of [defects] is borne by [the] seller only for a limited period of time and only with regards to particular characteristics of the good'.⁸⁸ However, it is submitted that the efficiency of the latter is easier to identify.

82. Cenini and Parisi, above n. 32, at 160; Wehrt, above n. 77, at 179-85; Sanford J. Grossman, *The Informational Role of Warranties and Private Disclosure about Product Quality*, J.L. & Econ. 461 (1981); Parisi, above n. 76, at 410-12.

83. Cenini and Parisi, above n. 32, at 162.

84. See George L. Priest, *A Theory of the Consumer Product Warranty*, 90 Yale L.J. 1297 (1981); Wehrt, above n. 77, at 179-85; *ibid.*, at 162-63; Parisi, above n. 76, at 414-15 ('second best' solution).

85. Cenini and Parisi, above n. 32, at 163; Parisi, above n. 76, at 407.

86. Cenini and Parisi, above n. 32, at 164.

87. Suggesting inclusion of ethical standards: Ingeborg Schwenzer, 'Conformity of the Goods – Physical Features on the Wane?' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play* 103, 111 (Eleven 2012).

88. Cenini and Parisi, above n. 32, at 164.

Insofar as characteristics of the goods are concerned, ‘credence’ attributes are not covered. This is an efficient choice, since attempting to cover non-verifiable qualities would create an impossible task for courts and tribunals.⁸⁹ Naturally, CISG warranties cover ‘search properties’ that can be discovered at the time of contract, and provides the seller with disclosure incentives for properties not so easily discovered, by creating an exception to liability for defects of which the buyer knew or should have known, and by removing or reducing the effect of the notice limitation in cases where the seller had private information regarding non-conformity, but failed to disclose. The balance achieved encourages prudent levels of information disclosure; in other words, appropriate incentives, particularly where large distances may make greater disclosure more valuable in terms of reducing economic waste.

Allocation of warranty risk to the seller for all non-conformities which exist at the time goods are handed to the first carrier (unless otherwise agreed) is efficient since the seller is normally the least-cost avoider until that point,⁹⁰ but has little control afterward. Sellers normally enjoy an informational advantage about likely defect rates, and a majoritarian rule will allocate risk of non-conformity to the seller as the party best placed to avoid or insure against such a risk. The drafters were probably wise not to explicitly deal with the vexed issue of the timing of deterioration problems.⁹¹ The question then becomes, what standard should be applied for the purposes of risk allocation under Article 35(2)(a)? Should goods be of ‘average’, ‘reasonable’ or ‘merchantable’ quality in order to be fit for ordinary purposes and thus conform to the contract?

There is some disagreement about the standard within the CISG.⁹² The Netherlands Arbitration Institute determined that ‘reasonable’ quality was appropriate.⁹³ Professors Gillette and Ferrari argue that because economic theory predicts sellers use price to signal quality, thereby conveying otherwise asymmetrical information to buyers, that a presumption of ‘merchantable’ quality (rather than an ‘iron rule’) is the most efficient (majoritarian) approach to conformity under the CISG, and that alternatives are less efficient since none provide the ‘graduated warranty’ signalled by price differences.⁹⁴ However, despite its rejection of the ‘merchantability’ standard, a Netherlands arbitral decision which applied the test of ‘reasonable’ quality did in fact take price into account, in addition to past practice.⁹⁵ Thus despite the label used in the award, the decision seems to employ the most efficient default rule for quality. The rule

89. *Ibid.*, at 163.

90. CISG Art. 67; *ibid.*, at 165.

91. Bridge, above n. 74, at 83.

92. Ingeborg Schwenzer, in *Schlechtriem & Schwenzer* 3rd edn, above n. 9, Art. 35, at 568, 577 [14].

93. Netherlands Arbitration Institute, 15 Oct. 2002, <http://cisgw3.law.pace.edu/cases/021015n1.html> (accessed 28 Feb. 2014).

94. Clayton P. Gillette and Franco Ferrari, *Warranties and “Lemons” under CISG Article 35(2)(a)*, 1 *Internationales Handelsrecht* 2, 10-14, 16 (2010) (arguing limits, in particular, while price as a signal works for discrete price levels, continuous prices hold little informational value). The test of ‘satisfactory quality’ replaced ‘merchantable quality’ in the *Sale of Goods Act 1979* (UK) s. 14(2A), (2B) as amended by the *Sale and Supply of Goods Act 1994* (UK).

95. Gillette and Ferrari, above n. 94, at 14; Netherlands Arbitration Institute, 15 Oct. 2002, above n. 93, at [123] (referring to the quality a buyer reasonably could expect in view of both ‘the price’ and ‘quality levels it had been used to’).

allocates risk to the least-cost avoider, by effectively requiring the goods to live up to the standard that might be expected of goods that could be resold at the contract price. Therefore, although interpretation of Article 35(2)(a) is not yet settled, an optimal interpretation of the standard is open, and has been applied in practice. Again, the biggest problem is the existence of divergent interpretations.

It is more difficult to determine whether the limitation of CISG warranties by means of the notice requirement and time limits for notice are majoritarian. Parisi argues that default time restrictions are appropriate for warranties even if risk of product failure is purely exogenous, if time limits correspond to the average period parties would be likely to have agreed upon.⁹⁶ He asserts this is efficient because transaction costs are reduced because parties no longer need negotiate the time period.⁹⁷ As mentioned earlier, notice periods in the CISG vary, with perhaps some convergence upon one month, depending on the transaction and type of goods.

Whether one month is an 'average' of what parties would want is difficult to deduce. What can be concluded is that some default time limit on notice is probably optimal, since it provides greater certainty regarding the finality of risk of liability/claims, reduces evidentiary costs that build commensurately with difficulty of proof over longer periods (since only prescription periods would otherwise apply), and eliminates the need and cost of negotiation for the same effect. Even if one month is optimal, consistency is the most vital aspect. Although the situation has now improved with German courts softening their formerly very short time frames in line with most other jurisdictions,⁹⁸ there is still considerable variability in outcomes under the CISG regarding time limits,⁹⁹ and this detracts somewhat from the certainty that might otherwise flow from the default rule. Additionally, in some instances, courts viewing the CISG through 'domestic lenses' have failed to even recognize the Article 39 notice requirement at all.¹⁰⁰ Again, this reduces the efficiency gains that the default rule might otherwise hold.

[F] Type of Damages

Expectation damages are in economic terms protective of the expectation interest, and thus generally considered appropriate in providing incentives for performance on the one hand, and reliance on performance on the other. The party which owes performance should ideally be encouraged to invest in a level of effort to perform that maximizes net exchange gains, whereas the party owed performance should be

96. Parisi, above n. 76, at 415.

97. *Ibid.*, at 415.

98. Stefan Kröll, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

99. Austrian courts have continued to apply a rule of thumb of 14 days, despite international developments: Wolfgang Faber, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

100. See Lisa Spagnolo, *The Last Outpost: Automatic CISG Opt Outs, Misapplications and the Costs of Ignoring the Vienna Sales Convention for Australian Lawyers*, 10 Melbourne J. Int'l L. 141, 187 (2009) (discussing *Ginza Pte Ltd v. Vista Corp Pty Ltd* [2003] WASC 11, Barker J, 11 Jan. 2003, <http://cisgw3.law.pace.edu/cases/030117a2.html>) (accessed 28 Feb. 2014).

encouraged to undertake a similarly optimal level of investment in reliance on forthcoming performance.¹⁰¹

There is an inverse relationship between these twin aims. Optimal performance efforts are generally spurred by the threat of expectation damages, however, expectation damages also tend to encourage overreliance in the form of ‘excessive reliance investments’.¹⁰² Cenini and Parisi point out that the latter problem can be ameliorated by the adjustment of expectation damages to take account of reliance investment beyond socially optimal levels, so that the latter is discouraged.¹⁰³ They believe that the CISG probably does this to some extent, by encouraging buyer disclosure of risks through the foreseeability limitation in Article 74, and by imposing a mitigation requirement in Article 77, although they concede that the latter would need to extend to reliance occurring before the breach to be fully effective in this respect.¹⁰⁴

Its approach to damages is to allow for expectation damages, since it provides for ‘a sum equal to the loss, including loss of profit’: Article 74. Thus the provision aims to place the party suffering loss in the position they would have enjoyed if the contract had been properly performed.

Higher potential damages in the form of expectation damages rather than reliance loss alone may have the effect of encouraging compliance, but may also discourage deals in the first place, in terms of entry into international transactions rather than concentrating on domestic trade alone.

It could be argued that the potential for higher damages under the CISG will not have such an effect because price will simply be adjusted for risk accordingly. However, as discussed in Chapter 7, the cognitive bias against loss vis-à-vis gain may mean that, despite the availability of price adjustment to account for this, fear of greater liability may lead to inefficiencies in the form of larger adjustments than rationally warranted, or non-entry into the international trade altogether.

Apart from causal link, there are two limitations on compensation in the CISG: the foreseeability test (Article 74) and the requirement of mitigation (Article 77). The latter limits recovery of consequential damages to only those losses foreseen or which ought to have been foreseen as a ‘possible’ consequence of the breach.

[G] Foreseeability Rule

Ayres and Gertner state that rules which limit consequential damages to those foreseeable at the time of the contract act as information-forcing penalty default rules, because they provide an incentive for the more informed party to disclose information.¹⁰⁵ Where the less informed party is the least-cost avoider, the rule is generally efficient. In the case of the CISG, the seller will often be in a position to efficiently avoid

101. Cenini and Parisi, above n. 32, at 165.

102. *Ibid.*, at 166-67.

103. *Ibid.*, at 167.

104. *Ibid.*, at 167.

105. Ayres and Gertner, above n. 24, at 101-104, 108; Ian Ayres and Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 Yale L.J. 729, 735 (1992).

a specific risk if informed by the buyer of relevant information. The CISG limits recovery of losses foreseen or foreseeable as a 'possible' consequence of the breach in Article 74.¹⁰⁶ Not every possible loss is recoverable,¹⁰⁷ but it establishes strong incentives for buyer disclosure by setting a fairly low threshold for recovery.

Cantora concludes the CISG rule is inefficient, since it over-incentivizes disclosure, which he argues will lead to raised *ex ante* costs beyond any gains.¹⁰⁸ Cenini and Parisi, and Katz on the other hand, see the CISG foreseeability test and its effect in encouraging disclosure as efficient.¹⁰⁹ It has been argued that the promisee often prefers the adjusted price rather than the risk of under-compensation.¹¹⁰

High levels of disclosure enable the parties to more closely match terms of trade to the risks involved. While this undoubtedly raises *ex ante* transaction costs, it reduces the cross-subsidization inherent in a price set by a party operating behind a 'veil of ignorance' as to the true risk involved with a particular counterparty.¹¹¹ The alternative is that all parties will face the same equilibrium average price, regardless of whether they carry a high or low consequential loss risk.¹¹² Greater disclosure produces a more accurate signal, alerting the seller to undertake precautions to avoid the risk, and/or adjust the price to individual buyer risk, so that buyers carrying higher consequential loss will be less likely to be subsidized by lower risk buyers. Whether parties agree to exclude certain risks, invest in risk avoidance, or shift the risk and raise the price, disclosure facilitates social welfare gains – a 'bigger pie' – due to the more efficient avoidance of risk by its disclosure to the least-cost avoider, and more accurate pricing of exchanges.

Effectively, welfare gains in this instance are the result of a reduction in information asymmetry. This results in 'separating' equilibria, whereby parties can be differentiated on the basis of risk, a far more efficient result than the cross-subsidized 'pooling' of indistinguishable risk profiles, provided transaction costs are not greater than the efficiency gains,¹¹³ and provided the rule does not inefficiently discourage

106. Arthur F. Murphey Jr, *Consequential Damages in Contracts for the International Sale of Goods and the Legacy of Hadley*, 23 *Geo. Wash. J. Int'l Law & Econ.* 415, 439–40 (1989); Oberster Gerichtshof [Supreme Court](OGH), Austria, 14 Jan. 2002, <http://cisgw3.law.pace.edu/cases/020114a3.html> (accessed 28 Feb. 2014) (foreseeability breach would produce a 'loss essentially of the type and extent that actually occurred').

107. See, e.g., *Re Siskiyou Evergreen, Inc. (Debtor)*, US Bankruptcy Court (D Or), 29 Mar. 2004, <http://cisgw3.law.pace.edu/cases/040329u2.html> (accessed 28 Feb. 2014) (third party contracts were unforeseeable thus lost profits could not be claimed pursuant to Art. 74).

108. Mark Cantora, *The CISG after Medellin v. Texas*, 8 *J. Int'l Bus. & L.* 111, 131 (2009).

109. Katz, above n. 26, at 388; Cenini and Parisi, above n. 32, at 168–69.

110. Cenini and Parisi, above n. 32, at 169.

111. Ayres and Gertner, above n. 24, at 106 n. 91 (referring to Rawls). See generally Michael Whincop and Mary Keyes, *Putting the 'Private' Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 *Melbourne U.L. Rev.* 515, 524, 531.

112. Ayres and Gertner, above n. 24, at 94.

113. *Ibid.*, at 94–95, 112; Whincop and Keyes, above n. 111, at 524; Richard A. Posner, *Economic Analysis of Law* 20 (Kluwer 7th edn, 2007).

beneficial information collection.¹¹⁴ It is submitted here that this will not be the case, since the relevant information is likely to be casually acquired in any event.

Importantly, information withholding may be motivated by strategic behaviour, and default rules should be structured to avoid this.¹¹⁵ Without a foreseeability limitation, high consequential loss parties have an incentive to stay in the 'pool' even though this is less efficient from a societal perspective, because they benefit from a larger slice of the 'pie' by means of a price cross-subsidized by lower risk buyers.¹¹⁶

Thus the CISG foreseeability rule encourages efficient behaviour: disclosure by the informed party where that party cannot avoid the risk; and avoidance of risk by the party best placed to do so following disclosure to that party or, alternatively, adjustment of the terms to allocate any remaining risk. Disclosure also reduces litigation costs, since it is easier for a court to establish the *ex ante* states of knowledge where disclosure has occurred.

However, Cantora's argument relies primarily on the increase in transaction costs under the lower CISG threshold overshadowing these gains.¹¹⁷ He argues the CISG disclosure incentive is too strong, and encourages high and excessively costly levels of disclosure about remote eventualities.¹¹⁸ For remote risk or low probability events, small potential gains may be dominated by transaction costs, or even psychological factors.¹¹⁹ Nonetheless, it is worth remembering that relatively informed parties will also face transaction costs of disclosure. It is therefore likely that there will be a personal incentive not to disclose every eventuality, but only those significant enough to warrant the transaction costs of disclosure. As the risks become increasing more remote, the benefit anticipated must be more heavily discounted.¹²⁰ Although it is difficult to assess the tradeoff between pre-contractual and post-contractual costs,¹²¹ it must be true that at some point the low probability will outweigh the *ex ante* negotiation and drafting costs involved in disclosure of the risk and dealing with it specifically in the contract.¹²² Accordingly, the incentive for disclosure disappears. This practical consideration itself would prevent excessive disclosures.

Another factor likely to preclude excessive disclosure is the relative ability of the parties to efficiently deal with the risk. Some will prefer to remain indistinguishable from other buyers, and may therefore refrain from disclosure.¹²³ This is not to say that by achieving the same price as others, such parties necessarily capture the cross-subsidization as a form of rent-seeking by strategic withholding. Such parties may prefer to effectively become self-insurers to the extent their non-disclosed potential

114. Anthony T. Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. Legal Stud. 1, 13-15 (1978) (arguing importance of distinction between 'casually acquired' or 'deliberately acquired' information due to investment incentives).

115. See generally Ayres and Gertner, above n. 24, at 94-95, 103.

116. *Ibid.*, at 101-104, 108.

117. Triantis, above n. 21, at 101, 111; Gillette, above n. 24, at 542.

118. Cantora, above n. 108, at 131.

119. Gillette, above n. 24, at 542. For discussion on psychological aspects, see Ch. 5.

120. Triantis, above n. 21, at 101.

121. See Gillette, above n. 24, at 575.

122. See generally, Triantis, above n. 21, at 111.

123. Ayres and Gertner, above n. 24, at 100.

losses are unforeseeable in CISG terms. There will be a particular incentive not to reveal where the anticipated price increase will not be worth the reduced risk. In such cases, there is no private incentive to contract around the CISG penalty default rule. This will be true when the seller is not the least-cost avoider. In such circumstances, non-disclosure is more efficient, since the buyer is best placed to efficiently bear the risk.

In summary, despite the views to the contrary, it is submitted that the CISG foreseeability rule is generally efficient.

[H] Price Reduction

As described in section §4.02[A], the CISG adopts a system of self-help remedies, including price reduction.

One matter on which Katz is critical is the formula in Article 50 which he claims alters the economic bargain agreed to accommodate greater risk-sharing.¹²⁴ He argues that it results in over or under compensation for loss in cases where the bargain struck is regretted by comparison with market value, since the formula refers to the proportionate difference in market value of delivered goods compared with conforming goods.

Torsello correctly points out that the formula was not intended as a compensatory measure, but instead, actually preserves the bargain struck, since only the proportion of the reduction is determined by reference to market value of delivery (conforming versus non-conforming). Once the proportion is determined, the contract price is scaled down, reflecting the original deal agreed by the parties.¹²⁵

It is therefore submitted that price reduction is a low-cost and highly efficient remedial tool,¹²⁶ and given its approximation to the original bargain, can be identified as a clearly majoritarian default rule.

[I] Limited Scope of Coverage, Ambiguity and Uncertainty

Realistically, no law can cover every eventuality. Furthermore, the CISG was a product of the diplomatically charged environment necessary for the creation of an international treaty. As mentioned earlier, certain compromises were made to ensure its passage, and this impacted upon the nature and extent of its substantive content. Certain provisions were left somewhat ambiguous,¹²⁷ and its scope incomplete, with matters such as validity largely excluded on the basis that it was thought agreement on them would not be feasible, or that they would be dealt with elsewhere.¹²⁸

124. Katz, above n. 26, at 388.

125. Torsello, above n. 8, at 408-409.

126. *Ibid.*, at 407; Piché, above n. 22, at 563.

127. See Gyula Eörsi, *A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods*, 31 *Am. J. Comp. L.* 333 (1983).

128. A different working group was working on a doomed separate Validity of Contracts of International Sale of Goods. See A/CN.9/WG.2/WP.29, <http://www.uncitral.org/uncitral/en/>

One example of the CISG's incomplete scope is the treatment of interest. The obligation to pay interest on damages is located within Article 78, but the rate of interest is not specified.¹²⁹ Another example is set-off, an issue which many conclude is not directly covered by the CISG.¹³⁰ These areas demonstrate the sacrifice of 'formal uniformity' in order to achieve any uniformity at all; a trade-off between territorial coverage and substantive uniformity.¹³¹ One example of this type of trade-off is explored in detail in Chapter 9. Notably, the Swiss Proposal of 2012 sought to begin work within UNCITRAL to address some of these external gaps in the CISG in a new instrument, although the proposal has not received the necessary support.¹³²

Incompleteness of scope and a certain level of imprecision, whatever their causes, are not unique to the CISG. They are inevitable features of many domestic laws, where frequently political compromise is necessary to ensure passage of legislation. What is different in the case of the CISG is the lack of a mechanism to resolve divergent interpretations. In a domestic setting, one might expect judicial decisions (or opinions) to clarify such matters. In the case of the CISG, while decisions by courts or arbitral tribunals may assist, there is no central hierarchy of judicial decision making or appeal to resolve divergent views. This raises the spectre of persistent jurisdictional differences in interpretation, which may be exacerbated by what has become known as the 'homeward trend'; the tendency to view the CISG through domestic lenses.¹³³

These issues are raised as potential disadvantages in the substantive character of the CISG. The criticism of incompleteness of coverage is also an issue which will be discussed further in Chapter 5, since it impacts upon non-substantive efficiency. However, one must be careful not to either overstate nor underplay the true nature of

commission/working_groups/2Sale_of_Good.html (accessed 28 Feb. 2014). In fact, the issue of validity is not excluded per se, but to the extent it is not 'otherwise expressly' dealt with by the CISG's provisions: CISG Art. 4 (second sentence), Art. 4(a). See UNCITRAL Secretariat, *Commentary*, UN Doc A/CONF.97/5 (14 Mar. 1979) Art. 4 [2] ('*Secretariat Commentary*'), in Diplomatic Conference, Vienna, 10 Mar.-11 Apr. 1980, UN Doc A/CONF.97/19 14, 17 ('*Official Records*'). See also for interesting analysis of consequences: Pedro Martini, 'Reading Article 4 with Article 7 Glasses. Shaping the CISG's Material Scope' and Ulrich G. Schroeter, 'The Validity of International Sales Contracts' both in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Boundaries and Intersections* (Eleven 2014).

129. Most conclude rate of interest is an external gap: Franco Ferrari, *Uniform Application and Interest Rates under the 1980 Vienna Sales Convention*, 24 Ga J. Int'l & Comp. L. 467, 475-78 (1995); Barry Nicholas, in *Bianca & Bonell*, above n. 5, Art. 78, 568, at 570.

130. Peter Schlechtriem, in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 4, 15, 72 [22a] (Oxford 2nd edn, 2005); Huber and Mullis, above n. 6, at 30; Bundesgericht [Supreme Court](BGer), Switzerland, 20 Dec. 2006, §2.2.1, <http://cisgw3.law.pace.edu/cases/061220s1.html> (accessed 28 Feb. 2014). A limited set-off may exist in Art. 88(3): CISG-AC Opinion No 9, above n. 14, *Commentary* [2.7], [3.3].

131. See Ch. 9. See also Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 Int'l Rev. L. & Econ. 446, 458-59 (2005); Steven Walt, *The CISG's Expansion Bias*, 25 Int'l Rev. L. & Econ. 342, passim (2005).

132. *Possible Future Work in the Area of International Contract Law*, Proposal by the Government of Switzerland, UN Doc A/CN.9/758 (45th Session UNCITRAL, 25 Jun.-6 Jul. 2012).

133. John E. Murray, *The Neglect of CISG: A Workable Solution*, 17 J. L. & Com. 365, 367 (1998); John Honnold, *The Sales Convention in Action — Uniform International Words: Uniform Application?*, 8 J.L. & Com. 207, 208 (1988); Franco Ferrari, *Homeward Trend and Lex Forism Despite Uniform Sales Law*, 13 Vindobona J. Int'l Commercial L. & Arbitration 15, 20 (2009).

such issues. Therefore closer analysis of each point is required before it is assumed that this supposed ‘disadvantage’ might impact upon efficiency.

It is true that the CISG does not cover all issues, but it is inaccurate in most instances to refer to it as adding *another layer of complexity*. It was only intended that the CISG substitute or replace domestic law in relation to the issues covered by it. Hence, while it is necessarily incomplete, it is no more so than the laws it displaces (with the exception of an exhaustive civil code, itself replete with overlapping provisions and parts). Matters not covered by the CISG are external gaps to be filled by domestic law. This is no different to the need to look to other domestic laws outside a particular domestic statute in regard to issues not dealt with by the latter. Are the English Sale of Goods Act or the American UCC inadequate because they do not deal with every issue that could potentially arise? Thus while certain reductions in formal scope were made to ensure the CISG’s adoption,¹³⁴ it must be remembered that incomplete scope is also a feature of most laws.

Thus it is submitted that in fact the CISG’s lack of completeness cannot truly be considered as constituting a special disadvantage per se or even point of difference vis-à-vis the alternative position of applying domestic sales law. Similarly, when asked about the analogous harmonization of European contract law, businesses in a recent survey acknowledged the cost of mastering another system, but overwhelmingly viewed such a proposal favourably and considered it would lower costs.¹³⁵ Indeed, practitioners have commented that the CISG’s scope covers the bulk of issues of concern to international traders.¹³⁶ Yet it is not suggested that the CISG’s scope causes no problems by comparison with displaced domestic law. However, it is submitted the real potential for disadvantage is more nuanced. It lies in the interaction of the CISG with residual law, which may indeed be problematic, and is dealt with in Chapter 5.

Further, the incompleteness of the CISG should not be overstated. Two examples of external gaps were mentioned above, but the most frequently cited example is ‘validity’, closely followed by ‘property’, probably because of the express exclusion in Article 4(a) and (b) CISG. Yet critics usually overlook the second sentence in Article 4, which makes it clear that the exclusion is not absolute, but only to the extent these issues are not ‘otherwise expressly’ dealt with by the CISG’s provisions.¹³⁷ One example is the express allowance of informal contracts despite domestic requirements of evidence in writing etc., which might variously be considered issues of validity or

134. See Eörsi, above n. 127, passim.

135. Institute of European & Comparative Law, Oxford University and Clifford Chance LLP, *Civil Justice and Choice of Contract Law: A Business Survey* (2008) spreadsheet on file with the author, Questions 44-47 (‘Vogenauer and Hodges’)(76% in favour of harmonizing European law, 36% stating this would reduce costs and 6% anticipating increased costs). See Stefan Vogenauer, *Oxford Civil Justice Survey*, <http://denning.law.ox.ac.uk/iecl/pdfs/Oxford%20Civil%20Justice%20Survey%20-%20Summary%20of%20Results,%20Final.pdf> (accessed 28 Feb. 2014) and Stefan Vogenauer and Chris Hodges (eds), *Civil Justice Systems in Europe: Implications for Choice of Forum and Choice of Contract Law* (Hart 2011).

136. Comments by Sörren Kiene and others during discussions at the Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

137. CISG Art. 4 (second sentence), Art. 4(a). The CISG prevails if in conflict with domestic validity rules: *Secretariat Commentary*, above n. 128, Art. 4 [2], in *Official Records*, above n. 128, at 14, 17.

enforceability.¹³⁸ The CISG also deals with obligations to pass property, including third-party claims, in the sense of contractual obligations rather than ownership.¹³⁹ Hence it is misleading to say that the CISG simply does not cover matters involving property or validity at all.

Criticisms of the CISG's efficiency are levelled by Professors Gillette and Scott. They argue that the CISG was created in circumstances where drafters were personally motivated by the possibility of prestige, and commercial interests were underrepresented.¹⁴⁰ Gillette and Scott primarily blame this political economy for problems relating to scope and ambiguity.¹⁴¹ They say the legislative environment provided private incentives for its drafters to rely on vague 'standards',¹⁴² to enter into 'obfuscatory' compromises,¹⁴³ and to enable State reservations,¹⁴⁴ so as to facilitate the conclusion of a treaty, even on the basis of incomplete and unsatisfactory provisions – in other words, the drafters were motivated to reach resolution at all costs, and so sacrificed substantive for formal uniformity.¹⁴⁵

While undoubtedly this problem of political economy exists for all international agreements, it must be said that the same is also true of every law, international or domestic.

Whatever personal motivations individual drafters may have had, it is apparent that the creation of UNCITRAL and subsequent adoption of the CISG was driven by perceived economic benefits of uniformity.¹⁴⁶ Although the drafters' may have been preoccupied with achievement of broader acceptance than its predecessors ULIS and ULF, this is not necessarily incompatible with efficiency aims.¹⁴⁷ The converse is also true. Further, absence of debate over whether uniform law was desirable per se must be viewed against the background of UNCITRAL's creation for this very purpose, and an earlier acceptance that harmonization could improve the efficiency of international trade and trade levels (discussed in Chapter 3). Indeed, the design of the CISG frequently demonstrates concern for the economic impact of the new rules.

The criticism that the drafting process motivated a proliferation of reservations which undermine uniformity and increase information costs might have been a strong one had this in fact eventuated. However, far from proliferating, reservations have

138. CISG Arts 8(3), 11 & 29.

139. CISG Arts 30, 41 & 42. See also Bridge, above n. 25, at 905, 948-949 [16.73]-[16.74] (the CISG is 'not silent on property matters').

140. Gillette and Scott, above n. 131, at 448, 461-72, n. 54.

141. Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 Va J. Int'l L. 743, 752, 773, 779 (1999); Gilles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 Vand. J. Transnat'l L. 1511, 1516, 1518, 1519, 1541 & 1546 (2006). See generally Alan Schwartz and Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. Pa L. Rev. 595 (1995).

142. Gillette and Scott, above n. 131, at 448-49, 457, 462, 465-66, 468-69, 473-75; Walt, above n. 131, at 347. See generally Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541 (2003).

143. Jacob S. Ziegel, *The Future of the International Sales Convention from a Common Law Perspective*, 6 New Zealand Bus. L. Quarterly 336, 338 (2000).

144. Gillette and Scott, above n. 131, at 468-69; Walt, above n. 131, at 343-44.

145. Gillette and Scott, above n. 131, at 448, 461-72, n. 54.

146. For discussion of 'obstacles' to trade and 'stimulation' of trade see Ch. 3, §III.

147. But see Gillette and Scott, above n. 131, at 464.

been minimal, declining in impact, and some have been withdrawn.¹⁴⁸ The declaration with greatest historical impact was that of the Scandinavian States precluding operation of the CISG's formation provisions,¹⁴⁹ but these have been/are being withdrawn.¹⁵⁰ Next in terms of impact is Article 95, but as discussed in Chapter 2, this declaration was made by only a few States, most significantly the USA and China, and was later withdrawn by Canada.¹⁵¹ In any event, as previously noted, as the number of Contracting States steadily increases, the importance of this declaration is now withering due to the overarching effect of Article 1(1)(a). In what may perhaps be the most significant blow to the remaining effect of Article 95, China is presently seriously contemplating the withdrawal of its declaration pursuant to that provision.¹⁵² Article 96 declarations were made by few countries, and seem to have had little practical impact as the socialist bloc fell and writing requirements dissipated with it. Thus China has now withdrawn its Article 96 declaration.¹⁵³

Gillette and Scott are by no means alone in criticizing the CISG as 'vague'.¹⁵⁴ As discussed below, the criticism is most often heard from commentators with a common law background. However, somewhat ironically, the observation that the CISG is replete with ambiguous 'standards' is often made by way of general assertion, but with few references to current scholarly interpretations or cases. While Gillette and Scott in fact give specific examples of potential ambiguities and refer to papers and texts, they cite only one USA CISG case on point, and unfortunately refer to Articles 7(a) and (b)[*sic*].¹⁵⁵ On irrevocability of offers, after discussing the legislative debate, they do not cite any cases or any of the many papers written subsequently to those debates.¹⁵⁶ Professor Bailey describes CISG rules on interpretation as 'so obscure', vague and 'elusive' that they inhibit uniformity, and argues that there is a lack of guidance as to how to implement interpretive rules,¹⁵⁷ and Scheaffer describes them as an

148. Estonia and China have withdrawn their Art. 96 declarations, Canada has withdrawn its Art. 95 declaration in relation to British Columbia: *CISG Status*, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (accessed 28 Feb. 2014).

149. Originally, Denmark, Finland, Norway and Sweden originally declared pursuant to Art. 92 that they would not be bound by Part II. Now only Norway remains an Art. 92 declarant state and is about to withdraw: *CISG Status*, above n. 148; Camilla Baasch Andersen, 'Reservations of the CISG: Regional Trends and Developments' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Globalization vs Regionalization* 1, 9 (Eleven 2013).

150. Castellani, above n. 70, at ix; Christopher Kee and Edgardo Muñoz, *In Defence of the CISG*, 14 *Deakin L. Rev.* 99, 110 (2009).

151. See above n. 148. Art. 95 declarations were made by China, Czech Republic, St Vincent and the Grenadines, Singapore, Slovakia and the USA: *CISG Status*, above n. 148. On the status of Germany, see Ch. 2, §2.03[B][2].

152. Li, Wei, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011 (reporting that on 29 Oct. 2011, the Treaty and Law Department of China recommended the People's Republic of China consider withdrawing both its declarations to the CISG).

153. Li, above n. 152; Andersen, above n. 149, at 11.

154. Gillette and Scott, above n. 131, at 448-49, 457, 462, 465-66, 468-69, 473-75; Walt, above n. 131, at 347; Stephan, above n. 141, at 774; James E. Bailey, *Facing the Truth*, 32 *Cornell Int'l L.J.* 273, 276, 286-94 (1999).

155. Gillette and Scott, above n. 131, *passim*.

156. *Ibid.*, at 475.

157. Bailey, above n. 154, at 276, 286-94.

impediment to uniformity on the basis of their ‘ambiguity and deficiency in providing for a hierarchical structure of interpretation’.¹⁵⁸ Nonetheless, somewhat mysteriously given his critique, Bailey asserts that a clear hierarchy is set down within Article 7, and sets out at length the policy choices within it.¹⁵⁹

Yet there is some truth in these criticisms. Some compromises did leave certain provisions ambiguous.¹⁶⁰ A recurrent argument is made that the notion and role of ‘good faith’ is a potential source of ambiguity.¹⁶¹ Certainly it is true that there is considerable variation in the definition of ‘reasonable’ length of time for notice of non-conformity.¹⁶² Gillette and Scott themselves nominate a number of examples, including the concepts of ‘sale’, ‘goods’, ‘reasonableness’ and ‘fundamental breach’ as ‘vague standards’ pervading the CISG.¹⁶³ These can be grouped as criticisms concerning scope or ambiguity leading to legal uncertainty.¹⁶⁴ However, at no stage are domestic laws shown to deal with similar issues in a more precise manner. In fact, as discussed below, one such author has also criticized the UCC on similar grounds.

In relation to good faith, this is a potential source of ambiguity,¹⁶⁵ and was a compromise reached during drafting.¹⁶⁶ However, the meaning and practical effect of good faith in the context of the CISG has been debated and explained in numerous cases and journal articles.¹⁶⁷ The original level of uncertainty regarding good faith has accordingly been substantially, albeit not completely alleviated (as discussed in Chapter 9), with the now numerous cases helping in this process of reducing uncertainty.¹⁶⁸ Depending on the goods, CISG cases have held that anything from 25 days to 4 months has been held unreasonable for Article 39(1), and (naturally) far less for perishables.¹⁶⁹ These considerable differences in what is considered a ‘reasonable’ time for notice of non-conformity may be slowly decreasing in severity. German courts initially interpreted ‘reasonable time’ as involving far shorter periods than those applied in courts in other jurisdictions, but are now increasingly recognizing that the

158. Christopher Scheaffer, *The Failure of the United Nations Convention on Contracts for the International Sale of Goods and a Proposal for a New Uniform Global Code in International Sales Law*, 15 *Cardozo J. Int'l & Comp. L.* 461, 477 (2007).

159. Bailey, above n. 154, at 286-94.

160. See Eörsi, above n. 127, passim.

161. CISG Art. 7(1), and potentially Art. 7(2). See Eörsi, above n. 127, at 349; Michael Joachim Bonell, *The UNIDROIT Principles of International Contracts and the CISG: Alternative or Complementary Instrument?*, 1 *Uniform L. Rev.* 26, 29 (1996); Bailey, above n. 154, at 294-96; Scheaffer, above n. 158, at 471-72. One aspect of good faith, precontractual liability, is discussed in Ch. 9.

162. Rechtbank [District Court] (Rb) Breda, Netherlands, 16 Jan. 2009, <http://cisgw3.law.pace.edu/cases/090116n1.html> (accessed 28 Feb. 2014) (watermelons, a few days): CISG-AC Opinion No 2, above n. 10; Schwenger, above n. 10, passim; Schwenger, above n. 75, passim.

163. Gillette and Scott, above n. 131, at 474; Stephan, above n. 141, at 777-78; Walt, above n. 131, at 346-47.

164. Gillette and Scott, above n. 131, at 469, 473; Cuniberti, above n. 141, at 1519. See also Scheaffer, above n. 158, at 464, 469.

165. See above n. 161.

166. As discussed in Ch. 9.

167. See further in Ch. 9.

168. See also Alison E. Butler, *Knowing When, Why, and How to “Opt Out” of the United Nations Convention on Contracts for the International Sale of Goods*, 76 *Fla Bar J.* 24, 26 (2002).

169. See above n. 162.

CISG notice period has an independent meaning from that under domestic law, and are now sensibly applying less strict periods for notice.¹⁷⁰ Admittedly Austrian courts may take longer to do the same, but it seems reasonable to expect they will be influenced by the German trend in time. Some convergence can be observed in relation to interest rates, which have generally been determined by rates prevailing in the country whose contract law was displaced.¹⁷¹ The CISG introduced new concepts such as fundamental breach, arguably making it ‘even more difficult for parties ... to know exactly what their respective rights and duties are and to predict probable outcomes of litigation.’¹⁷² The potential for uncertainty may constitute a disadvantage, and prompt parties to opt out.¹⁷³

It is important that the overall simplicity of the CISG’s provisions should not be mistaken as drafting trade-offs at the cost of certainty. The CISG was drafted to withstand long periods without amendment. The drafters knew a future Diplomatic Conference to alter it would be unlikely. In such an environment, development through decided cases and scholarship that could deal with unanticipated issues was a more suitable solution than unsustainable yet highly detailed provisions. It is true that the CISG followed a more civilian-style format of a highly structured but less detailed legislation, designed to withstand long periods without amendment, but this does not necessarily render it ‘vague’, uncertain or overly reliant on ‘standards’.

We should also recognize that much depends on the legal culture of the beholder’s eye. Common lawyers are frequently ‘accustomed to extremely detailed legislation’,¹⁷⁴ whereas this approach is considered superior by civilian lawyers, and not some ‘sad consequence of an unfortunate legislative process’.¹⁷⁵ In any event, even if precision and detail are desirable, surely the level of ‘vagueness’ inherent in the CISG can only fairly be criticized by comparison with alternative laws, not as an absolute matter.

It is refuted that the rules on interpretation are overly ambiguous, and instead submitted that they actually do provide clear hierarchical guidance balanced against a necessary degree of flexibility to enable future growth and development. A fairly consistent view of what Article 7(1) means has been developed and accepted by most scholars and courts, including at a fundamental level, the imperative of taking an

170. See above nn 98 and 99.

171. Tribunal Cantonal Valais, Switzerland, 19 Aug. 2003, <http://cisgw3.law.pace.edu/cases/030819s1.html#cx>; District Court Dolný Kubín, Slovak Republic, 21 Jan. 2008, <http://cisgw3.law.pace.edu/cases/080121k1.html>; ICC Award No 9448/1999, <http://cisgw3.law.pace.edu/cases/999448i1.html>; Court of Appeal (OLG) München, Germany, 2 Mar. 1994, <http://cisgw3.law.pace.edu/cases/940302g1.html> (each accessed 28 Feb. 2014).

172. Michael Joachim Bonell, in *Bianca & Bonell*, above n. 5, at 11 [2.2.1]. See also Walt, above n. 131, at 347.

173. The evidence is discussed in Ch. 6. For non-empirical speculation, see Ziegel, above n. 143, at 345–46; Patrick Thieffry, *Sale of Goods Between French and US Merchants*, 22 Int’l Lawyer 1017, 1033 (1988); Cuniberti, above n. 141, at 1511, 1515–16, 1518–19, 1544–47.

174. Ingeborg Schwenzer and Pascal Hachem, *The CISG - Successes and Pitfalls*, 57 Am. J. Comp. L. 457, 468 (2009).

175. Cuniberti, above n. 141, at 1549.

autonomous approach to interpretation, detached from domestic concepts and methodology, and consultation of jurisprudence from other jurisdictions and scholarship.¹⁷⁶

Notably, most critics appear to ignore the wealth of scholarship clarifying interpretive methodology. It is contended that the interpretive rules are evident and not unclear. Internal gap filling by reference to general principles followed, at last resort, by the law applicable pursuant to private international law of the forum is easily discernible as is the hierarchy within Article 7(2). Related but slightly less obvious, it is widely agreed that internal gap filling by liberal interpretation and analogous reasoning from other provisions within the CISG is also required.¹⁷⁷ The last part of the interpretive hierarchy follows as an obvious, if unstated proposition; matters not covered by the CISG, that is, external gaps outside its scope, must be dealt with by the law made applicable by the private international law of the forum.¹⁷⁸ The degree of adherence to the accepted approach by courts and tribunals in practice is of course more difficult and nuanced, but no more so than for any set of domestic interpretive guidelines. One cannot state that the CISG should have made clear the precedent value of cases¹⁷⁹ without ignoring the problems this may have created for national legal systems and simultaneously disregarding the clear view within the scholarship that foreign decisions are of persuasive but not binding value.

Of all the matters within Article 7, the least clear is certainly the reference to general principles, which are not enumerated.¹⁸⁰ It is true that one must again rely on cases and scholarship for guidance in this regard, and that some disagreement still arises, but at the same time, core principles are frequently not controversial at all. Therefore it is submitted that this does not render the CISG indeterminate per se, and certainly not relatively so by comparison with domestic interpretive mechanisms. Thus it is submitted that the interpretive methodology of the CISG itself does not involve a disadvantageous degree of substantive uncertainty.

Not all ambiguities were a by-product of compromises during the drafting process. Although one might expect degrees of differences of opinion between those who favour a bright-line test and others who prefer case-by-case flexibility, a certain level of flexibility can accommodate differences across transaction types. Excessive detail precludes a desirable level of flexibility to achieve this.¹⁸¹ Some variability in the definition of a reasonable time for notice of non-conformity is due to inevitable differences in each factual matrix. To the extent there is vagueness within the definition of 'fundamental breach' it should be remembered that the 'contours' of Article 25 are shaped by the express terms and circumstances of the transaction reflecting the parties' intent.¹⁸² In any event, it is submitted that the test is rather strict and not 'vague' when

176. See also Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, above n. 9, Art. 7; Camilla Baasch Andersen, Francesco G. Mazzotta and Bruno Zeller (eds), *A Practitioner's Guide to the CISG* 79-82 (Juris 2010).

177. See, e.g., Bonell, above n. 5, Art. 7, at 76 [2.3.1].

178. See Ch. 9, §9.03[A].

179. Bailey, above n. 154, at 293.

180. Walt, above n. 131, at 347; Bailey, above n. 154, at 296-99; Scheaffer, above n. 158, at 473-74.

181. Stephan, above n. 141, at 747.

182. Schroeter, above n. 20, Art. 25, at 398, 403-404 [9].

compared to alternative rules (discussed below in §4.03[B][9]). Common law tests relating to classification of contract terms are themselves by no means clear.¹⁸³ Thus while it is true that there are certain areas of ambiguity and divergence, they must always be tested against the background that in any law some extent of flux is inevitable. The development of the ‘knock out’ view within formation theory is an example. This does not mean that the CISG has ‘failed’. There can hardly be a legal system in existence without a degree of divergence or imprecision, or which does not undergo gradual development. What counts is whether a law is too unpredictable by comparison with its competitor choices of law (for a comparative discussion see §4.03[B] below). It is submitted that the certainty of the CISG now differs little from alternative domestic laws, although the homeward trend remains a concern. While criticisms regarding uncertainty are in part warranted, it is submitted they are seriously overstated. It should be remembered that the oft-touted alternative domestic choice of the UCC was similarly criticized for its reliance on standards and uncertainty.¹⁸⁴ Indeed, Gillette and Scott lament the ‘few bright-line default rules that are found in Article 2 of the [UCC]’.¹⁸⁵

Naturally it is important for parties to select a law which is reasonably developed and stable, and which offers accessible commentary and case opinions so parties can ascertain the content of the law,¹⁸⁶ since this reduces information costs associated with the transaction, thereby maximizing exchange gains. The guidance provided by judicial decisions and writings on a set of rules is part of the ‘package’ which a party selects when deciding to choose a particular law.¹⁸⁷ The criticism that the CISG is a novel law largely untested by the courts is no longer valid.¹⁸⁸ Contrary to the view that there is ‘virtually no caselaw’ on the CISG,¹⁸⁹ more than 2000 cases and plentiful scholarship are now available, which ameliorates many of the uncertainties originally created by drafting compromises, or simply by its former novelty. Naturally there are still some areas of disagreement, but the bare bones of the CISG are now fleshed out by much in the way of guidance. Closer attention to the abundance of material reveals that many criticisms about ambiguity have been overstated, certainly when compared with the level of indeterminacy found domestically.

The incomplete scope of the CISG may entail information costs associated with ascertaining the content of the subsidiary law for issues outside its coverage. Importantly, however, it does not differ in this respect from any domestic sales law,¹⁹⁰ and thus both involve the same learning costs in relation to matters outside their respective

183. Alastair C. L. Mullis, ‘Termination for Breach of Contract in C.I.F. Contracts Under the Vienna Convention and English Law’ in E. Lomnicka and C. G. J. Morse (eds), *Contemporary Issues in Commercial Law* 137, at nn 29-38 (Sweet & Maxwell 1997).

184. Schwartz and Scott, above n. 141; Cuniberti, above n. 141, at 1549.

185. Gillette and Scott, above n. 131, at 455-56.

186. Gary B. Born, *International Commercial Arbitration* 2220 (Kluwer 2009).

187. Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 Ga L. Rev. 363, 401-403 (2003).

188. *Contra* Walt, above n. 131, at 347; Stephan, above n. 141, at 777-78.

189. *Delchi Carrier SpA v. Rotorex Corp.*, 6 Dec. 1995, <http://www.cisg.law.pace.edu/cases/951206u1.html> (accessed 28 Feb. 2014) (cited in many subsequent cases).

190. *Contra* Cuniberti, above n. 141, at 1544.

scopes. The difference is that within the area covered by the CISG domestic law need not be consulted, thereby reducing information costs of ascertaining the content of a domestic sales law foreign to one or both parties to that extent – a non-substantive efficiency analysed in Chapter 5.¹⁹¹ The only remaining issue is the interaction between the two systems, also a matter discussed in Chapter 5. However, it is submitted that incompleteness of the CISG's scope per se, has no relevant effect at the substantive level.

It is submitted that the provisions of the CISG are not so vague as to detract from substantive efficiency, and can provide a necessary degree of flexibility to account for different transaction types. This enables default rules to be more closely tailored *ex post* by courts and tribunals, which may sometimes provide a more efficient solution by counteracting other inefficiencies such as high transaction costs and cognitive bias.¹⁹² Further, it should be recalled that the CISG allows parties to modify most of its rules,¹⁹³ and to derogate from any provision they deem unsuitable. In most cases, the CISG will match or surpass the degree of autonomy parties might enjoy under domestic law to modify the default rules, although of course, parties will still be subject to the relevant mandatory domestic laws.¹⁹⁴

Above it was concluded that the CISG interpretive methodology is not relatively uncertain by comparison with domestic interpretive methods, and that, although matters such as the general principles for internal gap filling were not settled within the CISG itself, the hierarchy of interpretive rules and the manner in which they are to be applied, are broadly accepted. Thus it is submitted that interpretive method does not constitute a relative substantive disadvantage.

One criticism which should not be dismissed is the means for the resolution of divergence in the CISG's interpretation by courts and tribunals. The influence of the homeward trend in court decisions is still a significant problem within the CISG, and critics of the CISG are right to point out that this causes uncertainty.¹⁹⁵ There is always the ever present danger courts will view the CISG through 'domestic lenses', a fear which has been borne out on a number of occasions.¹⁹⁶ The absence of a supranational

191. Cuniberti, above n. 141, at 1544 (CISG 'can only partially reduce...transaction' costs).

192. Russell Korobkin, 'Behavioral Economics, Contract Formation, and Contract Law' in Cass R. Sunstein (ed), *Behavioral Law and Economics* 116, 140 (Cambridge 2000).

193. CISG Art. 6.

194. See generally, Whincop and Keyes, above n. 111, at 527-29.

195. Scheaffer, above n. 158, at 469; Gillette and Scott, above n. 131, at 452, 479 & 485; Cuniberti, above n. 141, at 1517, 1545.

196. Michael G. Bridge, *Issues Arising Under Articles 64, 72 and 73 of the United Nations Convention on Contracts for the International Sale of Goods*, 25 J.L. & Com. 405, 405 (2005-6); Murray, above n. 133, at 367; Honnold, above n. 133, at 208; Ferrari, above n. 133, at 20. Notably, continued repetition in numerous US cases of the misleading 'tracking statement' in *Delchi Carrier SpA v. Rotorex Corp*, 6 Dec. 1995, above n. 189, leading many courts to incorrectly rely on UCC cases in CISG decisions. See, e.g., *Hanwha Corp v. Cedar Petrochemicals*, 18 Jan. 2011, above n. 50. The problem is also noted in Australia: above n. 100.

supreme judicial body to end divergences must be accorded serious weight.¹⁹⁷ Linguistic differences may exacerbate the homeward trend. Naturally, courts find it easiest to access materials in their own language, thus the practical availability of decisions decided in other jurisdictions may be limited by language issues. That is not to say uniformity is doomed. CISG cases often receive quick and insightful critique from scholars, and points of divergence receive far more attention and careful analysis than one might expect to find in relation to domestic sales cases. Frequently, a 'prevailing' body of opinion is discernable from cases and scholarly materials, and this reduces uncertainty. The establishment of an international court with appellate jurisdiction in relation to Contracting State courts would not be politically feasible,¹⁹⁸ nor would it be possible for an apolitical UNCITRAL to engage in an appraisal to 'approve or disapprove' of decided cases,¹⁹⁹ but the advent of the CISG Advisory Council, a private body of respected CISG scholars, has added a further authoritative voice for the amelioration of difficult issues.²⁰⁰

The problem of the homeward trend, or more particularly, lack of centralized judicial structure remains of real concern and potential disadvantage when compared with alternative domestic sales law. It is this issue in relation to substantive certainty, more than any other substantive concern that might give parties reason to question whether a choice of the CISG is efficient. The homeward trend problem must not be underestimated, but it is submitted that convergence within the CISG is now arguably approaching levels typical of those found in most sophisticated legal systems, and very familiar to those within federal systems, where the ultimate Supreme Court hears only a very small proportion of potential appeals. Leaving certain divergences unresolved for long periods. Yet conflicting decisions do not prompt allegations of failure' in the case of domestic codes, and nor should they in case of the CISG, given the current levels of divergence.²⁰¹ Some unpredictability in application is inevitable in any system of law, otherwise we would expect a complete absence of litigation. Fortunately for lawyers, this is rarely the case. It is therefore contended that there is undoubtedly some uncertainty remaining about certain areas within the CISG, perhaps for long periods, but that current levels probably no longer pose a significant disadvantage vis-à-vis competing choices.²⁰² Indeed, the tradition of swift and highly developed CISG scholarship and influence of the CISG Advisory Council may prove a faster avenue to the identification of fruitful convergent paths than is presently the case within the domestic law of some more fragmented jurisdictions.

197. See, e.g., Bonell, above n. 5, Art. 7, at 89 [3.1.2]; Schwenger and Hachem, above n. 174, at 468 (this is a 'severe deficit'); Gillette and Scott, above n. 131, at 452, 485; Cuniberti, above n. 141, at 1517, 1545; Kee and Muñoz, above n. 150, at 114-15.

198. Kee and Muñoz, above n. 150, at 110.

199. Bailey, above n. 154, at 310 (suggesting this approach).

200. CISG Advisory Council Website: <http://www.cisgac.com/>. The views of the CISG-AC are persuasive only, but might be expected to carry the weight a court might accord to the opinion of an eminent scholar: Joshua D. H. Karton and Lorraine de Germiny, *Can the CISG Advisory Council Affect the Homeward Trend?*, 13 *Vindobona J. Int'l Commercial L. & Arbitration* 71 (2009).

201. Kee and Muñoz, above n. 150, at 110.

202. *Contra* Cuniberti, above n. 141, at 1517.

One should also note that many CISG decisions take the form of arbitral awards. However, since most award decisions are unpublished, their nature is often overlooked. Accordingly, the influence of the homeward trend may in fact be less powerful than it might otherwise appear, simply because most arbitral decisions are not taken into account, since it can be presumed arbitrators will often take a more internationalist view.²⁰³

Even if one were to accept that the level of uncertainty within the CISG is somewhat higher than for alternative domestic sales law, one should be careful not to lose sight of the other substantive and non-substantive economic effects of the CISG, which may on balance overshadow any perceived inefficiency due to the effect of the homeward trend.

[J] Preliminary Conclusion

Importantly, it was noted above that CISG provisions are closely geared to the needs of international transactions, and that its design features, which are aimed at keeping contracts on foot, generally lead to significantly greater efficiency in international trade.

It is thus submitted that the CISG contains default rules which promote efficient behaviour in the context of cross-border contracts for sale, by promoting disclosure of risks and encouraging performance and self-help remedies. Uncertainty exists in some areas; however, most criticisms in this respect are overstated and fail to take an in-depth account of the current state of development of the law.

It appears that, in general terms, the CISG's substantive rules are efficient. Non-substantive issues affecting its efficiency are yet to be examined (see Chapter 5).

§4.03 'EFFICIENCY' OF SUBSTANTIVE CONTENT FROM INTER SE, COMPARATIVE AND TRANSACTIONAL PERSPECTIVES

The above section identified some significant substantive features of the CISG, and discussed whether they could be described as efficient in a general sense. This section analyses those substantive features from different perspectives: briefly, as between the parties inter se; then for relative efficiency when compared with alternative competing laws. Mention will also be briefly made of transactional considerations.

[A] Advantages and Disadvantages – Inter Se

The substantive features described above will be sometimes advantageous, and on other occasions disadvantageous for particular parties. Neutrality is an important

203. See, e.g., Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* [5.48] (Oxford 2012). *Contra* Petra Butler, 'CISG & International Arbitration - A Fruitful Marriage?', presentation, Albert H. Kritzer Conference on the CISG, Sao Paulo, Brazil, November 2011.

substantive characteristic of a desirable choice of law, and experienced arbitrators urge parties to seek a 'neutral, predictable body of law'.²⁰⁴ Arguably, the interpretive rules of the CISG and its general principles favour neither buyers nor sellers.

One might argue that the requirement of notice of non-conformity specifying the nature of the defect within a reasonable time on pain of loss of remedies provides an advantage to the seller, who could escape liability for non-conformities if the transaction happens to be with a buyer who is lax in communication. The seller can also take comfort from the fact that under the CISG, the buyer generally cannot reject the goods and bring the contract to an end for minor non-conformities in most cases, unlike the common law perfect tender rule.²⁰⁵ Of course a fundamental breach can trigger the end of the contract, but lesser non-conformities will simply result in a damages claim, price reduction, or a request to rectify the problem. The seller also benefits from a right to cure provided this does not cause unreasonable delay or inconvenience, although the buyer may still seek damages.²⁰⁶

However, the buyer enjoys countervailing advantages. If the goods have still not arrived by the delivery date, the buyer can resolve the uncertainty as to when failure becomes serious enough to warrant avoidance of the contract, by simply setting an additional reasonable time for delivery.²⁰⁷ If the seller fails to comply, or declares they will not, the buyer can then confidently declare the contract avoided.²⁰⁸ The buyer need not be left in the uncertain position as to whether time was 'of the essence'. The buyer is also given the advantage of unilateral price reduction for non-conformity.²⁰⁹ This self-help remedy is available for both mere non-conformity and fundamental breach, although in practical terms, it will be of little comfort if a letter of credit has already been provided.

In relation to damages, the CISG's selection of the date for delivery as opposed to the date for performance as the relevant time for calculation of the difference between market price and the contract price in measuring damages is a more neutral choice since it tends to preserve the bargain rather than afford the aggrieved party a chance to speculate at the breaching party's expense. By contrast, more asymmetric systems such as the UCC may afford 'breachers with excessive incentive to perform' while simultaneously providing aggrieved parties with inefficient opportunities to speculate.²¹⁰

Overall, the substantive balance achieved is reasonably even.²¹¹ Arguably, therefore, from the perspective of the counterparties, the content of the CISG does not

204. Born, above n. 186, at 2220.

205. CISG Advisory Council, CISG-AC Opinion No 5, above n. 8, *Commentary* [2.2] nn 18–22 (but different treatment for certain commodity transactions); Butler, above n. 168, at 28; Ziegel, above n. 1, at 124 (buyer right of rejection weaker than UK law).

206. CISG Art. 48.

207. CISG Art. 47.

208. CISG Art. 49(1)(b).

209. See above n. 6.

210. See Katz, above n. 26, at 388 n. 38. See discussion below at §4.03[B][4].

211. Sandra Saiegh, 'The Business Lawyer's Perspective' in Fletcher, Brand & Walter, above n. 43, at 257 (referring to the 'myth' amongst in-house counsel that CISG favours buyers); Ingeborg Schwenzer, 'The CISG: A Global Story of Success' paper presented at Monash University,

unduly advantage nor disadvantage either party vis-à-vis the other. This conforms with the aim of drafters to produce a substantively ‘neutral’ instrument.²¹² Thus on its face, the CISG does not by its substantive content shift costs between sellers and buyers, so in this sense at least, it is neutral inter se.

It could be argued neutrality is unimportant because risk allocation can always be accounted for in the price, however, it is submitted that the aim of neutrality is consistent with the notion that a law which is more frequently chosen is, *ceteris paribus*, a more efficient choice due to network effects,²¹³ and thus, in order to maximize its appeal to both buyers and sellers and hence its (non-substantive) efficiency, a sales law should contain substantive rules that are relatively neutral inter se.

[B] Efficiency: Relative to Competing Law

In order to determine whether they are relatively more efficient, competing choices of law should be compared to the CISG. It might be generally stated that the CISG offers a superior choice to less developed laws in unsophisticated domestic systems.²¹⁴ But how does it compare with the law applicable to sales in a sophisticated legal system?

It would be impossible to conduct a survey of the provisions of all or even the major competing choices in the space available here. For present purposes, it is therefore proposed to briefly examine some major aspects of the UCC and English law, and to consider their comparative effect vis-à-vis the CISG. The reason for this selection is that English and US law are amongst the most frequently chosen in international trade.²¹⁵ They are also argued by some to provide superior rules to the CISG (upon the CISG’s exclusion in the case of the US). Although there are variations from state to state, the New York enactment of the UCC is taken as the main reference point for US law. A few brief references will be made to Swiss and German law where relevant.

Some writers have undertaken the comparison in mind here. The majority have understandably been US scholars, who have been described in one paper as simply reinforcing ‘prejudices’ by describing the CISG as ‘unpredictable, imprecise, not being suited for the needs of (American) international trade, in short; being clearly inferior to

Melbourne, Australia, 5 Feb. 2009 (buyer and seller advantages cancel one another out); Mathias Reimann, *The CISG in the United States*, 71 *Rabels Z* 115, 125 (2007) (CISG is balanced); Corinne Widmer and Pascal Hachem, ‘Switzerland’ in Franco Ferrari (ed), *The CISG and its Impact on National Legal Systems* 281, 297 (Sellier 2008).

212. See Ch. 3, nn 43-45 and accompanying text.

213. Network effects in choice of law are discussed in later chapters, but were already briefly introduced in Ch. 3, §3.04[E].

214. Cuniberti, above n. 141, at 1518.

215. English, New York and Swiss law have been identified by respondents to surveys as their preferred choice of law (other than the law of their home jurisdiction): Vogenauer and Hodges, above n. 135, at 15, 16, Questions 17.4 & 18; School of International Arbitration at Queen Mary, University of London, *International Arbitration Survey* (2010), 11, 15, http://www.arbitrationonline.org/docs/2010_InternationalArbitrationSurveyReport.pdf (accessed 28 Feb. 2014) (reporting corporate counsel respondents, after their own law, preferred English law (40%), New York Law (17%), or Swiss law (8%)).

the Uniform Commercial Code.²¹⁶ The modest aim here is to attempt to assess the effect of any real differences in terms of efficiency.

In an interesting analysis, Cantora concludes that the CISG is an ‘economically efficient and beneficial’ law for US businesses.²¹⁷ He compares the CISG with the UCC to determine their comparative efficiency in relation to five points of comparison: formality requirements; the parol evidence rule; foreseeability of damages; price terms; and quantity terms. While the approach is inherently useful and to be admired, it must be noted that even the choice of issues as points of comparison is dependent on legal cultural background. One cannot imagine a civilian lawyer comparing the CISG with a civil code of obligations for efficiency in relation to the parol evidence rule.

Nonetheless, Cantora’s approach is adopted here, albeit for both US and English law, and expanded to at least nine substantive issues. Considerably more points are addressed, however, since in relation to ‘vii. *Favor Contractus* & Notice’ below, multiple rules are considered within the one issue.

[1] ‘In Writing’ Requirement

The UCC contains a ‘writing requirement’ in §2-201 for contracts of sale for goods of greater than USD 500.²¹⁸ Cantora reasons that it cannot be a ‘majoritarian’ rule, since this is not generally “‘what the parties’” would have wanted when they entered the deal’,²¹⁹ nor a penalty default rule since it provides no ‘important and significant information that would lower the otherwise high *ex-post* litigation costs for both the parties and the publicly subsidized court system’ other than quantity.²²⁰ He surmises it is ineffective in achieving its original aim of prevention of fraud, and in eliciting information that might lower *ex post* costs of litigation,²²¹ and concludes the UCC rule is inefficient because it simply raises transaction costs without any corresponding benefit. By contrast he argues that the CISG’s rejection of formality requirements in Article 11 is more efficient since, relative to the UCC, it decreases *ex ante* transaction costs.²²²

Since 1954 English law has not included a general formality requirement for sales, and is therefore equally efficient as the CISG in this regard.²²³

216. Ingeborg Schwenzer, *The Application of the CISG in Light of National Law*, 2 Internationales Handelsgericht 45, n. 86 and accompanying text (2010).

217. See, e.g., Schwartz and Scott, above n. 141, at 601 (discussing moral hazard in UCC standards); Cantora, above n. 108, at 113.

218. Uniform Commercial Code §2-201(1), as enacted in New York as at 2010-11 <http://codes.lp.findlaw.com/nycode/UCC/2/> (‘UCC’).

219. Cantora, above n. 108, at 125.

220. *Ibid.*, at 126 n. 90 (emphasis omitted).

221. *Ibid.*, at 126-27.

222. *Ibid.*, at 127.

223. L. S. Sealy, ‘Formation of the Contract’ in *Benjamin’s Sale of Goods*, above n. 2, at 97, 111 [2-022].

[2] Parol Evidence Rule

The CISG has not adopted the parol evidence rule: Articles 8(3), 9 and 11.²²⁴ In England, the rule was perhaps best described in 1986 as a circular legal proposition to the effect that when it is proved the parties intended all the terms of their agreement should be recorded in a document or documents, other evidence, by its very nature, is irrelevant and thus inadmissible.²²⁵

Cantora describes the parol evidence rule in UCC §2-202 as a ‘majoritarian’ default rule. He reasons that investment in *ex ante* costs of memorialization of terms makes it likely parties would have intended that such terms were not to be later contradicted by other evidence, since ‘[t]he very act of their agreeing to memorialize the term in the first place, negates the possibility that either party did not actually want that term to be the true evidence of their agreement’.²²⁶ Thus he reasons that parol evidence rule has ‘proven utility’ as an efficient default rule, particularly since the UCC version allows written terms not to be contradicted but ‘explained’ or ‘supplemented’ by other evidence if ambiguous, unless parties have agreed the written agreement to be complete and exclusive.²²⁷ Cantora concludes that the CISG’s rejection of the parol evidence rule is thus inefficient by comparison with the UCC rule, since the latter effects a ‘majoritarian rule which reduces both the *ex ante* transaction costs of the parties, and the *ex post* litigation costs to the parties and society’.²²⁸ On this reasoning, the same conclusion would be drawn in relation to English law vis-à-vis the CISG.

While it is easy to see how the parol evidence rule might reduce *ex post* litigation costs in the sense that less evidence can be brought to bear about the nature of the transaction, it is more difficult to conclude that it is efficient per se. Certainly, the existence of the parol evidence rule might tempt more parties to invest in *ex ante* memorialization costs, but whether this is efficient in terms of reduced litigation costs *ex post* is difficult to say.

Entry into contracts is a common occurrence, whereas litigation is relatively rare, so what the parol evidence rule appears to encourage is greater *ex ante* costs with little return, other than perhaps some societal gains from some discouragement of litigation based on oral terms where contrary written evidence exists. Additionally, given that the parol evidence rule allows other evidence when written terms are ambiguous, the reduction in *ex post* costs where litigation does occur may be reasonably small, since it may take little effort in most cases to find some measure of ambiguity, especially in international settings where differences in language and culture are likely.

As is the case under the UCC and English law, the existence of a ‘merger agreement’ will prevent other evidence from being adduced under the CISG, except to the extent of explaining the meaning of the merger agreement itself.²²⁹ Thus it is

224. CISG Advisory Council, CISG-AC Opinion No 3, above n. 43, at §1, *Comments* [1.1.1].

225. English Law Commission, *Law of Contract, The Parol Evidence Rule* (Cmnd 9700, January 1986) [2.7].

226. Cantora, above n. 108, at 128 n. 96 (emphasis omitted).

227. UCC §2-202(b); *ibid.*, at 128 nn 98, 99.

228. Cantora, above n. 108, at 129.

229. CISG Advisory Council, CISG-AC Opinion No 3, above n. 43, at §3.

submitted that in fact the CISG may be the more efficient solution, especially for international transactions.

[3] *Foreseeability of Damages*

Both the CISG and the *Hadley* rule (applicable in both the UK and the US)²³⁰ limit recovery of consequential damages to only those foreseeable at the time of the contract. Both operate as information-forcing penalty default rules, providing incentives for a relatively informed party to disclose information to the least cost avoider.²³¹ As many have observed, the wording in the CISG is different from the *Hadley* rule in the sense that it limits recovery of losses foreseen or foreseeable as a ‘possible’ consequence of the breach in Article 74, rather than those contemplated as the ‘probable result of the breach’ in *Hadley*.²³² The wording of Article 74 CISG broadens the availability of consequential damages by setting a lower threshold for recovery than *Hadley*.²³³ The mixed subjective and objective elements of foreseeability in *Hadley*²³⁴ are more clearly distinguished within the CISG,²³⁵ and certainly the limitation appears more generous than the ‘50%’ limitation implied by ‘probable’ loss under *Hadley*.²³⁶

Yet this is an incomplete picture. Damages have been denied as ‘unforeseeable’ pursuant to the CISG, so plainly not every possible claim is recoverable.²³⁷ A less obvious limitation is the effect of Article 8(2) CISG. Statements of parties must be given the meaning that would be understood by a reasonable person in such circumstances.²³⁸ Arguably it follows that disclosures can only extend liability for those damages that a reasonable person might have understood would flow from the facts disclosed. Thus the CISG threshold is not as low as it might first appear.

Nonetheless, it must be acknowledged that the threshold in the CISG does appear somewhat lower than under *Hadley*. It must be concluded that, relative to US and English law, CISG buyers have greater incentives to disclose, and that this raises *ex ante* transaction costs accordingly. However, the benefits of greater disclosure must also be taken into account. Relative to the higher thresholds under these alternative

230. *Hadley v. Baxendale* [1854] 9 Ex 341; 156 ER 145 (UK), Courts of Exchequer, 23 Feb. 1854. See American Law Institute, *Restatement (Second) of Contracts* (1981) §351.

231. Cantora, above n. 108, at 129; Ayres and Gertner, above n. 24, at 101-104, 108; Ayres and Gertner, above n. 105, at 735.

232. *Hadley v. Baxendale*, above n. 230.

233. Murphey, above n. 106, at 439-40; Nicholas, above n. 106, at 230; V. Susanne Cook, *The UN Convention on Contracts for the International Sale of Goods: A Mandate to Abandon Legal Ethnocentricity*, 16 J.L. & Com. 257, 260 (1997); Cantora, above n. 108, at 130.

234. G. H. Treitel, *Remedies for Breach of Contract: A Comparative Account* 155 (Clarendon 1988).

235. Djakhongir Saidov, *Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods*, 14 Pace Int'l L. Rev. 307, 315 & 341 (2002); Spagnolo, above n. 100, at 179-180.

236. See above n. 232.

237. See, eg, *Re Siskiyou Evergreen, Inc. (Debtor)*, above n. 107 (rejection of third party contracts unforeseeable and therefore lost profits could not be claimed pursuant to Art. 74).

238. See Oberster Gerichtshof [Supreme Court](OGH), Austria, 14 Jan. 2002, above n. 106 (‘Generally an objective standard is applied for foreseeability. The obligor must reckon with [what] a reasonable person in his situation (art 8(2) CISG) would have foreseen ... Whether he actually did foresee this is ... insignificant’).

laws, the CISG arguably produces more accurate risk allocation and pricing, reduced cross-subsidization of buyer risks,²³⁹ more efficient avoidance of risk by the least-cost avoider, and accordingly, improves exchange values and results in greater social welfare gains by comparison with competitor laws. This is particularly so in international settings, where buyer risk may be more difficult to ascertain without buyer disclosure thereby heightening information asymmetry, and where consequential risks may also be far higher.

However, information-forcing penalty rules are efficient only if transaction costs of disclosure are not greater than the efficiency gains. In this vein, Cantora argues that the rule in the CISG is relatively inefficient by comparison with the *Hadley* rule, since the increase in transaction costs under the CISG overshadows any efficiency gains.²⁴⁰

It is true that the CISG threshold is still lower than under *Hadley*, even if it is not quite as generous as it might first seem. Cantora concludes the difference means that while US law provides an incentive to disclose information only about probable events, under the CISG, informed parties are given a strategic incentive to provide information about every possible contingency, thus raising *ex ante* costs 'exponentially'.²⁴¹ Katz disagrees, concluding that the foreseeability test in Article 74 simply imposes a limitation 'better encouraging *ex ante* disclosure'.²⁴²

As discussed earlier, it is submitted that there are incentives militating against excessive disclosure in any event, such as buyer-borne costs of disclosure, discounting of anticipated gains from disclosure by the probability of disputes arising, additional negotiation or drafting costs entailed in tailoring the price or terms for individual risk, and the desire of some parties to remain indistinguishable from the 'pool' in terms of risk profile by strategic withholding and voluntary self-insurance, especially where the buyer is the least-cost avoider. Accordingly, at some point the low likelihood of the gain eventuating will be not worth the *ex ante* costs of disclosure and specifically dealing with the risk in the contract,²⁴³ and it is therefore contended that disclosure disincentives are likely to prevent efficiency gains from being overshadowed by remote risks.

As mentioned earlier (in §4.02[G] above), the *Hadley* rule decreases strategic incentives for parties to stay in the 'pool' in order to achieve price cross-subsidization.²⁴⁴ The penalty default rule is stronger pursuant to the lower threshold in the CISG. It follows that disclosure is likely to be more extensive under the CISG than alternative English or US laws. Thus moral hazard and concomitant rent-seeking²⁴⁵ is reduced further under the CISG than competitor laws, since its incentives better encourage risk avoidance by the party best placed to do so and/or efficient price adjustment to match risk allocation, and reduction of potential litigation costs by facilitating evidence of *ex ante* subjective knowledge.

239. Ayres and Gertner, above n. 24, at 94-95, 112. See also Whincop and Keyes, above n. 111, at 524; Posner, above n. 113, at 20.

240. Cantora, above n. 108, at 131.

241. *Ibid.*

242. Katz, above n. 26, at 388.

243. See generally, Triantis, above n. 21, at 111. But see Gillette, above n. 24, at 575.

244. Ayres and Gertner, above n. 24, at 94-95, 101-104, 108.

245. Victor Goldberg, *Readings in the Economics of Contract Law* 49 (Cambridge 1989).

Like the CISG, the *Hadley* rule also imposes penalty defaults to encourage parties to deal with the risk of consequential loss, but under alternative English and US domestic law, the risk more frequently will remain with the party least able to avoid it due to the higher threshold, while under the CISG, the risk is likely to be more frequently either reduced and/or specifically allocated. Arguably, the CISG more closely performs one of the key economic functions of law – allocation of risk to the party in the superior position to minimize it, and disclosure to support ‘separating’ of risk profiles. This reduces the likelihood of cross-subsidization by spread of risk in the form of higher prices to all buyers, and allows the more accurate pricing of transactions generally. It also encourages efficient minimization of risk.

As submitted above (in §4.02[E] above), there is good reason to believe that disclosure disincentives relating to ‘excessive’ disclosure of remote risks will prevent disclosure costs from overtaking these gains. The CISG thereby arguably improves net exchange gains and social welfare gains from contracting by encouraging somewhat higher levels of disclosure regarding buyer risks. It is submitted that the foreseeability penalty default rule in the CISG is efficient, especially when one takes into account the greater likelihood of information asymmetry and greater unwinding costs involved in international transactions.

[4] *Measure of Damages*

Katz commends the more liberal approach to damages in the CISG as relatively efficient by comparison with the domestic US rule in the international context of ‘relatively high transportation costs [which] tend to make cover and resale less feasible than in comparable domestic transactions’.²⁴⁶ He argues that ‘in at least three respects’ the CISG measures expectation damages ‘more accurately’ than the UCC,²⁴⁷ due to: the explicit duty to mitigate in the CISG Article 77, which he contrasts favourably with the ‘implicit and incomplete treatment afforded under UCC §2-706 and §2-712’; default availability of interest pursuant to Article 78; and timing of market price at the time of avoidance for the purposes of damages for the difference between contract and market price.²⁴⁸ In regard to the latter, Katz compares the solution in Article 76 favourably with UCC §§2-708 and (arguably) 2-713, which states:

Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller’s breach.

This effectively peg the market price at the time of performance, ‘thus granting the aggrieved party an undeserved an[d] inefficient speculative opportunity, and giving potential breachers an excessive incentive to perform’ amounting to an ‘asymmetric

246. Katz, above n. 26, at 388.

247. *Ibid.*

248. *Ibid.*, at 388.

treatment of buyers and sellers'.²⁴⁹ He therefore concludes the remedial structure of the CISG in most respects is comparatively efficient for international sales vis-à-vis the UCC.²⁵⁰

Like the UCC, English sales law prima facie takes the difference between contract price and market price for non-delivery using the date for delivery as the measure of the lost expectation.²⁵¹

It is submitted that Katz's analysis is broadly correct. The CISG does contain an approach to damages more suited to the context of international sales, and a clearer rule in relation to mitigation than the UCC. Insofar as the CISG reduces the opportunity for speculation by pegging damages at the time of avoidance pursuant to Article 76, it is likewise arguable that it provides a more efficient rule than English law, at least in this respect.

While the formula used in Article 76 would seem to reduce inefficient speculation, one could argue Article 77 would in any event preclude opportunism. However, this is irrelevant since a mitigation rule naturally applies in all three systems. Clear selection of a time for measuring damages at the time of avoidance provides incentives for efficient behaviour and preservation of the pre-existing risk allocation, and it is this that amounts to the relevant point of difference.

[5] *Formation and Missing Terms*

The UCC allows contracts to be concluded validly without an agreed price, by inserting 'a reasonable price at the time for delivery' in absence of agreement, which is generally interpreted to mean the 'prices charged by other sellers of similar products' or 'market price'.²⁵² He states that this rule is 'majoritarian' and 'eliminates the ex-ante transaction costs of complex negotiations for every price term detail' without large increases in *ex post* litigation costs since 'contemporaneous market pricing is not difficult to ascertain'.²⁵³ After determining that Article 55 'mirrors' the UCC's rule, he concludes that both provide efficient 'majoritarian' default rules.

As it is unlikely that parties will deliberately omit negotiation on price, the rule probably does not in fact reduce *ex ante* costs in the sense that parties would consciously rely upon gap-filling by default rules to refrain from negotiation on price. Their real benefit appears to be the function of upholding contracts by supplying a term omitted in error, which might otherwise lead to the dissolution of the contract and large *ex post* costs to unwind the transaction. They both represent rules in which it is not too burdensome for adjudicative gap-filling to occur, provided active markets for the goods exist. As such, the existence of a gap-filling price rule is clearly a majoritarian approach.

249. *Ibid.*, at 388 n. 38.

250. Yet Katz is critical of the formula utilized in the CISG regarding price reduction: *ibid.*, at 388.

However, see discussion about the nature of this criticism: above text at n. 125.

251. Michael Bridge, *The Sale of Goods* 747 [12.03] (Oxford 2nd edn, 2009).

252. See *Commentary*, §2-201(1) UCC as enacted in New York; Cantora, above n. 108, at 132 n. 120; Posner, above n. 113, at 96.

253. Cantora, above n. 108, at 132-33.

In England, the *Sale of Goods Act 1979* (UK)²⁵⁴ states:

Section 8(1): ‘The price in a contract of sale may be fixed by the contract, or may be left to be fixed in a manner agreed by the contract, or may be determined by the course of dealing between the parties’.

Section 8(2): ‘Where the price is not determined as mentioned in subsection (1) above the buyer must pay a reasonable price’.

Thus section 8(2) applies so that the buyer must pay a reasonable price where the price ‘is not determined’.²⁵⁵ The section codifies earlier case law whereby the buyer would be liable for the price upon an *indebitatus* count of goods sold and delivered, determined at the reasonable/fair/market value of the goods as at the time of delivery.²⁵⁶ In Swiss law, the ‘average price’ at the time of performance applies.²⁵⁷

Price gap-filling default rules appear to provide a majoritarian approach. A difference exists between the CISG and the US and English positions (and the Swiss approach) in the timing of the default price. The CISG relies on the price at the time the contract was concluded for goods in similar circumstances.²⁵⁸ In the case of US, English and Swiss laws, the relevant time is that of performance/delivery. It is submitted that the time of conclusion is a more efficient rule, since it discourages speculative conduct by the seller, who might have ‘purposely kept back’ the goods,²⁵⁹ thus making the price at the date of delivery far from objective or ‘reasonable’, resulting in less accurate contract pricing in the sense of the price that the parties would have intended *ex ante*. By pricing at the time of conclusion, the result closest to what parties would probably have bargained for is achieved. Arguably, this makes the CISG rule more efficient.

By contrast, neither the UCC, English law, nor the CISG supplies missing quantity terms. Moreover, pursuant to formality requirements, the UCC requires that the quantity be written, and where it is not, renders the contract unenforceable.²⁶⁰ Cantora describes this as a non-majoritarian penalty default rule, which effectively forces the parties to turn their minds to the question of quantity, since it is more efficient for them, rather than the courts, to establish the quantity term.²⁶¹ He points out that Article 14 CISG also requires the quantity in order for a valid offer, and concludes that the two rules are functionally equivalent and efficient.²⁶²

254. *Sale of Goods Act 1979* (UK).

255. See Bridge, above n. 251, at 30 [1.41].

256. *Ibid.*, at 30-31 [1.42] & [143]; Sealy, in *Benjamin’s Sale of Goods*, above n. 223, at 122-23 [2-047] (the claim is contractual, but a restitutionary *quantum valebant* could be awarded if the contract is discharged, void or unenforceable).

257. Florian Mohs, in *Schlechtriem & Schwenzler* 3rd edn, above n. 9, Art. 55, at 815, 820 [14].

258. *Ibid.*, at 820-21 [14].

259. Sealy, in *Benjamin’s Sale of Goods*, above n. 223, at 123 [2-047].

260. UCC §2-201(1); Cantora, above n. 108, at 133.

261. Cantora, above n. 108, at 134. See also Ayres and Gertner, above n. 24, at 95-96.

262. Cantora, above n. 108, at 134.

[6] **Formation ('Last Shot' versus 'Knock Out' Rule)**

An aspect not considered by Cantora is the effect of formation provisions. As noted above, the CISG is traditionally viewed as employing the 'last shot' theory, but has increasingly been interpreted pursuant to a 'knock out' approach.²⁶³ English law essentially adopts the 'last shot' approach.²⁶⁴ It accepts that, sometimes even where paramountcy stipulations exist, the parties' performance may demonstrate a contract existed and thus an examination of the exchange of terms must be conducted to determine which terms ultimately prevailed.²⁶⁵ The UCC rejects the 'last shot' approach in favour of 'knock out' theory in §2-207.

Professor Ben-Shahar analyses the *ex ante* effects of these two approaches in terms of the incentive for parties to read terms and to draft moderate terms rather than one-sided terms.²⁶⁶ He concludes that the 'last shot' approach encourages parties to read terms, but also to draft in a one-sided manner, whereas the knock out approach induces moderation in drafting depending on whether the background default rules favour or disfavour the drafter.²⁶⁷ He argues that the UCC favours buyers, so sellers have an incentive to draft more moderately under the 'knock out' rule, but buyers do not, and neither have an incentive to read terms.

Ben-Shahar proposes instead that Victor Goldberg's 'reasonable shot' approach pursuant to which courts would select the most reasonable of the terms proposed by both sides, and he argues that this gives both sides an incentive to draft moderate terms, in theory motivating a 'race to the middle', and nullifying the incentive to engage in a 'battle of the forms' altogether.²⁶⁸

As litigation costs are higher in international trade than domestic sales, Ben-Shahar's 'reasonable shot' proposal might provide even stronger incentives to offer moderate terms than would otherwise be the case for domestic traders, although the theory does not appear open on the basis of the CISG's provisions. However, it seems likely that, if, as submitted above, the CISG is relatively neutral as between buyer and seller, that the knock-out approach might spread the incentive to draft moderate terms more evenly between buyers and sellers than under the UCC, in addition to the potential improvement to the CISG's efficiency by comparison with adherence to the 'last-shot' method discussed earlier (in §4.02[B]).

However, the relative efficiency of the CISG compared with domestic sales law should be considered in light of another potential effect of the 'knock out' theory. As opposed to the 'last shot' theory, the knock out rule is sometimes said to reduce the predictability of transaction terms, therefore increasing performance and litigation costs, as discussed above in §4.02[B]. Indeed, at least one German practitioner has observed that one reason German lawyers often try to avoid domestic German sales

263. See above n. 46 and accompanying text.

264. Bridge, above n. 42, at 538 [11.09].

265. Sealy, in *Benjamin's Sale of Goods*, above n. 223, at 104-105 [2-014].

266. Ben-Shahar, above n. 45, *passim*.

267. *Ibid.*, at 352-56, 363-67.

268. *Ibid.*, at 357-60, 367.

law is to avoid the uncertainty raised by the domestic knock out rule,²⁶⁹ and Flechtner has commented that such uncertainty could endanger the CISG itself.²⁷⁰

It is submitted that the better view is that the knock out rule provides an efficient outcome under the limited circumstances discussed earlier, and that any uncertainty and transaction costs caused by it would probably be off-set by its efficient majoritarian nature, as well as the *ex ante* benefits flowing from the incentive towards moderate terms. On this basis the approach developing within the CISG should be considered an attractive alternative to English domestic rules, and just as efficient as the UCC rule.

[7] Favor Contractus and Notice

Another aspect not considered by Cantora is the threshold for unwinding the contract. It was noted above that the CISG was designed to uphold the principle of *favor contractus*, with the difficult test of fundamental breach and certain features designed to facilitate keeping the contract on foot should problems arise, being at the forefront of its design. The suitability of these features will differ depending on the transaction type,²⁷¹ but it is submitted that, in general terms, they are more efficient for international sales than laws which more easily facilitate the unwinding of contracts. Thus while specific performance under normal conditions might lead to ‘insufficient breach’ in economic terms,²⁷² the underlying assumptions must be adjusted in the international context.

As previously discussed, costs of returning goods will often be prohibitive in cross-border transactions, and there is also the added difficulty of disposal of rejected goods in a foreign country. Thus remedies of a damages claim, price reduction or repairs might well be more economically efficient in an international setting.²⁷³ Overall reduction in the cost of performance creates a larger exchange surplus available to be shared between the parties. Furthermore, such a rule is most probably ‘majoritarian’ in that this is what parties engaged in cross-border trade would probably want, assuming they are fully cognizant of the high costs of alternative rules in the international context, and informed of the continued availability of damages.

On the other hand, the UCC and English sales law provide for the right to reject the goods,²⁷⁴ or alternatively, to terminate upon breach of terms characterized as conditions ‘casuistically’ distinguished from warranties. The UCC has been criticized as ‘marred in this area by technical and insubstantial distinctions’.²⁷⁵ Pursuant to UCC Article 2-601, acceptance of the goods can also subsequently be revoked if it can be

269. Burghard Piltz, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

270. Harry M. Flechtner, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

271. Briefly discussed below in §4.03[C], and again in Ch. 5.

272. Triantis, above n. 21, at 105.

273. *Contra* Cuniberti, above n. 141, at 1512 (criticizing CISG scholars for purely asserting reduced costs without explanation).

274. See *Sale of Goods Act 1979* (UK) ss 13-15, as modified by s. 15A for implied terms; UCC §§2-601, 2-602 & 2-608 (rejection, revocation and acceptance).

275. Honnold, above n. 8, at 20 n. 9 [27].

shown that the non-conformity ‘substantially impairs’ their value to the buyer, but this is to be distinguished from reliance on the ‘perfect tender’ rule prior to acceptance of the goods. As mentioned earlier, it might be said that English common law tests for classification of contractual terms are by no means clear.²⁷⁶ Although the development of intermediate terms in common law brings it a little closer to the first part of the test for fundamental breach in the CISG,²⁷⁷ and the strictness of implied terms for minor breaches in English sales law has been slightly softened,²⁷⁸ the fundamental breach hurdle is still arguably higher than the bundle of termination options under these alternatives.²⁷⁹ Rejection of goods on the basis of the ‘perfect tender’ rule under the UCC adds to the picture of easier access to termination under domestic US law.²⁸⁰ The English right of rejection can be characterized as more generous than the CISG right of avoidance, or even the UCC right of rejection, since the latter is subject to a right to cure, whilst the English rule is not.²⁸¹

As Katz notes, although the UCC contains a cure provision, the seller’s right of cure in UCC §2-508 is somewhat weaker than that found in Article 48 CISG. In the UCC, cure is indelibly linked to ‘perfect tender’, whereas in the CISG cure is linked to ‘substantial performance’ in the form of the fundamental breach hurdle to termination, thus the UCC ‘hurdle’ for termination cannot really be said to approximate that of the CISG.²⁸² Given these factors, the CISG seems to more effectively restrict termination and to encourage completion of the contract, although not necessarily by means of performance of the original terms, but instead by a range of self-help and secondary remedies.²⁸³ It arguably does so in a clearer fashion, particularly given that the UCC provision is ‘difficult to interpret’.²⁸⁴

Thus for many types of transactions and breaches, the CISG provides a far more predictable and lower cost solution. This view accords with that of Katz who similarly considers that in the international context, the greater emphasis on self-help remedies in the CISG are likely to be more efficient than the heavier reliance on rights of rejection and termination found in the UCC, since this minimizes the higher transport and dispute costs in international sales, and minimizes the potential for opportunistic behaviour *ex post* to reverse the allocation of market risk under the contractual bargain

276. Mullis, above n. 183, at nn 29-38.

277. *Ibid.*, at nn 29-38; Bridge, above n. 42, at 567 [12.03]; *Hong Kong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha* [1962] 2 QB 26, English Court of Appeal.

278. Section 15A *Sale of Goods Act 1979* (UK). Breaches ‘so slight that it would be unreasonable ... to reject [the goods]’ will disqualify the buyer from reliance for the purposes of termination: s. 15A(1)(b). See Bridge, above n. 42, at 405-406 [905].

279. See, e.g., *Sale of Goods Act 1979* (UK) s. 11.

280. See also Michael G. Bridge, *A Comment on “Towards a Universal Doctrine of Breach-The Impact of CISG,”* by Jürgen Basedow, 25 *Int’l Rev. L. & Econ.* 501, 508 (2005). Bridge compares perfect tender avoidance with suspension pursuant to CISG Art. 71(1): at 509. See also Piché, above n. 22, at 520.

281. Ziegel, above n. 1, at 124 (CISG buyer’s right of rejection is less generous than under UK sales law); Piché, above n. 22, at 534. See Bridge, above n. 251, at 583 [12.22]; Bridge, above n. 251, at 608 [10.24] (noting s. 15A *Sale of Goods Act 1979* (UK) was ‘conceived as an alternative to ... [cure] in commercial cases’) & 674 [10.135].

282. *Contra* Piché, above n. 22, at 565.

283. Torsello, above n. 8, at 407.

284. Piché, above n. 22, at 524 (referring to §2-508(2)).

after unfavourable market conditions transpire.²⁸⁵ It is submitted that for international sales, by comparison with the UCC, the CISG provides generally optimal design features in focussing on the *favor contractus* position, and therefore represents a relatively more efficient solution.

As mentioned earlier, the contrast is even more stark in relation to English law, where the general concept of cure is unknown,²⁸⁶ thereby arguably rendering the English rule further from the optimal rule for international sales than the UCC, with the exception of easily replaceable fungible commodities (discussed in Chapter 6).²⁸⁷ This conclusion finds support in a recent economic analysis of remedial systems by Friehe and Tröger discussed above (in §4.02[B]),²⁸⁸ which found that sequenced remedies with emphasis on cure in modern regimes such as the CISG held greater societal benefits than the English remedial structure,²⁸⁹ on the basis that the former reduced opportunistic buyer termination²⁹⁰ and disaggregated initial from post-performance quality investment incentives for sellers, despite overall investment levels remaining identical.²⁹¹ Although the authors refer to the additional rights available to consumers, the lack of cure within English law arguably means their conclusion still holds true for commercial sales in relation to the comparative efficiency of the two remedial structures.²⁹²

Additionally, as discussed above (in §4.02[C]), drafters specifically opted for avoidance by notice rather than *ipso facto* on the basis that for most transactions this would prevent wastage and ensure parties knew where they stood.²⁹³ It is submitted that, as discussed by drafters, this solution would be favoured by the majority of parties for general contracts of sale and contracts for industrial goods, although unlikely to be favoured in commodity transactions where *ipso facto* termination prevents price speculation in sectors where price fluctuations are frequent and sometimes large. It is submitted that in regard to this choice the CISG has adopted a majoritarian rule. Under the UCC a similar approach is adopted in relation to the right of rejection, which must be within ‘a reasonable time after their delivery or tender’, conditioned by ‘seasonable’ notice.²⁹⁴ Alternatively, after the goods have been accepted, then, provided there is a defect which substantially impairs the value of the goods, the buyer may (sometimes)

285. Katz, above n. 26, at 392.

286. See Bridge, above n. 42, at 583 [12.22] (CISG right to cure has ‘no true counterpart in English law’) although insertion of s. 15A may have led to increased acceptance of offers to cure in practice): Bridge, above n. 251, at 610 [10.25]-[10.26].

287. See Piché, above n. 22, at 532. See also Lisa Spagnolo, ‘The CISG as Soft Law & Choice of Law: Gōjū Ryū?’ in Larry DiMatteo (ed), *International Sales Law: A Global Challenge* 154 (Cambridge 2014).

288. Friehe and Tröger, above n. 36.

289. *Ibid.*, at 161-62 Table 1.

290. *Ibid.*, at 183.

291. *Ibid.*, at 161, 183.

292. But see comments above n. 37.

293. *Progress Report of the Working Group*, 3rd sess, UN Doc A/CN.9/62 Adds 1 and 2, Annex I, [29] (24 Feb., 3 Mar. and 21 Mar. 1972), in UNCITRAL Yearbook Vol III, above n. 64, at 77, 85 [29].

294. UCC §2-602(1).

revoke acceptance,²⁹⁵ by means of notice of cancellation.²⁹⁶ In regard to notice, it seems both unifications have adopted the most efficient solution in terms of ‘what parties want’, since this approach minimizes verification costs. In English law, the election to reject or accept goods is a matter of considerable uncertainty, particularly concerning the timing of acceptance of the goods and loss of the right to reject, such that it is difficult to advise clients whether the remedy is still available ‘with full confidence’.²⁹⁷

The rejection of *ipso facto* termination, however, is not unique to the CISG. Although under English law, breach of condition or grave breaches of an intermediate term will justify termination, the aggrieved party can elect between affirmation of the contract or acceptance of the breaching party’s repudiation. For the latter to effect termination, the intent to terminate must be clear and unequivocal.²⁹⁸ While no particular form of intimation is required, a prudent party would give notice of such an intent.²⁹⁹ It is submitted that, for the more drastic step of termination, a clear rule requiring notice provides clarity and thus is more efficient.

Not all domestic systems require notice before the buyer can rely upon non-conformity to make any type of claim. In those that do, the period for notice might differ markedly from those applicable under the CISG. Hence, even if the notice requirement of the CISG is broadly neutral *inter se*, it might advantage either the buyer or seller relative to an alternative choice of national sales law.

English law does not require notice of non-conformity as a pre-requisite for a claim for defects. As Professor Bridge points out, it could be argued that this is a rare instance of the CISG ‘sacrific[ing] flexibility and justice ... on the altar of certainty’.³⁰⁰ Thus the comparative efficiency of the CISG rule vis-à-vis the English one simply raises the more fundamental question as to whether it is more efficient to impose a notice requirement as a precondition for relief from non-conformity. As discussed above in §4.02[C] & §4.02[E], notice periods probably improve efficiency in the context of international trade, and on that basis, the rule in the CISG is probably more efficient as a default position than the English rule.

It is more difficult to determine whether the CISG notice rule is as efficient as the UCC. As discussed earlier, there are still some issues relating to the certainty of the application of the notice requirement in some jurisdictions, and some variation in the strictness of the period required between jurisdictions. Nonetheless, it is submitted that with gradual convergence, the CISG rule will be as efficient as the US rule.

295. UCC §2-608(2).

296. UCC §2-309(3). See also UCC §2-616(1).

297. Bridge, above n. 251, at 630 [10.58].

298. *Sale of Goods Act 1979* (UK) s. 35 (right to terminate is lost if goods are deemed accepted in three circumstances: by intimation of acceptance (s. 35(1)(a)); conduct inconsistent with seller ownership (s. 35(1)(b)); or after lapse of reasonable time (s. 35(4)). See generally Bridge, above n. 42, at 405 [9.04]; Jeannie Paterson, Andrew Robertson and Peter Heffey, *Principles of Contract Law* 398 [25-105] (Thomson 2nd ed, 2005)(on various forms of intimation in Australia).

299. Paterson et al, *ibid*.

300. Michael Bridge, *International Sale of Goods* 583 [12.43] (Oxford 2nd edn, 2007).

It has been noted by a number of German practitioners that following the modernization of the German Law of Obligations in 2002,³⁰¹ the CISG provides a more advantageous choice of law for both buyers and sellers. In the case of sellers, this is because, contrary to the position under the CISG, the competing German rule allows any material breach to be upgraded to one warranting termination by the setting of a *Nachfrist*.³⁰² The reforms have made it ‘much easier for the obligee to terminate the contract and to claim compensation in lieu of performance’.³⁰³ Additionally, the CISG now provides a better position for the buyer, since the interpretation of the period for notice under the competing German rule favours a far shorter period than applicable under the CISG, especially following the recognition by German courts of the need to view CISG notice periods in an autonomous manner to those under domestic law.³⁰⁴ Thus the CISG provides what appears to be a more majoritarian choice by comparison with German domestic law, and is now recommended by business associations as a better choice of law.³⁰⁵

It would appear by extension the same conclusion follows in relation to Swiss domestic law. Swiss law is a popular alternative choice of law.³⁰⁶ However, it still relies on a troubled distinction between *aliud* and *peius*.³⁰⁷ It also implements ‘alarmingly short’ notice periods for defects.³⁰⁸ This makes Swiss law far from a balanced, neutral or efficient choice of law between the parties, despite its popularity. For these reasons, the CISG appears to provide a more efficient rule, despite residual issues relating to uniformity in application.

301. From 1 Jan. 2002, the *Act on the Modernisation of the Law of Obligations* dramatically changed the German Civil Code: *Bürgerliches Gesetzbuch* [German Civil Code](BGB), translated by G. Thomas and G. Dannemann, <http://www.iuscomp.org/gla/statutes/BGB.htm#b2> (accessed 28 Feb. 2014).

302. BGB §281 (1).

303. Hans Schulte-Nölke, ‘The New German Law of Obligations: an Introduction’ (2002) §III.2, <http://www.iuscomp.org/gla/literature/schulte-noelke.htm> (accessed 28 Feb. 2014) (the old §326 BGB had a much longer list of prerequisites for termination and claim in lieu against the obligee compared to the current BGB §281).

304. Panel Members, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

305. Ulrich Magnus, ‘Germany’ in Franco Ferrari (ed), *The CISG and Its Impact on National Legal Systems* 143, 146 (2008); Wolfgang Faber, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

306. Vogenauer and Hodges, above n. 135, Questions 17(g-2) (in a 2008 study yielding 103 responses from European businesses, when asked which law they preferred for cross-border trade other than the law of their home jurisdiction, the most popular response was Swiss law (29%), followed by English law (23%), US law (14%)).

307. Christiana Fountoulakis, *The Parties’ Choice of “Neutral Law” in International Sales Contracts*, 7 *European J.L. Reform* 303, 304, 306-11 (2005); Schwenzler and Hachem, above n. 174, at 465-66 (referring to Arts 201 and 210 Schweizerisches Obligationenrecht, 30 Mar. 1911 [Swiss Code of Obligations]). See also Ingeborg Schwenzler and Christopher Kee, *International Sales Law – The Actual Practice*, 3 *Penn St. Int’ L. Rev.* 425, §II (2011) (distinguishing *aliud* and *peius* ‘almost impossible’, and ‘extremely short’ notice periods for defects).

308. Fountoulakis, above n. 307, at 306-11; Schwenzler and Hachem, above n. 174, at 465-66.

[8] Preservation

The CISG rules in Articles 85-88 regarding the duty to avoid loss or deterioration of goods once a contract has been avoided is an example of an efficient shift of obligation to the least cost avoider.³⁰⁹ The party in possession of the goods is best placed to deal with them in the most timely and cost-effective manner, and has a right to reimbursement for the expenses of doing so.³¹⁰ It is generally cheaper for those in control of goods to protect and deal with them.³¹¹

Despite its efficiency, the rule is unknown in English law, and the buyer becomes a mere gratuitous bailee of the goods, with no duty to preserve or deal with them except in rare cases where the doctrine of agency by necessity applies.³¹² Instead, the *Sale of Goods Act 1979* (UK) s. 36 merely states that after rejecting the goods, the buyer is 'not bound to return them to the seller'. In the UCC, the buyer has a general duty to take 'reasonable care' of goods rejected,³¹³ can resell them upon rightful rejection,³¹⁴ can reship, store or resell rejected goods,³¹⁵ and indeed must resell rejected goods likely to rapidly decline in the absence of instructions from the seller.³¹⁶ In the case of the buyer in possession of the goods, these obligations perform a similar function to those in Articles 86-88. However, in the UCC the seller only has a duty to 'hold' the goods and an associated right of resale arises once the buyer repudiates or fails to pay the price,³¹⁷ or wrongfully rejects or repudiates.³¹⁸

These do not amount to a comprehensive duty of preservation, nor an obligation to resell in all circumstances where to do so would prevent loss, and thus will not preclude economic waste or uncertainty to the same degree as Articles 85, 87 and 88 CISG. Additionally, in international sales, the UCC rule allowing the buyer the option to reship rejected goods is submitted to be unduly costly.³¹⁹

Upon avoidance, the CISG rule shifts the task to the party best placed to perform it at least expense. Duties regarding dealing with the goods after avoidance are clear, thereby minimizing moral hazard.³²⁰ The rule is therefore both efficient in the sense of overall exchange surplus and probably majoritarian in nature, particularly given the long distance nature of international trade.

309. See above n. 231. See also, Kronman, above n. 114, at 1-7.

310. Bridge, above n. 25, at 938-940, [16.57]-[16.60].

311. See generally, Gillette, above n. 24, at 543.

312. F. M. B. Reynolds, 'Remedies in Respect of Defects' in *Benjamin's Sale of Goods*, above n. 2, at 529, 568-69 [12-065].

313. UCC §2-602(2).

314. UCC §2-711(3). See also §2-715 (allowing recovery of expenses for custody and care).

315. UCC §2-604 (right to store, reship or resell rejected non-perishable goods).

316. UCC §2-603(1).

317. UCC §2-709(2).

318. UCC §2-703. See also §2-710 (allowing recovery of expenses for custody and care).

319. See above n. 315 and accompanying text.

320. Thus there is little room for moral hazard at this point. Moral hazard is a topic discussed in Ch. 7.

[9] Certainty

In terms of overall clarity, naturally the vagueness of a particular law can be expected to raise the cost of enforcement,³²¹ and also of performance. Given the range of risk attitudes in contracting from ‘egoistic’ to ‘cooperative’ risk takers, it is generally difficult to determine whether ‘bright line’ default rules or more flexible ones are preferred by most parties.³²² However, uncertainty in default rules raises verification costs and may make it harder to allocate risk accurately. As mentioned above, while some matters remain unsettled, it is submitted that the level of substantive certainty inherent in the provisions of the CISG probably now approaches that in other sophisticated systems and can be expected to continue to develop incrementally. The UCC is also less detailed than many would prefer.³²³ Gillette and Scott point out that UCC resorts to vague standards such as ‘ordinary purposes’ and ‘impracticable’ in relation to excuse for performance (§2-314(2)(c), §2-615), which by reason of information asymmetry enables evasion of contractual responsibility. In other words, the indeterminacy of the UCC’s reliance on vague standards creates moral hazard.³²⁴ Although the CISG remains uncertain in some respects as discussed earlier, it is submitted that in relation to predictability, the UCC holds little advantage over the CISG.

Despite some changes and reforms slightly elevating concerns,³²⁵ English law is frequently said to carry the qualities of certainty and clarity.³²⁶ In this respect, at this stage, it is submitted that English law may well carry a slight advantage over the CISG, which as noted above, is still uncertain in some respects, a matter exacerbated by the homeward trend. Yet, as the analyses in this chapter demonstrate, any advantage is certainly not of the magnitude that the ‘mantra’ of English certainty appears to suggest.

[10] Quality

As noted above, the CISG quality standard under Article 35(2)(a) is not yet settled, but is capable of bearing the most efficient quality default rule, and has been determined in line with such a rule in at least one case.³²⁷ Breach of Article 35(2)(a) will not necessarily trigger a right to terminate. It may lead only to a damages claim, unless so

321. Gillette and Scott, above n. 131, at 456.

322. See generally Gillette, above n. 24, at 574-75.

323. See nn 184 and 185, and accompanying text.

324. Gillette and Scott, above n. 131, at 457.

325. See below n. 329 (interplay between express and implied terms and application of s. 15A). See also Bridge, above n. 251, at 612, 614 [10.29] [10.32] (noting *Hongkong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha* [1962] 2 QB 26 (UK) also put into doubt ‘for a while’ the ability of parties to stipulate conditions); Mullis, above n. 183, at nn 29-38; *Cehave NV v. Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1976] QB 44 (UK).

326. Queen Mary International Arbitration Survey, above n. 215, at 13 (the most common reasons for respondents’ choice of law were given as familiarity, predictability, foreseeability or certainty, and English law was most commonly cited by respondents as the law most fulfilling of these criteria).

327. Netherlands Arbitration Institute, 15 Oct. 2002, above n. 93.

serious as to amount to a fundamental breach. This is arguably optimal in international trade, where unwinding transactions is often costly and inefficient.

By contrast, the English implied term of merchantable quality is a condition, breach of which prima facie gives rise to a right to reject. Yet since 1995, the new test replacing ‘merchantable’ quality, ‘satisfactory’ quality, is open-ended, and minor breaches of the implied condition no longer necessarily give rise to the right to reject.³²⁸ While it could be argued the latter amendment raises uncertainty in the English rule,³²⁹ it is the case that its introduction brings the two rules slightly closer in terms of the trigger for termination. However, it is submitted there is still a considerable difference, with the CISG being closer to optimal for international sales, with perhaps the exception of commodities (see Chapter 6). The same conclusion applies with less force in the case of the UCC where the right to reject is tempered further by the right to cure (discussed above at section §4.02[E]).

In passing it is further submitted that the CISG quality rule is more apt for international sales than the rules found in the PECL or UNIDROIT Principles, since these expressly rely on an ‘average quality’ test as opposed to being amenable to a test tied at least in part to price.³³⁰ The former test is convincingly argued by Gillette and Ferrari to be problematic and inefficient, since it continuously pushes up quality requirements (creating uncertainty by setting a moving target) and drives lower quality but cheaper goods from the market in a manner which dampens trade and narrows buyer choices.³³¹

[11] *Preliminary Conclusion*

It is submitted that, commodity contracts aside, the above analysis demonstrates the CISG’s features to be comparatively more efficient on balance than the English position. The latter demonstrates superiority for international transactions in relation to certainty, but is arguably less efficient in relation to most other substantive features examined.

Cantora concludes from his survey that the UCC is slightly more efficient than the CISG, since the UCC is economically efficient in its treatment of four out of the five issues examined, while the CISG is relatively efficient in its treatment of three out of the five issues examined,³³² but concedes ‘these numbers may be misleading’ and that a review of the five issues in greater depth or indeed a review of different issues may lead

328. See above nn 278 & 94. Bridge states ‘merchantable quality’ was too difficult for statutory definition, while the new standard at least gives courts guidance: Bridge, above n. 251, at 432-34 [7.55]-[7.57].

329. In terms of certainty, s. 15A *Sale of Goods Act 1979* (UK) may be undermined by the tenuous link between s. 13 and the distinction between express and implied terms relating to time being of the essence. See *ibid.*, at 609-10, n. 81 [10.24]-[10.25] (citing the opposing view of McKendrick).

330. See UNIDROIT Principles, above n. 18, Art. 5.1.6; PECL, above n. 18, Art. 6:104.

331. See above n. 94.

332. Cantora, above n. 108, at 135.

to a different result.³³³ He further concedes that since unification of sales law within one set of rules is itself economically efficient, it follows that, overall, the CISG is a 'highly desirable set of default rules for US businesses'.³³⁴ In passing, it is noted that the latter criterion is probably unsuitable for determining whether or not an international sales law is substantively preferable to the majority of its users.

It is submitted that the CISG is more efficient than the UCC. The broader analysis above shows the relative substantive efficiency of the UCC and CISG is perhaps even somewhat closer than Cantora concludes, and may even favour the CISG. However, non-substantive efficiencies must also be taken into account before the overall economic effect can be assessed, and these will be discussed below (in Chapter 5).

[C] Advantages and Disadvantages: Transaction Type

It bears repeating that the comments made in relation to substantive efficiency cannot be generalized across all transaction types or even to a single transaction type in all circumstances.

Thus for example, it may be that within a specific sector, peculiar requirements or conditions demand numerous modifications to the provisions of the CISG such that, for that sector, the CISG could not be considered majoritarian or efficient. Some have suggested that this may be the case for commodities³³⁵ and as we have seen, the need for notice of avoidance was highlighted by drafters as a choice potentially not suited to the fluctuating prices prevalent in commodity trade, since it would encourage price speculation.³³⁶ Others have suggested that the complex intellectual property aspects of software contracts and even their usual nature as licensing agreements may mean that the CISG would be an unsuitable choice for such contracts.³³⁷

These issues go beyond the scope of this volume; however, some influences on choices of law in commodity trade will be discussed further in Chapter 6. For present purposes, it is however noted that the generalized substantive pros and cons cannot be assumed for every market sector, nor for every kind of transaction within a sector.

§4.04 COSTS OF OPTING OUT OF THE CISG AS A DEFAULT RULE?

The CISG's application is automatic in instances where its applicability rules are satisfied and parties have not opted out (see Chapter 2). Thus it operates as a default

333. *Ibid.*, at 135 n. 134.

334. *Ibid.*

335. Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 *Pace Int'l L. Rev.* 55, 69 (2003). *Contra* Lachmi Singh and Benjamin Leisinger, *A Law for International Sale of Goods: A Reply to Michael Bridge*, 20 *Pace Int'l L. Rev.* 161 (2008); Mullis, above n. 183, at nn 29-38; Peter Schlechtriem, *Interpretation, Gap Filling and Further Development of the UN Sales Convention*, 16 *Pace Int'l L. Rev.* 279, § 1.1 (2004).

336. See above n. 293 and accompanying text.

337. Hiroo Sono, 'The Applicability and Non-Applicability of the CISG to Software Transactions' in *Kritzer Festschrift*, above n. 5, 512, passim; Bridge, above n. 25, at 954-56, [16.86]-[16.87]. See also Walt, above n. 131, at 348.

rule. Although it was submitted above that in many instances CISG rules are majoritarian or otherwise as efficient as US or English law, as noted, others have argued to the contrary.

Less preferred default rules impose greater costs, because more parties must expend on the cost of opting out than if the default rules were those preferred by a higher proportion of the marketplace for law.³³⁸ Majoritarian default rules are said to be efficient because they minimize the transaction costs of contracting out.³³⁹

However, an argument based on opt out costs depends to a large degree on the size of those costs and the extent of difference in the efficiency between competing rules. While it is true that it would be 'dangerous' to set non-majoritarian defaults where transaction costs of opting out are high, it is argued here that the form required of an effective opt-out clause is generally well known.³⁴⁰ In some industry sectors, 'boilerplate' CISG exclusions exist, so the marginal costs of opting out of the CISG are minimal or negligible.

In these circumstances, opt out costs can offer only weak support against the CISG as an efficient default rule, provided it is otherwise close to optimal relative to any alternative choice of law. Moreover, as discussed in section §4.03 above, it is submitted that the CISG is just as if not more efficient than competing default rules for many international sales.

§4.05 CONCLUSION

In this chapter, the efficiency of the CISG's substantive content was examined. It was concluded that the CISG is neutral inter se for parties, and is probably relatively more efficient than competing alternative English and US laws. It was also concluded in absolute economic terms that the CISG holds economic benefits due to its substantive design specifically tailored for international trade, given that many of its rules are majoritarian, and others encourage efficient behaviour as penalty defaults. They often maximize exchange surplus in the context of most international sales, although to appreciate their full benefit, anticipated *ex post* cost reduction must also be taken into account. It is worth noting at this point that significant *ex post* efficiency gains arise from many of the features discussed above. *Ex post* efficiencies are involved with features described at §4.02[A], §4.02[C], §4.02[E], §4.02[F], and §4.02[H]; and also comparatively – while arguably *ex post* costs were sometimes traded for *ex ante* savings (§4.03[B][1] and §4.03[B][2]) (no writing requirement and no parole evidence rule)), many features result in *ex post* savings: §4.03[B][4], §4.03[B][5], §4.03[B][7], §4.03[B][8] and §4.03[B][10]. Additionally, costs of opting out are very low.

338. Gillette and Scott, above n. 131, at 447, 474, 482; Walt, above n. 131, at 348. See generally: Ribstein, above n. 187, at 398-99.

339. Schwartz and Scott, above n. 141, at 594; Korobkin, above n. 192, at 139 (*status quo* bias tends to support the majoritarian view).

340. Generally see Whincop and Keyes, above n. 111, at 532, 534 (costs of negotiating choice of law border on zero, and uniformity of laws may discourage contracting out of default rules).

From these conclusions, we might be justified in arguing that the CISG lives up to its normative justification, and that its increased use will bring about more efficient trade.

However, the economic impact of the CISG has received some ardent criticism, notably from Professors Gillette and Scott, and from Professor Cuniberti. Many of the problems they highlight are indeed substantive, but non-substantive matters should be fully explored before the overall effect of the CISG can be assessed, therefore analysis of their views is delayed until the end of Chapter 5.

In the following chapter, the non-substantive efficiency of the CISG will be examined, following which it will be possible to assess whether the CISG is indeed efficient.

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CHAPTER 5

The CISG and Efficiency: Non-substantive Advantages and Disadvantages

§5.01 INTRODUCTION

Professor Kazuaki Sono once stated that '[a]bove all, we know that it is much easier to understand one convention than to understand a great number of foreign laws, the miscomprehension of which has often been the source of unnecessary disputes'.¹ The statement aptly highlights the basis of many non-substantive efficiencies of uniform law.

It could be argued that the *efficiency* of the CISG's substantive content discussed in Chapter 4 holds only marginal relevance to the economic effects that could potentially arise from its widespread use. Likewise, Professor Black questions whether the substantive content of corporations law even matters, given that its financial impact pales into insignificance in proportion to the value of a company float.²

Although the notion that the form of legal rules is insignificant may not sit well with lawyers who pride themselves on careful choice of law selections within contractual clauses, it has considerable merit. Thus this chapter isolates non-substantive economic impacts, and then analyses critical views of the economics of the CISG from the combined perspective of both substantive and non-substantive efficiency, in order to evaluate the normative justification for the CISG, and its value as a choice of law.

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1. Kazuaki Sono, 'The Vienna Sales Convention: History and Perspective' in Petar Šarčević and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* 1, 15 (Oceana 1986).
 2. Bernard Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 558 (1990).

§5.02 LEARNING EFFECTS AND NETWORK EFFECTS IN THE MARKET FOR LAW

Much of the truth in the argument that the substantive content of the law is of marginal relevance to the law's economic efficiency arises from economies of scale in the repeated use of the same legal knowledge. Reduction in legal risk is also an important aspect of non-substantive efficiency. Another part of the picture is the gain from network effects in the market for law. This can be seen in both boilerplate terms and choice of law.

[A] Boilerplate

As an instance of the type of network effects analogous to those argued throughout this volume, consider the well-documented rise of boilerplate contractual terms in general. A great deal has been written on their advantages and disadvantages.³ Boilerplate enables lawyers to implement tried and tested solutions which anticipate a variety of possibilities that have arisen in past cases. This saves time spent negotiating if presented on a 'take it or leave it' basis (*ex ante*, negotiation stage). Importantly, it saves lawyers and businesses a great deal of time in determining the meaning or predicted construction of terms drafted for each contract, so in theory, this should reduce transaction costs due to improved efficiencies in drafting⁴ (*ex ante* efficiency, drafting stage). Such an advantage is due to economies of scale; the lawyer or business by investing in drafting the standard clause, contract or in ascertaining its meaning, then reutilizes that knowledge on multiple occasions. The work of negotiation and 'drafting' can be delegated to 'underlings'⁵ with no legal training who can rely upon the boilerplate.⁵ The need to incur information costs is thereby minimized.

Before the drafting stage, there is another efficiency inherent in the use of boilerplate, even in circumstances where standard terms are not presented as a 'take it or leave it' proposition – negotiation costs may be reduced by the fact that some commonly encountered boilerplate terms are more likely to be widely acceptable to both parties (*ex ante* efficiency, negotiation stage). The willingness of parties to agree to standard terms derives from their widespread use by many actors in the market for law, which breeds familiarity, certainty and confidence. This in turn enhances the objective value of the standard terms themselves. Essentially, this means that to some degree, the value to one party of contractual terms is a function of the number of others who utilize those same terms – that the value of contractual terms is directly related to

3. See, e.g., Omri Ben-Shahar (ed), *Boilerplate: Foundations of Market Contracts* (Cambridge, 2006).

4. Marcel Kahan and Michael Klausner, *Path Dependence in Corporate Contracting*, 74 *Wash. U. L.Q.* 347, 350-53 (1996) ('*Path Dependence in Corporate Contracting*'); Marcel Kahan and Michael Klausner, *Standardization and Innovation in Corporate Contracting*, 83 *Va L. Rev.* 713 (1997) ('*Standardization and Innovation*'); Robert A. Hillman, *Rolling Contracts*, 71 *Fordham L. Rev.* 743, 751 (2002); Robert A. Hillman and Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 *N.Y.U. L. Rev.* 429, 435-36, 439 (2002).

5. See, e.g., Omri Ben-Shahar, *An Ex-Ante View of the Battle of the Forms*, 25 *Int'l Rev. L. & Econ.* 350, 364 (2005).

the frequency of their use in the market. As mentioned in Chapter 3, the phenomenon is observable in many fields as a ‘network effect’, whereby a product increases in value simply by reason of its frequent use by others. This was true of the introduction of telephones, or in modern times, the rise of the Internet.⁶ Similarly, one can observe increasing returns by the widespread use of boilerplate clauses and contracts.⁷

Boilerplates can provide a measure of certainty where clauses have been encountered by courts in litigation, and perhaps modified as a result of judgments in a cyclic relationship that, in some cases, may stretch across decades or centuries.⁸ The predictability of the outcome may reduce litigation costs since the parties may quickly appreciate where they stand should performance not proceed as expected – they might even dispense with lawyers and negotiate their own resolution without litigation (*ex post* efficiency, litigation stage). Accordingly, a potential link exists between frequency of litigation and learning effects. This link will be revisited later in this volume.

Between the precontractual and litigation stages there is a further efficiency gain – because boilerplate is re-used by the same parties, each party presumably better understands the nature and extent of their obligations under familiar boilerplate terms. The cost of managing performance is accordingly lowered. For a single entity performing pursuant to multiple contracts the effect is magnified, since there will be less need to consult multiple sets of terms and ascertain the nature of the various obligations thereunder, where the same boilerplate terms are used across many or most of their sales transactions or ‘portfolio’ of contractual dealings (*ex post* efficiency, performance stage). Thus the use of boilerplate can decrease information costs *ex post* even without litigation. Across all of these stages, whether by a lawyer or business person, repeated use of boilerplate results in a reduction of information costs and lower transaction costs.⁹

In a different vein, boilerplate terms also facilitate hedging and speculative activity within industries, resulting in other economic benefits (and disadvantages).

6. A network effect occurs when ‘one consumer’s value for a good increases when another consumer has a compatible good’. The classic example is the telephone: Joseph Farrell and Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 *Rand J. Econ.* 70, 70 (1985); Michael L. Katz and Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 *American Economic Rev.* 424, 424 (1985); W. Brian Arthur, *Positive Feedbacks in the Economy*, 262 *Scientific American* 92 (1990), in W. Brian Arthur (ed), *Increasing Returns and Path Dependence in the Economy* 1 (Ann Arbor 1994).

7. On network effects of boilerplate terms: Kahan and Klausner, *Path Dependence in Corporate Contracting*, above n. 4, at 348-49.

8. Michael G. Bridge, *A Law for International Sales*, 37 *Hong Kong L.J.* 17, 22, 29, 40 (2007) (symbiotic English law and standard commodity forms) (*‘A Law for International Sales’*); Alastair C. L. Mullis, ‘Termination for Breach of Contract in C.I.F. Contracts Under the Vienna Convention and English Law’ in E. Lomnicka and C. G. J. Morse (eds), *Contemporary Issues in Commercial Law* 137, n. 158 and accompanying text (Sweet & Maxwell 1997) (*‘Termination in CIF Contracts’*); Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 *Pace Int’l L. Rev.* 55, 68 (2003) (*‘Uniformity and Diversity’*) (English sales law ‘functions as a system that was designed for commodity sales’); Alastair C. L. Mullis, *Twenty-Five Years On – The United Kingdom, Damages and the Vienna Sales Convention*, 71 *Labels Z* 35, 37 (2007).

9. Kahan and Klausner, *Path Dependence in Corporate Contracting*, above n. 4, at 350-53 (positive learning externalities from certainty generated by past use of boilerplate terms, and positive network externalities accruing from their future use).

These issues will be dealt with in Chapter 6. For present purposes, it can be noted that boilerplate can facilitate negotiation and drafting not only due to the improved ease of reaching agreement, but also because boilerplate acts as a ‘medium of communication’ between parties, thereby performing a ‘labelling function’,¹⁰ making communication between the parties about contractual obligations easier and faster.

The rise of boilerplate is testimony to the above advantages. Examples of widely accepted boilerplate terms include ISDA Master Agreements in relation to derivative transactions,¹¹ UCP for letters of credit,¹² and Incoterms in relation to delivery risks and costs.¹³ Standard commodities contracts have been developed by numerous commodity associations including GAFTA, FOSFA,¹⁴ and instruments adapted for a range of specific industry sectors.¹⁵

There is also a serious downside to boilerplate terms. They encourage complacency in drafting. Boilerplate clauses and contracts can sometimes take on an undeserved ‘reverence’ leading to a reluctance to tailor to suit particular circumstances, and reliance upon them may see their continued use long after legal or economic developments have eliminated benefits gained thereby, or even rendered the clause disadvantageous.¹⁶

In these circumstances, failure to review the substantive value of boilerplate quickly tips into the negative efficiency gains mentioned above, at all levels. This notion underpins much of Chapters 6 and 7, and shows how the substantive content of law interacts with any non-substantive efficiencies relating to law. Thus, although non-substantive gains are very real and perhaps overshadow substantive level efficiencies, substantive content can never be dismissed altogether, since it ultimately sets the ‘fundamentals’ which underpin the market value of the product (law) being traded, in much the same way as derivative prices ultimately flow from more concrete spot prices in the commodities world.

10. Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. Rev. 789, 842 (2002) (standard terms as a ‘medium of communication’; Charles J. Goetz and Robert E. Scott, *The Limits of Expanded Choice*, 73 Cal. L. Rev. 261, 287 (1985) (‘labelling function’).
11. See International Swap Dealers Association Inc (‘ISDA’) Master Agreements, and standardized addendums relating to specific transactions. Parties typically adopt these and modify them by schedules, which themselves are largely standardized in accordance with the transaction type: *2002 ISDA Master Agreement (Multicurrency-Cross Border)*, <http://www.isda.org/publications/isdamasteragmt.aspx> (accessed 28 Feb. 2014). See Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 Pace L. Rev. 179, 184 (2008).
12. See ICC Uniform Customs and Practice for Documentary Credits, UCP 600 (ICC Publication No. 600) (‘UCP’).
13. See ICC Incoterms 2010, <http://www.iccwbo.org/incoterms/> (accessed 28 Feb. 2014).
14. See, e.g., Grain and Feed Trade Association (‘GAFTA’): GAFTA No. 100, *Contract for Shipment of Feedstuffs in Bulk Tale Quale CIF Terms*, 1 Jan. 2003; GAFTA No. 124, *Sampling Rules*, 1 Jan. 2003; Federation of Oil Seeds and Fats Associations (‘FOSFA’), www.fosfa.org (accessed 28 Feb. 2014).
15. See, e.g., ICE contracts, options, futures and swaps for various commodities <https://www.theice.com/homepage.jhtml>, for example, ICE Sugar No 11 Futures contract, <https://www.theice.com/productguide/ProductDetails.shtml?specId=23> (accessed 28 Feb. 2014).
16. This will be further discussed in Ch. 6. See Omri Ben-Shahar and John A. E. Pottow, *On the Stickiness of Default Rules*, 33 Fla St. U. L. Rev. 651, 680-87 (2006); Perillo, above n. 11, at 187, n. 31 (arguing this could mean standard boilerplate sticks more than it should); Dan M. Kahan, *Gentle Nudges vs. Hard Shoves*, 67 U. Chi. L. Rev. 607, 614-15 (2000).

[B] Choice of Law

Boilerplate efficiency arguments apply equally to contractually agreed choice of law. All else being equal, regardless of substantive content, repeated use of particular choices of law reduces learning or information costs, enhances economies of scale and taps into network effects. Transaction costs, in theory, are lowered simply by repetition of specific choices of law per se. However, the impact of substantive content will still be important, particularly if legal and economic circumstances change.

Presently in international transactions a range of choices of law are made. Some choices have become prevalent in particular industries. For example, in commodities trade, choices are overwhelmingly made in favour of English or New York law.¹⁷ One commentator has described the reason for this as the ‘symbiotic’ relation between the standard terms developed by (originally) English trade associations and the development of English law in relation to international sales of commodities.¹⁸ Of the two, English law dominates in relation to grain trade.¹⁹ In finance, ISDA Master Agreements grant non-exclusive jurisdiction to the courts of England or New York, and although parties are left to nominate the governing law in their schedule,²⁰ it seems the predominant choice is for English or perhaps more often, New York law.²¹ English and New York law are said to be desirable for lenders and creditors.²² However, the choices evident in these particular industries are also influenced by factors beyond the efficiency arguments detailed above, as discussed in Chapters 6 and 7.

For transactions where the choice of law clause is individually negotiated without strong industry influences, often parties will ‘instinctively’ seek a choice of law clause in favour of the law of their home jurisdiction, yet this choice will often be without substantive basis, and frequently results in outcomes that may be to that party’s disadvantage.²³ Nonetheless, such parties may perceive a strategic ‘home ground’ advantage should there be a dispute. The economic rationality and psychology of choices of law is further discussed in Chapter 7.

A similar problem can occur with negotiated choices of third-party countries as a ‘neutral’ alternative. The classic example is the predominant tendency to choose Swiss

17. See, e.g., GAFTA No. 100, *Contract for Shipment of Feedstuffs in Bulk Tale Quale CIF Terms*, 1 Jan. 2003, cl. 28; GAFTA No. 124, *Sampling Rules*, 1 Jan. 2003, cl. 27; Federation of Oil Seeds and Fats Associations (‘FOSFA’); Bridge, *Uniformity and Diversity*, above n. 8, at 69; Jacob S. Ziegel, *Commentary on Party Autonomy and Statutory Regulation: Sale of Goods*, 6 J. Contract L. 123, 124, 124(1993) (suggesting the law of London, New York, Chicago, or in other words ‘the law where the trading association has its headquarters’); Mullis, *Termination in CIF Contracts*, above n. 8, passim.

18. Bridge, *Uniformity and Diversity*, above n. 8, at 40.

19. Christiana Fountoulakis, *The Parties’ Choice of “Neutral Law” in International Sales Contracts*, 7 European J.L. Reform 303, 306 (2005) (London Corn Trade Association). See, e.g., GAFTA No. 100, above n. 17, cl. 28; GAFTA No. 124, above n. 17, cl. 27; Bridge, *Uniformity and Diversity*, above n. 8, at 60.

20. 1992 ISDA Master Agreement, cl 13(a) and (b).

21. Fountoulakis, above n. 19, at 306.

22. Gary B. Born, *International Commercial Arbitration* 2221 (Kluwer 2009).

23. *Ibid.*, at 2219-20 (observing this approach is often ‘uninformed’ and ‘detrimental’ to the party seeking the choice); Fountoulakis, above n. 19, at 304.

law for this purpose, a trend documented in the Oxford Civil Justice Survey by Professors Vogenauer and Hodges.²⁴ While this may seem like a politically neutral choice, the parties (especially the buyer) seldom reckon on the ‘alarmingly short’ notice periods for defects under Swiss law, nor its very thorny distinction between *aliud* and *peius* (one which carries severe temporal and remedial consequences) and one year limitation period.²⁵ Thus ‘automatic’ choices are often fraught with danger, and one should be careful not to confuse political neutrality with legal suitability.²⁶

[C] Features of the CISG Relevant to Non-substantive Efficiency

In the same way as boilerplate contract terms and standardized choices of law generally lead to non-substantive efficiencies, the effect of applying the CISG can be assessed quite aside from substantive considerations about the content of competing laws in the market for law (discussed earlier in Chapter 4). But it is also clear that the repeated choice of *any* law, provided it is widespread, holds certain non-substantive benefits, *ceteris paribus*. The CISG is no exception, and is merely one of many competing possibilities, including perhaps most relevantly, English, US (New York) and Swiss law.

Recalling the aims of the CISG discussed in Chapters 2 and 3, it is evident that one of the reasons for its creation was to provide a single law that could help reduce information costs caused by the plurality of legal systems and consequent high transaction costs for cross-border trade, as opposed to domestic sales. It was thought that the differential between transaction costs in the domestic, as opposed to the

24. Institute of European & Comparative Law, Oxford University and Clifford Chance LLP, *Civil Justice and Choice of Contract Law: A Business Survey* (2008) spreadsheet on file with the author, Questions 17(g-2) (‘Vogenauer and Hodges’) (email correspondence with author October 2009) (of 103 responses from European businesses surveyed in 2008, when asked for preferred law for cross-border trade other than the law of their home jurisdiction, the most popular response was Swiss law (29%), the English law (23%), and US law (14%)). See Stefan Vogenauer, *Oxford Civil Justice Survey*, <http://denning.law.ox.ac.uk/iecl/pdfs/Oxford%20Civil%20Justice%20Survey%20-%20Summary%20of%20Results,%20Final.pdf> (accessed 28 Feb. 2014) and Stefan Vogenauer and Chris Hodges (eds), *Civil Justice Systems in Europe: Implications for Choice of Forum and Choice of Contract Law* (Hart 2011).

25. Fountoulakis, above n. 19, at 306-11; Ingeborg Schwenzer and Pascal Hachem, *The CISG - Successes and Pitfalls*, 57 Am. J. Comp. L. 457, 465-66 (2009) (referring to Arts 201 and 210 Schweizerisches Obligationenrecht, 30 Mar. 1911 [Swiss Code of Obligations]). Fountoulakis explains that if classified as a ‘non-delivery’ (*aliud*), remedies are not restricted to sales law (Arts 197 et seq., Code of Obligations) and general contract law allows buyers to set an additional performance period, after which buyers theoretically have 10 years to rescind or claim specific performance: at 309-10 (Arts 107 et seq., Art. 127 Code of Obligations). However, if classified as ‘defective delivery’ (*peius*), buyers can only claim price reduction or rescission within strict time limits: at 310. Furthermore, it is notoriously difficult to predict which classification applies. Fountoulakis gives the example where a manual rather than automatic forklift was delivered, and classified as a ‘non-delivery’: at 309 n. 36. See also Ingeborg Schwenzer and Christopher Kee, *International Sales Law – The Actual Practice*, 3 Penn St. Int’l L. Rev. 425, §II (2011) (*aliud* and *peius* distinction ‘almost impossible’ and numerous links in chain of causation for consequential damages without fault). For defective delivery, ‘extremely short periods’ apply to notice: at II, n. 76.

26. Fountoulakis, above n. 19, at 306-11; Schwenzer and Hachem, above n. 25, at 465-66.

international arena could operate as a disincentive to international trade – an effective barrier to entry – thus reducing the economic benefits flowing from increased buyer choice and supplier competition fostered by higher levels of international trade. As discussed in Chapter 3, there is indeed now evidence to support this conclusion.²⁷

To some degree, as indicated above, the identity of the particular law utilized for this purpose is immaterial. The repeated choice of *any* law can reduce the incidence of information costs inherent in dealing with multiple laws. The repeated choice of *any* law can also have network effects as the incidence of its use increases in the market for law. These considerations result in lower transaction costs, making international trade more efficient.

However, not all laws are equal. Leaving substantive features aside, it is noteworthy that the CISG is neither the (non-uniform) domestic law of the seller or the buyer, nor is it the law of any one nation. Instead it bears the special characteristic of ‘neutrality’ as a uniform law adopted by 80 nations.²⁸ More often than not, it is also a law adopted by both parties’ home States. It will be submitted in section §5.03 that this quality of neutrality may enhance its non-substantive efficiency relative to alternative choices of law. Additionally, it will be argued that the applicability rules of the CISG (discussed in Chapter 2) reduce the vagaries of choice of law rules of the forum by comparison with competing laws. These two features are unique to the CISG, and may make a difference to potential non-substantive efficiency gains from the use of the CISG vis-à-vis competing choices of law. In section §5.04, its economic impact at the societal level will be briefly considered from a jurisdictional vantage.

§5.03 MICRO-LEVEL EFFICIENCY: ADVANTAGES AND DISADVANTAGES FOR INDIVIDUAL PARTIES

As the above discussion indicates, there will be advantages or disadvantages in terms of efficiency gains and losses to be considered by an individual party (or by the lawyer advising them), quite apart from the substantive issues discussed in Chapter 4.

One question which arises is whether a particular choice of law will reduce information costs at the precontractual and post-contractual stages. Further, in anticipation of the litigation stage, are there advantages and disadvantages in the application of the CISG to disputes that might arise? This query is posed from the perspective of a party (or lawyer) at the time of structuring the transaction (anticipated *ex post*, litigation stage). This point in time is appropriate due to the obvious *ex post* bias, since after the fact, once the dispute has crystallized, ‘regret’ may cause a party to change its assessment of the pros and cons of the original choice of law given the benefit of

27. See Ch. 3, nn 106-107 and accompanying text.

28. Or at least 80 nations are parties – however, while they are signatories, Ghana and Venezuela are yet to implement the CISG: *CISG Status*, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (accessed 28 Feb. 2014).

hindsight in light of facts as they happened to unfold in a particular case.²⁹ The relevant consideration here is the maximization of *anticipated* exchange gains.

The efficiency arguments presented in relation to boilerplate and choice of law in particular (in section §5.02 above) generally play out here too. A number of strategic and systemic considerations may affect the value of the CISG as a choice of law for a specific party and/or for a particular transaction.³⁰

For clarity, a ‘choice of law’ for present purposes refers to an effective choice of law clause. As discussed in Chapter 2, this can be problematic for direct choices of the CISG as an a-national law, therefore the present discussion presumes a clause which effectively chooses the law of a Contracting State.³¹ Choice of a ‘competing’ law would therefore be a choice of the law of a non-contracting State, for example, English law, or choice of the law of a Contracting State coupled with exclusion of the CISG.

For most lawyers, the question of whether to use the CISG is a narrow one: is the CISG a suitable choice of law for the transaction in question? The answer will be the same as for any law: sometimes. In many circumstances the CISG can be the best choice, but no law is ideal in every situation. Like any law, it has its shortcomings, some of which were discussed in Chapter 4. For some types of transactions the choice might not be appropriate or even feasible.³² However, discussion here is confined solely to the non-substantive advantages and disadvantages of the CISG as a choice of law.

Its strategic benefits derive from its role as a potential alternative to the multitude of anachronistic, idiosyncratic localized sales laws around the world, each comprising different mixes of code, statute and cases, each in their own language, each to be located and understood in context. Even where similar wording is used within multiple sales laws, the meanings attached to them can drastically vary from one jurisdiction to the next.³³ This arguably affords the CISG certain advantages over competing choices of law: uniformity, neutrality, accessibility, predictability and simplicity.³⁴

The term predictability is used below to refer to the quality of certainty as to the identity of the law to be applied in litigation. The CISG’s neutrality arises from a number of aspects: its status as a uniform law rather than the law of a particular national jurisdiction,³⁵ its design as a law which blends features from civil and common law systems, but which avoids jurisdiction-specific terminology in favour of

29. See generally Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535, 546 (1990).

30. See Ronald A. Brand, ‘Article 79 and a Transactions Test Analysis of the CISG’ in Franco Ferrari, Harry M. Flechtner and Ronald A. Brand (eds), *The Draft UNCITRAL Digest and Beyond* 392, 392 (Sellier 2004).

31. Leaving aside choice of the law of a declaring Contracting State, where one party’s business is located in a non-Contracting State (see Ch. 2 discussion).

32. See Ch. 6.

33. See Christopher Kee and Edgardo Muñoz, *In Defence of the CISG*, 14 Deakin L. Rev. 99, 120-23 (2009); Global Sales Law Project Thesaurus Overview, <http://www.globalsaleslaw.org/index.cfm?pageID=11> (accessed 28 Feb. 2014).

34. See Ch. 2.

35. Fountoulakis, above n. 19, at 314; Ziegel, above n. 17, at 124, 127-28; Joseph Lookofsky, ‘Online with AI K’ in Camilla Baasch Andersen and Ulrich G. Schroeter (eds), *Sharing International Commercial Law across National Boundaries* 287, 291 (2008)(neither side has a ‘home ground

practical and neutral terms;³⁶ its availability in six official languages; and the requirement that it be interpreted in a manner which promotes its international character, regardless of which forum determines the dispute.³⁷ This is intended to steer courts away from the temptation to view the CISG via ‘domestic lenses’, a noble aim which has sometimes met with some resistance, particularly in certain common law jurisdictions.³⁸ Nonetheless, despite the tendency toward the ‘homeward trend’, the CISG is (correctly) perceived as a neutral law.³⁹

These qualities may lead to a number of economic effects for individual contracting parties that can be considered separately from those arising from the substantive content of the rules themselves. Each of these will be considered in turn.

[A] Information Costs

Accessibility of laws, commentary and case opinions are important components of the suitability of a law for international commercial transactions. As noted by one very experienced arbitrator it ‘is important to insist on a law ... whose content they can ascertain with reasonable ease. ... parties should select a law from a state which offers published statutes and judicial decisions, as well as commentaries’.⁴⁰

Even where such materials are available, transacting with parties from multiple jurisdictions make the ascertainment task incredibly difficult. Different legal cultures and linguistic issues make reliable access to multiple foreign laws impracticable and expensive for busy practicing lawyers, and almost impossible for all but the most sophisticated of parties. The cost of finding and ascertaining the meaning of foreign law is an information cost – a component of the transaction costs at each of the stages mentioned earlier (*ex ante*, *ex post*, negotiation, drafting, performance, litigation). According to Professor Wagner, such costs are effectively ‘a tax on international business’.⁴¹

The problems facing anyone wishing to access the intricacies of specific points of any foreign law can be contrasted with the relative ease of accessibility to the CISG. Not

advantage’); Alison E. Butler, *Knowing When, Why, and How to “Opt Out” of the United Nations Convention on Contracts for the International Sale of Goods*, 76 Fla Bar J. 24, 26 (2002).

36. CISG drafters carefully avoided terms from domestic law: John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention* Art. 4, 15 [17], 118 [87] (Kluwer 4th edn, 2009).

37. CISG Art. 7(1). See discussion below.

38. Michael G. Bridge, *Issues Arising Under Articles 64, 72 and 73 of the United Nations Convention on Contracts for the International Sale of Goods*, 25 J.L. & Com. 405, 405 (2005-6); John E. Murray, *The Neglect of CISG: A Workable Solution*, 17 J. L. & Com. 365, 367 (1998). See Ch. 4, nn 199-207 and accompanying text.

39. See below nn 60, 63, 64.

40. Born, above n. 22, at 2220.

41. Gerhard Wagner, *The Economics of Harmonization: The Case of Contract Law*, 39 Common Market L. Rev. 995, 1017 (2002).

only is its text available in six official languages,⁴² but it is also simple to comprehend. Materials on the CISG are easily accessible worldwide on free public internet sites dedicated to the dissemination of CISG cases and scholarship, the largest of which is the Pace CISG Website, which provides access to over 2,500 cases, as well as numerous scholarly articles and texts.⁴³ Additionally, UNCITRAL has published a Case Digest which organizes decisions on an article-by-article basis,⁴⁴ and a number of Advisory Opinions have been published by the CISG Advisory Council, a private body of eminent scholars.⁴⁵ To a great extent, this means lawyers, clients, courts and tribunals around the world are effectively ‘working from the same page’.

It must however be acknowledged that there are differences in the extent of access to material on the CISG depending on language. The English language material accessible on websites and published scholarship is the most extensive, perhaps followed by German.⁴⁶ Nonetheless, materials are available in many languages. The UNCITRAL CLOUT website makes case abstracts available in the six official CISG languages, and there are texts and journal articles in many more languages,⁴⁷ as well as a network of national websites ranging from China to the Slovak Republic.⁴⁸ A great deal of translation work has been done, particularly translation of German and Chinese cases into English, and while not all are perfect, they are generally quite reliable.⁴⁹ One need only look at the Pace bibliography of scholarly materials in numerous languages to understand that interest in the CISG has led to the availability of articles linguistically and logistically accessible to courts and lawyers in most jurisdictions,⁵⁰ and many are produced by multi-lingual scholars drawing from decisions and papers from around the

42. Official texts of the CISG are in Arabic, Chinese, English, French, Russian and Spanish. See http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html. For further (non-official) translations, see <http://cisgw3.law.pace.edu/cisg/text/text.html> (each accessed 28 Feb. 2014).

43. See Institute of International Commercial Law, Pace Law School, *CISG Database*, <http://cisgw3.law.pace.edu>; CISG online, University of Basel, <http://www.globalsaleslaw.org/>; UNILEX, *UNILEX on CISG and UNIDROIT Principles: International Case Law and Bibliography*, <http://www.unilex.info>; UNCITRAL, *CLOUT Abstracts*, http://www.uncitral.org/uncitral/en/case_law/abstracts.html. There are also many national CISG websites that can be accessed at <http://www.cisg.law.pace.edu/network.html> (each accessed 28 Feb. 2014).

44. UNCITRAL, *UNCITRAL Digest of Case Law on the [CISG]* (2012), <http://www.uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf> (accessed 28 Feb. 2014).

45. See CISG-AC Website, <http://www.cisgac.com/>.

46. Ingeborg Schwenzer, *The Application of the CISG in Light of National Law*, 2 *Internationales Handelsgericht* 45, §2 (2010); Schwenzer and Hachem, above n. 25, at 469. See Global Sales Law Project Website, <http://www.globalsaleslaw.org/> (for CISG materials including in German).

47. The Pace CISG Website categorizes scholarly material according to language. Its bibliography page lists articles written in Arabic, Azerbaijani, Bulgarian, Catalan, Chinese, Croatian, Czech, Danish, Dutch, English, Estonian, Finnish, French, German, Greek, Hebrew, Hungarian, Italian, Japanese, Korean, Norwegian, Persian, Polish, Portuguese, Russian, Serbo-Croatian, Slovak, Spanish, Swedish, Thai and Turkish: <http://www.cisg.law.pace.edu/cisg/biblio/biblio.html> (accessed 28 Feb. 2014).

48. See *CLOUT Abstracts*, above n. 43. See the list of 25 autonomous CISG national websites at <http://www.cisg.law.pace.edu/network.html>. See also the China CISG Website <http://aff.whu.edu.cn/cisgchina/en/index.asp> (both accessed 28 Feb. 2014).

49. *Contra* Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 *Int'l Rev. L. & Econ.* 446, 472 n. 58 (2005).

50. See above n. 47.

world. Additionally, the Global Sales Law Thesaurus of legal concepts relating to sales law is a step forward. This identifies the equivalence or non-equivalence of legal concepts in numerous languages and jurisdictions as well as the CISG, supplements the understanding of comparative materials, and will help provide better translations.⁵¹

Difficulties inherent in translation will always be a feature of law, but this is not a problem unique to the CISG. Whatever the choice of law, in international trade, it is likely the law and associated materials will be in a foreign language for at least one of the parties – unless, of course, the applicable law is the CISG, in which case both parties might well find that they are able to access the law, cases and articles in each of their own languages.

The situation regarding access to the CISG is therefore imperfect and variable, but nevertheless far from unworkable for parties, courts and tribunals. Incontrovertibly, the extent of accessibility in so many languages cannot be matched by similar materials on any national sales law, therefore it is difficult to see how choice of the CISG can be anything but advantageous in terms of accessibility relative to alternative choices. On this basis, when viewed from a multinational perspective, it is submitted that information costs are generally minimized at every transactional stage where the CISG is chosen over competing national laws.

There is an argument, however, that the choice of the CISG actually increases learning costs.⁵² A uniform law, by its nature, cannot cover every issue. The introduction of a harmonized, uniform law will therefore not remove all barriers presented by divergent national laws, but arguably increases the complexity by adding a further layer to the morass of potential applicable law.⁵³ It increases the likelihood of *dépeçage* with all its attendant difficulties. Under this view, the CISG adds to transaction costs, and increases barriers to trade.

It has also been argued that a choice of a national law excluding application of the CISG is best to minimize information costs.⁵⁴ A national law, especially an established and sophisticated system, by its nature offers a degree of certainty and stability which may make it a better choice than a novel uniform law.⁵⁵ It would follow that traders might feel more reassured by the choice of a domestic sales law. Under this view, the CISG would not reduce but instead increase barriers to trade in a new market.

The above rationale for exclusion of the CISG might well have been a very strong argument some twenty years ago, but the enormous amount of literature and large

51. Kee and Muñoz, above n. 33, at 106-108, 119-23; Global Sales Law Project Thesaurus Overview, above n. 33.

52. Jan Smits, 'Diversity of Contract Law and the European Internal Market' in Jan Smits (ed), *The Need for a European Contract Law: Empirical and Legal Perspectives* 153, 168 (Europa 2005).

53. *Ibid.*, at 168; Jan Smits, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011. Similarly regarding proposed European Contract Law, see European Commission, *Green Paper from the Commission on Policy Options for Progress towards a European Contract Law for Consumers and Businesses*, COM(2010) 348 final, Brussels, 1 Jul. 2010, 9-10, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0348:FIN:en:PDF> (accessed 28 Feb. 2014) ('Green Paper').

54. See, e.g., Gillette and Scott, above n. 49.

55. Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 Va J. Int'l L. 743, 778-80 (1999); Steven Walt, *Novelty and the Risks of Uniform Sales Law*, 39 Va J. Int'l L. 671 (1999).

body of cases now decided on the CISG has reduced the persuasiveness of this view today. It was therefore concluded earlier in Chapter 4 that the level of uncertainty in application of the CISG today resembles that which is to be found in many sophisticated legal systems, so that while the homeward trend remains an issue, it does not represent a serious disadvantage vis-à-vis choice of competing national laws.⁵⁶

While it is true that the CISG adds another layer of potentially applicable substantive law, on balance, it does not necessarily follow that it adds complexity. As submitted earlier, it simply replaces the need to know the otherwise applicable sales law, and moreover reduces the need to investigate certain other matters, such as formality requirements.⁵⁷ Thus it does not ‘add’ a layer at all, but substitutes for another law.

Moreover, viewed from the perspective of a single trader, the CISG not only substitutes for one sales law, but for many. Therefore, provided the alternative applicable law for a particular party in all the transactions they enter is not a singular national law, but many potential national laws, the CISG offers a recognizable reduction in search costs and complexity from the perspective of a single trader, despite its incomplete coverage.

Against this advantage, one must trade-off the uncertainty surrounding the interaction between the CISG and the domestic law. The degree to which the CISG displaces certain domestic rules, such as misrepresentation and *culpa in contrahendo*, remains contentious. Undeniably, these are complexities which exist when the CISG applies, and not all have been resolved. In Chapter 9, the latter will be discussed. It must however be acknowledged that by comparison with some domestic systems, the borderline between laws in these areas is less settled.

However, it is submitted that, on balance, a choice of the CISG has the potential to reduce information costs, even with the potential for added complexity regarding interaction with residual domestic law. The vast majority of issues which arise in practice will fall squarely within the walls of the CISG. Arguably, the potential information cost reductions for the vast bulk of contracts where no real problems eventuate or where problems arise but clearly fall either squarely inside or outside the CISG, must invariably outweigh the potential information cost increases from the remaining few situations where less-clearly delineated problems eventuate.

Additionally, one must recall that the search costs and uncertainty in identifying which (often foreign) law applies via conflict rules will frequently be eliminated where the CISG applies through Article 1(1)(a).

[B] Negotiation and Drafting Costs

It has been suggested that, in order to maximize the exchange surplus available to both parties, the domestic law (presumably excluding the CISG) of one of the parties should be chosen, and the equilibrium of the bargain adjusted to reward the disadvantaged

56. See Ch. 4.

57. See Ch. 4.

party.⁵⁸ The assumption is that the chosen law in a cross-border transaction will be foreign to at least one party, so information or learning costs are minimized where at least one party need not familiarize themselves with the content of the applicable law, thereby maximizing exchange gains.

The unfortunate consequence of this approach is that, unless they invariably occupy the stronger bargaining position, each party will always face a multiplicity of laws across its portfolio of international contracts, so that despite maximization of exchange value for a single transaction as suggested, that party still faces high information costs involved in familiarization with a number of laws across its portfolio of contracts. Furthermore, in each case where it accepts the task of incurring learning costs, the parties must also negotiate to adjust the equilibrium accordingly. Thus this approach involves both information costs and additional negotiation costs.

The CISG, on the other hand, is intended to become equally familiar to both parties. The high level of accessibility discussed above aids in lowering initial information costs for parties that have not previously encountered it. Recurrent usage is the key. With widespread use, not just one party, but both parties can avoid bearing the information costs of familiarization, thus maximizing the exchange surplus available to both. Broad acceptance of the CISG as the 'boilerplate' choice of law in international sales may allow an individual party to maximize the standardization of a single choice of law across all of its contracts. It goes without saying that the reduction in transaction costs would also bring societal benefits from welfare maximization and encourage trade. Like boilerplate, more frequent use of the CISG is also likely to bring network effects, since the more widespread its acceptance, the greater value it will hold on each occasion as a 'standard' choice of law for international sales. Again, this improves exchange gains for parties.

However, this could be achieved with the widespread choice of any law, for example, with the choice of English law in grain commodity trade. What benefit is there in seeking to promote the CISG as the standard for cross-border choice of law?

As a neutral choice, the CISG in theory might be more readily agreed upon with counterparties as presenting a 'level playing field'. The absence of any 'home ground advantage' is the essence of this idea rather equal treatment according to whatever is the applicable law.⁵⁹ The CISG can reduce negotiation costs and delays in actually reaching agreement. Negotiations may in some cases be protracted or break down altogether if one party insists on a choice of a law that is foreign to the other. Thus the CISG can help to break the 'own law' impasse.⁶⁰ Conclusion of the contract should in theory be quicker and cheaper (*ex ante* efficiency, negotiation stage).

There is some support for such a theory. The advantage of having available a neutral law in the CISG was acknowledged by 33 % of German, 21 % of Swiss, and 21 %

58. Gilles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 Vand. J. Transnat'l L. 1511, 1525 (2006).

59. *Contra* Louis T. Visscher, 'A Law and Economics View on Harmonization of Law', 1 Sep. 2010, RILE Working Paper No 2010/09, 10 <http://ssrn.com/abstract=1669944> (accessed 28 Feb. 2014).

60. See also Butler, above n. 35, at 26.

of Austrian lawyers surveyed by Meyer.⁶¹ In one survey 26% of Swiss lawyers surveyed believed the CISG made negotiations easier because it was more readily agreeable than national law.⁶² Thus it was perceived as providing a platform for more efficient negotiations. As one surveyed lawyer remarked, choosing the CISG reduced costs by ‘avoid[ing] interminable discussions about legal details’.⁶³ In another survey, a respondent commented that the CISG was ‘neutral’ in that neither contracting party had a ‘closer relationship’ to it, and therefore ‘neither party is at a disadvantage’.⁶⁴ Additionally, there will be no need to negotiate to adjust the equilibrium to allow for the information costs borne by one party as discussed above, thereby further reducing *ex ante* negotiation costs by comparison with a law foreign to one of the parties.

Not only might the neutrality of the CISG help in reaching quick and cheaply negotiated agreement, but its ease of accessibility may also play a part. Parties might be more willing to agree knowing that information is readily available in regard to the governing law. Naturally, lower information costs should reduce drafting costs, including legal costs (*ex ante* efficiency, drafting stage),⁶⁵ and anticipated *ex post* information costs.

Beside advantages with regard to the neutrality and accessibility of the law, another *ex ante* saving may be reduction of search costs in identifying the law that will be applicable, by the substitution of a variety of potential choice of law rules with the clearly stated CISG applicability rule whenever Article 1(1)(a) is satisfied.⁶⁶ Some have correctly asserted choice of law rules themselves are more efficient than a duty of disclosure upon one party to inform the other of substantive rules, as default rules of competing systems are equally ‘knowable by the parties’,⁶⁷ but this is not the point. The efficiency gains just mentioned are two-fold: the first is that the clarity inherent in Article 1(1)(a) is relatively more efficient than the multitude of potentially applicable choice of law rules, thereby reducing the costs of identifying the applicable law. The second is that search costs involved for the party (or parties) unfamiliar with the proposed law in ascertaining the content of that law are reduced under the CISG. While any default laws are of course ‘knowable’, the process is not easy or costless given the accessibility problems involved, and the frequent need to engage foreign counsel. These transaction costs reduce the exchange surplus available to both parties. The highly accessible nature of the CISG reduces these information costs.

61. Justus Meyer, *UN-Kaufrecht in der deutschen Anwaltspraxis*, 69 *Rabels Z* 457, 480 (2005); Ulrich G. Schroeter, ‘To Exclude, To Ignore, or to Use?’ in Larry DiMatteo (ed), *International Sales Law: A Global Challenge* (Cambridge 2014), at n. 97 and accompanying text.

62. Corinne Widmer and Pascal Hachem, ‘Switzerland’ in Franco Ferrari (ed), *The CISG and Its Impact on National Legal Systems* 281, 281, 286 (Sellier 2008) (‘*Ferrari Impact*’).

63. *Ibid.*, at 281, 286.

64. Martin F. Koehler, ‘Survey regarding the Relevance of the ... (CISG) in Legal Practice and the Exclusion of its Application’ (October 2006) 4, <http://cisgw3.law.pace.edu/cisg/biblio/koehler.html> (accessed 28 Feb. 2014).

65. Who actually captures this efficiency gain is another matter, discussed in Chs 6 and 7.

66. See Ch. 2. But see Michael Whincop and Mary Keyes, *Putting the ‘Private’ Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 *Melbourne U.L. Rev.* 515, 535 (1997).

67. *Ibid.*, 535.

Naturally, the ability of an individual client to standardize its choice of law across the range of contracts it enters into will also be dependent on other issues. If a party deals frequently with counterparties in regions where the CISG is widely accepted as a viable choice of law, this will not be so difficult. However, a party may deal with counterparties from jurisdictions in which it is less well known, or trade in sectors in which the CISG is broadly rejected. This will make the standardization process difficult or impossible. Actual acceptance rates of the CISG as a choice of law are examined in Chapter 6.

One can argue that many parties in fact do not incur the type of transaction costs contemplated here. Professor Cuniberti rightly points out that many parties give no thought to choice of law issues, and that lowering such costs is a fictional exercise in circumstances where parties do not incur them in the first place.⁶⁸ This view is challenged below.

Even for those for whom this is in fact true, where the CISG applies by default, the parties will still benefit from non-substantive efficiencies that exist at the stages of performance or litigation *ex post*, due to reduced information costs, or the other non-substantive efficiencies outlined below. These would still be beneficial, as they nonetheless can minimize performance and litigation costs and potentially enhance social welfare, even if not anticipated by parties at the *ex ante* stage. Moreover, as concluded at §4.05, the CISG brings many substantive *ex post* benefits. This is further discussed below.

[C] Market Access: Neutrality

The above discussion of reduction in negotiation and information costs assumes that parties are willing to engage in cross-border trade provided it is worthwhile on a cost-benefit basis. However, some parties may lack the degree of confidence necessary to conduct international trade because of the legal risks involved, which may seem overwhelming, particularly to small- or medium-sized businesses. Such parties might often be forced to select a law other than their own, and lack the resources to consider the legal impact properly. Rather than go ahead without concern for the potential legal risks, they may simply decide not to trade internationally at all. Professor Cuniberti's conclusion that many businesses proceed in cross-border trade without concern for the applicable law does not negate this possibility, since the parties observed in his study of cases by definition had already gone ahead and engaged in international trade,⁶⁹ whereas those who refrained from trade after weighing the risks would necessarily be absent from his sample.

In fact, there is now evidence to suggest that this indeed occurs. Professors Vogenauer and Hodges' recent study of European businesses demonstrated that divergence in contract law is still considered a major impediment to cross-border trade.

68. Cuniberti, above n. 58, at 1513, 1514.

69. The study involved analysis of decided cases: Cuniberti, above n. 58, at 1529 et seq.

Contrary to Cuniberti's conclusion that many proceed without concern for the applicable contract law, they found that 91% of European businesses surveyed considered the ability to choose the applicable contract law important.⁷⁰ Other survey results which also hint that neutrality is of importance are consistent with this view.⁷¹ In its recent Green Paper, the European Commission noted that in business to consumer transactions, there is a significant incidence of 61% of businesses refraining from international e-commerce trade due to legal complexity involved in cross-border trade, particularly for smaller to medium sized businesses for which information costs are proportionately much higher relative to prospective benefits.⁷² From studies it has emerged that businesses still perceive divergence amongst national contract laws as a significant barrier to trade.⁷³ In the field of consumer contract law, harmonization efforts are just beginning. While the Commission discussion concerned the feasibility of a European Contract Law, the arguments presented in regard to uniformity are exactly those which inspired the CISG; reduction in transaction costs, improved certainty, and encouragement of cross-border trade.

It is submitted that parties might be more prepared to trade beyond their own domestic borders due to the availability of the CISG, quite apart from potential information cost reductions. Its accessibility, simplicity and neutrality combine to provide smaller businesses or new businesses with a level of legal comfort that might prompt them to take up opportunities for export or import across national borders previously shunned. Thus the CISG can act not only to reduce transaction costs of those *already* actively participating in international trade, but also to increase the number of parties willing to do so.

In other words, the very fact of knowing that the CISG applies to their first foray into international trade could encourage parties to engage in international trade in circumstances where legal uncertainty might otherwise have dampened their enthusiasm for it. Simply knowing that the applicable law was designed by UNCITRAL, and is therefore ostensibly multi-lingual, neutral and fair may be enough, even without an awareness of its actual content. For the individual party, such confidence may eliminate barriers to access to new markets. The economic benefits from such opportunities flow not only from reduced information costs (*ex ante*, negotiation, drafting, anticipated *ex post* performance), but also from perceived predictability should a future dispute arise (anticipated *ex post*, litigation stage), and perceived fairness of the applicable rules.

One might rightly observe that a willingness to engage in cross-border transactions due to increased confidence about the legal underpinnings involves the same

70. Vogenauer and Hodges, above n. 24, Question 15.

71. See above nn 62-64 and accompanying text.

72. European Commission, *Green Paper*, above n. 53, at 4 n. 20, 5 (citing Communication from the Commission on Cross-Border Business to Consumer e-Commerce in the EU, COM(2009) 557, 22 Oct. 2009 'consumers were not able to place an order mainly because businesses refused to serve the consumer's country').

73. European Commission, *Green Paper*, above n. 53, at 4 (citing Special EUROBAROMETER 292 (2008), Flash EUROBAROMETER 278 (2009) and Clifford Chance Survey in European Contract Law (2005)). *Contra* Visscher, above n. 59, at 10 (concluding that businesses perceived it to be more costly but not a barrier to trade).

consideration as the discussion in the previous section – reduced information costs. While this is true, there is a sense in which the level of comfort differs. The confidence derived from the CISG, rightly or wrongly, may be a function of the *perceived* sense of equity, and a fear of the unknown, not necessarily a rational assessment of the information costs themselves. That comfort may be drawn more from the form of the rules than their substantive content. If the CISG has been adopted by the small businesses' home State, the business may be further comforted by its own nation's imprimatur. The CISG offers a standardized, uniform and knowable law, belonging as much to 'us' as 'them'. The novice international trader may be more reassured by an understandable and neutral 'safety net' than a foreign law.

Admittedly, such an 'instinctive' choice might be in truth, disadvantageous, in the same way as the 'instinctive' reflex to attempt a choice of the law of one's home jurisdiction.⁷⁴ An objective assessment of the substance of the CISG might yield a different view about whether it rather than a competing choice of law is more suitable for the novice cross-border trader's purposes. However, this does not detract from the confidence derived from its perceived qualities, and from the fact that this perception alone may reduce barriers to trade.

[D] Performance Costs

A real benefit of standardization of choice of law within a particular party's portfolio of contracts is likely to be reduced compliance costs (*ex post* efficiency, performance stage). While standardization can presently occur with other choices of law, in trading zones that are increasingly pro-CISG,⁷⁵ or other circumstances where neutrality or accessibility assists in reaching agreement, a preference for the CISG whenever it is substantively suitable may have the effect of increasing the proportion of contracts governed by a single law within that party's portfolio. This brings economies of scale. In turn this could result in performance or compliance costs efficiencies. The simplicity of the CISG, its ease of accessibility, and the improved certainty of its applicability (further discussed below) may also reduce information costs for parties whose alternative is to comprehend obligations pursuant to larger numbers of foreign laws. This advantage will be further heightened for large and/or multinational businesses. It is submitted that this advantage may also increase in value as the frequency of the CISG as a choice of law increases in international sales transactions generally – in other words, the potential exists for network effects in the form of increased reductions in performance costs. The CISG provides a long-term solution to information costs arising from plural laws applying to international transactions, and decreases the unpredictable effect of choice of law rules.⁷⁶

There remains however, the disadvantage that even a standardized choice of the CISG cannot guarantee elimination of all such information costs. For matters not dealt with by the CISG, the applicable domestic law will still be relevant. Thus for example,

74. See above n. 23 and accompanying text.

75. Discussed in Ch. 6.

76. Where Art. 1(1)(a) applies: see Ch. 2.

matters of competition law, tort or delict, and most issues concerning validity will require resort to domestic laws. However, the choice of a Contracting State's law still allows standardization of the main contractual obligations, and these, more often than not, will be the most important for the parties. Thus the CISG will minimize the bulk of transaction costs and thereby lower performance costs, although there may be potential increased costs from uncertainty in interaction between domestic residual law and the CISG, as mentioned above.

Again, it should be noted that the CISG provides a greater level of certainty about the identity of the applicable law. The applicability rules in Article 1(1)(a) reduces the range of contracts to which unpredictable choice of law rules apply, so the search costs involved in identifying the applicable law will be considerably lower than they might otherwise be, thus lowering costs of performance and maximizing social welfare. The validity of an agreed choice of law would still be subject to the otherwise applicable domestic law.⁷⁷

Greater certainty about obligations, including the identity of the applicable law, brings about another efficiency. Litigation becomes less likely when parties are better able to ascertain the nature of their rights and duties (*ex post* efficiency, performance, litigation), and this enhances social welfare by lowering the societal costs of judicial resources.

[E] Choice of Law Rules and Legal/Forum Risk

Two serious risks are faced by parties engaged in cross-border trade where a deliberate choice of law has been agreed. The first is that the law chosen might be misapplied by the forum seized of the dispute. The second is that it might not be applied at all.

In theory, parties that make a choice of law that leads to the CISG should face a reduced risk of misapplication of the law chosen in the event of a dispute reaching court or an arbitral tribunal. This can best be described by way of example. If a court from country X determines it has jurisdiction and proceeds to apply the national law of country Y, will the outcome be as originally expected by the parties when they chose law Y to govern the contract? This is of particular concern if X is a nation with a less developed or very different legal system to that of the forum. Beside the attendant risk that the foreign law might not be applied correctly by a foreign court, there is an additional risk that the court will determine that the content of the foreign law cannot (or has not) been adequately 'ascertained', and therefore cannot be safely applied by the court. This will normally lead to application of the forum's domestic law as a default substitute law (discussed in Chapter 10).

However, if the CISG governs the contract, then the obligation upon courts in Contracting States X, Y and even courts in third-party State Z, is exactly the same: to apply the CISG autonomously, having regard to its status as uniform international law, in accordance with its own internal interpretive method and rules of contractual construction found within Articles 7-9. Courts are directed to have 'regard to ... its

77. See Ch. 2.

international character and the need to promote uniformity in its application’,⁷⁸ thus in interpreting the CISG they should make reference to cases decided on the CISG around the globe and to CISG scholarship, as naturally this promotes an internationally uniform interpretation. Reference to local rules and cases not decided on the CISG is the antithesis of this direction. Internal gaps, that is – matters ‘governed by [the CISG] which are not expressly settled in it’ – are filled by liberal interpretation by analogy and general principles underlying the CISG itself, with recourse to the domestic law applicable through choice of law rules permissible only as a last resort: Article 7(2). For external gaps – matters not governed by the CISG – resolution is not by the CISG at all, but by the law determined by application of choice of law rules.⁷⁹ It is this obligation upon Contracting State courts in any one of the 80 Contracting States to comply with a single methodology that underlies reduction in forum risk. In countries that have not acceded, interpretation in such a manner is not a treaty obligation, but even so one might expect that upon finding the CISG applicable courts would also be sensibly guided by Article 7. Indeed, arbitral tribunals have little difficulty applying the CISG.⁸⁰ Additionally, accessibility of the CISG and materials guiding its interpretation should assist in minimizing any chance that the law will not be ‘ascertained’ and forum law applied in lieu.

It is certainly not proposed that outcomes under the CISG are utopian or perfectly predictable. Indeed, as discussed in Chapter 4, one of the biggest problems facing the CISG is that some courts have interpreted it in accordance with their own domestic outlook, the so-called ‘homeward trend’.⁸¹ One cannot help but surmise that the application of foreign law within courts suffers from a similar affliction to the CISG’s homeward trend, and arguably, its prospects of misapplication are greater. Certainly the homeward trend persists today, although there are some promising signs that in jurisdictions such as the US, perhaps the heartland of the homeward trend, that the tendency is beginning to dissipate.⁸² It is also true that a court in a non-contracting

78. Article 7(1) CISG.

79. See Ingeborg Schwenzer and Pascal Hachem, in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 7, 142-44 [42]-44 (Oxford 3rd edn, 2010) (‘Schlechtriem & Schwenzer 3rd edn’); Honnold, above n. 36, Art. 7, at 117-152 [85]-[103.2].

80. Monica Kilian, *CISG and the Problem with Common Law Jurisdictions*, 10 J. Transnat’l L. & Pol’y 217, 243 (2001); George V. Philippopoulos, *Awareness of the CISG among American Attorneys*, 40 UCC L.J. 357, 369 (2008).

81. John Honnold, *The Sales Convention in Action — Uniform International Words: Uniform Application?*, 8 J.L. & Com. 207, 208 (1988); Franco Ferrari, *Homeward Trend and Lex Forism Despite Uniform Sales Law*, 13 Vindobona J. Int’l Commercial L. & Arbitration 15, 20 (2009). See also for discussion on the development of an international jurisconsultorium: Camilla Baasch Andersen, *The Uniform International Sales Law and the Global Jurisconsultorium*, 24 J.L. & Com. 159, 159-61 (2005).

82. See *Chateau des Charmes Wines Ltd v. Sabaté USA Inc*, (9th Cir, 2003), US Circuit Court of Appeals, 5 May 2003, <http://cisgw3.law.pace.edu/cases/030505u1.html> (correctly rejecting domestic ‘in writing’ requirements); *MCC-Marble Ceramic Center v. Ceramica Nuova D’Agostino* (11th Cir, 1998), US Circuit Court of Appeals, 29 Jun. 1998, <http://cisgw3.law.pace.edu/cases/980629u1.html> (citing scholarship and rejecting parol evidence rule). Citing foreign CISG cases, see *Chicago Prime Packers Inc v. Northam Food Trading Co* (ND Ill), US District Court, 21 May 2003, <http://cisgw3.law.pace.edu/cases/040521u1.html>; *St Paul Guardian Insurance Co v. Neuromed Medical Systems and Support GmbH* (SD NY), US District Court, 26 Mar. 2002,

State will not be under an obligation to apply the CISG pursuant to its internal interpretive rules.⁸³ But more than any alternative choice of law, it is submitted that the CISG stands the best chance of being applied and correctly interpreted. The existence of the obligation to apply the CISG in Contracting States, the familiarity of arbitral tribunals with it, and its accessibility and simplicity each contribute to this conclusion. Thus it is arguable that the CISG has relatively more stable, predictable outcomes for international sales than many competing choices of law, on the basis of reduced legal or forum risk.

In addition to the risk of misapplication, one must also consider the risk of application of a law other than the law intended by the parties. The outcome of choice of law rules is often unpredictable.⁸⁴ This affects transactions where a deliberate choice of law has been agreed, cases where parties were unable to agree and simply omitted a choice of law clause,⁸⁵ and situations where parties did not consider the issue at all.

In every case, uncertainty inherent in choice of law rules undermines the ability of parties to assess their legal position, whether that assessment takes place pre- or post-contractually. This type of choice of law uncertainty increases the chance that each party will blame the other, since lawyers for each side will naturally seek application of the law most favourable to their client's *ex post* position. Such legal risks mean that remedial action might not be taken because rights and obligations are unclear. This inflates the possibility and length of litigation. Harmonization can reduce this legal risk,⁸⁶ and will do so provided the level of uncertainty inherent in the uniform regime is lower than the combined level of uncertainty in each of the potentially applicable regimes plus the choice of law uncertainty per se. Again, it is submitted that this is likely to result in reduced litigation (*ex post* efficiency, litigation) and increased social welfare.

However, the CISG goes one step further. The applicability rules of the CISG (discussed in Chapter 2) reduce the need to resort to choice of law rules in each of these situations, and the cost of disputing this issue in litigation (*ex post* efficiency, litigation). When both parties have places of business in Contracting States, Article 1(1)(a) ensures that the CISG will be the governing law for all issues within its scope rather than the choice of law rules that the forum would have otherwise applied. This improves the level of certainty as to the applicable law, at least to the extent of its scope. While the applicability of the CISG still depends on the status of the forum state to some degree (see Chapter 2), the high and growing number of Contracting States is

<http://cisgw3.law.pace.edu/cases/020326u1.html>; *Medical Marketing v. Internazionale Medico Scientifica* (ED La), US District Court, 17 May 1999, <http://cisgw3.law.pace.edu/cases/990517u1.html>; *Amco Ukrservice v. American Meter Co* (ED Pa), US District Court, 29 Mar. 2004, <http://cisgw3.law.pace.edu/cases/040329u1.html>; *Barbara Berry SA de CV v. Ken M Spooner Farms Inc* (WD Wash), US District Court, 13 Apr. 2006, <http://cisgw3.law.pace.edu/cases/060413u1.html> (each accessed 28 Feb. 2014).

83. Chapter 2, §2.03[B][3].

84. Born, above n. 22, at 2219 (there will 'often be doubt as to the conclusion that contemporary conflict of laws rules will produce'); Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* [5.33]-[5.35] (Oxford 2012).

85. Born, above n. 22, at 2219.

86. Stephan, above n. 55, at 746-48; but at 778 (claiming the CISG increases legal risk).

rapidly eroding the likelihood that a non-contracting State forum will be seized of proceedings. Even if it is, it would be probable that it would apply the CISG pursuant to its own choice of law rules where both parties are from Contracting States, since in most (but not all) cases the law of one of their States will be applicable.⁸⁷ Additionally, as mentioned in Chapter 2, the growing number of CISG Contracting States means the secondary resort to choice of law rules within Article 1(1)(b) has now decreased.

In transactions where parties are unable to agree on a choice of law, the improvement in legal certainty relating to ascertaining the governing law may prompt entry into transactions which might have otherwise been abandoned due to uncertainty. This will particularly be so where the other party's place of business is in a jurisdiction with a less developed legal system, but which has adopted the CISG. Therefore the default applicability of the CISG reduces choice of law risks which may act as *ex ante* barriers to trade.

Since the CISG decreases the difficulty of ascertaining the applicable law, information costs *ex post* during performance or in litigation stages will be lowered by the reduced need to resort to less predictable choice of law rules, primarily when both parties have businesses in Contracting States (*ex post* efficiency, litigation). This will be true whether the CISG applies by agreed choice or is applicable by default.

Although in the latter case parties may not have consciously chosen to be in the position in which they find themselves, the CISG as applicable law *ipso iure* provides the same reductions in information costs already discussed (*ex post*, performance, anticipated litigation/litigation). The problem with this argument is that it assumes parties realize the CISG applies. If its default application comes as a surprise, their efforts in performance or anticipated positions in a dispute will be miscalculated. Yet this is really no different to the surprise application of any foreign domestic sales law arising from unpredictable choice of law rules, itself dependent on the location of a forum seized of the dispute. Indeed, some jurisdictions do not allow choice of law by agreement at all.⁸⁸ Arguably, if anything, the CISG's rules on applicability simply reduce the confusion about the applicable law in this respect (see Chapter 2).

Importantly, the conclusions thus far regarding legal risks hold *despite* the potential for failure of the jurisdiction clause. No choice of forum clause is completely airtight. In light of quite different and sometimes unexpected interpretations of choice of forum clauses in some jurisdictions,⁸⁹ the CISG at least reduces uncertainty regarding outcomes, even if the anticipated choice of forum proves ineffective.

87. For example, as the State having the closest connection, characteristic performance etc.

88. See, e.g., in Brazil the *lex loci contractus* applies, and parties cannot choose other law unless they also choose arbitration: Art. 9 Lei de Introdução ao Código Civil Brasileiro 1942 [Introductory Law to the Brazilian Civil Code], Decreto-Lei N° 4657/1942.

89. See, e.g., *Vetreteria Etrusca Srl v. Kingston Estate Wines Pty Ltd* [2008] SASC 75. See also *Guiliani v. Linamar Holdings Inc* (2007) 52 CPC (6th) 129, Superior Court of Justice, Ontario, Canada 20 Sep. 2007, aff'd *Linamar Holdings Inc v. IGM USA Inc* [2008] ONCA 256, Ontario Court of Appeal, Canada, 8 Apr. 2008; James M. Klotz, Peter Mazzacano and Antonin I. Pribetic, *Case Comment*, 46 Canadian Business L.J. 430 (2008). See also Schwenzer, Hachem and Kee, above n. 84, at [5.33]-[5.35].

Similarly, additional stability is derived from the fact that the CISG would be most likely to apply if neither party's choice of law prevails.⁹⁰

Improvements in predictability of the identity of the law to be applied and its correct application enables more accurate risk allocation within contracts, reduces wasteful precautionary investments, and decreases anticipated litigation costs since there will be less post-contractual 'wriggle room' for argument about the identity of the applicable law in the event of litigation. On balance it is submitted that the CISG increases certainty, although the existence of the homeward trend reduces what might otherwise be a much greater comparative efficiency. To the extent that this view is correct, the CISG reduces transaction costs and increases trade.

[F] Litigation Costs

Application of the CISG can reduce litigation costs should a dispute reach court. Costs of litigation under a domestic law foreign to the court seized of the matter are invariably amplified due to the need to ascertain the identity and content of foreign law, the need for expert witnesses to prove foreign law, and the costs of official translations.⁹¹

This is not true of the CISG in most cases. In forums in non-contracting States, the CISG will be treated as foreign law, and its proof will therefore be subject to the same additional expenses in litigation as any other foreign law. However, in all other forums, as mentioned earlier, the CISG is not foreign law, and should not be treated as such.⁹² Whether or not the court follows the procedural principle of *iura novit curia*, proof of foreign law is a serious efficiency concern. The principle simply divides the economic burden of proof of foreign law between the parties or the court, but both entail social welfare costs. In any event, courts operating under this principle can and frequently do require parties to assist the court in establishing the content of foreign law.

Because the CISG is not foreign law, proving its content is relatively efficient compared to a choice of foreign law (*ex post* efficiency, litigation). Expert witnesses are not required to prove the nature of the CISG, and it must be treated as a matter of law, not fact, in each Contracting State. Likewise, in Contracting States domestic law cannot be applied in lieu of the CISG on the basis that the content of the law has not been ascertained.⁹³ Thus, provided the forum is in a Contracting State, the expense of litigating pursuant to the CISG should be favourable by comparison with litigation under foreign law. As courts and lawyers become increasingly familiar with the CISG, it can be surmised that the costs of ascertaining the content of the law in court will be reduced further still. The value of the CISG in the market for law may accordingly increase in direct proportion to the frequency with which it is used and litigated. Therefore it is submitted that this aspect of non-substantive efficiency is susceptible to network effects.

90. See also William S. Dodge, *Teaching the CISG in Contracts*, 50 J. Legal Educ. 72, 79 (2000).

91. Cuniberti, above n. 58, at 1524.

92. Discussed in Chs 2 and 10. See Schwenzer, Hachem and Kee, above n. 84, at [5.33]-[5.35].

93. Discussed in detail in Ch. 10.

It has been suggested that such problems might be avoided by choice of forum in the same jurisdiction as the expressly chosen law.⁹⁴ This would decrease anticipated litigation costs in much the same way. However, as discussed above, the solution entails information costs on the part of one or more parties, so it simply trades off one set of costs for another rather than reducing net transaction costs. Further, this solution will not work in situations where the parties have not negotiated choice of law or choice of forum clauses. Yet such parties may not have been inhibited from trading. Where this happens and the CISG applies, it will nonetheless result in reduced litigation costs to the benefit of parties, and improve social welfare, especially in terms of the publicly subsidized court system.

Reducing the cost of proving the content of the applicable law is only one way that the CISG helps reduce litigation costs. As noted above, simplification of conflicts rules in Article 1(1)(a) CISG further reduces the likelihood, length and cost of legal proceedings (*ex post* efficiency, litigation), with consequential societal benefits.

[G] Competitiveness

In some regions the CISG is increasingly viewed as a key choice of law.⁹⁵ Chinese counterparties frequently prefer to use the CISG.⁹⁶ Thus, in trade with China, a party that insists on a choice of non-CISG domestic law might increasingly be made to pay a price for the privilege, or possibly even lose deals altogether.⁹⁷ Conversely, agreement to the choice of the CISG may secure comparatively attractive terms of trade under such circumstances.

Yet the opposite may be true of trade with other counterparties, particularly in certain industry sectors. For example, as discussed in Chapters 4 and 6, the CISG is widely rejected within commodities sectors. Attempts to negotiate a choice of the CISG within a commodities transaction are unlikely to result in favourable terms, and the transaction could be lost altogether, except in those circumstances attenuated by elements which take it out of normal commodities trade, such as where a commodity is sold as part of a larger transaction which requires the buyer to process the commodity and resell it to the original seller in processed form.⁹⁸

Therefore it seems willingness to choose the CISG may in some cases provide a party with a comparative advantage in negotiating its 'share of the pie', but in other circumstances will not assist at all. A willingness to choose the CISG may, in certain circumstances, improve a businesses' competitive standing and profitability.

94. Cuniberti, above n. 58, at 1524.

95. See on growing acceptance of the CISG in the Asia-Pacific: UNCITRAL Secretariat, *Technical Co-operation and Assistance*, UN Doc A/CN.9/627 (18 Apr. 2007) [8]–[9]. Noting trade pressures on USA, see Kilian, above n. 80, at 242. See Chs 6 and 7.

96. Discussed in Ch. 6.

97. Harry M. Flechtner, 'Changing the Opt-Out Tradition in the United States', Paper presented at 'Modern Law for Global Commerce: Congress to Celebrate the 40th Annual Session of UNCITRAL', Vienna, Austria, 11 Jul. 2007, 2, <http://www.uncitral.org/pdf/english/congress/Flechtner.pdf> (accessed 28 Feb. 2014).

98. This was conveyed to the author in discussions with Australian practitioners advising parties in the mining sector.

[H] Preliminary Conclusion

The non-substantive issues considered above demonstrate that the CISG has the potential to create economic benefits for individual parties, from reductions in information costs to decreased forum risks and choice of law risks, improved market access, competitiveness and reduced litigation costs due to simplified choice of law rules and a reduced need to prove foreign law. In each case, the qualities discussed earlier of neutrality, accessibility, simplicity and predictability play an underlying role. The accessibility of the CISG can reduce information costs at all contractual stages vis-à-vis competing foreign law. The neutrality of the CISG creates the potential for lowering *ex ante* costs of negotiation. The predictability of the CISG potentially reduces the length and cost of litigation vis-à-vis competing foreign law and/or forum risks and choice of law rules.

Importantly, it is submitted that these advantages are necessarily magnified with greater frequency of the CISG as a choice of law – in other words, many non-substantive advantages could incrementally increase in value if the CISG becomes more widespread as a choice of law due to network effects. For example, streamlining the performance costs of a company's portfolio of contracts is facilitated if it becomes increasingly easier to negotiate for application of the CISG.

However, some non-substantive disadvantages were also noted: the complexity of interaction between the CISG and residual domestic law at the margins; limitations on the ability to standardize by reason of market preferences and/or suitability for transactions; and treatment of the CISG as foreign law with attendant litigation costs in forums located in non-contracting States. Along with the ongoing nature of the homeward trend, these must be taken into account in determining whether the CISG as a choice of law is efficient or not.

Some critics have strongly asserted that the CISG is inefficient. Although some of their points have already been discussed above and in Chapter 4, the full range of arguments will be examined further below. First, however, to complete the discussion of non-substantive issues, the following section will briefly observe some economic effects at the societal level of jurisdictions.

§5.04 MACRO-LEVEL EFFICIENCY: JURISDICTIONAL ADVANTAGES AND DISADVANTAGES

The effects of the choice of the CISG for jurisdictions should be briefly mentioned for the sake of completeness. Many of the issues considered above and in Chapter 4 were noted to have implications for societal welfare, which would also naturally affect efficiency within the jurisdiction concerned. Below, further issues at the jurisdictional level are considered, including competitiveness vis-à-vis other jurisdictions. Improvement of a particular jurisdiction's competitiveness simply shifts wealth from one jurisdiction to another, without necessarily 'increasing the size of the global pie' itself. However, it is worth considering reasons why a single jurisdiction might prefer to have

parties based within it choose the CISG over other laws. Essentially, a jurisdiction might benefit from a larger market share of the market for law and legal services.

The following discussion briefly considers the non-substantive effects of the frequency with which the legal profession deals with the CISG in a given jurisdiction. In each case, the question is whether a jurisdiction benefits or suffers from increased CISG usage.

[A] 'Hubs' and Comparative Legal Expertise

Frequently, jurisdictions tout themselves as potential 'hubs' for legal services. A jurisdiction might represent itself as having the best commercial law, or a superior court system in the sense of one which is relatively corruption free, internationally-oriented and fair. The examples which most frequently come to mind are England and New York.

Others seek to promote their expertise in particular legal services, sometimes building a reputation within specific regions or legal sectors. For example, in Asia, Hong Kong and Singapore are high volume centres for arbitration services for cases frequently involving parties outside those jurisdictions. Australia too has launched an initiative aimed at securing a larger proportion of the arbitration services market.⁹⁹

It is interesting to contemplate what jurisdictions do when they wish to demonstrate their suitability as a particular service provider. For less developed legal systems, adoption of the CISG itself can signal to traders that the country is now a better place to do business. Frequently, arbitration laws will be updated to conform to the latest international standard.¹⁰⁰ Rarely, however, are local sales laws similarly updated. It seems, however, likely that much of the comparative advantage of one jurisdiction over another is the level of expertise within its legal profession. If one jurisdiction's lawyers are more adept at advising and litigating on the basis of a law frequently chosen by parties, that jurisdiction may attract greater volumes of legal business than a jurisdiction in which lawyers and courts rarely encounter that law. Hence, since English law is chosen frequently, it is no surprise that English lawyers are in high demand.

To the extent the CISG is chosen in international trade, it can be surmised that expertise in the CISG should bring a comparative advantage to those jurisdictions frequently handling CISG litigation and advising clients on the CISG.¹⁰¹ If it is anticipated that the incidence of contracts governed by the CISG will rise, those jurisdictions which comparatively have higher volumes of CISG exposure can be expected to benefit the most, due to their comparative advantage. Conversely, in jurisdictions with less CISG expertise, one would expect lawyers and the legal industry

99. Robert McClelland, 'Simply Resolving Disputes' (Speech delivered at the International Commercial Arbitration Conference 'Making it Work for Business', Sydney, 21 Nov. 2008).

100. Fountoulakis, above n. 19, at 319 and passim.

101. See also Gary F. Bell, *Why Singapore Should Withdraw Its Reservation to the United Nations Convention on Contracts for the International Sale of Goods (CISG)* 9 Singapore Year Book of Int'l L. 55, 70-71(2005).

to experience a decline in business. In Chapter 6, the levels of CISG exposure in various jurisdictions will be analysed. The Oxford Civil Justice Survey revealed that, in relation to arriving at a choice of forum, respondents placed high levels of importance on the quality of judges, fairness, substantive contract law, and (to a lesser but still significant extent), the expertise of its lawyers.¹⁰²

The prevailing approach of practitioners and the bench toward the CISG may signal a jurisdiction's capacity to appropriately deal with international commercial matters more broadly. It is conceded that this is by no means the only, or even the most important manner in which such readiness can be made apparent. Equally however, it is submitted, a track record of automatic shunning of the CISG in choices of law, and moreover, a demonstrated history of failure to apply the CISG properly could undermine the important rational factors that should underpin efficient choices of law, as discussed in Chapter 7. It may also signal an absence of capacity that could be detrimental to regional competitiveness in the broader picture.

The strength of that signal in the case of the CISG is relevant to this view. Unlike cases dealing with local laws, CISG decisions from all countries are collected, disseminated and analysed at the international level. Cases that fail to properly argue and apply the CISG attract swift international critique, and consequently the comparative ability of counsel and courts to properly handle CISG cases is widely known by academics and practitioners familiar with the CISG, and says something about that jurisdiction's capacity for international legal work. It is submitted that, to some degree, the ability to interpret and apply the CISG properly contributes to that jurisdiction's reputation in handling international transactions. After all, in the market for legal services, legal insularity is no longer a luxury many jurisdictions can afford.

It may be that clients have also begun to differentiate. It would be drawing a long bow in terms of direct support for the above argument, but it is interesting to note that the number of Australian parties involved in CISG court decisions before Australian courts is a mere fraction of the number who are parties to CISG proceedings before Chinese arbitral bodies.¹⁰³ In China, courts and tribunals have decided numerous CISG cases. While it is difficult to know the exact figure as most cases are unreported, it is likely to be more than one thousand.¹⁰⁴ By 2009 in Australia, there had only been 13 cases mentioning the CISG, and it was applicable law in only 9 of them. In contrast, there were some 21 Chinese cases involving Australian parties by 2009.¹⁰⁵ As of March

102. Vogenauer and Hodges, above n. 24, Questions 33-35 (respondents' most common reasons for positive choice of forum were: quality of judges and courts, fairness, corruption, predictability, speed, then contract law, and for avoidance of a forum: predictability, fairness, corruption, quality of judges and courts, speed, contract law, costs, discovery then quality of lawyers).

103. Albert H. Kritzer, 'CIETAC Arbitration Awards: First 288 CISG Cases Translation — Identification of 21 of These Cases Involving Australian Parties' (Working Document, 2009), on file with author.

104. There were 386 cases reported from China on the Pace Website as at 2009, but this was only a small proportion of actual cases: <http://www.cisg.law.pace.edu/cisg/text/queenmary.html> (accessed 28 Feb. 2014). By March 2014, there were only 432 cases from China reported on Pace: <http://www.cisg.law.pace.edu/cisg/text/caselit.html> (accessed 28 Feb. 2014).

105. There were at least 21 Chinese cases involving Australian counterparties by 2009: Kritzer, above n. 103.

2014, Australia still had only 17 cases applying the CISG.¹⁰⁶ This could be due to a huge number of factors, such as comparative costs of litigation, but one cannot fail to notice the disparity between the exposure of Australian lawyers to CISG dealings as opposed to their Chinese counterparts. The observation does not suggest Australian lawyers are of lower quality by any means, but may suggest that in CISG matters, Chinese arbitrators and lawyers have more experience, and perhaps therefore a comparative advantage. The relationship between CISG exposure and choice of law is examined further in Chapter 6.

Obviously, however, increased litigation involves costs borne at the individual level which are not recouped by those individual parties. Greater quantities of CISG litigation would undoubtedly enhance jurisdictional awareness and improve comparative advantage through learning effects, but for the parties this is a positive externality – effectively, society and the profession get a free ride from another’s investment. A collective action problem arises from the need to develop CISG case law and inability to capture benefits of this for individual parties involved.¹⁰⁷

The issue is the same for the CISG as it has been for boilerplate terms. In both cases, the incidence of litigation has beneficial learning effects in terms of predictability, which in turn translates into better efficiency in future transactions. This raises the intrinsic value of the boilerplate terms in question in lowering future transaction costs. The same is true of the CISG. In both cases, positive learning effects and network effects arise. Yet those benefits are overwhelmingly reaped by others, not the parties engaged in the litigation themselves who bear the cost but capture little in the way of gains. The only exception might be very large ‘repeat’ players who may decide that it is worth litigating a point, not because of the potential gain or loss in the case itself, but in order to clarify their own anticipated future dealings on the same terms.

Recognition of the comparative advantage that such international expertise offers for a particular jurisdiction has recently led to concerted efforts by at least one professional body to improve the level of CISG knowledge within its jurisdiction. The New York State Bar Association has since 2010 been actively engaged in promoting knowledge of the CISG as part of the law of New York.¹⁰⁸ Recognizing that practitioners may need assistance in improving their awareness and expertise, they plan to launch an online contract resource explaining key features of New York law, including CISG-specific comments and links, as well as related activities. Practitioners and commercial chambers have also recently been active in other jurisdictions. Indeed Brazil recently adopted the CISG, due to efforts of business, arbitrators and lawyers in raising awareness of the potential for the CISG to enhance trade, including a major conference on the CISG hosted by commercial chambers FIESP.

106. Although 26 Australian cases were reported on the Pace Website as at March 2014, 9 of these did not apply it.

107. Steven Walt, above n. 55, at 692-97. See discussion in Chs 6 and 10.

108. The author was involved in the Checklist Project of the International Section of the New York State Bar Association. See NYSBA, *Mission Statement*, 14(2) International Chapter News 42-3 (2009); Email, 25 Jan. 2010 to International Section Members (on file with author).

[B] Ethical Considerations

Lawyers, due to their standing as professional advisors to their clients, owe an ethical duty to provide an appropriate level of care and expertise in advising their clients. Even if a particular lawyer, or a jurisdictionally-based group of lawyers, is unconcerned by their competitive advantage, a level of CISG expertise should be expected of every lawyer advising clients in relation to international sales. As Andersen states, 'good (expensive) lawyers must know all the options'.¹⁰⁹ If a lawyer knows little about the CISG, can it be said that they can act ethically in advising a client in relation to an international sale? Should it make a difference whether or not that lawyer is located in a Contracting State? Should such a lawyer endeavour to act for a litigant? To date, this author is not aware of any such professional malpractice cases that have proceeded to hearing.

Increasingly, it is being recognized that lawyers who do not provide adequate CISG advice may be doing their clients a disservice. Failure to grasp the CISG amounts to an absence of knowledge about a relevant part of the domestic law of any Contracting State, therefore a failure to know the law of the lawyer's own jurisdiction. If this is a systemic issue for lawyers across that jurisdiction, there will be adverse consequences for the quality of advice received by clients in that jurisdiction, and their representation in dispute resolution. Such clients may additionally enter less than optimal bargains in those circumstances where the CISG is a more suitable and efficient choice of law (see Chapter 6).

[C] Administration of Justice

It can be expected that the spread of harmonized law over time 'alleviate[s] the administrative load on the judicial system' by removing the need for courts to investigate foreign law, and instead replacing this task with 'consistent reference to a single body of rules'.¹¹⁰ Although parties themselves may bear the expense of counsel and expert witnesses, the extra time spent in court is also a societal cost. Accordingly, it can be argued that greater use of a single harmonized law and lower reliance on multiple foreign laws decreases the burden on the publicly subsidized court system, frees judicial resources, and correspondingly increases social welfare.

However, this benefit cannot be realized if courts and lawyers experience exposure to the CISG only occasionally, in which case reference to the CISG may be perceived as almost as onerous as investigation of foreign law. Where exposure is more frequent, the benefit may be more readily perceived. The frequency of litigation on the CISG and its effect on its efficiency are discussed further in Chapters 6 and 7.

109. Camilla Baasch Andersen, 'United Kingdom' in *Ferrari Impact*, above n. 62, 303, at 305.

110. See generally European Commission, *Green Paper*, above n. 53, at 9 (referring to potential European Contract Law).

[D] Retaining Existing Comparative Advantage

One of the arguments in support of the UK's continued reluctance to adopt the CISG has been that it could damage the standing of the UK in terms of provision of legal services, that '[t]here is a fear that joining the CISG may diminish [the UK's] advantage' as a forum often chosen in international sales.¹¹¹ It is true that English law and the English legal system are well regarded as a choice of law and forum. However, the argument is unpersuasive.

First, one need only look at the example of other Contracting States. The Oxford Civil Justice Survey demonstrated that, at least among European businesses, beside the choice of their home jurisdiction, parties favoured Swiss law over English law, even though they (incorrectly) perceived that (other) businesses generally would favour English law.¹¹² As previously discussed, the other choice of law most commonly nominated by commentators as frequently chosen for international transactions is New York law. The US and Switzerland are both Contracting States, but this does not seem to have altered their standing as favoured choices of law. Likewise, one hardly imagines parties will suddenly swap from the law of England to the law of (non-Contracting State) India as their preferred choice were the UK to adopt the CISG.

Secondly, the argument seems to disregard the ability to opt out of the CISG. As discussed in Chapter 6, exclusion of the CISG is not uncommon in many jurisdictions. Additionally, if parties do not wish for the CISG to apply, they can easily choose the law of a non-contracting State, such as English law.

On the other hand, what of those parties that wish to apply the CISG, but would like English law to apply to residual matters? As discussed in Chapter 2, the Rome I Regulation prevents the choice of the CISG as 'a-national' law, although an express choice to that effect might successfully result in the application of the CISG as incorporated into the terms of the contract. However, this method of application is technically less direct than simply choosing the law of a Contracting State, and it is submitted that this might detract from a choice of English law for those who wish the CISG to apply.

The argument of retention of comparative advantage is therefore highly flawed, and it is submitted that the UK's position is more likely to cause comparative disadvantage than advantage. The stance will not attract parties who wish to avoid the CISG, as they can readily opt out. Yet, it is conceivable that failure to adopt it will simply deter the choice of English law for those who desire application of the CISG, with corresponding consequences for English lawyers and courts. In fact, two such responses of this nature were received during UK government consultations. One stated that '[f]ailure to adopt the Convention may adversely affect the City of London as a forum for litigation and arbitration' and another pointed out that adoption of the

111. Hiroo Sono, *Japan's Accession to the CISG: The Asia Factor*, 25 *Zeitschrift für Japanisches Recht* 195 (2008), reprinted in 20 *Pace Int'l L. Rev.* 105, 106 (2008); Qi Zhou, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011. See also Sally Moss, *Why the United Kingdom has not Ratified the CISG*, 25 *J.L. & Com.* 483, 484-85 (2005-6).

112. Vogenauer and Hodges, above n. 24, Questions 17, 18.

CISG would ‘rebut[] the negative perception of the UK as being a reluctant participant in international trade law initiatives’.¹¹³ Given the ease of exclusion, it seems the UK’s reluctance lacks a rational basis.

[E] Preliminary Conclusion

At the jurisdictional level, there seems little reason not to promote wider use of the CISG and much to be said for the comparative advantage and signalling effect that CISG expertise might bring. As mentioned earlier, this may result in greater levels of international legal services performed within such a jurisdiction. The possibility of improved competitiveness should spur efforts by some professional associations to invest in CISG expertise in the hope that this may capture a larger market share. This is already occurring in some jurisdictions.¹¹⁴ Poor levels of CISG expertise and the failure to adopt the CISG provide no advantage, and at worst may act as a signal of comparative disadvantage in the market for legal services.

Although jurisdictional comparative expertise might not appear at first glance to affect overall (global) efficiency per se, it might well do so if the effect is to remove choice of law as a factor in choice of forum. Parties could instead base their choice on other, more rational reasons, such as the quality of the civil justice system or alternate dispute resolution track records, allowing them to make more efficient choices for resolving their disputes.¹¹⁵

Additionally, there are undeniable ethical concerns resulting from low levels of CISG expertise. These can be addressed through education,¹¹⁶ but can also benefit from greater levels of exposure of the profession and courts to the CISG through litigation. It can be argued that greater levels of CISG litigation have precedent value and beneficial learning effects (positive externalities) within a jurisdiction, with implications facing information costs for the jurisdictions’ practitioners.¹¹⁷

Finally, social welfare gains may be observed within a jurisdiction if the CISG as harmonized law becomes widely used, since this arguably has the potential to improve the efficient use of judicial resources, and the quality of legal advice. The latter aspect will be considered at length in Chapters 6 and 7.

Having explored non-substantive effects at a jurisdictional or societal level, it is now possible to return to the economic effect of the CISG upon individual parties.

113. Moss, above n. 111, at 485.

114. See above, n. 108 & accompanying text (New York & Brazil).

115. Currently, 79% of European businesses surveyed by Vogenauer and Hodges claim that variations in contract law affect their choice of jurisdiction, and quality of lawyers and contract law were both significant factors in choice of jurisdiction: Vogenauer and Hodges, above n. 24, Questions 14, 33.

116. As mentioned in Ch. 1, education is beyond the scope of this book, but is briefly addressed in Chs 6 and 8.

117. See generally Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 89 (1989). See also Walt, above n. 55, at 692-97 (in relation to the CISG).

§5.05 CRITICS AND OVERVIEW OF OVERALL EFFICIENCY

In this section, the views of those who argue the CISG is inefficient are re-examined in relation to both the substantive issues raised in Chapter 4, and non-substantive matters raised above. This is followed by an assessment of the overall efficiency of the CISG as a choice of law.

[A] Sophisticated versus Unsophisticated Parties and Quality of the CISG

Professor Cuniberti raises a valuable concern regarding the nature of *ex ante* transaction cost savings. From a study of CISG cases from the US, France and Germany, he concludes that the majority of parties do not negotiate for a choice of law.¹¹⁸ He argues unsophisticated parties lack awareness of the gap-filling role of default rules, viewing clauses dealing with choice of law as ‘formal legal ornaments’, useful only as a dispute resolution tool, and he contends such parties are unlikely to consider them during negotiations.¹¹⁹ He therefore contends that the reduction in *ex ante* information costs originally sought by the CISG’s drafters are simply never expended in the first place by unsophisticated parties, thus it achieves little for unsophisticated parties because it aims to save costs that simply do not exist.¹²⁰

On the other hand, in the case of sophisticated parties, Cuniberti contends that it is still unlikely the CISG provides any benefit due to its ‘poor quality’ in the form of its ‘limited scope’ and ‘vague’ provisions.¹²¹ I will address the arguments relating to unsophisticated and sophisticated parties in turn.

[1] Unsophisticated Parties

First is the matter of *ex ante* transaction cost savings, and whether parties expend anything on negotiation costs and drafting costs in relation to choice of law in the first place. Professor Cuniberti reasons that if they do not, then the CISG brings no benefit *ex ante*, because there is nothing to ‘save’, and therefore no efficiency gains.¹²²

Cuniberti states that since the ‘vast majority’ of unsophisticated parties do not negotiate choice of law, the CISG fails in its original aims to reduce transaction costs and legal uncertainty.¹²³ The argument goes that, for unsophisticated parties, the CISG has no effect upon barriers to trade, and cannot increase trade as originally anticipated.

This is a fair point. Parties who do not consciously turn their minds to the issue of applicable laws at all cannot be influenced in their choice of law by the substantive content of such law, since they do not (consciously) make such a choice at all.

118. Cuniberti, above n. 58, at 1529 et seq.

119. *Ibid.*, at 1520, 1539.

120. *Ibid.*, at 1520, 1521, 1540-41.

121. *Ibid.*, at 1515; Stephan, above n. 55, at 752, 773, 779; Steven Walt, *The CISG’s Expansion Bias*, 25 Int’l Rev. L. & Econ. 342, passim (2005).

122. Cuniberti, above n. 58, at 1521, 1540-41.

123. Cuniberti, above n. 58, at 1513, 1514.

The argument rests on four pillars: (1) that parties can be divided into the categories of ‘sophisticated’ and ‘unsophisticated’; (2) ‘unsophisticated’ parties do not expend on decision-making about applicable law because they do not care (hence absence of choice of law); (3) *ex ante* savings were the aim of the CISG; and (3) the implicit presumption that the level of ‘care’ of unsophisticated parties is static rather than dynamic and prone to change. Each pillar is addressed below.

While it is certainly true the drafters were concerned with *ex ante* savings and legal certainty, it seems likely they also had *ex post* efficiencies in mind, albeit this was less clearly articulated. That much is evident from some of the historical record, but more importantly, from the design of the CISG itself, as discussed in Chapter 4.

In any event, irrespective of the aims of drafters, if the CISG produces *ex post* efficiencies for ‘unsophisticated’ parties as a default law, then the criticism loses much of its sting. Cuniberti concludes any *ex post* savings for unsophisticated parties are unlikely because of the CISG’s ‘poor quality’ relative to alternative law,¹²⁴ and claims that the probability of invalidity might be reduced by reliance on clauses used in industry practice.¹²⁵ He mentions the fact that high costs might transpire if the contract is unenforceable under the law eventually applied.¹²⁶

The possibility of unenforceability and a party relying upon that *ex post* are indeed small. There is a dearth of evidence that application of the CISG makes it more likely contracts will be unenforceable, and the analysis in Chapter 4 demonstrates that the CISG is not of poor quality relative to alternative law, but is at least as efficient if not more efficient than laws commonly chosen for international transactions.

However, Professor Cuniberti does concede some potential *ex post* savings. He correctly points out these must be discounted by the likelihood of litigation, and argues the expected *ex post* cost savings may not be worth the negotiation costs which could have avoided such a result.¹²⁷

Substantive litigation efficiencies are not the only potential *ex post* saving that the CISG is capable of providing. It was argued above that non-substantive litigation costs may also be reduced, not least because parties will not need to prove foreign law. It was also contended that the CISG reduces the risks associated with failure of jurisdiction clauses.

Notably, not all *ex post* savings are contingent on the quality of law: as discussed above, most non-substantive efficiencies that arise on an *ex post* basis will exist irrespective of the quality of the law. Indeed, this is mentioned in passing by some critics including Cuniberti.¹²⁸ Even if one were to assume the CISG to be substantively equal or slightly inferior, the non-substantive benefits detailed above may still mean the CISG is, on balance, the most efficient law. Additionally, as mentioned earlier, to the degree that some unsophisticated parties rely upon the CISG’s default application,

124. *Ibid.*, at 1515, 1544. See also Stephan, above n. 55, at 752, 773, 779; Walt, above n. 121, passim.

125. Cuniberti, above n. 58, at 1521.

126. *Ibid.*, at 1542, 1543.

127. *Ibid.*, at 1521.

128. *Ibid.*, at 1544 (stating that CISG could only partially reduce learning costs due to its incomplete scope).

there in fact may be *ex ante* savings in the form of negotiation and drafting costs. As discussed earlier, significant social welfare gains also arise.

Nonetheless, the substantive quality of the law is naturally important. In Chapter 4, it was concluded that, on balance, the CISG is probably substantively efficient in an absolute sense, but also in a comparative sense, at least with regard to the alternative choices examined – its *relative* efficiency.

In an absolute sense, in the previous chapter the CISG's substantive design was evaluated, and it was concluded the CISG is probably efficient for international sales. This conclusion was based on both *ex ante* and *ex post* efficiencies. Ignoring the *ex ante* advantages, many substantive efficiencies were of an *ex post* nature, and they extend well beyond Cuniberti's concession that some *ex post* efficiencies might arise but must be discounted for the probability of litigation. Performance savings potentially accrue for every contract, and should not be discounted for the probability of litigation arising because contract management or compliance costs are incurred even in cases where no dispute arises. It was concluded above that the CISG would probably lower *both* performance and dispute costs due to its substantive design, and efficiencies relating to *both* performance and dispute stages were outlined at §4.02[A] (*favor contractus*, restriction of termination, cure, *Nachfrist*); §4.02[C] and §4.02[E] (notice requirements at performance and dispute stages); §4.02[F] (damages encouraging compliance); §4.02[H] (price reduction remedy). It would be an oversight to dismiss these *ex post* benefits, which accrue when the CISG applies by default as much as when it is deliberately selected.

Furthermore, in a *relative* sense, *ex ante* and *ex post* efficiencies were identified in Chapter 4, leading to the conclusion that it was relatively as efficient, and probably more efficient than commonly chosen alternative laws. Ignoring *ex ante* savings for the moment, even where it applies by default due to failure of parties to turn their mind to choice of law, the CISG still brings *ex post* cost savings by comparison with the UCC and English law due to its design: see §4.03[B][4] (damages measures leading to reduced *ex post* speculation, clearer and stronger preservation of original risk allocation); §4.03[B][5] (gap-filling), §4.03[B][7] (*favor contractus*, termination restrictions and notice); §4.03[B][8] (clearly defined preservation obligations); §4.03[B][10] (effect of quality requirements at performance stage).

While these features also reduce the chances and costs of litigation, it must also be remembered that, at a non-substantive level, there is also the potential for economies of scale across a party's portfolio of contracts by standardization of choice of law to lead to the CISG by simply choice of a Contracting State law without exclusion. This offers the possibility of magnifying the value of each of these performance stage efficiencies, especially for those who trade with counterparties in a multitude of jurisdictions.

It is, however, worth revisiting these issues given the weight placed upon core matters raised by critics. The flaws asserted by Cuniberti, Gillette and Scott, Walt and

Stephan in relation to scope, ambiguity and divergence,¹²⁹ were briefly addressed in Chapter 4. The main thrust of their arguments is that the CISG is inefficient because it has a limited scope, is vague and ambiguous, and places heavy reliance on legal standards. On this view, it is argued the CISG is imprecise and cannot reduce legal uncertainty, and its application simply results in an increase of the legal regimes governing the contract.¹³⁰

While it is true that the CISG's coverage is not complete, neither is the coverage of any sales law component of domestic law. The CISG intends to replace existing law only to the extent of the issues covered within it, therefore it does not 'add' a layer of complexity at all.¹³¹ Primarily, it simply performs the functions that the displaced domestic sales law would have done. As previously mentioned, this means that in the sense of added 'complexity' there is no relative disadvantage in the application of the CISG vis-à-vis domestic (or foreign) sales law.¹³² It was contended that the only real issue in this regard is interrelation of sales law with other residual laws at the margin.¹³³ Undoubtedly this problem exists for the minority of cases involving those external issues in relation to which opinion is divided. Again, much work has been done to identify overlaps and extensive scholarship has been devoted to interrelationship issues, which serves to isolate key points of remaining uncertainty so that they may be incrementally resolved over time. Chapters 9 and 10 will address two such remaining concerns. However, it must be acknowledged that 'interaction' with residual domestic law does introduce some uncertainty regarding unsettled areas.

I agree with Cuniberti's argument that the CISG's lack of central judicial oversight may result in parochial interpretations and thus result in information costs to establish the extent of jurisdictional variations.¹³⁴ There can be no doubt that the homeward trend remains a problem (as acknowledged in Chapter 4). However, the problem should not be overstated. As mentioned earlier, some convergence has already occurred, and in regard to remaining divergences, it was concluded the CISG today probably differs little in terms of substantive certainty from most sophisticated systems. No legal system can deliver absolute clarity in all things. Moreover, one must be careful not to overlook the non-substantive elephant in the room. It is submitted that, by comparison with the multitude of potential foreign laws that necessarily constitute the alternative, this problem, although very real, does not constitute a serious comparative disadvantage in terms of information costs.

It would present a very unbalanced picture to emphasize learning costs inherent in areas of divergence under the CISG without comparing this to learning costs inherent in alternative choices of law, each no doubt carrying their own level of divergence/

129. Stephan, above n. 55, at 777-78; Gillette and Scott, above n. 49, at 461-65. See also, Walt, above n. 121, passim; Jacob S. Ziegel, *The Future of the International Sales Convention from a Common Law Perspective*, 6 *New Zealand Bus. L. Quarterly* 336, 338 (2000).

130. Cuniberti, above n. 58, at 1516, 1544 et seq. (citing Gillette and Scott, and Stephan).

131. *Ibid.*

132. See *ibid.*, at 1544 (conceding CISG might partially reduce learning costs but was limited due to its scope).

133. See *ibid.*, at 1546.

134. *Ibid.*, at 1545.

uncertainty. Add to this the non-substantive potential for streamlining that the CISG presents for a single business trading across many borders, plus efficiency gains from decreases in forum risk and choice of law risk, and it is submitted that the CISG may well carry positive economic effects as a choice of law for parties, as well as for society.

Additionally, it was argued above that the CISG's substantive features are, on balance, likely to bring economic benefits by comparison with alternatives. Using the UCC and English law as examples, it was seen that when a broader range of design features than those considered by Cantora were taken into account, particularly the *favor contractus* principle, transaction costs for international transactions seem to be relatively lower under the CISG. If so, the surplus available to both parties is increased, thereby creating an efficiency gain irrespective of whether both, neither or only one of them realizes it at the time the contract is concluded. In other words, substantively, the CISG's features probably result in *ex post* savings, even in default application scenarios, and both *ex post* and *ex ante* gains in conscious choice situations. At the very least, the CISG does not carry comparatively negative economic effects due to its substantive features, except in cases where the transaction type or other considerations make it unsuitable or infeasible as a choice of law (see Chapter 6).

Nonetheless, Cuniberti argues that it is unclear that transaction costs will be reduced and that the solution lies in clauses used in industry practice.¹³⁵ Why 'unsophisticated' parties who have ignored choice of law altogether would have sufficient motivation to do this is unclear. One cannot sensibly dismiss the value of a default law which brings *ex post* savings in the absence of private decision-making on the basis of the potential for better private decision-making. After all, in essence, this is the very role of default law in the first place. Further, the argument disregards the fact that to implement the suggestion entails *ex ante* negotiation costs, and dismisses too readily the significance of *ex post* savings which benefit all parties including those who make no choice of law.

As mentioned earlier, anticipation of *ex post* costs can act as a deterrent to trade. There may be parties that enter trade on the basis of the existence of a default law, and the fact they may not negotiate a choice of law may not betray a lack of 'care' at all. In any event, *ex post* savings for parties that do not negotiate choices of law are tangible savings that can accrue at either performance or litigation stages. In addition to the efficient allocation of risks, *ex post* costs also consist of search costs. For international transactions, choice of law rules greatly add to search costs, however, it is submitted this aspect is not given adequate weight within Cuniberti's argument.¹³⁶ It was argued above that not only does Article 1(1)(a) ease the task of ascertaining which law is applicable *ex ante* by displacing choice of law rules, but also that litigation costs of proving the content of the applicable law are significantly lowered in many cases under the CISG because it is not a foreign law. Further, as discussed above, choice of law risk and forum risk are also reduced.

Certainly the absence of a choice of law clause might show that, at the time the contract was concluded, the parties did not care about the issue, but this does not

135. *Ibid.*, at 1522.

136. Cuniberti does mention this issue: *ibid.*, at 1543.

detract from the fact that the CISG can reduce the legal uncertainty at the point when events have prompted one or both parties to care about their legal obligations. Thus even for ‘unsophisticated parties’ the CISG produces more efficient results than the alternative. It removes legal uncertainty inherent in choice of law rules post-contractually where Article 1(1)(a) applies, thereby reducing information costs associated with identifying and ascertaining the applicable law;¹³⁷ its design generally reduces performance costs by upholding the *favor contractus* principle and requiring notice of avoidance or non-conformity, etc. (see Chapter 4); and it reduces the cost and effort of proof of law in litigation.¹³⁸

Cuniberti argues, however, that it would be possible to address the problem by designing better choice of law rules, and that parties could simply and more efficiently include a choice of law clause instead.¹³⁹ However, by definition, such parties would not be ‘unsophisticated’. That parties *could have* included a choice of law clause fails to address the real issue at the *ex post* stage. That it is *possible* to design predictable default choice of law rules and have them widely adopted misses the point.¹⁴⁰ Wishful thinking provides no efficiency savings to such parties. Moreover, even if predictable default choice of law rules were in existence (and applicable), they would simply lead to a law foreign to at least one of the parties, thereby leading to relatively inefficient increases in information costs due to linguistic/accessibility barriers, and relatively higher litigation costs due to the need to prove foreign law. Additionally, parties would continue to face the forum risks discussed earlier. As mentioned above, the CISG’s application in litigation may produce positive externalities in terms of information costs (see Chapters 6 and 10).

Thus even if it is conceded (as it is) that some parties do not negotiate choice of law at all, it does not follow that this renders the CISG inefficient. It simply means it does not produce significant *ex ante* efficiency savings for those parties. Yet it probably benefits even these parties by actual *ex post* savings, both by reason of substantive and non-substantive efficiencies. Additionally, because it can maximize social welfare more broadly, it is submitted that, irrespective of the fact some parties may not care *ex ante*, the CISG is still on balance a relatively efficient law, even for them. This is so notwithstanding valid criticisms noted above concerning the homeward trend, interaction with residual domestic law, market preferences and/or suitability for certain transaction types, and treatment of the CISG as foreign law in non-contracting State forums.

The claim that parties who do not care about choice of law make up the vast majority deserves closer consideration. It derives from a survey of 181 cases mentioning the CISG from the US, France and Germany, and some ICC arbitration cases.¹⁴¹ While Cuniberti also cautions against reliance on the ‘very limited’ data underpinning

137. *Ibid.*, at 1543 (acknowledging this potential benefit of the CISG).

138. Irrespective of whether parties or the court must establish the content of foreign law. See above n. 93 and Ch. 10.

139. Cuniberti, above n. 58, at 1515 (doubting reduction in legal uncertainty on this and other bases).

140. *Contra ibid.*

141. *Ibid.*, at 1529 et seq.

his study, ultimately he contends it would be unlikely the results would be contradicted by a larger study inclusive of non-litigated cases.¹⁴² Cuniberti reviews them and determines that no choice of law was agreed in the majority of cases.¹⁴³ It is from this that he concludes that ‘parties to international sales are generally not concerned with the legal regime governing their contracts’ since failure to provide for applicable law ‘must mean that they are just not concerned with the applicable regime’.¹⁴⁴ In other words, ‘none of them cares ex ante’.¹⁴⁵ This conclusion concerning ICC cases, as noted elsewhere, does ‘not reflect the ICC’s own observations on this point’.¹⁴⁶ It also runs contrary to empirical evidence suggesting the ability to choose applicable law is highly valued.¹⁴⁷

There are alternative explanations for the high number of cases where a choice of law clause is lacking, and not all of them can be said to involve a lack of ‘care’ by parties. In truth, it may simply be that disputes which came before courts and tribunals involved a greater proportion of parties who did not negotiate a choice of law, compared to non-litigated cases. The absence of a choice of law clause can be why an otherwise relatively uncontentious case ends up in court. This is a possibility that Cuniberti indeed acknowledges.¹⁴⁸ Or it may be that the parties turned their minds to the matter, but simply could not agree upon a choice of law clause.¹⁴⁹ A final alternative theory, that parties might be aware of the default applicable law rules and have been content to rely upon the application of the CISG, is rightly (for his data set) dismissed by Cuniberti as ‘completely unrealistic’ on the basis that it is unlikely parties knew of the CISG so soon after it entered into force.¹⁵⁰ In support, he says that Professors Gordon and Dodge have shown that even lawyers were often unaware of the CISG and often advised parties to opt out.¹⁵¹ Cuniberti dismisses the possibility the transaction value might influence whether it is worthwhile negotiating for a choice of law, since he finds no correlation between inclusion of a clause and transaction value.¹⁵²

Rates of exclusion are dealt with in Chapter 6. Suffice to say for now that Dodge related only anecdotal evidence, and the sample size of Gordon’s study cannot be ascertained. While sometimes cited as having 124 respondents, Gordon’s sample size

142. *Contra ibid.*, at 1536.

143. *Ibid.*, at 1529, 1541 (on the basis that the contracts failed to provide for applicable law in 63% of a sample of 38 US cases sampled, 75% of German cases sampled, 95% of French cases sampled and 60% of 30 ICC cases sampled).

144. *Ibid.*, at 1529, 1537, 1539, 1540-41. Confidence levels are not provided for the population statement.

145. *Ibid.*, at 1541.

146. Schwenzler, Hachem and Kee, above n. 84, at [5.21] n. 43.

147. Vogenauer and Hodges, above n. 24, Question 15 (49% of respondents in a survey of European businesses felt the ability to choose the applicable law was ‘very important’). See also *ibid.*, at [5.21] & n. 43.

148. Cuniberti, above n. 58, at 1536.

149. *Ibid.*, at 1537, 1539.

150. *Ibid.*, at 1537-38.

151. *Ibid.*, at 1537-38 (citing Dodge, above n. 90; Michael Wallace Gordon, *Some Thoughts on the Receptiveness of Contracts Rules in the CISG and UNIDROIT Principles*, 46 (Suppl) Am. J. Comp. L. 361 (1998)). Gordon’s study is analysed in Ch. 6.

152. Cuniberti, above n. 58, at 1540.

is in fact unclear. Gordon himself does not disclose the number of responses received, but only mentions that the ‘survey was sent’ to 124 members of the Florida Bar.¹⁵³ Therefore, it is probable that Gordon’s sample size is a far smaller figure than 124, and any estimate would be speculative.¹⁵⁴

Furthermore, many extensive and statistically reliable surveys have now become available, and these demonstrate interesting trends regarding exclusions (see Chapter 6). Where no choice is made, it is possible there has been conscious reliance upon default application of the CISG. This may seem unlikely at first, but it is submitted one cannot today so easily dismiss awareness of the CISG amongst all parties or their lawyers. Where they originate from jurisdictions such as China or Switzerland, reliance on the default rule might indeed be a reasonable explanation for a significant proportion of cases, and there is anecdotal support for this practice by Italian specialist drafters who are said to prefer to deliberately chose the law of a Contracting State because they know this means that the CISG will apply without explicit disclosure of this result to the counterparty.¹⁵⁵

So-called ‘unsophisticated’ parties which ultimately decide not to bother with a choice of law may nonetheless perfunctorily consider the issue, thus they do expend on *ex ante* costs which can be reduced, and really cannot be grouped as ‘default’ or unconscious decision-makers.¹⁵⁶ More importantly, such minimalist decision makers may at some stage be induced into negotiating, should they become aware that it may be worthwhile. The neutral safety net of the CISG may provide the psychological comfort some businesses need to begin international trade, quite apart from any economic effects on those transactions. Furthermore, *ex post* cost reductions improve social welfare and maximize exchange gains, even if they do not influence the decision to engage in trade.

[2] *Sophisticated Parties*

The other group identified by Cuniberti is ‘sophisticated parties’ that are aware of the importance of the legal regime governing the contract, and who actively negotiate choices of law. In relation to this group, Cuniberti argues the CISG still fails to provide efficiency gains for two reasons: because such parties will rely on lawyers; and because of the CISG’s ‘poor quality’.¹⁵⁷ The claim about the CISG’s quality has already been discussed above.

The claim that use of lawyers to negotiate means the CISG holds no benefit for sophisticated parties relies heavily on the idea that lawyers operate within multinational law firms that can costlessly draw on the expertise of their firm colleagues in

153. It was sent to 100 members of the Florida Bar International Law Section and 24 members of the Section’s Executive Committee: Gordon, above n. 151, at 368.

154. Based on response rates elsewhere, Schroeter, above n. 61 reasonably guesses the sample was 20%, or around 24.

155. Marco Torsello, ‘Italy’ in *Ferrari Impact*, above n. 62, 187, at 190, 195-99.

156. *Contra* Cuniberti, above n. 58, at 1542.

157. Cuniberti, above n. 58, at 1541.

foreign jurisdictions.¹⁵⁸ Yet such an assumption may not be borne out in the majority of cases. A recent business survey suggests that respondents perceived that one of the advantages of harmonization is savings on legal fees.¹⁵⁹ Many lawyers are not in multinational law firms, and those that are may not have an office in the relevant jurisdiction. Even if they do, reliance on expertise within the firm may indeed not be costless for the client. And even if research and/or consultation costs are absorbed by the law firm, those costs still exist, regardless of who bears them.

As discussed in Chapters 6 and 7, this may have a profound effect upon the choice of law. Thus the real question is whether such learning costs are greater (for either party/lawyer) when dealing with multiple foreign laws relative to when the CISG is chosen time and again. It is suggested that information costs are necessarily lower (and efficiency accordingly maximized) by repeated use of the CISG, even for sophisticated parties. The advantages of streamlining across the particular business' portfolio of contracts as outlined above apply just as much to sophisticated parties as any other business trading across multiple borders. In fact, the truth is that such advantages are by far even more relevant for sophisticated parties as they will more likely be large-sized businesses which may even be based in multiple jurisdictions.

Cuniberti supports the prediction by Gillette and Scott¹⁶⁰ that parties will engage in 'wholesale' exclusion of the CISG due to its 'poor quality'. He relies upon evidence in the form of exclusions in a few of the 181 cases surveyed, a study by Koehler, anecdotal accounts from Professor Ziegel, and Professor Bridge's observations relating to commodity trade to support his view.¹⁶¹ However, the reasons for opt-outs are interwoven and complex, as discussed in depth in Chapters 6 and 7. For now, although it is acknowledged that the contention holds some truth, in Chapter 6 it will be contended that current evidence shows exclusions are far from 'wholesale',¹⁶² and it is submitted that the nature of reasons for opt-outs must give pause to anyone who asserts they occur purely because of the substantive content of the CISG, as Cuniberti claims.¹⁶³ In particular, the data available demonstrates that it cannot simply be hoped that lawyers are by definition 'sophisticated' in this respect, so it cannot simply be asserted that reliance on the ability of lawyers will negate the effect of information costs for sophisticated parties. Even in the very Koehler study that Cuniberti cites, some 33.3% of US lawyers said the CISG was 'unknown' to them.¹⁶⁴ To the contrary, it will be argued that learning costs may trigger a series of complex influences that may actually lead to a less efficient choice of law than the CISG, a matter extensively

158. See *ibid.*, at 1523, 1543, 1541 & 1549 (arguing exclusion of CISG raises transaction costs). *Contra* see discussion in Ch. 4, §4.04. See also Visscher, above n. 59, at 10 (regarding multinational businesses).

159. Vogenauer and Hodges, above n. 24, Question 46 (33% of European businesses responding felt that lower legal costs flowed from harmonization of contract laws).

160. Gillette and Scott, above n. 49, at 477.

161. Cuniberti, above n. 58, at 1547 refers to Michael Bridge, *The International Sale of Goods* §1.03 (Oxford 1999), Koehler, above n. 64, and Ziegel, above n. 129, at 341.

162. See Ch. 6.

163. Cuniberti, above n. 58, at 1547; Gillette and Scott, above n. 49, at 456, 478; Walt, above n. 121, at 346.

164. See Cuniberti, above n. 58, at 1548; Koehler, above n. 64.

discussed in Chapter 7. Indeed, in following chapters, the assertion that main reason for opt-outs is the CISG's 'poor quality' is tested empirically, and found to be far from accurate.

Cuniberti concludes that the economic benefits of the CISG are overshadowed by costs associated with it.¹⁶⁵ This must be doubted. The costs imposed by the CISG are quantified by Cuniberti as twofold: the costs of its creation, borne by society, which presumably refers to the efforts of UNCITRAL and the Diplomatic Conference; and the costs imposed by the added complexity of an additional layer of law with which courts, tribunals and parties must contend.¹⁶⁶

The latter overstates the effect of the CISG, which simply replaces the law that would otherwise apply by reason of choice of law rules, to the extent of its scope. As mentioned earlier, by comparison with the alternative, the only additional cost involved is the extent to which homeward trend problems and marginal interrelationship issues arise. Even if one were to accept the proposition that the CISG's substantive benefits are minimal, the argument dismisses altogether the considerable non-substantive benefits for parties and society: reduction in costs of administration of justice by comparison with the alternative of a multiplicity of foreign law and choice of law rules; the costs of proof of foreign law (whether by the parties, by the court or a combination);¹⁶⁷ and the costs of complex and unpredictable choice of law rules etc. Parties can take advantage of it to streamline their portfolio of transactions, thus reducing performance costs. The potential for non-substantive savings, on balance, probably outweighs the disadvantages mentioned, even on the assumption of neutral substantive effect.

It is submitted that the costs of creating the CISG, such as Diplomatic Conferences and other costs borne by UNCITRAL, should be ignored in assessing its efficiency. These are now sunk costs and consequently irrelevant. Before the CISG came into existence such arguments might have been relevant, but one would need to consider countervailing savings in national legislative efforts which have since utilized the CISG as a model for domestic sales laws, savings from removing the need in each jurisdiction to design laws suitable for international sales, in addition to the issues which remain relevant today.

Additionally, by definition, 'sophisticated' parties negotiate for choices of law. For these parties, the CISG can also offer *ex ante* savings. For transactions which do not incur *ex ante* costs relating to choice of law, *ex post* costs are reduced nonetheless, thereby maximizing exchange gains. Just as drafters envisaged, the substantive design features of the CISG are tailored for international transactions, and these ensure that the CISG provides a greater surplus due to reduced potential for termination.

165. *Contra* Cuniberti, above n. 58, at 1541, 1550.

166. *Ibid.*, at 1550; Jan Smits, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

167. See Ch. 10.

[3] *The Classification of Sophisticated versus Unsophisticated*

The arguments presented by Professor Cuniberti are that the CISG does not improve transactional efficiency because most parties are either ‘sophisticated’ and thus choose to exclude the CISG (incurring opt out costs as a result), or are relatively ‘unsophisticated’ and thus unwittingly apply the CISG by default (so efficiency gains at the contractual stage are irrelevant because parties do not consciously choose law anyway).

However, the ‘sophisticated’ versus ‘unsophisticated’ divide itself is arguably too simplistic.

There are a range of decision-making profiles which may lead to application of CISG by default, which cut across the range of ‘sophisticated’ and ‘unsophisticated’ categories, and it is impossible to discern which one a particular case falls into simply by absence of a clause nominating a choice of law. Further, it is contended that decisions to exclude the CISG similarly fall across a range, and these are equally important. For example, the ‘unconscious’ decision may involve:

- (1) a complete ignorance and failure to consider the issue at all;
- (2) some consideration, but ultimately no choice made due to inability to agree or conclusion a conscious choice of law is not worth the cost or effort;
- (3) minimal consideration, but ultimately exclusion of the CISG as an ‘automatic’ choice;
- (4) careful consideration and a deliberate failure to choose (by at least one side), in the knowledge that the CISG will apply by default; or
- (5) careful consideration and deliberate exclusion.

All of the above decision profiles involve expenditure on *ex ante* costs of negotiation (and sometimes drafting) with the exception of 1). All except 4) and 5) may lead to suboptimal choices of law.

As discussed earlier, the decision in 4) might at first glance seem unlikely, but indeed does occur.¹⁶⁸ Further, while it would be classified in Cuniberti’s analysis as an ‘unsophisticated’ decision due to the absence of a choice of law, it actually involves quite sophisticated analysis and a deliberate choice – at least by one party. Such a case in truth fits neither the ‘sophisticated’ nor the ‘unsophisticated’ categories proposed by Cuniberti, but involves *ex ante* expenditure on choice decision-making without resulting in any overt choice to exclude, and ultimately default application by design.

In 2), the CISG may apply by default, and would be classified as an ‘unsophisticated’ decision, however, Cuniberti himself acknowledges that his argument cannot apply to such situations,¹⁶⁹ as the failure to make choice is due to other factors.

The decision in 3) involves *ex ante* costs and exclusion. The parties still expend on negotiation and drafting, but might well have made an inefficient choice. It certainly does not fit the profile of a ‘sophisticated’ choice of law; in fact, it is a choice of law that

168. See above n. 155 and accompanying text.

169. See above n. 149.

may be suboptimal. It is an ‘unsophisticated’ decision, but contrary to Cuniberti’s argument, carries the potential for *ex ante* cost savings.

It would seem arguable that a proportion of those that Cuniberti classifies as ‘unsophisticated’ exclude for reasons other than the substantive quality of the CISG, and do expend *ex ante* costs. The fact that parties might ‘automatically’ bargain for the law of their country of origin, or a ‘neutral’ third-party national law may be the result of a series of behavioural influences which may not be ‘rational’ in classical terms, but this does not denote a complete lack of conscious decision-making.¹⁷⁰ The psychological and economic reasons for choices of law deserve closer examination, and are discussed in greater detail in Chapter 7. Notably, psychological factors have the potential to affect choices of all parties, even ‘sophisticated’ ones, and failure to take them into account can too easily obscure analysis of the decision making process.

It is also important not to forget that whatever the situation might be at present, decision-making conditions can change. Parties involved in situations 2) or 3) may become aware of better choices. Even parties involved in situation 1) may become aware of benefits to be gained and become motivated to begin actively making decisions, should they discover negotiation for choice of law could be worthwhile. In other words, the decision-making environment could change so that they incidentally become aware that they ‘should care’.

While this would lead to *ex ante* expenditure, it could result in net savings. The key, of course, is a change in the environment that leads to the realization that choice of law matters, either per se, or because of newly perceived availability of an especially tailored neutral and efficient international law that counterparties can readily agree to select, especially if making such a choice were to ripen into a ‘norm’.

This realization could come about due to higher or rising levels of CISG litigation, or were the CISG to become a more frequent choice in international sales transactions generally. The potential for this will be explored in following chapters. If chosen more frequently, it would become inherently more valuable and efficient due to networking effects, possibly becoming a norm. With more CISG cases, lawyers may become more cognizant of the CISG. These could increase the probability of parties being alerted to the need to consider choice of law, and/or the benefits of the CISG, either by their own legal advisors, or, in many cases, by a ‘trickle-down’ effect. Parties may interact with counterparties who have engaged lawyers, and/or utilize boilerplate originally drafted by lawyers.

A consequent raised general level of awareness by all parties as to its existence, and/or benefits of choice of law more generally, could lead those presently in 1) who make no choice at all to begin to ‘care’, whereupon they would shift categories to fall within 2) - 5), depending on how much they decide to care. It could also prompt parties otherwise presently distracted by psychological reasons from ‘automatically’ excluding (reversing 3), or cause parties in situation 2) to assess negotiations as now worthwhile on a cost-benefit basis when previously they were not. The potential for triggers and

170. See generally the interesting discussion in Richard A. Posner, *Economic Analysis of Law* 17-20 (Kluwer 7th edn, 2007).

effects of changes in the decision-making environment are explored further in following chapters.

[B] Majoritarian versus Non-majoritarian

As discussed in Chapter 4, Professors Gillette and Scott argue that the political economy in which the CISG was conceived inexorably led to undesirable rules. They conclude that the CISG is of a substantively inferior quality as discussed extensively above.¹⁷¹

Gillette and Scott argue that this means the CISG fails as a majoritarian rule, and is therefore inefficient.¹⁷² The authors characterize the twin concerns to be resolved by international sales law as legal knowledge costs and problem solving costs.¹⁷³ In regard to problem solving, they argue efficient default rules should be majoritarian, as does Professor Walt.¹⁷⁴ As noted in Chapter 4, the bases for their argument are primarily within the substantive sphere; that is, that the compromises involved in its creation led to the sacrifice of legal certainty in favour of a restricted scope of formal coverage, ambiguous provisions, and reliance on vague standards. They say that this reduces its substantive quality to the extent that it is not a socially optimal default rule because it does not deliver the problem solving terms which parties would prefer.¹⁷⁵ On this basis, they argue the CISG has failed to meet its original aims.

By contrast, in Chapter 4, it was concluded that the CISG at a substantive level was probably relatively efficient. However, that evaluation was not based on the aims of the CISG's drafters alone, but on a broader perspective. Furthermore, the conclusion did not view the qualities of the CISG in isolation, but considered its qualities relative to an alternative choice of law. It is contended that it is not possible to determine whether a law is majoritarian solely on its own substantive merits. Instead, its *relative* efficiency is what is relevant in the real world.

Irrespective of the conclusion in relation to its substantive qualities, a law may possess significant non-substantive qualities that become relevant in determining whether it is efficient. In this regard, it is important to note that Gillette and Scott 'began with the assumption that the [CISG's] normative goals ... are to provide the *substantive* solution to particular contracting problems that most contracting parties want'.¹⁷⁶ It is of course possible that parties 'want' non-substantive benefits as much as, if not more so, than substantively preferable rules; that they care as much for efficiencies generated by form as they do for the implications of substance. Unlike others who do not address non-substantive effects, Gillette and Scott (and Cuniberti) recognize the potential for reduced legal knowledge costs at the *ex ante* stages of drafting and reduced negotiation.¹⁷⁷ The point made here is that rules can be majoritarian not only

171. Gillette and Scott, above n. 49, at 461-65; see §5.05[A] above.

172. *Ibid.*, at 447, passim.

173. See, e.g., *ibid.*, at 453-54.

174. See, e.g., *ibid.*, at 459; Walt, above n. 121, at 345.

175. Gillette and Scott, above n. 49, at 447-49, passim.

176. *Ibid.*, at 453 (emphasis added).

177. Cuniberti, above n. 58, at 1544; *ibid.*, at 453. See also Walt, above n. 121.

due to their substantive quality, but because parties desire non-substantive benefits that such rules facilitate.

In response, this chapter sought to highlight the full range of non-substantive issues that should also be taken into account when assessing the CISG's efficiency, including *ex post* information effects at the performance and litigation stages which tend to be mentioned only briefly amongst analyses that concentrate primarily on the economic impact of various substantive characteristics of the CISG.¹⁷⁸ Although such *ex post* information costs are rarely discussed at length,¹⁷⁹ their anticipated value impacts upon *ex ante* transaction costs, and affects net exchange gains and social welfare.

Furthermore, this chapter drew attention to the efficiency inherent in reduced legal uncertainty regarding the identity of applicable law where the CISG effectively acts as a substitute meta-default rule. Also described were network effects arising from recurrent use of uniform law due to increased returns. It is argued that this broader description of non-substantive effects show that the CISG is an efficient choice even if the CISG's content is considered to bring no efficiency gains. This further strengthens the conclusion reached in Chapter 4 that the provisions of the CISG are in fact efficient. It is therefore contended that, despite its imperfections, the CISG is often an efficient choice of law, and has the potential to become more efficient still as frequency of use increases.

Gillette and Scott predict that parties involved in international trade 'tend to be sophisticated actors' who will either bargain around the CISG due to its sub-optimality, or factor its inefficiency into their price.¹⁸⁰ They therefore predict that parties will engage in 'wholesale opting out' of the CISG.¹⁸¹ While it is true that we might expect rational behaviour from sophisticated players who share the authors' view, at least four points should be made about these conclusions.

First, in this chapter and in Chapter 4, the claim that the CISG is suboptimal is disputed. It is submitted that on balance, the CISG is optimal, unless the transaction type or other considerations make it an unsuitable or infeasible choice of law.

Secondly, the related prediction that there will be 'wholesale' opting out on the basis of the substantive quality is one which should now be tested against available evidence. Although they were unaware of it, at the time of Gillette and Scott's prediction, at least one study on CISG exclusions existed.¹⁸² Moreover, since then, a number of studies have been conducted, thus a great deal of empirical data now exists,

178. See e.g., Avery W. Katz, *Remedies for Breach of Contract under the CISG*, 25 Int'l Rev. L. & Econ. 378, 383 (2005); Gillette and Scott, above n. 49, at 453-54 (at *ex ante* negotiation and drafting stage).

179. *Contra* Katz, above n. 178, at 392 (referring to dispute costs).

180. Gillette and Scott, above n. 49, at 459.

181. *Ibid.*, at 477. See also Walt, above n. 121, at 345 (arguing parties exclude because the CISG does not reduce costs); Christopher Scheaffer, *The Failure of the United Nations Convention on Contracts for the International Sale of Goods and a Proposal for a New Uniform Global Code in International Sales Law*, 15 Cardozo J. Int'l & Comp. L. 461, 464, 469 (2007) (exclusion is due to concerns over scope, reservations and interpretive provisions).

182. Gillette and Scott, above n. 49, at 477 (stating they are not aware of studies regarding opt out rates).

and it is submitted this demonstrates less than ‘wholesale’ opting out, although one must be careful when interpreting this data. In Chapter 6, the evidence on opt out rates is presented and analysed to identify the rates and causes of exclusions.

Thirdly, as Cuniberti also concludes, many parties involved in international trade are simply not sophisticated players.¹⁸³ The Internet and availability of relatively cheap container shipment have enhanced the practical route to entry into international trade for small and medium business, even in relatively remote locations like Australia, extending potential participation in international trade to much less sophisticated players than previously. It would therefore perhaps be more accurate to expect a mix of both ‘sophisticated’ parties making deliberate choices, including whether to exclude the CISG or not, and less-sophisticated parties who may make minimalist conscious choices, or simply no choice at all.

Fourthly, the prediction assumes purely rational economic behaviour and perfect information. While a cost-benefit analysis of default rules provides us with a rational underpinning as to their value, it should also be remembered that this is not the sum total of relevant factors for parties deciding whether to stay with a default rule or opt out. A party proposing to opt out from a standard rule may be perceived as higher risk merely due to the proposed deviation from the norm – in other words, the negotiation itself may signal information to the counterparty. For this reason alone, a party might hesitate before proposing terms contracting around a non-preferred default rule. This may be due to purely rational grounds, including a perfectly rational strategy of avoiding effective disclosure of a party’s choice of law preferences,¹⁸⁴ or due to non-rational grounds, as a result of cognitive bias. For present purposes, this means that, even if it were true that ‘wholesale’ exclusion occurs, one could not from this alone presume the CISG is sub-optimal. Unless one can be sure of the absence of cognitive error, opt-out rates cannot be relied upon as proof of majoritarian preferences, since distortions introduced by irrationality would result in outcomes inconsistent with expected utility theory.¹⁸⁵ Majority choice of a different set of default rules may be due, for example, to a *status quo* bias.¹⁸⁶ In fact, there is a range of psychological or behavioural economic issues which can impact upon this decision, or even cause parties to make no decision at all. These are discussed in Chapters 6 and 7.

For this reason, if the aim is to design a majoritarian default rule, it has been correctly observed that lawmakers should imagine a ‘counterfactual world – one

183. Cuniberti, above n. 58, at 1513, 1514.

184. Ayres and Gertner, above n. 117, at 90 n. 23, 100 (arguing a party may prefer to remain indistinguishable from the cross-subsidized pool of counterparties than effectively disclose by contracting around the default rule); Goetz and Scott, above n. 10, at 278; Gillette and Scott, above n. 49, at 482.

185. Gillette, above n. 29, at 544.

186. Russell Korobkin, ‘Behavioral Economics, Contract Formation, and Contract Law’ in Cass R. Sunstein (ed), *Behavioral Law and Economics* 116, 137, 139-40 (Cambridge 2000) (arguing preference for default terms might be ‘highly suspect’ due to the *status quo* bias, leading to implicit value placed upon default norms and ‘quasi-immutable’ status). See further, Chs 6 and 7.

without defaults'.¹⁸⁷ Despite the political economy in which the CISG was created, in relation to the broader design of the CISG, this is what the drafters in fact did. By upholding the *favor contractus* principle and incorporating applicability rules which reduced resort to unpredictable private international law, they chose a cost effective set of default rules for international trade.¹⁸⁸ Additionally, the rules selected included an easy mechanism for opt-outs, thus minimizing the cost of exclusion. On balance, it is submitted this represents a majoritarian approach.

Above all, it is argued that one cannot effectively assess whether a law is majoritarian in isolation, but only in comparison with its alternative. It is not enough to point out the faults of the CISG. If one is to conclude that it is 'inefficient', this can only be by comparison with an alternative. The alternative in the case of the CISG is for businesses to each continue to deal with a portfolio of contracts encompassing a morass of choice of law rules and multiplicity of foreign laws requiring extensive cost and mastery. It is submitted that the rule-by-rule analysis conducted in Chapter 4 shows that the CISG compares well with the UCC and English law in terms of efficiency. While it is conceded the CISG has faults and could be improved in terms of its problem-solving capacity, and that the homeward trend and interaction with domestic law present some uncertainties, this must be held in perspective. The alternative is by no means less expensive or more certain.

In particular, once non-substantive issues are taken into account, the net advantages of the CISG become more apparent. While no law is perfect, on balance the substantive and non-substantive effects of the CISG together render it majoritarian, or close to majoritarian with negligible opt-out costs.

§5.06 CONCLUSION

Like any law, the CISG holds advantages and disadvantages at many levels. Indeed, a diversity of laws per se holds advantages by facilitating a choice of law to suit a particular transaction, or even a particular sector. The CISG was never intended to be universal, and cannot suit every transaction.

Critics have correctly pointed out that the CISG is subject to difficulties such as the homeward trend without a central judicial structure to ensure convergence, and that *ex ante* efficiencies cannot be claimed in circumstances where parties fail to consider choices of law at all. These are indeed valid points, but it is submitted that other criticisms have been somewhat overstated, especially when the CISG is compared with its alternatives.

Whether or not its application arises as the result of a conscious choice of law or by default, despite its drawbacks, on balance the CISG generally brings the qualities of predictability, stability, efficiency and neutrality to most transactions. Its substantive

187. *Ibid.*, at 140 (suggesting lawmakers should design default rules that mimic rules most parties *would* choose rather than those default rules which the majority presently *do* choose).

188. See Ch. 4.

rules generally encourage efficient behaviour, as much as, if not more than some popular alternatives examined in Chapter 4, being English law and the UCC. The provisions of the CISG were specifically designed for their purpose, and again, while not apt for every transaction, on the whole, appear to provide a sound alternative for international transactions as opposed to plural foreign domestic sales laws.

Moreover, it is submitted that the very existence of a uniform law to cover many aspects of international sales has the potential to lower transaction costs and maximize social welfare by reducing the length and cost of legal proceedings, and by reducing the likelihood of litigation arising at all. This is due to lower information costs, including accessibility costs, lowered contract management costs and improved certainty in terms of forum and choice of law risks. It is also a result of the reduced need to rely upon foreign law in litigation. These bring potential net benefits for individual parties, jurisdictions, as well as regional and global benefits.

Furthermore, in this chapter it was contended that non-substantive efficiencies have the potential to be increased further still due to network effects that can flow from widespread use of the CISG. There is greater capacity for this under the CISG than competitor laws due to its comparative neutrality, superior accessibility, and improved predictability of application in many cases vis-à-vis competing choice of law rules. In other words, its neutrality, accessibility and predictability deliver economic gains that no one domestic sales law can deliver.

While the CISG certainly has its drawbacks, this chapter has demonstrated that, on balance, it is both capable of, and presently does lower transaction costs. The original aims of the drafters, it is maintained, are not now hollow promises. More importantly, the CISG bears the potential for efficiencies beyond those contemplated by the drafters. It follows that the greater the proportion of transactions governed by the CISG, the greater the economic benefits attained due to increasing returns. Conversely, if the CISG fails to attain (or sustain) sufficient frequency as a choice of law, this will reduce the realization of potential efficiency gains, in particular, non-substantive efficiencies due to network effects.

It is thus contended that the CISG is efficient, and its broader acceptance will improve the efficiency of international trade. However, if this is indeed true, one must question the frequency with which the CISG is currently utilized and the reasons for its exclusion to determine whether the frequency with which the CISG is presently utilized is sub-optimal.

Although businesses make choices of law, their choices are often guided by the advice of lawyers. This influence varies in size, and can range from the ad hoc use of a lawyer on an infrequent basis to re-draft the standard form terms used by the business (for example, perhaps once per decade in some cases), to the borrowing of boilerplate terms from other businesses which themselves have previously sought legal advice, to the other extreme of constant and close consultation with a retained lawyer or in-house legal counsel.

It follows that the frequency with which the CISG is utilized is influenced by choices of law advised by lawyers. Many of the same factors affecting the choices of

lawyers might equally influence business, but factors affecting lawyers' choice of law are ultimately of primary importance in shaping business attitudes in matters of choice of law.

Thus the next chapter will turn to the rate at which lawyers prefer to exclude or not exclude the CISG, and their reasons for doing so.

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CHAPTER 6

Lawyer Opt-Out Rates and Reasons

§6.01 INTRODUCTION

In earlier chapters, it was concluded that the CISG is an efficient choice of law for international sales, with the potential to become increasingly efficient still with greater frequency of use, due to potential network effects.

Yet if the CISG is indeed efficient, then one might next ask whether its advantages are being fully realized in practice, and if not, why not. The CISG's aim was to improve efficiency in international trade by providing a neutral alternative law designed specifically for international trade. There is, of course, a hitch – the CISG cannot hope to attain its efficiency goals if it is not utilized. More precisely, the greater the rate of opt-outs, the less likely it is that the CISG will achieve its aim. Thus frequent exclusion of the CISG stands as a prime threat to the efficiency gains promised by harmonization of international sales law.

In determining the rate of exclusions, lawyer preferences are of key importance. In shaping contractual choices, it has been argued that '[i]t is lawyers who draft the fine print who are the "true" rivals', so it is the factors that drive these players that count.¹

This chapter analyses evidence pertaining to lawyer preferences for exclusion or application of the CISG. Although it has been adopted by some 80 nations, in some places, notably common law jurisdictions such as the US, Australia and Canada, it has 'barely registered on the consciousness' of lawyers.² In such jurisdictions, it is submitted that most lawyers take the easy route and exclude the CISG – they 'opt out,' since if they do not, the CISG will apply by default.

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1. Omri Ben-Shahar, *An Ex-Ante View of the Battle of the Forms*, 25 *Int'l Rev. L. & Econ.* 350, 365 (2005).
 2. John P. McEvoy, 'Canada' in Franco Ferrari (ed), *The CISG and its Impact on National Legal Systems* 33, 33-34 (Sellier 2008) ('*Ferrari Impact*') (stating anecdotally that it 'barely registers on the consciousness of Canadians').

While exclusion of the CISG can naturally be justified by proper legal evaluation of the client's best interests and transactional requirements, it is submitted that well considered legal decisions do not account for the bulk of CISG exclusions, nor for variations in exclusion levels between various market sectors and between different jurisdictions. This chapter will attempt to identify exclusion rates, and to isolate the reasons why lawyers exclude, differences between jurisdictions, and reasons for those differences.

Importantly, the focus will be on the degree to which various factors influence lawyer choices of law, including the extent to which lawyers exclude due to the substantive content of the CISG, rather than other reasons. This chapter will therefore draw together and use meta-analysis of existing empirical evidence as well as anecdotal evidence to identify the various relevant factors on lawyer choice and their degree of influence.

The present chapter will present and analyse empirical evidence consisting of surveys conducted up until early 2008. Surveys conducted in following years, including the Global Sales Law survey,³ will be analysed in Chapter 7 in order to test whether predictions based on earlier empirical evidence are borne out.

§6.02 RATES OF EXCLUSION

From surveys conducted up to and including 2008, we can conclude CISG exclusions are indeed more common in certain jurisdictions than in others, although the available data varies in quality.⁴ In the US, various studies suggest between 55%-71% of lawyers 'typically/generally' opt out.⁵ In Germany around 45% of lawyers 'generally/

3. Ingeborg Schwenzer, Pascal Hachein and Christopher Kee, *Global Sales and Contract Law* Ch. 5 (Oxford 2012).

4. Empirical studies involving small sample sizes must be treated with caution. While smaller results may be unreliable, larger results may enable relatively reliable inferences regarding population, since

$$z = \frac{\hat{\pi} \pm \pi_0}{\sqrt{\frac{\hat{\pi}(1-\hat{\pi})}{n}}}$$

where an alternate hypothesis would be accepted if the test statistic (right side value) is more extreme than a critical value (z): see Edwin Mansfield, *Statistics for Business and Economics* 202, 284 (Norton 5th ed, 1994). Statements concerning normal distributions, confidence levels and intervals in this and following chapters rely on this source unless otherwise stated.

5. Studies of US lawyers have yielded three rates: 55%, 61% and 71%. In 2006-2007, from a sample of 47 for the question involved, Fitzgerald found 55% of US lawyers surveyed 'typically' opt out of the CISG: Peter L. Fitzgerald, *The International Contracting Practices Survey Project*, 27 J.L. & Com. 1, 67 (2008), Question 11. This allows an inference with 80% confidence of 46-64% of US lawyers 'typically' opting out. In 2007 from a sample of 46 (mostly litigation) US lawyers, Philippopoulos found an 'overwhelming majority' preferred to opt out, although no proportion is stated: George V. Philippopoulos, *Awareness of the CISG Among American Attorneys*, 40 UCC L.J. 357, 361, 363 (2008). Working backwards from alternative responses, it appears this figure was 61%, allowing an inference with 80% confidence of 52-70% of US lawyers preferring to opt out. In 2004-2005 on the basis of a sample of 48 US lawyers, Koehler found 71% surveyed 'generally/predominantly' opted out: Martin F. Koehler, 'Survey regarding the Relevance of the ... (CISG) in Legal Practice and the Exclusion of its Application' (October 2006), 1, <http://>

predominantly' opt out.⁶ In Switzerland the figure is approximately 41%,⁷ and 55% for Austrian lawyers.⁸ By contrast, it has been reported that just 37% of Chinese lawyers typically opt out.⁹

It may on first sight seem that there is not much difference between 55% in the US and 37% in China as the rate for lawyers who 'generally' opt out.¹⁰ However, it is submitted that careful analysis reveals that the Chinese trend in favour of the CISG runs much deeper. Not only do Chinese lawyers 'generally' exclude at comparatively lower

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- cisgw3.law.pace.edu/cisg/biblio/koehler.html (accessed 28 Feb. 2014). This allows an inference with 80% confidence of 62-79% of US lawyers generally opting out. In a survey for which sample size is unknown and therefore confidence levels cannot be inferred (see Ch. 5, n. 154 and accompanying text), Gordon states half of the 32% claiming reasonable or good knowledge of the CISG had opted in or out: Michael Wallace Gordon, *Some Thoughts on the Receptiveness of Contracts Rules in the CISG and UNIDROIT Principles*, 46 (Suppl) Am. J. Comp. L. 361, 368 (1998)).
6. A 2004 survey of 479 German lawyers by Meyer found opt outs were 'normal' practice for 45%: Justus Meyer, 'The CISG in Attorneys' Every Day Work' (2009) 6, Question 4, Tables 4A-4C (on file with author) ('Attorneys' Work'). See Justus Meyer, *UN-Kaufrecht in der deutschen Anwaltspraxis*, 69 Rabels Z 457 (2005). Note some gave multiple answers: (email on file with author). In 2004-2005, from a sample of 33 German lawyers, Koehler found 73% 'generally/predominantly' opted out: Koehler, above n. 5 (link to Chart 'Frequency of Exclusion'); Martin F. Koehler and Yujun Guo, 'Combined Charts (Survey Germany USA China) – Frequency of Exclusion' (2008) (spreadsheet on file with author). At an 80% confidence level this yields an inference of 63-83% of German lawyers generally opting out, while Meyer's result gives an inference of 41-49% with 90% confidence, due to its larger sample. Thus the Meyer study is primarily relied upon here.
 7. Two studies have been conducted, with results of 41% and 62% respectively. A 2007 study of 393 Swiss lawyers by Meyer found 41% 'normally' opted out: Meyer, *Attorneys' Work*, above n. 6, at 6, Question 4, Tables 4A-4C. See Justus Meyer, *UN-Kaufrecht in der schweizerischen Anwaltspraxis*, 104 Schweizerische Juristen-Zeitung 421 (2008). Note some gave multiple answers: (email on file with the author). A survey in early 2008 of 153 Swiss lawyers found 62% 'regularly' opt out, and Swiss lawyers 5 times more likely to agree to exclude rather than opt in: Corinne Widmer and Pascal Hächem, 'Switzerland' in *Ferrari Impact*, above n. 2, 281, at 285, 286. Although 170 lawyers responded, 17 were not involved in international sales: at 282. With 90% confidence, this indicates an interval of 55-69% of the population, while the Meyer result yields an interval of just 37-45% with the same confidence given the larger sample. Thus Meyer's study is primarily relied upon here.
 8. A 2007 study of 25 Austrian lawyers by Meyer found 55% 'normally' contracted out: Meyer, *Attorneys' Work*, above n. 6, at 6, Question 4, Tables 4A-4C. See Justus Meyer, *UN-Kaufrecht in der österreichischen Anwaltspraxis*, 63 Österreichische Juristen-Zeitung 792 (2008). Again, some gave multiple responses: (email on file with author). Meyer's result predicts 50-60% of Austrian lawyers normally opt out with 90% confidence.
 9. In 2007, from a small sample of 27 Chinese lawyers, Koehler and Guo found that 37% 'generally/predominantly' opt out: Martin F. Koehler and Yujun Guo, *The Acceptance of the Unified Sales Law (CISG) in Different Legal Systems*, 20 Pace Int'l L. Rev. 45. The Koehler and Guo survey only allows an inference of 27-47% with 70% confidence (2008). Normality of the sample can be presumed because both $n\hat{\pi}$ and $n(1-\hat{\pi}) > 5$: 9.99 and 17.01 respectively. Anecdotal observations perhaps indicate an even lower rate: Han who reports Chinese lawyers 'seldom' opt out: Shiyuan Han, 'China' in *Ferrari Impact*, above n. 2, 71, 71; Joseph Lookofsky, 'Online with Al K' in Camilla Baasch Andersen and Ulrich G Schroeter (eds), *Sharing International Commercial Law across National Boundaries* 287, 291 (2008) ('Kritzer Festschrift') ('Chinese merchants are ready and most willing to do business on the [basis of the CISG]'); Fan Yang, *CISG in China and Beyond*, 40 UCC L.J. 373, 376 (2008) ('US trend has been ... to opt out of the CISG ... the trend in China goes the other way').
 10. I use Fitzgerald's figure of 55% here as the lowest of the US studies for which confidence levels can be stated: see above n. 5.

rates, but the figure for those that ‘seldom or never’ opt out is much higher – potentially up to 64%, compared with no more than 25% and 29% in Germany and the US, respectively.¹¹ Even more significantly that the low level of practitioners who generally opt out in China, this sets China apart as a pro-CISG jurisdiction.

Consequently, as at 2008, the US can be categorized as occupying one end of the spectrum, that of prevalently ‘blind’ or ‘automatic’ opt-outs from the CISG in practice, and China at the other end, tantamount to being a ‘pro-CISG’ jurisdiction.

Although no empirical evidence is available yet, anecdotal accounts suggest Canada and Australia are more closely aligned with the American position, and that perhaps the situation in those countries may be even more pronounced than in the US.¹² Switzerland, Germany and Austria appear to fall between the two extremes, thus comprising the ‘middle’ category of the exclusion spectrum, with Switzerland being at the lower and Austria at the higher frequency ends.

The next question is, having established that exclusion rates differ between jurisdictions, why do such differences exist?

§6.03 FACTORS IN LAWYER CHOICES OF LAW

The key factors in choices of law in international sales contracts, specifically the decision to opt in, default into, or exclude the CISG, can be summarized as: unfamiliarity, learning costs, bargaining strength, substantive concerns and market sector pressure.

[A] Unfamiliarity

Like exclusion rates, lawyer unfamiliarity with the CISG also seems to vary markedly depending on jurisdiction. At the lower end of familiarity, ‘unawareness’ rates are perhaps the most telling form of evidence; from around 44% in the US,¹³ to much lower

11. Koehler and Guo, above n. 9, found 52% of Chinese lawyers surveyed seldom or never opt out: at § II. With 80% confidence this indicates at least 39% and up to 64% of Chinese lawyers seldom or never opt out. Comparatively, Koehler found 21% of US practitioners and 18% of German practitioners surveyed never or seldom opt out: Koehler, above n. 5 (link to Chart ‘Frequency of Exclusion of the Convention’). The later results allow us to infer with 80% confidence that no more than 25% of German lawyers and no more than 29% of the population of US lawyers seldom or never opt out because a normal sample can be assumed in each case as both $n\hat{p}$ and $n(1-\hat{p}) > 5$ for the US (10.08, 37.92) and for Germany (5.94, 27.06).
12. In Australia, in this author’s experience, and according to other anecdotal evidence: David Fairlie, ‘A Commentary on Issues Arising under Articles 1 to 6 of the CISG’, presented at ‘Celebrating Success: 25 Years United Nations Convention on Contracts for the International Sale of Goods’, Singapore, 22-23 Sep. 2005, 40, <http://cisgw3.law.pace.edu/cisg/biblio/fairlie.html>; Bruno Zeller, *CISG Cases* (2004), <http://www.business.vu.edu.au/cisg/Cases.htm> (each accessed 28 Feb. 2014); Luke Nottage, *Who’s Afraid of the Vienna Sales Convention (CISG)?*, 36 *Victoria U. Wellington L. Rev.* 815, 817 n. 8, 836 n. 113 (2005); Canada: McEvoy, above n. 2; and empirical data in the case of the US: see above, n. 5.
13. In the US, 44% of lawyers surveyed were ‘not at all familiar’ with the CISG: Fitzgerald, above n. 5, at 41, Question 3 (sampling on this question 134 lawyers in 2006-7). Fitzgerald’s result allows an inference with 80% confidence that between 39-50% of US lawyers are not at all

rates in Germany,¹⁴ Austria¹⁵ and in Switzerland, where it was recently reported that less than 2% of lawyers were unaware of it.¹⁶ Anecdotally, it is said to ‘barely register[] on the consciousness’ of Canadian lawyers,¹⁷ is not at all well known in Australia,¹⁸ and is currently in what has nicely been described as a ‘sleeping beauty slumber’ in New Zealand.¹⁹ Where lawyers are completely unaware of the CISG, it may apply by default: if no choice is made, because both businesses are in Contracting States, or the law of a Contracting State is held applicable; or where a choice of law has been agreed, by choice of the law of a Contracting State without exclusion of the CISG: Article 1(1)(a) and (b).²⁰ Dire unfamiliarity in some jurisdictions can be contrasted with the very good familiarity found in China and Denmark.²¹

A less extreme form of unfamiliarity exists when a lawyer knows of the CISG, but has insufficient familiarity to properly determine whether it is the better choice for a given situation. Even where baseline familiarity levels are very high, the depth of familiarity will naturally vary between lawyers,²² and can range from simply knowing it is ‘something to be excluded’ to something more, but still too sketchy to enable any meaningful assessment of advantages and disadvantages.²³

familiar. See Gordon, above n. 5, 371 (reporting in 1997, lawyers in Florida had a ‘poor level of knowledge’); Philippopoulos, above n. 5, 364, Question 9 (suggesting US lawyers rate their professions’ awareness level at 3.12 out of 10).

14. Meyer found that across Switzerland, Austria and Germany, almost half of the lawyers surveyed spent up to 10% of their workload dealing with CISG disputes: Meyer, *Attorneys’ Work*, above n. 6, at 4, Question 2, Tables 2A-2C. Due to Meyer’s large survey size, we can infer with 90% confidence the result is accurate to within +2.4%. German lawyers were most prevalent at the higher frequency end of CISG dispute work, with 18% spending more than a quarter of their workload on CISG disputes (Austria 13%, Switzerland 10%), and 9% of German lawyers spending half or more of their workload this way (3% in Austria and Switzerland): at 4, Question 2, Tables 2A-2C. At 90% confidence these figures are indicative of the result for German, Austrian and Swiss lawyers within +2.9, 3.2, 2.5% respectively. Citing Meyer and Koehler, Magnus points to high levels of familiarity amongst German lawyers (citing familiarity figures of almost 100%): Ulrich Magnus, ‘Germany’ in *Ferrari Impact*, above n. 2, 143, at 145. However, he cautions there is a ‘wide range within which the degree of knowledge [amongst German lawyers] varies’: at 145.
15. See Meyer, *Attorneys’ Work*, above n. 6.
16. Widmer and Hachem in 2008 reported only 2% of Swiss lawyers were not aware of the CISG: above n. 7, at 284, 287. With 92% confidence we can infer that 0-4% of Swiss lawyers are not aware of the CISG. See also the results of Meyer’s study regarding proportion of workload Swiss lawyers devote to CISG dispute work, above n. 7.
17. McEvoy, above n. 2.
18. See above n. 12.
19. Petra Butler, ‘New Zealand’ in *Ferrari Impact*, above n. 2, 251, at 251, 252, 258.
20. See Ch. 2 for discussion regarding applicability.
21. To become a lawyer in China it is necessary to ‘understand or even gain mastery’ of the CISG: Han, above n. 9, at 71-72; Joseph Lookofsky, ‘Denmark’ in *Ferrari Impact*, above n. 2, 113, at 119 (Danish lawyers are ‘well acquainted with the CISG’).
22. Magnus, above n. 14, at 145. For example, although 98% of Swiss lawyers were aware of the CISG, 93% of Swiss lawyers had a ‘basic’ or better knowledge, 37% had a ‘good’ knowledge, and one stated CISG work formed the predominant part of his practice: Widmer and Hachem, above n. 7, at 284, 287. At 90% confidence these figures reflect the underlying population within +3.4, 6.4 and 1.9% respectively.
23. Franco Ferrari, ‘General Report’ in *Ferrari Impact*, above n. 2, 413, at 474-75.

Unfamiliarity has long been blamed for opt-outs,²⁴ and it is submitted correctly so, although it can only ever form part of the overall picture. It has been pointed out elsewhere that unfamiliarity leads to ‘legal ethnocentricity’.²⁵ A small survey indicated that possibly 16% of US lawyers exclude the CISG ‘principally’ due to unfamiliarity,²⁶ and insufficient familiarity seems significant in choice of law decisions in other jurisdictions too.²⁷ Further, these figures could under-represent the extent to which unfamiliarity drives exclusion, since in many more cases familiarity is a significant but not leading reason.²⁸ For example, one survey allowing multiple responses indicated that 54% of US lawyers surveyed admitted that at least one of their reasons for opting out was that the CISG was ‘not widely known’.²⁹ It is submitted that in many cases this response would reflect the respondent’s own unfamiliarity.³⁰

With a reasonable level of confidence, we can say that in low opt-out China and medium opt-out Switzerland, Germany and Austria, lawyers are more familiar with the CISG.³¹ In high opt-out USA, lawyers are less familiar with the CISG.³² On this basis it

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24. See, e.g., Mathias Reimann, *The CISG in the United States*, 71 *Rabels Z* 115, 126 (2007) (agreeing US unfamiliarity is significant in opt outs); Monica Kilian, *CISG and the Problem with Common Law Jurisdictions*, 10 *J. Transnat’l L. & Pol’y* 217, 230, 238 (2001); Jacob Ziegel, *The Scope of the Convention: Reaching Out to Article One and Beyond*, 25 *J.L. & Com.* 59, 67-71 (2005-6); Sonja Krusinga, *(Non-)Conformity in the 1980 UN Convention on Contracts for the International Sale of Goods: a Uniform Concept?* 9 (Insentia 2004); Nottage, above n. 12, at 817 n. 8; John E. Murray, *The Neglect of CISG: A Workable Solution*, 17 *J. L. & Com.* 365, 365, 371-72 (1998); V. Susanne Cook, *CISG: From the Perspective of the Practitioner*, 17 *J.L. & Com.* 343, 349 (1997-8); Gordon, above n. 5, at 368 (anecdotally); William S. Dodge, *Teaching the CISG in Contracts*, 50 *J. Legal Educ.* 72, 74-78 (2000).
25. Cook, above n. 24.
26. Fitzgerald, above n. 5, at 68, Question 12 (arguing the figure would be higher were one to re-categorize masked responses). Multiple answers were not allowed, and since only 45 lawyers responded to this question it should be treated with a degree of caution as it involves a slight result from a small sample size: above n. 4. With 80% confidence we can say it indicates between 9-23% of US lawyers would give this answer, since the sample can be assumed to be normally distributed since both $n\hat{\pi}$ and $n(1-\hat{\pi}) > 5$: 7.2 and 37.8 respectively. Reasons for opt outs were not sought by Gordon: above n. 5.
27. Anecdotally, insufficient familiarity in Japan: Shinichiro Hayakawa, ‘Japan’ in *Ferrari Impact*, above n. 2, 225, at 225, 227; McEvoy, above n. 19, at 34, 37, 40, 46-49, 60-66. Widmer and Hachem’s Swiss survey did not specifically provide ‘unfamiliarity’ as an option for respondents as to why they opted out. However, 42% responded one reason was ‘lack of certainty’ (multiple responses were permitted), which the authors attribute in part to insufficient familiarity and consequent lack of confidence rather than lack of awareness: above n. 7, at 285. With 80% confidence, we can infer 37-47% of the population of Swiss lawyers would give the same response.
28. Some 54% of US lawyers surveyed admitted at least one of their reasons for opting out was that the CISG was ‘not widely known’: Koehler and Guo, above n. 9, at §IV (in a study of 48 US lawyers in 2004-2005). As many as 52% gave this response in Germany: *ibid.* With 80% confidence the result should hold true for 45%-63% of US and 43%-65% of German lawyers.
29. See above n. 28, at §IV.
30. Fitzgerald clearly considers 16% to be under-representative of the true extent to which unfamiliarity motivates US exclusions, stating the ‘primary motivation for [routinely opting out] appears to be a lack of familiarity with the CISG’ and reclassifies certain responses indicating ‘general preference for the UCC’ as in fact relating to unfamiliarity: Fitzgerald, above n. 5, at 15-16.
31. See above §6.02, nn 14-16, 21 and accompanying text.
32. *Ibid.*, nn 26 and 29.

would seem there may be a link between familiarity and exclusion.³³ Indeed, tested on the basis of the results on unfamiliarity from Switzerland and the US, there is a strong positive correlation between unfamiliarity and exclusion rates in those jurisdictions, indicating that as unfamiliarity increases, exclusion rates also increase.³⁴

[B] Learning (Information) Costs

There are significant costs involved in becoming proficient in any area of law. One reason for excluding the CISG is the cost in terms of time and effort to become familiar with it, as Ziegel has pointed out.³⁵ Flechtner aptly refers to large upfront investment in familiarization as ‘start up’ costs and argues that these can be amortized over long periods.³⁶ There is much evidence to support the idea that the initial costs of becoming familiar with the CISG, or learning costs, are a significant factor in choices of law, and therefore we must conclude that information costs are relevant factors in exclusion rates.³⁷

For present purposes, it must be accepted that information costs prompt exclusions, despite the fact that the alternative requirement of familiarity with multiple foreign sales laws inherently carries an equal or probably greater information cost. What drives exclusions is the perception of information costs, which bear some connection with actual costs but can be distorted due to psychological biases. For

33. *Contra* Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 Int'l Rev. L. & Econ. 446, 478 (2005) (scientific about claims lawyer ignorance is a primary reason for exclusion).
34. Unfortunately, these are the only jurisdictions for which unambiguous ‘unfamiliarity’ statistics can be stated. Based on the figures of 35% general exclusion preference and 44% baseline unfamiliarity for the US (above nn 5 and 13), and 41% general exclusion preference and 2% baseline unfamiliarity in Switzerland (above nn 7 and 16), a perfect coefficient of correlation of +1 can be observed between exclusion rates (x) and unfamiliarity (y) for $r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{[N\sum X^2 - (\sum X)^2][N\sum Y^2 - (\sum Y)^2]}}$: William Mendenhall et al, *Statistics for Management and Economics* 502 (PWS 5th ed, 1986). Unless otherwise indicated, coefficients of correlation determined in this chapter rely upon this source.
35. Jacob S. Ziegel, *The Future of the International Sales Convention from a Common Law Perspective*, 6 New Zealand Bus. L. Quarterly 336, 346 (2000) (‘economic’ constraints ‘may limit the amount of research they are willing to do’); Ziegel, above n. 24, at 345 (costs of becoming familiar as ‘economic’ reasons for paucity of CISG cases in the US).
36. Harry M. Flechtner, ‘Changing the Opt-Out Tradition in the United States’, Paper presented at ‘Modern Law for Global Commerce: Congress to Celebrate the 40th Annual Session of UNCITRAL’, Vienna, Austria, 11 Jul. 2007, <http://www.uncitral.org/pdf/english/congress/Flechtner.pdf> (accessed 28 Feb. 2014).
37. Koehler surmised ‘a large number of the respondents have not yet taken the trouble to compare the legal aspects of the [CISG and non-CISG domestic law] in detail’: Koehler, above n. 5, at 10. One respondent remarked ‘you can’t teach an old dog new tricks’ and another pointed to the ‘steep learning curve’ to ‘buy into the CISG’: at 3. In the Philippopoulos study there were comments that respondents ‘would rather simply opt out of the CISG than to take the time to learn its provisions’ and found it ‘very confusing to figure out how it differs from reliance on [the UCC]’ or did not want to ‘spend the time and money to figure it out so they automatically opt out’: Philippopoulos, above n. 5, at 365-66. See Sandeep Gopalan, *A Demandeur-Centric Approach to Regime Design in Transnational Commercial Law*, 39 Geo. J. Int'l L. 327, 336 (2008) (‘learning externalities are a key contributor to the lack of impact’ of the CISG); Gillette and Scott, above n. 33, at 478 (‘attorneys have incentives to avoid learning about novel law, and thus they incorporate [familiar law] into their contracts’).

example, one respondent to Fitzgerald's study commented that internal legal teams of multinational companies 'do not have the time or occasion to try to determine whether the CISG ... might actually be favorable in a particular situation and choose instead to exclude'. The same respondent then detailed how a 'cookbook' of differences between US and local law was kept when foreign domestic law applied'.³⁸ The irony seemed to be lost on the respondent.

An interesting question is whether information costs are higher for some lawyers than others. Does the cost of becoming sufficiently knowledgeable about the CISG vary from jurisdiction to jurisdiction? Is it not just as time consuming to pick up a book, read an article, or look at cases in Germany as opposed to say, the US?

It is submitted that information costs differ significantly, depending on which jurisdiction the lawyer is in. Arguably, the information costs for a practising lawyer to become familiar with the CISG are much higher in some jurisdictions than others. It is submitted that there are three key differentials at play in determining the level of information costs facing a particular lawyer: education, litigation exposure and influence on domestic law.

[1] Education Differential

Obviously, exposure to the CISG at law school influences preferences for opting out amongst lawyers.³⁹ The extent to which law students are exposed to the CISG might range from a mere mention in contract law/private obligations subjects, to constant reference by way of comparison or as a fundamental teaching tool in others.

The degree to which law schools incorporate teaching on the CISG is a good indicator of the depth of lawyer familiarity in the jurisdiction. In countries where study of the CISG is compulsory, well-integrated within texts, or examinable, lawyers tend to be more familiar with it. China, Denmark, and also Germany fit at least some of these criteria. Despite being generally optional in German law schools, the CISG is 'part of the ordinary curriculum of most German law faculties' and 'almost every standard commentary on the German Civil code' includes CISG commentary, and in Denmark, the CISG is integrated into the University of Copenhagen curriculum.⁴⁰ In China, the CISG is part of the compulsory curriculum, and examinable for the purposes of professional qualification within the National Judicial Examination (bar exam), as is now the case also in South Korea.⁴¹

On the other hand, exposure in law school is minimal in Australia, New Zealand, Canada and Italy, where familiarity is anecdotally low, at least amongst domestic lawyers. Italian law schools provide only limited exposure within contract law, with

38. Fitzgerald, above n. 5, at 107.

39. Similarly see, e.g., Widmer and Hachem, above n. 7, at 288; Gordon, above n. 5, at 368.

40. Lookofsky, above n. 21, at 119 (this has helped ensure Danish lawyers are 'well acquainted with the CISG'); Magnus, above n. 14, at 145.

41. Han, above n. 9, at 71-72; Yong Eui Kim, *The Present and Future Role of the CISG in Korea*, 48 *Dong-A Law Rev.* 737 (2010).

broader coverage in comparative private law and international business transactions.⁴² In Australia at present, the CISG generally receives only passing reference within compulsory contract law subjects, and limited attention in optional subjects. In New Zealand, it is not generally taught in compulsory courses, and receives only minimal attention within private international or international commercial subjects.⁴³ It has been reported that exposure in UK law schools is very low. Some 42% of UK academics responding to one survey indicated they did not incorporate the CISG into their relevant courses and, for academics that did incorporate the CISG, 77% involved optional courses, despite the fact that 79% felt it should be taught to UK students, and 57% considered students did not have sufficient knowledge of the CISG.⁴⁴ There are some signs of improvement in US law schools, and slowly, some is expected within Australian law schools.⁴⁵ Elsewhere, the extent of exposure varies.⁴⁶

Obviously, one can expect that the less exposure a lawyer has had to the CISG at law school, the more inclined the lawyer will be toward exclusion in practice.⁴⁷ Indeed, '[a]ttorneys have incentives to avoid learning about novel law, and thus they incorporate into their contracts legal principles with which they are already familiar'.⁴⁸

The practice of widespread exclusion in a jurisdiction might encourage that jurisdiction's law schools not to cover the CISG in depth, creating a vicious circle that further entrenches high information costs for practising lawyers within that jurisdiction. Compulsory inclusion of CISG at law school forces investment in basic familiarity. Nonetheless, there is more to information costs than just legal education.⁴⁹

42. Marco Torsello, 'Italy' in *Ferrari Impact*, above n. 2, 187, at 208.

43. Butler, above n. 19, at 252.

44. These results arose from a survey of 42 UK legal academics: Anna Rogowska, 'Teaching the CISG at U.K. Universities' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Towards Uniformity* 133, 142-47 (Eleven 2011).

45. The push to 'internationalize' law school curricula in Australia has led to gradual improvement. For example, Monash University LLB compulsory Contracts course plans to include the CISG from 2015. Fitzgerald's survey of US professors in 2006-7 revealed substantial improvement in CISG coverage in courses and casebooks since Gordon's survey some 10 years earlier: Fitzgerald, above n. 5, at nn 108-112 and accompanying text, 88-89, Questions 32 and 33; Gordon, above n. 5, at 364-67. Fitzgerald found 76% taught CISG in basic contracts courses, but in 95% of cases it was only mentioned occasionally or in passing. He found 96% covered CISG in basic sales courses, and in 46% formed a substantial part of them: Fitzgerald, above n. 5, at 85-91, Questions 29, 30, 33 and 35. The 96% coverage in basic sales courses may be statistically unreliable, as it allows an inference of +16% with a 68% confidence level. Others are more reliable: at 80% confidence levels, the 76% coverage within contracts course gives an interval of +7.7%; the passing coverage in contracts result within +4.5%, and the substantial part of sales course result with a +13% interval.

46. See, e.g., Switzerland, where the CISG is taught within the compulsory contract law course, but both emphasis and examinability vary greatly: Widmer and Hachem, above n. 7, at 284, 287-89, 292.

47. See also *ibid.*, at 288; Gordon, above n. 5, at 368.

48. Gillette and Scott, above n. 33, at 478.

49. This is also known as a co-ordination problem in economics: see, e.g., S. J. Liebowitz and Stephen E. Margolis, *Path Dependence, Lock-in and History*, 11 J.L. Econ. & Organization 205, 213 (1995); S. J. Liebowitz and Stephen E. Margolis, *The Fable of the Keys*, 33 J.L. & Econ. 3, 1-2 (1990).

[2] *Dispute Work Differential*

Exposure to the CISG via litigation or arbitration work forces practising lawyers to invest in CISG information costs whether they like it or not.⁵⁰ It might follow that in jurisdictions producing greater quantities of CISG dispute work, there are more lawyers who have already made the investment in familiarization with the CISG. Having already invested in information costs, one might expect such lawyers to be less inclined to opt out on the basis of unfamiliarity, since there is no longer an incentive to avoid incurring information costs.

It is submitted that a tentative correlation might exist between rates of CISG exclusion and dispute work exposure in lawyers by using case numbers as a proxy.⁵¹ However, it is extremely difficult to test this theory.

Even simply determining CISG case numbers is far from an exact science. The best guide is the Pace Law School website, but it does not provide a complete picture. For example, arbitration cases are vastly underreported in most instances.⁵² The website reports only two American Arbitration Association cases, does not report Australian arbitration cases, nor does it contain many ICC cases.⁵³

Nor are the only difficulties with arbitration decisions. Court decisions are also difficult to gauge. In some countries, even internal reporting within the jurisdiction is limited and delayed. For example, many Chinese court cases are not reported at all, and only selected arbitral cases more than three years old are reported by CIETAC.⁵⁴ Therefore, whilst we know that China is producing many CISG cases,⁵⁵ the proportion of case numbers reported precludes direct comparison between it and other jurisdictions as yet.

Additionally, reporting of court cases to CISG websites depends on the proactiveness of individual reporters. Consequently, the degree of underreporting of cases varies widely between jurisdictions. Another issue to consider is that conversion rates of disputes into decisions might vary between jurisdictions. All of these factors mean that comparison between case numbers from different jurisdictions is extremely difficult.⁵⁶

50. Flechtner, above n. 36.

51. However, in doing so, one must always be cognizant of the limitations: from underreporting in some jurisdictions, to the difficulty of linking exposure through 'back end' dispute work with 'front end' drafting trends in others, given the tendency in some jurisdictions to segregate the work of lawyers specializing in these areas.

52. Russia, Serbia and China report many more arbitration cases than other jurisdictions. Confidentiality of arbitral proceedings is often proffered in justification of the reluctance to report arbitration proceedings. It is true that de-identification requires (minimal) resources. However, the process can yield valuable guidance for future decision-making.

53. As at 29 Mar. 2011. Case numbers are reported at <http://cisgw3.law.pace.edu/cisg/new-features.html> (accessed 29 Mar. 2011).

54. Han, above n. 9, at 73; Paul Mitchard, *Is CIETAC Leading Arbitration in Asia into a New Era of Transparency?*, *Asia Pacific Arbitration Rev.*, n. 27 and accompanying text (2009).

55. CIETAC will soon overtake all other international arbitral bodies in case numbers: Fan Yang, 'CISG, CIETAC Arbitration and the Rule of Law in the PR of China: A Global Jurisconsultorium Perspective' in *Kritzer Festschrift*, above n. 9, 600, at 601.

56. See also Ulrich G. Schroeter, 'To Exclude, To Ignore, or to Use?' in Larry DiMatteo (ed), *International Sales Law: A Global Challenge* (Cambridge 2014), at n. 66 and accompanying text.

It must therefore be conceded that comparative measures of dispute work are necessarily speculative. Although some have argued to the contrary,⁵⁷ this does not mean we should refrain from considering the figures, but it does mean we should proceed with a very high degree of caution, and take care not to overstate conclusions.

With this in mind, looking at a sample of nations for which we have some empirical or anecdotal evidence, if we take the number of CISG cases for each jurisdiction reported on the Pace website and divide them by the population of the jurisdictions involved then we arrive at a tentative but nonetheless quite interesting figure that I will denote as ‘cases per million capita’ (cpmc). We can also derive a similar figure, ‘cases per trillion trade dollar’ (cptd) by dividing the number of cases by the jurisdiction’s combined import and export in trillion USD. Case numbers and population statistics are held constant at March 2011 so as to more closely correspond with the period of opt out studies analysed in this chapter.

Given the problems mentioned with comparing case numbers, any analysis of the results requires some judgment as to the level of underreporting in each case. Therefore, as a precaution, I have indicated in bold those jurisdictions in which case numbers are perhaps more accurate than others. It is submitted that *unhighlighted* jurisdictions are *unlikely to fall* but could climb in rank, whereas the jurisdictions in bold are likely to stay constant.

Table 6.1 CISG Cases per Million Capita (cpmc)⁵⁸

Switzerland	22.2 ^(a)
Austria	15.2 ^(b)
Netherlands	12.2^(c)
Germany	5.7 ^(d)
New Zealand	2.3^(e)
Russia	2.0 ^(f)
Australia	0.9^(g)
USA	0.5 ^(h)
Canada	0.4⁽ⁱ⁾

57. *Ibid.* (‘impossible’ to equate low case numbers with low practical use in a particular jurisdiction).

58. In this table, in order to approximately correspond with the period during which the surveys analysed were conducted, case numbers reflect the number of cases for the jurisdiction listed on the Pace Website <http://cisgw3.law.pace.edu/cisg/new-features.html> as at 29 Mar. 2011, and population numbers are derived from populations reported for 2010 by the United Nations Population Fund, *State of World Population 2010* (UN 2010) 106-110, http://www.unfpa.org/webdav/site/global/shared/swp/2010/swop_2010_eng.pdf (accessed 29 Mar. 2011). Each cpmc calculation is derived by dividing the number of cases by the population for that jurisdiction. For (a) 169 Swiss cases divided by a population of 7.6m; (b) 128 Austrian cases divided by a population of 8.4m; (c) 203 Dutch cases divided by a population of 16.7m; (d) 465 German cases divided by a population of 82.1m; (e) 10 New Zealand cases divided by a population of 4.3m; (f) 285 Russian cases divided by a population of 140.4m; (g) 19 Australian cases divided by a population of 21.5m; (h) 144 United States cases divided by a population of 317.6m; (i) 15 Canadian cases divided by a population of 33.9m.

Table 6.2 CISG Cases per Trillion Trade Dollar (cptd)⁵⁹

Switzerland 101 ^(j)
Austria 978 ^(k)
Russia 945 ^(l)
Netherlands 470^(m)
Germany 412 ⁽ⁿ⁾
New Zealand 401^(o)
USA 136 ^(p)
Australia 124^(q)
Canada 48^(r)

Without wishing to overstate their accuracy, the results at least allow us to approximate lawyers' *relative* level of dispute work exposure in jurisdictions shown. Each measure hints at the likelihood an individual lawyer has encountered CISG litigation, but relies upon different underlying assumptions as to the prevalence of lawyers within jurisdictions: the cpmc measure relies on population as a proxy for lawyer numbers, and thus assumes similar proportions of lawyers within populations between different nations; the cptd relies upon total trade volume as a proxy for lawyer numbers, and thus assumes that lawyer numbers increase in direct proportion to trade volumes.

Despite the different assumptions underlying the two measures, there is a modest degree of consistency in the rankings. It is true that Russia holds a quite different position on each table. Yet, on both cpmc and cptd measures, the USA, Canada and Australia consistently rank in the bottom three jurisdictions, separated by a considerable degree from the others. Switzerland and Austria rank highly on both measures but, as indicated, Germany could climb the rankings beyond the positions shown.⁶⁰

Even allowing for underreporting, it can be seen that Canadian, US and Australian lawyers are relatively rarely involved in CISG dispute work. By contrast, the results enable us to predict that comparatively, Swiss, Austrian, Russian, Dutch and German lawyers are far more likely to have encountered CISG litigation in their work. The results are consistent with available empirical studies. According to Professor Meyer's study, the overwhelming majority of German, Austrian and Swiss lawyers, have

59. In this table, in order to approximately correspond with the period during which the surveys analysed were conducted, case numbers reflect the number of cases for the jurisdiction listed on the Pace Website <http://cisgw3.law.pace.edu/cisg/new-features.html> as at 29 Mar. 2011, and each cptd calculation consisted of taking case numbers and dividing them by the Total trade figures for 2009 in trillion USD reported by the United Nations Statistics Division (UNSD), *UNSD Annual Totals Trade (ATT) 2000-2009* (14 Nov. 2010, 4th edn), <http://unstats.un.org/unsd/trade/imts/annual%20totals.htm> (accessed 29 Mar. 2011). I have utilized the widely accepted 'short scale' definition of trillion. For (j) 169 Swiss cases divided by trade of 0.166847 trillion USD; (k) 128 Austrian cases divided by trade of 0.130791 trillion USD; (l) 285 Russian cases divided by trade of 0.301656 trillion USD; (m) 203 Dutch cases divided by trade of 0.431839 trillion USD; (n) 465 German cases divided by trade of 1.127636 trillion USD; (o) 10 New Zealand cases divided by trade of 0.024931 trillion USD; (p) 144 United States cases divided by trade of 1.05675 trillion USD; (q) 19 Australian cases divided by trade of 0.153884 trillion USD; (r) 15 Canadian cases divided by trade of 0.313982 trillion USD.

60. In the 12 months to Jul. 2009, only 16 German CISG cases were reported on the Pace Website. It seems unlikely this was the total number of cases decided in Germany in that period.

encountered the CISG in dispute work at least once, if not more often.⁶¹ Between 70%-78% of German, Austrian and Swiss lawyers surveyed indicated they had dealt with CISG in litigation.⁶²

The data above does not depict absolute levels of dispute work exposure, but it does indicate *relative* exposure in various jurisdictions. It demonstrates that lawyers in Canada, USA and Australia probably have *relatively* low exposure to CISG dispute work by comparison with other jurisdictions where exposure is relatively higher, although the internal ranking within high and low exposure groups is less certain, and subject to change based on more accurate case reporting. Yet, the identity of those in the lowest three ranks vis-à-vis the higher ranks is less prone to change.⁶³ In fact, more accurate case reporting is only likely to heighten the chasm.

To what extent does the forced exposure by litigation work explain opt-outs? At the very least, one might expect a link between litigation rates and familiarity. It is submitted that different levels of investment in CISG information costs exist from jurisdiction to jurisdiction, by virtue of the divergent frequency with which lawyers encounter the CISG in their work. On this basis, it could be concluded that lawyers in the USA, Australia and Canada are far less likely to have already invested in CISG information costs, compared to their Swiss, Austrian, Russian, Dutch and German counterparts.

This conclusion is consistent with empirical results. For example, very low Swiss unfamiliarity levels of 2% of lawyers surveyed relative to unfamiliarity in the US of 44% of lawyers surveyed⁶⁴ are consistent with the relationship of Switzerland's much higher cpmc relative to the US cpmc.⁶⁵ Likewise, Austria and Germany also far outrank the US in terms of cpmc and cptd, just as they do in terms of the levels of familiarity amongst respondents from those jurisdictions, as discussed above.⁶⁶ This correlation is quite remarkable given all the flaws in available data mentioned above, and tends to support the reliability of the results in the Tables 6.1 and 6.2.

It is tempting to surmise that not only does lack of litigation lead to unfamiliarity and higher information costs, but also to conclude that ergo, lack of litigation must also lead to higher opt-outs – that learning effects might directly encourage exclusion of the

61. Meyer, *Attorneys' Work*, above n. 6, at 4.

62. Meyer, *Attorneys' Work*, above n. 6, at 4, Question 2, Tables 2A-2C (at least once). Given the large sample set, the interval for the population is less than +3% for this result with 95% confidence.

63. In the USA, court case numbers are likely to be fairly accurate, but few US arbitration decisions are reported, so it could be argued the US would climb the rankings. On the other hand, Australia and Canada are unlikely to yield much greater case numbers with the inclusion of arbitration. German case numbers would also likely be boosted even further by more frequent reporting. For these reasons, the USA is unlikely to ultimately move beyond the last three ranks even on more accurate case data.

64. Fitzgerald, above n. 5, at 41, Question 3 (44% of US lawyers were 'not at all familiar' with the CISG). Within +5.5% it can be predicted this finding will hold true for the population of US lawyers with a confidence level of 80%.

65. Widmer and Hachem, above n. 7, 284, 287 (only 2% of Swiss lawyers unaware of the CISG). The confidence level cannot be estimated for this finding due to its size.

66. See discussion above in §6.03[A].

CISG.⁶⁷ However, it is pertinent to note two complications here, before such a conclusion can be extended further. The first is that exclusion decisions are influenced by a range of reasons, not just familiarity or information costs. Thus we can only ever expect a weak correlation, if any, between familiarity, litigation rates and exclusion rates. Further, information costs are affected by more than litigation exposure alone. As already discussed, education is also important. Another complication is that even if litigation exposure forces investment in CISG information costs, there may be blockage to the transfer of information due to the way legal work is organized. In some jurisdictions, there is a high degree of separation of court or litigation work from non-court work (e.g., barristers are distinguished from solicitors). There can also be a pragmatic tendency within law firms to separation of litigation lawyers from ‘front end’ lawyers who broker and draft deals. In such jurisdictions, even forced exposure via litigation will take longer to filter into ‘front end’ choice of law decisions. This division of work has long been true of the US but is becoming more common even in Europe.⁶⁸

Despite all of the flaws and complications just stated, it is possible to discern a link between *cpmc*, *cptd* and opt-outs.

Table 6.3 Rate of Lawyers Generally Opting Out⁶⁹ by *cpmc* & *cptd*

Proportion of Lawyers Generally Opting Out	<i>Cpmc</i>	<i>Cptd</i>
Switzerland 41%	Switzerland 22.2	Switzerland 1,013
Germany 45%	Austria 15.2	Austria 941
Austria 55%	Germany 5.7	Germany 412
USA 55%-71%	USA 0.5	USA 166

The ‘medium’ opt-out jurisdictions of Germany and Switzerland share high measures of litigation work exposure. The Swiss appear to have much greater litigation exposure relative to the Germans, and also tend to exclude less. By stark contrast, lawyers in the ‘high’ opt-out USA have vastly poorer exposure to CISG dispute work.

It is submitted that the results in Table 6.3 provide corroborative but not conclusive evidence that higher exposure to CISG litigation work reduces the tendency

67. Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale L.J.* 87, 88 (1989) (concurring with Coase that if transaction costs exist and parties or third parties have no means to protect themselves that social detriment will result, as a justification for immutable rules protecting such parties).

68. The essentially American/English influenced phenomenon of dividing law firms into departments focussed respectively on negotiation/drafting on the one hand, and litigation/dispute work on the other, is now having a wider influence. The practice has long been followed in Australia, especially in large-medium sized firms. Traditionally, such divisions were not seen in German law firms, but the trend is now becoming apparent in larger German and Swiss law firms. Germany’s system of compulsory internships requiring experience in a wide range of areas over 2 years may help mitigate this influence to a small degree, as might the fact that it is still not unusual to have a lawyer represent the same client in all matters.

69. Utilizing largest/more recent sample size available: For China, Koehler and Guo, above n. 9; for Germany, Switzerland and Austria, Meyer, *Attorneys’ Work*, above n. 6; for the US, as each of three surveys achieved similar sample sizes, see Koehler, Philippopoulos, Fitzgerald, above n. 5.

to exclude the CISG. This is supported by a very close correlation between each of the above measures of litigation exposure and exclusion rates, strongly indicating that as litigation exposure increases, exclusion rates tend to decrease.⁷⁰

Something should briefly be said about the situation in China. It will be recalled that the small study conducted in China by Koehler and Guo indicates high levels of familiarity in that jurisdiction, and low exclusion rates, confirming anecdotal accounts. While case numbers from China are vastly underreported, it is interesting in light of the above findings to at least speculate on what the cpmc and cptd rates might be from China in contrast to those presented above. It must be stressed however, that the following discussion is presented only as a point of interest and is necessarily no more than a rough estimate.

The number of CISG cases reported on the Pace Website from China at the relevant time of March 2011 was 418.⁷¹ This would yield results of 0.3 cpmc⁷² and 348 cptd for China,⁷³ roughly approximate to the cpmc of Canada, and near to the cptd for New Zealand. Undoubtedly this under-represents the level of exposure in China, since many cases are unreported.⁷⁴ The question therefore arises, what would be the results if the true number of cases were known? Here, we enter the realm of guesswork. It might be speculatively estimated from available statistics that the number of CIETAC cases reported to Pace sits at around 23% of the actual number of CIETAC decisions on the CISG.⁷⁵ We might therefore calculate the approximate number of Chinese CISG cases on the basis that reported cases represent 23% of the true number. This would be highly conservative since it does not estimate perhaps even greater underreporting of cases from courts or other arbitral institutions. Based on this figure, rather than 418, the true number of Chinese CISG might stand at more than 1,817. It would follow that

70. The coefficient of correlation between exclusion rates (x) and cpmc (y) in Table 6.3 is -0.97 , strongly indicating that as litigation exposure measured by cases per million capita increases, the rate of exclusion decreases. Likewise, the coefficient of correlation between exclusion rates (x) and cptd (y) in Table 7.3 is -0.96 , strongly indicating that as litigation exposure measured by cases per trillion trade dollars increases, the rate of exclusion decreases. Note that in each case this is despite utilizing the lowest measure of exclusion in the range for the US of 55%.

71. See above n. 55.

72. Pace Website as at 29 Mar. 2011, <http://cisgw3.law.pace.edu/cisg/new-features.html>. This is derived from 418 cases divided by a population of 1,354.9m in 2009: *State of World Population 2010*, above n. 58.

73. 418 cases divided by trade of 1.20179 trillion in 2009: *UNSD Annual Totals Trade (ATT) 2000-2009*, above n. 59.

74. See above nn 54-55.

75. In 2008, CIETAC accepted 1230 new cases, including 548 (45%) international cases: *TDM News Digest*, Issue 12, Week 12, and 16 Mar. 2009, <http://www.transnational-dispute-management.com/news/tmnewsdigest.htm>. In 2005, 979 cases were handled by CIETAC across its Beijing, Shanghai and South China offices. Of these, 427 were international: Nadia Darwazeh and Michael Moser, 'Arbitration Inside China' in M. Moser (ed), *Managing Business Disputes in Today's China: Duelling with Dragons* 45, 49 (Kluwer 2007). Assuming only a third of international cases involved the CISG (a conservative estimate given opt-out levels in China), there were probably around 109 CIETAC cases pursuant to the CISG in 2005. At the time of writing, Pace has reported 25 of these, representing around 23% of this estimated number. From 2012, the three CIETAC branches have been independent, and renamed as Shanghai (SHIAC) and South China (SIAC).

Chinese litigation work exposure results might be 1.3 cpmc⁷⁶ and 1,511 cptd.⁷⁷ The former is similar to that of Australia, but the cpmc measure using estimated case numbers is more than that of Switzerland.

Of course, since even more caution must be exercised with Chinese case figures for obvious reasons, they are not included in the above Tables. However, it can be surmised that Chinese lawyers have a very high exposure to CISG litigation work, and that they might accordingly be expected to be highly familiar with it, and to face much lower information costs. This estimate accords with the findings of Koehler and Guo (discussed above at §6.02 and §6.03[A]) regarding familiarity and exclusion rates amongst Chinese respondents, and is therefore in line with the general conclusion submitted here, that, *inter alia*, frequency of exposure to CISG influences, but is not the only factor in jurisdictional exclusion rates from the CISG.

[3] Domestic Law Differential

Lawyer perceptions of the size of information costs can be influenced another way. In jurisdictions where the domestic law has been influenced by or modelled on the CISG, lawyers might (justifiably or otherwise) perceive CISG learning costs as lower than in jurisdictions where this is not the case.⁷⁸ Arguably, it might be expected lawyers will be less likely to exclude under such conditions, as they will not perceive significant information costs in becoming familiar with the CISG. This situation exists to an increasing degree in many parts of the world, notably including China, Africa, and in some EU Member States,⁷⁹ including perhaps Germany.⁸⁰

76. 1,817 cases divided by a population of 1,354.9m in 2009: above n. 72.

77. 1,817 cases divided by trade of 1,20179 trillion in 2009: above n. 73.

78. See Filip De Ly, *The Relevance of the Vienna Convention for International Sales Contracts*, 4 Business L. Int'l 241, 244 (2003) (one reason why Dutch lawyers do not generally exclude might be similarity between Dutch law and the CISG). De Ly reports even Dutch trade associations do not tend to exclude CISG: at 244, 245 n. 18.

79. The CISG has directly influenced domestic law in China, Germany, Scandinavia, Japan, Québec, Czech Republic, Russia and Estonia and reforms in the Netherlands, Germany, Japan, Greece and Organization for the Harmonization of Business Law in Africa (OHADA) Member States. It has had an indirect impact on domestic law in Denmark, France and Italy via the *Directive 99/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees* [1999] OJ L 171/12, itself based on the CISG: Ferrari, above n. 23, 472-73. It directly influenced the EU DCFR, especially sales (IV.A), contract formation (II) and obligations and remedies (III): e.g., DCFR IV.A.-2:306 Note 1, 1305, and directly influenced the EU CESL: Ulrich Magnus, 'The Roots and Traces of the CISG in the Draft of a Common European Sales Law' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Boundaries and Intersections* (Eleven 2014).

80. The influence of changes to the German Law of Obligations was cited by a number of German practitioner-scholars as highly influential. The anecdotal narrative shared by many at a recent conference was that exclusions have decreased following the reforms: Ch. 4, n. 304 and accompanying text, relating discussion at the Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011. Although the principal reason given was the substantive advantages of the CISG relative to non-CISG domestic German law, it can be perhaps surmised that part of the change may also be due to lower information costs and more widespread familiarity.

[4] *Preliminary Conclusion*

It is submitted that the available evidence suggests information costs help explain the reluctance of lawyers to consider the CISG in choices of law, and that information costs should not be easily dismissed as one of the drivers behind exclusion of the CISG.⁸¹ It should also be noted that within empirical studies conducted thus far, the issue is often masked by respondents nominating unfamiliarity or uncertainty as the reason for their exclusion preference. The underlying reasons for unfamiliarity or uncertainty are not usually probed in surveys; however, this section attempts to illuminate some of those reasons.

Ultimately it seems reasonable to conclude that in jurisdictions where the CISG is taught prominently and well in law schools, or where the domestic law has been modelled on CISG, information costs will be lower for lawyers making choices of law. Likewise, in jurisdictions with high exposure to CISG litigation, many lawyers will have already invested in CISG familiarity.

Where these three conditions coincide, lower information costs will face the lawyer at the time when a choice of law must be made. One might then anticipate that there will be a reduced motivation for exclusion in order to avoid information costs, that advantages of the CISG (as discussed in Chapters 4 and 5) might be better appreciated,⁸² and consequently, that opt-out rates might be lower; although naturally exclusion can and should still occur when the CISG is unsuitable for the transaction. The difference is that in the latter case, the lawyer's decision to exclude is an informed one.

Thus within any jurisdiction, the combination of these three elements – educational imperative, litigation exposure, and influence on domestic law – will ultimately determine the information costs generally facing lawyers in that jurisdiction. It is submitted that the balance struck within a jurisdiction predisposes that jurisdiction's legal profession toward or against exclusion of the CISG. For example, in 'pro-CISG' China where opt-out propensity is lowest, all three elements combine to reduce information costs for practising lawyers: high compulsory levels of forced exposure at law school and bar exam requirements; (apparently) frequent dispute work; and a domestic legal regime shaped on the CISG. By contrast, in Australia, Canada, and the US, all three combine to produce high information costs: low levels of mostly optional exposure in law school; little litigation work; and domestic regimes untouched by the CISG's influence. Consequently, it is perhaps unsurprising to see higher exclusion rates in these jurisdictions.⁸³

It is submitted that familiarity is driven by information costs, and taken together, they partly explain the greater reluctance of lawyers in some jurisdictions to properly consider the CISG in choices of law. However, reduced information costs and improved

81. Gillette and Scott, above n. 33, at 478 ('[w]e are sceptical that the current pattern of opting out is primarily attributable to attorney ignorance or self-interest').

82. More than mere awareness of CISG is required to take advantage of it: Ferrari, above n. 23, at 428.

83. See above n. 12.

familiarity alone may not guarantee lower exclusion rates.⁸⁴ They can only eliminate one predisposition against choice of the CISG, and therefore contribute to an objective selection of the best and most efficient law for the transaction on an informed basis. Other factors may cloud that objectivity, as will be submitted below in Chapter 7.

[C] Bargaining Strength

Despite the claim that it is unlikely unequal bargaining power explains exclusions of the CISG,⁸⁵ empirical evidence shows that it is a significant influence. In fact, bargaining strength influences choice of law for approximately 26%, 39% and 37% of US, German, and Chinese lawyer respondents, respectively, and was the second most commonly selected reason for exclusion of the CISG in Germany and China.⁸⁶ A recent survey found that 53% of respondents stated the law of the home jurisdiction of the stronger party was imposed in unequal bargaining situations.⁸⁷ The latter did not test exclusion of the CISG, but corroborates the strong influence of bargaining power on choice of law decision making.

It therefore seems that a counterparty with superior bargaining strength frequently succeeds in imposing its preferred choice of law, just because it can. This is not always driven by the substantive qualities or efficiency of the preferred choice.⁸⁸ It is simply a fallacy that stronger parties will choose the law that actually favours their position.⁸⁹ On the contrary, as discussed previously, preferences may be driven by a desire for the 'home ground advantage'⁹⁰ or a so-called 'neutral law',⁹¹ and bargaining strength may be utilized to realize these preferences, regardless of the fact that the substantive rules in the preferred law are objectively disadvantageous. As mentioned in §5.05[A][3], choices of law are sometimes decided after minimal consideration, and are open to various influences, psychological and otherwise. There is no reason why parties with bargaining strength would not fall within this category. Indeed, stronger

84. See Magnus, above n. 14, at 147 (lamenting 'reluctance towards/satisfaction with the CISG depends ... a great deal on how much practitioners specialise in international sales, how much [exposure they have to] the CISG in their daily work').

85. Gillette and Scott, above n. 33, at 478.

86. Koehler found that for 26% of US lawyer respondents, one reason for opting out was simply strength of bargaining position: Koehler, above n. 5, at 10. Indeed, the second most common reason for Chinese and German exclusion was an inability to dissuade counterparties from choice of their own national law, indicated by 37% of Chinese respondents, and 39% of German respondents, and also by 27.1% of US respondents: Koehler and Guo, above n. 9. We can say with 80% confidence the true population rate is: for US lawyers 18-34%; for Chinese lawyers 25-48%; for German lawyers 28-50%.

87. School of International Arbitration at Queen Mary, University of London, International Arbitration Survey (2010), 11, 13-14, http://www.arbitrationonline.org/docs/2010_InternationalArbitrationSurveyReport.pdf (accessed 28 Feb. 2014).

88. *Contra* Gillette and Scott, above n. 33, at 478.

89. *Contra, ibid.* (dismissing bargaining strength as a convincing argument partly on the basis that it is unlikely any one country's law will favour the buyer or seller).

90. Lookofsky, above n. 9, at 291.

91. See discussion in Ch. 5, at §5.02[B] regarding misguided choices of Swiss law as a 'neutral' choice: Christiana Fountoulakis, *The Parties' Choice of "Neutral Law" in International Sales Contracts*, 7 *European J.L. Reform* 303, 314 (2005).

parties often unknowingly push for a disadvantageous selection,⁹² and it can be expected many insist on exclusion of the CISG in situations where it would better suit their interests.

In such circumstances, it is clear that even if the lawyer acting for the weaker party believes the CISG is the best law for the transaction, the lawyer will often have little choice but to exclude if that is the desire of the stronger party. Anecdotal accounts suggest this occurs in Slovenia, Czech Republic, and in Mexico due to stronger US counterparties.⁹³

However, lawyers who prefer to exclude may find it increasingly difficult to exclude as their client's relative bargaining position weakens, as is the case in Japan following the decline of Japanese corporations.⁹⁴ In time, continually acting for parties on the weaker side of the bargain may actually have led lawyers in some jurisdictions such as Denmark, Croatia and Brazil to develop a preference for the CISG, because they cannot insist on their own domestic law.⁹⁵

Bargaining power can also reduce exclusions.⁹⁶ A stronger 'pro-CISG' party can insist on the CISG. But how often are 'pro-CISG' parties the stronger counterparty? Notably, there has been a relative increase in bargaining power of Chinese traders in recent years, and corresponding relative decrease in other countries. It is submitted that this means 'automatic' exclusion preferring lawyers from jurisdictions like the US increasingly face more powerful Chinese parties whose lawyers might insist on the CISG.

We might already have had a taste of what is to come. Arguably, the studies of US lawyers discussed above demonstrate a trend towards exclusions slowly decreasing.⁹⁷ Flechtner commented in 2007 that he was receiving a greater number of 'front end' queries from US lawyers, rather than simply reactionary litigation queries, and the New York State Bar in 2009 moved to address this need with online tools and other

92. See above n. 91. See also Schwenzer, Hachem and Kee, above n. 3, at [5.36].

93. Some 16% of Swiss lawyers gave as a reason for opting out that the 'CISG was unacceptable to counterparties': Widmer and Hachem, above n. 7, at 285. We can thus infer with 80% confidence this result will hold for 12-20% of the population of Swiss lawyers. See Naděžda Rozehnalová, 'Czech Republic' in *Ferrari Impact*, above n. 2, 107, at 108; Hernany Veytia, 'Mexico' in Ferrari, *ibid.*, at 231, 235, 237, 239, 248; Damjan Možina, 'Slovenia' in Ferrari, *ibid.*, at 265, 265, 272, n. 26.

94. Hayakawa, above n. 27, 226.

95. See Lookofsky, above n. 21, at 120; Marko Baretić and Saša Nikšić, 'Croatia' in *Ferrari Impact*, above n. 2, 93, at 94-95.

96. See Ferrari, above n. 23, at 428 (lawyers 'ultimately cannot avoid becoming more knowledgeable about the CISG' because they can only exclude if their clients have stronger bargaining positions).

97. Note the change from 71% in 2004 to 61% or 55% in 2006-7: Koehler, Philippopoulos and Fitzgerald: above n. 5. Differences could simply be due to survey design, sample composition (e.g., the Philippopoulos study targeted litigators), but not sample sizes (which were similar, at 48, 46 and 47, respectively). For population figures see above n. 5.

measures.⁹⁸ There are also anecdotal signs of trends away from exclusion in Germany and Italy, although opt-outs are nonetheless still prevalent.⁹⁹

Further, comments in surveys and anecdotal accounts indicate there could be an underlying Chinese influence. For example, US respondents have commented that '[p]articularly in Chinese transactions, the CISG will apply to the international contract'¹⁰⁰ and that they prefer the CISG 'when contracting with Chinese firms because CISG is more easily understandable than the Chinese law alternative'.¹⁰¹

There appears to be a strong correlation between bargaining strength and exclusions.¹⁰² It is submitted that bargaining strength is therefore influential in choice of law. In particular, it is suggested that 'pro-CISG' Chinese lawyers are more likely to want the CISG to apply, and their clients are increasingly more likely to possess enough economic clout to ensure it does.

[D] Substantive Concerns

As discussed in Chapters 4 and 5, Professors Gillette and Scott squarely attribute CISG exclusions to lawyer concerns over the inefficient substantive content of the CISG.¹⁰³ Professor Ziegel similarly elaborates upon 'legal' reasons of coverage and reservations by Contracting States.¹⁰⁴ The nature of criticisms of the CISG's substantive content was discussed in earlier chapters, and it was concluded that, although the CISG has some substantive difficulties, that on balance, taking into account both substantive and non-substantive issues, as a choice of law for international sales it is generally efficient, with the potential to become increasingly efficient with increased frequency of use in practice.

98. Flechtner, above n. 36 (US pressure exerted by globalization of legal services markets and observing a 'change' in queries he received from practitioners regarding CISG from purely litigious to front end (drafting and choice of law) queries). The New York State Bar is undertaking projects to improve use of NY law including the CISG Checklist Project of the International Section of the New York State Bar Association. See NYSBA, *Mission Statement*, 14(2) International Chapter News 42-3 (2009); Email, 25 Jan. 2010 to International Section Members (on file with author).

99. Anecdotally, while opting out is still prevalent in Italy, many English speaking specialist drafters in Italy are now choosing not to opt out: Torsello, above n. 42, at 189, 190, 195-99, 208. It seems a similar trend is appearing in Germany, where increasing numbers of business associations no longer generally recommend opting out, which is no longer the norm for standard forms: Magnus, above n. 14, at 146; Ch. 4, n. 308 and accompanying text, relating discussion at the Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011.

100. Fitzgerald, above n. 5, at 107.

101. Philippopoulos, above n. 5, at 364.

102. The coefficient of correlation between exclusion rates (x) and the proportion of respondents indicating bargaining strength as a factor (y) is -0.82, strongly indicating that as bargaining strength increases in significance, the rate of exclusions decrease. This measure utilizes the lowest measure of exclusion in the range for the US of 55%.

103. Gillette and Scott, above n. 33, at 478.

104. Ziegel, above n. 24, at 72-73; Ziegel, above n. 35, at 345-46; McEvoy, above n. 2, at 60. Technically, these are declarations, but have similar effect: see Ch. 2. Note the decline in enthusiasm for declarations, with some withdrawn or withdrawals being contemplated in recent times, discussed in Ch. 4 at §4.02[A], nn 148-153 and accompanying text.

Nonetheless, the perception of lawyers regarding the substantive content of the CISG is important. In interpreting the empirical data, one should remain mindful of the difference between perception and objective assessment, especially given that familiarity levels can be expected to affect perceptions of survey participants. As previously discussed there are misconceptions, still fuelled by US courts, about a scarcity of CISG cases.¹⁰⁵ It can also be anticipated that lower familiarity levels inevitably leverage an impression of uncertainty that may on an objective assessment be unwarranted.¹⁰⁶

On the other hand, some concerns, particularly where made on an informed basis, are indeed completely rational. As noted in earlier chapters, legitimate concerns over the interaction of the CISG with background law can be raised, and problems with the homeward trend in divergent interpretations are still of concern. Additionally, the CISG is not the right law for every contract, nor was it ever intended to be. There will always be legitimate transactional features which on proper assessment make exclusion advisable.

For present purposes, substantive concerns are defined broadly as including reasons relating to 'uncertainty' on the basis that, while ambiguous, in some cases this may refer to the perceived substantive nature of CISG rules, or predictability of outcomes upon application of those rules by a court or tribunal.

Turning to the empirical evidence, as might be expected, we find that perceived substantive concerns play a role in exclusion decisions by lawyers. How significant is difficult to say, since data varies, and reasons that arguably relate to substantive concerns are often hidden in responses designed to test familiarity. Some unravelling of the relevant data is therefore necessary.

Koehler concludes that legal aspects play very little part in the decision to exclude, and that the 'overriding reasons' were practical.¹⁰⁷ The study design split reasons for exclusion into 'legal' and 'practical' categories, and most surveyed nominated 'practical' reasons as the prime motivation for exclusion.¹⁰⁸ Only 9% of German, 11% of Chinese and 6% of US respondents excluded primarily due to 'legal' considerations,¹⁰⁹ but a further 15% of German, 26% of Chinese and 25% of US respondents made such decisions equally based on both 'legal' and 'practical' reasons.¹¹⁰ Thus

105. Perpetuating the myth repeated in many US cases that CISG case law is 'scant' or 'sparse' (there are over 2,000 on the Pace Website): *Delchi Carrier SpA v. Rotorex Corp.*, 71 F 3d 1024, 1027 n. 1 (2nd Cir) US Circuit Court of Appeals, 6 Dec. 1995, <http://www.cisg.law.pace.edu/cases/951206u1.html> (accessed 28 Feb. 2014).

106. See Chs 4 and 5.

107. Koehler, above n. 5, at 9-10 ('legal aspects' not of practical importance in light of significant variation between German and US practitioner assessments).

108. 73% of German, 52% of Chinese and 50% of US lawyers responded that the paramount motivations for exclusion were 'practical': Koehler and Guo, above n. 6. With an 80% confidence level, for the population of US lawyers the expected range is 40%-59%, for German lawyers 63%-83%, and Chinese 39%-64%.

109. *Ibid.* With an 80% confidence level, the expected range for the population of German lawyers is 2-15%, Chinese lawyers 3%-19% and US lawyers 2%-11%.

110. See Koehler, above n. 5, at 7, n. 19; *ibid.* With an 80% confidence level, the expected range for the population of German lawyers is 7%-23%, Chinese lawyers 15%-37% and US lawyers 17%-33%.

substantive concerns at least played a principal or equal role in 24% of German, 31% of US, and 37% of Chinese participant exclusion decisions.

Koehler also asked US and German lawyers whether the CISG was legally advantageous compared with national law. Most were ambivalent, and a small proportion felt the CISG advantageous vis-à-vis national law.¹¹¹ In all, 79% of German, 55% of Chinese and 48% of US responses were either ambivalent or favourable, and therefore largely consistent with the conclusion from Chapter 4 that the CISG is not disadvantageous on assessment of its substantive efficiency, but on balance advantageous, even before non-substantive effects are taken into account.

Having concluded substantive concerns played a significant part in at least 24% (Germany), 31% (USA) and 37% (China) of respondent exclusions according to Koehler's work, it is useful to compare these results with those of Fitzgerald.

The Fitzgerald study returned a raw figure of 22% of US lawyer respondents who indicated that they exclude on the basis of substantive issues or 'concern with specific provision(s) of the CISG'.¹¹² However, Fitzgerald considers this number over-represented.¹¹³ Thus he proceeds to 'unpack' individual comments made by almost all participants giving this reason, and attributes some to unfamiliarity.¹¹⁴ While I agree with Fitzgerald's reclassification for two of the responses,¹¹⁵ it is submitted that five could more conservatively be classified as involving substantive concerns where these are broadly defined as including issues of clarity of interpretation, a further two simply not re-classified, and one re-classified to a another category altogether. The following reordering for reasons for exclusion is suggested:

- First respondent - 'client unfamiliarity'. This more aptly belongs within 'client preference' category than either familiarity or substantive concern.
- Second respondent - 'warranty exclusions'. Presumably this concerns limitation or exclusion of liability clauses, thus issues of scope, and ultimately belongs in the category of substantive quality (irrespective of whether the perception of a problem is accurate).

111. Koehler, above n. 5, at 5 (link to Chart: 'Legally advantageous CISG/national law'); Koehler and Guo, above n. 6, §V. Koehler found 73% of German, 44% of Chinese and 40% of US respondents were ambivalent, and 6% of German, 11% of Chinese, and 8% of US respondents felt the CISG was more advantageous. The variance between US and German lawyers here is not surprising given the entry into force on 1 Jan. 2002 of the new German Law of Obligations (*Schuldrechtsmodernisierungsgesetz*) which rendered the German Civil Code (*Bürgerliches Gesetzbuch* or BGB) similar to the CISG, as noted by many German and some US respondents: Koehler, *ibid.*, at 5. See Hans Schulte-Nölke, 'The New German Law of Obligations: An Introduction' (2002) II, <http://www.iuscomp.org/gla/literature/schulte-noelke.htm> (accessed 28 Feb. 2014).

112. Fitzgerald, above n. 5, at 68, Question 12. With an 80% confidence level, the population result is within the range of 14-30%.

113. *Ibid.*, at 15-16. In fact, the 22% figure relates to 'US and foreign' attorneys. However, this differs only marginally from 'US only' sample. It is utilized here due to the need to 'unpack' responses to reach an accurate estimate.

114. *Ibid.*, at 15-16, 69, Question 13.

115. Specifically, the 3rd response of 'home field advantage' and the 9th response expressing preference for the laws of Ontario/Canada as 'general preference for UCC': *ibid.*

- Fourth respondent – ‘meeting of the minds could be deemed to occur at a different stage’ with the potential to affect ‘the entire negotiating process’. Again, irrespective of the accuracy of this perspective, the concern is about pre-contractual liability, and thus substantive matters.¹¹⁶
- Fifth respondent – ‘gap fillers’, comparing UCC use of common law as a ‘gap-filler’ as opposed to ‘reasonable expectation analysis’ under the CISG. Again, while I concur with Fitzgerald about the level of misconception displayed in the comment, it does concern the interpretive process. The respondent further adds the CISG does not ‘address validity issues’, demonstrating concern with scope, thus overall, belonging within the category of substantive content and clarity.
- Sixth respondent – ‘international software licence agreements’. This does not require reclassification.
- Seventh respondent – ‘limitation period’ and ‘lack of case law’. The latter comment at least, pertains to certainty of substance of the CISG.
- Eighth respondent – ‘possible interpretations of the CISG’ as not as ‘settled as generic case law’. Again, this concerns perceived uncertainty of the CISG’s substantive content.
- Tenth respondent – CISG did not generally ‘meet US client expectations’. Without details, this is taken to mean the lawyer had advised clients to exclude due to certain features. Consequently, no reclassification is required.¹¹⁷

Reordering in this manner would reduce the 22% raw score to 16%.¹¹⁸ However, it can also be argued that a proportion of those who nominated ‘general preference for UCC’ as their reason for exclusion are likely to actually be motivated by perceived legal differences (correctly or not). Additionally, unlike Koehler’s study in which multiple and graduated responses were allowed, Fitzgerald’s survey design only asked for the ‘principal’ reason. There is no indication therefore of the numbers for whom it is an ‘equal’ or ‘significant’ but not ‘principal’ reason. Accordingly, it is submitted that, overall, after reclassification of both categories, the original raw score of 22% probably more accurately portray the extent to which substantive concerns principally motivate US exclusion decisions.

One of the concerns that can be grouped within substantive issues is highlighted by Fitzgerald’s US respondents. The clarity and predictability of its application by courts is a matter that affects its substantive effect in practice. When lawyers were asked whether the judiciary were familiar with the application of the CISG, 72% responded that they felt the bench to be ‘not at all familiar’ with it.¹¹⁹ However, only 18

116. On pre-contractual liability, see further Ch. 9.

117. *Contra* Fitzgerald, above n. 5, at 15-16, 69, Question 13.

118. The 22% raw figure comprised of 12/55 US respondent practitioners. On reclassification of 5 and addition of the remaining 2 without comments, the result is readjusted to 9/55 (16%).

119. Fitzgerald, above n. 5, at 73, Question 16.

lawyers responded to this question. Nonetheless, it can be said with a reasonable degree of confidence that more than half of all US lawyers would have this concern.¹²⁰

The 22% figure in Fitzgerald's work approaches the finding of Koehler that 31% of US practitioners surveyed take substantive legal aspects into account in their decisions to exclude, especially when one considers that the latter includes cases where legal reasons were not only of principal, but equal weight to practical concerns.

Yet there is one important aspect which is not reflected in either result. Choice of law is about more than simply excluding the CISG. Surveys on the CISG tend to be designed around the premise that participants exclude the CISG, and therefore ask respondents for their reasons for exclusion. However, some respondents effectively opt into the CISG. For example, in Fitzgerald's US survey 9% of participants typically opt in.¹²¹ Additionally, there is also a proportion who make no real decision, who presently do not consider substantive concerns.

Presumably those who typically 'opt in' do so because they feel the substantive qualities of the CISG to be advantageous, thus their choice of law (rather than exclusion) decision is also influenced by substantive matters. If we could combine the proportion who 'opt in' to those who exclude for substantive reasons, we could get an overall picture of how influential substantive matters are in choice of law relating to the CISG – not just exclusions. Unfortunately, this is not possible. For example, the survey design in the Fitzgerald study results in significant overlap between those answering that they 'typically' opt into the CISG, and those giving reasons for exclusion.¹²² While this is useful in the sense that it tests the 'typical opt in' group's reasons for excluding on the (logically) rare occasions when they do so, in means we are unable to ascertain their reasons for their more frequent choice for opting in, and moreover, means we cannot ascertain the true nature of the influence of substantive issues on choice of law (rather than exclusion of the CISG alone). The same matter appears to also affect the results of the Koehler survey. It is to be hoped that those designing surveys in future consider how to deal with this issue. Not only would this give a better indication of how many lawyers actually consider the substantive quality of the CISG, but it would give a more balanced and realistic picture of both those who contemplate its substantive quality negatively and those who assess its content positively.

There is also a further group which could be susceptible to influence by the CISG's substantive content – lawyers who presently make no reference to the CISG at all, or appear to make decisions without any rational basis whatsoever. It is this group to whom Professor Cuniberti refers in his critique of the efficiency of the CISG discussed in Chapters 4 and 5. It is submitted that there is potential for this group to be influenced by the substantive content of the law, although this is presently not the case. This might occur if, as discussed in Chapter 5, the decision-making environment were to change. It is impossible to estimate the extent to which substantive concerns would

120. With a confidence level of 80% it can be predicted that at least 58% and up to 85% of US lawyers share this concern.

121. Fitzgerald, above n. 5, at 67, Question 11.

122. In Fitzgerald's survey, 47 US lawyers answered the question on exclusions, of which 4 stated that they typically 'specifically subject the transaction to the CISG'. A total of 45 answered the following question as to why the CISG was excluded: *ibid.*, at 67, 68, Questions 11 and 12.

play a part in choice of law under conditions approaching full familiarity. It is however submitted that substantive reasons would affect a greater proportion of decisions than is presently the case, and thus as familiarity rises, it is likely that substantive reasons will increase in their relative importance as a factor in choice of law. The potential effects of growing familiarity in the future are discussed in Chapter 7.

In summary, this section has demonstrated that substantive concerns are relevant in every jurisdiction for which empirical evidence exists, although results vary considerably. With appropriate caution due to small sample sizes, it seems substantive concerns perhaps influence to some degree 22% of US decisions, 24% of German and 37% of Chinese lawyer decisions.¹²³ These figures no doubt underestimate the true proportion, since they do not measure the positive influence of substantive issues on those who prefer to 'opt in'.

On the basis of available studies it seems substantive issues play a significant role in lawyer decisions to opt in or exclude the CISG, but certainly not the overwhelming role envisaged by some.¹²⁴ A strong correlation between substantive concerns and exclusion rates exists, indicating that as substantive concerns are considered more important, exclusion rates decrease.¹²⁵ It seems concern over application of the CISG by US courts could be an important substantive concern. Additionally, it was noted that the influence of substantive issues on choice of law can be expected to increase as familiarity grows.

[E] Market Sector

Not every choice of law is negotiable. Sometimes the decision is effectively pre-ordained by standard form contracts designed and sanctioned by industry bodies. Trade associations involved in particular commodities publish and update standard terms which are then commonly used for trade in that commodity.¹²⁶ Universal exclusion of the CISG in commodities contracts, usually in favour of English law, has been widely noted.¹²⁷ Examples include the rules of FOFSA and GAFTA.¹²⁸

123. See above nn 109, 110, 112 for population confidence levels.

124. *Contra* Gillette and Scott, above n. 33, at 478.

125. Taking the significance of substantive concerns as 22% of US decisions, 24% of German and 37% Chinese decision, the coefficient of correlation between exclusion rates (x) and the proportion of respondents indicating bargaining strength as a factor (y) is -0.89, strongly indicating that as bargaining strength increases in significance, the rate of exclusions decrease. This measure utilizes the lowest measure of exclusion in the range for the US of 55%.

126. Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 Pace L. Rev. 179, 184 (2008) (highlighting role of ISDA for derivatives).

127. Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 Pace Int'l L. Rev. 55, 69 (2003) ('Uniformity and Diversity') ('every commodities sale form and oil company's standard terms that I have seen expressly excludes the ... CISG'); Lachmi Singh and Benjamin Leisinger, *A Law for International Sale of Goods: A Reply to Michael Bridge*, 20 Pace Int'l L. Rev. 161 (2008); Alastair C. L. Mullis, 'Termination for Breach of Contract in C.I.F. Contracts Under the Vienna Convention and English Law' in E. Lomnicka and C. G. J. Morse (eds), *Contemporary Issues in Commercial Law* 137, passim (Sweet & Maxwell 1997); Peter Schlechtriem, *Interpretation, Gap Filling and Further Development of the UN Sales Convention*,

In commodity markets, the influence of the trade association upon choice of law is profound. Information costs or the familiarity of either side will be almost inconsequential, since the preferences of individual lawyers or parties matter little, save for exceptional circumstances.¹²⁹ It follows that the substantive suitability of the CISG as opposed to English law will usually have no bearing on choice of law in individual commodities transactions.

However, it is submitted that their comparative substantive suitability is (or should be) relevant to the trade associations that design standard form contracts. Despite the view that industries with ‘longstanding self-regulatory regimes’ benefit least from generic laws,¹³⁰ such regimes of contractual obligations are still premised upon a background law.

There is debate on the suitability of the CISG for commodities markets. Commodities trade has been singled out by some as a transaction for which the CISG is inappropriate, on the basis of substantive features such as good faith, the strict test for termination in fundamental breach, cure, price reduction, and method of damages calculation.¹³¹ These are said to make the CISG less certain and precise than English law.¹³²

By contrast, the legal certainty offered by English law is held up as particularly suited to commodities transactions, including ‘hair trigger’ availability of termination.¹³³ One such proffered feature is the ‘perfect tender rule’ whereby the buyer can reject goods or documents that do not strictly conform.¹³⁴ A general principle of good

16 Pace Int'l L. Rev. 279, § 1.1 (2004); Filip De Ly, ‘Opting Out’ in Franco Ferrari (ed), *Quo Vadis CISG?* 25, 28, 40 (Sellier 2005).

128. See, e.g., Grain and Feed Trade Association (‘GAFTA’): GAFTA No. 100, *Contract for Shipment of Feedstuffs in Bulk Tare Quale CIF Terms*, 1 Jan. 2003, cl. 28; GAFTA No. 124, *Sampling Rules*, 1 Jan. 2003, cl. 27; Federation of Oil Seeds and Fats Associations, www.fosfa.org (accessed 28 Feb. 2014) (‘FOSFA’); Bridge, *Uniformity and Diversity*, above n. 127, at 60.
129. As noted in Ch. 5, at §5.03[G], n. 98 in some circumstances the CISG is chosen for commodities transactions, such where buyers are required to process commodities and resell them to the original seller in processed form.
130. Gillette and Scott, above n. 33, at 478.
131. Bridge, *Uniformity and Diversity*, above n. 127, at 69 (this perception of certainty is fair and accurate); Alastair C. L. Mullis, *Twenty-Five Years On – The United Kingdom, Damages and the Vienna Sales Convention*, 71 *Rabels Z* 35, 38 (2007) (‘*Twenty-Five Years On*’); Mullis, above n. 127, text accompanying n. 155 (ambivalently); Michael G. Bridge, *A Law for International Sales*, 37 *Hong Kong L.J.* 17, 30, 31 (2007) (‘*A Law for International Sales*’) (the right to cure would interfere with the ‘clean documents’ rule in commodity trade). On damages, see Djakhongir Saidov, *The Present State of Damages Under the CISG*, 13 *Vindobona J. International Commercial L. & Arbitration* 197, 206-207 (2009).
132. G. H. Treitel, in A. G. Guest (ed), *Benjamin’s Sale of Goods* [18-004] 966, [18-232] n. 61 (Sweet & Maxwell 6th ed, 2002); Bridge, *A Law for International Sales*, above n. 131, at 30; Mullis, above n. 127, text accompanying n. 156 (but arguing this is ‘over-exaggerated’).
133. Bridge, *Uniformity and Diversity*, above n. 127, at 65, 69. Not all commodity traders favour such harsh rights of rejection: Treitel, above n. 132, at [18-231] 1142.
134. *Sale of Goods Act 1979* (UK), s. 35. See *Cehave NV v. Bremer Handelsgesellschaft mbH (the Hansa Nord)* [1976] QB 44 (UK), Court of Appeal, 16 Jul. 1975 (Roskill LJ confirming obiter documentary conformity to be ‘sacrosanct’); *SIAT Di Dal Ferro v. Tradax Overseas* [1980] 1 Lloyd’s Rep 53 (UK), Court of Appeal, 14 May 1980; *Hansson v. Hamel & Horley Ltd* [1922] 2 AC 36 (UK), House of Lords, 16 Mar. 1922 (upholding ‘clean documents’ rule on the basis documents should be ‘fit to pass current in commerce’); *Soon Hua Seng Co. Ltd v. Glencore Grain Ltd* [1996] 1 Lloyd’s Rep 398, 402 (UK), High Court (Queen’s Bench Div), 17 Jan. 1996

faith is absent from English law.¹³⁵ Although the harsh nature of easy termination allows buyers in falling markets to take opportunistic advantage of trivial non-conformities,¹³⁶ the strictness of the law is said to enable parties to quickly ascertain their position without legal advice.¹³⁷ Speedy decision making is essential, since the decision whether or not to take up or reject documents must be made promptly, with insufficient time for ‘detailed factual enquiries’.¹³⁸ To quote Macdonald in a different context, the argument is that for commodities, a ‘Toyota bright line’ law is more effective than a more nuanced legislative ‘Lamborghini’.¹³⁹ Professor Bridge points to the ‘symbiotic’ development of a century of English case law and the standard forms used in commodities markets, which grew side-by-side with the English sales law developed in those cases, the implication being that there is a seamless relationship between them, resulting in certainty.¹⁴⁰

Others argue the CISG can easily accommodate commodity transactions. They contend its choice does not threaten legal certainty because the commercial context of

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- (contractual requirement of liner terms amounted to condition precedent enabling buyer to reject documents). See P. S. Atiyah, *The Sale of Goods* 488 (Pitman 8th ed, 1990; Bridge, *A Law for International Sales*, above n. 131, at 28; Schlechtriem, above n. 127, at §5(c).
135. *Bunge NV v. Tradax Export SA* [1981] 2 All ER 513 (UK), Queen’s Bench Division (Commercial Court), 11 Apr. 1979 (termination justified on basis of late delivery by seller despite delay in buyer notice transmission back up the string); Michael G. Bridge, ‘Good Faith in Commercial Contracts’ in Roger Brownsword, Norma J. Ford and Geraint Howells (eds), *Good Faith in Contract* 139 (Ashgate 1999) (‘Brownsword’), Bridge, *Uniformity and Diversity*, above n. 127, at 65 (good faith would not sit well with commodities trade); Michael G. Bridge, *International Private Commodity Sales*, 19 *Canadian Business L.J.* 485, 488 (1991) (‘*Canadian Business LJ*’) (relational loyalty ‘cuts very little ice here’).
136. Treitel, above n. 132, at [18-231] 1141-42; Bridge, *Canadian Business LJ*, at 488; *Reardon Smith Line Ltd v. Hansen Tangen* [1976] 1 WLR 989, 998 (UK), House of Lords, 7 Oct. 1976 (description in commodities vital). See, e.g., strategic behaviour by buyer in a falling market: *Bowes v. Shand* (1877) 2 App Cas 455 (UK), House of Lords, 8 Jun. 1877 (buyer could reject despite no loss from late shipment); *Richco International Ltd v. Bunge & Co. Ltd (the New Prosper)* [1991] 2 Lloyd’s Rep 93 (UK), Queen’s Bench Division (Commercial Court), 13 Nov. 1990 (seller successfully seized upon a technical defect to take advantage of rising market). Recent amendments would overtly sanction such behaviour, but opportunistic reasons in commodity sales are ‘ring-fenced’ from recent restrictions on rejection: Bridge, above n. 127, at 69. See below, n. 157.
137. Bridge, *Uniformity and Diversity*, above n. 127, at 65-66, n. 48 (such contracts are entered without legal assistance, and that involvement of law firms is primarily confined to litigation).
138. *Hansson v. Hamel & Horley Ltd* [1922] 2 AC 36 (UK), above n. 134, 45; Djakhongir Saidov, ‘Documentary Performance and the CISG’ in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play* 49, 72 (Eleven 2012).
139. Roderick A. Macdonald, *Article 9 Norm Entrepreneurship* 42(2) *Canadian Business L.J.* 240, 265 (2006).
140. Bridge, *A Law for International Sales*, above n. 131, at 22, 29, 40 (English law for commodities focuses on express terms and has developed largely outside the Sale of Goods legislation, and noting richness of English case law on documentary sale); Mullis, above n. 127, text accompanying n. 158; Bridge, *Uniformity and Diversity*, above n. 127, at 68 (English sales law ‘functions as a system that was designed for commodity sales’); Angelo Forte, *The United Nations Convention on Contracts for the International Sale of Goods: Reason or Unreason in the United Kingdom*, 26 *U. Balt. L. Rev.* 51, 58 (1997); Mullis, *Twenty-Five Years On*, above n. 131, at 37.

commodities trade dictates,¹⁴¹ even if not expressly agreed, that time and documentary performance is ‘always of the essence’ so that delay or non-conforming documentary performance is necessarily fundamental, thus termination for fundamental breach is more readily available than for other transactions.¹⁴² They assert the right to cure will not arise for defective documents in commodities contracts because cure would normally cause the buyer unreasonable inconvenience.¹⁴³ This is because documentary cure would create an inability to immediately on-sell obligations. The ability to immediately on-sell is a key characteristic of string transactions and of prime concern to most parties in commodities sectors, given that most contracts within the string are not entered for the purpose of obtaining the physical goods at all.¹⁴⁴ In fact, arguably, the CISG position on cure in relation to defective documents may be somewhat stricter than in English law.¹⁴⁵ Thus it is suggested that the CISG would operate in a manner similar to the perfect tender rule for commodities.¹⁴⁶ It has been convincingly argued the tools for damages under the CISG, such as the abstract measure under Article 76, are well suited to commodities.¹⁴⁷ Unlike English law, the CISG has provisions regarding delivery of documents as it was always envisaged that it would be applicable

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141. Construed per Arts 8(2), 8(3), 9(1), 9(2) CISG; Schlechtriem, above n. 127, at §2(c); CISG Advisory Council, CISG-AC Opinion No 5, 7 May 2005, Rapporteur: Prof. Dr Ingeborg Schwenzer, *Commentary* [4.17]; Singh and Leisinger, above n. 127, at 175.
142. Schlechtriem, above n. 127, at §5(bb) (variable stringency on the requirement of fundamental breach depending on usage pursuant to Art. 9(2)); CISG-AC Opinion No. 5, above n. 141, *Commentary* [4.17]; Ingeborg Schwenzer, *The Danger of Domestic Pre-Conceived Views with Respect to the Uniform Interpretation of the CISG*, Victoria U. Wellington L. Rev. 795, 806-807 (2004-5) (delivery of clean and timely documents is always of the essence in commodity trade); Mullis, above n. 127, text accompanying n. 149-153 (at ‘least arguable’ slight defects or late delivery of documents might allow CISG avoidance); Peter Schlechtriem, *Subsequent Performance and Delivery Deadlines*, 18 Pace Int’l L. Rev. 83, 87, 92-95 (2006) (‘Subsequent Performance’) (asserting an interpretation which ‘practically leads to a result corresponding to the perfect tender rule’); Peter Huber, *CISG – The Structure of Remedies*, 71 *Rechts Z* 13, 32 (2007) (documentary obligations are ‘at least as strict as current English law’ given good faith, trade usages, and express/implied terms including CIF Incoterms and UCP documentary credits); Bruno Zeller, *Commodity Sales and the CISG* in *Kritzer Festschrift*, above n. 9, 627, at 628, 632. *Contra* Bridge, *A Law for International Sales*, above n. 131, at 19, 22. See, e.g., time as essential given the circumstances: Court of Appeal (OLG) Hamburg, Germany, 28 Feb. 1997, <http://cisgw3.law.pace.edu/cases/970228g1.html> (accessed 28 Feb. 2014) (time was foreseeably of ‘special interest’ to the buyer, as denoted by the Incoterm CIF, so delay was a fundamental breach).
143. See Art. 48(1) CISG; CISG-AC Opinion No. 5, above n. 141, *Commentary* [4.14]; Schwenzer, above n. 142, at 806-807 (ability to cure defective documents inapplicable to commodities); Huber, above n. 142, at 32; Amtsgericht [Petty District Court] (AG) München, 25 Jun. 1995, <http://cisgw3.law.pace.edu/cases/950623g1.html> (accessed 28 Feb. 2014).
144. A more detailed discussion of the significance of string transactions in commodity trade appears in Ch. 7, at §7.02[F].
145. On limited right to cure in Bridge, *A Law for International Sales*, above n. 131, at 177-78, 186-87.
146. CISG-AC Opinion No. 5, above n. 141, *Commentary* [4.14]; Huber, above n. 142, at 32; Schlechtriem, *Subsequent Performance*, above n. 142, at 94-95 (on different basis); Zeller, above n. 142, at 632.
147. For detailed analysis, see Saidov, above n. 131, at 206-208 (abstract measure under Art. 76 has and would be employed); at 209-215 (description, market and price). *Contra* Bridge, *Uniformity and Diversity*, above n. 127, at 68 (English position in determining damages as at due date for delivery is better suited to commodity trade as opposed to the CISG determination at date of

to documentary sales.¹⁴⁸ Additionally, the CISG has previously shown itself adaptable to widespread express terms.¹⁴⁹

Other issues are yet to be debated, such as the manner in which the CISG treats the interlocking nature of string contracts, particularly the effect on rights and obligations relating to physical delivery for intermediate buyers when commodity sales on CIF terms are linked by transfer of a notice of appropriation.¹⁵⁰ Under English law, this process contractually locks a particular cargo to each of the previously unconnected contracts. If considered an assignment of contractual rights to demand physical delivery, a subsidiary law would need to be engaged in the choice of law since CISG does not deal with assignment.¹⁵¹ Alternatively, the transfer and acceptance of the notice of appropriation could simply be seen as an agreement to dispense with physical delivery pursuant to Article 29 CISG. It is submitted this view is preferable. Arguably such modification is clearly anticipated by both usage and the guarantee by each seller that they pass on any notice promptly, and that all prior sellers will also do so.¹⁵²

Another issue is the effect of events hindering performance. It is submitted that express standard terms detailing the effect of what might otherwise fall within Article 79 CISG will undoubtedly vary the effect of that provision in the same way as they presently prevail over the English doctrine of frustration.¹⁵³

While it is true that English law has developed symbiotically with commodities trade, it may always have given the appearance of being stricter than it was in fact,¹⁵⁴ and its relative suitability may be slowly subsiding. The so-called perfect tender rule was always subject to limitations,¹⁵⁵ and its strictness as a 'hair trigger' for termination

avoidance); Zeller, above n. 142, at 636, 637 (in addition to Art. 75 or 76 traders can still claim lost profits under Art. 74 to account for price fluctuations between avoidance and delivery date).

148. CISG Arts 30, 32, 34. See UNCITRAL Secretariat, *Commentary*, UN Doc A/CONF.97/5 (14 Mar. 1979) 14, 16 Art. 2, [8], in Diplomatic Conference, Vienna, 10 Mar.-11 Apr. 1980, *Official Records*, UN Doc A/CONF.97/19 14, 16, http://www.uncitral.org/pdf/a_conf.97_5-ocred.pdf (accessed 28 Feb. 2014) (in regard to exclusion of stocks, shares, investment securities, negotiable instruments in sub-Art. (d) that '[t]his subparagraph does not exclude documentary sales of goods from the scope of this Convention even though, in some legal systems, such sales may be characterized as sales of commercial paper'); CISG-AC Opinion No. 5, above n. 141, *Commentary* [4.12]; Schlechtriem, above n. 127, at §1.1 (views that the CISG was not suited to commodity trade would have surprised the CISG's architects).
149. Singh and Leisinger, above n. 127, at 186-87 (interaction of Incoterms with CISG).
150. On retrospective transfers of risk under CIF contracts and the CISG triggered by notice of appropriation, see Michael Bridge, 'The Transfer of Risk under the UN Sales Convention 1980 (CISG)' in *Kritzer Festschrift*, above n. 9, 77, at 97.
151. For example, by a choice of the law of a Contracting State, which will ensure the CISG applies to the extent of its scope, and residual laws of the Contracting State to any other issues.
152. Bridge, *Uniformity and Diversity*, above n. 127, at 63 n. 29.
153. See, e.g., GAFTA 100, above n. 128, cl. 18, cl. 25 (dealing with governmental intervention preventing shipment).
154. In fact, requirements of fairness and co-operation are inherent in rules on transmission of appropriation notices: Bridge, in *Brownsword*, above n. 135, at 155-56.
155. Atiyah, above n. 134, at 494 (if possible within the time for delivery, the seller can deliver substitute goods after rejection). See Bridge, *A Law for International Sales*, above n. 131, at 29-30 (discussing substitution of documents susceptible to this).

is somewhat deceptive.¹⁵⁶ The insertion of section 15A removing rights of rejection for minor breaches of implied terms into the *Sale of Goods Act 1979* (UK) from 1995 has already been discussed in Chapter 4. This is one example of how EU law has made noticeable inroads into English law, and although so far this has not had an impact on commodities which rely primarily on express terms,¹⁵⁷ its future influence is yet to be seen. The DCFR would have made a significant difference.¹⁵⁸ Were England to adopt the proposed CESL more inroads could be expected, although its application is currently by party opt in,¹⁵⁹ and one would expect trade associations to be less than keen to embrace the proposed CESL's much maligned approach.

In any event, the requirement of documentary conformity in English law at present is also not crystal clear, and even though undoubtedly English law 'pursues legal certainty and rigour' it views 'clerical error or ... minor discrepancy as insufficient' for breach;¹⁶⁰ it is not always readily apparent to parties whether a term is a condition or warranty,¹⁶¹ and development of the third category of intermediate terms

156. A number of observations support this view. First, acceptance is often deemed: *Sale of Goods Act 1979* (UK), s. 35(1) (when buyer intimates acceptance or the buyer acts toward goods delivered in a manner inconsistent with seller's ownership, or after lapse of a reasonable period without intimation of rejection); *Kwei Tek Chao v. British Traders & Shippers Ltd* [1954] 2 QB 459, 475 (UK), High Court (Queen's Bench Div), 19 Jan. 1954 (acceptance of goods and delay in rejecting documents constituted affirmation despite false date on bill of lading); Treitel, above n. 132, at [12-044]; Atiyah, above n. 134, at 426-97 (contrasting ease with which right to reject can be lost for sale of goods as opposed to general contract law, in particular, before awareness of breach or existence of the right to reject); CISG-AC Opinion No. 5, above n. 141, *Commentary* [2.2].

157. English law has been indirectly influenced by the CISG by EU law: see, e.g., Directive 99/44/EC, above n. 79, Art. 3 (price reductions); Bridge, *Uniformity and Diversity*, above n. 127, at 71; Huber, above n. 142, at 22 (influence of EU initiatives in decreasing English law's relative suitability vis-à-vis the CISG); Zeller, above n. 142, at 638; Mullis, above n. 127, *passim*. Mullis considers the 1994 insertion of s. 15A into the *Sale of Goods Act 1979* (UK) restricting termination due to slight breaches of conditions implied by ss 13-15 to have added uncertainty to UK law. However, the restriction on the right to reject does not affect express terms, which are paramount in commodities trade, and does not apply to late or documentary performance: Bridge, *Uniformity and Diversity*, above n. 127, at n. 58; Bridge, *A Law for International Sales*, above n. 131, at 23; Bridge, in *Brownsword*, above n. 135, at 164. See also *Halsbury's Laws of England* (Butterworths/Lexis Nexis electronic version 2010), (2) CIF Contracts, (ii) Legal Incidents, §340, n. 14; CISG-AC Opinion No. 5, above n. 141, *Commentary* [2.2].

158. The DCFR would alter English law relating to commodities on formation, obligations and remedies, and property in movable goods and assignments. It proposes a general duty of good faith: DCFR, II, III, IV.A., VIII. In particular, see the comments at IV.A.-2:101, 2:301, 1253 (discussing documentary sales). See concerns in House of Lords EU Committee, 12th Report, *European Contract Law: the Draft Common Frame of Reference*, 19 May 2009, Ch. 3, [30]-[38], <http://www.publications.parliament.uk/pa/ld200809/ldselect/lddeucom/95/9506.htm>; European Financial Markets Lawyers Group (EFMLG), *The Draft Common Frame of Reference: A Position Paper*, 1 Sep. 2009 <http://www.efmlg.org/documents.htm> (each accessed 28 Feb. 2014), discussing the DCFR on standard financial instrument termination, set-offs, netting, assignment, and the effect of the unfairness test, but similar issues arise for commodities. See Bridge, *Uniformity and Diversity*, above n. 127, at 71-72 (if supplanted by European contract law there would be no 'legacy English law' to which commodity traders could turn).

159. Proposed Regulation on CESL, RCESL Recital 8.

160. Saidov, above n. 138, 72.

161. *Tradax Internacional SA v. Goldschmidt SA* [1977] 2 Lloyd's Rep 604, 612 (UK), Queen's Bench Division (Commercial Court), 27 Jan. 1977 (FOB contract requiring certificate of quality of no

for which serious or substantial breach is required before termination is justified has complicated the previously clear ‘bright line’.¹⁶² Waiver, the principle of inconsistent behaviour and rules on express contrary terms further dilute the rigour of English law and therefore its relative suitability.¹⁶³ It is at least arguable therefore, that substantive differences are not as significant as they might otherwise appear.

However, the volume of cases developing the English law in relation to commodities standard forms and trade terms must be taken into account as adding a level of substantive clarity which the CISG is yet to attain, irrespective of its substantive capacity to reach the same outcomes in practice. This can be seen in relation to trade terms such as CIF where no express reference is made to Incoterms.¹⁶⁴ The English rule provides a default position, whereas, while cases on the CISG may suggest Incoterms as a trade usage of the CISG,¹⁶⁵ arguably this is not warranted in markets where they are less commonly utilized, or even in markets in which they are so well known that the omission of a specific reference to Incoterms evidences ‘a desire by the parties that they not apply’.¹⁶⁶ In the latter case it could even be argued that English interpretations of trade terms might be relevant under Article 9(2). The latter would be a difficult position attenuated by obvious concerns of encouraging a homeward trend, but English law is exceptional in this specific regard due to its wide influence on

more than 4% impurities, no right to reject on grounds certificate of quality showed 4.1% impurity in absence of agreement was a condition). See Mullis, above n. 127, text accompanying n. 137. See *the New Prosper*, above n. 136, at 98-9.

162. *Hong Kong Fir Shipping Co. v. Kawasaki Kisen Kaisha* [1962] 2 QB 26 (UK), Court of Appeal, 20 Dec. 1961; *the Hansa Nord*, above n. 134; *Tradax v. Goldschmidt*, above n. 161, at 612. Mentioned but not applied in *SIAT Di Dal Ferro*, above n. 134.
163. Atiyah, above n. 134, at 497-98 (right to reject goods can be lost by waiver through ‘clear and unequivocal representations’ by words or conduct goods will be accepted or not rejected; *Kwei Tek Chao*, above n. 156, at 475; *Vargas Pena Apezteguia y Cia Saic v. Peter Cremer GmbH* [1987] 1 Lloyd’s Rep 394, 398 (UK), Queen’s Bench Division (Commercial Court), 3 Jul. 1986 (estoppel/inconsistent behaviour upheld, no rejection when simultaneously state intent to resell); *Panchaud Frères v. Etablissements General Grain Co.* [1970] 1 Lloyd’s Rep 53 (UK), Court of Appeal, 5 Nov. 1969 (termination rights lost for inconsistent behaviour/waiver); *Bremer Handelsgesellschaft mbH v. C Mackprang Jr* [1979] 1 Lloyd’s Rep 221 (UK), Court of Appeal, 2 Nov. 1978. But see *Société Italo-Belge Pour le Commerce et l’Industrie SA v. Palm & Vegetable Oils (Malaysia) Sdn Bhd (the Post Chaser)* [1981] 2 Lloyd’s Rep 695; [1982] 1 All ER 19 (UK) Queen’s Bench Division (Commercial Court), 16 Jul. 1981; *Proctor & Gamble Philippine Manufacturing Corp. v. Peter Cremer GmbH (the Manila)* [1988] 3 All ER 843, 853 (UK), Queen’s Bench Division (Commercial Court) (survey report tendered with documents insufficient to show buyer knowledge of late shipping); *V Berg Ltd & Son Ltd v. Vanden Avenne-Izegem PVBA* [1977] 1 Lloyd’s Rep 499, 504 (UK), Court of Appeal, 12 Nov. 1976; *Jackson v. Rotax Motor & Cycle Co.* [1910] 2 KB 937 (UK), Court of Appeal, 22 Jul. 1910; *SIAT Di Dal Ferro*, above n. 134.
164. Express reference to Incoterms usually leads to the conclusion Incoterms were intended as the source of seller documentary duties: Saidov, above n. 138, at 60.
165. See, e.g., *St Paul Guardian Insurance Co. v. Neuromed Medical Systems & Support, GmbH*, US District Court (SD NY), 26 Mar. 2002, <http://cisgw3.law.pace.edu/cases/020326u1.html>; Oberster Gerichtshof [Supreme Court](OGH), Austria, 15 Oct. 1998, <http://cisgw3.law.pace.edu/cases/981015a3.html> (each accessed 28 Feb. 2014) (trade usages must be observed by majority for Art. 9(2)). See also *ibid.*, at 60-61; Singh and Leisinger, above n. 127, at 186-87.
166. Bridge, above n. 150, at 547; Saidov, above n. 138, at 61 (concurring but concluding different results are unlikely in practice).

commodities trade contract standard forms and clauses across many jurisdictions, which in some markets may amount to a competing usage similar to Incoterms.¹⁶⁷ Indeed, the uncertainty surrounding this process may constitute a substantive reason for exclusion of the CISG.¹⁶⁸

In any event, it is submitted that the sheer dominance of any particular law in a market sector undoubtedly and drastically clouds perceptions of its substantive merit as choice of law.¹⁶⁹ Additionally, it seems probable that there are more than purely substantive reasons for the decisions of trade associations to opt out of the CISG, a point to which I will return.¹⁷⁰

§6.04 CONCLUSION

This chapter set out to identify the rate of exclusion from the CISG, and the reasons for exclusion by lawyers as the first step in understanding why, even if the CISG is objectively efficient, it might still be excluded.

It was observed that the rate of exclusion varied between jurisdictions, particularly when the data was closely considered, such that a spectrum can be detected, with ‘pro-CISG’ jurisdictions at one end, such as China, and ‘automatic’ exclusion jurisdictions, such as the USA and probably Canada and Australia, at the other end. It was also observed that a range of jurisdictions fell between these extremes, including Switzerland, Germany and Austria.

It was concluded that as at 2008, the most important factor in exclusion rates seems to be the level of familiarity with the CISG. This bore the strongest correlation with exclusion rates. A connected and apparently significant factor was also jurisdictionally influenced information costs. It was concluded that the latter was affected by three differentials: education, litigation and domestic law, each of which could alter the perceived cost involved in a practising lawyer becoming familiar with the CISG, and the lawyer’s perception of the advantages of the CISG identified in Chapters 4 and 5. One of these differentials, litigation exposure, was found to very closely correlate with exclusion rates across jurisdictions, suggesting the higher the exposure to CISG litigation, the lower the likely exclusion rate. Bargaining strength and market sector were also identified as strong influences on lawyer choice of law.

Similarly, substantive concerns were also found to be correlated with exclusion rates. Although they were not the overwhelming factor in exclusions predicted by some, they did bear a strong relationship with exclusions. Importantly, it appears that

167. For the view that English CIF and FOB decisions could form the basis for interpretation of those trade terms in other jurisdictions, see Bridge, above n. 166, at 548. On problems with Art. 67 CISG for CIF contracts: Michael Bridge, ‘The Transfer of Risk under the UN Sales Convention 1980 (CISG)’ in *Kritzer Festschrift*, above n. 9, 77, at 91.

168. Bridge, above n. 150, at 548.

169. This touches on status quo bias, group polarity and institutionalization which are discussed in Ch. 7. See Singh and Leisinger, above n. 127, at 189 (asserting this as the primary reason for CISG exclusion); Mullis, *Twenty-Five Years On*, above n. 131, at 38. Generally ‘attempts to deviate are met with great resistance’ where neutral standard forms exist: Perillo, above n. 126, at 187.

170. See Ch. 7, at §7.02[F].

as substantive concerns increase in relative importance in choice of law decisions within a jurisdiction, exclusion rates correspondingly decrease. It was observed that perceptions of judicial familiarity might be significant amongst lawyers' substantive concerns about the application of the CISG, and thus the clarity and predictability of the outcomes achieved under it.

It was submitted that as familiarity increases and information costs correspondingly decrease, substantive concerns may play a more important role in choice of law decisions. Accordingly, I contend that when lawyers are better equipped to assess the CISG on its substantive (and non-substantive efficiency) merits, exclusions decrease because they are better able to objectively assess the advantages and disadvantages discussed in Chapters 4 and 5, and base their decision on the CISG's comparative efficiency as a choice of law.

To the degree the CISG is excluded due to proper assessment of substantive concerns, bargaining strength or due to market sector pressure (from an individual lawyer perspective), the decision to exclude does not preclude optimal utilization of the CISG. Conversely, it is submitted that to the degree unfamiliarity and information costs drive exclusions, that is, to the extent 'blind' or 'automatic' exclusions exist, whereby there is little consideration of the CISG's objective value before opting out, then sub-optimal CISG utilization necessarily occurs, since in a proportion of those cases, an objective assessment would result in non-exclusion.

It is therefore contended that evidence of the influence of familiarity and information costs demonstrates that inefficient choices are currently made for a proportion of international transactions, and the full potential economic benefits of the CISG are yet to be realized. Hence it is submitted increased frequency of the CISG's application to transactions would improve efficiency in international sales transactions.

Familiarity, information costs, bargaining strength, substantive concerns and market sector are, however, only the bare bones behind lawyer choices of law. Besides the interaction between these factors, there are a range of other influences on the decision-making process in which lawyers engage when advising on choice of law. The next chapter examines how the factors identified above interface with economic and psychological variables in the decision-making process, which in turn may affect the exclusion rates.

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CHAPTER 7

Interdisciplinary Analysis of Lawyer Choices of Law

§7.01 INTRODUCTION

Chapter 6 isolated the rate of lawyer exclusions from the CISG and the reasons for this from the evidence available up to 2008. Yet in Chapters 4 and 5, it was concluded that the CISG was an efficient law. It is not proposed that it is an efficient law in all transactions, but if the CISG is indeed efficient, as was concluded earlier, then why do lawyers – in some jurisdictions more than others – exclude it? The juxtaposition of efficiency and exclusion presents a paradox that warrants a more nuanced explanation. In particular, motivations for exclusion must be examined in the context of the decision-making environment in which they are made before they can be properly understood.

Lawyers do not make decisions in a perfect vacuum. This chapter analyses the factors for exclusion through theoretical prisms relevant to decision-making processes drawn from economics and psychology. It attempts to build uniquely contextualized insights into lawyer choice of law and to develop a fuller picture of exclusion decisions and how these might be susceptible to change over time. These insights are then tested against new empirical evidence released from 2011 onward.

By examining the context in which exclusion decisions are made and the range of behavioural and economic factors that might be brought to bear on the decision-making process, this chapter seeks to better clarify why the CISG might be excluded irrespective of the earlier conclusion that it is often a rationally efficient law for international sales.

§7.02 RATIONALITY AND EXCLUSIONS

Each lawyer viewing the choice of law decision is faced with a different combination of factors relevant to exclusion decisions. For some, a combination of low information costs, high familiarity and strong bargaining power makes a choice of the CISG more likely. For others, low familiarity levels fuelled by high information costs will predispose them to irrational exclusions. Given the rates of exclusions and reasons examined in Chapter 6, for present purposes it is useful to surmise that these factors have led to ‘pro-CISG’ China on the one hand, and on the other, ‘automatic’ or ‘blind’ opt-out predominant jurisdictions of Canada, Australia, and the US, on the other. Of course, there are at least two sides to an international sales contract. This chapter examines the interactions and dynamics of lawyers and counterparties on choice of law in terms of behavioural economics, psychology, neoclassical economics and game theory and institutionalization of choice.

The frameworks of neoclassical and behavioural economics are well known. Neoclassical economics proceeds on the basis that perfectly competitive markets efficiently optimize expected utility. It assumes parties make rational choices on the basis of perfect information in the absence of market distortions caused by information costs, transaction costs and externalities.¹ Implicitly, rational choice theory assumes actors make decisions on the basis of a cost-benefit analysis.² Its so-called rival, behavioural economics, attacks the assumption of rational choice and perfect information.³ Behavioural economics draws on cognitive psychology to give insight into what appear to be irrational choices in the real world.

1. Kenneth J. Arrow, ‘The Organization of Economic Activity’, in Kenneth J. Arrow (ed), *Collected Papers of Kenneth J. Arrow*, Vol 2: General Equilibrium 133, 142-148 (Harvard 1983) (‘Arrow’); Joseph E. Stiglitz, *Principles of Microeconomics* 493-502 (WW Norton 1st edn, 1993); Russell B. Korobkin and Thomas S. Ulen, *Law and Behavioural Science: Removing the Rationality Assumption from Law and Economics*, 88 Cal. L. Rev. 1051, n. 104, 1055, 1060-66 (2000). An earlier version of this chapter was published as *Green Eggs & Ham*, 6(2) J. Private Int’l L. 417 (2010).
2. Korobkin and Ulen, above n. 1, at 1082; Cass R. Sunstein, *Cognition and Cost-Benefit Analysis*, 29 J. Legal Stud. 1059 (2000) (‘Cost-Benefit’); Stiglitz, above n. 1, at 28-29.
3. See Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Quarterly J. Econ. 99, 101, 104 (1955) (‘Behavioral Model of Rational Choice’); Herbert A. Simon, *Rational Choice and the Structure of the Environment*, 63(2) Psychological Rev. 129, 129 (1956) (‘Structure of the Environment’); Daniel Kahneman and Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 Econometrica 263 (1979) (‘Prospect Theory’); Herbert A. Simon, *Rational Decision Making in Business Organizations*, 69(4) Am. Econ. Rev. 493 (1979) (‘Business Organizations’); Amos Tversky and Daniel Kahneman, ‘Heuristics & Biases’ in Daniel Kahneman, Paul Slovic and Amos Tversky (eds), *Judgment Under Uncertainty* 1, 3 (Cambridge 1982) (‘Judgment under Uncertainty’); Amos Tversky and Daniel Kahneman, ‘Rational Choice and the Framing of Decisions’ in Robin M. Hogarth and Melvin W. Reder (eds), *Rational Choice* 67, 88, 91 (U. Chi. Press 1987) (‘Framing’); Gerd Gigerenzer and Daniel G. Goldstein, *Reasoning the Fast and Frugal Way*, 103 Psychological Rev. 650, 650 (1996); Christine Jolls, Cass R. Sunstein and Richard H. Thaler, ‘A Behavioral Approach to Law and Economics’ in Cass R. Sunstein (ed), *Behavioral Law and Economics* 13, 14 (Cambridge 2000) (‘Sunstein’); Daniel Kahneman, *Maps of Bounded Rationality*, 93 Am. Econ. Rev. 1449, 1454-56 (2003) (‘Maps of Bounded Rationality’).

Rational choice theory has useful predictive qualities,⁴ provided its limitations are acknowledged. Behavioural economics and cognitive psychology provide nuances that reflect real life complexities, but for this reason can lack predictive power. Institutional economics draws together elements of neoclassicism with structural constraints.⁵ Since each offers benefits, I will draw on them all to contextualize how unfamiliarity, learning costs, bargaining strength and institutionalization contribute to choices of law.⁶

The practice of ‘automatically opting out’ of the CISG involves a choice of law excluding application of the CISG without proper consideration as to whether it is the more appropriate law for the transaction in question. In jurisdictions displaying both high levels of preference for exclusion and high unfamiliarity, it is submitted that it is likely that a great deal of ‘automatic’ or ‘blind’ opting out is occurring. This is arguably true of the US, and probably more so in Australia and Canada.

In neoclassical terms such decisions can be described as irrational because they are based on imperfect information and do not involve cost-benefit analyses. A choice of the CISG can bring many advantages.⁷ Consequently, it is inevitable that such decisions frequently (but not always) result in suboptimal choices of law. Despite its inevitable suboptimality in at least some cases, ‘blind’ opting out has shown remarkable persistence.

[A] Path Dependence

Businesses are unlikely to ponder choices of law in everyday transactions.⁸ At the business coal-face much CISG exclusion occurs via general conditions. Redrafting those standard terms with legal input, for most businesses, can only occur occasionally, with smaller businesses seeking advice less frequently.⁹ As legal advice is a form of information cost, small-medium businesses face proportionately higher information costs since, relative to larger business, the same costs must be averaged across a

4. Korobkin and Ulen, above n. 1, at 1074. *Contra* Gigenzer and Goldstein, above n. 3, 650; Richard H. Thaler, ‘The Psychology of Choice and the Assumptions of Economics’ in Richard H. Thaler (ed), *Quasi Rational Economics* 137, 163 (Sage 1991).

5. The ‘new’ institutional economics (NIE) combines marginal analysis with institutions in the form of rules within organizations. ‘Old’ institutional economics concerned human and organizational behaviour, and considered markets as yet another institution. See Herbert J. Hovenkamp, *Coase, Institutionalism, and the Origins of Law and Economics*, U. Iowa Legal Studies Research Paper No 10-07 (2010), <http://ssrn.com/abstract=1538279> (accessed 28 Feb. 2014).

6. An approach espoused by Mark Kelman, *Behavioral Economics as Part of a Rhetorical Duet*, 50 *Stan. L. Rev.* 1577 (1998).

7. See Chs 4 and 5.

8. Schroeter aptly describes choice of law questions in the minds of business people, as ‘like the entrance of a distant relative at a wedding reception, where he lets everyone know in a loud voice his highly unpleasant experiences with divorces’: Ulrich G. Schroeter, *Creation and Acceptance of Uniform Private Law in Europe*, 14 *Jahresheft der Internationalen Juristenvereinigung Osnabrück* 35, §1(b)(bb) (2007)(translation by Sylvester Urban on file with author).

9. Expressing concern that only 13% of the 60 business respondents to a survey reported using external lawyers: Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* [515](Oxford 2012).

smaller number of lower value transactions.¹⁰ Small- to medium-sized businesses are therefore more prone to imperfectly informed decision making and concurrent efficiency losses from less-suitable choices of law. This is but one example of how information and transaction costs lead to inefficiency in markets.¹¹

The intervals between seeking legal redrafts of general conditions can be characterized as periods of ‘path dependence’. Path dependence occurs when people are ‘locked-into’ suboptimal choices because of a historical path of events.¹² By relying on what they have done in the past such choices violate the neoclassical assumption of deliberative, rational choice.¹³ Effectively the decision maker ignores any potential gains from the more suitable law.¹⁴

Legal advice is an information cost for business. When clients seek legal input into drafting their standard or individual contract terms, the lawyer is paid to determine the best choice of law in a rational manner, by exercising his/her professional judgment. It is at this point that ‘automatic’ opt-outs become a serious legal and ethical issue. For lawyers, exclusion as a means of avoiding an unfamiliar law is no more than an abdication of professional responsibility. As observed in Chapters 4 and 5, the CISG offers advantages over domestic law in many situations. Even if a client prefers or insists on exclusion, the lawyer has a duty to advise on the advantages forgone to

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10. John Linarelli, *The Economics of Uniform Laws and Uniform Lawmaking*, 48 Wayne L. Rev. 1387, 1402 (2002-3); Luca Castellani, *Promoting the Adoption of the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, 13 Vindobona J. Int'l Commercial L. & Arbitration 241, 247 (2009).
 11. See generally Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & Econ.1 (1960). See Joseph Farrell and Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 Rand J. Econ. 70 (1985).
 12. See Kahneman and Tversky, *Prospect Theory*, above n. 3, at 263, 274, 277; Tversky and Kahneman, *Judgment under Uncertainty*, above n. 3; Tversky and Kahneman, *Framing*, above n. 3; Paul A. David, *Clio and the Economics of QWERTY*, 75 Am. Econ. Rev. 332, 332 (1985); W. Brian Arthur, *Competing Technologies, Increasing Returns, and Lock-in by Historical Events*, (1989) 99 The Economic J. 116 (‘Lock-in’); S. J. Liebowitz and Stephen E. Margolis, *Path Dependence, Lock-in and History*, 11 J.L. Econ. & Org. 205, 205-206 (1995) (‘Path Dependence’); S. J. Liebowitz and Stephen E. Margolis, *The Fable of the Keys*, 33 J.L. & Econ. 3, 6-21 (1990) (‘Fable of the Keys’). Loss aversion can lead to path dependence: see Kahneman, *Maps of Bounded Rationality*, above n. 3, at 1457; Korobkin and Ulen, above n. 1, at 1104-11. On path dependence in uniform law: Linarelli, above n. 10, at 1394-95, 1398, 1402. See also Sandeep Gopalan, *A Demandeur-Centric Approach to Regime Design in Transnational Commercial Law*, 39 Geo. J. Int'l L. 327, 330 (2008) (mentioning ‘path dependence’ in relation to CISG exclusion).
 13. However, weaker path dependence where inefficiency is knowable only ex post or change is not feasible after initial choice is compatible with rational choice theory: Liebowitz and Margolis, *Path Dependence*, above n. 12, at 206.
 14. Consistent with ‘status quo bias’: Russell Korobkin, ‘Behavioural Economics, Contract Formation and Contract Law’ in Sunstein (ed), above n. 3, at 116, 137; Thaler, above n. 4, at 143 (‘losses loom larger than gains’); Cass R. Sunstein, ‘Introduction’ in Sunstein (ed), above n. 3, at 1, 4; Korobkin and Ulen, above n. 1, at 1069, 1095, 1111-12; Kahneman, *Maps of Bounded Rationality*, above n. 3, at 1457; Sunstein, *Cost-Benefit*, above n. 2, at 1068 (tendency to overvalue ‘loss from the status quo’ and to ignore or undervalue gains); Liebowitz and Margolis, *Path Dependence*, above n. 12, at 205; Kahneman and Tversky, *Prospect Theory*, above n. 3, 280. In relation to the CISG see Mary Hiscock, ‘The Role of International Conventions in International Business Transactions’, paper, 2008 International Trade Law Symposium, 11-12 Apr. 2008, Canberra, 5 (on file with author).

ensure the client makes an informed choice.¹⁵ It seems some do exactly that, but many do not.¹⁶ Of most concern is where the issue is not even contemplated by the lawyer, let alone discussed with the client. By not even considering whether or not the CISG is appropriate in the circumstances, lawyers act against their client's best interests.¹⁷ The path dependent lawyer risks liability for malpractice¹⁸ and reprimand by the lawyer's professional practice body.¹⁹

An excluding lawyer might argue their client receives an advantage from the lawyer's expertise in their own domestic law relative to the other party's lawyer, and that the CISG would add no greater substantive benefits but would entail loss of this relative expertise. The appeal to relative expertise indisputably involves path dependent behaviour. Thus the very same ethical dilemma is involved. The lawyer cannot seriously contend the preferred choice, even with the advantage of relative expertise, is superior unless the lawyer is sufficiently familiar with the substantive, strategic and systemic advantages of choosing the CISG.²⁰ Until then, the assessment is purely guesswork, and merely glosses the 'blind' exclusion. Indeed, it was contended in Chapters 4 and 5 that on balance, the CISG is often an efficient choice of law.

Information and switching costs are key components of path dependent behaviour.²¹ The existence of 'automatic opt outs' in high exclusion jurisdictions can become self-reinforcing informal institutions. Lawyers can obtain increased returns by sticking with familiar law since they have already invested in that knowledge. Pressure to look at unfamiliar alternatives will be resisted because it depreciates their existing human capital.²²

15. Alison E. Butler, *Knowing When, Why, and How to "Opt Out" of the United Nations Convention on Contracts for the International Sale of Goods*, 76 Fla Bar J. 24 (2002).

16. Schwenzer, Hachem and Kee, above n. 9, at [5.16], but cautioning that 40% of eligible respondents did not answer this question.

17. *Contra* general findings presence of lawyers improves efficiency: Russell Korobkin and Chris Guthrie, *Psychology, Economics and Settlement*, 76 Texas L. Rev. 77, 81 (1997) (litigation settlements).

18. In common law systems this involves a negligence lawsuit, admittedly with difficult causation questions, and potential breach of contract. See Franco Ferrari, 'General Report' in Franco Ferrari (ed), *The CISG and Its Impact on National Legal Systems* 413, 427 (Sellier 2008) ('*Ferrari Impact*'); Ronald A. Brand, *Uni-State Lawyers and Multinational Practice*, 34 Vand. J. Transnat'l L. 1135, 1162-66 (2001); Ronald A. Brand, *Professional Responsibility in a Transnational Transactions Practice*, 17 J.L. & Com. 310, 341 (1997-8); Sandra Saiegh, 'The Business Lawyer's Perspective' in Harry M. Flechtner, Ronald A. Brand and Mark S. Walter (eds), *Drafting Contracts under the CISG* 254 (Oxford 2008); William S. Dodge, *Teaching the CISG in Contracts*, 50 J. Legal Educ. 72, 74 (2000). *Contra* Camilla Baasch Andersen, 'United Kingdom' in *Ferrari Impact, ibid.*, at 303, 305.

19. I am not aware of any instances in which such matters have not been settled.

20. See Chs 4 and 5. As contended in Ch. 10, as the CISG governs its own exclusion, 'no legal advisor can eventually escape his obligation to know the CISG': Ulrich G. Schroeter, 'To Exclude, To Ignore, or to Use?' in Larry DiMatteo (ed), *International Sales Law: A Global Challenge* (Cambridge 2014), 22, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1981742 (accessed 28 Feb. 2014).

21. W. Brian Arthur, *Positive Feedbacks in the Economy*, 262 Scientific American 92 (1990), in W. Brian Arthur (ed), *Increasing Returns and Path Dependence in the Economy* 13 (U. Michigan Press 1994) ('*Positive Feedbacks*'); Arthur, *Lock-in*, above n. 12.

22. Mariana Prado and Michael Trebilcock, *Path Dependence, Development, and the Dynamics of Institutional Reform*, 59 U. Toronto L.J. 341, 351, 361 (2009).

Signs that lawyers are making ‘automatic’ choices to exclude the CISG are present in the data examined in Chapter 6, to the effect that the most prevalent influence on choice of law is unfamiliarity and information costs including litigation exposure. They can also be detected in choice of law clauses. A number of cases demonstrate choices made in ignorance of the CISG. In the US case of *Asante Techs., Inc. v. PMC-Sierra, Inc.*,²³ the choices of law in each side were respectively:

APPLICABLE LAW. The contract between the parties is made, governed by, and shall be construed in accordance with the laws of the Province of British Columbia and the laws of Canada applicable therein, which shall be deemed to be the proper law hereof.

APPLICABLE LAW. The validity [and] performance of this [purchase] order shall be governed by the laws of the state shown on Buyer’s address on this order. [the buyer’s address was shown as in San Jose, California].

The court correctly held the CISG applied because it is the law of the Canadian province of British Columbia, and the US state of California. No doubt the decision came as a shock to those who drafted the clauses, who (if they at all turned their mind to the matter), had probably felt they had opted out.

A more subtle and telling example of the exclusion reflex exists in the wording of a choice of law clause in the recent Australian case of *Olivaylle Pty Ltd v. Flottweg GmbH*,²⁴ where the relevant document contained a retention of title clause and then the following phrase:

Australian law applicable under exclusion of UNCITRAL law.

The drafters seemed to grasp that selection of Australian law would have led to the CISG, but did not seem to be capable of clearly identifying it. They therefore attempted express exclusion.²⁵ In fact, the exclusion in *Olivaylle* was probably an example of a suboptimal choice of law by unfamiliar lawyers. The contract contained terms for something akin to a *Nachfrist* and allowed for ‘price reduction’ – concepts for which the CISG is perfectly adapted but which are foreign to Australian contract law – so much so that the court actually drew upon the CISG in construing the contract, although it was not applicable per se.²⁶ Yet the choice of law meant there was a risk that the court in its discretion might have chosen not to refer to the CISG for guidance, and consequently could have interpreted the clause in a manner not intended by the parties. The obvious appropriateness of the CISG as a choice of law in this case underscores the knee-jerk nature of its exclusion.

It is submitted that lawyers who ‘automatically’ opt out will inevitably make some suboptimal choices of law involving efficiency losses for their clients. Thus in

23. 164 F Supp 2d 1142, US District Court, (ND Cal), 27 Jul. 2001, <http://cisgw3.law.pace.edu/cases/010727u1.html> (accessed 28 Feb. 2014).

24. *Olivaylle Pty Ltd v. Flottweg GmbH* (No 4) [2009] FCA 522, Federal Court of Australia, 20 May 2009, <http://cisgw3.law.pace.edu/cases/090520a2.html> (accessed 28 Feb. 2014) (*‘Olivaylle’*).

25. Express and implied opt outs are possible, but implicit opt out requires ‘clear’ indications of ‘real’ intent, as discussed in Ch. 10.

26. *Olivaylle* [2009] FCA 522, above n. 24, at [203]-[209].

jurisdictions where unfamiliarity and information costs are relatively higher, clients will be more likely to engage in relatively inefficient transactions. In accordance with the link demonstrated in Chapter 6 between familiarity and exclusions, and between information costs and exclusions, it is submitted that in the US (but possibly also in Canada and Australia) efficiency loss due to uninformed choice of law is more common than in other jurisdictions where familiarity is higher and/or information costs are lower.

[B] Agency, Heuristics, Moral Hazard and Lemons

One could cynically view the lawyer's behaviour in 'blind' opt-outs as simply a matter of self-interested behaviour by an agent. It is rational from the agent's perspective to maximize short-term gains by earning the same fee without investment in information costs. In high exclusion jurisdictions, it is possible that lawyers feel that there is little chance of clients being alerted to the inadequacy of their advice, given that so few of their peers are familiar with the CISG, making discovery unlikely unless there is subsequent litigation, itself perhaps the most expensive (and therefore most unlikely) of monitoring methods.²⁷ Lawyers might therefore prefer to run the risk rather than invest in familiarity,²⁸ since in the context of such a jurisdiction, there is little competitive pressure to do otherwise. Or, they might be willing, but not have the time. Either way, it is the client who unwittingly bears the detrimental effect of an inefficient choice of law.

The problem is really one of information asymmetry.²⁹ Where CISG unfamiliarity is high, lawyer and client interests unfortunately diverge.³⁰ The thought process of the

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27. See generally Stiglitz, above n. 1, at 311, 551, 567-72. See Steven Walt, *Novelty and the Risks of Uniform Sales Law*, 39 Va J. Int'l L. 671, 687 (1999); Kenneth J. Arrow, 'Information and Economic Behavior' in Arrow, above n. 1, Vol 2: The Economics of Information 136, at 150 (professional ethics and information asymmetry).
28. Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 Int'l Rev. L. & Econ. 446, 478 (2005) ('attorneys have incentives to avoid learning about novel law' and will exclude even 'optimal' novel law): see Gopalan, above n. 12, at 328-29 (public conflicts arguments cannot explain failures of private law agreements like the CISG). However, when party choices are considered in light of lawyer-client agency, conflicts of interest are arguably highly important in explaining opt out practices. On such behaviour as 'opportunism': Oliver E. Williamson, *The Economic Institutions of Capitalism* 47-49 (New York Free Press 1985).
29. Stiglitz, above n. 1, at 551, 567-72; Sidney G. Winter, *Satisficing, Selection and the Innovating Remnant*, 85 Quarterly J. Econ. 237, 237 (1971); Christoph Engel, *The Behaviour of Corporate Actors*, 6 J. Institutional Econ. 445 (2010); M. Kahan and M. Klausner, *Path Dependence in Corporate Contracting*, 74 Wash. U. L.Q. 347, 353-55 (1996).
30. Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Financial Econ. 305, 308-310 (1976); Frank H. Easterbrook and Daniel R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1424 (1989) (listing monitoring costs, bonding costs and residual costs of divergence of interest as 'agency costs'); Kahan and Klausner, above n. 29, at 353-55; Walt, above n. 27, at 685-88 (considering whether exclusion rates are influenced by lawyers seeking to maximize litigation fees in future, but ultimately dismissing the possibility). On principal-agency problems, see generally John Armour, Henry Hansmann, and Reinier Kraakman, 'Agency Problems and Legal Strategies' in Reinier Kraakman, John Armour, Paul Davies et al, *The Anatomy of Corporate Law* 35 (Oxford 2nd edn, 2009).

lawyer who simply excludes due to unfamiliarity is not at all obvious to the client, who relies on the lawyer's 'expertise'. Clients have imperfect information about quality of legal work.³¹ The complexity of the problem makes it prohibitively costly to monitor the quality of services for all but highly sophisticated clients with the time and expertise to critically evaluate such choices in-house. Large multi-national companies may have cross-jurisdictional legal expertise in the form of in-house counsel, but this still involves difficulty and high costs.³² However, for most clients this is not a feasible solution to what is a classic principal-agent problem.

In neoclassical terms, the information asymmetry between lawyers and clients leads to a situation of moral hazard – an opportunity to extract rent from the bargain – and consequently a market distortion.³³ It is doubtful that costs of CISG research could be charged to the client, and it is submitted this would not be commercially or ethically justifiable given the CISG in a Contracting State is part of the domestic law of the lawyer's own jurisdiction. Presuming the lawyer cannot recover information costs from the client,³⁴ there is a risk that their bargain will not be mutually advantageous.³⁵ The gap between client perceptions of legal expertise and the reality of lawyer unfamiliarity or shirking precludes optimal allocative efficiency in the jurisdiction's legal services market because the true nature of the bargain is not reflected in pricing of legal fees.³⁶ Additionally, there is a related issue known as 'adverse selection' – the problem of 'lemons' – whereby because clients cannot distinguish between requisite skill levels due to information asymmetry about the quality of legal services, buyers (clients) are only prepared to pay average prices irrespective of CISG familiarity, since, like used cars, they cannot know whether they are getting a lemon.³⁷ Without transparency, clients will not reward higher quality services, and pay average prices for poor quality services, rather than commensurately low prices. Consequently, improvements in the quality of legal services are discouraged from being developed by lack of transparency regarding skills.

It is therefore submitted that within the legal services market, average prices for 'lemon' services will prevail. In transactions for legal services, a form of rent extraction

31. Kahan and Klausner, above n. 29, at 353.

32. Amour et al, above n. 30, at 3; Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 Am. Econ. Rev. 134, 138 (1973); Stiglitz, above n. 1, at 311 (patients have difficulty judging quality of medical services).

33. A moral hazard exists when a market distortion can be induced by information asymmetries, here due to the agency relationship. Here inaccuracy in the pricing of legal services are treated as market distortion or rent extracted by an agent: see above n. 30.

34. Even if the lawyer were able to recover information costs by charging the client for research, other consequences may rationally decrease the lawyer's enthusiasm, see below §§7.02[C][2] and 7.02[D][2].

35. See discussion of imperfect information as market failure: Stiglitz, above n. 1, at 311.

36. See Alan Schwartz and Louis L. Wilde, *Imperfect Information in Markets for Contract Terms*, 69 *Va L. Rev.* 1387, 1388 (1983); Shmuel I. Becher, *Asymmetric Information in Consumer Contracts*, 45 *Am. Bus. L.J.* 723, 734 (2008).

37. George Akerlof, *The Market for Lemons: Qualitative Uncertainty and the Market Mechanism*, 84 *Quarterly J. Econ.* 488 (1970).

may occur due to the existence of moral hazard.³⁸ Further, the client in receipt of inexperienced advice may also bear the brunt of potentially suboptimal choices of law within the transaction for goods itself.³⁹ The latter efficiency loss affects the efficiency of transactions for goods between buyers and sellers, although the cause is in fact a distortion due to moral hazard in a different market – the market for legal services.

The above presents an unflattering picture of lawyers as callous, ruthless and unethical. However, it is submitted that the reality, while no more flattering, is at least less calculating. In truth, where familiarity is low, the lawyer's decision is probably a simple function of unfamiliarity and path dependence. If the lawyer is completely unaware of the CISG, it will be a case of ignorance, not one of cutting corners. If the lawyer knows of it but only has a low level of familiarity, imperfect information can still cloud the judgment made. He/she may be unaware of the advantages his client will lose by opting out, harbour unwarranted substantive concerns or an exaggerated perception of uncertainty in its outcomes.⁴⁰ Conversely, there may be an underestimation of choice of forum risks,⁴¹ due to the human tendency to underestimate the probability of failure where events are disjunctive, in this case, the separate choices of forum and law.⁴² If a choice of forum clause fails to attain the intended result, it may affect the efficacy of the choice of law. The chosen law may unexpectedly become a foreign law to be proven as fact in some jurisdictions and applied by a tribunal unfamiliar with that law; both a costly and risky exercise, as discussed in Chapter 5. It is also submitted that, in the context of 'automatic' exclusion jurisdictions, there may be an element of personal reputational risk involved in non-exclusion, discussed further below.⁴³

Past choices of law are irrationally attractive due to a cognitive bias known as the *status quo* bias. This is due to the endowment effect, whereby the value of what one already has is irrationally inflated.⁴⁴ Thus the *status quo* is often preferred even when it is not the best option on a pure cost-benefit analysis. It has been empirically

38. See generally Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 29 Yale L.J. 87, 98, 100, 103 (1989); Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541, 608 (2003).

39. The cost of inefficient choice of law amounts to an agency cost. See Jensen and Meckling, above n. 30, at 5; Eugene F. Fama and Michael C. Jensen, *Separation of Ownership and Control*, 16 J.L. & Econ. 301, 304 (1983) (agency costs include lost output).

40. See discussion in Ch. 4.

41. See Ch. 5.

42. Humans systematically underestimate probabilities of failure where events are disjunctive – i.e., where one failure alone causes loss of all intended outcomes. In cognitive psychology, this is an 'anchoring' bias: Tversky and Kahneman, *Judgment Under Uncertainty*, above n. 3, at 16; Kahneman and Tversky, *Prospect Theory*, above n. 3, at 271, 275; Gregory Todd Jones, 'Designing Heuristics (2009)', <http://ssrn.com/abstract=1370525> (accessed 28 Feb. 2014) (loss of other optimal outcomes due to tendencies to confine negotiations to a small range of possibilities).

43. Although irrelevant to the client's interests, this may affect decisions in high opt out-low familiarity jurisdictions: below, §7.02[C][1] and §7.02[D][1].

44. Kahan and Klausner, above n. 29, at 355-58. Risk aversion and status quo biases are strong predictors of choices, due to the endowment effect, and may cause path dependency: Richard H. Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behavior & Org. 39, 44-47 (1980); Kahneman, *Maps of Bounded Rationality*, above n. 3, at 1459. Unfamiliarity levels can exacerbate the problem via accessibility bias in decision making: see generally: Kahneman,

demonstrated that this cognitive bias undermines one of the foundational elements underlying rational analysis and Coasian theory.⁴⁵ Potential losses from change are overestimated, while potential gains tend to be underestimated. An example given by Goldstein and Gigerenzer⁴⁶ is the neophobia of rats. They instinctively know everything they have eaten to date has, necessarily, failed to kill them, hence their reluctance to eat anything new. Without wishing to compare our noble profession to rodents, it is submitted that many lawyers in high exclusion jurisdictions have an irrationally inflated fear of the CISG; a ‘fear of the unknown’.⁴⁷ It is a case of ‘green eggs and ham’.⁴⁸ The unfamiliarity heuristic will be heightened if the lawyer never encountered the CISG in law school, or it looks very different from local domestic law, or because he has never encountered it in litigation work – more so if all three are true – so the risk averse rule of thumb is to simply opt out, if the other party will let them.

Like many highly complex decisions, choices of law must often be made quickly, in less than ideal conditions.⁴⁹ Rather than optimize utility, we tend to cope with complexity by simplification of decision making strategies. Sticking to what has served us well in the past is one such strategy. Under constraints of limited time, knowledge and capability, every lawyer employs ‘bounded rationality’⁵⁰ to streamline decision

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- ibid.*, at 1459 (interrelatedness of cognitive biases and externalities in standardization of suboptimal contract terms). See above, n. 44.
45. The ‘near equivalence prediction’ underlying Coase Theorem has not held in experiments whereby subjects show disparity between the price at which they would be willing to buy and the price at which they would be willing to sell the same item, and results tend to support the endowment effect: J. De Coninck, *Overcoming the Mere Heuristic Aspirations of (Functional) Comparative Legal Research*, 2(4) Article No 3 Global Jurist 9 nn 28-30, 13 n. 41 (2009). See Christine Jolls, ‘Behavioral Law and Economics’, Public Law & Legal Theory Research Paper No 342, in Peter Diamond (ed.), *Economic Institutions and Behavioral Economics* (Princeton 2006); Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 Nw. U. L. Rev. 1227 (2003) (‘Endowment Effect’); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 Cornell L. Rev. 608, 664-65 (1998) (concluding endowment effect, not Coase Theorem, provides the best account of the effect of default rules on actual terms agreed, even with low transaction costs).
46. Daniel G. Goldstein and Gerd Gigerenzer, ‘The Recognition Heuristic, How Ignorance Makes Us Smart’ in Gerd Gigerenzer, Peter M. Todd and ABC Research Group (eds), *Simple Heuristics that Make Us Smart* 37, 40 (Oxford 1999) (‘Gigerenzer et al’).
47. John Murray Jr, *The Neglect of CISG: A Workable Solution*, 17 J.L. & Com. 365, 365 (1998); V. Susanne Cook, *CISG: From the Perspective of the Practitioner*, 17 J.L. & Com. 343, 351 (1997-8); Angelo Forte, *The United Nations Convention on Contracts for the International Sale of Goods: Reason or Unreason in the United Kingdom*, 26 U. Balt. L. Rev. 51, 57 (1997) (the view the CISG is a ‘trap[]’ for unwary English lawyers seems ‘paranoid’). See generally Jon Elster, *Ulysses and the Sirens: Studies in Rationality and Irrationality* 66 (Cambridge 1979).
48. The childrens’ story character Knox refuses the fictional dish of green eggs and ham he has never tasted by saying he ‘does not like them’ whereupon Sam urges, ‘Try them! Try them! And you may’: Dr Seuss, *Green Eggs and Ham* (Random House 1960).
49. Gerd Gigerenzer and Peter M. Todd, ‘Fast and Frugal Heuristics, The Adaptive Toolbox’ in Gigerenzer et al, above n. 46, 3, at 5; Korobkin and Ulen, above n. 1, at 1077.
50. Simon, *Business Organizations*, above n. 3, at 502 (‘rationality is bounded when it falls short of omniscience’); Simon, *Behavioral Model of Rational Choice*, above n. 3, at 101, 112; Simon, *Structure of the Environment*, above n. 3, at 129; Korobkin and Ulen, above n. 1, at 1075.

making.⁵¹ It is submitted that this is inevitable, and not problematic, provided the shortcut or heuristic fits the jurisdictional environment in which the lawyer practices.⁵²

Thus an ‘automatically’ excluding lawyer is making do, or ‘satisficing.’⁵³ Like the rat, the lawyer can be generally expected to stick to the familiarity of ‘generally opting out’. Satisficing is one form of bounded rationality, employing a particular heuristic, the aspiration level, as the satisfaction threshold.⁵⁴ Rather than search for the ‘sharpest needle in the haystack’, a satisficing decision maker settles for one ‘sharp enough’ for sewing.⁵⁵ Once this aspiration is achieved, no further thought is given to potential alternatives.

Aspiration levels serve to reduce search costs in complex problems by limiting outcomes to a confined number considered ‘OK.’⁵⁶ The outcomes sought will depend upon prior aspiration levels and how difficult or easy it was to achieve them in the past.⁵⁷ Aspiration levels can comprise a single outcome.⁵⁸ For lawyers in high opt-out jurisdictions, it is submitted that this is likely to be a singular preference to exclude the CISG in favour of a more familiar domestic law. Thus the benchmark is set to ‘generally opt out’ and, providing this is agreeable to the counterparty’s lawyer, non-exclusion need not be considered at all.

As an automatic preference, aspiration level or heuristic,⁵⁹ this achieves the lowest possible information search costs. Arguably, the lawyer’s position as an agent, combined with similarly low aspirations on the part of opposing lawyers, creates the perfect environment for this shortcut to flourish,⁶⁰ despite the suboptimal outcome in many cases for one or both clients.⁶¹

On a day-to-day basis, the decision may be primarily intuitive. It has been noted that conflicts of interest often arise from subconscious decisions, as the process is prone to bias self-interest. Some suggest lawyers actually have a high capacity for

51. Korobkin and Ulen, above n. 1, at 1069, 1076; Gigenzer and Todd, above n. 49, at 5.

52. Gigenzer and Todd, above n. 49, at 13, 18 (similarly ‘ecological rationality’ used for matching heuristics and decision making environment); Simon, *Structure of the Environment*, above n. 3, at 129-30.

53. Rather than searching for all alternatives and completely ordering preferences per rational choice theory, ‘satisficing’ behaviour only partially orders alternatives by setting an aspiration level of viable alternatives. This facilitates ‘limited’ rationality under constraints of knowledge and capacity, as opposed to global rationality which optimizes outcomes under conditions of perfect information and limitless capacity: Simon, *Behavioral Model of Rational Choice*, above n. 3, at 104-113; Simon, *Structure of the Environment*, above n. 3, at 129, 136.

54. Simon, *Business Organizations*, above n. 3, at 501.

55. Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 *Stan. L. Rev.* 211, 214 (1995).

56. Jones, above n. 42, at 3.

57. Simon, *Behavioral Model of Rational Choice*, above n. 3, at 113; Simon, *Structure of the Environment*, above n. 3, at 137.

58. Simon, *Structure of the Environment*, above n. 3, at 129, 136; Simon, *Business Organizations*, above n. 3, at 501; Gigenzer and Todd, above n. 49, at 14-18.

59. Simon, *Business Organizations*, above n. 3, at 507 (satisficing theories and psychological heuristics are a clear ‘fit’).

60. The feasibility of the heuristic depends on a suitable environment: Gigenzer and Todd, above n. 49, at 14-18.

61. See Korobkin and Ulen, above n. 1, at 1075. *Contra* Gillette and Scott, above n. 28, at 478 (doubting lawyer self-interest or ignorance explains opt-outs).

rationalization in a manner which distorts or prevents recognition of ethical problems, and are susceptible to unconscious and automatic biases toward self-interest in legal decision making.⁶² Thus it is hardly surprising that lawyers may seek *ex post* to rationalize this habitual behaviour on the basis of firm policy, or that ‘everyone else’ in the high exclusion jurisdiction does it,⁶³ hence the underlying ethical dilemma may actually go unrecognized.⁶⁴

Whether by design, by less calculated satisficing, or by intuitive subconscious decision making, the front end lawyer operating in a highly unfamiliar jurisdiction is in fact behaving efficiently, at least from a personal perspective, since information costs are avoided but the same fee is earned.⁶⁵ If risks remain low and no other pressure comes to bear, the lawyer’s personal utility is maximized in the short term. But this behaviour might be far less than rational in the longer term.

Can this situation of automatic exclusion path dependence, with its concomitant legal services market failure and inefficient choices of law for clients continue unchecked in jurisdictions like the US, Canada and Australia? It is contended that it cannot persist indefinitely. In many market sectors, the ability of lawyers to avoid information costs may be eroded over time. There could be a change in the (rational) cost-benefit balance, something which might alternatively be described as a change in the environment in which the (behavioural) heuristic must work.⁶⁶

From where might the impetus for this change spring? It is possible clients might begin in increasing numbers to litigate for malpractice or professional bodies receive complaints. If one looks at the quality of some CISG cases in some jurisdictions, then one is tempted to think this will happen sooner rather than later.⁶⁷ However, it seems there is a much more likely prospect for change.

62. Kath Hall, ‘Why Good Intentions are Often Not Enough: The Potential for Ethical Blindness in Legal Decision-Making’ in Kieran Tranter, Francesca Bartlett, Lillian Corbin et al (eds), *Reaffirming Legal Ethics* 210, 215-18 (Routledge 2010); Jonathan Haidt, *The Emotional Dog and its Rational Tail*, 108 *Psychological Rev.* 814, 819-23, 830 (2001)(moral decisions are normally made intuitively and only justified *ex post facto* by publicly acceptable rationalizations). See generally Don A. Moore and George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflict of Interest*, 17 *Social Justice Research* 189, 195, 196, 199 (2004); Marc Hauser, Fiery Cushman, Liane Young et al, *A Dissociation Between Moral Judgment and Justifications*, 22 *Mind & Language* 1, 17 (2007)(evidence decision making is primarily intuitive). Note self-interest itself may be ‘bounded’; Jolls, above n. 45, at 17-18.

63. Haidt, above n. 62. Influences of group dynamics are discussed below, §§7.02[C] and 7.02[D].

64. Hall, above n. 62; Moore and Loewenstein, above n. 62, at 199.

65. However, see Korobkin and Ulen, above n. 1, at 1076. It is presumed the lawyer cannot recover learning costs by charging the client for time spent researching the CISG: above n. 34 and accompanying text.

66. Gigenzer and Todd, above n. 49, at 32. Contractual incentives are often touted as the solution to principal-agency monitoring costs, but the matter is not as easily resolved where the agent is hired to provide expert services without easily measured outcomes: discussing medical profession, see Arrow, above n. 27; Stiglitz, above n. 1, at 311; Ross, above n. 32.

67. I am not aware of any instances in which such matters have not been settled.

[C] Polar Herds, Critical Mass and Game Theory

It is submitted that the most likely catalyst for change for ‘automatic’ exclusion jurisdictions is the forced internalization of information costs due to interaction with stronger ‘pro-CISG’ players. While the term ‘internalization’ is strictly related to externalities, it is borrowed here in relation to legal services market distortions due to moral hazard and the ‘lemon’ problem, and inefficient (suboptimal) choices of law caused by information asymmetry within the market for goods. In truth, it is these which are internalized when lawyers or firms make investments in familiarity by expending or rewarding higher skill levels.

To explain how change through internalization might occur, it is necessary to first locate the forces behind the current situation in high exclusion jurisdictions, circumstances which will be referred to as ‘Scenario One’ for present purposes. Game theory and notions of group polarization can help clarify how the norm of automatic exclusion came to be widely accepted in such jurisdictions in the first place. Later (in §7.02[D]), the circumstances will be adjusted to create ‘Scenario Two’ and reanalysed.

[1] Group Polarization and the Norm of Automatic Opt-Outs

The concept of a ‘social cascade’ is often used to describe norm creation within society. Social cascades depict the process of adoption of widespread beliefs, not necessarily involving any processes of deliberation.⁶⁸

‘Group polarization’ on the other hand, describes the tendency for groups of like-minded people to migrate toward a more extreme view than those initially held by individual group members following group deliberations.⁶⁹ Errors are ‘amplified’ within groups.⁷⁰ Groups have informational influence on their members: individuals tend to defer to views expressed by other group members either because they are persuaded by, or wish to be part of the majority.⁷¹ One reason is that group discussion tends to be asymmetrical:⁷² as pre-existing views are continuously reinforced by discussions,⁷³ the ‘pool’ of acceptable views shrinks; consequently counterviews are

68. Deliberation results in more extremist views: Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 *Yale L.J.* 71, 75, 85 (2000) (‘*Deliberative Trouble*’); Dan M. Kahan, *Gentle Nudges vs Hard Shoves*, 67 *U. Chi. L. Rev.* 607, 614-15 (2000); Daniel J. Isenberg, *Group Polarization*, 50 *J. Personality & Social Psychology* 1141, 1141 (1986).

69. Kahan, above n. 68, at 614; Isenberg, above n. 68, at 1141; Cass R. Sunstein, *Deliberating Groups Versus Prediction Markets*, 3 *Episteme* 192 (2006), U. Chicago, Public Law Working Paper No 146, 2, 4-5, http://ssrn.com/abstract_id=956189 (accessed 28 Feb. 2014) (‘*Hayek’s Challenge*’).

70. Sunstein, *Hayek’s Challenge*, above n. 69, at 2, 4-5; Kahan, above n. 68, at 614 (group views tend to move toward a more extreme end rather than median); Engel, above n. 29, at 12 (groups move towards more ‘radical’ member views).

71. Isenberg, above n. 68, at 1144-45; Sunstein, *Deliberative Trouble*, above n. 68, at 78; Sunstein, *Hayek’s Challenge*, above n. 69, at 2-5.

72. Isenberg, above n. 68, at 1141; Engel, above n. 29, at 13; Sunstein, *Deliberative Trouble*, above n. 68, at 75, 85.

73. Referred to as the ‘common-knowledge effect’: Sunstein, *Hayek’s Challenge*, above n. 69, at 10-13; Isenberg, above n. 68, at 1150. Thus group views are based on incomplete information: Daniel Gignone and Reid Hastie, *The Common Knowledge Effect*, 65 *J. Personality & Social*

repressed, norms of overt discussions tend to prompt self-censorship of dissenting views, and thus healthier aggregation of all knowledge held by group members is prevented.⁷⁴ Notably, informational influences are only effective where individuals possess little or no private information upon which they could reach their own conclusions.⁷⁵ There is safety in numbers, and sticking with the majority allows one to at least ‘share the blame’ if proven incorrect.⁷⁶ Customization always carries greater reputational risk for the ‘maverick’ lawyer who must shoulder any error alone.

The second reason group deliberations lead to extreme views is the existence of social pressure, particularly reputational sanctions.⁷⁷ Even if an individual knows the group view is wrong, the individual may go with the flow rather than risk sanctions, disapproval or even hostility of the group.⁷⁸ Although more difficult to observe, it might also be that collective groups find it more difficult to explore and agree on more nuanced solutions than to simply fix upon one of two simple but extreme polar views.

The overall effect is one of decreasing variance between members of the deliberating group, and reinforcement of an extreme view, which may in fact be wrong.⁷⁹ The effect is observed amongst groups of experts,⁸⁰ so law firms and the legal profession are not immune. It is submitted that, in a similar vein, CISG unfamiliarity may currently play a key role in the process of polarization where a jurisdiction or a law firm is seen as the ‘deliberative group.’

In Scenario One jurisdictions such as the US, there is evidence unfamiliarity and information costs play a prominent role in higher exclusion levels (see Chapter 6). Applying the lessons of group deliberative theory, the following may describe the decision-making context for Scenario One jurisdictions. Individual lawyers armed with little or no private CISG knowledge from law school or elsewhere are prone to absorbing the informational signals of the law firm majority inherent in firm precedents or pro forma contracts that almost invariably exclude the CISG,⁸¹ and the neophobia of their colleagues. Automatic exclusion of the CISG is within the ‘acceptable’ pool of

Psychology 959, 959, 961 (1993); Sunstein, *Hayek’s Challenge*, above n. 69, at 19; Garold Stasser, Laurie A. Taylor and Coleen Hanna, *Information Sampling in Structured and Unstructured Discussions of Three- and Six-Person Groups*, (1989) 57 J. Personality & Social Psychology 67.

74. Stasser, Taylor and Hanna, above n. 73, at 75-76; Gigone and Hastie, above n. 73, at 960, 966; Isenberg, above n. 68, at 1150. By contrast, where disagreements are aired groups make more accurate decisions: Gigone and Hastie, *ibid.*, at 967; Sunstein, *Deliberative Trouble*, above n. 68, at 75.

75. Sunstein, *Deliberative Trouble*, above n. 68, at 81-83; Sunstein, *Cost-Benefit*, above n. 2, at 1066.

76. Kahan and Klausner, above n. 29, at 356-58 (boilerplate).

77. Sunstein, *Deliberative Trouble*, above n. 68, at 78; Sunstein, *Hayek’s Challenge*, above n. 69, at 2, 4-5.

78. Sunstein, *Hayek’s Challenge*, above n. 69, at 2, 4-5, 19.

79. *Ibid.*, at 2, 4-5.

80. *Ibid.*, at 4-5. On studies demonstrating framing biases even amongst experts: Thaler, above n. 4, at 137, 158. See also Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535, 544 (1990).

81. See, e.g., Hernany Veytia, ‘Mexico’ in *Ferrari Impact*, above n. 18, at 231, 235, 237, 239, 248 (US standard forms are forced on Mexican lawyers in law firms controlled by the US); Filip De Ly, *The Relevance of the Vienna Convention for International Sales Contracts*, 4 Business L. Int’l 241, 243-245 (2003) (similarly in Dutch firms by German law firms).

views in such a law firm. Pro-CISG views are not, and thus go unheard. Even a lawyer armed with high levels of familiarity may deliberately choose not to stand against the majority and risk peer sanction by speaking against the ‘party line’ due to reputational concerns epitomized by the perception that to do so would be experimental, or ‘sticking one’s neck out.’⁸² Whilst a small number might receive some CISG training at university,⁸³ once employed within firms in high exclusion jurisdictions they may repeatedly encounter negative attitudes amongst unfamiliar senior lawyers cemented in firm pro forma contracts containing exclusion clauses which then informally institutionalize the firm exclusion norm. In such circumstances, a junior lawyer is likely to perceive the issue, but unlikely to raise the matter with a conservative senior partner. Reputational concerns are heightened by ‘affective ties’ between the lawyer, his firm and profession through jurisdictional affiliation, reputational capital, and promotional opportunities.⁸⁴

Thus it can be seen that the norm of ‘blindly’ opting out, although extreme and suboptimal, can persist within a group such as a firm or jurisdiction, even if it is palpably irrational.⁸⁵ This explains why in some jurisdictions blind exclusion is achieved and maintained as a group *status quo*.

[2] *Game Theory and the Strategy of Automatic Opt-Outs*

Even presuming rational choice, the need for individual lawyers to invest in information costs to obtain CISG familiarity may contribute to a ‘collective action problem’.⁸⁶ Collective action problems arise whenever others can obtain ‘free rides’ from another’s investment, such that the investor might not recoup the cost or obtain all the benefits.⁸⁷ Free rides are positive externalities,⁸⁸ because they benefit those who have not invested in the cost. Their existence can create a disincentive to invest.

Are lawyers who have not yet invested in CISG familiarity rationally discouraged from doing so by an inability to gain from their investment? I will confine the following analysis to the position of an individual lawyer working within a law firm in a predominantly opt-out jurisdiction such as Canada, the US or Australia. Of course, in

82. Kahan and Klausner, above n. 29, at 355 (noting lawyer ‘bias in favor of standard terms’ due to the ‘dynamic ... of “herd” behaviour’). Similarly, Sunstein, *Cost-Benefit*, above n. 2, at 1067 (an individual member knowing the alarmist view held by the group is unwarranted, ‘may not voice ... doubts’); Gillette and Scott, above n. 28, at 478; Gillette, above n. 80, at 536.

83. Perhaps by participation in the enormously influential annual Willem C. Vis International Commercial Law Arbitral Moot.

84. Sunstein, *Deliberative Trouble*, above n. 68, at 91-92.

85. Kahan and Klausner, above n. 29, at 348.

86. David Goetze, *Comparing Prisoner’s Dilemma, Commons Dilemma, and Public Goods Provision Designs in Laboratory Experiments*, 38 J. Conflict Resolution 56, 56 (1994) (defining ‘collective action dilemmas’ as situations where individual incentives are inconsistent with achievement of collective ends that benefit everyone).

87. Oren Bar-Gill, *The Behavioural Economics of Consumer Contracts*, 92 Minn. L. Rev. 749, 759 (2008). On the need to develop CISG caselaw and inability of litigating parties to reap benefits: Walt, above n. 27, at 692-97. By contrast, the present discussion focusses on collective action problems in drafting choice of law clauses.

88. See above, n. 33.

reality, many will be oblivious to the advantages of investment in CISG familiarity. However, *in arguendo*, I will presume some minimal appreciation of potential advantages.

Game theory can help explain collective action problems. It maps out (hyper-)rational choices where outcomes are contingent upon the combined choices of all decision makers.⁸⁹ CISG investment decisions are multidimensional because they yield consequences for the lawyer, law firm, clients and profession.

At a societal level, in a predominantly opt-out jurisdiction, expenditure on information costs is a good thing. Accumulation of expertise within the profession benefits all clients as better quality advice becomes more widely available. For clients, the result is likely to be more efficient choices of law⁹⁰ and more accurately priced legal services.⁹¹ Investment at the ‘front end’ might lead to greater CISG court decisions with precedent value and thus provide significant positive learning effects for the jurisdiction.⁹² Investment also improves the skills and competitiveness of the profession vis-à-vis professions in other jurisdictions, to the benefit of all lawyers within it. In this sense, investment in overcoming information deficits is of societal benefit to all clients and the whole profession (see also Chapter 5, at §5.04).

However, the incentives facing an individual lawyer are a different matter. In high automatic opt-out jurisdictions a bold lawyer might capture an innovator’s ‘early mover advantage’.⁹³ This differs from simply charging the client for CISG research; as mentioned earlier, it is unlikely the lawyer can or should directly recover such costs from the client. However, as an (jurisdictional) innovator, the lawyer might have a competitive edge, and thus expect to capture some of his client’s transactional efficiency gains through higher legal fees.⁹⁴ Beside ethical benefits of providing proper advice, he may also perceive concurrent reduction of risks such as potential malpractice actions or professional body complaints.

However, in all likelihood, the picture is not so rosy. Even when aware of these potential benefits, the individual lawyer’s latent cognitive biases may be reinforced if firm peers do not value investment in CISG familiarity. Such a situation is highly likely

89. William Poundstone, *Prisoner’s Dilemma* 6 (Oxford 1992); Daniel H. Cole and Peter Z. Grossman, *Institutions Matter!*, 69 *Theory & Decision* 219, 225-26 (2010). Game theory was developed in 1944 by John von Neumann and Oskar Morgenstern, *Theory of Games and Economic Behavior* (Princeton 60th Anniversary edn, 2004). See Richard A. Posner, *Economic Analysis of Law* 18-20 (Kluwer 7th edn, 2007)(game theory requires hyper-rationality, since rational players anticipate rationality of others).

90. See Kahan and Klausner, above n. 29, at 350-53 (positive learning externalities from certainty generated by past use of boilerplate terms, and positive network externalities accruing from future use).

91. See above §7.02[B].

92. Walt, above n. 27, at 692-97. See generally: Ayres and Gertner, above n. 38, at 89, n. 13; Louis T. Visscher, ‘A Law and Economics View on Harmonization of Law’, 1 Sep. 2010, RILE Working Paper No 2010/09, <http://ssrn.com/abstract=1669944> (accessed 28 Feb. 2014).

93. Farrell and Saloner, above n. 11, at 73, 82; Bar-Gill, above n. 87, at 759, n. 46.

94. Players are assumed completely logical and self-interested in game theory: Poundstone, above n. 89, at 6, 37, 44. As mentioned earlier, it is presumed lawyers cannot recover information costs by charging clients for research on CISG: above, n. 34.

in Scenario One. Despite the irrationality of the group norm,⁹⁵ this makes the CISG a less feasible choice simply because it requires deviation from the safety of the ‘herd.’⁹⁶ The irony is that each lawyer has a professional and ethical responsibility to consider the CISG as a legal tool whenever suitable to the transaction at hand, and thus an obligation not to be blindly led by ‘the mob mentality’ or by his/her own unfamiliarity.⁹⁷ Yet in reality, deviation from firm norms risks disapproval and endangers career opportunities if the lawyer is viewed by the firm as too radical.⁹⁸ Informal institutionalization of ‘automatic’ exclusion within a firm might make the practice very hard to resist. The remote risk of a malpractice suit might pale into distantly contingent irrelevance compared to the immediate wrath of one’s peers.⁹⁹

The firm itself could choose to invest directly in CISG information costs by making training available. A firm indirectly invests by the way it structures rewards and sanctions, and by how it values firm skills and expertise. However, organizations reward successes far less than they punish failures.¹⁰⁰ This means that successes flowing from individual investment like increased fees and improved firm skills are likely to be undervalued and consequently rewarded only mildly, unless of course the firm also decides to invest (directly or indirectly). The same cognitive bias means it is likely downsides of exposure to liability will be overinflated by the firm, but its perspective will differ depending on its own investment decision: if it decides to invest, it probably correctly anticipates that the firm actually risks exposure to liability due to unfamiliarity with the CISG; whereas if it decides against investment, it may not appreciate this problem, and may in fact wrongly perceive CISG choices of law as increasing firm exposure to liability. The firm’s reputation within a conservative profession must also be considered: the firm will overvalue losses and undervalue gains from changes to its reputational *status quo* within the profession.

If neither the lawyer nor the firm knows in advance with absolute precision whether the other will in future decide to invest, the result is a typical game. In the well known Prisoner’s Dilemma, two prisoners must independently decide whether to

95. Crowd irrationality can reduce even the most informed market participant’s ability to make rational choices: Bar-Gill, above n. 87, at 789. This highlights the importance of the way the decision maker perceives the world: Herbert A. Simon, *A Comparison of Game Theory and Learning Theory*, 21 *Psychometrika* 267, 271 (1956).

96. On reputational issues facing lawyers in the choice between standard terms and customization of terms, see Kahan and Klausner, above n. 29, at 356-58 (safety of the ‘herd’ allows lawyers choosing suboptimal but standard terms to ‘share the blame’ if it is revealed). See similarly in IT industry, Jay Pil Choi, *Herd Behavior, the “Penguin Effect,” and the Suppression of Informational Diffusion*, 28 *RAND J. Econ.* 407, 410-11 (1997).

97. Arrow, above n. 27.

98. Kahan and Klausner, above n. 29, at 361 (status quo bias and endowment effect may contribute to path dependent standard terms); Korobkin, *Endowment Effect*, above n. 45, at 1228-29; Engel, above n. 29, at 12.

99. The human cognitive tendency is to discount distant future payoffs: Moore and Loewenstein, above n. 62, 198. See Partha Dasgupta and Eric Maskin, *Uncertainty and Hyperbolic Discounting*, 95 *Am. Econ. Review* 1290 (2005).

100. Engel, above n. 29, at 1. See generally Kahan and Klausner, above n. 29, at 358 (risk aversion and sanctions). By taking account of cognitive biases, the model here is not strictly rational, but instead hybrid (and hopefully more accurate).

remain silent or testify against the other prisoner (and hope the other stays silent).¹⁰¹ In the Herder Problem, two farmers can choose to place further cows on a communal meadow, or act for the greater good by refraining.¹⁰² The classic Prisoner's Dilemma is a one-off game, while the Herder Problem is replayed each year.

The 'choice of law game' is notionally played each time the lawyer drafts a choice of law clause. Interests of individual lawyers and their firms overlap, resulting in a non-zero sum game.¹⁰³ The sequence of play is assumed to be simultaneous, in a two-player, one-shot game.¹⁰⁴ Although relevant immediate decisions are made by the lawyer and his firm, payoffs also accrue more generally for the jurisdiction's clients and legal profession as a whole, as mentioned above. However, when acting purely rationally to maximize their own payoffs, these societal effects hold no consequences or influences for the decision makers themselves, thus in a game theory sense, the individual decision makers do not represent the entire jurisdiction's profession or body of clients.¹⁰⁵

The following table sets hypothetical values for the purposes of illustration. The purpose of Table 7.1 is to present Scenario One as a backdrop for comparison with changes in Scenario Two in the following §7.02[D]. The payoffs for the lawyer are on the left side of the bracket; those of the firm on the right; and further, payoffs appear on the right separately for the jurisdiction's clients and profession as a generalized (non-player) group.

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101. The Prisoner's Dilemma involves two prisoners suspected of the same crime. To elicit evidence for a more serious conviction, a prisoner giving evidence against the other prisoner is rewarded, but only if the other remains silent. If both remain silent each receives a 3 year sentence; if one gives evidence and the other does not, the silent prisoner receives a 10 year sentence and the prisoner giving evidence goes free; whereas if they both give evidence, each receives a 6 year sentence: Douglas G. Baird, Robert H. Gertner and Randal C. Picker, *Game Theory and the Law* 33 (Harvard 1994); Poundstone, above n. 89, at 116-18.
 102. Garrett Hardin, *The Tragedy of the Commons*, 162 *Science* 1243, 1244 (1968) (attributing it to a pamphlet by WF Lloyd, *Two Lectures on the Checks to Population* (1833)). In its game theory version, two farmers have access to an open meadow. If they graze equal numbers of cattle and both do not add extra cattle, total profits are 20 units, each reaping 10 units. If one adds extra cattle but the other does not, total profits decrease to 10 units, but the self-interested herdsman reaps 11 units profit while the other suffers a 1 unit loss. If they both add extra cattle, total profit for all and for each is zero: see Elinor Ostrom, *Governing the Commons* 3-4 (Cambridge 1990); Goetze, above n. 86, at 78.
 103. As opposed to zero-sum games where the loss of one player amounts to the gain of the other: Poundstone, above n. 89, at 51.
 104. This approach enables comparison with a second game in light of changes in circumstances and payoffs: see below, Table 7.2.
 105. In this analysis individual lawyer and firm are not representative agents of the jurisdiction's clients generally or the profession as a whole. Unless it becomes transparent to the jurisdiction's clients and profession generally, the issue will not affect demand for or pricing of legal services, and thus not influence rational decision makers in terms of payoffs. As explained in §7.02[B], there is a divergence of interests between the decision making players on the one hand, and the jurisdiction's profession and clients as a whole on the other. In this sense, the current analysis is different to public enforcement agencies decisions where likely effects on the public influences enforcement decisions: e.g., Rimawan Pradipto, *Does Punishment Matter?*, 3 *Rev. L. & Econ.* 197 (2007).

Table 7.1 Scenario One – Opt-Out Dominant Jurisdiction,
Costs and Benefits of Learning Investment¹⁰⁶

LAWYER	FIRM	
	INVEST	NOT INVEST
INVEST	(3, 1) (+20)	(0, 3) (+20)
NOT INVEST	(2, 0) (-20)	(1, 2) (-20)

What does game theory really tell us about Scenario One? Cooperative investment by both lawyer and firm is obviously optimal if we include effects on all clients and the profession generally, since this produces the best outcome for society as a whole (+24 units). This is also the best outcome when confined to the collective perspective of just the firm and lawyer (+4 units). Nonetheless, when each decision maker looks at the decision self-interestedly, they will probably conclude investment is not a good idea.

From the firm's perspective, non-investment is better no matter what the lawyer decides – it is the firm's dominant strategy. Using the values assigned in Table 7.1, if the lawyer invests, the firm is better off not investing (3 units instead of 1); the same is true if the lawyer does not invest (2 units rather than 0). Thus non-investment is the firm's optimal strategy. After all, it can save the training expenses, and still reaps the (undervalued) benefits if the individual lawyer goes ahead.

The lawyer might prefer to invest, but fears the consequences if the firm does not do likewise. Distortions in the firm's perception of risks and benefits and imposition of firm sanctions could overshadow the lawyer's gains in increased fees and reduced exposure to liability, and might preclude recapture of the individual's investment in investment costs. Conversely, by adopting a non-investment strategy, the lawyer potentially still stands to receive a modest free ride should the firm invest from reduction in exposure due to availability of CISG expertise in colleagues, without the risk of incurring the wrath of firm imposed sanctions from going it alone.

The result is that for the lawyer, the best strategy is less clear. If the firm does invest, the lawyer would be slightly better off also having invested (3 units instead of 2). Yet if the firm does not invest, it would be slightly better for the lawyer not to have invested (1 unit rather than 0). Thus the riskier strategy for the lawyer is to invest. The investment strategy can either go very well or very badly, yielding either 3 or 0 units, whereas a non-investment strategy earns at worst 1 unit, at best 2 units. On balance, the lawyer may rationally avoid the riskier strategy. Moreover, if the lawyer thinks the

106. The table depicts an asymmetric hybrid game akin to a mirror image 'bully' game: the lawyer faces preferences from the standard 'stag' game whereby he prefers cooperation (investment by both) but fears defection (non-investment by the firm); the firm faces preferences from the standard 'deadlock' game, whereby it prefers to defect (not invest) no matter what: see Poundstone, above n. 89, at 221; Baird et al, above n. 101, at 36-37. It is not a standard 'co-ordination' game as there is only one equilibrium: see Richard H. McAdams, *Beyond the Prisoners' Dilemma*, 82 S. Cal. L. Rev. 209, 218 (2009).

firm is unlikely to invest, a reasonable guess given the prevailing norm in the jurisdiction, then on average, non-investment is sensible; for example, if the anticipated likelihood of firm investment is 30%, expected gains from investment are just 0.9 compared with 1.3 units from non-investment.¹⁰⁷ Thus a rational individual lawyer would not invest in learning costs. The exception to this conclusion would exist if the lawyer believes the firm is likely to invest, however, this is implausible in Scenario One.

Therefore the probable outcome of the game in Scenario One is that neither firm nor lawyer will invest. Non-investment by both lawyer and firm is the singular Nash equilibrium solution to the game, although suboptimal when viewed collectively for the players themselves, and for society.¹⁰⁸

Unlike the prisoners, who cannot communicate and have no second chances, the farmers replay the game every year.¹⁰⁹ This can vastly change the nature of the game. The difference is in repetition and communication.¹¹⁰ The farmers can agree to prevent overgrazing. Likewise, our choice of law game is repeated with each choice of law decision, so the possibility of cooperation and learning arises.¹¹¹ The lawyer can seek to influence outcomes by persuading peers of the irrationality of automatic CISG exclusion and the incorrectness of perceived payoffs by the firm.¹¹² Unfortunately, law firms probably do not ‘communicate’ in the game theory sense.¹¹³ In trying to persuade peers, the lawyer might incur the very sanctions he/she seeks to change. It might be added that, given the lawyer’s ties to the firm and profession, this is not a situation where ultimatum games apply.¹¹⁴

107. For example, if he estimates the likelihood of firm investment at 30%, average gain from investment is 0.9 units (3×0.3), whereas gain from non-investment is on average 1.3 units ($(2 \times 0.3) + (1 \times 0.7)$). This reasoning employs a mixed strategy approach: see Baird et al, above n. 101, at 37; Korobkin and Ulen, above n. 1, at 1062-64, 1084.

108. See Baird et al, above n. 101, at 310 (a Nash Equilibrium exists when paired strategies ‘cannot be improved upon given the other strategy’); McAdams, above n. 106, at 212; Poundstone, above n. 89, at 98-99 (each player in hindsight would have ‘no regrets’ given how others played). An equilibrium that does not coincide with one producing the best possible outcome for at least one player and ‘at least as good for the others’ is a Pareto-inferior outcome: Ostrom, above n. 102, at 5.

109. Ostrom, above n. 102, at 4; Cole and Grossman, above n. 89, at 2, 4.

110. James E. Alcock and Diana Mansell, *Predisposition and Behavior in a Collective Dilemma*, 21 J. Conflict Resolution 443, 444 (1977).

111. This is the case in theory and in practice in situations of communal resources throughout history: Ostrom, above n. 102, at 58-102; Cole and Grossman, above n. 89, at 9. See generally Francesco Parisi, *The Harmonization of Legal Warranties in European Law*, 52 Am. J. Comp. L. 403, 418-19 (2004) (reputation, accreditation and ratings as important in encouraging cooperation in consumer transactions).

112. Diana Richards, *Reciprocity and Shared Knowledge Structures in a Prisoner’s Dilemma Game*, 45 Journal of Conflict Resolution 621, 621 (2001); Cole and Grossman, above n. 89, at 8.

113. Kahan and Klausner, above n. 29, at 352 n. 15.

114. Ultimatum games demonstrate that in a choice between an unfair deal and no deal at all, some prefer the latter, even if they would be better off with an unfair deal: Richard H. Thaler, *The Ultimatum Game*, 2 J. Econ. Perspectives 195, 202-205 (1988); Werner Güth, Rolf Schmittberger and Bernd Schwarze, *An Experimental Analysis of Ultimatum Bargaining*, 3 J. Econ. Behavior & Org. 367 (1982) (first proposing the ultimatum game).

Consequently, conditions in high exclusion jurisdictions are ripe for ‘excess inertia,’ despite the fact societal benefits outweigh costs¹¹⁵ (as discussed in Chapters 4 and 5), and regardless of competitive pressure, which might otherwise be expected to encourage development of CISG expertise.¹¹⁶ Without cooperation, one might conclude high exclusion jurisdictions are doomed to self-perpetuating automatic opt-outs.

[D] Iteration, Network Effects and External Shocks

In the long-term, it is doubtful that the decision not to invest in information costs will continue to be viable. International trade, by its nature, involves interaction between lawyers from various jurisdictions. Jurisdictions that predominantly prefer to exclude cannot completely inoculate themselves from all CISG exposure. The effect of this exposure is described in this section as Scenario Two.

As more individual lawyers encounter the CISG due to dealings with pro-CISG counterparties, a situation of increasing returns or ‘network effect’¹¹⁷ may slowly arise. Network effects were mentioned in Chapters 3 and 5 in relation to the efficiency of the CISG as a choice of law for transactions in the market for goods, however in the current context, it relates to fees for legal services. CISG expertise amongst lawyers may become increasingly valued even in high exclusion jurisdictions as more lawyers are marginally familiarized in the course of practice at the front end, or indeed, as a result of growing litigation exposure. As with any other network effect, upon the spread of lower level familiarity it can be anticipated that any one lawyer’s higher expertise in CISG matters becomes more recognizable and intrinsically more valued.

Over time, the existence of stronger pro-CISG bargaining parties can slowly change the atmosphere in the decision making environment. But how does a firm or entire profession arrive at a new norm?

115. Farrell and Saloner, above n. 11, at 70-72, 79-80; Liebowitz and Margolis, *Fable of the Keys*, above n. 12, at 3.

116. *Contra* Gillette and Scott, above n. 28, at 478 (arguing competition among attorneys should ‘offset tendencies towards slack in learning about the [CISG]’). It is submitted that this is ultimately true, but only once pay-offs are reshaped by those competitive forces, which may not presently be the case in ‘automatic’ exclusion jurisdictions. See discussion below in §7.02[D].

117. A network effect occurs when ‘one consumer’s value for a good increases when another consumer has a compatible good.’ The classic example is the telephone: Farrell and Saloner, above n. 11, at 70; Michael L. Katz and Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 Am. Econ. Rev. 424, 424 (1985); W. Brian Arthur, *Positive Feedbacks*, above n. 21, at 13; Michael L. Katz and Carl Shapiro, *Systems Competition and Network Effects*, 8(2) J. Econ. Perspectives 93 (1994); S. J. Liebowitz and Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, 8 J. Econ. Perspectives 133, 135 (1994); Mark A. Lemley and David McGowan, *Legal Implications of Network Economic Effects*, 86 Cal. L. Rev. 479, 483 (1998). Arguing boilerplate network effects: Kahan and Klausner, above n. 29, at 348-49. See Walt, above n. 27, at 688; Gopalan, above n. 12, at 330 (mentioning network effects in relation to CISG exclusion).

[1] Group Polarization: Environmental Change and New Norms

External shocks can change a group view. At some point after an external shock the group will reach a critical mass or ‘tipping point’¹¹⁸ whereby a new view prevails as the norm.¹¹⁹ A paradigmatic shift can be triggered by changes to incentives or perspectives.¹²⁰ In essence, it is submitted that rewards are likely to be revised when network effects flowing from encounters with a stronger pro-CISG jurisdiction such as China cause familiarity to become increasingly valuable. The process of group deliberation may begin again, but this time gradually reversing the previous view and arriving at a new one. Societal cascades may spread the new norm across the jurisdiction’s profession by similar processes, even without deliberation.¹²¹

Like game theory, behavioural science emphasizes the frequency of repetition.¹²² Obviously the frequency with which jurisdictions deal with counterparties from pro-CISG jurisdictions would affect the speed with which network effects might lead to such a reevaluation of CISG skills. In turn, this may affect the time taken to reach the point of critical mass at which ‘blind’ opt-outs are likely to be rejected in favour of a new norm. Indeed, in a decision making environment of frequent exposure to pro-CISG counterparties, one might expect decision makers to more rapidly appreciate the long-term danger of losing business if they dared not invest in CISG information costs.¹²³ Firms might under such circumstances also be more likely to perceive unfamiliarity as a threat to competitiveness. In path dependence theory, this can be viewed as a critical juncture whereby it is submitted that firms will become willing to break with what may have become institutionally embedded locked-in practices of ‘blind’ opt-outs in favour of new approaches.¹²⁴

[2] Game Theory: Altered Cost-Benefits and New Strategies

When forced to deal with the CISG due to interaction with pro-CISG counterparties through front end or litigation work, even at low levels, firms may be effectively forced to invest in familiarity. Over time, one can argue this should cause firms slowly to reassess and adjust sanctions and incentives. Under circumstances of repeated interaction with pro-CISG counterparties, individual lawyers investing in information costs are much more assured of recapture of their investment through higher fees and more

118. Kahan and Klausner, above n. 29, at 349.

119. Mark Granovetter, *Threshold Models of Collective Behavior*, 83 Am. J. Sociology 1420, 1441-42 (1978); Sunstein, *Deliberative Trouble*, above n. 68, at 81, 82, 84 (describing the point of critical mass, and ‘epidemic’ nature of change).

120. Sunstein, *Deliberative Trouble*, above n. 68, at 95-96.

121. Sunstein, *Hayek’s Challenge*, above n. 69, at 13-20.

122. Isenberg, above n. 68, at 1141; Sunstein, *Deliberative Trouble*, above n. 68, at 75, 95.

123. On the contrary, occasional suboptimal decisions do not usually cause business failure: Korobkin and Ulen, above n. 1, at 1071; Engel, above n. 29, at 5.

124. ‘Automatic’ exclusion practices can be viewed as an informal institution within firms since information costs and learning effects encouraged path dependent behaviour in high exclusion jurisdictions. Critical junctures are points at which institutions are more amenable to change path dependent courses: see generally Prado and Trebilcock, above n. 22, at 355.

frequent CISG transactions or litigation work, allowing them the certainty of amortization. It is submitted these effects combine to alter the cost-benefit structure, with the consequence that new rational strategies will dominate the game.

The different structure is attributable to the firm's new appreciation of the true nature of risks and rewards of familiarity and changes in the jurisdictional environment relating to firm reputation.¹²⁵ Additionally, even low level forced exposure to the CISG has a flow on effect on information costs, reducing the size of direct training costs, while simultaneously rendering more apparent to firms the potential upside in terms of increased fees. If the firm still decides against investment, increased frequency of CISG exposure may provide the lawyer an opportunity to recapture investment costs through increased fees and/or more frequent transaction or litigation work. A non-investing firm might still hold some distorted views, but might revise others in light of the new environment. Thus even a non-investing firm might react neutrally to investment by individual lawyers, for example, by not imposing sanctions, while perhaps still undervaluing benefits.

Consequently, in a jurisdiction now having frequent contact with pro-CISG jurisdictions the hypothetical risk-reward structure under a new norm might look more like Table 7.2, although of course the representation does not account for the ongoing dynamics inherent in iteration and network effects.

Table 7.2 Scenario Two – After Frequently Dealing with Stronger Pro-CISG Jurisdiction, Costs and Benefits of Investment

LAWYER	FIRM	
	INVEST	NOT INVEST
INVEST	(3, 3) (+20)	(2, 1) (+20)
NOT INVEST	(2, 2) (-20)	(0, 0) (-20)

Game theory illustrates the effects of the changes wrought by the external shock in Scenario Two. As before, from a societal perspective the best solution is for both lawyer and firm to invest (+26 units). Moreover, it is now clear to both that they should invest. For the firm, investment is the best decision, irrespective of the lawyer's decision, since it will enhance perceived gains in either case.¹²⁶ For the lawyer, regardless of the direction the firm takes, investment yields better results than non-investment, due to the new reward structure in Scenario Two.¹²⁷ The new singular

125. On reputation, rewards and motivation in co-operative game strategy: Gillette, above n. 80, at 536, 538.

126. The firm receives either 3 or 2 units if it invests, depending on the lawyer's decision. If the firm decides not to invest, it receives just 1 or 0 units, depending on the lawyer's decision.

127. The lawyer receives 3 or 2 units by investing, depending on whether the firm also invests. Alternatively, the lawyer can receive just 2 or 0 units by not investing, depending on whether the firm invests. Thus investment is always better, or at least just as good as non-investment

Nash equilibrium in the game in Scenario Two is for both lawyer and firm to invest, since the non-investment strategy is strictly dominated by the investment strategy for both players under the revised payoff structure.

As reformulated after the external shock, there is a new solution to the choice of law game. If all act rationally, the decisions will converge upon a solution collectively optimal for the decision makers themselves, and for society.

[E] Internalization of Information Costs and Transparency

Even limited dealings with superior bargaining strength in pro-CISG counterparties might profoundly alter the decision making environment in a number of ways. One change might be to the information asymmetry between lawyer and client. In most principal-agent problems incentives built into the agency contract are suggested as appropriate solutions to the monitoring problem.¹²⁸ By contrast, as suggested above, in the present analysis, broader background incentives beyond the specific lawyer-client relationship are more likely catalysts for realignment of interests, and far more effective than any ethical or contractual incentive.

In Scenario Two, the lawyer who has to date been ‘sacrificing’ is suddenly faced with a stark choice. The lawyer could still insist on the exclusion anyway, and allow the client to bear, in addition to costs of a potentially inefficient choice of law, a worse bargain, which the party in the superior position will exact in terms of price,¹²⁹ other contractual terms, or even loss of the deal. Alternatively, the lawyer could ‘bite the bullet’ and invest in the time and effort of becoming familiar with the CISG, thereby internalizing the efficiency losses born by the client due to inefficient choice of law and neutralizing the effect of the moral hazard and the ‘lemon’ problem.

Thus it is submitted that pro-CISG bargaining strength is extremely powerful, because it has the power to make more transparent to the client the real cost of the lawyer’s preferred ‘path.’ The client faced with disadvantageous terms may suddenly have reason to question why it is so important not to use the CISG. Pressure from a client asking for an explanation, if not embarrassment at his/her own inability to give a professionally competent answer, might prompt the lawyer to reconsider investment in information costs.

However, as discussed in relation to game theory analysis, it is the iteration of this pressure which is the most important characteristic of bargaining power in the

from the lawyer’s perspective. The strategy is further enhanced if, as is likely in the new environment of Scenario Two, the lawyer perceives the likelihood of the firm investing is greater than 50%.

128. See above, n. 66.

129. Harry M. Flechtner, ‘Changing the Opt-Out Tradition in the United States’, Paper presented at ‘Modern Law for Global Commerce: Congress to Celebrate the 40th Annual Session of UNCITRAL’, Vienna, Austria, 11 Jul. 2007, 2, <http://www.uncitral.org/pdf/english/congress/Flechtner.pdf> (accessed 28 Feb. 2014); Joseph Lookofsky, ‘Online with AIK’ in Camilla Baasch Andersen and Ulrich G. Schroeter (eds), *Sharing International Commercial Law across National Boundaries* 287, 291 (2008) (‘Kritzer Festschrift’) few, if any, ‘well-positioned’ Chinese traders would contract on the basis of a foreign trader’s domestic law ‘without additional compensation’).

hands of a pro-CISG jurisdiction with superior economic power. The isolated embarrassment of a single less advantageous deal is one matter, but the lawyer is more likely to actively address the situation if the issue arises time and again. It is submitted that repeated interactions with stronger pro-CISG parties best reveals to clients the true expense of unfamiliarity. Arguably, bargaining strength can erode the ability to shirk information costs and redress market failure to account for lack of expertise within the pricing of legal fees. The problem of 'lemon' lawyers and market deficiencies in pricing of legal services is thereby ameliorated.

Transparency accentuates the possibility that an individual lawyer who fails to invest in information costs will simply become uncompetitive in a global legal market.¹³⁰ By contrast, expertise in international transactions allows firms to compete with international mega-firms.¹³¹ Such competitive pressure also answers the argument that there would be no benefit to clients if lawyers were to invest in familiarity, since lawyers would simply raise the price of legal fees. Internalization of information costs may become increasingly attractive if firms begin to notice the trend and adjust their risk-reward structures accordingly, as demonstrated above. Through this new perspective, the previously 'insurmountable' information costs that led to suboptimal exclusions may seem to magically shrink, relatively speaking, from the perspective of both firms and lawyers.

Pressure from clients as a by-product of transparency may reinforce the process of reaching 'critical mass' within high exclusion jurisdictions, and prompt a cascade effect across jurisdictions. If that happens, then jurisdiction by jurisdiction, we may see a reduction in 'automatism' in choice of law in formerly high exclusion jurisdictions. Thus it is submitted that global bargaining strength holds the key to reduction of persistent market distortions from the 'lemon' problem and moral hazard in the longer term,¹³² since 'pro-CISG' bargaining power drives the more frequent repetition of the game, and iteration arguably leads to outcomes approaching optimal solutions.¹³³

Of course, even in this new environment, busy lawyers will no doubt still 'satisfice,' but at a new aspiration level. As aspiration levels become more difficult to attain, they are generally adjusted.¹³⁴ Arguably, the evolution of a new heuristic to suit the altered environment in Scenario Two would involve consideration of the CISG on

130. Ultimately I therefore favour the view that in the longer term, some persistent errors are eliminated by evolutionary competitive forces favouring behaviour closer to (while perhaps not perfectly) rational. *Contra*, see generally Korobkin and Ulen, above n. 1, at 1071; Tversky and Kahneman, *Framing*, above n. 3, at 89-91; Thaler, above n. 4, at 158-59 (taking the middle ground). The present argument poses competitive forces as likely to lead to transparency and ultimately improved (though not perfect) rationality: see Tversky and Kahneman, *ibid.*, at 88; Winter, above n. 29, at 245; Liebowitz and Margolis, *Fable of the Keys*, above n. 12, at 4.

131. Mid-sized German firms have 'developed competence and experience in international transactions' enabling them to provide even 'mega' UK and US-based law firms with 'strong competition': Fabian P. Sosa, 'Cross-Border Dispute Resolution from the Perspective of Mid-sized Law Firms' in Volkmar Gessner (ed), *Contractual Certainty in International Trade* 107, 109 (Hart 2009).

132. See above n. 130.

133. See generally Gillette, above n. 80, at 536, 549, 578-79 (expectation of repeat play leads to contracts which 'approach optimal solutions').

134. Simon, *Behavioral Model of Rational Choice*, above n. 3, at 104-106, 108-110.

a case-by-case basis – perhaps reduced to some key elements, unless there is no choice due to bargaining position or market sector. This necessarily involves greater familiarity.

If the number of jurisdictions in which lawyers are less prone to exclusion slowly climbs, one would expect lawyers in remaining jurisdictions to feel increasing pressure to revise their heuristic toolbox to fit the new environment as the process gradually cascades through interactions between the jurisdictions.¹³⁵ Repeated encounters with the CISG and thus a dilution of the economic and psychological factors presently operating in high exclusion jurisdictions will be the key to alerting individuals and the profession to the need to raise their aspirations to seriously consider the CISG as a choice of law.¹³⁶

[F] Institutionalization of Choice of Law

As mentioned earlier, in commodity markets, individual preferences of each side will matter little. An individual lawyer's substantive concerns, familiarity, information costs and even the client's bargaining power rarely impact upon the choice of law, and it would be 'arrogant' as Professor Bridge puts it, to argue otherwise.¹³⁷ In commodity markets, choices of law by trade associations dominate, and these universally exclude the CISG, usually in favour of English law through standard form contractual terms.

In these market sectors the institutionalization of choice of law is more relevant than any individual view. Undeniably, substantive issues are not the sole factor behind institutional choice. Interestingly, there are parallels between influences on institutional and individual choices of law.

Within commodities markets an important feature is the string transaction. Commodities contracts take the form of documentary spot and forward sales.¹³⁸ The tendency for huge volumes of trade and volatile price fluctuations creates powerful

135. While heuristics are useful, they often lead to 'severe and systematic errors': Tversky and Kahneman, *Judgment Under Uncertainty*, above n. 3, at 1; Kahneman, *Maps of Bounded Rationality*, above n. 3, at 1449; Sunstein, *Hayek's Challenge*, above n. 69, at 9. See Kahan and Klausner, above n. 29, at 352 (previously optimal terms may become suboptimal).

136. Repetition of encounters with the CISG can be expected to correct the 'availability bias' whereby lawyers may be unable to recall instances in which CISG familiarity was important from personal experience. See generally Tversky and Kahneman, *Judgment Under Uncertainty*, above n. 3; Sunstein, *Cost-Benefit*, above n. 2, at 1065-66; Thaler, above n. 4, at 157; Gillette, above n. 80, at 553.

137. Bridge argues it is 'arrogant' to assert lack of familiarity is to blame for exclusion of the CISG in commodities markets: Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 Pace Int'l L. Rev. 55, 70 (2003). *Contra* Lachmi Singh and Benjamin Leisinger, *A Law for International Sale of Goods: A Reply to Michael Bridge*, 20 Pace Int'l L. Rev. 161, 189 (2008); Peter Schlechtriem, *Interpretation, Gap Filling and Further Development of the UN Sales Convention*, 16 Pace Int'l L. Rev. 279 (2004).

138. Like most international sales other than ex-works contracts: ICC Incoterms 2010, <http://www.iccwbo.org/incoterms/> (accessed 28 Feb. 2014). See also the qualification 'if customary' in CPT and CIP). The seller's obligation thus includes an obligation to deliver documents of title to the buyer, or to assist the buyer in obtaining documents of title, such as in FOB terms: *ibid.*

incentives for trade in price risk.¹³⁹ Numerous intermediate parties with no interest in the physical goods speculate on price risk on these markets, seeking margin profits by predicting price movement. Exposure to price risk can be limited to the financial difference between two contracts.¹⁴⁰ The repetition of this process of on-selling obligations in relation to particular goods creates a 'string,'¹⁴¹ with physical buyer and seller at either end of a chain of contracts strung together by an appropriation notice issued by the physical seller and transmitted down the string.¹⁴² It is not uncommon for there to be 100 such intervening contracts in a string.¹⁴³

Effectively, string transactions and the smooth operation of commodities markets depend on the commodification of the underlying contract through standardization of terms, including standardization of the goods, ports of destination, choice of forum and choice of law.¹⁴⁴ In a sense, this is an extreme example of the 'boilerplate' labelling function of standard contractual terms described in Chapter 5. Contracts traded by intermediate parties in a string are identical other than in price and (where broken up into standard amounts) quantity.¹⁴⁵ The standardized choice of *any* law, carries economic value per se by facilitating trade in these contracts, thereby allowing the creation of string transactions,¹⁴⁶ and ultimately the vital economic function of trade in price risk.

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139. Robert L. Deutch and Mark Saccasan, *Derivatives Demystified* 41 (Prospect 1995); Michael G. Bridge, *International Private Commodity Sales*, 13 Canadian Bus. L.J. 485, 486 (1991).
140. Those with primary exposure to the underlying physical market (agricultural or oil producers, or their financiers) can remove some or all price risk by entering the market and taking an opposing position to their physical exposure, or by using derivatives in futures markets such as options or swaps for notional delivery at the time as their physical commitment is due to hedge against price risk: Deutch and Saccasan, above n. 139, at 41; see, e.g., <https://www.theice.com/homepage.jhtml> (accessed 28 Feb. 2014).
141. Within a string, an intermediate party's exposure more than once creates a 'circle'. For GAFTA, once a circle is identified, parties involved in the circle must bilaterally settle financial differences based on the excess of their contract price above the lowest price in the string. Once a settlement has been agreed, the circle is removed ('circled out') from the physical string: see, e.g., GAFTA No. 100, *Contract for Shipment of Feedstuffs in Bulk Tale Quale CIF Terms*, 1 Jan. 2003, cl. 24; GAFTA No. 124, *Sampling Rules*, 1 Jan. 2003, cl. 23. See Michael G. Bridge, 'Good Faith in Commercial Contracts' in Roger Brownsword, Norma J. Hird and Geraint Howells (eds), *Good Faith in Contract* 131, 153, 154 (Ashgate 1999) (GAFTA 100 effectively creates a 'multipartite contract' for circle purposes).
142. A notice of appropriation must specify the name of vessel, approximate weight shipped, date or presumed date of bill of lading, quantity: GAFTA 100, above n. 141, cl. 10; Bridge, above n. 139, at 489 (it must also specify the contract to which goods are being appropriated); Bridge, above n. 141, at 152-53, n. 66 (truncated document delivery can enable bypass of intermediate parties in the string).
143. Bridge, above n. 139, at 489-90 (each seller in the string is obliged to ensure the primary seller and all prior sellers issued the appropriation notice in time). For GAFTA 100, this is within 10 or 14 days of the bill of lading: above n. 141, cl. 10.
144. Lisa Bernstein, *Private Commercial Law in the Cotton Industry*, (2001) 99 Mich. L. Rev. 1724; Bridge, above n. 137, at 57-59, 61 (explaining practice of concentrating bulk trade to large central ports such as Rotterdam).
145. Alastair C. L. Mullis, 'Termination for Breach of Contract in C.I.F. Contracts Under the Vienna Convention and English Law' in E. Lomnicka and C. G. J. Morse (eds), *Contemporary Issues in Commercial Law* 137, n. 15 (Sweet & Maxwell 1997); Bridge, above n. 137, at 62.
146. Bridge, above n. 137, at 60.

Clearly there is a strong network effect at play in choice of law for commodities markets; the more contracts conform to a singular model, the greater flexibility there is for all in the market to bargain for exactly the level of risk each is willing to bear. Intermediate transactions are really contracts for financial difference,¹⁴⁷ and commodity contracts within the string are the building blocks used to exactly define that difference. Contracts that are not alike cannot be netted ('closed out') against each other. Therefore there is a degree of impracticality in suggesting any current choice of law should be altered,¹⁴⁸ since 'swapping platforms' midstream (to borrow software terminology), would necessarily create a major disruption to the market, regardless of the substantive merit of the new choice of law.

In this sense, although mimicking path dependence, the institutionalized choice of *any* law over a long period has considerable practical and economic merit. The fact that it is not truly irrational means this is not path dependence in the sense normally meant by behavioural economists. Arguably, optimality can be legitimately maximized by means of stability rather than substantive merit in any market where string transactions occur, since standardization of transactions is paramount to the ability of parties to evaluate and trade contracts. This is essentially another example of a network effect discussed above,¹⁴⁹ whereby the commonality of the choice enhances or perhaps in this case, eclipses any intrinsic value of the chosen law itself due to the connectivity of transactions in the market.¹⁵⁰ Choices of law made decades, even a century earlier, might therefore still hold value despite any present-day erosion of the substantive suitability of those laws relative to other available choices. The peculiarity of the string characteristic creates switching costs and network effects so great that they effectively render impervious the institutionalized choices of law in commodity markets.¹⁵¹

Despite the persuasiveness of the notion that stability is efficient in commodities markets, other forces may also explain the steadfastness of institutional choice. These are related more to the political economy. Litigation industries have sprung from the UK seats of trade associations creating a substantial financial interest in the maintenance of the choice of law *status quo*. An ingrained choice of English law has gone

147. Bridge, above n. 141, at 154-55 ('subsequent frustrating event affecting physical performance will have no effect on the financial settlement' between intermediate parties in the string). Notably, circle settlement clauses ensure intervening contracts as are given effect as contracts for financial differences rather than physical obligations to prevent unconscionable results where parties appear more than once in the string. See *R Pagnan & Fratelli v. NGJ Schouten NV (the Filipinas I)* [1973] 1 Lloyd's Rep 349, 356 (UK), Queen's Bench Division (Commercial Court), (similar conclusion without circle clause).

148. Mullis, above n. 145, text accompanying n. 158.

149. See above, n. 117 and accompanying text. The phenomenon is to a lesser degree reflected in arguments presented in Ch. 5.

150. On the manner in which standard terms become a 'medium of communication between transactors': Michael P. Van Alstine, *The Costs of Legal Change*, 49 *UCLA L. Rev.* 789, 842 (2001-2); Charles J. Goetz and Robert E. Scott, *The Limits of Expanded Choice*, 73 *Cal. L. Rev.* 261, 287 (1985)(this facilitates risk comparison).

151. Prado and Trebilcock, above n. 22, at 350-51.

hand-in-hand with a choice of forum based in London. Thus dominant trade associations, traditionally of English origin,¹⁵² are said to have effectively allocated dispute work for lawyers, and consequently universally directed the associated financial rewards to London. Indeed, some contend this is the reason for the failure of the UK thus far to accede to the CISG.¹⁵³ The relationship between derivative futures and physical markets is a further form of institutional interconnectivity. Thus it is not enough to dismiss institutional constraints *merely* as a product of mere persuasiveness of English lawyers.¹⁵⁴ The embeddedness of institutional interdependence combined with the scale of switching costs effectively explains the strength of this market's resistance to institutional change.¹⁵⁵

If vested financial self-interest has at least partly guided trade association choice of law, then there are parallels between the institutional maintenance of the *status quo* and the lawyer who shies from the CISG to avoid information costs. In both cases, a potentially suboptimal decision later becomes a path dependent behavioural pattern, institutionalized within the firm or trade association, jurisdiction or market sector, respectively. However, unlike the lawyer who relies on information asymmetry and a similarly satisficing counterparty, trade associations can provide their members with a rational economic justification for retention of the *status quo*; the switching or change-over costs in terms of market disruption that would ensue from altering locked-in choices of law.

For commodities, historic institutionalization of the choice of law and the pervasive interconnectivity of string transactions means English law as the dominant choice has and may continue to persist irrespective of whether it is substantively superior or suboptimal relative to the CISG.¹⁵⁶ From an institutional perspective, this

152. Membership of many English trade associations is now dominated by multinational companies: Bridge, above n. 137, at n. 8; Bridge, above n. 141, at 150-51 (five major companies dominate world grain trade).

153. Sally Moss, *Why the United Kingdom has not Ratified the CISG*, 25 J.L. & Com. 483, 483, 485 (2005-6) (ratification was opposed in 1997 by the Law Society of England & Wales and Commercial Bar Association, but at a 2004 business community meeting it was contended 'London would lose its edge in international arbitration and litigation'. Strangely, at a second similar meeting it was argued failure to adopt the CISG 'may adversely affect the City of London as a forum for litigation and arbitration'); Forte, above n. 47, at 57-58, 63-64 (threat to 'world brand-name' of English adjudication under English law really underwrote legal profession objections, but accession was supported in 1989 by Department of Trade and Industry and City of London Law Society because without accession the UK might lose dispute work); Alastair C. L. Mullis, *Twenty-Five Years On – The United Kingdom, Damages and the Vienna Sales Convention*, 71 *Rebels Z* 35, 37 (2007). Arguing lack of political will is to blame: Bridge, above n. 137, at 71; Moss, *ibid.*, at 483, 485; Mullis, *ibid.*, at 38.

154. See Gillette and Scott, above n. 28, at 481 (English lawyers 'cannot easily compel commercial actors from other jurisdictions to apply English law to their contracts if some alternative body of legal principles is superior').

155. Prado and Trebilcock, above n. 22, at 358.

156. At a substantive level, my own view is that the CISG is equally capable of dealing with commodity transactions. But it must be recalled, purported substantive merit is *at most* only one reason for retention of English law in commodity sales. *Contra* Bruno Zeller, 'Commodity Sales and the CISG' in *Kritzer Festschrift* 627, at 634, 639.

behaviour is at least a semi-rational (second order) centralized mode of path dependence.¹⁵⁷ Although change might be possible if carefully managed by a suitable transition clause,¹⁵⁸ under circumstances of high switching costs and institutional embeddedness, even bounded change is unlikely within commodity trade association choices of law,¹⁵⁹ in the absence of some external shock.¹⁶⁰ This is especially true where it may still be perceived (rightly or wrongly) as a threat to the interdependent English litigation industry that advises trade associations. Of course, when viewed from an individual lawyer's perspective, institutionalization makes the choice to exclude in such market sectors not only rational, but inevitable.¹⁶¹

§7.03 EVIDENCE OF CHANGES SINCE 2008

It is interesting to contemplate whether the processes and changes to the situation in 'automatic' exclusion jurisdictions have occurred in line with the above predictions. It will be recalled that in Chapter 6, significant links between exclusion rates and familiarity, information costs, bargaining strength, substantive concerns and market sector were identified, with the strongest correlations being between exclusion and familiarity and litigation exposure respectively. It was concluded there that as substantive concerns played a greater part in the exclusion decision, exclusion rates fell.

Hence in the present chapter, it was submitted that greater exposure to CISG front end work and litigation work in currently 'automatic' exclusion jurisdictions such as the US might be brought about by repeated interaction with counterparties from jurisdictions at the 'pro-CISG' end of the exclusion spectrum such as China. It was concluded that this would encourage greater levels of investment in CISG familiarity because such repeated interactions would amount to shocks to group dynamics leading

157. By this I refer to decisions determined by historical path and cognizant of inefficiency of the choice, but costly to change. Liebowitz and Margolis, *Path Dependence*, above n. 12, at 207. This is not typically seen as being in conflict with neo-classical rational behaviour, which is better identified as 'benedial' third order path dependence: *ibid.*

158. Trade associations could insert a new standard choice of law with minimal disruption by means of a transitional clause which makes clear parties intend new head contracts to be subject to the new law if entered after a fixed date, and that all parties to on-sold contracts intend to be subject to the same law as the head contract. This would allow continuation of existing strings without mismatches, and facilitate transition to the new choice of law for all new strings.

159. Normally bounded change might be expected 'until something erodes or swamps the mechanisms of reproduction that generate continuity' in cases of institutional path dependence: Prado and Trebilcock, above n. 22, at 358. Additionally, uncertainty over who will benefit from change will increase institutional resistance: Raquel Fernandez and Dani Rodrik, *Resistance to Reform*, 81 Am. Econ. Rev. 1146, 1146, 1154 (1991). Leaders of existing organization threatened by reform will help render an institution impervious to change: Douglass C. North, *Understanding the Process of Economic Change* 62 (Princeton 2005); Prado and Trebilcock, *ibid.*, at 354.

160. Such as reform of English law foreshadowed above.

161. In this way, standard commodity contracts are 'sticky' in that there is great resistance to (and suspicion about) any attempts to deviate from them: Omri Ben-Shahar and John A. E. Pottow, *On the Stickiness of Default Rules*, 33 Fla St. U. L. Rev. 651, 680-87 (2006); Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 Pace L. Rev. 179, 187, n. 31 (2008) (thus standard boilerplate sticks more than it should); Kahan, above n. 68.

to changed competitive conditions within the jurisdiction, altered incentive structures within law firms, and increasingly rendering moral hazards and 'lemons' more transparent to clients. Increased bargaining power in the hands of jurisdictions like pro-CISG China was submitted to be a major driver behind greater numbers of CISG contracts, and in turn, more CISG litigation.

One might thus reasonably anticipate that the rise in Chinese economic power will gradually alter the composition of factors in choice of law involving the CISG previously found amongst US lawyers (and other similar jurisdictions), ultimately reducing the prevalence of unfamiliarity and information costs as reasons for exclusion, and increasing the importance of substantive reasons. As noted in Chapter 6, the evidence available suggests that greater emphasis on substantive reasons as a factor in choice of law leads to less exclusions. Additionally, it was concluded that where unfamiliarity and information costs influence choice of law decisions, greater numbers of uninformed 'blind' exclusions can be expected, resulting in a proportion of suboptimal choices of law, and inefficiencies. Thus the reduction in significance of these factors as a reason for exclusion should decrease the likelihood of suboptimal choices of law and improve efficiency in trade.

From 2011, further data has become available. The most important of these, the Global Sales Law ('GSL') survey was published in 2011.¹⁶² Two smaller surveys have also been conducted: involving Korean and New Zealand practitioners respectively.¹⁶³ It is interesting to contemplate whether the results shed further light on whether changes predicted above are accurate. In this section, the results of that survey and other anecdotal and empirical information will be discussed to determine whether any signs exist of the trends suggested in this chapter.

There is recent evidence to suggest that greater CISG litigation levels are being experienced. It seems that there has been a significant increase in the number of CISG cases coming to arbitration in recent years. The GSL survey conducted in 2009 found that in recent years arbitrators were experiencing higher levels of cases in which the CISG was the governing law. Arbitrators who participated in the study reported that they had dealt with some 217 CISG arbitration cases during 2008.¹⁶⁴

Interestingly, as predicted above, US dispute work exposure rates do appear to have increased over the period of 2009-2012. The same is true in Australia, to a lesser extent. It will be recalled that in the discussion in Chapter 6 on information costs (at §6.03[B][2]), the figures for cases per million capita and cases per trillion trade dollars were roughly estimated. In 2009, the US had much lower exposure rates of 0.4 cpmc, rising 0.5 by 2012, an increase of 25% in 3 years. Similarly, its cptd was 85 in 2009,

162. The GSL survey had 640 responses from lawyers, academics, business and arbitrators: Schwenzer, Hachem and Kee, above n. 9, [5.8].

163. Katrina Winsor, PhD Thesis (University of Wellington, forthcoming)(chapter on file with author); Yong Eui Kim, *The Present and Future Role of the CISG in Korea*, 48 *Dong-A Law Rev.* 737 (2010).

164. From responses of 98 arbitrators participating in their 2009 survey: Schwenzer, Hachem and Kee, *ibid.*, at [5.8] n. 21, [5.13].

rising to 102.22 by 2012.¹⁶⁵ Australia has also modestly increased its litigation exposure over that same period of 2009-2012, from a cpmc of 0.56 to 1.048, and increase of 87% in 3 years, and likewise increased its cptd from 78 to 93.¹⁶⁶

So did lawyers become more familiar with the CISG than they were before 2008? At a world-wide level, in 2009, the responses of lawyers from Contracting States to the GSL survey indicated that 56% of participants felt they were familiar with the CISG, 28% 'somewhat' familiar, while 9% were not familiar with it.¹⁶⁷ Unfortunately, as we have not previously had an international survey of this nature,¹⁶⁸ it is difficult to ascertain whether this represents a shift in familiarity levels.¹⁶⁹

However, in South Korea where the CISG was only adopted in 2005, familiarity levels were found to be low, as might be expected. A very small survey of Korean lawyers found 76% of respondents were unaware of the CISG.¹⁷⁰ The remainder mostly indicated that they excluded it, and were aware of it mostly to that extent only. Their preference for exclusion appears to have been motivated by perceived unpredictability, lack of counterparty familiarity, or anticipation of higher litigation costs, or preference for familiar law.¹⁷¹ This is hardly surprising given the recent accession, but faster improvement in familiarity can be expected given that the CISG now forms part of the examinable material for bar exams in South Korea.¹⁷²

Similarly, a recent New Zealand study in mid-2012 found over 65% of respondents had either heard of the CISG but had no knowledge of it, or had never heard of it. Over 97% of lawyers surveyed had encountered it five or less times, if at all. Nonetheless, 28% of respondents did indicate they would like to find out more about it, and 65% felt it may be beneficial for use in their client's transactions.¹⁷³

165. USA cases of 90 (2009), 158 (2012), divided by a population of 307.2m (2009), 313.9m (2012), and total trade in USD trillion 1.05675 (2009), 1.545719 (2012); <http://www.cisg.law.pace.edu/cisg/text/casecit.html> (accessed 1 Jul. 2009, 18 Oct. 2012); US Census Bureau, https://www.census.gov/popest/data/historical/2000s/vintage_2009/index.html; *UNSD Annual Totals Trade (T.T) 2000-2012*, <http://unstats.un.org/unsd/trade/imts/annual%20totals.htm> (both accessed 28 Feb. 2014).

166. Australian cases: 12 (2009), 24 (2012), divided by a population of 21.3m (2009), 22.9m (2012), and total trade in USD trillion 0.153884 (2009), 0.256665 (2012): above n. 165.

167. Schwenzler, Hachem and Kee, above n. 9, at [5.8] n. 23, [5.15]. GSL sample sizes (correspondence 6 Mar. 2012, on file with the author) allow an inference for the population of lawyers worldwide of 'familiar' or 'somewhat familiar' of 78%, $\pm 2.9\%$ with 80% confidence. Similarly, for the population of lawyers from Contracting States worldwide, 84%, $\pm 3.1\%$ with 80% confidence.

168. The GSLs received responses from lawyers in 88 countries including South America, the Middle East, Africa and Asia: *ibid.*, at [5.8].

169. Stating that 'unfamiliarity with the CISG is seldom mentioned for a reason to exclude it by the lawyers': *ibid.*, at [5.19].

170. Kim, above n. 163 (finding of 20 small firm lawyers surveyed, 90% responded that they were unaware of the CISG, and of 10 lawyers from large firms, over 50% were unaware of the CISG). Thus 23 of 30 surveyed were unaware of the CISG. With 80% confidence, the population inference is between 66-86%.

171. *Ibid.*, at 5, 6.

172. *Ibid.*, at 6.

173. Winsor, above n. 163. The survey yielded 71 responses, thus absence of familiarity is indicated for the New Zealand lawyer population at between 57-72% with 80% confidence.

However, on a global scale, it appears the GSL survey found a high degree of familiarity.¹⁷⁴ It seems likely that this is true in the US and to a lesser extent, Australia.

Although we cannot know whether or not increased litigation exposure or (possible) changes in familiarity are responsible for any changes observed, we can look directly at exclusion rates themselves. It will be recalled that (in §7.02 above), it was predicted that bargaining strength of pro-CISG jurisdictions would, at a gradual but increasingly rapid rate, cause a reassessment of rational pay-offs (and of optimal satisficing levels) for lawyers operating in what were characterized as ‘automatic’ exclusion jurisdictions, particularly as the ‘tipping point’ for polarized change within the group dynamic was achieved.

The GSL survey provides possible clues. From it we can deduce that for the population of lawyers on a world-wide basis in Contracting States in 2009:

- just 13% of lawyers ‘always’ exclude the CISG (+ 3.8%);
- 32% ‘sometimes’ exclude it (+ 3.8%);
- while a surprising 55% ‘rarely or never’ exclude it (+ 5.7%).¹⁷⁵

This is the first measure on an international level, so again, we cannot definitively derive a trend in exclusion frequency from it alone. However, these figures do reveal a much lower exclusion rate than earlier jurisdiction-based surveys. For example, the GSL category of participants who ‘rarely or never’ exclude at 55% globally dwarfs previous findings of (at most) 24% for Germany and approaches the possible 64% of ‘pro-CISG’ China.¹⁷⁶

There might be a number of explanations for this result,¹⁷⁷ one being the jurisdictional composition of the GSL survey, but nonetheless, the result is certainly higher than might have been expected based on previous results. Therefore it is possible that exclusion rates have, on a global scale, decreased since 2008, but this cannot be stated conclusively.

Another important finding from the GSL survey concerns US lawyers. While it is difficult, due to survey design, to compare the exclusion frequency results from the GSL survey in 2009 to those of earlier surveys of US lawyers, some matters are clear.

The Koehler study also provided participants with a graduated response regarding exclusion preferences, albeit with different categories. In 2004-2005 Koehler found

174. The authors caution that respondents might have been ‘pro-CISG’ vis-à-vis the population, however, it is submitted that this is true of all surveys on the CISG: *ibid.*, at [5.18] & [5.20].

175. *Ibid.*, at [5.18] & [5.20]. With confidence levels of 80%, given sample sizes for respondents from Contracting States (correspondence 6 Mar. 2012, on file with the author).

176. Koehler and Guo found 52% of Chinese lawyers surveyed seldom or never opt out. With 80% confidence this indicates at least 39% and up to 64% of Chinese lawyers seldom or never opt out: Martin F. Koehler and Yujun Guo, *The Acceptance of the Unified Sales Law (CISG) in Different Legal Systems*, 20 Pace Int’l L. Rev. 45, § II (2008). Comparatively, Koehler found 18% of German practitioners surveyed never or seldom opt out: Martin F. Koehler, ‘Survey regarding the Relevance of the ... (CISG) in Legal Practice and the Exclusion of its Application’ (October 2006) 1, <http://cisgw3.law.pace.edu/cisg/biblio/koehler.html> (accessed 28 Feb. 2014) (link to Chart ‘Frequency of Exclusion of the Convention’). This allows us to infer with 80% confidence that no more than 25% of German lawyers seldom or never opt out because a normal sample can be assumed in each case as both $n\hat{\pi}$ and $n(1-\hat{\pi}) > 5$ for Germany (5.94, 27.06).

177. See above n. 174.

that 71% of US lawyer respondents indicated they ‘generally/predominantly’ opted out, while 4.2% excluded around half the time, 12.5% ‘seldom’ excluded, and 8.3% ‘never’ opted out.¹⁷⁸ Given the sample size, we can infer that between 14%-29% of US lawyers rarely or never excluded in 2004-2005 (with a confidence level of 80%).¹⁷⁹

This can be compared to the GSL result for US lawyers in 2009. It found that 12% of US lawyer respondents indicated they ‘always’ excluded, 42% ‘sometimes’ excluded, and 46% ‘rarely/never’ did.¹⁸⁰ If we divide the results from each study into ‘rarely/never’ on the one hand, and ‘generally/always/half the time’ on the other, we arrive at roughly comparable categories in regard to exclusion preferences. Given the sample size, we can infer (with a confidence level of 80%) that in 2009, between 39%-53% of US lawyers rarely or never excluded,¹⁸¹ and that no more than 16.5% of US lawyers always excluded.¹⁸²

The result is striking. In 2009, 46% of lawyer respondents stated they rarely or never excluded, whereas in 2004, that number was far lower at 21%.¹⁸³ Likewise, in 2009 those who responded that they always or sometimes excluded amounted to 54%, whereas in 2004, a much higher figure of 75.2% of US lawyer respondents gave a comparable response.¹⁸⁴ Given the respective sample sizes, we can infer that the proportion of the population of US lawyers who always/sometimes opt out has moved from 62%-79% down to 47%-61% from 2004-2009 (with 80% confidence). In all, the data suggests a significant shift away from exclusion of the CISG within the US.¹⁸⁵ It is submitted that these findings support the predictions for the US and similar jurisdictions advanced in this chapter.

It is also interesting to note that the proportion of US lawyers who respond that they ‘generally’ exclude has decreased over time. Again, there may be sample composition reasons for differences, but it can be observed that in the Koehler 2004-2005 survey 71% of respondents fell into this category, while in the 2006-2007 Fitzgerald survey 55% did so, although in 2007 apparently 61% of Philippopoulos’s respondents gave a similar answer.¹⁸⁶ In 2009, the GSL survey used different categories

178. Martin F. Koehler and Yujun Guo, ‘Combined Charts (Survey Germany USA China) – Frequency of Exclusion’ (2008)(spreadsheet on file with author).

179. Koehler found 21% of US practitioners surveyed never or seldom opt out: Koehler, above n. 176 (link to Chart ‘Frequency of Exclusion of the Convention’). See Ch. 6, n. 11 for confidence levels.

180. Schwenzer, Hachem and Kee, above n. 9, at [5.18]. The GSL Survey received responses from 85 US lawyers: *ibid.*, at [5.8] n. 23. Thus the results allow us to infer with 80% confidence that these results holds true for US lawyers within $\pm 4.5\%$ (of 12%), $\pm 6.9\%$ (of 42%) and $\pm 6.9\%$ (of 46%) respectively.

181. See above n. 180. With 80% confidence we can infer no more than 39.1-52.9% of US lawyers ‘rarely/never’ exclude.

182. See above n. 180. With 80% confidence we can infer no more than 16.5% of US lawyers ‘always’ exclude.

183. For the population of US lawyers, with 80% confidence, we can infer ranges of 39.1-52.9% for 2009 and 14-29% for 2004 respectively: above nn 179 & 181.

184. For the population of US lawyers, with 80% confidence, we can infer ranges of 47-61% and for 2009 and 62-79% for 2004 respectively.

185. See above nn 183-184 for population measures.

186. Peter L. Fitzgerald, *The International Contracting Practices Survey Project*, 27 J.L. & Com. 1, 64, Question 11 (2008)(‘typically’); George V. Philippopoulos, *Awareness of the CISG Among*

than previous studies, making comparison difficult. It found that 12% of US lawyer respondents 'always' exclude, while 42% responded they 'sometimes' exclude, and 46% that they 'rarely' or 'never' exclude.¹⁸⁷

From this, one can still discern that *less* than 54% gave a response analogous to the 'general' or 'typical' exclusion category of earlier surveys. To attain a comparable figure, this combines the 'always' and 'sometimes' responses as the nearest equivalent to the 'generally' category used in earlier surveys, since it is surmised respondents who do not *always* exclude, but who generally do so, would have chosen 'sometimes' as the closest response available to them below the definitive option of 'always'. However, it must be remembered that 54% necessarily overstates the comparative response rate, because 'sometimes' no doubt includes those who exclude less than 'generally' but more than 'rarely'. Hence in 2009, it can only be stated that the figure was something probably substantially *less* than 54%.

Nonetheless, it can be concluded that the observable trend in survey results for US exclusions is downward. This is not conclusive evidence of the efficiency of the CISG, nor is it determinative of the question of motivation behind exclusions, but it can be stated that the trend is consistent with the submissions in this chapter, and runs contrary to the predictions of those who argue the CISG is inefficient and will be increasingly ignored and excluded over time.¹⁸⁸

The available data regarding the increase in litigation exposure within the US is also consistent with the predictions in this chapter that increased interaction with pro-CISG jurisdictions would lead to greater 'front end' and litigation exposure. Naturally greater litigation exposure increases familiarity and decreases information costs as a factor encouraging uninformed exclusion. Although it cannot be concluded that this is instrumental in the reduction of exclusion rates within the US, it is consistent with the picture of behavioural change outlined in this chapter, and with the conclusion in Chapter 6 that an increased litigation exposure tends to decrease the exclusion rate within the jurisdiction concerned.

The empirical data regarding the US confirms earlier anecdotal evidence to the effect that US lawyers are becoming anxious to improve their knowledge of the CISG for purposes outside litigation, in other words, 'front end' work.¹⁸⁹ Anecdotal accounts also hint that Italian and German lawyers are becoming less likely to opt out, and that exclusions are now less likely to be the norm for standard terms,¹⁹⁰ although in the case of Germany, as previously mentioned, there are anecdotal suggestions that the driver

American Attorneys, 40 UCC L.J. 357, 361, 363 (2008) ('preferred'); Koehler, above n. 176 ('generally/predominantly'). With 80% confidence, this permits US lawyer population inferences of 46-64%, 52-70% and 62-79% respectively.

187. Schwenzer, Hachem and Kee, above n. 9, at [5.18].

188. Gillette and Scott, above n. 28, at 485 (predicting the CISG will become less useful and ultimately lose out in the competition for law).

189. Flechtner, above n. 129 (noting pressure in the US exerted by globalized legal services market and observing a 'change' in queries he received from practitioners regarding CISG from purely litigious to front end (drafting/choice of law) queries); NYSBA, Email, 25 Jan. 2010 to International Section Members (on file with author).

190. Marco Torsello, 'Italy' in *Ferrari Impact*, above n. 18, 187, at 187, 189, 190, 195-99, 208; Ulrich Magnus, 'Germany' in *Ferrari Impact*, *ibid.*, 143, at 146.

is the substantive relative advantage of the CISG after changes to domestic law.¹⁹¹ German trade associations appear now to be increasingly removing exclusions from their recommended standard terms.¹⁹² Although exclusions still dominate in these jurisdictions, it is submitted that there seem to be signs of change.

§7.04 CONCLUSION

The CISG was never intended to ‘claim a monopoly over international sales law’.¹⁹³ Yet its underutilization in some jurisdictions is due to factors independent of the real benefits it holds for many transactions and clients. The market failure identified here is not the failure to adopt the CISG universally, but the failure of some lawyers to properly consider it as a potential choice of law in circumstances where it indeed could be a viable and rational choice. In commodity markets, where institutionalized choices of law are pervasive, exclusion of the CISG is a forgone conclusion for the individual lawyer or party. However, in other markets, ‘automatic’ exclusion of the CISG is often a form of path dependence reinforced by jurisdictional peer groups which maintain the *status quo*. Their continued ability to ignore the CISG is dependent on environments of CISG unfamiliarity and high learning costs, which are conducive to the satisficing behaviour of ‘blind’ exclusion, encouraged and indeed rewarded by the incentive structures and group dynamics within jurisdictions demonstrating such characteristics as high exclusions, low familiarity and high information costs.

In this chapter, it is submitted that in the long-term, path dependent automatic opt-outs are unsustainable in non-institutionalized markets. Even low level exposure to pro-CISG counterparties carries the potential for network effects that can slowly increase the value placed on CISG skills, alert clients to costs borne by them due to automatic exclusions, and awaken firms to changed conditions in the market for legal services. Frequent or repeated exposure may act as an external shock, leading to a critical mass for change within firms and across the entire profession. In the newly ‘shocked’ jurisdictional environment, it could become worthwhile or indeed imperative for competitive survival to invest in CISG knowledge, and eschew blind opt-outs. New heuristics are likely to be required, and satisficing may need to take place at a more sophisticated aspiration level, resulting in more informed choices of law for clients, and hence greater efficiency in trade.

In relation to investment in information costs, it is submitted that ‘pro-CISG’ bargaining power has capacity to take something once seen as an optional and risky strategy, and convert it into something increasingly seen as a basic training requirement necessary for professional survival. As discussed above, once a ‘tipping point’ or ‘critical mass’ is reached, prior co-ordination problems are resolved by the substitution

191. Chapter 4, nn 304 & 305 and accompanying text, relating discussion at the Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011. Nonetheless, other factors such as those identified in this chapter may also have been influential.

192. Ulrich Schroeter, Presentation, Global Challenges of International Sales Law Conference, Florida, USA, 11-13 Nov. 2011; Magnus, above n. 190.

193. Filip De Ly, *Sources of International Sales Law: An Eclectic Model*, 25 J.L. & Com. 1, 3 (2005-6).

of a competitive imperative in place of communication between decision-making peers.¹⁹⁴ Thus 'pro-CISG' bargaining power has the potential to shift the scales in jurisdictions like the US, Canada and Australia, by changing the decision making environment from one in which automatic exclusion satisficing is feasible to one in which it is not.

Thus it was suggested in this chapter that the environment that in some jurisdictions has fostered market distortions, path dependence or the satisficing heuristic of automatic exclusion, would slowly come to an end, due to the catalytic effect of 'pro-CISG' China. This may be just the catalyst needed to correct market failure. China's relatively strong economic position and similar trends in ASEAN nations could ultimately serve to slowly force CISG exposure on more reluctant jurisdictions such as the US, Canada and Australia, and may prove particularly significant in jurisdictions that previously had few CISG cases, or where firm or professional structures preclude litigation exposure from easily filtering through to 'front end' lawyers. It was submitted that 'pro-CISG' China, with its massive economic power, will by repeated interactions with other jurisdictions, inevitably change the choice of law landscape, whether viewed from the perspective of global or limited rationality.¹⁹⁵

It was observed in this chapter that there are already signs that the global decision making environment may be changing. In jurisdictions where lawyers do not favour exclusion, but have so far had little choice because of the superior bargaining power of counterparties from predominantly 'automatic' exclusion nations,¹⁹⁶ it may take little for the social cascades and network effects described in this chapter to unfold. Additionally, cascades may be slowed down in some jurisdictions may be due to other kinds of pressure from high exclusion nations, such as the influence on choices of law in Mexico due to US control of some law firms, or in Dutch law firms due to German control.¹⁹⁷

Although exclusions still dominate, European opt-outs may be becoming less common.¹⁹⁸ Indeed, as discussed, trends in litigation in the past few years hint that this process may have already begun for the US, and to a much lesser extent, Australia.¹⁹⁹ US opt-out behavior seems to be slowly changing, as indicated by the recent GSL data and anecdotal evidence.²⁰⁰ These recent trends seem a far cry from the decline anticipated by critics, and are consistent with the trend predicted in earlier chapters of this volume (revised editions of which were published in 2009).

The story is of course very different for institutionalized markets. It is submitted that the CISG is not unsuited to the task, but it will take a seismic jolt to move trade

194. See above, n. 119; Linarelli, above n. 10, at 1413 (persistence of path dependence is due to 'information costs, costs of cooperation or coordination'); Baird et al, above n. 101, at 191.

195. That is, rational choice or satisficing heuristic.

196. See Ch. 6, n. 93 (in relation to Slovenia, Mexico, Czech Republic and the Netherlands).

197. Veytia, above n. 81 (thus some Mexican lawyers have little choice but to exclude); similarly, Dutch preferences to use the CISG have been dampened by German control of Dutch firms: De Ly, above n. 81.

198. See above n. 190.

199. See above §7.03.

200. See discussion at §7.03 above.

associations to re-consider a choice of law which underpins the enormous trade in price risk, itself entirely dependent on stability and standardization. The network effects from the established choice are vast. However, it is not impossible to envisage pressure from European-led English law reforms,²⁰¹ nor is it impossible to contemplate how change could be implemented.²⁰²

The above analysis and factors identified in Chapter 6 as influential in exclusion decisions demonstrate that exclusion rates alone cannot demonstrate whether or not the CISG rules are majoritarian.²⁰³ As discussed in Chapter 6, a range of factors influence exclusion rates, and in addition, the economic and psychological influences on decision making examined in the present chapter warn us that lawyer choices of law are subject to pressures which could lead to choices that bear little relation to an informed assessment of the most efficient choice of law for the transaction.

It is therefore submitted that it would be an overstatement to attribute exclusion rates entirely to the substantive content of the CISG.²⁰⁴ From the broader perspective presented in this chapter, and from available empirical evidences, it can be seen that the substantive content of the law is a relevant factor, but only one part of the overall picture regarding reasons for choice of law.

However, of all the factors identified in Chapter 6 as influences in choice of law, this chapter concluded that bargaining strength has the highest potential to 'cut through' the jurisdictional environment in high exclusion jurisdictions in which unfamiliarity and information costs currently predominant, so that the decision making context increasingly encourages lawyers to acquire and value the ability to objectively assess the CISG's efficiency. The process suggested in this chapter is that bargaining strength in the hands of 'pro-CISG' jurisdictions with economic power is likely to undermine the competitiveness of uninformed choices of law. It was submitted that this would reduce suboptimal choices of law by lawyers and improve the efficiency of trade.

It is not contended that exclusions would disappear altogether, but instead that the process would reduce the occurrence of suboptimal exclusions, whereby uninformed 'blind' exclusions occur with no real assessment of the substantive (or non-substantive) advantages and disadvantages identified in Chapters 4 and 5. By the same logic, this would hold true not only for truly 'blind' exclusions, but also for exclusions based on inadequate levels of familiarity. It is therefore contended that these too will slowly become uncompetitive. Effectively, it is submitted that 'pro-CISG' bargaining strength will alter familiarity levels and information costs over time in all jurisdictions.

Having concluded that bargaining strength has a fundamental role to play in changing exclusion rates by no means downplays the importance of substantive concerns in choice of law decisions. On the contrary, as noted in this chapter,

201. See Ch. 6, n. 157 and accompanying text, discussing the influence of potential EU law upon English law.

202. See above, n. 158.

203. *Contra* Gillette and Scott, above n. 28, at 477 (predicting parties will engage in 'wholesale opting out' of the CISG on the basis of its substantive inferiority).

204. *Contra ibid.*, at 478.

bargaining strength may simply encourage the very investment that allows lawyers to assess the CISG on its merits, thereby increasing the importance of substantive concerns as a factor in choice of law into the future. It was also noted in Chapter 6 that there is empirical evidence to suggest a strong link between the increased significance of substantive concerns in choice of law and decreased exclusion rates in the jurisdiction concerned.

Thus it can be anticipated that the importance of substantive concerns in choice of law decision making will slowly increase. Accordingly, in the following chapter, the focus will switch to substantive concerns and how these might influence exclusions.

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CHAPTER 8

Interpretation in Light of Reasons for Exclusion and Efficiency

§8.01 INTRODUCTION

So far in this work, it has been suggested that the CISG is an efficient law for international sales, and that lawyer decisions to exclude it are often unrelated to its merits. In Chapter 7 it was concluded that lawyer exclusions occur for a range of other reasons, and that insofar as lawyer choices are ‘automatic’ exclusions, they result in suboptimal choices of law. Furthermore, it was submitted in Chapter 6 that there is evidence to support the notion that the CISG was excluded *less often* in circumstances where substantive concerns played a greater role in the choice of law decision. In other words, far from the prediction by Professor Cuniberti of ‘wholesale’ exclusion in situations where sophisticated parties considered the quality of the CISG, the evidence suggests that where parties actually considered the quality of the CISG in the decision to exclude or not, they were less inclined to opt-out. This is not surprising, since it was concluded in Chapters 4 and 5 that the CISG is probably efficient law for many international sales.

The slowly growing proportional significance of substantive reasons in choice of law envisaged in Chapter 7 once again highlights the rising importance of the connection between reduced exclusion of the CISG, improved efficiency in trade, and informed decisions based on merit.

Essentially, given the earlier conclusion that the CISG is generally efficient, it is contended that increased frequency of CISG application, particularly in substitution for ‘blind’ or relatively uninformed exclusion, will improve efficiency in trade, and that this is likely to come about in all jurisdictions primarily due to the groundswell of Chinese bargaining strength flowing through to altered reward structures within law firms. It was contended that ultimately, this would improve familiarity, decrease information costs and raise transparency by lowering information asymmetry. However, the other side of this coin is that this will alter the relative merit of choosing the

CISG as opposed to competing laws. In this sense, merit relates to both substantive and non-substantive efficiency. It will be recalled from Chapter 5 that network effects are vital in the achievement of non-substantive efficiency under any law, including the CISG. Thus increased frequency in its use per se can make the CISG more valuable as a choice of law, by improving its relative efficiency as a choice of law, and its capacity to increase the efficiency of trade globally.

Consequently, this chapter lays the groundwork for possible avenues for development of the CISG that might assist in this process. It is submitted that in interpreting the CISG scholars should prefer the most efficient interpretation where two or more interpretations are doctrinally open, and that adjudicators should also do so, either by reference to scholarship or independently. To this end, this chapter briefly highlights dimensions from the earlier analyses of reasons for exclusions that may influence decisions to exclude or utilize the CISG, or alter the manner in which the CISG is valued within jurisdictions. It thus builds on previous chapters to discern matters that might be useful in future interpretation of the CISG, but which might simultaneously influence the frequency with which it is used, and thus assist in the achievement of its economic ends.

The 'lessons learned' from the study of exclusions in this chapter are then utilized to inform two specific interpretive developments suggested in the following chapters.

§8.02 VICIOUS CIRCLE #1: LITIGATION FREQUENCY, EDUCATION, FAMILIARITY AND INFORMATION COSTS

In Chapter 6, the predominant importance of familiarity and information costs in lawyer exclusion decisions was highlighted. Information costs in turn were defined to include two matters beyond the scope of this book: education exposure, and influence on domestic law; and one matter within the scope of this book; litigation or dispute resolution exposure. It was noted that, despite problems in the underlying data, that there was nonetheless a very strong correlation between litigation exposure and exclusions.

However, although it cannot be tested here, it may be that litigation exposure not only directly influences the exclusion decisions of practising lawyers, but that it also has a much more subtle indirect effect on those decisions. It is suggested that the prevalence of CISG cases within a jurisdiction weighs heavily on the decisions of law schools to include the CISG within the curriculum, and perhaps more importantly, to ensure it is covered in compulsory subjects. The same influence may impact upon the decision to include the CISG as an examinable subject within the bar exam for legal qualification, which would naturally have flow on effects for legal education decisions.

Thus litigation exposure may have a two pronged effect on education. Since low litigation exposure encourages 'front end' exclusions, there are fewer cases decided on the basis of the CISG, thereby further lowering litigation exposure. Moreover, to the extent low litigation exposure effectively dampens enthusiasm of legal educators, education exposure is reduced, thereby further encouraging 'front end' exclusion and

again, leading to decreased litigation exposure. In theory, there may be two intertwined ‘vicious circles’ at work.

Naturally, the direction of the circles can be reversed, such that if one component is altered, the others might also become inclined to change in a domino effect. In the preceding chapter, the potential for bargaining strength to commence that domino effect was discussed, and indeed some recent evidence was presented in support. However, bargaining strength may not be the only way that these particular ‘vicious circles’ might be reversed.

There are a number of cases in which, *ipso iure*, the CISG governs the contract, but is not applied by the court or tribunal concerned. Sometimes this is due purely to the ignorance of the bench and counsel involved; in Chapter 6, the unfamiliarity of the bench with the CISG was mentioned as one of the ‘substantive’ concerns of lawyers. However, in a growing number of instances, it is simply because counsel have decided to present the case on the basis of (familiar) domestic sales law rather than the (unfamiliar) CISG. Naturally, if the court or tribunal does not apply the CISG as governing law in these instances, the number of CISG cases within a jurisdiction will be reduced artificially, consequently lowering litigation exposure for the wider group of lawyers practising in that jurisdiction, precluding positive learning effects and encouraging *ex ante* exclusions.

In Chapter 7, it was concluded that many economic and psychological influences may discourage investment in CISG information costs that would be beneficial for lawyers, firms and society. Similarly, collective action problems exist in regard to the need to develop case law on the CISG, since individual litigating parties may be unable to completely capture the positive effects flowing to the jurisdiction as a result of their expenditure on litigation.¹ Greater numbers of CISG cases within a jurisdiction naturally reduce information costs and decrease the perception of substantive uncertainty for *other* lawyers practising within the jurisdiction.

Through the vicious circle described above, a broader collective action problem may exist in regard to litigation exposure, one which may preclude maximization of societal welfare. It is not suggested litigation should be encouraged per se, but that in cases where the CISG is applicable law, its application may be justified despite the cost to individual parties, given the negative and (lost) positive externalities arising from associated effects of application, including the learning effects from the precedent value of case law, suboptimal skill levels within the jurisdiction’s profession, mispricing of legal services, and social losses relating to relative inefficiency in trade and preclusion of potential network effects from frequent use.

Greater numbers of CISG cases may also affect the level of negotiation for choice of law more generally. In Chapter 5, section §5.05[A][3] canvassed the possibility of a change in decision-making environment upon parties who presently make no choice of law, and upon parties making sub-optimal choices to exclude. It was contended that more efficient outcomes could be anticipated from greater general awareness of the

1. Steven Walt, *Novelty and the Risks of Uniform Sales Law*, 39 Va J. Int’l L. 671, 692-97 (1999). See generally Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 89, n. 13 (1989).

existence and benefits of the CISG. Greater awareness would flow most directly to those parties advised by lawyers who become aware of the CISG, perhaps due to greater litigation exposure, with significant impact on all decisions of the type described in Chapters 6 and 7. However, for parties that do not regularly engage lawyers, greater awareness might still flow through ‘trickle down’ effects of contract terms that derive from encounters with counterparties, law associations or trade or industry bodies, and/or redrafting of terms by lawyers they might consult ad hoc. This may ultimately change the decision-making environment such that parties who do not presently consider the issue of choice of law at all are prompted to do so. There may also be some counter-balancing economic benefits for litigant parties. Hence there may be two normative bases for immutability in litigation proceedings where the CISG governs the contract: reduction of negative externalities and increased net joint efficiencies of the parties themselves.²

In Chapter 10, the nature of this issue is explored and an interpretive solution suggested that reconciles substantive interpretation of the CISG with economic effects upon the parties and social welfare.

§8.03 VICIOUS CIRCLE #2: CERTAINTY, SCOPE AND SUBSTANTIVE CONCERNS

In Chapter 6, it was noted that, although substantive issues are not the most important factor, they were significant for exclusion decisions, and tended to play a greater role in jurisdictions with lower exclusion rates. Additionally, in Chapter 7 it was concluded that, due to the influence of Chinese bargaining strength, we might anticipate substantive concerns to become more influential in exclusion decisions more broadly over time, relative to factors unrelated to merit that contribute to suboptimal choices.

It was noted in Chapters 4 and 5 that critics have suggested that the lack of scope, and uncertainty regarding the scope of the CISG would be likely to prompt exclusions from it. Indeed, individual comments to some of the studies did reveal substantive concern with scope and uncertainty albeit mixed with a level of unfamiliarity.³ It was submitted however, that when objectively assessed, the real source of uncertainty is in fact interaction between the CISG and residual domestic law. In certain key areas this might be of legitimate concern to lawyers properly assessing substantive suitability.

One such area is that of precontractual liability. Good faith has in the past been the subject of much scholarly debate. It will also be recalled from Chapters 4 and 5 that scope was a recurring concern for critics of the CISG’s efficiency.

Whilst an informed exclusion based on subjective concerns is entirely appropriate, it must be recognized that even appropriate exclusions affect the non-substantive efficiency of the CISG. Infrequent use of the CISG on the basis of (valid) substantive concerns ultimately has the same effect as suboptimal opt-outs, that is, exclusions motivated by unfamiliarity and avoidance of information costs by lawyers. Both

2. See Ayres and Gertner, above n. 1, at 88 (referring generally to the normative bases for immutable default laws).

3. See, e.g., the analysis of individual comments in the Fitzgerald survey: Ch. 6, n. 117 and accompanying text.

prevent the unlocking of network effects that drive many non-substantive efficiencies. Both prevent litigation exposure, which, as discussed above, may have multiple effects in raising information costs. In other words, optimal exclusions made on entirely legitimate grounds contribute to sub-optimal exclusions that decrease efficiency for parties and society more broadly. Thus the addressing of perceived issues relating to substantive concerns and substantive efficiency may not only reduce exclusions for substantive reasons per se, but sub-optimal exclusions.

In Chapter 9, the issue of precontractual liability is considered and an interpretive approach suggested, again with the emphasis on substantive interpretation of the CISG bearing in mind the ultimate effect of that interpretation on exclusions and efficiency.

§8.04 OTHER INTERPRETIVE AREAS

Space allows analysis of only two areas of interpretation of the CISG. However there are many other examples of interpretive areas ripe for law and economics analysis, some of which have been discussed elsewhere, including interpretation of the warranty in Article 35 (see Chapter 4),⁴ incorporation of standard terms,⁵ Article 79 exemption and remedies.⁶

§8.05 CONCLUSION

If the CISG is an efficient law for international sales, but is presently inefficiently excluded in some cases, then substantive interpretations designed to reduce the frequency of exclusions will assist in promoting efficiency in trade. It is submitted that scholars should promote efficient interpretations, and that efficient interpretations can be effected by courts and tribunals either directly, or by reliance upon scholarly doctrine. This chapter suggests two avenues by which this could be done, by highlighting issues identified in the analysis of exclusion decisions in earlier chapters.

The approach in section §8.03 above is aimed at improving the clarity of the scope of the CISG in regard to precontractual liability. In this way, it is submitted the CISG might be made more substantively attractive to lawyers in the future, so that *ex ante* decisions on choice of law might be less inclined toward exclusion and more inclined to utilization of the CISG, particularly in the future, given the earlier conclusion that substantive merit will become increasingly important in such decisions. Chapter 9 will focus on the second vicious circle described in section §8.03.

4. See Clayton P. Gillette and Franco Ferrari, *Warranties and "Lemons" under CISG Article 35(2)(a)*, 1 *Internationales Handelsrecht* 2 (2010); René Franz Henschel, 'The Use of Law & Economics Arguments in Cases Governed by CISG' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play* 29, 47 (Eleven 2012).

5. See Henschel, above n. 4, at 43.

6. Two such papers were mentioned in Ch. 4: Tim Friehe and Tobias H. Tröger, *Sequencing of Remedies in Sales Law*, 33 *Eur. J.L. & Econ.* 159 (2012); Catherine Piché, *The Convention on Contracts for the International Sale of Goods and the Uniform Commercial Code Remedies in Light of Remedial Principles Recognized under U.S. Law*, N.C. J. Int'l L. & Com. Reg. 519 (2002-2003).

The approach in §8.02 above looks to substantive legal grounds per se, but also their effects on efficiency inter se, and at the societal level. It targets exclusions at the other end of the contractual process: where exclusion is purported to occur *ex post*, during litigation, given the case was argued by counsel on the basis of domestic sales law alone. This approach relies for its effect on the direct importance of litigation exposure and hence information costs in exclusion decisions, and on its potential indirect importance in education exposure, and hence information costs in exclusion decisions. A number of specific matters are raised with economic implications for litigants themselves. Chapter 10 will focus on the first vicious circle described above in section §8.02.

Analysis of reasons for exclusion of the CISG may offer avenues to mould its development, and may help decrease opt-outs, or improve efficiency in other relevant ways. Importantly, it is submitted that, where interpretation of the CISG is sensitive to efficiency concerns including issues related to exclusion discussed in Chapters 6 and 7, those interpretations will be more effective in achieving its aim of improving efficiency. Even if suggested interpretations only achieve small decreases in exclusions in absolute terms, it is nonetheless submitted that the more important consequence will be network effects flowing from those incremental decreases that may heighten the CISG's relative efficiency as a choice of law, as will the contributory effect of the decrease in resolution of collective action problems which presently encourage suboptimal choices.

Hence it is postulated that the ability of parties to exclude imposes an external discipline on interpretation which can guide development of the CISG in a manner that optimizes net exchange gains and social welfare. In any event, it is submitted that the suggestions in Chapters 9 and 10 will not only improve efficiency, but will bring about qualitative legal improvements.

CHAPTER 9

Precontractual Liability and the Efficiency Dilemma

§9.01 INTRODUCTION

This chapter takes the 'lessons learned' from the earlier analysis of CISG efficiency and exclusions, and applies them to one aspect of CISG interpretation, precontractual liability, in order to guide the CISG's development in a manner sensitive to the aim of economic efficiency. It will be submitted that there are competing views about the potential for precontractual liability within the CISG, with important implications for qualitative development of the CISG, its value and frequency as an *ex ante* choice of law, suboptimal *ex ante* exclusions and other relevant economic concerns. Thus this chapter adopts a doctrinal approach, but aims to feed back into the interpretive process some of the matters raised in earlier chapters to reconcile potential future interpretative development with its impact upon efficiency in trade.

§9.02 NORMATIVE LESSONS LEARNED

The interpretation of the CISG in relation to precontractual liability is a matter that may impinge on efficiency. It will be recalled from Chapter 6 that substantive concerns were found to be a factor in decisions by lawyers to exclude the CISG, and tended to be more significant in jurisdictions with lower exclusion rates. It was concluded that, as lawyers increasingly utilize the CISG, familiarity and information costs decrease in importance for exclusion decisions, while substantive concerns will rise in relative importance as influences on opt-out rates. Likewise, in Chapter 7 it was concluded that as co-ordination and collective action problems are gradually dissolved we can anticipate substantive concerns will become increasingly influential in the future.

The efficiency of the CISG's substantive content was analysed in Chapter 4, and revisited in Chapter 5, where it was concluded that overall, the CISG is an efficient

default law. However, a number of critical views were canvassed. Recurring themes raised by critics were uncertainty of scope,¹ ‘vagueness’ of CISG provisions, complexities introduced by an added ‘layer’ of law, and good faith.² While it was concluded that such claims were overinflated, two matters were conceded: the problem of homeward trends, and the potential for uncertainty in regard to the interrelationship of the CISG with domestic law.

Precontractual liability is such an issue. It clearly raises questions about the CISG’s scope and interaction with domestic law. It is also related to the effect of good faith in the CISG. Good faith has been the target of critics who state that its inclusion makes the CISG ambiguous and uncertain.³ Uncertainty has been mentioned as a substantive concern by some lawyers in regard to exclusion decisions,⁴ and precontractual liability was the focus of one practitioner’s specific comment in the Fitzgerald survey.⁵ CISG coverage of liability for breaking off negotiations is likely to be a matter of substantive concern to those making choice of law decisions.

Resolution of this issue would obviously improve the quality of the CISG’s substantive content per se. However, with the aim of advancing efficiency, this chapter attempts to infuse a doctrinal approach with considerations from the earlier analysis.

Correction of any issue that presently detracts from the CISG’s substantive efficiency (discussed in Chapter 4) will obviously benefit all transactions governed by it. The correction of a substantive deficiency, particularly in an area which lawyers presently perceive as contributing to uncertainty, should also improve the CISG’s perceived relative efficiency as a choice of law, directly decreasing exclusions prompted by substantive reasons. This decrease would relate to both optimal and sub-optimal exclusions. The correction may render the CISG the optimal choice in circumstances where, previously, it was not. In other circumstances, increased frequency of choice of the CISG by others may raise its incremental value as a choice of law per se. Thus increased frequency of use should also raise *non-substantive efficiency* (see Chapter 5), with benefits for parties and society.

As noted in Chapter 8, this may also affect *suboptimal* exclusions. Increased frequency of selection can be expected to reverberate into raised litigation rates, which would decrease unfamiliarity and information costs for all lawyers within a jurisdiction. Since these tend to motivate *suboptimal exclusions*, we can expect suboptimal exclusions to decrease accordingly, bringing network effects, improved transparency and adjustment to deterrent payoffs and satisficing behaviours. Furthermore, litigation exposure may feed through to choices made by legal educators, further dampening other causes of suboptimal exclusions.

From this we can draw a valuable lesson for this chapter: an interpretation that promotes certainty about the scope of application of the CISG should be preferred to an interpretation which detracts from predictability in regard to its scope. If both

1. See Chs 4 and 5. Websites referred to in this chapter were checked 28 Feb. 2014 unless otherwise stated.

2. See Chs 4, 5, and Ch. 6, text accompanying n. 117, 4th comment.

3. See Ch. 4, §4.02[A] & §4.02[B][9].

4. See Ch. 6, text accompanying n. 117, 7th and 8th comments.

5. *Ibid.*, 4th comment.

interpretations are doctrinally open, then, all else being equal, the former should be chosen as it best maximizes social welfare. This may seem trite, but it is submitted that it is often overlooked and goes to the heart of the question of precontractual liability in the CISG. The essential effect of the lesson will be revisited below.

§9.03 INTERPRETIVE METHODOLOGY, LEGISLATIVE COMPROMISE AND GOOD FAITH

The issue of precontractual liability is intertwined with the legislative history of good faith. Scholarly views are divided on the topic of precontractual liability, frequently due to differences regarding good faith and interpretation.

[A] Interpretive Method

As previously discussed, the interpretive methodology of the CISG is largely controlled by Article 7, although in particular respects, Articles 8 and 9 are obviously important. Of interest in the current context is Article 7(2). If an issue of interpretation of the CISG's provisions cannot be resolved by resort to legislative history, international case law or scholarship,⁶ or filled by analogical extensions of specific provisions,⁷ then it falls to Article 7(2) to break the deadlock.

Article 7(2) holds that if internal gaps cannot be resolved by the above methods, then they can be filled by reference to the general principles upon which the CISG is based. General principles derived from its provisions can be found in scholarly works,⁸ and more controversially, some argue they can be found within the UNIDROIT Principles.⁹ Finally, if all such avenues fail, internal gaps can be filled by recourse to the

6. See generally Franco Ferrari, *Uniform Interpretation of the 1980 Uniform Sales Law* 24 Ga. J. Int'l & Comp. L. 183 (1994).

7. Michael Joachim Bonell, in Cesare Massimo Bianca and Michael Joachim Bonell (eds), *Commentary on the International Sales Law Art. 7*, 65, 78-83 [2.3.2]-[2.3.2.1], [2.3.3.2] (Giuffrè 1987); Franco Ferrari, 'Interpretation of the Convention and Gap Filling: Article 7' in Franco Ferrari, Harry M. Flechtner and Ronald A. Brand (eds), *The Draft UNCITRAL Digest and Beyond* 138, 160 (Sellier 2004) ('*Digest and Beyond*'); Fritz Enderlein and Dietrich Maskow, *International Sales Law Art. 7*, 58-59 [9.1] (Oceana 1992).

8. Bonell, above n. 7, Art. 7, at 78 [2.3.2]. See also Jan Hellner, 'Gap Filling by Analogy' in Lars A. E. Hjernner (ed), *Studies in International Law* 219, 220 (Norstedts 1990), <http://www.cisg.law.pace.edu/cisg/text/hellner.html> (sometimes use of analogy and general principles in gap-filling is indistinguishable).

9. Some believe these can serve as a source of general principles for CISG gap-filling: John Felemegas, 'Article 7 and Uniform Interpretation' in Pace International Law Review (ed), *Review of the Convention on Contracts for the International Sale of Goods (CISG)* 115, 291-94 (Sellier 2001); Michael Joachim Bonell, *The UNIDROIT Principles of International Contracts and the CISG: Alternative or Complementary Instrument?* 1 Uniform L. Rev. 26, 33-36 (1996); Ulrich Magnus, *General Principles of UN-Sales Law*, 59 *Rabels Z* 492 (1995) ('*General Principles*'); Ulrich Magnus, *Remarks on Good Faith* (2007), <http://cisgw3.law.pace.edu/cisg/principles/uni7.html> ('*Remarks*'); Ulrich Magnus, 'Comparative Editorial Remarks on the Provisions Regarding Good Faith in CISG Article 7(1) and the UNIDROIT Principles Article 1.7' in John Felemegas (ed), *An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law* 45, 46 (Cambridge 2007). *Contra* Ferrari,

applicable domestic law, ascertained by the forum's choice of law rules. Recourse to domestic law is provided only as a last resort.¹⁰ These rules can be collectively referred to as the 'internal interpretive method' or 'internal interpretive technique'.¹¹

A very different position exists in relation to external gaps. If an issue is not governed by the CISG, then the internal interpretive method has *no application*.¹² External gaps must be filled by recourse to residual domestic law alone.¹³

But how does one determine whether an issue is external or internal? Some 'shopping lists' exist,¹⁴ but the basis for the classification is often left unstated. As will be submitted below, this is a major issue in the context of precontractual liability.

[B] Legislative Compromise

Views on whether or not precontractual liability is governed by the CISG are often linked to the history of Article 7(1), which contains its only express reference to good faith. However, closer examination reveals this source to be of little guidance, thus only a brief overview is provided here.¹⁵ It is well known that inclusion of good faith in Article 7(1) was a compromise which masked unresolved disagreements between delegates.¹⁶ As mentioned in Chapter 2, UNCITRAL was acutely aware of the failure of the CISG's predecessors in attaining widespread acceptance; as a result, drafting committees comprised representatives from various legal systems and geographic regions.¹⁷ This made broader acceptance more likely, but also made compromise much

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- above n. 7, at 171; Troy Keily, *Good Faith and the Vienna Convention on Contracts for the International Sale of Goods*, 3 *Vindobona J. Int'l Commercial L. & Arbitration* 15, 35 (1999).
10. See Gyula Eörsi, 'General Provisions' in Nina M. Galston and Hans Smit (eds), *International Sales 2-01, 2-04* (Bender 1984) ('no recourse to national law should be admitted in interpretation' (citation omitted)); Bonell, above n. 7, Art. 7, at 82 [2.3.3.2].
 11. See also Monica Kilian, *CISG and the Problem with Common Law Jurisdictions*, 10 *J. Transnat'l L. & Pol'y* 217, 229 (2001).
 12. Franco Ferrari, 'The CISG's Sphere of Application: Articles 1-3 and 10' in *Digest and Beyond*, above n. 7, 21, at 21 ('Indeed, unless it has been decided ... that the CISG applies at all, neither [its] substantive provisions, nor its provisions on interpretation ... can be used to solve any dispute').
 13. See UNCITRAL, *UNCITRAL Digest of Case Law on the [CISG]* (2012), Art. 7 [10] <http://www.uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf> ('UNCITRAL Digest'); Bonell, above n. 7, Art. 7, at 83 [2.3.3.1]; Ferrari, above n. 7, at 158, 171; Joseph Lookofsky, *Walking the Article 7(2) Tightrope Between CISG and Domestic Law*, 25 *J.L. & Com.* 87, 90 (2006) ('*Tightrope*'); Joseph Lookofsky, *Understanding the CISG in the USA*, 20 (Kluwer 1995) ('*Understanding*'); Helen Elizabeth Hartnell, *Rousing the Sleeping Dog*, 18 *Yale J. Int'l L.* 1, 18 (1993).
 14. See, e.g., *UNCITRAL Digest*, above n. 13, Art. 4, at [13]-[14].
 15. The author extensively reviewed the legislative history of good faith in the CISG in an earlier published version of this chapter.
 16. See Gyula Eörsi, *Problems of Unifying Law on the Formation of Contracts for the International Sale of Goods*, 27 *Am. J. Comp. L.* 311, 323 (1979) ('*Problems*'); Gyula Eörsi, *A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods*, 31 *Am. J. Comp. L.* 333, 349 (1983) ('*Propos*'); Bonell, above n. 9, at 29.
 17. See Alejandro M. Garro, *Reconciliation of Legal Traditions in the UN Convention on Contracts for the International Sale of Goods*, 23 *Int'l Law.* 443, 443 (1989); Disa Sim, *The Scope and Application of Good Faith in the Vienna Convention on Contracts for the International Sale of Goods*, 4, 5-6 (September 2001), <http://cisgw3.law.pace.edu/cisg/biblio/sim1.html>. A revised version was published as Disa Sim, 'The Scope and Application of Good Faith in the Vienna

more difficult.¹⁸ Good faith became a flash point for disagreement. This was hardly surprising since the creation of a final contract is a more dramatic legal event in common law than in civil law systems.¹⁹ Common law traditionally takes an aleatory view—parties generally enter negotiations at their own risk and bear any consequent losses.²⁰ A different philosophy prevails in civilian systems, where the focus is on the relationship between parties; consequently, courts are more inclined to consider the parties legally bound at an earlier stage of negotiations.²¹ The absence of a general common law doctrine of good faith in bargaining led to concern regarding general principles of good faith amongst common law countries.²² Although the starkness of the contrast has now been ameliorated by common law developments in estoppel and unjust enrichment, many of these were still in their infancy when the CISG was drafted.²³

Good faith was first tabled at the eighth session of the Working Group, and later, in modified form, draft Article 5. At this early stage, the proposal clearly encompassed precontractual liability for bad faith during negotiations.²⁴ At the Commission's eleventh session many argued for deletion of any reference to good faith on grounds

Convention on Contracts for the International Sale of Goods' in Pace International Law Review (ed), *Review of the Convention on Contracts for the International Sales of Goods* 19 (Kluwer 2002-3); Kazuaki Sono, 'The Vienna Sales Convention: History and Perspective' in Petar Šarčević and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* 1, 3 (Oceana 1986) ('Dubrovnik Lectures').

18. Sim, above n. 17, at 4; Garro, above n. 17, at §1.

19. Ralph B. Lake, *Letters of Intent*, 18 Geo. Wash. J. Int'l L. & Econ. 331, 342 (1984). See John Klein and Carla Bachechi, *Precontractual Liability and the Duty of Good Faith Negotiation in International Transactions*, 17 *Harv. J. Int'l L.* 1, 17 (1994) (common law requires greater formality for enforceability).

20. E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements*, 87 *Colum. L. Rev.* 217, 221 (1987) (using the term 'aleatory' to describe the view that 'a party that enters negotiations in the hope of the gain that will result from ultimate agreement bears the risk of whatever loss results if the other party breaks off the negotiations').

21. Lake, above n. 19, at 342. See J. F. O'Connor, *Good Faith in International Law* 111 (Dartmouth 1991); E. Allan Farnsworth, *Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 *Tul. J. Int'l & Comp. L.* 47, 57 (1995); Klein and Bachechi, above n. 19, at 17; Diane Madeline Goderre, *International Negotiations Gone Sour*, 66 *U. Cin. L. Rev.* 257, 265 (1997); Simon Whittaker and Reinhard Zimmermann, 'Coming to Terms with Good Faith' in Simon Whittaker and Reinhard Zimmermann (eds), *Good Faith In European Contract Law* 653, 689 (Cambridge 2000) ('Whittaker & Zimmermann'); Friedrich Kessler and Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract*, 77 *Harv. L. Rev.* 401 (1964).

22. Ewoud H. Hondius, 'Pre-Contractual Liability' in F. Willem Grosheide and Ewoud Hondius (eds), *International Contract Law* 5, 8-9 (Intersentia 2004) ('Grosheide & Hondius'); Farnsworth, above n. 20, at 221.

23. See, e.g., Lake, above n. 19, at 346.

24. The Hungarian suggestion was combined with a third paragraph suggested by East Germany:

I. In the course of the formation of the contract the parties must observe the principles of fair dealing and act in good faith. ...

III. In case a party violates the duties of care customary in the preparation and formation of a contract of sale, the other party may claim compensation for the costs borne by it.

including vagueness and uncertainty.²⁵ Supporters argued it added flexibility and would be clarified by case law.²⁶

A Working Group was set up to find a solution to the stalemate. It rejected shifting good faith to the preamble or the provision on interpretation of statements and conduct.²⁷ Most believed the ‘clause was dead’²⁸ when the Working Group finally decided to include good faith as an interpretive concept.²⁹ After minor amendments,³⁰ the newly numbered draft Article 6 was adopted in a form essentially the same as the present Article 7(1).³¹

An ‘uneasy compromise’ had been found.³² There were efforts at the Diplomatic Conference to resurrect a more broadly constructed good faith provision, the most interesting of which was an intriguing proposal by East Germany:³³

Where in the course of the preliminary negotiations or the formation of a contract a party fails in his duty to take reasonable care, the other party is entitled to claim compensation for his expenses.³⁴

These efforts failed after only minor debate, reflecting the feeling that the compromise had been ‘hard-won’,³⁵ and that reopening the rift³⁶ could potentially unravel the nascent CISG altogether. Better to keep such mischief shut tight within the Pandora’s box of Article 7(1).

Had the original draft provision or the final East German proposal succeeded, the CISG would have contained an express provision imposing a precontractual obligation of good faith, including a duty to negotiate in good faith. However, this was abandoned

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25. Sim, above n. 17, at 15; Peter Winship, *Commentary on Professor Kastely’s Rhetorical Analysis*, 8 *Nw. J. Int’l L. & Bus.* 623, 631 (1988) (some supporters of good faith considered its inclusion ‘unnecessary’).
26. *Summary of Deliberations of the Commission*, UN Doc A/33/17 (30 May – 16 Jun. 1978) (‘*Summary of Deliberations*’), in *UNCITRAL Yearbook* [1978] Vol. IX, UN Doc No. A/CN.9/SER.A/1978, 35 annex I, [46]-[48].
27. *Ibid.*, at [54], at 35; Sim, above n. 17.
28. Eörsi, above n. 10, at 2-6.
29. *Summary of Deliberations*, above n. 26, at 36 [56]. Professor Eörsi maintains good faith ‘survived, though exiled to a remote province’: Eörsi, *Propos*, above n. 16, at 349.
30. The Working Group proposed Art. 5 of the draft formation convention include the ‘need ... to observe good faith in international trade’: *Summary of Deliberations*, above n. 26, at 36 [56].
31. Draft Art. 6 is the same as the final Art. 7(1) CISG, with the minor omission of the phrase ‘and application’. See *Summary of Deliberations*, above n. 26, at 36 [60].
32. Eörsi, *Problems*, above n. 16, at 314.
33. See *Report of the Working Group on the International Sale of Goods on the Work of its 9th Session*, UN Doc A/CN.9/142, in *UNCITRAL Yearbook* [1978], above n. 26, at 66 [70], [73]-[77], [80]-[86], nn 8-9.
34. *East German Proposed Amendment to Article 12 of the Draft Convention*, UN Doc A/CONF.97/C.1/L.95 (18 Mar. 1980); *11th Meeting of the First Committee*, UN Doc A/CONF.97/C.1/SR.11 [77]-[87] (18 Mar. 1980).
35. Bonell, above n. 7, Art. 7, at 83 [2.4].
36. The issue of good faith ‘sharply divided the Commission’: *Summary of Deliberations*, above n. 26, at 35 [57]; Eörsi, *Propos*, above n. 16, at 349 (describing the solution as ‘strange’); Michael Bridge, *The International Sale of Goods* 509-10 [10.41] (Oxford 3rd edn, 2013) (‘something of a mystery’).

to ensure more widespread acceptability, a classic example of the political economy necessitating a compromise that left matters open.³⁷

Far from being dead, some authors favour an ‘expansive role for good faith’.³⁸ Interestingly, when the good faith compromise in Article 7(1) was struck, a gap-filling provision had not yet been envisaged,³⁹ since Article 7(2) was inserted during the last drafting stage.⁴⁰ Arguably, this temporal mismatch contributed to good faith’s phoenix-like quality. The revival can be probably largely attributed to the masking of continued disagreement within the compromise.⁴¹

As previously discussed, the compromise has drawn the attention of critics. The allegation of vagueness, combined with a traditional distrust of good faith, has been said to make common lawyers uncomfortable with the CISG.⁴² It is submitted, however, that no convention of importance could have been achieved without at least one such compromise,⁴³ and many domestic legislative proposals undergo similar compromises. Compromise alone does not necessarily render the entire exercise inefficient. Further, it will be seen below that support for views on good faith’s role are slowly converging on a majority ‘middle ground’ solution, so some of the force of the critics’ arguments has been dissipated, although it has by no means disappeared altogether. What is left is a collection of specific areas of potential uncertainty, particularly at the CISG’s boundaries.

[C] The Nature of Good Faith

A range of arguments have claimed the role of good faith in the CISG as:

- (1) an aid to interpretation of the CISG;
- (2) a general principle for internal gap-filling;
- (3) a direct, positive obligation imposed upon parties;
- (4) a collective term for classifying derivative general principles for internal gap-filling;

37. Taking such an argument much further: Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 Int’l Rev. L. & Econ. 446, 461 (2005), discussed in Chs 4 and 5.

38. See, e.g., Michael P. Van Alstine, *Dynamic Treaty Interpretation*, 146 U. Pa. L. Rev. 687, 780 (1998).

39. Eörsi, above n. 10, at 2-9.

40. John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention Art. 7*, 137 [96] (Kluwer 4th edn, 2009).

41. See Eörsi, *Problems*, above n. 16, at 323 (draft Art. 6 was a failure to reach a ‘real compromise’); Eörsi, *Propos*, above n. 16, at 349 (everyone in the Working Group possessed a similar view); Bonell, above n. 9, at 29 (Art. 7(1) ‘hide[s] the lack of any real consensus’).

42. See, e.g., Arthur Rosett, *Critical Reflections on the United Nations Convention for the International Sale of Goods*, 45 Ohio St. L.J. 265, 290 (1984) (the ‘potentially mischievous concept’ of good faith); Farnsworth, above n. 21, at 60 (describing reliance on good faith as an ‘unsettling tendency’ of civil lawyers, and a ‘cloak’ to disguise other doctrines).

43. See also Sir Roy Goode, ‘Contract and Commercial Law: The Logic and Limits of Harmonization’ in *Grosheide & Hondius*, above n. 22, 309, at 314 (‘[i]t is better to have a limited target that is achievable than a grand design that is not’).

- (5) a product of international usages or practices established by the parties; and/or
- (6) an independent source for the creation of new rights and obligations which may contradict or extend the CISG.

Of course, these are not necessarily mutually exclusive. The first role is unanimously supported. However, only a minority of commentators and cases restrict good faith to this role alone.⁴⁴

The second role is also widely accepted.⁴⁵ Drawn either from various provisions⁴⁶ or less commonly from Article 7(1) itself,⁴⁷ sometimes manifested in derivative principles such as reasonableness,⁴⁸ good faith is said to be a general principle of the CISG,⁴⁹ for use in internal gap-filling pursuant to Article 7(2). In fulfilling this task good faith can simply amount to a pre-requisite to the exercise of other rights, for example, it can preclude the right to avoid or seek specific performance where the right is exercised in bad faith,⁵⁰ such as when motivated by a swing in market conditions.⁵¹ Such interpretations employ a negative definition of good faith in accordance with Professor Summers' famous 'excluder analysis'.⁵² However, more commonly, as a general principle in the CISG, good faith has generally been accorded a positive role in internal gap-filling.⁵³

The third role for good faith is as a positive and substantive duty imposed directly on the parties by Article 7(1).⁵⁴ Proponents argue conduct and contracts must be

44. ICC Award No. 8611/HV/JK, 23 Jan. 1997, <http://www.unilex.info/case.cfm?pid=1&do=case&id=229&step=FullText>; Farnsworth, above n. 21, at 56-57 (recognition of a good faith general principle would be a 'perversion of the compromise' struck).

45. Peter Schlechtriem, in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 7, 95 [7] (Oxford 2nd edn, 2005) ('*Schlechtriem & Schwenzer 2nd edn*'); Bonell, above n. 7, Art. 7, at 85 [2.4.1]; Van Alstine, above n. 38, at 780-81; Winship, above n. 25, at 634; Bridge, above n. 36, at 509 [10.41].

46. See UNCITRAL Secretariat, *Commentary on the Draft Convention*, UN Doc A/CONF.97/5 (14 Mar. 1979) ('*Secretariat Commentary*'), in Diplomatic Conference, Vienna, 10 Mar.-11 Apr. 1980, UN Doc A/CONF.97/19 14, 17 Art. 5 [2]; Ingeborg Schwenzer and Pascal Hachem, in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* (Oxford 3rd edn, 2010) Art. 7, 136 [32] ('*Schlechtriem & Schwenzer 3rd edn*').

47. Amy H. Kastely, *Unification and Community*, 8 Nw J. Int'l L. & Bus. 574, 607 (1988); Keily, above n. 9, at 28. But see Schwenzer and Hachem, above n. 46, Art. 7, at 136 [32] (derivation from Art. 7(1) is 'erroneous').

48. Schlechtriem, above n. 45, Art. 7, at 104 n. 50; Michael G. Bridge, 'Good Faith in Commercial Contracts' in Roger Brownsword, Norma J. Hird and Geraint Howells (eds), *Good Faith in Contract: Concept and Contexts* 139, 162 (Dartmouth 1999).

49. Schwenzer and Hachem, above n. 46, Art. 7, at 136 [32]; *Secretariat Commentary*, above n. 46, at C.7; *UNCITRAL Digest*, above n. 13, Art. 7, at [9].

50. Sim, above n. 17; Keily, above n. 9, at 24.

51. Honnold, above n. 40, Art. 7, at 136 [95].

52. Robert S. Summers, "Good Faith" in *General Contract Law and the Sale Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195 (1968).

53. Winship, above n. 25, at 634.

54. Enderlein and Maskow, above n. 7, Art. 7, at 54-55 [2.1]; Michael Joachim Bonell, *Vertragsverhandlungen und culpa in contrahendo nach dem Wiener Kaufrechtsübereinkommen*, 36 *Recht der Internationalen Wirtschaft* 693, 700 (1990); Bonell, above n. 7, Art. 7, at 85 [2.4.1]; Fritz Enderlein, 'Rights and Obligations of the Seller' in *Dubrovnik Lectures*, above n. 17, 133, at 136;

interpreted in accordance with good faith, either because the CISG forms an integral part of the contract⁵⁵ or because Article 7(1) is addressed to parties as well as tribunals and courts.⁵⁶ Likewise, it is difficult to completely separate interpretation of CISG provisions from contractual interpretation.⁵⁷ Thus, albeit indirectly,⁵⁸ substantive obligations are likely to arise on even the most conservative view, and ‘the distinction ... is likely to prove more apparent than real’.⁵⁹ Even those who reject direct duties of good faith concede positive obligations arise indirectly through interpretation or internal gap-filling,⁶⁰ since the outcome of such processes inevitably requires parties to act in good faith.⁶¹

The fourth and fifth roles are less relevant for present purposes. The fourth role has substantial support, and sees good faith as a ‘unifying thread’⁶² without real legal impact. According to this argument, good faith has so many meanings that it has become meaningless,⁶³ and more specific derivative principles—such as a duty to communicate, a duty to facilitate rather than frustrate performance, and estoppel—are better suited to both gap-filling and interpretation.⁶⁴ The fifth view simply acknowledges practices and usages could involve good faith, and might impose overriding substantive duties directly upon the parties in accordance with Article 9(1) and (2).⁶⁵

The sixth role views good faith as an independent source of rights and obligations. As a direct source of new general obligations, arguably such duties could

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- Van Alstine, above n. 38, at 781; Winship, above n. 25, at 634; Magnus, *Remarks*, above n. 9; Magnus, *General Principles*, above n. 9, at §51(3). *Contra* Ferrari, above n. 6, at 215; Schwenger and Hachem, above n. 46, Art. 7, at 136 [32].
55. Enderlein and Maskow, above n. 7, at 54 [2.1]; Eörsi, above n. 10, at 2-8 (interpretation of the CISG and the contract cannot be separated); Magnus, *Remarks*, above n. 9. *Contra* Sim, above n. 17, at 26; Michael Bridge, ‘A Commentary on Articles 1-13 and 78’ in *Digest and Beyond*, above n. 7, 235, at 253; Schwenger and Hachem, above n. 46, Art. 7, at 128 [17] (denying direct application to contracts, but acknowledging indirect influence in construction of communications through Art. 8).
56. Bonell, above n. 7, Art. 7, at 84 [2.4.1]. *Contra* Schwenger and Hachem, above n. 46, Art. 7, at 122-128 [6], [19]; Sim, above n. 17, at 26.
57. See above n. 55 and accompanying text.
58. Keily, above n. 9, at 23. See also Michael Bridge, ‘Choice of Law Issues’ in James J. Fawcett, Jonathan M. Harris and Michael Bridge (eds), *International Sale of Goods in the Conflict of Laws* 905, 938-940, [16.57]-[16.60], n. 118 (Oxford 2005).
59. Lookofsky, *Understanding*, above n. 13, at 19.
60. Bridge, above n. 36, at 509 [10.41] (discussing); Bridge, above n. 55, at 252; Winship, above n. 25, at 634; Van Alstine, above n. 38, at 765, 779; Bonell, above n. 7, Art. 7, at 84, 85 [2.4.1] (however, supporting the third role).
61. Keily, above n. 9, at 24-25; Bonell, above n. 7, at Art. 7, 84 [2.4.1]; Franco Ferrari, ‘Scope of Application: Articles 4-5’ in *Digest and Beyond*, above n. 7, 96, at 155.
62. Sim, above n. 17, at 18, 25.
63. Bridge, above n. 55, at 251; Sim, above n. 17, at 19-21; Duncan Kennedy, *The Political Stakes in “Merely Technical” Issues of Contract Law*, 10 *European Rev. of Private Law* 7, 19 (2002) (‘the phrase good faith has no content at all’); Whittaker and Zimmermann, above n. 21, at 701 (‘precise definition is impossible’).
64. Bridge, above n. 48, at 139, 143, 147, 148 (confronting ‘particular problems’ with ‘well-tested tools’ preferable to a ‘broad standard of good faith’); John Klein, *Good Faith in International Transactions*, 15 *Liverpool L. Rev.* 115, 125-33 (1993); Sim, above n. 17, at 24, 25, 28, 32.
65. Art. 9(1) and (2) usages override the CISG text: Schwenger and Hachem, above n. 46, at Art. 7, 127 [18].

contradict or extend the CISG.⁶⁶ Based on a supposed ‘common core’ of domestic good faith, this approach has both supporters⁶⁷ and detractors⁶⁸ but receives only peripheral attention. Arguably, the sixth and third roles bear similarities, but the sixth is significantly more radical.

Good faith tends to cut across defined roles even in domestic settings,⁶⁹ perhaps due to its inherently reductionist character.⁷⁰ One theory suggests that civil law good faith, in truth, acts as a mask for the judge’s role in interpreting, supplementing, and correcting abstract rules not susceptible to short-term legislative alteration.⁷¹ Faced with all-encompassing yet ageing codes, it allows courts to supplement or even override their texts and thereby create new law.⁷² Good faith is said to make this process more palatable.⁷³ The manner in which it responds to ‘weak spots’ in a rigid legal system has been likened to *ius honorarium* in Roman law or the early response of equity in England⁷⁴ to the rigidities of common law forms of action and procedure. In their domestic settings, good faith and equity have acted as mechanisms for law reform.

It is submitted that there is a noticeable trend amongst scholarly opinion toward ‘middle ground’ convergence, with the more extreme views of a purely interpretive role (first role exclusively), or as an independent source of rights and obligations (sixth role) outnumbered by those who support ‘middle ground’ roles. However, it remains an open question whether good faith can reach into the precontractual period either as

66. Good faith as a direct obligation: *SARL Bri Production ‘Bonaventure’ v. Société Pan African Export*, Cour d’Appel de Grenoble, Chambre Commerciale, France, 22 Feb. 1995, <http://cisgw3.law.pace.edu/cases/950222f1.html>. See below §IV.D.i.

67. Honnold, above n. 40, Art. 7, at 135 [94]; Rolf Herber, in Peter Schlechtriem (ed), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 7, 65 (Clarendon 1st edn, 1998); Bonell, above n. 54, at 700; Keily, above n. 9, at 32.

68. Sim, above n. 17, at 18-33; Peter Schlechtriem, ‘Good Faith in German Law and in International Uniform Laws’ in Michael Joachim Bonell (ed), *Saggi, Conferenze e Seminari* 1, 3-4 (Centro di studi e ricerche di diritto comparato e straniero No. 24 1997); Schlechtriem, above n. 45, Art. 7, at 100; Schwenger and Hachem, above n. 46, Art. 7, at 128-29 [18]-[19].

69. See Martijn W. Hesselink, ‘The Concept of Good Faith’ in *Grosheide & Hondius*, above n. 22, 93, at 101-02 (roles of good faith in most systems; interpretation, supplementation, limitation/correction); Werner F. Ebke and Bettina M. Steinhauer, ‘The Doctrine of Good Faith in German Contract Law’ in Jack Beatson and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* 171, 172-189 (Oxford 1995); Schlechtriem, above n. 68, at 6-12 (German *Treu und Glauben* grew from humble minor gap-filling tool to multiple roles of interpretation, supplementation and correction of both legislation and contracts); Harry Flechtner, *Comparing the General Good Faith Provisions of the PECL and the UCC*, 13 Pace Int’l L. Rev. 295, 302 (2001).

70. See, e.g., Farnsworth, above n. 21, at 60.

71. Hesselink, above n. 69, at 111.

72. Ebke and Steinhauer, above n. 69, at 172 (supplemental good faith led to newly created action for breach of contract); Schlechtriem, above n. 68, at 5; Ewan McKendrick, ‘Good Faith: A Matter of Principle?’ in A. D. M. Forte (ed), *Good Faith in Contract and Property* 39, 56 n. 75 (Oxford 1999).

73. Simon Whittaker and Reinhard Zimmermann, ‘Good Faith in European Contract Law: Surveying the Legal Landscape’ in *Whittaker & Zimmermann*, above n. 21, 7, at 32 (§242 Bürgerliches Gesetzbuch [BGB] ‘is often needed merely for a transitory phase’ until establishment of new rule).

74. Hesselink, above n. 69, at 120-24; Martin J. Schermaier, ‘*Bona Fides* in Roman Contract Law’ in *Whittaker & Zimmermann*, above n. 21, 653 at 663-65; Whittaker and Zimmerman, above n. 21, at 669, 675, 697.

a general principle (second role) or as a directly imposed obligation (third role). Thus despite the convergence of views on good faith on the ‘middle ground,’ there are still a range of views about the doctrinal capacity of the CISG in relation to precontractual good faith.

[D] Majority and Minority Doctrinal Positions

While the majority of scholarly opinion weighs against the idea of precontractual liability within the CISG,⁷⁵ a minority argue to the contrary. This is not surprising, given the historical compromise and diverse potential for good faith. What is surprising, given its centrality to the issue, is the lack of attention to the question of scope. There is also a disappointing lack of discussion directed to the normative question of whether the CISG should include precontractual obligations. For convenience, minority and majority views are presented below as four groups or ‘schools’ of thought arranged by interpretive technique.

[1] Minority Group One: By Internal Interpretive Methodology Alone

Despite the absence of express provisions within the CISG imposing precontractual liability, certain scholars have overcome these obstacles by relying on the ‘internal interpretive method’ discussed earlier. Thus, through a process of liberal interpretation, analogical extension, and/or application of general principles of good faith, some argue that concrete precontractual duties arise pursuant to the CISG.

Many authors and cases confirm a general principle of estoppel within the CISG more broadly. This principle is variously referred to as a prohibition against *venire contra factum proprium*, or inconsistent conduct;⁷⁶ protection of reasonable reliance;⁷⁷ or prohibition against abuse of formal legal rights. These are drawn by analogy from Articles 16(2)(b), 29(2), 50(2), and 80.⁷⁸ As mentioned above, general principles can be used for internal gap-filling in accordance with Article 7(2).⁷⁹ The question is whether analogical extensions and general principles can support precontractual liability within the CISG.

75. Albert H. Kritzer, *Pre-Contract Formation* (2008), <http://cisgw3.law.pace.edu/cisg/biblio/kritzer1.html>.

76. Vienna International Arbitral Centre of the Austrian Federal Chamber of the Federal Chamber of Commerce, Austria, 15 Jun. 1994, <http://cisgw3.law.pace.edu/cases/940615a4.html>; Court of Appeal (OLG), Karlsruhe, Germany, 25 Jun. 1997, <http://www.unilex.info/case.cfm?pid=1&id=296&do=case>; Arbitral Award, Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, 27 Jul. 1999, <http://cisgw3.law.pace.edu/cases/990727r1.html>.

77. Schwenzer and Hachem, above n. 46, Art. 7, at 136 [32]; Schlechtriem, above n. 45, Art. 7, at 104; Magnus, *General Principles*, above n. 9, at §5b(4).

78. Magnus, *General Principles*, above n. 9, at §5b(3); Peter Schlechtriem, in *Slechtriem & Schwenzer* 2nd edn, above n. 45, Art. 24, at 278, n. 62 [17]; Ulrich G. Schroeter, in *Slechtriem & Schwenzer* 3rd edn, above n. 46, Art. 24, at 395, n. 131 [41].

79. CISG Art. 7(2).

Goderre believes they can. After reviewing a range of mechanisms consistent with the second and third roles for good faith,⁸⁰ she ultimately concludes that precontractual liability will find expression within the CISG based on specific common law-style theories by analogical extension of provisions, rather than a broader, civil-style direct duty.⁸¹ In this way, Goderre believes that a theory of detrimental reliance could impose precontractual liability by reference to Article 16(2) and implied contract by extension of restitution concepts in Article 81,⁸² and suggests letters of intent could result in precontractual liability under Article 8.⁸³ Klein and Bachechi also argue factors outlined in Article 8(3) could result in binding preliminary agreements.⁸⁴ Thus Goderre, Klein and Bachechi rely on the second (general principle) and third (direct duty) roles for good faith to arrive at precontractual liability within the CISG.

Professor Honnold also suggests room within the CISG for an obligation like *culpa in contrahendo*,⁸⁵ and in particular, relief for wrongfully revoked offers.⁸⁶ *Culpa in contrahendo* was formulated in domestic civil law systems to deal with situations arising during negotiations, but the theoretical basis and form taken by *culpa in contrahendo* vary between jurisdictions: in France there are competing bases, including abuse of rights;⁸⁷ whereas in Germany it is based on the principle of good faith.⁸⁸

80. Goderre, above n. 21, at 274-79.

81. *Ibid.*, at 274-81.

82. *Ibid.*, at 280.

83. *Ibid.*, at 279. A 'unilateral binding declaration of will' can support expectation damages under French law: Konrad Zweigert and Hein Kötz, *Introduction to Comparative Law* 360 (Clarendon 3rd edn, 1998); Shahdeen Malik, *Offer: Revocable or Irrevocable*, 25 *Indian J. Int'l L.* 26, 47 (1985); Klein and Bachechi, above n. 19, at 18. See also below n. 85.

84. Klein and Bachechi, above n. 19, at 3, 22. Arguing common law may lead to a similar obligation to the civil law duty to negotiate in good faith 'by implying the existence of a contract': Klein, above n. 64, at 135.

85. *Culpa in contrahendo* refers to 'fault in negotiating': Lake, above n. 19, at 352. Advanced by Rudolf von Ihering in 1861, it softened 'will theory' through the device of *pactum de contrahendo* or 'implied contract'. By negotiating, parties enter a relationship of trust and confidence, and thus liable if they negligently create expectations they know or should know cannot be realized: Hondius, above n. 22, at 16; Arthur Taylor von Mehren and James Russell Gordley, *The Civil Law System* 837-38 (Little Brown 2nd edn, 1977); Kessler and Fine, above n. 21, at 402-404. Relief can be granted for detrimental reliance where confidence in imminent contract was encouraged: von Mehren and Gordley, *ibid.*, at 842-43; Zweigert and Kötz, above n. 83, at 377. The doctrine influenced most civil law jurisdictions: Kessler and Fine, above n. 21, at 406-07.

86. Honnold, above n. 40, Art. 16, at 224 n. 26 [150]; Lookofsky, *Understanding*, above n. 13, at 22 n. 79.

87. In France, precontractual liability developed as *abus du droit* in delict in Arts 1382-83 Code Civil, France (19 Feb. 1804): von Mehren and Gordley, above n. 85, at 846; Ernst A. Kramer, 'Defects in the Contracting Process' in Arthur Taylor von Mehren (ed), *International Encyclopedia of Comparative Law* 57 (Mohr Siebeck 2001). Thus *abus du droit*, rather than good faith, 'permeates' French private law: Whittaker and Zimmerman, above n. 21, at 675. Liability can arise for breaking off advanced negotiations abruptly in 'without legitimate reason': von Mehren and Gordley, above n. 85, at 846. The competing '*avant contrat*' provides relief for premature withdrawal of offers under a collateral contract created when offer reaches offeree: von Mehren and Gordley, above n. 85, at 875-76. French *non cumul* precluded concurrent delict and contract actions on the same issue, now with a product liability delict exception due to 1985 EU Directive on Product Liability.

88. Thirty years after Ihering proposed *culpa in contrahendo*, it was inserted into the 1891 BGB, and became a generalized theory of precontractual liability: von Mehren and Gordley, above n. 85, at 839-43. See §311 BGB. German *culpa in contrahendo* is anchored in the permeating good faith

However, whilst he ponders the possibility, Honnold concludes elsewhere that *culpa in contrahendo* in the form of liability for breaking off negotiations in bad faith, is outside the scope of the CISG.⁸⁹ For this reason, it is submitted that Honnold ultimately falls within the majority view.

With differing degrees of tentativeness, others do not resile from their contention that *culpa in contrahendo*-style duties of good faith in negotiations arise through Article 7(1),⁹⁰ with some arguing a duty not to prevent a contract from forming in bad faith exists on this basis.⁹¹ Others more cautiously describe a duty to inform or disclose based on a good faith general principle.⁹²

Authors in this minority group look solely within the confines of the CISG to determine whether it contains duties pertaining to the precontractual phase. Essentially, they presume an internal gap; that is, a gap *praeter legem*, thus warranting resolution by the flexible and liberal internal interpretive method.⁹³ However, they leave unsaid *why* precontractual liability should be considered an internal rather than external gap.

theory; abuse of rights exists in §226 BGB but is rarely used: Whittaker and Zimmerman, above n. 21, at 695, 675; Kessler and Fine, above n. 21, at 403-04. Parties can break off negotiations but this freedom is limited in certain bad faith situations: Hein Kötz, *European Contract Law* Vol. I, 39 (Oxford 2002); Goderre, above n. 21, 266 (preventing contractual formation); Lake, above n. 19, at 353 (entry into negotiations without intent to contract, or unjustifiably breaking negotiations); Kessler and Fine, above n. 21, at 404-405, 421, 428 (non-disclosure if important and known to be unavailable to the other party). See generally Kramer, above n. 87, at 57. Italy, Greece, Israel, Argentina and Portugal also provide for good faith in negotiations: Hesselink, above n. 69, at 103; Farnsworth, above n. 20, at n. 84. In 1992 Burgerlijk Wetboek [Civil Code], Netherlands, abuse of rights appears at Art. 3:13, but its contractual function is largely covered by good faith, including c:182 (negotiations): Arthur S. Hartkamp, *Judicial Discretion Under the New Civil Code of the Netherlands*, 40 *Am. J. Comp. L.* 554, 566 (1992).

89. Honnold cited in Harry M. Flechtner, *Transcript of a Workshop on the Sales Convention*, 18 *J.L. & Com.* 191, 230 ('Workshop'); Honnold, above n. 40, Art. 2, at 54 [56.2] (precontractual issues in franchise relationships likely fall outside the CISG's scope).

90. Gert Reinhart, *Development of a Law for the International Sale of Goods*, 14 *Cumb. L. Rev.* 89, 100 (1984); Rosett, above n. 42, at 290-91; Ulrich G. Schroeter, in *Schlechtriem & Schwenger* 3rd edn, above n. 46, Introduction to Arts 14-24, 248 [56] (cautiously envisaging a duty of good faith in negotiations through Arts 7(1), 7(2), 16(2)(b)).

91. Schmid is cited as supporting gap-filling pursuant to Art. 7(2) to derive a duty of good faith in negotiations and duty not to prevent the formation of a contract in bad faith: Peter Schlechtriem, in *Schlechtriem & Schwenger* 2nd edn, above n. 45, Introduction to Arts 14-24, 176, at 182 n. 33 (citing Christoph Schmid, Dissertation München 1995); Schroeter, above n. 90, at 248 [56] (tentatively).

92. Klein locates 'omnipresent' good faith in duties to inform and cooperate, but connects this with specific articles: Klein, above n. 64, *passim*; Kock is cited as basing such duties 'simply on the principle of good faith and fair dealing': Schlechtriem, above n. 45, Art. 7, at 107 n. 73 (citing Annette Kock, Dissertation Hamburg 1995); Schroeter, above n. 90, at 248 [56] (possible duty to disclose through Art. 7(1) and (2)).

93. See Bonell, above n. 7, Art. 7, at 73 [2.2.1]. Some argue this leads to an 'expansion bias': Steven Walt, *The CISG's Expansion Bias*, 25 *Int'l Rev. L. & Econ.* 342, *passim* (2005).

[2] Minority Group Two: By Internal Interpretive Method but Acknowledging Scope

Professor Bonell and Gil-Wallin also treat the matter as one of internal interpretation. However, unlike the first group, they directly address the CISG's scope within their analyses. It is noteworthy that Gil-Wallin justifies her position on scope with two arguments.⁹⁴ First, she argues that a broad scope is necessary to prevent losses from unjustified withdrawal from negotiations;⁹⁵ that is, by an appeal to norms of fairness. Second, she contends that coverage of precontractual issues by the CISG improves uniformity by comparison with the variety of domestic laws that otherwise apply;⁹⁶ that is, by an appeal to uniformity aims. The latter hints at an underlying efficiency norm, but this is not expressly discussed. Nevertheless, Gil-Wallin's brief justifications are an unusually frank glimpse into the policy behind the minority view.

Bonell also openly discusses scope. The vanguard of the minority view, he dismisses the historical rejection of a precontractual provision as determinative of the CISG's scope and argues for liability in situations analogous to some covered by *culpa in contrahendo*, as matters governed but not expressly dealt with by the CISG.⁹⁷ He rightly acknowledges that the CISG seems unsuited to the task at first sight, but nonetheless argues expectation damages under Article 74 might lie despite absence of a contract.⁹⁸

Bonell looks to Article 7(1) and (2) as a source of positive obligations of good faith during negotiations,⁹⁹ and essentially relies upon the second (general principle) and third roles (direct obligation) for good faith. He contends that even in the absence of offer and acceptance, application of the CISG is not precluded.¹⁰⁰ Despite Article 4 providing that the CISG only governs formation of, and rights and obligations 'arising from [the] contract', Bonell further asserts that some matters are so closely related to conclusion of the contract that they can be regulated by the CISG.¹⁰¹ For example, he argues that parties are under an obligation to act in good faith when negotiating contracts, and that CISG liability might arise for non-disclosure or bad-faith prevention of the conclusion of a contract.¹⁰² In cases of a refusal to continue negotiations or

94. Silvia Gil-Wallin, *Liability under Pre-contractual Agreements and Their Application under Colombian Law and the CISG*, *Nordic J. Commercial L.* 1, 20 (2007).

95. *Ibid.*, at 13.

96. *Ibid.*, at 18.

97. Bonell, above n. 54, at 699.

98. *Ibid.*, at 701.

99. Bonell, above n. 7, at Art. 7, 81 [2.3.2.2]. Gil-Wallin argues UNIDROIT Principles and the PECL both contain precontractual liability, and this 'general principle' should also apply to extend the CISG through Art. 7(2): Gil-Wallin, above n. 94, at 16. *Contra* Schwenzer and Hachem, above n. 46, at Art. 7, 127 [19].

100. Bonell, above n. 54, at 695, 700. See Court of Appeal (OLG) München, Germany, 8 Mar. 1995, §II.2, <http://cisgw3.law.pace.edu/cases/950308g1.html>.

101. Bonell, above n. 54, at 695.

102. *Ibid.*, at 700-701. See also Peter Schlechtriem, in *Slechtriem & Schwenzer* 2nd edn, above n. 45, Art. 4, 63, at 75, n. 43 (contrasting Bonell's proposed application of Art. 7(1) to situations where bad faith prevents formation on the one hand against application of domestic *culpa in contrahendo* or tort on the other).

preliminary agreements made ‘subject to contract’, CISG liability would depend upon the parties’ intent, determinable by reference to such matters as: the type of business; the complexity of the deal; the stage of negotiations reached; usages relating to formation; the wording of any merger clause; and whether performance has started.¹⁰³ Thus to some extent, Bonell also relies on the general principle of party autonomy evident in Article 6 to argue that the CISG’s reach can be extended to precontractual obligations.¹⁰⁴

It is submitted that this analysis is clearly preferable to that of the first group. Rather than simply assume that precontractual liability forms an internal gap, effectively sweeping the issue under the carpet, Bonell openly and directly addresses the question before proceeding to apply expansive internal interpretive methods. It is contended that for Bonell, precontractual liability falls within the CISG’s scope due to doctrinal potential: it *is* an internal matter because it ‘could simply be’¹⁰⁵ if one takes a wide view of Article 7(1), (2) and/or Article 6. In combination with the ‘close connection’ between negotiation and contract conclusion, this is said to be sufficient to brand the issue ‘internal’.¹⁰⁶

Nonetheless, one might ask: does this represent a self-fulfilling prophecy? Perhaps not – the use of internal interpretive methods to address the question of internality or externality does not necessarily mean the answer is a foregone conclusion. Undeniably, however, internal interpretive methods contain inherent expansive tendencies,¹⁰⁷ so that the method employed by the first and second groups contains a strong tautological bias toward internality.

[3] Major Group Three: By the Interplay between CISG and Domestic Law

Another way of resolving the internal-external question is by reframing it as one involving relations between the CISG and domestic law at the formation stage. Does the CISG apply exclusively and pre-empt domestic law; apply concurrently with it; or does domestic law alone govern the issue?

Like Bonell, Honnold paints the CISG’s scope broadly so that it might cover issues arising from the *relationship* between the parties beyond just contractual issues.¹⁰⁸ It is

103. Bonell, above n. 54, at 697-98.

104. *Ibid.*, at 695, 700.

105. Kritzer, above n. 75 (translating Bonell’s ‘minority opinion’).

106. Bonell, above n. 54, at 695.

107. Walt, above n. 93, *passim*.

108. Honnold, above n. 40, Art. 7, at 144 [99] (‘various provisions of the [CISG] are inconsistent with a technical and narrow view of “contract” and *evinced a broader view of the relationship* between the parties to a sales transaction’)(emphasis added).

submitted that this initially led Honnold to take a cautiously positive approach to precontractual liability,¹⁰⁹ before ultimately adopting the majority view.¹¹⁰

Honnold's method clearly looks to interpretive stability and the interplay between domestic law and the CISG. For Honnold, the CISG applies to the exclusion of the domestic law if it is enlivened by the 'same operative facts' as those which lead to domestic remedies, but domestic precontractual remedies are displaced unless adjudicators decline to interpret CISG as covering the issue.¹¹¹ This indicates he considers any domestic and possible CISG remedies to be mutually exclusive rather than concurrent.

In a slightly different way, Professor Schlechtriem agrees they are mutually exclusive. However, while for Honnold, pre-emption turns on availability of remedies under the CISG, for Schlechtriem, pre-emption turns on whether or not an offer has been made. He argues the CISG should have exclusivity in cases of overlap¹¹² in order to prevent it from being pushed aside by the 'homeward trend'.¹¹³ He cites *culpa in contrahendo* as one such threat to the CISG's integrity.¹¹⁴ Once an offer is made, whether revocable or not, Schlechtriem argues that the CISG 'circumscribe[s] the field' and domestic precontractual¹¹⁵ laws such as *culpa in contrahendo* are displaced.¹¹⁶ Professor Lookofsky correctly identifies this as an assumption of 'preemption' by exclusive rather than concurrent application of the CISG.¹¹⁷

Slechtriem acknowledges that the CISG contains no rules governing negotiations.¹¹⁸ Therefore, he ultimately concedes that some 'compatible' domestic laws (such

109. *Ibid.*, Art. 16, at 224 [150] (uniformity improved by gap-filling to remedy for losses from wrongful revocation within the CISG). See Lookofsky, *Understanding*, above n. 13, at 22 n. 79 (commenting on Honnold's eventual 'bold' approach to Art. 7(2)).

110. Honnold, in *Workshop*, above n. 39, at 230. See Honnold, above n. 40, Art. 2, at 58 [56.2] (in relation to franchise relationships).

111. Honnold, above n. 40, at Art. 4, 63 [62] 68 [65] ('same operative facts'), Art. 16, 224-25 [150]-[151] (positing two alternative positions that a tribunal might take in relation to damages for wrongfully revoked offers: development of a remedy pursuant to Art. 16(2), *or*, recourse to domestic law, on the basis revocation was 'wrongful' under the CISG). See also Honnold, above n. 40, 59 [56.2] (arguing domestic precontractual issues are either 'dealt with or excluded' by CISG formation provisions).

112. Arguing courts have little leeway in granting remedies based in tort where matters governed by CISG: Peter Schlechtriem, *The Borderland of Tort and Contract—Opening a New Frontier?*, 21 *Cornell Int'l L.J.* 467, 468 (1988).

113. *Ibid.*, at 468; Peter Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 45, Introduction, 1, at 6-8 (reliance on domestic remedies could disrupt the CISG's formation rules and remedies); Peter Schlechtriem and Ingeborg Schwenger, in *Slechtriem & Schwenger* 3rd edn, above n. 46, Introduction, 1, at 7-8.

114. Schlechtriem, above n. 113, at 7; Schlechtriem, above n. 112, at 472, 474.

115. In the context of tort-contract overlaps: Schlechtriem, above n. 112, at 470-71. While *culpa in contrahendo* is considered a contractual doctrine under German law, for convenience, it is referred to as a 'precontractual' action.

116. Schlechtriem, above n. 91, Introduction to Arts 14-24, at 183 [6]; Peter Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 45, Art. 16, 207, at 213 [13]. See also Bridge, above n. 36, at 532 [11.04]; Schroeter, above n. 90, Introduction to Arts 14-24, at 252 [63].

117. Lookofsky, *Tightrope*, above n. 13, at 101; Joseph Lookofsky, *In Dubio Pro Conventione?*, 13 *Duke J. Comp. & Int'l L.* 263, 265 (2003).

118. Schlechtriem, above n. 78, Art. 24, at 278 [17]; Schroeter, above n. 78, Art. 24, at 395 [41], n. 131.

as for fraud) may continue to apply.¹¹⁹ For Schlechtriem, however, few forms of domestic *culpa in contrahendo* are compatible,¹²⁰ and the latter will be displaced where parties have ‘been moving towards a contract through corresponding offer and acceptance’.¹²¹

Yet despite this broad pre-emption, Schlechtriem still maintains a narrow scope for the CISG. He states that ‘[s]ince the CISG does not govern the situation where ... [negotiations are] broken off before the stage of ‘offer’ and ‘acceptance’ has been reached ... the only possibility is for recourse to domestic law via Article 7(2)’.¹²² Within the quoted statement and elsewhere, he strongly contends that precontractual issues are external to the CISG, partly because *culpa in contrahendo* proposals were historically rejected.¹²³ However, if it is indeed an external gap as contended by Schlechtriem, then it is submitted recourse to domestic law would not be through Article 7(2), but by virtue of the very fact the issue is external.¹²⁴

Obviously, Schlechtriem and Honnold construe scope differently. Moreover, they perceive the way scope affects pre-emption differently. While Honnold maintains a synchronicity between pre-emption and scope,¹²⁵ Schlechtriem disconnects pre-emption from scope by precluding recourse to ‘incompatible’ domestic precontractual laws once an offer is on the table, despite maintaining that parties cannot access CISG remedies *unless and until a contract exists*. Without acceptance of the offer, Schlechtriem argues that both CISG and domestic remedies are forgone,¹²⁶ and the offeree remains in limbo pending acceptance. Schlechtriem holds that ‘incompatible’

119. In situations of prevention of communications during contract formation, Schlechtriem implies recourse to domestic law is necessary if interpretive rules based on Arts 7 and 24 cannot be developed: above n. 78, Art. 24, at 279 [17]; Schroeter, above n. 78, Art. 24, at 396 [41]; Schlechtriem, above n. 102, Art. 4, at 74-75 [23a], and above n. 91, Introduction to Arts 14-24, at 184 (tort, delict, restitution or *culpa in contrahendo* where compatible). But see Schlechtriem, above n. 91, Introduction to Arts 14-24, at 183, n. 36 [6] (*culpa in contrahendo* is rarely compatible) and Schlechtriem, above n. 78, Art. 24, at 279 [17] (urging development of Art. 24); Schroeter, above n. 78, Art. 24, at 396 [41]. See also Filip De Ly, *Sources of International Sales: An Eclectic Model*, 25 J.L. & Com. 1, 3 (2005). For the view tort actions may only be available if ‘adapted’ to CISG notice and foreseeability requirements: Pascal Hachem, ‘Property Damages Under the CISG’ in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play 1*, 22 (Eleven, 2012); Schlechtriem, above n. 112, at 476.

120. See Peter Schlechtriem, in *Slechtriem & Schwenzer* 2nd edn, above n. 45, Art. 5, 76, at 80-81 [12]; Schlechtriem, above n. 91, Introduction to Arts 14-24, at 184 [6] (domestic laws for fraud during negotiations compatible). See also Ingeborg Schwenzer and Pascal Hachem, in *Slechtriem & Schwenzer* 3rd edn, above n. 46, Art. 5, 96, at 96-97 [2]; Schroeter, above n. 90, Introduction to Arts 14-24, at 250 [59] (concurrent application of domestic fraud, but pre-emption of domestic liability for negligent misstatement).

121. Schlechtriem, above n. 91, Introduction to Arts 14-24, at 183 n. 36 [6]. See also Ingeborg Schwenzer and Pascal Hachem, in *Slechtriem & Schwenzer* 3rd edn, above n. 46, Art. 4, at 81-82 [18].

122. Schlechtriem, above n. 91, Introduction to Arts 14-24, at 183 n. 36 [6].

123. *Ibid.*, at 182-83 [6]; Schroeter, above n. 90, Introduction to Arts 14-24, at 247-48 [55]. At one point Schlechtriem cautiously acknowledges the possibility of ‘careful development’ of CISG precontractual duties through Arts 7(1) and (2), but does not further explore the possibility: Schlechtriem, above n. 91, at 183 [6a].

124. See also, Schlechtriem, in *Workshop*, above n. 89, at 229.

125. See above n. 111.

126. Schlechtriem, above n. 116, Art. 16, at 213-14. See also, Schwenzer and Hachem, above n. 46, Art. 4, at 81-82 [18] (domestic remedies are excluded provided CISG formation rules ‘allow one

domestic actions must remain unavailable even if a contract never comes to fruition, in order to protect and preserve the CISG's structure. Likewise, even if an offer is properly revoked, he argues domestic *culpa in contrahendo* still remains unavailable, lest an offer, revocable in accordance with Article 16(1), be converted into an irrevocable one by threats of recourse to domestic law.¹²⁷

Implicit in his concept of compatibility is Schlechtriem's adoption of a wide-ranging preemptive quality for the CISG. Laws are considered incompatible if related 'to the seller's actual (typical and atypical) obligations, in particular as regards quality of the goods'.¹²⁸ Torts are similarly said to be incompatible if they deal with economic interests created by contract.¹²⁹ In other words, domestic laws are incompatible if they perform 'functions' tied to contractual enforcement.

Slechchtriem's assertion that precontractual issues are external to the CISG allows him to limit internal interpretive methods within a much narrower scope of application¹³⁰ despite far wider pre-emption of domestic law. Rather than utilizing general principles of prohibition against *venire contra factum proprium*¹³¹ or prohibition against the abuse of rights¹³² to found precontractual liability within the CISG like the first and second groups, Schlechtriem employs them to interpret formation provisions to determine whether a contract exists.¹³³ Thus, formation is pivotal, and 'everything [that] happens before the conclusion of the contract ... isn't really governed by the [CISG]',¹³⁴ although it may nonetheless pre-empt domestic precontractual liability.

It is submitted the norm of preservation of the CISG's structural integrity underpins Schlechtriem's analysis, although he also cites uniformity aims and historical fidelity as justifications.¹³⁵ Contrary to the first two groups, Schlechtriem

party to step back from ... negotiations'). *Contra* Malik, above n. 83, at 47 (advocating offeree choice between forcing the contract or pursuing domestic remedies).

127. Schlechtriem, above n. 116, Art. 16, at 214; Ulrich G. Schroeter, in *Slechchtriem & Schwenger* 3rd edn, above n. 46, Art. 16, 302, at 310-11 [14]. See Schlechtriem, above n. 112, at 472.

128. Schlechtriem, above n. 102, Art. 4, at 74-75.

129. Schlechtriem, above n. 120, Art. 5, at 81.

130. See above n. 122 and accompanying text. But see above n. 123.

131. Schlechtriem instead applies *nemo potest venire contra factum proprium* as a general principle to resolve whether Part III declarations are binding: Peter Schlechtriem, in *Slechchtriem & Schwenger* 2nd edn, above n. 45, Art. 27, 306, at 314-15 [14]; see Ulrich G. Schroeter, in Ingeborg Schwenger (ed), *Slechchtriem & Schwenger* 3rd edn, above n. 46, Art. 27, 447, at 457 [16].

132. See, e.g., Schlechtriem, above n. 78, Art. 24, at 278 n 62 [17]; Schroeter, above n. 78, Art. 24, at 395 n. 131 [41].

133. Where communication of acceptance was hindered by the addressee to prevent contract formation, Schlechtriem prefers an Art. 24 construction promoting good faith in accord with Art. 7(1) or that general principles be utilized to gap-fill Art. 24 pursuant to Art. 7(2), to prevent application of *culpa in contrahendo* by ensuring that the CISG covers the situations: Schlechtriem, above n. 78, Art. 24, at 278-79 [17]. See also Schroeter, above n. 78, Art. 24, at 395 [41].

134. Schlechtriem, in *Workshop*, above n. 89, at 230. Schlechtriem clearly confirms his view in discussing the case study involving a letter of intent scenario: at 221-24.

135. *Ibid.*, at 228-29; Schlechtriem, above n. 91, Introduction to Arts 14-24, at 182-84 [6]. See also Schroeter, above n. 78, Art. 24, at 247-48 [55].

characterizes the use of liberal internal interpretive techniques to extend the CISG into precontractual territory as ‘very uncertain and dangerous’.¹³⁶

On the other hand, Honnold views scope more broadly, giving internal interpretive methods more freedom to locate precontractual liability within the CISG. Therefore, to arrive at the majority view, Honnold reins in the bolting horse of the internal interpretive method by turning to an absence of general principles upon which to base precontractual liability. He warns that it would result in an obligation altogether too vague to encourage ‘the kind of uniformity that the [CISG] was designed to produce’.¹³⁷ Ultimately, both Schlechtriem and Honnold rely on norms of interpretive stability and structural integrity, thus both adopt a policy favouring better quality of uniformity over greater ‘geographic’ quantities of uniformity.

[4] *Majority Group Four: Historical and Comparative Absence Approaches*

The notion that the CISG does not govern the precontractual phase is normally asserted by the majority on historical grounds, primarily the rejection of the East German proposal.¹³⁸ Some deny coverage of precontractual obligations by comparing the CISG with other international rules.¹³⁹ The UNIDROIT Principles,¹⁴⁰ PECL,¹⁴¹ DCFR¹⁴² and the proposed CESL¹⁴³ explicitly reject the traditional common law ‘aleatory’¹⁴⁴ stance. They apply duties of good faith and fair dealing at every stage of party relations. All but the proposed CESL specifically make parties liable for losses caused by breaking off

136. Schlechtriem, in *Workshop*, above n. 89, at 231.

137. *Ibid.*, at 236.

138. See, e.g., Pilar Perales Viscasillas, ‘Comments on the Draft Digest Relating to Articles 14-24 and 66-70’ in *Digest and Beyond*, above n. 7, 259, at 264-65; Schlechtriem, above n. 91, Introduction to Arts 14-24, at 182-84 [6]; Schroeter, above n. 78, Art. 24, at 247-48 [55]. See also Albert H. Kritzer, ‘Precontractual Liability’ in Albert H. Kritzer (ed), *Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods* (Kluwer 1994).

139. See, e.g., Magnus, *Remarks*, above n. 9, at § 2(c)(aa); Felemegas, above n. 9, at 311 n. 743.

140. UNIDROIT Principles, Arts 1.7 (non-excludable general duty of good faith), 1.8 (inconsistent behaviour), 2.1.15 (bad faith in negotiations), 3.2.3 Comment 1 (fair dealing in informing mistaken party of error), 3.2.7 (gross disparity, unconscionability and avoidance/adaptation), 4.8 (supplying omitted terms), 6.2.1-3 (hardship, renegotiation/orders for termination and adaptation).

141. PECL Arts 1:201 (non-excludable general duty of good faith), 2:301 (liability for negotiations conducted or terminated in bad faith), 4:103 (consequences of failure to alert mistaken party), 4:109 (avoidance and court ordered adaptation of unconscionable contract), 4:110 (avoidance for gross disparity from standard terms), 6:111 (hardship, renegotiation/court ordered termination/adaptation), 8:108 (force majeure).

142. DCFR Arts II-3:101 (duty of disclosure), II-3:301 (duty of good faith and fair dealing in negotiations), II-3:302 (confidentiality).

143. Proposed CESL Arts 2 (mandatory duty of good faith and consequences for breach), 23-25, 29 (pre-contractual disclosure and liability for failure), 89 (hardship renegotiation/orders for termination in changed circumstances rendering obligations excessively onerous and court ordered adaptation/termination).

144. Farnsworth, above n. 20, at 221 (writing before proposed CESL & DCFR).

negotiations in bad faith,¹⁴⁵ a position ostensibly closer to that of the civil law.¹⁴⁶ The proposed CESL does not directly address the matter.¹⁴⁷ By contrast, the CISG lacks an express precontractual liability provision, and does not explicitly impose a general duty of good faith upon parties.¹⁴⁸

§9.04 THE 'EFFICIENCY DILEMMA'

Given that the CISG's underlying aim is to improve efficiency, one might expect views about precontractual liability to be steeped in analysis of how good faith affects the fundamental equation of CISG-enhanced efficiency. This is far from true. Arguments grounded in fairness or certainty hint at the issue, but it is submitted that the norms underlying the debate and the trade-offs between them should be better articulated.

This issue is of great importance. Modern transactions are increasingly complex. This results in lengthy negotiations punctuated by various preliminary memoranda of understanding, letters of intent, and/or preparatory work and expense.¹⁴⁹ In complex and protracted negotiations, it is difficult to pinpoint exactly when a contract is formed. Theoretical offer-acceptance patterns are not easily discernible and contracts tend to 'gradually ripen'.¹⁵⁰ This can be partially attributed to technological advancements in goods themselves.¹⁵¹ Even in less lengthy negotiations, however, reliance on statements or conduct before a contract is concluded raises similar issues. This type of behaviour is more likely to occur in the context of the longer-term relationships prevalent in global trade.

Should such issues fall within the scope of the CISG? On the one hand, good faith concepts are said to bring uncertainty and confusion.¹⁵² This could undermine predictability and uniformity, which would decrease the ability of parties to accurately allocate risks and result in increased transaction costs.¹⁵³ Conversely, precontractual good faith duties would expand the CISG's reach, which could arguably enhance

145. 'Bad faith' is defined in UNIDROIT Principles to include entry or continuation of negotiations without intent to reach agreement, or deliberate breaking off negotiations in bad faith: Arts 1.7, 2.1.15. The PECL provides for the same, but uses the phrase 'contrary to good faith and fair dealing' rather than 'bad faith': PECL, Art. 2:301.

146. However, the commercial nature of parties is often taken into account in domestic systems: Jan H. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* 165 (Hart 1st edn, 2000).

147. But see above n.143.

148. Bridge, above n. 36, at 509 [10.41]; Farnsworth, above n. 21, at 55; Winship, above n. 25, at 631, 633.

149. Hondius, above n. 22, at 9; Farnsworth, above n. 20, at 249-50. See Lake, above n. 19, at 331-32.

150. Rosett, above n. 42, at 292. See also Bonell, above n. 54, at 695-96 (referring to lengthy negotiations without clearly ascertainable offer or acceptance and consequent doubt as to whether or when a contract is concluded); *Workshop*, above n. 89, at 219-20. See also Schlechtriem, above n. 91, Introduction to Articles 14-24, at 177 [1].

151. See also Lake, above n. 19, at 332, n. 11.

152. Sim, above n. 17; Bridge, above n. 48, at 140.

153. Sim, above n. 17; Farnsworth, above n. 20, at 242-43.

predictability and uniformity¹⁵⁴ and thus reduce transaction costs. Clearly, each side is employing different concepts of efficiency and uniformity.

The result is an 'efficiency dilemma.' The following analysis isolates the normative tensions underlying the debate: formal versus substantive uniformity; efficiency versus fairness; and stability versus progressive evolution of law.

[A] Formal versus Substantive Uniformity

It is submitted that a trade-off exists between greater quantities of uniformity engendered by expansion and the quality of uniformity achieved. This might be summarized as the tension between formal and substantive uniformity. In this chapter, formal uniformity is used to denote the 'geographic' field of coverage of uniform law (formal/quantitative/theoretical uniformity), whilst substantive uniformity is used to refer to the quality of the uniformity achieved within that field (substantive/qualitative/actual uniformity).¹⁵⁵

The main argument in favour of precontractual expansion is that an extra dimension of formal uniformity has the potential to bring efficiency gains.¹⁵⁶ Increased 'geographic' coverage arguably improves certainty, by extending to a new territory those benefits which inspired the CISG's creation in the first place. This spills into many of the substantive and non-substantive efficiencies identified in Chapters 4 and 5. The expansion would reduce the need to rely upon unpredictable choice of law rules to identify the applicable precontractual law. The patchwork of alternative domestic precontractual laws would be replaced by a single uniform law. This would decrease the information costs of access to and familiarization with multiple foreign precontractual laws¹⁵⁷ to the benefit of at least one and possibly both parties at the negotiation stage. Wider coverage might reduce the time and costs involved in reaching agreement on choice of law.¹⁵⁸ Reliance by parties upon uniform precontractual obligations could encourage increased entry into cross-border negotiations, especially in longer-term or complex transactions, and this could increase trade volumes. Drafting costs might be lowered by reduced need for cautious preliminary agreements, as parties could rely upon the CISG to gap-fill.¹⁵⁹ Unity of the law of contract and precontractual law would

154. Honnold, above n. 40, Art. 16, at 224 [150]. See also Schlechtriem, above n. 91, Introduction to Arts 14-24, at 176, 183 ('diverging domestic laws' could be avoided by careful application of the CISG).

155. See Gillette and Scott, above n. 37, passim (utilizing different definitions).

156. Frank Diedrich, *Maintaining Uniformity in International Uniform Law Via Autonomous Interpretation*, 8 Pace Int'l L. Rev. 303, 309 (1996).

157. See Filip De Ly, 'Opting Out' in Franco Ferrari (ed), *Quo Vadis CISG?* 26, 37 (Bruylant 2005) (listing as a disadvantage the limited means for parties to protect themselves during the precontractual stage under the CISG).

158. See *ibid.*, at 36-37 (a 'common platform' would save time and promote fairness for parties from multiple countries).

159. See generally, discussion in Ch. 5. See Klein and Bachechi, above n. 19, at 20-23; Omri Ben-Shahar, *An Ex-Ante View of the Battle of the Forms*, 25 Int'l Rev. L. & Econ. 350, 351 (2005) (potential reduction in drafting costs by increased gap-fillers); Sim, above n. 17, at 6. See also Joseph M. Perillo, 'Hardship and its Impact on Contractual Obligations' in Michael Joachim Bonell (ed), *Saggi, Conferenze e Seminari* (Centro di studi e ricerche di diritto

arguably aid coherence between remedies in each field. Thus it can be argued that extension of good faith improves efficiency and certainty. Transaction costs are reduced due to enhanced predictability about which law applies, greater certainty about where the precontractual burden lies, improved coherence between remedies, and decreased reliance on multiple foreign laws and gap-filling by the default law.

However, convergence in domestic precontractual laws would arguably mean few of the above efficiency gains could be realized from expansion. If domestic laws display reasonably uniform outcomes, then the policy behind ever-increasing colonization by the CISG is not warranted. It is true that outcomes are often similar, but it is submitted substantial and confusing differences still exist between domestic precontractual laws.¹⁶⁰ More importantly, the issues of proof, access, predictability (of choice of law rules) and neutrality remain unanswered by substantive convergence. These relate to the non-substantive efficiencies discussed in Chapter 5. Greater formal uniformity therefore has the potential to extend these benefits.

By contrast it could be argued that efficiency would be hampered by overextension of the CISG. Good faith has been described as a problem to be 'minimized' to avoid 'long term chaos'.¹⁶¹ Unlike many other manifestations of good faith, the lack of specific provisions upon which to anchor potential precontractual coverage and utter dependence upon good faith as the basis for liability could raise uncertainty. The concern is that the CISG could generally 'lapse into generality and vagueness'¹⁶² with consequent reduced predictability for parties.¹⁶³ A slow and gradual expansion of the CISG through good faith could exacerbate this indeterminacy.¹⁶⁴

The concern extends beyond the precontractual issue. As Honnold and Schlechtriem state, because this expansion involves the CISG's scope, it may call into question its entire structural integrity. If the Article 4 definition of issues governed by the CISG as matters 'arising from [the] contract' can be expanded to include obligations arising in the absence of a contract, then what next? The rhetorical question captures the notion that the 'geographic' expansion would call into question other areas which might otherwise be considered settled, heightening substantive concerns of unpredictability and counteracting any potential gains.

Expansion could also make it harder to predict how the CISG will interact with residual domestic law, an issue generally highlighted in Chapters 4 and 5 as a

comparator e straniero No. 20 1996) (noting extreme length of American contracts attempting to anticipate 'every possible calamity' in the context of hardship).

160. See Malik, above n. 83, at 47 (same results arise under different domestic laws); Whittaker and Zimmermann, above n. 21, at 656 ('all legal systems allowed some recourse for the person who had undertaken work ... in reliance on the contract going ahead, though they differed considerably as to the juristic basis' except for Sweden and Finland); Goderre, above n. 21, at 265 (civil and common law positions on precontractual liability are fairly similar for detrimental reliance). See Sir Roy Goode, 'The Concept of Good Faith in English Law' in Michael Joachim Bonell (ed), *Saggi, Conferenze e Seminari 5-6* (Centro di studi e ricerche di diritto comparator e straniero No. 2 1992).

161. Sim, above n. 17, at 30, 34.

162. Goode, above n. 160, at 6.

163. See *ibid.*, at 6 (for English law predictability is 'more important than absolute justice').

164. See Schlechtriem, above n. 68, at 18 (German experience shows good faith can be 'abused by judges to exercise personal prejudices and biases').

deficiency in regard to the CISG's substantive efficiency. The CISG can produce efficiency gains only to the extent it effectively displaces domestic precontractual law. All the potential efficiency gains mentioned above would be illusory if domestic law still applied, either exclusively or concurrently. There are a number of precontractual laws that might be considered mandatory. Arguably, just defining the stage in negotiations at which pre-emption might occur poses serious difficulties that could engender elaborate precautionary measures, raising transaction costs and undermining any benefits gained from expanded uniformity.¹⁶⁵ Accordingly, some suggest that resort to domestic law is preferable to the 'loose cannon' of good faith.¹⁶⁶

According to the latter view, rather than improve certainty and efficiency, the extension of good faith to precontractual matters could have the opposite effect. Rather than reducing negotiation time and costs, the gains available from greater formal uniformity would be dissipated by inherent unpredictability of its content and its interaction with domestic law. Arguably, negotiators would face a more difficult task, perhaps leading to overcautious preliminary agreements and greater transaction costs.¹⁶⁷ Whichever path is ultimately chosen, there are strong policy reasons to ensure the clearest division of functions between domestic law and the CISG.

[B] Efficiency versus Fairness

Part of the attraction in expanding the CISG into the precontractual zone is the prospect of improved fairness, at least where the patchwork of domestic laws does not otherwise resolve situations perceived as 'unfair.' In this sense, it might be desirable to use the CISG to prevent abuse of weaker parties – for example, by risk-shifting in standard term contracts – where there has been no real opportunity to negotiate individual terms, due to the inequality of bargaining power, skill or experience, or because of the costs such negotiations would entail.¹⁶⁸ It could be argued that fostering long-term relationships¹⁶⁹ and mutual trust is beneficial because it encourages more global trade.

Of course, fairness has a price, primarily unpredictability and consequent *ex ante* inefficiency. The tension here pits liberalist freedom of contract against contractual justice, characterized by socialization of contract law. An extreme example of this dichotomy can be seen in the modern European retreat from *laesio enormis*, dealing with gross disparity,¹⁷⁰ a concept now largely seen as inappropriate in 'an economy

165. See generally Farnsworth, above n. 20, at 243.

166. Sim, above n. 17, at 25; De Ly, above n. 157, at 40 (describing the CISG as a set of 'open-ended rules').

167. Sim, above n. 17; Justice Steyn, *The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?* 6 Denning L.J. 131, 140 (1991) (arguing against a role for good faith in commercial contracts on a certainty of risk allocation basis).

168. See generally Zweigert and Kötz, above n. 83, at 334, 326.

169. However, the CISG will not normally apply to 'framework contracts' unless they create obligations to deliver goods and meet the other CISG requirements: CISG Advisory Council, CISG-AC Opinion No 9, 15 Nov. 2008, Rapporteur: Prof. Michael Bridge, *Commentary*, [3.4]; Bridge, above n. 58, at 959 [16.91].

170. Whereby contracts could be avoided if the price was less than half the true value (just price or market price) of the item sold: Kramer, above n. 87, Ch. 11, Vol. VII, *Contracts in General*, at

dominated by liberalism'.¹⁷¹ Yet characterization of the clash between fairness and efficiency is overly simplistic. It fails to recognize that efficiencies can arise from fairness itself, such as the fostering of long-term trading relationships.

Additionally, conceptions of 'fairness' depend partly on timing.¹⁷² Part of the difficulty in assessing whether strict rules are preferable to flexible ones is that contrary conclusions might be drawn, depending on the point at which the rules are tested. Measured at the time of negotiation and drafting, stricter laws might be considered 'fairer' because they provide greater predictability,¹⁷³ facilitate more accurate risk allocation, and reduce the burden on drafters to assiduously deal with every eventuality within the contract, thereby decreasing transaction costs.¹⁷⁴ For commercial parties, clarity and certainty about rule outcomes carry more weight at the negotiation and drafting stages than the particular legal shape of outcomes, which can still be accounted for at this stage through the pricing mechanism or insurance.¹⁷⁵

Conversely, knowledge that some precontractual protections exist could encourage trade by providing reassurance that, under some circumstances, investments can be recouped despite failure to reach a contractual agreement. Negotiation costs might be decreased if it is known that the law will adequately fill any gaps.¹⁷⁶ Negotiation might be perceived as more efficient and fairer where there are obligations of disclosure, especially in longer-term relations or complex negotiations.¹⁷⁷ Should this hold true, then arguably a compatibility rather than a trade-off exists, and CISG precontractual good faith could simultaneously improve *ex ante* fairness and *ex ante* efficiencies.

Yet, when tested *ex post* at the point of litigation, uncertain yet flexible rules improve 'fairness' because they give the court or tribunal more freedom to allocate contractual burdens.¹⁷⁸ This 'fairness' argument carries even more force for precontractual obligations, since flexible rules enable the court to distribute burdens which the parties failed to allocate contractually.

However, it is submitted these arguments are somewhat flawed. *Ex post* fairness will be improved only to the extent that domestic laws do not offer the same or even 'fairer' rules. Further, *ex ante* savings will not be realized if the vagueness of CISG

64. But see UNIDROIT Principles, Art. 3.10 (gross disparity, unconscionability, and avoidance or adaption); PECL Art. 4:110 (avoidance for gross disparity from standard terms); DCFR, II.-7:207, II.-9:405 (unfair terms in B2B standard terms). The proposed CESL only contains Art. 89 (adaption for hardship).

171. Zweigert and Kötz, above n. 83, at 329.

172. Ronald A. Brand, 'Article 79 and a Transactions Test Analysis of the CISG' in *Digest and Beyond*, above n. 7, 392, at 396 (on Art. 79).

173. See Harold J. Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade*, 63 Colum. L. Rev. 1413 (1963); Brand, above n. 172, at 396.

174. Brand, above n. 172, at 397.

175. Rosett, above n. 42, at 270, 283. See also Goode, above n. 160.

176. Zweigert and Kötz, above n. 83, at 327.

177. This will depend on the parties' preferred risk profiles: see Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535 (1990).

178. Brand, above n. 172, at 396-97. He also argues this can reduce litigation expenses, although how is not clear: Brand, above n. 172, at 396-97. See Gillette, above n. 177, at 538 (this approach assigns the job of determining norms of the agreement to judges).

precontractual rules overshadow any efficiency gains, and/or prompts parties to exclude. Claims of specific *ex ante* efficiencies can be equally problematic. Certainly fully informed markets in theory help maximize economic efficiency, and it follows that greater disclosure due to precontractual duties is desirable.¹⁷⁹ In practice, however, disclosure costs will add to transaction costs. Moreover, the imposition of a disclosure rule might actually discourage acquisition of information by the party subject to the duty.¹⁸⁰ Likewise, the claim that increased trade volumes might be fostered by expansion should be weighed against counterarguments that it could have a converse ‘chilling’ effect on entry into negotiations,¹⁸¹ especially for complex deals, for fear of liability.

It will be recalled from earlier discussion (in Chapter 4, section §4.02[B][3]) that in law and economics, it has been traditionally held that formation should follow party intentions,¹⁸² but more recently, efficient reliance has become the focus,¹⁸³ involving assessment of the point at which ‘relationship-specific investment’ should be protected against potential exploitation by the non-relying party who might seek to extort better terms.¹⁸⁴ For default rules covering a wide range of transactions, this is an extremely difficult task.¹⁸⁵ Therefore, it was submitted that the best that can be achieved by the CISG in relation to encouraging an efficient level of reliance in international transactions would be a very high level of clarity about when formation occurs, where possible, timed to roughly correspond with what the majority of parties probably intend. It is submitted that, given the high transaction costs involved in performing international sales, the point at which relationship-specific investment should be protected by contractual means should be delayed, in order to ensure that investment is undertaken when socially optimal. In any event, given the higher potential for misunderstandings due to differences in linguistic and cultural backgrounds, it is likely that most parties would be somewhat slower and more cautious as to the point at which they intend to be bound, making a delayed point of investment protection (at least by contractual means under the CISG) perhaps majoritarian in any event. Thus efficient reliance might be best encouraged by improved clarity and delayed protection in the case of international sales. In other words, this argument favours a clear and narrow scope for the CISG in regard to precontractual liability.

Normative accuracy and calculability are affected differently by good faith. Professor Wightman generally argues that good faith ensures results comply more

179. Hondius, above n. 22, at 10.

180. *Ibid.*

181. Farnsworth, above n. 20, at 243.

182. Marta Cenini and Francesco Parisi, ‘An Economic Analysis of the CISG’ in André Janssen and Olaf Meyer, *CISG Methodology* 151, 153 (Sellier 2009).

183. Charles J. Goetz and Robert E. Scott, *Enforcing Promises*, 89 Yale L.J.1261 (1980); Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 Stan. L. Rev. 481, et seq. (1996); Cenini and Parisi, above n. 182, at 153.

184. Cenini and Parisi, above n. 182, at 154.

185. See also *ibid.*, at 154-55.

closely with the law's normative values,¹⁸⁶ such that 'fairer' *ex post* outcomes are achieved. However, this has negative implications for commercial parties trying to predict risks and liabilities, making them less calculable in advance.¹⁸⁷ Essentially, one might expect good faith to create more *ex post* fairness, but it will inversely affect *ex ante* efficiency. This is consistent with the above analysis, although it does not consider the nuanced effect in fostering longer-term trade relations. However, irrespective of the latter, in the present context, the effect of *ex ante* efficiency on choice of law must also be considered.

[C] Stability versus Evolution

Arguably the CISG should not deal with precontractual liability because it was never intended to do so.¹⁸⁸ As noted above, historically, the fragile good faith compromise saved the day, and attempted forays into precontractual liability were repeatedly rejected.¹⁸⁹ Arguably, this limitation should be respected. According to this view, such an extension would not be mere evolution in the face of new circumstances, since unlike email or software, precontractual liability was not '*terra incognita*'¹⁹⁰ but something hotly debated and deliberately abandoned by drafters.¹⁹¹ Expansion in this case might overstep the spirit of the international consensus.¹⁹²

It is submitted that this historical perspective clashes with the need for the CISG to evolve so that it does not become a prisoner of the past. Narrow, restrictive interpretations are inappropriate for international conventions.¹⁹³ The CISG is a living document and must adapt, particularly since the possibility of amendment is remote.¹⁹⁴ Arguably, its internal interpretive tools should be relied upon to overcome any textual shortcomings in the area of precontractual liability. Growing support for this view might be expected; since the CISG was drafted, many common law jurisdictions have become increasingly (sometimes unwittingly) less suspicious of good faith, at least in limited and specific ways, including recognition of estoppel, unconscionability, unjust enrichment, and agreements to negotiate.¹⁹⁵

One objection to the evolution argument is that even if one were to abandon fidelity to the drafters' original inhibitions, and therefore the notion of historical

186. John Wightman, 'Good Faith and Pluralism in the Law of Contract' in Roger Brownsword, Norma J. Hird and Geraint Howells (eds), *Good Faith in Contract: Concept and Contexts* 41, 47-48 (Dartmouth 1999).

187. *Ibid.*, at 47-48.

188. See §9.03[D][4] above.

189. See §9.03[B] above.

190. See Frank Diedrich, *The CISG and Computer Software Revisited*, 6 (Supp) *Vindobona J. Int'l Commercial L. & Arbitration* 55, 55 (2002).

191. See above §9.03[B] above. See also Sim, above n. 17, at 13, 26.

192. Farnsworth, above n. 21, at 56 (even recognition of good faith as a general principle would be a 'perversion of the compromise' struck by delegates); Keily, above n. 9, at 28.

193. Keily, above n. 9, at 40.

194. See also Bonell, above n. 7, Art. 7, at 90 [3.1.3]; Diedrich, above n. 190, at 60; Magnus, *General Principles*, above n. 9, at §4a; *ibid.*, at 40.

195. Farnsworth, above n. 20, *passim*; Keily, above n. 9, at 37-39.

stability, interpretive stability and structural integrity remain important to the CISG as a choice of law. Hence a lack of specific tools may still hamper expansion under a preference for evolution. Unless one accepts that Article 7(1) independently imposes substantive duties directly upon parties (third role),¹⁹⁶ or the extreme position that Article 7(1) is an independent source of new obligations (sixth role), the CISG contains no provision upon which to base precontractual duties.¹⁹⁷ Its provisions relate to the formation, performance and enforcement of contracts and secondary obligations where contracts are avoided. Arguably, a precontractual expansion would be more reconstructive than interpretive, ironically reminiscent of judicial adaptation of contracts, that greatest of common law suspicions in relation to good faith.¹⁹⁸ While fears of adaptation may be far-fetched,¹⁹⁹ as discussed earlier, the absence of a sturdy foundation for precontractual liability raises the spectre of uncertainty and increased *ex ante* transaction costs. Worse still, substantive concerns relating to unpredictability may prompt practitioners to habitually ‘opt out’, as concluded earlier.

[D] Preliminary Conclusion

Ultimately, what emerges is a series of tensions between competing norms. By stretching the CISG to cover precontractual matters, expansionists advocate acceptance of greater internal uncertainty as the price for increased formal uniformity. In this sense, they are prepared to trade a certain amount of quality for greater quantities of uniformity, historical fidelity for evolutionary development, and to accept *ex ante* cost increases caused by unpredictability in order to capture other *ex ante* efficiency gains and *ex post* fairness at litigation.

By advocating the CISG’s confinement from precontractual issues, opponents of expansion are inclined to sacrifice greater formal uniformity in favour of better substantive uniformity, evolution for historical/structural stability, and prefer the *ex ante* savings afforded by certainty over other *ex ante* efficiency gains and *ex post* fairness.

196. That is, the third view of good faith discussed in §9.03[C] above. See Bonell, above n. 54, at 700; Kritzer, above n. 75 (commentary on Bonell’s analysis).

197. Bonell, above n. 54, at 693. But see Kritzer, above n. 75 (the CISG can ‘only artificially’ be made to apply to precontractual fact patterns); Schlechtriem, above n. 45, at 103.

198. Flechtner, above n. 69, at 310, 323 (commenting on PECL, good faith in the form of ‘peremptory judicial power to make or alter the parties’ agreement’ as at the heart of the ‘traditional distrust’ of good faith from common lawyers); Bridge, above n. 48, at 140 (good faith generally gives ‘too much power to the individual judge’ and that it represents ‘[v]isceral justice’).

199. See Schlechtriem, above n. 68, at 10-11 (anticipating advocacy for renegotiation and adjustment for hardship cases in the CISG); Schlechtriem, in *Workshop*, above n. 89, at 234-36 (duties of renegotiation or adaption remedies for hardship within the CISG Art. 79 as perhaps a ‘stretch too far’ given distrust of judges remaking contracts). The CISG Advisory Council ultimately left the issue of adjustment for hardship open, but suggested the possibility might be supported through Art. 7(1) or Art. 79(5): CISG Advisory Council, CISG-AC Opinion No 7, 12 Oct. 2007, Rapporteur: Prof. Alejandro M. Garro, *Commentary* [40].

How should this dilemma be resolved in relation to precontractual good faith? What weighting should each of the trade-offs identified be given?

When two doctrinally feasible directions for development emerge, it is submitted that the most appropriate choice is one which is most likely to further the goal of the CISG. This involves consideration of the relative effect of each direction on net exchange gains for the parties and on overall social welfare.

One might therefore advance the argument that 'fairness' should be traded for 'efficiency' where there is tension between the two norms, with the result that one rationale for expansion is eliminated. The historical-evolutionary tension offers little assistance in this case, since interpretive/structural stability leads us back to the last and apparently finely balanced trade-off between formal and substantive uniformity.

It is contended that in choosing between evenly weighted alternatives, careful attention should be paid to the incentive effect either direction might have on the CISG as a choice of law, and the flow on effects of frequency on its substantive and non-substantive efficiency, including efficient reliance and network effects and increased social welfare through resolution of collective action problems which foster suboptimal exclusions. It was submitted earlier (in section §9.02) that an interpretation that promotes certainty about the CISG's scope of application should be preferred to one which detracts from predictability regarding its scope. If both interpretations are doctrinally open, then, all else being equal, the former should be chosen as it best maximizes social welfare. To reduce the frequency of exclusions, and suboptimal exclusions in particular, quality of uniformity should be preferred to quantity.

The drafting stage is arguably the crucial point for exclusion. At that point, it is contended that the relevance of any potential efficiency gains at the negotiation stage will probably have been overtaken by the course of the transaction, and any efficiencies perceptible at a hypothetical litigation stage on the basis of precontractual events will seem a distant prospect. Amongst all the trade-offs identified, parties considering a choice of law provision are most likely to be concerned with *ex ante* efficiencies associated with drafting rather than efficiencies in negotiation or *ex post* fairness. Efficiency losses from expansion-led unpredictability in the content of the CISG's rules is thus of greatest concern for those considering opting out.

It is submitted that, all other things being equal, the CISG will be more attractive at the drafting stage if it enables parties to accurately predict the allocation of risks and consequent value of the contractual bargain. Provided it is not unexpected, any form of potential liability or risk can be accommodated by adjustments to price, insurance, or hedging. Uncertainty naturally reduces the calculability of the law.²⁰⁰ Bearing in mind the earlier observation that decision-makers overwhelmingly over-estimate anticipated losses and under-estimate expected gains (Chapter 7), the trade-off in the mind of lawyers contemplating exclusion is much more likely to be positively influenced by confinement rather than expansion in the case of precontractual liability, even if gains and losses are evenly balanced (when objectively assessed). It is submitted that any perceived gains from the ability of parties to rely upon precontractual gap-filling are

200. Wightman, above n. 186, at 41, 47-49.

unlikely to off-set perceived losses arising from an inability to predict risk. Further, as mentioned earlier, efficient reliance might be best encouraged by a delay in protection of reliance investments (at least by contractual means) in the case of international sales.

Thus a narrow scope arguably improves perceived substantive efficiency. The problem of incalculability in the case of precontractual liability is especially exacerbated by the absence of specific provisions. Additionally, Article 74 anticipates damages for breach of contract of sale, rather than preliminary contract or other pre-contractual liability.²⁰¹ The lack of ‘scaffolding’²⁰² heightens uncertainty for parties at the very point at which they make their choice of law. Generally, commercial actors will prefer a narrower scope for uniform law if it results in more precise rules because this reduces contracting costs.²⁰³ Inadequate specificity about the shape of obligation or its interaction with domestic precontractual obligations makes the task of rational price-setting at the drafting stage extremely challenging.²⁰⁴

Precision assists parties in this task.²⁰⁵ Predictability goes to lawyers’ substantive concerns as a reason for exclusion – the very factor earlier predicted to become increasingly significant in future exclusion decisions.

To bring precision, it is not enough to simply confine scope. Interaction with domestic law must also be considered. This can be best done by reference to function, and function alone.²⁰⁶ While it is possible to envisage an approach to scope combining the Honnold test of ‘same operative facts’ and the Schlechtriem ‘functionality’ approach, arguably the ‘factual criterion’ adds little to the overriding need to ensure that both laws have the same function, and could even detract from a clear test comparing the purpose of the two laws in question.²⁰⁷

The fact that CISG remedies become accessible only upon formation demonstrates that at its core, it seeks to protect contractual interests. By contrast, domestic precontractual laws such as estoppel and *culpa in contrahendo* both:

- act in ‘support of contract’ or protection of contractual interests; and
- create independent rights as ‘alternative to contract’.²⁰⁸

201. Bridge, above n. 36, at 533 [11.04]. Bridge states that to extend Art. 74 beyond sale contracts to ancillary or constructive contracts would be to do ‘violence to the language of the CISG’. But see Malik above n. 83, at 46 (likening expectations damages from estoppel to Art. 74 damages).

202. Schlechtriem, in *Workshop*, above n. 89, at 230 (referring to a lack of general principles).

203. Gillette and Scott, above n. 37, at 458.

204. Kennedy, above n. 63, at 19 (explaining circumstances under which good faith obligations of altruism arise cannot be ‘fully specified in advance’).

205. Rosett, above n. 42, at 270.

206. Function is generally emphasized as a key in determining externality by Schlechtriem: see Schlechtriem, above n. 113, Introduction, at 8.

207. Advocating a combined ‘same operative facts’ and ‘function’ approach, albeit in the context of a discussion of the issue of validity: Ulrich G. Schroeter, ‘The Validity of International Sales Contracts’ in I. Schwenzer and L. Spagnolo (eds), *Boundaries and Intersections* §§3.0, 3.1 and 3.2 (Eleven 2014).

208. In German law, *culpa in contrahendo* is classified as contractual: above n. 115.

Estoppel²⁰⁹ in common law jurisdictions now provides damages for reliance loss, expectation loss or sometimes specific performance of a contract. While in theory, orders effectively upholding the putative contract should be rarely granted, it appears that in most jurisdictions orders commonly protect expectation interests.²¹⁰ Over time estoppel moved from mere defensive shield, to ‘sword’,²¹¹ prompting some to argue that ‘courts are in fact awarding contractual damages’.²¹² As noted earlier, *culpa in contrahendo* imposes a wide range of obligations. Similarly, despite a general rule of thumb of reliance damages, orders upholding the putative contract have been awarded for *culpa in contrahendo*,²¹³ to prevent reliance on formality to deny a contract, to enforce terms anticipated by a party affected by non-disclosure,²¹⁴ to uphold preliminary contracts,²¹⁵ or to award expectation damages for negotiations ended in bad faith at a very late stage.²¹⁶

Thus estoppel and *culpa in contrahendo* at least partially compete with the CISG’s function of controlling the creation of contractual interests and protecting contractually created interests. However, there is no real competition where precontractual laws

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209. For convenience, ‘estoppel’ here refers to all forms of estoppel unless otherwise specified. Classifications and categories of estoppel abound in common law. For example, dichotomy between common law estoppel and equitable estoppel, the latter encompassing subcategories of promissory and proprietary estoppel, and estoppel by acquiescence: Patrick Parkinson, ‘Estoppel’ in Patrick Parkinson (ed), *The Principles of Equity* 216-24 (Thomson 2nd edn, 2003); Andrew Robertson, *Satisfying the Minimum Equity*, 20 Melbourne U. L. Rev. 805, 819 (1996). In the US promissory estoppel is treated as part of contract law, as a substitute for consideration: American Law Institute (‘ALI’), *Restatement (Second) of the Law of Contracts* s. 90 (ALI 1979); Edward Yorio and Steve Thel, *The Promissory Basis of Section 90*, 101 Yale L.J. 111, 112 (1991).
210. *Waltons Stores (Interstate) Ltd v. Maher* (1988) 164 CLR 387, High Court of Australia, 19 Feb. 1988 (‘Waltons Stores’). Observing that expectation damages are awarded in most cases: Robertson, above n. 209, at 328-36; Jeannie Paterson, Andrew Robertson and Peter Heffey, *Principles of Contract Law* 180 (Thomson 2nd edn, 2005). Likewise in the US a study demonstrated most courts award specific performance or expectation damages for promissory estoppel, despite the predominance of the reliance measure being ‘ingrained in the academic culture’: Yorio and Thel, above n. 209, at 132 et seq.; W. David Slawson, *The Role of Reliance in Contract Damages*, 76 Cornell L. Rev. 197 (1990).
211. *Central London Property Trust Ltd v. High Trees Ltd* (1947) 1 KB 130 (King’s Bench Division, UK, 18 Jul. 1946); *Hoffman v. Red Owl Stores, Inc.*, 26 Wis 2d 683, 133 NW 2d 267, Supreme Court Wisconsin, USA, 2 Mar. 1965.
212. Malik, above n. 83, at 45.
213. Kessler and Fine, above n. 21, at 405, 415-16; Hondius, above n. 22, at 28 (expectation damages not available in Israel or Italy).
214. Contractual interests can be upheld to rectify form, fraud, negligence or injustice: Kessler and Fine, above n. 21, at 405, 415-16.
215. Breach of preliminary agreements normally attracts expectation damages in civil law: Klein and Bachechi, above n. 19, at 18. For example, in French law ‘pre-contractual agreements are easily considered as being of contractual nature’: Hondius, above n. 22, at 16. See also above nn 83, 87.
216. Damages for termination of negotiations in bad faith in Dutch law can be awarded for expectation loss including lost profits under anticipated contracts: Hondius, above n. 22, at 22, 29; Hartkamp, above n. 88, at 557; Farnsworth, above n. 21, at 58. In French *délict*, damages for loss of a chance (*perte d’une chance*) may be awarded if realization of the chance was reasonably probable, causation can be proved and the damage has not been compensated: Hondius, above n. 22, at 29.

merely protect reliance interests 'as an alternative' to contract, since, if the CISG has the narrow scope suggested, then it provides no remedy without a contract.

To ensure interaction between the CISG and domestic law is abundantly clear, a very clear line should be precisely drawn. To achieve the clearest definition of interaction with domestic law, total disengagement between scope and pre-emption should not be advocated. Instead, it is suggested that the simplest dividing line is at the point of formation.²¹⁷ At this point, the CISG should be considered sufficient to perform the function of protection of both reliance and expectation interests. It is proposed that if pursuant to its formation provisions, a sales contract is found to exist, then the CISG should preclude recourse to domestic remedies for precontractual liability altogether (other than fraud), even if the CISG claim ultimately fails (e.g., for lack of Article 39 notice).²¹⁸ Concurrent liability in such cases would allow domestic precontractual protection to muddy the operation of the CISG upon matters clearly within its ambit, and should therefore be displaced where a contract is formed.

Likewise, if an offer is made but never accepted, then partial pre-emption of domestic precontractual law is advocated. It is submitted that laws protecting expectation but not reliance interests be displaced. Pre-emption of domestic expectation remedies in this situation is sensible, since the injured party is not left in limbo: it could look to the CISG for expectation losses by acceptance of the offer (even after purported but wrongful revocation), or rely on domestic law to recover reliance losses. It would be incongruous to enable such a party to use forms of domestic estoppel or *culpa in contrahendo* designed to protect expectation interests: access to domestic expectation damages or specific performance (however classified) should be pre-empted since, despite an offer being on the table, there are no contractual interests to be protected – at least not according to the CISG. To permit a 'second bite of the cherry' under domestic law would detract from the CISG's role in determining when contractual interests arise. The same holds for offers validly withdrawn in accordance with Article 16 CISG.

Yet if the CISG only protects interests created by the contract of sale,²¹⁹ then it may be a confusing step too far to pre-empt interests that are not created by that contract when, according to the CISG, no contract exists at all.²²⁰ Thus it is suggested that, to the extent that domestic precontractual laws simply protect reliance interests, they should not be displaced during negotiations. A party wishing to take advantage of

217. *Contra* Schroeter, above n. 90, Introduction to Arts 14-24, at 252 [63] (domestic law is pre-empted since the matter is governed by the CISG even if it does not provide liability for reliance or expectation losses, referring to Arts 15(2), 16(1), 19(2) and 21(2)); Schlechtriem, above n. 116, Art. 16, at 213-14; Schwenzer and Hachem, above n. 46, Art. 4, at 81-82 [18] (see above n. 121).

218. See also Ingeborg Schwenzer and Pascal Hachem, *The CISG - Successes and Pitfalls*, 57 Am. J. Comp. L. 457, 470 (2009).

219. See Schlechtriem, above n. 120, Art. 5, at 80-81 [12].

220. Analogous issues arise in relation to tort-contract overlaps. See Bridge, above n. 58, at 950-952, [16.77]-[16.81] (reservation about the CISG's ability to resolve overlap issues already existing in domestic law between contract and tort).

CISG remedies can accept the offer and create a contract.²²¹ While it is true this could enable the offeree to strategically ‘pressure the offeror into maintaining in force an offer that was revocable under the CISG’ thereby possibly distorting revocation rules in Article 16,²²² this is an insufficient justification for extending the pre-emptive force in circumstances where no CISG contract exists yet an offer remains open. It is likely that only a small proportion will actually take advantage of this strategic possibility.

Domestic precontractual reliance damages are far less strategically powerful than the full gamut of domestic precontractual remedies. Furthermore, without an election, there is a real possibility of an uncertain and confusing ‘limbo.’ Arguably, most will not perceive the need for acceptance and a notice or declaration under Articles 39, 71 or 72 until well after the appropriate period has passed, leaving them without remedy. This in turn creates a confusing vacuum for courts and tribunals trying to decipher the interaction between the two laws, and presents an indeterminate picture to those considering choices of law – a key efficiency concern. Pre-emption beyond that for which the CISG actually provides solutions arguably tilts the balance too far toward a greater ‘geographic’ effect at the cost of clarity.

It is submitted that the suggested course is justifiable because it facilitates mutually exclusive frameworks, a suitably precise dividing line, and ensures clarity within the CISG and in its interaction with residual law. The availability of domestic and CISG remedies are both made to hinge upon the same uniform formation provisions. It is contended that simplicity of scope will encourage choice of the CISG and thus maximize social welfare.²²³ The case for precision and simplicity is particularly strong in the case of precontractual liability, since expansion of the CISG into precontractual liability may bring broader structural instability and uncertainty, both compounding existing substantive concerns. Likewise, clarity of the timing and extent of displacement may help reduce uncertainty.

The above conclusion about the best path forward has the advantage of largely corresponding to most cases on point. In cases confirming the existence of a CISG contract, the trend has been against concurrency. The CISG has generally been considered to pre-empt *culpa in contrahendo* or estoppel, once a CISG contract is formed. In cases where no CISG contract is formed, the mutual exclusivity remains, and domestic pre-contractual law has generally been applied regardless of the existence of offers. A sample of cases will demonstrate the approach taken in practice.

[1] *Presence of a Sales Contract*

There are some cases where a CISG sales contract was held to exist on the basis of advanced negotiations. In some, usages or past practices played a part, so it is difficult

221. Schroeter, in *Schlechtriem & Schwenzer* 3rd edn, above n. 127, Art. 16, 302, at 310-11 [14] (sole avenue to remedies due to pre-emption of domestic *culpa in contrahendo* and estoppel).

222. Schlechtriem, above n. 116, Art. 16, at 213-14; Bridge, above n. 36, at 232 [11.04]. See also, Schwenzer and Hachem, above n. 46, Art. 4, at 81-82 [18]. *Contra* Malik, above n. 83, at 47 (advocating offeree choice between forcing the contract or pursuing domestic remedies).

223. See also Winship, above n. 25, at 629-30.

to establish whether negotiations alone would have led to the same result.²²⁴ However, it appears reliance on negotiations was the key in a Belgian case determined in the Hof van Beroep, Ghent.²²⁵ A signed letter of intent included a statement that it was not the final agreement and it was held that the parties intended to continue negotiations on some matters.²²⁶ Nonetheless, the court found a contract existed and that parties intended legal consequences by their conduct in advancing payment, creating the design, purchasing components and commencing prototype production. On that basis, in good faith, the parties could not deny the existence of the contract. The court stated parties 'can reach an agreement gradually as a consequence of a negotiation process in which offer and acceptance are not clearly distinguishable.'²²⁷ The result is consistent with the 'in support of contract' function being performed by the CISG by a broad interpretation of its formation provisions.²²⁸ As consideration is not required by the CISG, this function can normally be fulfilled adequately by interpretation of formation provisions, so the scope for general principles of estoppel within formation is limited.²²⁹ The court did not consider the possibility of domestic concurrency.

In the French *Bonaventure case*,²³⁰ the court awarded damages for conduct contrary to good faith in Article 7, on the basis the buyer's behaviour in commencing the lawsuit was an *abus de procedure* since the buyer itself was clearly 'at fault'. It might be said the court was applying a good faith interpretation of contractual enforcement. However, the more convincing analysis is that the court imposed positive obligations of good faith directly on the parties.²³¹ The result is inconsistent with the narrow scope suggested above, and instead creates an obligation arising 'outside the principal domain of interests created by contracts'.²³²

In a 1995 ICC case, a seller was held liable for failure to instruct the buyer on packaging requirements, but as a fundamental breach pursuant to the CISG, not domestic *culpa in contrahendo* for non-disclosure.²³³ It is contended that in such circumstances, where there is no 'fraud' and the representation (omission) relates to a

224. *W.T. GmbH v. P. AG*, Zivilgericht Kanton Basel-Stadt, Switzerland, P4 1991/238, 21 Dec. 1992, <http://cisgw3.law.pace.edu/cases/921221s1.html>. See Larry Di Matteo et al, *The Interpretive Turn in International Sales Law*, 34 *Nw. J. Int'l L. & Bus.* 299, 433 (2004).

225. Hof van Beroep (Court of Appeal), Ghent, Belgium, 15 May 2002, <http://cisgw3.law.pace.edu/cases/020515b1.html>.

226. *Ibid.*, at §6.6. Ultimately, the court held that the contract had been ended by mutual agreement of the parties.

227. *Ibid.*, at §6.1.

228. A German case similarly demonstrated the capacity for broad interpretation of CISG formation provisions in upholding a CISG contract. This was done on the basis of past dealings, negotiations, and buyer conduct in signing a contract form and accepting delivery, despite the non-applicability of Part II (Finland had made an Art. 92 declaration), the court stating 'other forms of consent are possible': Court of Appeal (OLG) München, Germany, 8 Mar. 1995, above n. 100. See Perales Viscasillas, above n. 138, at 263.

229. See above n. 76, at 131 and accompanying text regarding general principle of *venire contra factum proprium*. See also Bridge, above n. 58, at 938-940, [16.57]-[16.60].

230. *Bonaventure case*, above n. 66.

231. Schlechtriem, above n. 68, at 8 (court 'implemented an obligation to bear the costs of unsuccessful litigation').

232. Ferrari, above n. 61, at 104-5 (describing scope in terms of property damage).

233. ICC Award No 8128, Basel, 00.00.1995.

contractual obligation, the case falls squarely within the CISG's realm, provided a contract exists. Any pre-contractual obligations will normally 'spillover' into the subsequent contract once formed.²³⁴

In *Geneva Pharmaceuticals*, a court held that domestic estoppel 'in support of contract' was not pre-empted by the CISG, and in fact relied upon it in lieu of consideration under New Jersey law, which it characterized as a validity requirement.²³⁵ The court held that Article 16(2)(b) was limited to estoppel regarding proof of a firm offer, and, because the defendant had not argued that principles of reliance were relevant in determining CISG formation, held that domestic estoppel was not pre-empted.²³⁶ It is submitted this was an unduly narrow interpretation.²³⁷ Consideration is not required for CISG formation, and arguably should not have been reintroduced via the 'back door' of validity.²³⁸ Unfortunately, the absence of argument from the defendant had a notable impact on the quality of the judgment.²³⁹ Although it is not entirely clear, the court in summary judgment refused to strike out the claim for breach of a potential CISG contract formed with the support of domestic estoppel, but also refused to summarily strike out a completely separate potential domestic estoppel claim.

The decision appears to come dangerously close to the incongruity of using domestic estoppel to uphold a contract under domestic law should the CISG contractual claim fail, despite the existence of an Article 14 offer; that is, allowing a 'second bite of the cherry'.²⁴⁰ However, the decision was subsequently clarified in a related but often overlooked proceeding, which considered the latter action for domestic estoppel claim to reliance damages to be in the nature of an 'alternative to contract' estoppel only, for the protection of non-contractual reliance interests rather than seeking to uphold a contract under the guise of domestic law.²⁴¹ Other than reference to domestic estoppel as a matter of validity, the final decision ultimately accorded with the interpretation

234. As is the case with most domestic systems: *Hondius*, above n. 22, at 9-10, 30-1.

235. *Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories, Inc.*, 201 F Supp 2d 236, US District Court (SD NY), 10 May 2002, <http://cisgw3.law.pace.edu/cases/020510u1.html> ('*Geneva Pharmaceuticals* (2002)').

236. *Geneva Pharmaceuticals* (2002), above n. 235. Notably, the court contemplated potential pre-emption of reliance relief under estoppel: at n. 31.

237. See also Perales Viscasillas, above n. 138, at 263; Malik describes how, under common law interpretive rules, Art. 16(2) as a proviso to Art. 16(1) would be construed strictly, but given the compromise between common and civil law revocability positions contained within Art. 16, concludes strict interpretation is not appropriate: above n. 83, at 37-38. Schlechtriem supports an abuse of rights general principle derived from these provisions: above n. 78, Art. 24, at 278, n. 62.

238. See discussion by Bridge, above n. 58, at 938-940 [16.57]-[16.60], n. 127 (questioning whether estoppel is a validity question).

239. The court remitted the case for decision under domestic law: *Geneva Pharmaceuticals* (2002), above n. 235.

240. See also Joseph Lookofsky, 'CISG Case Commentary on Preemption in *Geneva Pharmaceuticals* and *Stawski*' (2004), <http://cisgw3.law.pace.edu/cisg/biblio/lookofsky8.html>.

241. *Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories Inc.*, 98 Civ. 861, 99 Civ. 3607, 2003 WL 1345136, US District Court, (SD NY), 19 Mar. 2003 ('*Geneva Pharmaceuticals* (2003)'). The application related to whether the plaintiff had a constitutional right to a jury trial. The former action was held to involve legal rights, while the latter action was equitable in nature. This was determinative of the right to a jury trial.

suggested above, because it posits a contractual claim under the CISG, but an alternative claim in domestic estoppel for reliance damages.

A Greek court held that domestic precontractual actions could ‘apply in parallel’ with CISG claims since ‘regulation of pre-contractual liability as a whole was excluded’ from the CISG.²⁴² The judgment refers to the competing view under Article 7(2), but does not enter into further discussion on the issue.

Two further US decisions have since upheld the concurrent availability of negligent or fraudulent misrepresentation as concurrent claims, even when the basis of the claim involves statements about the quality of the goods.²⁴³ Thus the US has ‘strictly kept to a formal distinction between contract and tort actions ... [to] advocate[] the availability of concurrent remedies’.²⁴⁴ The recent US case of *Electrocraft Arkansas v. Super Electric* stated that domestic negligence and unjust enrichment actions were displaced, but statutory claims for misrepresentation and tort of interference with business expectancy remained available.²⁴⁵

However, it has been noted that ‘no hard and fast rule can be applied’, and that the issue often turns on ‘the identity of the parties’ and ‘individual circumstances’.²⁴⁶ In *Pamesa Ceramica v. Yisrael Mendelson*, the Israeli Supreme Court considered that it followed that if the tort of negligence would have been open against the manufacturer of the goods, then it also had to be available concurrently with any remedies under the CISG where the manufacturer was also the seller.²⁴⁷ In an earlier German case the court held the tort claim became unavailable after the time for notice had expired.²⁴⁸

[2] Absence of a Sales Contract

Cases in which no CISG contract was formed consistently support the idea that domestic pre-contractual liability applies exclusively once it is determined that a CISG contract was not formed. In other words, they demonstrate that adjudicators view the

242. Multi-Member Court of First Instance of Athens, Greece, 5 May 1994, [2.2.14], <http://cisgw3.law.pace.edu/cases/094505gr.html>.

243. *Miami Valley Paper, LLC v. Lebbing Engineering & Consulting GmbH*, US District Court (SD Oh), 10 Oct. 2006, §B.1, <http://cisgw3.law.pace.edu/cases/061010u1.html> (‘Plaintiff argues that the CISG only preempts state contract law claims, and then only to the extent that such claims fall within [its] scope ... the Court finds Plaintiff’s argument well-taken. ... Therefore, the Court finds that the CISG does not prevent Plaintiff from pleading negligent misrepresentation and fraudulent inducement’); *Sky Cast, Inc. v. Global Direct Distribution, LLC*, US District Court (ED KY), 18 Mar. 2008, §C, <http://cisgw3.law.pace.edu/cases/080318u1.html> (‘negligent misrepresentation is a tort claim completely different from a claim for breach of contract. Being a tort claim, the court concludes that it is not controlled by the CISG’). See Hachem, above n. 119, at 22-23; Marco Torsello, Presentation, Global Challenges of International Sales Law Conference, 11-13 Nov. 2011, University of Florida, Gainesville, USA.

244. Hachem, above n. 119, at 27.

245. *Electrocraft Arkansas, Inc. v. Super Electric Motors, Ltd*, US District Court (ED Ark WD), 23 Dec. 2009, <http://cisgw3.law.pace.edu/cases/091223u1.html>; Hachem, above n. 119, at 23.

246. Hachem, above n. 119, at 25.

247. *Pamesa Ceramica v. Yisrael Mendelson Ltd*, Supreme Court, Israel, 17 Mar. 2009, [72]-[73], <http://cisgw3.law.pace.edu/cases/090317i5.html>.

248. Court of Appeal (OLG), Thüringen, Germany, 26 May 1998, <http://cisgw3.law.pace.edu/cases/980526g1.html>. See Hachem, above n. 119, at 23.

scope of the CISG as narrow, and mutually exclusive vis-à-vis domestic *culpa in contrahendo* and estoppel. However, contrary to the suggested approach, it is not always clear whether they limit the operation of domestic precontractual law to the function of providing reliance damages as an ‘alternative to contract’.

In a case determined by the OLG Frankfurt²⁴⁹ the buyer did not seek ‘conclusion of the contract based on promissory estoppel ... or the irrevocability of the offer ... but instead was seeking damages based on precontractual liability’.²⁵⁰ After deciding that a CISG contract did not arise because the buyer’s order amounted to a counter-offer pursuant to Article 19(1) thus rejecting the seller’s earlier offer, the court did not contemplate precontractual liability within the CISG itself. It instead turned to domestic *culpa in contrahendo*, and ultimately rejected the claim²⁵¹ in the absence of special fiduciary elements such as inducement to perform in advance or representation that the contractual conclusion was definite.²⁵² This approach accords with the proposed interpretation, since the court took a narrow view of the CISG’s scope, and determined that no CISG contract existed before contemplating the possibility of German *culpa in contrahendo*. It is submitted that, if it had been upheld, any domestic award should be limited to reliance damages alone.

In a 1997 Hungarian decision, the court treated estoppel as a matter for domestic law.²⁵³ A prior distribution contract had expired, and despite negotiations for extension, the court held no new contract had been created pursuant to CISG Article 19(3). It then rejected the domestic estoppel claim on the basis there had been no inducement to change position. Professor Perales Viscasillas notes the court did not consider whether formation provisions might be read more broadly pursuant to a general principle of estoppel.²⁵⁴ Whether the domestic estoppel claim was in the nature of an ‘alternative to contract’ claim for reliance relief is unclear,²⁵⁵ but the decision appears consistent with the strict scope argument in that, in the absence of a contract, no CISG liability arises and domestic law applies.

A Mexican court in *Kolmar Petrochemicals* discussed a duty of negotiation in good faith under the CISG, but ultimately did not need to decide the issue because no contract was concluded.²⁵⁶ It seems adherence to a narrow view of scope curbed the potential for more extreme views of good faith.

249. Court of Appeal (OLG) Frankfurt am Main, Germany, 4 Mar. 1994, <http://cisgw3.law.pace.edu/cases/940304g1.html>.

250. Perales Viscasillas, above n. 138, at 265.

251. Court of Appeal (OLG) Frankfurt am Main, Germany, 4 Mar. 1994, above n. 249.

252. *Ibid.* (referring to absence of *Vertrauenstatbestand* requirements).

253. *Vago’s Importers and Distributors Ltd. v. Monimpex Kereskedelmi Rt.*, Fovárosi Biróság [Metropolitan Court] Budapest, Hungary, 17 Jun. 1997 (CLOUT Abstract), <http://cisgw3.law.pace.edu/cases/970617h1.html>.

254. Perales Viscasillas, above n. 138, at 263, n. 16.

255. It is unclear from English abstracts whether the domestic estoppel claim in the Hungarian case on estoppel was a claim for performance, expectation or reliance damages: above n. 253. See also UNILEX Abstract, www.unilex.info.

256. *Kolmar Petrochemicals Americas Inc. v. Idesa Petroquímica Sociedad Anonima de Capital Variable*, Primer Tribunal Colegiado en Materia Civil del Primer Circuito [First Circuit Court, 1st Cir], Mexico, 10 Mar. 2005, <http://www.cisg.law.pace.edu/cases/050310m1.html>. See also

Most of the above cases are consistent with the suggested approach. All followed the pattern of first deciding whether or not a CISG sales contract has arisen initially on the basis of the CISG formation provisions alone. All saw CISG and domestic precontractual law as mutually exclusive, with formation as the dichotomous line in the sand. Only the *Bonaventure case* appears to take the CISG's scope beyond contractual issues. In cases where no CISG sales contract arose, the CISG was not considered to displace domestic law, despite the existence of an offer. In accordance with the suggested approach, in the *Geneva Pharmaceuticals case* ultimately only reliance-style estoppel was held applicable. However, in other cases various tort/delictual actions were held to be available concurrently.

It is submitted that such non-contractual actions should not be available *concurrently*, but instead should only arise where a contract has not been formed where the basis of the claim involves an essentially contractual interest, such as statements relating to the quality of the goods. If a contract has been formed, such actions should be considered displaced, even if the CISG claim ultimately fails. Furthermore, it is submitted that where a CISG offer is on the table, parties be required to elect between acceptance of the offer and CISG remedies on the one hand, or to elect non-acceptance of the offer and domestic actions protective only of *reliance* interests on the other. In this way, the clarity of interaction between the CISG and domestic law is heightened. As observed in Chapter 4, the predictability of the CISG's interaction between domestic law is of legitimate substantive concern to practitioners making choices of law. Thus it is submitted that complete disengagement between the CISG's scope and its displacement effect is too extreme and should be rejected in favour of the above approach, which provides a brighter line of delineation based on the nature of interests protected.

The suggested path clearly contradicts the broad scope favoured by the minority, and accords with the majority view, at least in relation to the preference for a narrow scope. Given that precontractual good faith could still go in either direction, a choice presently exists. It is submitted that if both expansion and confinement of scope are open as doctrinal possibilities, the majority view should be preferred on economic grounds. However, it remains to be seen whether all four schools of thought are indeed doctrinally open.

§9.05 INSIDE OUT: DOCTRINAL VIABILITY OF MINORITY AND MAJORITY POSITIONS

It is easy to allow the natural allure of greater quantitative harmonization to overshadow a fundamental point. The internal interpretive rules contained within Article 7(2) affect only matters 'governed' by the CISG.²⁵⁷ For matters it does not govern—that is, external gaps—the use of general principles is not sanctioned by Article 7(2). Instead, for external gaps, recourse to domestic law is not only permissible, 'but even

Alejandro Osuna González '*Kolmar Petrochemicals v. Grupo Idesa*' (July 2006), <http://www.cisg.law.pace.edu/cisg/biblio/osuna1.html>.
257. Lookofsky, *Tightrope*, above n. 13, at 89.

obligatory'.²⁵⁸ For this reason, it is submitted that it would be doctrinally incorrect to utilize general principles to determine whether an issue is in fact an external gap.

The sticking point is that the CISG is not an exhaustive code. It represents an intermediate model, whereby uniform rules are balanced against domestic law.²⁵⁹ It is not monolithic or fully self-contained.²⁶⁰ The CISG takes a hybrid rather than 'true code approach'.²⁶¹ Domestic rules are preempted, but only in relation to matters within the CISG's scope of application, and even then, arguably only to the extent solutions can be found within the CISG.²⁶² The latter is in fact a point of difference between the approach advocated above and Schlechtriem's view.

Regardless of the reasonableness of the forms of liability proposed by the first group, the allure seems to have had its effect. In assuming that precontractual issues are internal to the CISG without first analysing whether this is the case, the first group treats the CISG as an all-encompassing code. The use of general principles or analogy to interpret scope ignores the internal interpretive limits of Article 7(2) by allowing the use of general principles to expand the CISG's scope to capture external gaps, almost by stealth. Such an approach assumes that anything within the potential reach of internal interpretive methods is, by definition, internal to the CISG, regardless of scope. The result is a silent pre-emption by expansion. The second group openly acknowledges that scope is an issue and advocates an overt pre-emption by expansion. While Bonell's approach is consistent with preference for greater formal uniformity, his premise is essentially that because precontractual issues *might* be governed by the CISG, they should be. Thus internal interpretive techniques are used to demonstrate the feasibility of their internality rather than policy arguments.

The third and fourth groups both begin with the premise that precontractual liability is external to the CISG. The final group lacks a developed normative rationale. There is little by way of discussion about why historical stability should take precedence over evolutionary imperatives. In the current context, where matters can be internal even if not expressly dealt with, it is contended absence of an express provision alone cannot be sufficient: Article 7(2).²⁶³ The best justifications are offered by the third group. Schlechtriem refers to structural integrity, comparative function and historical

258. See above n. 13 and accompanying text.

259. De Ly, above n. 119, at 2-3, 7-8. See also Stefan Kröll, *Selected Problems Concerning the CISG's Scope of Application*, 25 J.L. & Com. 39, 39 (2005) (CISG is 'not a comprehensive code'); Marco Torsello, *Substantive and Jurisdictional Aspects of International Contract Remedies*, 25 Int'l Rev. L. & Econ. 397, 400 (2005) (disclaiming notions the CISG 'aim[s] at entirely displacing domestic rules governing an international sale of goods').

260. See De Ly, above n. 119, at 1, 3 (the CISG 'interacts and leaves room for rules from other origins').

261. Mindful of the criticisms of ULIS as a 'code', rather than a 'true code' or 'meta-code' approach, CISG drafters deliberately sought a combined approach in Art. 7(2): Ferrari, above n. 6, at 215, 218-20. Where no general principle can be found 'one not only is allowed to make recourse to the rules of private international law: one is obliged to do so': at 228.

262. See Joseph Lookofsky, *Impediments and Hardship in International Sales*, 25 Int'l Rev. L. & Econ. 434, 442 (2005) (perceiving pre-emption problems where the [CISG] does not 'clearly govern' an issue).

263. See also Bridge, above n. 58, at 932 [16.46] ('the existence of gaps within the Convention ... deprives of any great significance the silence of the Convention on a matter than might be seen as lying either at the outer limits of sale or beyond').

fidelity, but does not contemplate economic effects. Nevertheless, his warnings of the ‘danger’²⁶⁴ of precontractual expansion appear motivated by concern for the quality of uniformity.²⁶⁵ While not offering the same detail, Honnold most succinctly refers to the underlying tensions. He comments that lack of clarity about the CISG’s external borders can engender doubt about its entire content, encourage a lack of detailed reasoning by courts and tribunals, and give the impression of uncertainty. Therefore, he ultimately advocates a strict approach for outer boundaries as the ‘sharp edges’.²⁶⁶

At the very least, it is submitted that there needs to be more than a mere presumption that an issue is either external or internal. Classification should address scope directly, and consider policy issues and effects, certainly before application of internal interpretive techniques or alternatively, domestic law. Otherwise, the CISG’s scope is silently broadened or narrowed without disciplined regard for the consequences. The first group subordinates scope to internal interpretation, and broadening of scope is seen as nothing more than an incidental by-product of internal interpretive potential, while the last group bases a narrow scope on fragile historical or comparative grounds. Neither group provides a deeper understanding of the normative underpinning for the often unspoken presumption. For this reason, it is contended that irrespective of whether one agrees with their final conclusions, the *methods* of the first and last groups are unsatisfactory. By contrast, the methods of the other groups at least demonstrate a willingness to engage with policy to varying degrees, although it is contended attention to the economic aims of the CISG brings a useful policy perspective.

The prediction of uncertainty through expansion and the lack of detailed reasoning as to what constitutes an external gap seems to have resonated in practice. Professor Kröll points out that in most cases concerned with scope ‘no detailed reasoning is given why certain issues fall within or outside the scope of application of the CISG’.²⁶⁷ For the matter of scope to be settled with requisite certainty, it must be the CISG which ‘itself determines just how much intrusion by domestic law it is willing to tolerate’.²⁶⁸

It is submitted that it is not doctrinally open to treat the issue of internal-external classification as one in which the *mere possibility* of inclusion by means of internal interpretive technique is enough to justify internality. That approach treats the CISG as an all-encompassing code, which it is not. It is sometimes difficult to draw a line between creating new obligations and ‘concretizing’ existing ones,²⁶⁹ but arguably,

264. See above n. 136.

265. Schlechtriem, above n. 45, Art. 7, at 103 [29] (‘if the principles discernible are too vague to allow rules on specific issues’ then the matters fall outside the CISG’s scope). See also Schwenger and Hachem, above n. 46, Art. 7, at 135 [30]; Kritzer, above n. 75 (the CISG can ‘only be artificially’ made to apply to precontractual fact patterns).

266. Honnold, above n. 40, Art. 7, at 150 [103.1]. On sphere of application, Honnold says that ‘precise drafting and strict construction are useful’, otherwise ‘doubt about the applicability of the [CISG] produces uncertainty as to all of the problems governed by the [CISG]’: Honnold, above n. 40, Art. 3, at 71 [65].

267. Kröll, above n. 259, at 56.

268. Hachem above n. 119, at 24.

269. See Schwenger and Hachem, above n. 46, Art. 7, at 128-29 [18]-[19].

neither Article 7(1) or (2) give a mandate to create new obligations. In fact, Article 7(2) clearly confines itself to ‘matters governed by [the CISG]’. Thus internality is a precondition to its application.²⁷⁰ Those who fail to engage in any preliminary reckoning with scope arguably predispose the CISG to being unduly stretched beyond its scope.²⁷¹ By employing analogy and general principles to flesh out the possibility of CISG precontractual liability without first addressing its scope, they risk the impermissible application of internal interpretive methods to an external gap.

Naturally, the ability of the CISG to reach an issue is not irrelevant – it cannot cover that which it is unable to reach. However, reach is a doctrinal hurdle, not normative justification. The quality of the coverage and the effect of potential expansion on the achievement of the CISG’s economic norms, it is submitted, should be of far more importance in deciding the question of internal-external classification. To instead allow the hurdle to control the scope of the CISG is to confuse the role of internal interpretive methods, and to allow good faith to expand a non-exhaustive code to capture new ground. It is suggested that such a path would be highly destructive to the CISG’s economic aims. Unless we are prepared to view Article 7(1) as a general clause in the civil tradition,²⁷² fully cognizant of what this would mean for the future of the CISG as an attractive choice of law, we should be careful to separate the role of internal interpretive methodology from determination of scope.

It is thus contended that, for issues on the borderline of the CISG’s coverage, the internal-external classification should be treated as a preliminary step, in which the norm underlying the CISG of improved efficiency is a useful guide. This would require an examination of whether the CISG’s efficiency aims are advanced or hampered by coverage of a particular issue, before application of internal interpretive methods. It is proposed that promotion of efficiency should act as an underlying norm – a general principle of the CISG. Unlike other general principles,²⁷³ as the very reason for existence of the CISG and its acceptance into national law, the norm of promotion of efficiency can and should transcend its boundaries to help shape its outer limits.

270. See Bonell, above n. 7, Art. 7, at 75 [2.3.1]; Ferrari, above n. 259, at 21; Ferrari, above n. 7, at 158.

271. See also Honnold, above n. 40, Art. 3, at 71 [65] (cautioning against ‘doubtful interpretations’ that would extend the CISG’s scope by application of general principles and analogical extension to expand the CISG to areas that it does not ‘govern’); Lookofsky, *Tightrope*, above n. 13, at 103; Ferrari, above n. 6, at 214-15 (concern good faith as a general principle risks imposing ‘additional obligations of a positive character’ upon parties); see also Lookofsky, *Tightrope*, above n. 13, at 103 (general concern over covert techniques to expansively interpret CISG).

272. Analogously, civil lawyers have criticized the evolution of domestic good faith from original ‘deminimis’ gap filler to source of new laws that can expand pre-existing legislation, creating new causes of action: Ebke and Steinhauer, above n. 69, at 171-77, 190 (German good faith grew from ‘little more than a legislative acorn’ to the rise of ‘positive *Vertragsverletzung*’ or breach of contract, unknown to German law prior to 1907, and its function as a judicial lawmaking basis signals German courts are more openly creative); Hesselink, above n. 69, at 122 (good faith as ‘mouthpiece’ for new law); Schlechtriem, above n. 68, at 6-12 (good faith, embodied in §242 BGB, enabled German courts to ‘overrid[e] the text and meaning of special provisions’).

273. See also Bridge, above n. 58, at 938-940, [16.57]-[16.60] (‘avoidance of waste or economic loss’ as a general principle).

It is submitted generally that the CISG should not be shackled to its past; rather, it should evolve where appropriate. When more than one doctrinally open development is possible, it is contended that the appropriateness of each development should be assessed on grounds including consideration of the aims of the CISG and how each direction might affect their attainment. In other words, the question that might validly be asked, particularly for internal-external classification, is which has more economic merit, including potential effects on exclusions. In this way, development of the CISG can be guided by its aims, particularly for issues on the borderland.

It is submitted that a narrow scope should apply in relation to precontractual liability for the CISG. Arguably, greater uncertainty must also follow if the CISG's structure is extended beyond its natural shape in order to capture pre-contractual liability by overstretching its borders.²⁷⁴ It is submitted this would seriously undermine the quality of substantive uniformity and, on balance adds to transaction costs, particularly those that may affect choices of law and ultimately, the level of overall efficiency achieved by the CISG. A narrow scope with clear delineation achieves the best trade-off of values, and supports an efficient level of reliance investment in the context of international sales, as discussed above in §9.04. This conclusion is supported by the view that expansive interpretations of good faith within the CISG are a 'scary' prospect for lawyers, particularly interpretations that might facilitate an effective re-writing of the contractual obligations.²⁷⁵ It is submitted that a majoritarian approach to interpreting good faith would reject more radical constructions in favour of clearer and more predictable substantive outcomes.

A narrow scope is accordingly justified on economic grounds. Thus it is contended that the CISG should not deal with precontractual liability at all, but should pre-empt domestic law to the extent that it provides remedies designed to protect interests relating to the quality of the goods, at least in circumstances where a contract has been formed. Additionally, bright lines were proposed for the pre-emptive interaction between domestic law and the CISG to provide clarity and certainty at the border between contractual and other obligations. It is contended this best enhances predictability and, in turn, maximizes exchange gains and social welfare.

§9.06 CONCLUSION

Precontractual liability is just one example of how resort to economic analysis might assist in bringing interpretation closer to the norms underlying the CISG. It was concluded in this chapter that generally, the best approach is to consider scope as a preliminary matter, before application of internal interpretive methods, and to first openly question whether any borderline issues are internal or external to the CISG's scope. In answering this question, it was concluded that economic indicators should carry significant weight, and internal interpretive techniques should be held in check

274. See also Magnus, *General Principles*, above n. 9, at §4a; Ferrari, above n. 6, at 215; Honnold, above n. 40, Art. 7, at 150 [103.1]; Lookofsky, *Tightrope*, above n. 13, at 103.

275. Discussed by Francesco Mazzotta, Presentation, Global Challenges of International Sales Law Conference, 11-13 Nov. 2011, University of Florida, Gainesville, USA. See also, above n. 198.

until it is determined that the proposed expansion is likely to enhance efficiency rather than detract from it. At the borders of the CISG, it was contended that economic arguments are a normative tool that can validly guide its development in a manner which is entirely appropriate when it is remembered that the genesis of the CISG was to enhance efficiency of global trade.

Drawing from the analysis in previous chapters, the potential for precontractual liability within the CISG was rejected. On balance, it was concluded that any efficiency gains from greater formal coverage of new territory by the CISG would be far outweighed by the detriment to the quality of uniformity entailed – the clarity and predictability of its substantive content, as well as flow on effects for non-substantive efficiency. In particular, it was concluded the lack of legislative provisions upon which to base such obligations would heighten unpredictability when assessed by parties at the drafting stage, at which time the choice of law is often made. Such parties were also more likely to acutely perceive the disadvantages of expansion than its benefits. Thus a narrow and more certain scope would best serve the needs of potential CISG users who value substantive over formal uniformity at a stage when they are still able to adjust price, risk and insurance. Arguably, this approach ensures both better substantive efficiency and lower exclusion rates.

After all, the perception of contracting parties, rather than theoretical doctrinal potential, is critical to the rate at which the CISG is utilized, which in turn largely determines the level of suboptimal exclusion due to collective action problems, and the extent to which network effects are unlocked. These in turn determine maximization of social welfare through optimal use of a generally efficient default law. While the idea of a ‘one-stop shop’ may seem attractive to scholars in theory, if parties at the drafting stage perceive the scope of the CISG as poorly defined, or are unsure of its likely interaction with domestic laws, they will be more inclined to exclude it. The greater this uncertainty, the more ‘repugnant’²⁷⁶ it will be to potential users. Should this occur, the expansion, for all its theoretical attraction, will do more harm than good to the aim of the CISG to improve efficiency.

Thus, the ability of the contracting parties to exclude the CISG should impose a certain pragmatic extrinsic discipline on its development. There may well be a broad role for good faith within the CISG. Indeed, flexible developments in good faith might enhance its attractiveness as a choice of law. Accordingly it is submitted more generally that if more than one outcome is doctrinally feasible, we should develop the CISG in a way that minimizes exclusions, in order to maximize harmonization in practice. Ultimately, however, it was concluded that use of internal interpretive methods to expand the CISG on the basis of a mere presumption of internality was not doctrinally feasible.

It was contended that efficiency trade-offs can provide normative guidance for the CISG’s development, particularly for internal-external classifications regarding the CISG’s scope, where the use of internal interpretive methods alone is doctrinally insufficient and brings the risk of expansion bias. At the time they make their choice of

276. Bridge, above n. 48, at 163.

law decisions, if parties are inclined to value *ex ante* certainty over *ex post* fairness and *ex ante* savings at the negotiation stage, development of precontractual good faith to expand scope should be restricted if the CISG's goals are to be achieved.

That said, economic analysis might not always favour restriction of potential developments. Chapter 10 deals with a different interpretive issue, that of exclusion by waiver during litigation.

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CHAPTER 10

Exclusion by Conduct of Legal Proceedings

§10.01 INTRODUCTION

This chapter takes the 'lessons learned' from the earlier analysis of CISG efficiency and exclusions, and applies them to an aspect of interpretation, in order to guide the CISG's development in a manner sensitive to the aim of economic efficiency. In particular, it considers the issue of tacit waiver during legal proceedings, and the interrelationship between the CISG and procedural principle of *iura novit curia*. It will be submitted that there is a growing number of cases in which the CISG was clearly the applicable law *ipso iure*, yet the court or tribunal concerned has declined to apply it, simply because counsel failed to mention the CISG.¹ This chapter examines the relevant interpretive issues involved, and addresses them in light of their impact upon suboptimal *ex ante* exclusions and other relevant economic concerns. Thus, like Chapter 9, this chapter adopts a doctrinal approach, but aims to feedback into the interpretive process matters raised earlier to reconcile CISG interpretations with their impact upon efficiency in trade.

§10.02 THE PROBLEM, TRADITIONAL SOLUTION AND *IURA NOVIT CURIA*

[A] The Typical Situation

The problem of tacit waiver of the CISG during litigation can be best described by way of example. Two parties enter a contract to which the CISG clearly applies, as parties have their respective businesses in two different countries that have adopted the CISG,² and have not included a choice of law clause. Sometime later, a dispute arises. Counsel

1. All websites were accessed 28 Feb. 2014, unless otherwise stated.

2. CISG Art. 1(1)(a).

for each side present the case as if domestic sales law governs, and fail to mention the CISG.

There are many examples of this in practice. In a 2008 Chilean case,³ parties failed to plead or argue the applicable law of the CISG until appeal.⁴ In an Austrian case,⁵ both parties ignored the applicable CISG, and the court assumed domestic law applied. Only on appeal was the CISG considered.⁶ In three Slovak cases, the court simply overlooked the CISG and incorrectly applied the Slovak Commercial Code.⁷ In one Australian case, the CISG was completely overlooked both in argument and in the judgment, an oversight not fully corrected upon appeal.⁸ The failure to raise the CISG until too late in the trial hearing in the US case of *GPL Treatment* precluded its application and almost cost the plaintiff the case.⁹ Even in China, which has a converse record of applying the CISG in situations when it is inapplicable,¹⁰ there is at least one case where neither side argued the CISG and the court failed to mention it despite its applicability.¹¹

On the other hand, polar opposite cases also exist. In some decisions the CISG was applied regardless of the fact that counsel either did not present argument on the CISG at all, or barely mentioned it.¹²

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3. *Industrias Magromer Cueros y Pielas SA v. Sociedad Agrícola Sacor Limitada*, Corte Suprema, Chile, 22 Sep. 2008, <http://cisgw3.law.pace.edu/cases/080922ch.html>.
 4. *Industrias Magromer case*, above n. 3. The CISG was only argued in the Court of Appeal and Supreme Court: Jorge Oviedo-Albán, *Exclusión tácita de la ley aplicable e indemnización de perjuicios por incumplimiento de un contrato de compraventa internacional*, 14 *International Law, Revista Colombiana de Derecho Internacional* at 191, 194, 195 (2009) (arguing decision was incorrect).
 5. Supreme Court, Austria, 2 Apr. 2009, <http://cisgw3.law.pace.edu/cases/090402a3.html>.
 6. District Court(LG) Steyr, Austria, GZ 4 Cg 146/05m-45, 29 Jan. 2008. At first instance, both parties and the court referred to domestic law including Art. 922 Austrian General Civil Code (ABGB), then in Court of Appeal (OLG) Linz, Austria, GZ 3 R 46/08t-49, 25 Jul. 2008, the court applied CISG. In the see Supreme Court, 2 Apr. 2009, above n. 5, exclusion of CISG was upheld on basis of original choice of law and conduct of the case at first instance, stating infringement of § 182a ZPO by OLG in rendering surprise judgment.
 7. Regional Court, Nitra, Slovak Republic, 15 Oct. 2008, <http://www.cisg.sk/en/15cob-140-2008.html>; Supreme Court, Slovak Republic, 26 Oct. 2006, <http://www.cisg.sk/en/3obo-247-2005.html>; Supreme Court, Slovak Republic, 28 Feb. 2001, <http://www.cisg.sk/en/2cdo-114-2000.html> (translation by Juraj Kotrusz).
 8. *Italian Imported Foods Pty Ltd v. Pucci Srl*, New South Wales Supreme Court, Australia, 13 Oct. 2006, <http://cisgw3.law.pace.edu/cases/061013a2.html> ('*Italian Imported Foods*').
 9. *GPL Treatment v. Louisiana-Pacific Corp.*, 894 P 2d 470, Oregon Court of Appeal, 12 Apr. 1995; aff'd 914 P 2d 682, Supreme Court of Oregon, USA, 11 Apr. 1996, <http://cisgw3.law.pace.edu/cases/950412u1.html> ('*GPL Treatment*'); William S. Dodge, *Teaching the CISG in Contracts*, 50 *J. Legal Educ.* 72, 74 (2000); John O. Honnold, in Harry M. Flechtner (ed), *Uniform Law for International Sales under the 1980 United Nations Convention* Art. 11, 180 [127] (Kluwer 4th edn, 2009); Franco Ferrari, *Applicability and Applications of the Vienna Sales Convention (CISG)*, 4 *Int'l Legal Forum* 138, 220, n. 742 (1998).
 10. Yongping Xiao and Weidi Long, *Selected Topics on the Application of the CISG in China*, 20 *Pace Int'l L. Rev.* 61, 70 (2008), <http://www.cisg.law.pace.edu/cisg/biblio/xiao-long.html>.
 11. *Gammatex International Srl v. Shanghai Eastern Crocodile Apparels Co. Ltd.*, Shanghai First Intermediate People's Court, China, 21 Aug. 2002, <http://cisgw3.law.pace.edu/cases/020821c1.html>; *ibid.*, at 71. See also Appellate Court (OLG) Naumburg, 13 Feb. 2013, <http://cisgw3.law.pace.edu/cases/120213g1.html>.
 12. Tribunale di Vigevano, Italy, 12 Jul. 2000, <http://cisgw3.law.pace.edu/cases/000712i3.html>; Court of Appeal (OLG) Hamm, Germany, 9 Jun. 1995, §§ I and II, <http://cisgw3.law.pace.edu/>

In many instances, the court or tribunal may simply fail to appreciate that the CISG governs the matter. But what if the adjudicator *does* realize argument has been exclusively presented on the basis of the wrong law?

[B] Normative Lessons Learned

The situation described in the above example evokes some of the issues discussed in earlier chapters of this book. It is submitted that when two legitimate doctrinal solutions exist, the one which best addresses economic concerns is the better interpretation, particularly given the CISG's underlying aim of improving economic efficiency.

In Chapter 6, a strong link was demonstrated between a specific form of information costs – litigation exposure – and exclusion rates. In Chapter 7, it was concluded that information asymmetry in the lawyer-client relationship could lead to inefficient choices of law for sales contracts due to moral hazard and associated *status quo* bias or path dependence and satisficing behaviour. It follows that presenting a case within litigation on the basis of domestic sales law rather than the CISG will sometimes be detrimental for clients in terms of the outcome, since advantageous arguments might have been forgone. Like their 'front end' counterparts, litigation counsel face information costs when unfamiliar with the CISG. Thus a similar moral hazard exists at the litigious stage, and we can expect a similar lawyer disinclination to investment in familiarity or failure (sometimes due to unfamiliarity) to perceive any strategic benefit of investment for their client. In other cases, complete lack of awareness of the CISG may, like *ex ante* exclusions, cause 'blind' failures to present argument on the CISG. In both cases, it is submitted that the failure is strongly related to unfamiliarity, which itself leads to path dependence (as discussed in Chapter 7). It is submitted that both behaviours can be found amongst the cases described in this chapter, where unfamiliarity led to the CISG being (consciously or unconsciously) overlooked by counsel. The question is, what should the court or tribunal do about it?

In addition to doctrinal justifications, which will be discussed below, there may be a social welfare argument in favour of the bench insisting that argument be presented on the basis of the applicable law, and hence requiring lawyers to incur information costs, even if they cannot recover all such costs from the litigants. Ethically, lawyers should be aware of the law of their jurisdiction (including the CISG), and requiring them to invest in this would simply demand counsel meet their professional responsibilities. Economically, future clients of those lawyers will benefit from their greater level of skill, and society as a whole will benefit from greater expertise within the profession.

cases/950609g1.html; District Court (LG) Landshut, Germany, 5 Apr. 1995, <http://cisgw3.pace.edu/cases/950405g1.html>; District Court (LG) Saarbrücken, Germany, 1 Jun. 2004, [1], <http://cisgw3.law.pace.edu/cases/040601g1.html>; Marco Torsello, 'Italy' in Franco Ferrari (ed), *The CISG and Its Impact on National Legal Systems* 187, 191–95, 209, nn 20, 22 (Sellier 2008); Oviedo-Albán, above n. 4, at 204; Franco Ferrari, 'CISG Rules on Exclusion and Derogation' in Franco Ferrari, Harry M. Flechtner and Ronald A. Brand (eds), *The Draft UNCITRAL Digest and Beyond* 114, 131 (Sellier 2004) ('*Digest and Beyond*').

However, it is submitted the benefits are much more complex and significant than this immediate marginal effect. Earlier, it was concluded that the CISG is an efficient law, but is presently suboptimally excluded in *ex ante* contractual choices of law, and that this, in turn, reduces the potential for network effects and a range of non-substantive efficiencies including maximized social welfare in various respects. Given the link between litigation exposure, learning effects and exclusion rates, what a tribunal decides to do in the situation described above may affect the frequency of suboptimal exclusions because it alters how many CISG cases exist within the jurisdiction concerned. In Chapter 6, litigation exposure as a measure of information cost was shown to be significant. In Chapter 8, it was suggested that litigation exposure may be even more influential still, due to ‘vicious circles’ involving litigation frequency and education exposures. The predominant role of unfamiliarity and information costs in exclusion, and it is submitted specifically, *in suboptimal exclusions*, is key. Effectively, it was concluded earlier that low litigation exposure contributes to *status quo* bias in high exclusion jurisdictions which, as was concluded in Chapter 7, underpins presently suboptimal choices of law. To a much lesser extent, the same processes may contribute to absence of choice altogether (see Chapter 8).

Therefore, ironically, the situation presented above demonstrates one way in which what happens at the *ex post* litigation stage can affect the efficiency of choices of law at the *ex ante* stage. It can be expected that, if courts were to insist upon application of the CISG in the situation described, CISG case numbers would increase in the jurisdiction concerned; litigation exposure would increase, learning effects would be maximized, suboptimal exclusions would become less common, and network effects would be enhanced. From this, we can draw a valuable lesson for this chapter: interpretation in favour of application of the CISG (where it is the applicable law) at the insistence of the bench, will probably maximize social welfare interpretation by comparison with an interpretation which effectively treats application of the CISG as ‘optional’ or discretionary. Thus if both interpretations are doctrinally open, the former should be preferred in order to further the CISG’s aim of improving efficiency.

What is suggested therefore is that the effect of litigation exposure and existence of *status quo* bias support the notion of a default rule constructed in a way that encourages correction of the suboptimal tendency to deviate from the applicable law.

Whilst an approach making a default rule ‘quasi-immutable’ might be thought to amount to a penalty default rule, the contrary can be argued. To the extent such a rule reduces moral hazard for client litigants, or creates other efficiency gains at the litigation stage for parties (as will be discussed below), the quality of semi-immutability might actually be desirable from the *ex ante* perspective of most parties, at least before the subsequent course of factual events leads to later ‘regret’ at the litigation stage.¹³ In other words, semi-immutability might in fact be majoritarian,¹⁴

13. See Ch. 5, n. 29 and accompanying text.

14. Russell Korobkin, ‘Behavioral Economics, Contract Formation, and Contract Law’ in Cass R. Sunstein (ed), *Behavioral Law and Economics* 116, 139-40 (Cambridge 2000) (to craft a majoritarian untailored default rule, one should imagine a ‘counterfactual world’ free of defaults, to predict terms parties are most likely to agree upon, although such an approach is error prone).

given that *ex ante* most parties would probably favour it if the decision were made in the knowledge of potential *ex post* moral hazard and its effects at the litigation stage, and other expected *ex post* efficiency gains (discussed below). Effectively, it is suggested that parties would favour a solution that reduces the potential *status quo* bias and disadvantage due to lawyer incompetence. Thus, far from a simple assertion of a presumption in favour of the CISG's application on doctrinal grounds,¹⁵ it is submitted that there are valid economic reasons for the treatment of the CISG as a semi-immutable default rule, from the perspective of the parties and wider social welfare considerations.

It is apparent from this discussion that the present chapter relates to the *ex ante* exclusion factors of familiarity and information costs (litigation exposure and its implications for education). However, it also relates to another exclusion factor, namely substantive concerns. It will be recalled that there were empirical indications that judicial application was of concern in exclusions,¹⁶ and also that uncertainty in application was a point of criticism in relation to the merits of the CISG as a choice of law.¹⁷ Although it was contended that such perspectives tended to be tainted by unfamiliarity, and that many materials and cases were now available, it was also conceded that these concerns held some validity insofar as they related to the homeward trend and interaction between the CISG and domestic law in certain marginal respects (see Chapter 5). However, in Chapter 7, it was concluded that substantive concerns, whilst presently significant in *ex ante* exclusion decisions, would become much more influential in future. Hence another valuable lesson arises from reasons for exclusion. It is submitted that where one doctrinal approach potentially leads to variant outcomes in practice but another is likely to lead to greater consistency in the practical application of uniform law, the latter should be preferred. In developing a better doctrinal approach, close attention should be paid to improving consistency in judicial application and greater certainty, so as to address perceived substantive concerns. As will be discussed, this is presently problematic in relation to tacit waiver.

Thus the new interpretive approach in this chapter paradoxically looks at *ex post* exclusions or waivers during litigation as a means of altering *ex ante* exclusions and maximizing social welfare. However, it also attempts to design a rule that creates *ex post* efficiency gains for litigant parties themselves, and to reduce *ex post* societal costs inherent in wastage of judicial resources. And while the justifications presented in this section relate to economic grounds, this chapter more broadly aims to improve the qualitative nature of the CISG's substantive legal rules per se, so that suggested interpretations can be simultaneously justified on a purely doctrinal basis.

15. The tendency to favour expansion of the CISG by a presumption of application without supporting economic indicators has been criticized as creating a potentially inefficient expansion bias: Steven Walt, *The CISG's Expansion Bias*, 25 Int'l Rev. L. & Econ. 342, 349 (2005).

16. Chapter 6, text accompanying n. 117, 8th comment.

17. See Ch. 5.

[C] The Traditional Solution

Thus it is necessary to now review the situation once again from a doctrinal perspective. The typical situation illustrated in the example seems to lead to the question as to which law the court or tribunal should apply; the law argued for, the applicable law?

The resolution traditionally advanced by scholars is that the procedural law of the forum determines which law is to be applied where neither side has presented argument on the law that is applicable *ipso iure*. Pursuant to the traditional view, the course which a court must take is determined by the procedural law of the forum, and specifically, whether it follows the principle of *iura novit curia* (the court knows the law).¹⁸

Naturally, since procedural rules vary, the traditional view has the potential to foster divergent outcomes. Depending on whether or not the forum follows the principle of *iura novit curia*, the court may be obliged to apply the applicable law, irrespective of whether parties have invoked it, have discretion in regard to application, or conversely, may be prohibited from applying it at all.¹⁹

It is submitted that the traditional approach has indeed influenced decisions in practice. The procedural principle of *iura novit curia* has been explicitly relied upon in a number of cases to justify application of the CISG in cases where counsel did not plead it.²⁰ Similarly, in one case where the CISG was not applied, criticism was levelled

18. *UNCITRAL Digest of Case Law on the United Nations Convention on the International Sales of Goods* (2008) Art. 6 [10], http://www.uncitral.org/pdf/english/clout/08-51939_Ebook.pdf ('UNCITRAL Digest 2008'). The 2012 version omitted these comments: *UNCITRAL Digest of Case Law on the [CISG]* (2012), Art. 6 [14], <http://www.uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf> ('UNCITRAL Digest 2012') (both accessed 28 Feb. 2014); Ferrari, above n. 9, at 220; Oviedo-Albán, above n. 4, at 203, n. 22, at 214 (denying CISG applies unless the parties invoke it or *iura novit curia* applies) (my translation); Mathias Reimann, *The CISG in the United States*, 71 *Rabels Z* 1:5 (2007) n. 48 and accompanying text; Michael Bridge, 'Choice of Law Issues' in James J. Fawcett, Jonathan M. Harris and Michael Bridge (eds), *International Sale of Goods in the Conflict of Laws* 905, 916-17 [16.22] (Oxford 2005); Torsello, above n. 12, at 191-92, n. 20; Franco Ferrari, *Remarks on the UNCITRAL Digest's Comments on Article 6 CISG*, 25 *J.L. & Com.* 13, 30-31 (2005); Peter Schlechtriem and Pilar Perales Viscasillas, *Case note on decision of Court of First Instance of Tudela (Spain)*, 29 *Mar.* 2005, n. 10, <http://www.cisg.law.pace.edu/cisg/biblio/perales4.html> (unknown whether counsel argued the CISG, but it would be irrelevant 'since *iura novit curia*'); Antonin I. Pribetic, *An 'Unconventional Truth'*, 27, 10 *Mar.* 2009, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1302962; Francesco Mazzotta, *The International Character of the UN Convention on Contracts for the International Sale of Goods: An Italian Case Example*, 15 *Pace Int'l L. Rev.* 437, 443 (2003); Franco Ferrari, *Applying the CISG in a Truly Uniform Manner*, 1 *Uniform L. Rev.* 203, 211 (2001).

19. See also Stephen L. Sass, *Foreign Law in Civil Litigation – A Comparative Survey*, 16 *Am. J. Comp. L.* 332, 334-35 (1968).

20. Tribunale di Vigevano, 12 *Jul.* 2000, above n. 12, [5]; Tribunale Civile di Cuneo, Italy, 31 *Jan.* 1996, <http://cisgw3.law.pace.edu/cases/960131i3.html>; *Georgia Pacific Resins Inc. v. Grupo Bajaplay SA de CV*, Baja California, Fourth Panel of the Fifteenth Circuit Court [Federal Court of Appeals], Mexico, 9 *Aug.* 2007, <http://cisgw3.law.pace.edu/cases/070809m1.html> ('*Georgia Pacific case*'); Tribunale di Padova, Italy, 25 *Feb.* 2004, <http://cisgw3.law.pace.edu/cases/040225i3.html>.

on the basis that the court failed to observe the procedural law of the forum which was subject to *iura novit curia*.²¹

In terms of the CISG, this traditional view is an interpretation. A fundamental aspect of the CISG is the determination of which matters fall inside and outside of its scope. The traditional solution effectively treats the issue as an external gap, that is, that the duty of the adjudicator is a matter not covered by the CISG itself. It therefore denotes the issue as one for determination under domestic procedural law. In this chapter, that view is challenged.

On its face, it seems inevitable that leaving the matter to domestic procedural law would produce diverse outcomes. However, that is not necessarily so.

[D] The Principle of *Iura Novit Curia*

At its core, the procedural principle of *iura novit curia* allocates the burden of establishing the identity of the applicable law and ascertaining its content.²² It defines the very roles and respective responsibilities of the court and parties in relation to the substantive law.²³

The suggestion in the traditional solution that the outcome depends on whether a jurisdiction follows the principle of *iura novit curia* presupposes its absence in some of them. In truth, some version of *iura novit curia* exists in all jurisdictions. Judges are presumed to know and empowered to apply the law, or at least the domestic law.²⁴

There are, of course, differences in approach. A 'strict' approach to *iura novit curia* obliges the court ex officio to identify and apply the substantive law it considers applicable to the case. A 'soft' approach to *iura novit curia* authorizes this, but does not demand it.

While civil law jurisdictions overtly acknowledge the principle, it has been claimed that it has no application in common law jurisdictions.²⁵ Yet it is submitted that it is probably more accurate to say that common law courts operate under a 'soft' form of *iura novit curia* in relation to domestic law, since common law judges also have an inherent power to apply points of law not invoked by counsel, subject to due process

21. See, e.g., criticism of the Chilean *Industrias Magromer case*, above n. 3, by Oviedo-Albán, above n. 4, at 203, n. 22, 214.

22. Teresa Isele, *The Principle of Iura Novit Curia in International Commercial Arbitration*, 13(1) Int'l Arbitration L. Rev. 14, 14 (2010). This is sometimes referred to as the 'burden of education': Matti S. Kurkela, "*Jura Novit Curia*" and the Burden of Education in International Arbitration, 21(3) ASA Bulletin 486, 490 (2003).

23. Sass, above n. 19, at 332.

24. See Isele, above n. 22, at 14-15; Kurkela, above n. 22, at 489. See also International Law Association, *Final Report: Ascertaining the Contents of the Applicable Law in International Commercial Arbitration* (2008) 3, <http://www.ila-hq.org/en/committees/index.cfm/cid/19> ('ILA Final Report').

25. F. A. Mann, *Fusion of the Legal Profession*, 93 Law Quarterly Rev. 367, 375 (1977) (absence of *iura novit curia* distinguishes English legal procedure vis-à-vis civil law). This has led to assertions of so-called principle of 'judicial unpreparedness': *ibid.*, at 369.

concerns.²⁶ The same due process concerns obviously also apply in courts which overtly follow the *iura novit curia* principle.

In the present context, the most important due process issue is the principle of *audi alteram partem*, the right to be heard, the contours of which are defined differently in different jurisdictions.²⁷ The breadth or narrowness with which the right to be heard is defined essentially determines the degree to which the court will feel constrained in a situation where counsel have not presented the case on the basis of the relevant law, as the ensuing decision may be overturned for failure to accord due process if counsel have not been invited to comment.²⁸

Therefore it is submitted that it is the breadth of the right to be heard and its effect in triggering potential appeals rather than whether a particular jurisdiction overtly follows *iura novit curia* that might, under the traditional solution, impact on outcomes. These will be taken into account in the solutions proposed in section §10.05 below.

[E] Diversity of Approaches and Outcomes

It is apparent that reactions to the failure to plead the CISG have been highly variable. As might be expected, domestic procedural rules have had an impact. However, the real causes of the diversity deserve closer attention, since differences in domestic procedural rules do not entirely explain the range of outcomes. There are at least three variations on approaches taken by courts.

The first approach follows the traditional solution. In these cases, application of the CISG is justified by direct reference to the domestic procedural principle of *iura novit curia*, and courts apply the applicable law (CISG) irrespective of the arguments presented.²⁹

26. In fact ‘courts are typically expected to know their law’: ILA Final Report, above n. 24, at 8. Isele also concludes some form of the principle applies in England, since ‘judge[s] may suggest new legal reasoning and [are] free to decide in accordance with such reasoning, and that rejection of application of law not pleaded in *Goldsmith v Sperrings Ltd* [1977] 1 WLR 478, 486 (UK) was not due to lack of authority in the court, ‘but due to the lack of the opportunity to be heard on the specific legal issue’ above n. 22, at 22, 23; Mann, above n. 25, at 369 (English courts may put new legal questions to counsel, but are under no obligation to do so).

27. The right to be heard is often found in provisions designed to prevent ‘surprise’ decisions. See, e.g., in Austria: Art. 182 Zivilprozessordnung [Austrian Code of Civil Procedure 1895] (Austrian ZPO); Supreme Court, Austria, 2 Apr. 2009, above n. 5 (lower court infringed ZPO Art. 182 in applying CISG where parties had overlooked it, but error not affecting outcome). See also Art. 139 Zivilprozessordnung, Germany (German ZPO), (5 Dec. 2005 version). Regarding common law, see Terence Ingman, *The English Legal Process* 491 (Oxford 2008); Mauro Cappelletti and Bryant G. Garth, ‘Introduction’ in Mauro Cappelletti (ed), *International Encyclopedia of Comparative Law* Ch. 1, Vol XVI, Civil Procedure, 81, §1-81 (Mohr Siebeck 1987).

28. Isele, above n. 22, at 15 noting strict right to be heard in relation to legal reasoning in common law; Maurice Rosenberg, Jack B. Weinstein and Hans Smit, *Elements of Civil Procedure* 9 (NY Foundation Press 2nd edn, 1970) (parties may otherwise be denied opportunity to test or address research conducted by the judge outside of court). Similarly, see also Mann, above n. 25.

29. *Georgia Pacific case*, above n. 20 (Mexico) (irrelevant whether parties had mentioned the CISG because of the principle ‘da mihi factur, dabo tibi ius’ and ‘iura novit curia’); Tribunale Civile di Cuneo, 31 Jan. 1996, above n. 20 (no reference in argument, but CISG ‘rules must be followed by this Court from the principle *iura novit curia*’); Tribunale di Vigevano, 12 Jul. 2000, above n. 12, at [5] (‘[t]hus according to the principle *iura novit curia*, it is up to the judge to determine

A second approach is to infer waiver on the basis of domestic procedural practice and waiver concepts. For example, in the US case of *GPL Treatment*, counsel's failure to argue the CISG was held to amount to a waiver, which permitted the court to apply the inapplicable domestic law that had been pleaded.³⁰ Its applicability could have changed the outcome, yet the Court of Appeal merely dismissed reliance on the CISG as having been 'waived' by way of footnote in the dissenting judgment.³¹ Similarly, in the Australian *Playcorp* case, although the court was awake to the CISG's relevance, it was still convinced its application was 'unnecessary', given that counsel had not suggested that its provisions were 'inconsistent' with local sales law.³² This view has since been unfortunately and incorrectly upheld in later Australian decisions, such as *AG Botswana v. Aussie Diamond*, in which it was held 'unnecessary' to refer to the (applicable) CISG 'having regard to the way the case was run'.³³ In each of these cases, no interpretation of the CISG was involved in the determination of waiver. Instead, the conclusion was exclusively based upon domestic procedure.

While none of the cases actually referred to it, the second approach is reminiscent of the effect of the procedural rule enabling default application of domestic law by the court in lieu of applicable foreign law where the latter cannot be proven as fact.³⁴ The problem is, of course, that in Australia and the USA, the CISG is not foreign law.

The third approach involves cases in which courts appear to interpret the CISG to determine whether counsel's conduct during litigation amounts to an exclusion pursuant to Article 6. Thus these cases look to the applicable law for the solution to the 'waiver' or 'exclusion' issue, rather than deferring to domestic procedural rules.

Unfortunately, pursuant to the third approach, there have nonetheless been vast variations in outcomes. Italian and German courts have *expressly denied* that mere

which Italian rules should be applied'); Tribunale di Padova, 25 Feb. 2004, above n. 20 ('by virtue of the principle of *iura novit curia*, it is for the judge to determine the applicable Italian rules'). See also in support of the traditional view, above n. 18.

30. The CISG was raised in argument only very late in the trial: *GPL Treatment*, above n. 9. See also *Italian Imported Foods*, above n. 8.
31. *GPL Treatment*, above n. 9, Leeson J (dissenting, n. 8). The domestic 'in writing' requirement was displaced by the CISG, but counsel failed to raise this until too late, and the case was decided on the basis of the UCC.
32. The implementing legislation stated the CISG was to have the force of law, and was to prevail to the extent of any inconsistency: ss 5 and 6 *Sale of Goods (Vienna Convention) Act 1987* (Vic). It is submitted that the court elevated the 'inconsistency' concept to effectively bypass the force of law given to the CISG. In the present author's view, the unique interpretive methodology of the CISG will always render it different to domestic law despite any superficial resemblances. See *Playcorp Pty Ltd v. Taiyo Kogyo Ltd*, Victorian Supreme Court, Australia, 24 Apr. 2003, at [235], [245], <http://cisgw3.law.pace.edu/cases/030424a2.html>.
33. *Attorney-General of Botswana v. Aussie Diamond Products Pty Ltd* [No 3] [2010] WASC 141, at [210], Supreme Court Western Australia, 23 Jun. 2010, <http://cisgw3.law.pace.edu/cases/100623a2.html> ('AG Botswana case'); *Castel Electronics Pty. Ltd. v. Toshiba Singapore Pte. Ltd.*, Federal Court of Australia, 28 Sep. 2010, <http://cisgw3.law.pace.edu/cases/100928a2.html> (where, despite recognizing the CISG applies, the court applied domestic law on the basis that, although claimant invoked both domestic sales law and the CISG, the two imposed 'effectively the same obligations', citing *Playcorp* and other cases).
34. See Ch. 2 and below §10.03[A] and §10.03[B].

failure to argue the CISG amounts to an implicit agreement to exclude it.³⁵ One Italian case held that the fact that ‘the [fact that] parties based their arguments exclusively on ... domestic law ... cannot be considered an implicit manifestation of an intent to exclude application of the [CISG]’.³⁶ It has been held that failure to argue due to a misapprehension that domestic law was applicable, or because parties were simply unaware of the CISG, is *insufficient* to support an imputation of intent to exclude it.³⁷ Thus an assumption of intent to exclude should be inferred ‘only if it appears in an unequivocal way that they recognized its applicability and they nevertheless insisted on referring only to national, non-uniform law’.³⁸ Two cases have held argument on exclusively based on German domestic law was either not exclusion, or was positive agreement to apply German law which in turn meant they had agreed on the CISG.³⁹

On the other hand, the very same conduct has been construed as demonstrating an intention to exclude pursuant to Article 6. An implicit exclusion of the CISG was upheld in a Chilean case,⁴⁰ where the failure of parties to plead the CISG until the appellate stages was characterized as involving a tacit exclusion or implied waiver of the CISG pursuant to Article 6.⁴¹ A Slovak court interpreted such conduct as exclusion and tacit choice of domestic law.⁴² Spanish courts have also determined the CISG was tacitly excluded pursuant to Article 6 due to the failure of parties to raise it until the appeal stage.⁴³ The French Cour de Cassation in two cases initially determined that failure by the parties to invoke the CISG during oral argument was tacit exclusion under Article 6,⁴⁴ but then later held absence during oral argument alone was not conclusive,

35. Tribunale di Cuneo, 31 Jan. 1996, above n. 20; Tribunale di Vigevano, 12 Jul. 2000, above n. 12, at [5]-[6]; Charles Sant’Elia, *Editorial Remarks*, <http://cisgw3.law.pace.edu/cases/000712i3.html>; Tribunale di Forlì, Italy, 16 Feb. 2009, at §4.3.3, <http://cisgw3.law.pace.edu/cases/090216i3.html>; Oberlandesgericht [Court of Appeal] (OLG) Stuttgart, Germany, 31 Mar. 2008, <http://cisgw3.law.pace.edu/cases/080331g1.html>; Court of Appeal (OLG) Hamm, 9 Jun. 1995, above n. 12; District Court (LG) Landshut, 5 Apr. 1995, above n. 12, at II.1.a (the fact that both parties based their case on the BGB ‘does not change anything’). See ICC Award No. 7565 of 1994, <http://cisgw3.law.pace.edu/cases/947565i1.html>; *UNCITRAL Digest 2012*, above n. 18, Art. 6, at [14].
36. Tribunale di Vigevano, 12 Jul. 2000, above n. 12, at [5].
37. Court of Appeal (O.C.) Zweibrücken, Germany, 2 Feb. 2004, [3], <http://cisgw3.law.pace.edu/cases/040202g1.html>.
38. Tribunale di Vigevano, 12 Jul. 2000, above n. 12, at [5].
39. Court of Appeal (OLG) Hamm, 9 Jun. 1995, above n. 12, at I. Similarly, District Court (LG) Saarbrücken, Germany, 2 Jul. 2002, <http://cisgw3.law.pace.edu/cases/020702g1.html> (not exclusion).
40. *Industrias Magromer case*, above n. 2.
41. *Ibid.*; Oviedo-Albán, above n. 4, at 194, 195, 198, 199, n. 7.
42. Regional Court, Bratislava, Slovak Republic, 10 Oct. 2007, <http://www.cisg.sk/en/3cob-102-2007.html> (pursuant to §9(1) Act No. 97/1963 Coll, on International Private and Procedural Law (as amended)) (translation by Juraj Kotrusz).
43. Supreme Court, Spain, 24 Feb. 2006, <http://cisgw3.law.pace.edu/cases/060224s4.html>, Pilar Perales Viscasillas, *Abstract* (not raised until third level of appeal, held tacit consent to domestic law, CISG inapplicable, court citing Art. 1)); Audiencia Provincial de Alicante, Spain, 16 Nov. 2000, <http://cisgw3.law.pace.edu/cases/001116s4.html>, Pilar Perales Viscasillas, *Abstract* (tacit exclusion for three reasons, including absence in pleadings and failure to argue until appeal); see also <http://cisgw3.law.pace.edu/cases/001116s4.html>.
44. *Société Muller Ecole et Bureau v. Société Federal Trait*, Supreme Court, France, 26 Jun. 2001, <http://cisgw3.law.pace.edu/cases/010626f1.html> (French judges must apply CISG as the substantive French law but by ‘failing to invoke the [CISG]’ parties had tacitly excluded under

but instead, absence in both oral argument and pleadings could be tacit exclusion.⁴⁵ In China and Serbia courts and tribunals have applied domestic law on the basis that failure by parties to invoke the CISG is tacit exclusion under Article 6, and similar reasoning has been employed in the Netherlands and Austria.⁴⁶ In all these cases the domestic law was ultimately applied despite the CISG's prima facie applicability.

The diversity of approaches demonstrates that outcomes from the factual example given are currently highly unpredictable. The application of domestic procedural rules under the first and second approaches seems to be partly to blame. Yet the third approach, which purports to apply a uniform Article 6 CISG, still produces outcomes that appear highly unpredictable. Uncertainty is a matter affecting the clarity of the substantive content of the CISG, and of concern to lawyers making *ex ante* decisions, but it is also submitted that the tendency to favour domestic law may also reveal a *status quo* bias that may be harmful to litigant parties themselves.

However, it is submitted that it would be wrong to blame the diversity completely on the traditional solution of looking to the forum's procedure. It is not unknown for a jurisdiction which does *not* overtly follow *iura novit curia* to refuse to apply the argued but inapplicable domestic law;⁴⁷ and it can be seen that many jurisdictions which *do* overtly follow *iura novit curia* have still interpreted such conduct as waiver.⁴⁸ Moreover, within a single jurisdiction, apparently conflicting decisions have been reached.⁴⁹ In any event, as discussed above, all jurisdictions employ some version of *iura novit curia*, tempered by due process concerns. That said, the first and second approaches do seem to at least contribute to divergence. It can be concluded that the

Art. 6); Supreme Court, France, 25 Oct. 2005, CISG-online 1098, <http://cisgw3.law.pace.edu/cases/051025f1.html> ('that by invoking and discussing, without any reservation, the [French Civil Code] all of the parties ... voluntarily placed the resolution of their dispute under French domestic law' by exclusion under Art. 6)(my translations).

45. *Société Anthon GmbH & Co. v. SA Tonnellerie Ludonnais*, Supreme Court, France, 3 Nov. 2009, <http://cisgw3.law.pace.edu/cases/091103f1.html> (rejecting lower court's finding of exclusion based on the fact seller had pleaded CISG provisions but not 'requested [its] before the court'); C. Witz & E. d'Almeida *Abstract*, <http://cisgw3.law.pace.edu/cases/091103f1.html>.
46. *Gammatex case*, above n. 11; Xiao and Long, above n. 10, at 71 (the court ignored the CISG's applicability despite fulfilment of the requirements of Art. 1(1)(a) and no apparent intent to exclude); CIETAC Arbitral Award No CISG/2006/17 <<http://cisgw3.law.pace.edu/cases/060500c3.html>> (tribunal ruled that the CISG governed the contract but applied domestic law because the parties pleaded only Contract Law of China); Amanda Waters, *Digest*, ICC Award No. 8453/1995, October 1995, *ICC Court of Arbitration Bulletin*, 2000, 55, <http://cisgw3.law.pace.edu/cases/958453i1.html>. See also Hof's-Hertogenbosch [Appellate Court], Netherlands, 13 Nov. 2007, <http://cisgw3.law.pace.edu/cases/071113n1.html> (*inter alia*, relevant that CISG was not raised until late in argument)(translation S. Kruisinga); Appellate Court (OLG) Aargau, Switzerland, 3 Mar. 2009, <http://cisgw3.law.pace.edu/cases/090303s1.html> (*inter alia*, failure to object to argument based on domestic law relevant, although ultimately exclusion was not upheld)(translation P. Landolt, 26 Aug. 2013, www.jusletter.ch and A. Raab); High Commercial Court, Serbia, 9 Jul. 2004, <http://cisgw3.law.pace.edu/cases/040709sb.html> (*inter alia*, conduct of the case was relevant to the decision on applicable law).
47. See *Perry Engineering Pty Ltd v. Bernold AG* [2001] SASC15, South Australian Supreme Court, 11 Feb. 2001, <http://cisgw3.law.pace.edu/cases/010201a2.html> (discussed below in §V).
48. See above nn 40, 42, 43, 44, 47 and accompanying text.
49. Compare Regional Court, Bratislava, 10 Oct. 2007, above n. 42; Regional Court, Nitra, 15 Oct. 2008, above n. 7; Supreme Court, Slovak Republic, 26 Oct. 2006, above n. 7.

diversity apparent in the cases can be partly attributed to the traditional solution, although it is not the sole cause.

[F] Critique of Traditional Solution

It is submitted that the traditional solution should be rejected, since leaving the issue to local domestic procedural rules is both unsatisfactory and in many circumstances, doctrinally incorrect.

It is submitted that leaving the matter to be determined by the procedure of the forum is unsatisfactory because it contributes to uncertainty in uniform application of the uniform law. It arguably tends to encourage the treatment of the CISG in the same way as foreign law, with consequences for predictability of its substantive application. Reliance on domestic procedural rules adds to an already messy picture of diverse outcomes. Thus it does not score well in relation to the above lesson regarding the need to, where possible, seek solutions that enhance substantive predictability and consistency in judicial application.

Further, the traditional view demonstrates a lack of faith in the capacity of the CISG to deal with the issue of inferences from the failure to plead. It is submitted the CISG is more than capable of this, as discussed in section §10.04 below.

It will be submitted that the dependence of the traditional solution on the domestic procedural principle of *iura novit curia* is often incorrect at law, because it ignores the duty in certain fora to apply the CISG. This will be discussed in §10.03 below.

With regard to the above cases, it is therefore argued that the first and second approaches are less than economically optimal and, as will be discussed below, doctrinally incorrect. In other words, it is submitted decisions based on domestic *iura novit curia* principles and domestic procedural conceptions of implicit waiver are doctrinally incorrect.

By contrast, it will be submitted that cases which do interpret Article 6 in determining exclusion indeed rely on the correct source of law, and are consistent with the other lesson above, regarding the potential economic benefit of preference for a rule favouring application of the CISG where it is the governing law. Unfortunately, cases following the third approach presently display an unsatisfactorily wide range of inconsistent interpretations. While some might be explicable on their facts, most appear too quick to conclude there has been a tacit exclusion without careful consideration of the issue. In this respect, they too fail the lesson of consistency and predictability, and manifest a probable *status quo* bias not dissimilar to that displayed by lawyers at the *ex ante* stage (see Chapter 7).

Thus this chapter not only seeks to re-evaluate the doctrinal position in relation to the interaction of the CISG and domestic procedural rules, but attempts to develop a more satisfactory interpretation of the CISG to improve its substantive content and clarity. In combination, it is hoped that these developments will benefit substantive concerns relating to certainty and predictability, while simultaneously increasing

litigation exposure rates, providing efficiency gains for parties by reducing *status quo* bias and moral hazard, and producing societal benefits.

In order to do this, the first step must be to reformulate the questions asked. To date, the traditional solution has quietly obscured the real issues to be resolved. Rather than ask whether the court or tribunal should apply the 'law argued' or the 'applicable law', it is instead submitted that more fundamental questions must be answered:

- (1) If the CISG is not pleaded, is there an obligation upon the adjudicator to apply it?
- (2) Does failure to plead the CISG per se amount to an agreement to exclude it pursuant to Article 6?

§10.03 IS THERE A DUTY TO APPLY THE CISG IF IT IS NOT PLEADED?

If the CISG is the governing law of the contract, then it is submitted a court begins on the wrong foot when it attempts to resolve the above problem by resort to domestic procedural rules. The first question to be asked is whether the CISG is applicable despite the failure to plead it. Essentially, one must ascertain whether there is an obligation upon the adjudicator to apply the CISG flowing from international law. Depending on the answer, domestic procedure may have no relevance at all.

The primary enquiry turns on the location and nature of the forum making the determination; whether the forum is a court or arbitral tribunal, and if it is a court, whether it is located in a Contracting State. A further permutation is whether the matter is a trial or appeal.

[A] Courts in Contracting States

This presents the simplest permutation. Where a court in a Contracting State hears a matter at the trial stage, it is submitted that it would be incorrect to consider domestic procedural laws such as *iura novit curia* relevant to the decision as to which law the court should apply.

[1] Obligation to Apply the CISG

In Contracting State courts where argument is based solely on inapplicable domestic law in relation to a contract to which the CISG applies, the court is *obliged* to apply the CISG to resolve the effect of such conduct. It is submitted that this is true irrespective of whether the Contracting State operates as a monist or dualist system, provided the CISG has been effected.⁵⁰ Each will be considered in turn.

50. The CISG is not necessarily in effect in all regions of Contracting States, nor implemented in them all. See below n. 64.

In summary, a court in a monist Contracting State is obliged to apply the CISG to the extent it covers a particular issue as a matter of international law.⁵¹ Any domestic procedural rules relating to issues of *iura novit curia* are therefore irrelevant due to this obligation. Only the right to be heard is not irrelevant.

The obligation arises as a matter of international law because, of course, the CISG is an international treaty. The *Vienna Convention on the Law of Treaties*⁵² Article 26 states:

Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

Provided its basic criteria are met,⁵³ the CISG is the applicable law. The applicability of the CISG to the typical situation described earlier arises under Article 1(1)(a) CISG, but the same would be true should the CISG apply via Article 1(1)(b). Absence of argument from counsel on the CISG cannot alter the court's fundamental obligation to apply it under these circumstances.⁵⁴ In a monist system, the existence of a treaty obligation to apply the CISG *ipso iure* imposes upon the court, as an organ of a CISG Contracting State, a strict duty to apply the correct law rather than a softer authority to do so.

Lest it be thought that domestic procedural rules could still play a part in relation to waiver by conduct of the CISG as non-mandatory law, the *Vienna Convention on the Law of Treaties* Article 27 states:

A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty ...

Thus to the extent that any rule of domestic procedure interferes with the application of the CISG, its observance by a court in a Contracting State would amount to a breach of that State's international obligation to apply the CISG. This is true of both dualist and monist systems, irrespective of how they define internal obligations of national courts.

The obligation upon national courts to apply the CISG as a matter of international law is relatively (but not entirely)⁵⁵ unproblematic in monist states, where a theory of unity of legal systems and primacy of international law ensures that self-executing

51. See generally on monism: Antonio Cassese, *International Law* 213, 215 (Oxford 2005); Ian Brownlie, *Principles of Public International Law* 31 et seq. (Oxford 7th edn, 2008). On monism in Japan and CISG: Hiroo Sono, 'Japan's Accession to and Implementation of the United Nations Convention on Contracts for the International Sale of Goods (CISG)' in Akira Kotera (ed), *Japanese Yearbook of International Law* Vol 53, 410, §III.2(1) (Yushodo 2010).

52. *Vienna Convention on the Law of Treaties*, Vienna, UN Doc. A/CONF. 39/27, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 Jan. 1980).

53. On applicability, see Ch. 2, at §2.03.

54. Stating the applicability of the CISG is not dependent on a claim by the parties, but is to be examined *ex officio* by the court: Ingeborg Schwenzer and Pascal Hachem, in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)*, Introduction to Arts 1-6, 19-20 [3] (Oxford 3rd edn, 2010) ('*Schlechtriem & Schwenzer* 3rd edn').

55. Benedetto Conforti, *International Law and the Role of Domestic Legal Systems* 26 (Martinus Nijhoff 1993) (reluctance in some monist states to implement treaties without internal directives).

international treaty obligations directly bind national courts without ‘transformation’.⁵⁶ However, the proposition will not generally hold true in dualist states, where the accepted theoretical construct suggests two distinct legal orders of international law and municipal law, and in which, consequently, international law is not necessarily recognized as directly binding upon national courts until ‘transformed’ or ‘incorporated’ in a manner determined internally.⁵⁷

It is interesting to contemplate how courts have dealt with this. In some dualist systems, particularly those in the EU, courts have evolved a more ‘internationalist’ approach over time to increasingly recognize the direct effect of international law.⁵⁸ Many courts in dualist systems have developed a presumption to the effect that domestic laws should be interpreted to conform to international law whenever possible, on the basis that, having entered into a treaty, the state is presumed to have intended to give it effect unless the contrary is evident.⁵⁹ However, in certain dualist states, even though such presumptions are recognized, they are seldom utilized.⁶⁰ Indeed, there is a much-criticized persistent reluctance in the USA to accept the integration of international law, which is expressed in the doctrine of non-self-execution.⁶¹ Perhaps anachronistically, in the UK and Australia, national courts are not bound by international law per se, and will uphold domestic law, despite the fact that to do so where the domestic and international laws conflict involves a violation of international treaty obligations on the part of the State.⁶²

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56. European municipal courts are ‘accustomed to the doctrine of “direct effect” under community law’, such that the content of clear and unconditional international norms apply directly once integrated into the domestic legal order: Andrea Bianchi, *International Law and US Courts* 15 *Eur. J. Int’l L.* 751, 758 (2004); *ibid.*, at 25; Cassese, above n. 52, at 213-16.
57. Chief Justice Robert French, *International Law and Australian Domestic Law*, paper, Annual Supreme Court of New South Wales Conference, Hunter Valley, 21 Aug. 2009, 23; Cassese, above n. 52, at 9, 213-14; Brownlie, above n. 52, at 31, 41.
58. This is so in Italy, without constitutional or statutory change, in relation to EU Regulations: Conforti, above n. 57, at 39.
59. See, e.g., in Italy, Cassese, above n. 52, at 229-30; in Australia, *Mabo v. Queensland (No 2)* (1992) 175 CLR 1, at 41-43, High Court of Australia, 3 Jun. 1992; *Minister for Foreign Affairs and Trade v. Magno* (1992) 97 FCR 298; 112 ALR 529, at 534-535, Federal Court of Australia, 26 Nov. 1992 (‘*Magno case*’).
60. The US ‘Charming Betsy’ statutory interpretation rule: *Murray v. The Schooner Charming Betsy*, 6 US 64, 81; 2 Cranch 64, Supreme Court, USA, 22 Feb. 1804; *Talbot v. Seeman*, 5 US 1, at 76; 1 Cranch 1, Supreme Court, USA, 11 Aug. 1801; American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States* §114 (1987); Bianchi, above n. 57, at 761, 771-73. By contrast, international obligations can affect Australian domestic common law: see *Magno case*, above n. 60, but this was recently doubted in administrative law: Matthew Groves, *Treaties and Legitimate Expectations*, 12 *Judicial Rev.* 323 (2010).
61. US constitutional norms govern the internal binding effect of treaties. Despite the constitutional Supremacy Clause rendering treaties self-executing, this depends on construction of intent: see, e.g., *Medellin v. Texas*, 552 US 491, 504-505 (2008), Supreme Court, USA, 25 Mar. 2008; *Hamdi v. Rumsfeld*, 316 F 3d 450, Court of Appeals (4th Cir), USA, 8 Jan. 2003. Thus a doctrine of non-self-execution has flourished: John C. Yoo, *Globalism and the Constitution*, 99 *Colum. L. Rev.* 1955, 1959-60, 1982 (1999); Bianchi, above n. 57, at 759, 760. The USA has signed but not ratified the *Vienna Convention on the Law of Treaties*.
62. Cassese, above n. 52, at 236 (this is extreme ‘statism’); *ibid.*, at 40. See also French CJ, above n. 58, at 23-29; *R v. Jones* [2007] 1 AC 136 (UK), House of Lords, 29 Mar. 2006; *Magno case*, above n. 60, at 534-35; Roger O’Keefe, ‘The Doctrine of Incorporation Revisited’ in James Crawford and Vaughan Lowe (eds), *British Year Book of International Law 2008 Vol 79(1)* 7 (Oxford 2009).

Whatever may be the case generally, it is submitted that the CISG presents a special case. First, the CISG has been integrated into the internal legal systems of Contracting States, in the case of dualist states, either by being ‘incorporated’ or ‘transformed’ at the domestic level.⁶³ For example, in Australia, the CISG has been adopted in the form of a statute in each of the jurisdictions within its federation. In the USA, even following the decision in *Medellin v. Texas*,⁶⁴ it is likely the CISG would be considered a self-executing treaty.⁶⁵ From a dualist perspective, there is thus no conflict between the international obligations of the Contracting State and domestic law. The CISG forms part of the domestic law, and its provisions incontrovertibly bind national courts in dualist systems.

Second, in Contracting States, the CISG applies automatically and dictates both when and how it is to apply. Consistent with the view presented in Chapter 2,⁶⁶ where the CISG is applicable pursuant to Article 1, the domestic law itself demands its application. Thus in a dualist system, the court is charged by its domestic law with the task of enforcement of the CISG where it is the applicable law according to its own terms.⁶⁷ It might be argued that courts can still observe procedural rules or principles which recognize the freedom of litigants to run their cases.⁶⁸ This would be inconsistent with the lesson regarding economic preference for semi-immutable judicial insistence on the application of the CISG. However, it is submitted that implementation of the CISG is not left to the court as a matter of domestic procedure. There is no discretion granted to the court in relation to whether or not it should be applied.⁶⁹ As discussed in Chapter 2, the CISG contains its own rules of applicability. The CISG also sets out the hierarchy of laws in relation to matters within its scope in Article 7(2) CISG, and imposes upon courts in Contracting States a duty to take into account the CISG’s

63. Note Ghana and Venezuela have signed but not ratified the CISG: *CISG Status*, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html. In Ghana, ad hoc legislation is required: Cascese, above n. 52, at 229; Emmanuel Laryea, *Why Ghana Should Enact Certain International Legal Instruments relating to International Sale of Goods Transactions*, 19(1) *African J. Int’l & Comp. L.* 1, 9-17 (2011).

64. *Medellin case*, above n. 62, at 505, 520-23 (majority conclusion that to be self-executing treaties must textually convey an intention to be so, and resort may be had to secondary sources).

65. Mark Cantora, *The CISG after Medellin v. Texas*, 8 *J. Int’l Bus. & L.* 111, 113, 114 (2009) (sufficient indications of intent by US President and Senate for CISG to apply as a self-executing treaty in a clear statement by the President to the Senate demonstrating an understanding it was self-executing); *Hanwha Corp v. Cedar Petrochemicals*, US District Court (SD NY), 18 Jan. 2011 (CISG is a ‘self-executing treaty’); Leandro Tripodi, *Editorial Comments*, <http://cisgw3.law.pace.edu/cases/110118u1.html>. See earlier statements to this effect before *Medellin: Delchi Carrier SpA v. Rotorex Corp*, 71 F 3d 1024, 1027 n. 1, US Court of Appeals (2nd Cir), 6 Dec. 1995, <http://www.cisg.law.pace.edu/cases/951206u1.html>; *Filanto, S.p.A. v. Chilewich International Corp.*, 789 F. Supp at 1237 789 F Supp 1229, US District Court (SDNY 1992), 14 Apr. 1992, <http://www.cisg.law.pace.edu/cases/920414u1.html>; James E. Bailey, *Facing the Truth*, 32 *Cornell Int’l L.J.* 273, 276-86 (1999) (CISG is self-executing but ‘buried’ in an Appendix to Title 15).

66. See in particular, in Ch. 2, at n. 77 and accompanying text.

67. *Contra Bridge*, above n. 18, at 917 [16.22] (Art. 1 does ‘not with sufficient clarity abridge’ the longstanding freedom of litigants to ignore foreign law).

68. See *Bridge*, above n. 18, at 917.

69. Other than (irrelevantly for present purposes) regarding specific performance orders: Art. 28 CISG. See also Ulrich G. Schroeter, ‘To Exclude, to Ignore, or to Use?’ in Larry DiMatteo (ed), *The Global Challenge of International Sales Law* (Cambridge 2014) at text accompanying n. 62.

international nature in its interpretation,⁷⁰ and a duty to interpret it in a manner that promotes uniformity. In other words, in accordance with the CISG's own internal methodology: Article 7(1) CISG.⁷¹ Essentially, the domestic law *directs* the court to honour the international obligations of the Contracting State pursuant to the CISG in relation to individual cases.

Similarly, in *Fothergill v. Monarch Airlines Ltd* in relation to Article 32 *Vienna Convention on the Law of Treaties* and consultation of *travaux préparatoires* by English courts in interpretation of a treaty, Lord Diplock stated:

By ratifying that Convention, [the] Government has undertaken an international obligation on behalf of the United Kingdom to interpret future treaties in this manner and since under our constitution the function of interpreting the written law is an exercise of judicial power and rests with the courts of justice, that obligation assumed by the United Kingdom falls to be performed by those courts.⁷²

Hence the issues foreshadowed above regarding dualist states are not problematic for present purposes. While in monist states, courts are bound by the direct effect of the CISG as international law, it is submitted that courts in dualist states are bound by the terms of the CISG as municipal law to implement the international obligations of the Contracting State, in a manner which reflects the CISG's nature as international uniform law. It could be argued that the CISG effectively 'pierces the armour' of the dualist international-domestic law dichotomy⁷³ in a practical sense. However, in any event, it is submitted that the direction within the CISG to apply it where it is the governing law *ipso iure* will bind courts in dualist Contracting States to apply the CISG *ex officio* if necessary, even if the obligation technically arises as a matter of domestic law.

Importantly, as mentioned in Chapter 2, it should be noted that when the court is in a Contracting State, the CISG is not a foreign law. Despite the fact that it is simultaneously a treaty, it forms part of the domestic law of the jurisdiction – a part of the law of the forum.⁷⁴ Therefore in Contracting States, how the forum treats foreign

70. Article 7(1) demands that, in interpreting the CISG, 'regard is to be had to its international character'.

71. Describing these as international obligations: Peter Schlechtriem, *The Borderland of Tort and Contract — Opening a New Frontier?* 21 *Cornell Int'l L.J.* 467, 468-69 (1988); John O. Honnold, *Documentary History of the Uniform Law for International Sales* 89 (1989) ('*Documentary History*'); Honnold, above n. 9, at 128 [92]; Bridge, above n. 18, at 922; Jacob S. Ziegel, *The Future of the International Sales Convention from a Common Law Perspective*, 6 *New Zealand Bus. L. Quarterly* 336, 342 n. 30 (2000); Camilla Baasch Andersen, *The Uniform International Sales Law and the Global Jurisconsultorium*, 24 *J.L. & Com.* 159, 166 (2005) (recourse to foreign CISG jurisprudence is a duty); Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, Art. 7, 123 [7] ('regard is to be had' as a 'command' directed to courts and tribunals).

72. *Fothergill v. Monarch Airlines Ltd* [1981] AC 251 (UK), House of Lords, 10 Jul. 1980. The House of Lords was concerned with the *Warsaw Convention for the Unification of Certain Rules relating to International Carriage by Air*, as amended at the Hague 1955, and implemented as *Carriage by Air Act 1961* (UK).

73. Used in a different context by Cassese: above n. 52, at 217.

74. Similarly, see Bridge, above n. 18, at 916; Schwenzer and Hachem, above n. 55, Introduction to Arts 1-6, at 19 [3]; Leif Sevón, 'Method of Unification of Law for the International Sale of Goods'

law is irrelevant.⁷⁵ Its applicability and content are a question of law, not fact. Any default rule regarding substitution of domestic for a foreign law has no place in the process. This will be true regardless of how the CISG applies. In the case of Article 1(1)(a), where the CISG's requirements for application are satisfied, the CISG applies automatically.⁷⁶ If, on the other hand, the forum's private international law leads to the law of a Contracting State in accordance with Article 1(1)(b), then a Contracting State court is still bound to apply the CISG.⁷⁷ Normally, once choice of law rules have identified the applicable foreign law, the manner in which its content would be ascertained would turn on whether the forum's procedural rules treat foreign law as law or fact, as discussed below.⁷⁸ However, where the forum is located in a Contracting State, the CISG is not foreign law at all. Thus it is submitted that the CISG should always be treated as a matter of law *where it forms part of the forum's own law*. To the extent it governs a particular issue, the forum of a Contracting State is bound to apply it.

Most importantly, on the basis of this analysis, it is submitted that the obligation to apply the CISG ex officio arises from the CISG itself, and not from any domestic procedural principle. It follows that the obligation to apply the CISG in both dualist and monist Contracting States approaches a principle of *iura novit curia* pursuant to its own provisions. This view stands in direct contrast to the traditional solution, and also contradicts cases which have upheld the CISG expressly on the basis of the local procedural principal of *iura novit curia*.⁷⁹

[2] Displacement of Domestic Procedural Rules

The corollary of this obligation to apply the CISG ex officio is that, where the CISG covers an issue, its provisions take precedence over any domestic procedural rules which would interfere with the fulfillment of that duty by the court. It is submitted that this flows from the hierarchy in Article 7(2). It arguably follows that the legitimacy of such rules is essentially limited by the extent to which they can be reconciled with the Contracting State's obligation to apply the CISG. Even domestic procedural rules themselves often recognize the need to modify default rules in light of international obligations.⁸⁰

in Kaarina Buure-Hägglund (ed), *The Finnish National Reports to the Twelfth Congress of the International Academy of Comparative Law* 11 (1986); *Georgia Pacific case*, above n. 20.

75. Contrast position of non-contracting states discussed below in §B.

76. Honnold, above n. 9, Art. 1, at 29-48; Franco Ferrari, 'The CISG's Sphere of Application' in *Digest and Beyond*, above n. 12, passim.

77. The only complicating factor here is whether or not the forum Contracting State, or Contracting State whose laws are determined applicable have made an Art. 95 declaration: see Ch. 2.

78. See discussion below in §10.02[B].

79. See discussion of traditional view in §10.02[C], and see also, above n. 29 (cases expressly relying on *iura novit curia* to apply CISG).

80. Trevor C. Hartley, *Pleading and Proof of Foreign Law*, 45 Int'l & Comp. L.Q. 271, 287-88 (1996) (default rule substituting English for unproven foreign law is displaced by international obligations). See also, Hartley, *ibid.*, at 277, n. 25 (Swiss default rule substituting the *lex fori* for foreign law may not prevail over an international obligation); 中华人民共和国民法通则: Zhōnghuá Rénmín Gònghéguó Mínfǎ Tōngzé [General Principles of the Civil Law of the People's Republic of China] National People's Congress, 12 Apr. 1986, <http://www.lawinfochina.comlaw/>,

The issues addressed by domestic *iura novit curia* and tacit waiver in domestic law have the potential to interfere with the obligation of courts in Contracting States to apply the CISG. To that extent, it can be submitted that such rules should have no place in determining the appropriate course for such a court when faced with counsel who fail to plead the CISG. The duty requires the CISG to be applied to the extent of issues governed by it. While some disagree with blanket pre-emption,⁸¹ others hold that the CISG applies exclusively within its scope on the basis that, were it otherwise, the CISG could not implement uniform outcomes.⁸² This will be so even if the law displaced is procedural – indeed, the very idea of a clear division between uniform substantive law and choice of law has been described as a ‘fallacy’.⁸³ Incontrovertibly, the CISG deals with its exclusion by choice of law, as discussed below in §10.04.

The displacement view of the obligation to apply the CISG *ex officio* would mean that there would no longer be room for any domestic rule which says another law is to be applied by the court, either because of procedural rules relating to the court’s role, local concepts of waiver, or due to rules of pleading.⁸⁴ The function of determining which law should be applied by the court would have already been performed by the duty imposed upon the court. Consequently, this view holds that it would be impermissible for any domestic procedural rules to confine the court to the inapplicable laws argued, or to provide it with discretion to so confine itself. It follows that domestic rules which might otherwise have done this would have been effectively displaced, leaving only the residual effect of the right to be heard.

Thus, it is doctrinally open to interpret the obligation to apply the CISG uniformly and internationally as inexorably leading to the imperative that the CISG prevails over domestic procedural rules in Contracting States, at least to the extent such rules allow application of inapplicable law, thereby interfering with fulfilment of the duty.⁸⁵ It is submitted that, by comparison with the traditional solution, this is the better view. The position cannot only be supported on a purely doctrinal basis, but also on economic grounds, as consistent with the lesson drawn above (in section §10.02[B] above) in relation to preference for an interpretation favouring application at the insistence of the bench rather than one which treats the matter as optional or discretionary. Non-displacement of any domestic rule of procedure which would enable parties to oust the CISG from a contract to which it applies without actual agreement to that effect would

Art. 142(2) providing to the extent of any inconsistency, treaty obligations prevail over substantive civil laws, unless China has made a reservation. In this regard, China’s Art. 95 declaration may be relevant: see Weidi Long, ‘The Reach of the CISG in China’ in Ingeborg Schwenzer and Lisa Spagnolo (eds), *Towards Uniformity* 83 (Eleven 2011).

81. See, e.g., Joseph Lookofsky, *In Dubio Pro Conventione?*, 13 *Duke J. Comp. & Int’l L.* 263 (2003).

82. See generally: Schlechtriem, above n. 72, *passim*; Peter Schlechtriem and Ingeborg Schwenzer, in *Schlechtriem & Schwenzer* 3rd edn, at 8-9.

83. Generally, Bridge, above n. 18, at 908, [16.05], n. 8.

84. Inferences to exclude cannot be drawn from rules of pleading that purport to preclude entitlement, although it must be conceded that loss of entitlements due to issues outside the CISG’s scope, such as limitation periods, will obviously not be displaced. See also, regarding appeals, §10.03[D] below.

85. See also Pribetic, above n. 18, at 27 (if applicable CISG must be applied despite common and civil law differences on this point).

in turn relegate the Contracting State's treaty obligations to the unfettered whims of counsel and threaten the harmonizing effect of the CISG.

It is contended that the quality of a semi-immutable default application of the CISG is economically desirable. The semi-immutable quality of its application is arguably brought about by the combination of recognition of an obligation to apply it, displacement of incompatible domestic law, and rejection of the traditional solution. It ensures future development of a uniform solution under the CISG itself, improving the potential for clarity and predictability of the law, and arguably, reducing *ex post* societal burdens. As discussed above, correction of path dependence and *status quo* bias in the conduct of litigation by the adjustment of payoffs is socially optimal. Semi-immutability may encourage judicial warnings to counsel, and induce counsel to invest in information costs to properly argue the case at trial, or to inform clients of their rights and obligations under the CISG. This may save judicial resources wasted in appeals, and discourage moral hazard by ensuring counsel consider strategic avenues that would otherwise have been left unexplored. It is also submitted that it is appropriate to balance state interests in compliance with treaty obligations against local procedural law in this way.

Thus mandatory application is arguably warranted not only on doctrinal grounds, but also to deter inefficient behaviour.⁸⁶ Furthermore, 'mandatory' application in truth results in only semi-immutability, since parties can agree to opt out, even at the litigation stage, as discussed below. Accordingly, it is submitted the displacement of local procedural rules that might interfere with the duty to apply the CISG is justified because it maximizes net joint efficiency gains for parties, and improves social welfare both in terms of judicial resources and increased litigation exposure with associated effects.

Displacement resolves one aspect of the erratic and unpredictable outcomes seen in practice, as outlined in section §10.02 above. However, as seen above, even cases decided pursuant to Article 6 CISG display a range of divergent outcomes not always explicable on the facts. It follows that an improved interpretation of Article 6 is necessary to advance uniformity and certainty under the CISG. A suggested range of practical solutions will be presented in §10.05, which will also seek to address non-displaced considerations of due process and jurisdictional sensibilities.

[B] Courts in Non-contracting States

Obviously a court in a non-contracting State is not bound by any obligation to apply the CISG of the type discussed above in §10.03[A], even if its choice of law rules point to the law of a State which has adopted the CISG. Application of the CISG in such circumstances amounts to application of a foreign law.⁸⁷

86. Generally on mandatory application of treaty obligations and inefficiencies: Michael Whincop and Mary Keyes, *Putting the 'Private' Back into Private International Law*, 21 Melbourne U. L. Rev. 515, 530 (1997).

87. Marco Torsello, *Substantive and Jurisdictional Aspects of International Contract Remedies*, 25 Int'l Rev. L. & Econ. 397, 401 (2005).

Since in this permutation the CISG applies as foreign law, the extent to which a court considers itself either obliged, empowered or prohibited from applying the foreign law will be influenced by whether the forum's procedural rules treat foreign law as a question of fact or law.

The classification of law or fact profoundly alters the burden of discovering the foreign law and applying it.⁸⁸ Proof of foreign law is frequently a matter for the parties, who might bear the onus of proof of the foreign law as a matter of fact, even in jurisdictions where *iura novit curia* overtly applies to domestic law.⁸⁹ Yet, even if the court bears the primary burden, courts can normally require parties to assist in establishing foreign law, irrespective of characterization.⁹⁰ Finally, when the content of foreign law cannot be ascertained, pursuant to domestic procedural rules, domestic law usually operates as a default.⁹¹

A non-contracting State court's classification of foreign law as fact or law is therefore crucial, and will influence the manner in which the CISG's applicability and content are to be ascertained.⁹² In these circumstances, the forum's procedural rules are determinative. Clearly, the traditional view that domestic procedural law determines the law to be applied indeed holds true in non-contracting States.

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88. English courts cannot take judicial notice of foreign law: Sofie Geeroms, *Foreign Law in Civil Litigation* 114 (Oxford 2004); Cappelletti and Garth, above n. 27, at 29, nn 176-177, §1-26. In the US, foreign law is a question of law, and federal and certain state courts are empowered (but not obliged) to take judicial notice of it: Rule 44.1 Federal Rules of Civil Procedure, USA. See *Frummer v. Hilton Hotels International, Inc.*, 60 Misc 2d 840, 304 NYS 2d 335, Supreme Court, New York, USA, 18 Aug. 1969. By contrast, a duty to establish foreign law ex officio if necessary exists in some jurisdictions: see, e.g., Francesco Galgano, *The New Lex Mercatoria*, 2 Ann. Surv. Int'l & Comp. L. 99, 105, n. 11 (1995) (Italian judges must ascertain and apply foreign law ex officio); Sass, above n. 19, at 357, n. 85 (Italy); Burkhard Bastuck and Burkard Gopfert, *Admission & Presentation of Evidence in Germany*, 16 Loy. L.A. Ent. L. Rev. 609, 622-23 (1994) (Germany); Gerhard Dannemann, *Establishing Foreign Law in a German Court*, paper, British Institute of Int'l & Comp. Law, 30 Jun. 1994, at text accompanying nn 4-7.
89. See, e.g., foreign law as question of fact in Australia: Martin Davies, Andrew S. Bell, and Paul Brereton, *Nygh's Conflict of Laws in Australia* 353 (LexisNexis 8th edn, 2010). In Scandinavian countries aspects of foreign law are variously questions of law or fact: Imre Zajtay, 'The Application of Foreign Law' in Kurt Lipstein (ed), *International Encyclopedia of Comparative Law* Ch. 14, Vol III, Private International Law, 8, §14-13 (Mohr Siebeck 1972).
90. The court may require parties to assist in ascertaining foreign law in many jurisdictions. See, e.g., Rule No. 44.1 Federal Rules of Civil Procedure, USA; Art. 293 German ZPO; Isele, above n. 22, at 15-16 (Germany and France); Sass, above n. 19, at 356-58 (Germany); Art. 12(6) Spanish Civil Code, Preliminary Title on legal rules, their application and effect; Isele, above n. 22, at 15 (Switzerland); Art. 14 Brazilian Introductory Law to the Civil Code 1942, Decree N° 4.657; Art. 13 French Code of Civil Procedure; Sass, above n. 19, at 356 (Italy); Kurkela, above n. 22, at 493 (Finland); Jacob Dolinger, *Application, Proof and Interpretation of Foreign Law*, 12 Ariz. J. Int'l & Comp. L. 225, 235-36, 247-48, nn 55-59, 110-11 (Greece) (1995).
91. Lawrence Collins (ed), *Dacey & Morris: The Conflict of Laws* 221 (Rule 18) (UK) (Sweet & Maxwell 13th edn, 2000); Hartley, above n. 81, at 285 (UK); Richard Fentiman, *Foreign Law in English Courts*, 108 L. Quarterly Rev. 142, 147 (1992) (different basis for the English rule); Dannemann, above n. 89, at text accompanying n. 23 (Germany); Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 23 Dec. 1981, NJW (1982) 1215; Kurkela, above n. 22, at 486, n. 5 (Finland); Jerzy Rajska, *The New Polish Private International Law, 1965*, 15 Int'l & Comp. L.Q. 457, 463 (Poland) (1966); Geeroms, above n. 89, at 113 (France).
92. Noting CISG classification as foreign law in such circumstances: Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, Art. 1, at 40 [31].

[C] Arbitrations

Except for tribunals such as ICSID which have been established pursuant to Conventions and are therefore of a public law nature,⁹³ arbitral tribunals are private institutions. They are not organs of the State, and have no duty to fulfil treaty obligations. Arguably, the tribunal owes duties only to the parties involved.

Yet arbitral tribunals do not operate in a complete vacuum. Their authority is derived from the arbitration agreement and relevant procedural law. However tribunals may need to consider a host of laws and rules to determine the respective roles of the tribunal and parties in relation to identification and application of the substantive law. These include procedural rules including rules of due process,⁹⁴ any arbitration rules agreed by the parties and the arbitration agreement.⁹⁵ Additionally, unlike courts, arbitral tribunals have no default substantive law of the forum upon which to fall back.⁹⁶

Debate has recently arisen as to whether a principle of *iura novit arbiter* should be employed by arbitrators facing the type of situation posed in this chapter. Arbitral tribunals are bound by the procedure contained within the relevant arbitral law and arbitration rules. The arbitral law of the seat normally requires the tribunal to follow the choice of law made by the parties, and provides it with discretion where no choice has been made.⁹⁷ A choice of particular arbitral rules can clarify the role of the tribunal, as some rules contemplate the *iura novit arbiter* issue. For example, Rule 22(1) LCIA Rules expressly gives the tribunal the power to ascertain and apply the law *sua sponte*, provided the parties have not agreed otherwise, and provided a reasonable opportunity to be heard is afforded.⁹⁸ Similarly, the UK Arbitration Act sections 34(1) and (2)(g) is

93. Ieva Kalniņa, *Iura Novit Curia*, 8 *Baltic Yearbook of International Law* 89, 95 et seq. (2005).

94. Gary B. Born, *International Commercial Arbitration* 426 (Kluwer 2009); Julian D. M. Lew, Loukas A. Mistelis and Stefan M. Kröll, *Comparative International Commercial Arbitration* 524 [21-17] (Kluwer 2003). Generally, see Giuditta Cordero Moss, *Can an Arbitral Tribunal Disregard the Choice of Law made by the Parties?* 1 *Stockholm Int'l Arbitration Rev.* 1, 4 (2005).

95. Sir Roy M. Goode, *Litigation or Arbitration?*, 19 *Pace Int'l L. Rev.* 53, 56 (2007) (while arbitrators often follow conflict rules of the seat of arbitration, they are normally not *obliged* to do so); Lew et al, above n. 95, at 427 [17-51]; Schwenzer and Hachem, above n. 55, Introduction to Arts 1-6, at 23 [13]; Gabrielle Kaufmann-Kohler, *Globalization of Arbitral Procedure*, 36 *Vand. J. Transnat'l L.* 1313, passim (2003). The tribunal might consider rules on enforceability, although normally these reflect the *lex arbitri*. See, e.g., Art. 36 *UNCITRAL Model Law on International Commercial Arbitration 1985*, as amended in 2006, GA Res 40/72, UN Doc A/40/17, annex I, 11 Dec. 1985, GA Res 61/33, 4 Dec. 2006 ('UNCITRAL Model Law'); Art. V *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, New York, opened for signature 10 Jun. 1958, 330 UNTS 38 (entered into force 7 Jun. 1959) ('New York Convention').

96. See also, Kaufmann-Kohler, above n. 96, at 1332 (arbitral tribunals only have foreign law, and 'no *lex fori*'); Isele, above n. 22, at 16 (they have 'no forum law to fall back on').

97. See, e.g., Art. 28 *UNCITRAL Model Law*.

98. London Court of International Arbitration Rules 1998 ('LCIA Rules') Rule 22(1) expressly provides the tribunal with power to take the initiative to identify and ascertain the relevant or applicable rules of law. Less emphatically, Art. 21(1) *ICC Rules of Arbitration* (effective 1 Jan. 2012) ('ICC Rules').

an arbitration law that specifically deals with this aspect of procedure.⁹⁹ These point to a soft version of *iura novit arbiter*; the tribunal is empowered to look beyond party legal submissions (unless parties have agreed to the contrary) but is not obliged to do so. In the case of the LCIA Rules, the power is subject to the due process proviso that parties must be given an opportunity to comment on independent research or novel legal points.¹⁰⁰

It is submitted that, even where LCIA Rules are not applicable, they encapsulate the preferable approach to which tribunals should aspire. The soft form *iura novit arbiter* achieves the right balance between the respective roles of the parties and the tribunal, and provides flexibility to deal with inadequate submissions.¹⁰¹

This flexibility is inherently useful because unless the tribunal is expressly appointed as *amiable compositeur*,¹⁰² its mandate is to decide the dispute *according to law*.¹⁰³ A tribunal cannot decide a matter capriciously. If the tribunal can ignore the relevant law, the duty to decide according to law is rendered purely fictional.¹⁰⁴ Treatment of applicable law as a merely evidentiary matter is not compatible with fulfilment of this duty.¹⁰⁵ Faced with counsel who fail to address the relevant law, flexibility ensures the tribunal can draw on its own experience and research to direct counsel toward the correct law.¹⁰⁶

Moreover, the soft version of *iura novit arbiter* combined with a broad right to be heard maintains standards that safeguard against challenges to the arbitration or award.¹⁰⁷ The need for due process is an overriding principle of arbitration,¹⁰⁸ and while awards by tribunals employing a narrow right to be heard have been upheld, there are also awards that have been set aside for failure of due process, even by courts renowned for employing a relatively narrowly defined right to be heard in relation to

99. Arbitration Act 1996 (UK) s. 34(1) and (2)(g): unless parties agree otherwise, the arbitral tribunal may decide 'whether and to what extent the tribunal should itself take the initiative in ascertaining the facts and the law'. See also Kurkela, above n. 22, at 493.

100. Above n. 99. Indeed, some rules require tribunals to take account of contractual terms and usages including where parties have not invoked them: Art. 21(2) ICC Rules; Art. 35(3) UNCITRAL Arbitration Rules 2010.

101. ILA Final Report, above n. 24, Recommendation No. 7 (the tribunal is not confined to sources invoked by parties, subject to the opportunity to be heard in Recommendation No. 8). *Contra* Recommendation No. 6 (arbitrators should not generally introduce new legal issues unless due to public policy or issues which may later lead to challenges to the award); Antonias Dimolitsa, *The Equivocal Power of the Arbitrators to Introduce Ex Officio New Issues of Law*, 27(3) ASA Bulletin 426, 427 (2009) (describing the power (but not obligation) of a tribunal to ascertain the contents of applicable law as 'a facet of their jurisdictional mission').

102. That is, appointed to decide *ex aequo et bono*. Generally tribunals must be expressly authorized to decide in this manner: see, e.g., Art. 28(3) UNCITRAL Model Law; Art. 21(3) ICC Rules. See also Sophie Nappert, *Observations*, 3 Stockholm Int'l Arbitration Rev. 283, 286 (2008); ILA Final Report, above n. 24, at 6.

103. ILA Final Report, above n. 24, at 19.

104. Kurkela, above n. 22, at 495.

105. *Ibid.*, at 495.

106. Swiss courts consider *iura novit curia* to apply to arbitrations: Dimolitsa, above n. 102, at 431; ILA Final Report, above n. 24, at 14, n. 42.

107. New York Convention Art. V; UNCITRAL Model Law Art. 34(2).

108. Kaufmann-Kohler, above n. 96, at 1322-23; ILA Final Report, above n. 24, at 20.

arbitral awards.¹⁰⁹ Careful observance of a broadly defined right to be heard is therefore prudent.

Naturally, this would mean that tribunals cognizant that the CISG applies would need to suggest this to the parties before they would be empowered to apply it pursuant to this approach. Some have remarked upon the potential threat to the appearance of neutrality that such intervention might invite, since this could lead to the award being set aside for bias.¹¹⁰ Nonetheless, if attention of counsel is focussed on clarification of the legal point involved, the success of such a challenge is difficult to envisage.

Awards or indeed arbitrations can also be challenged on an *ultra petita* basis.¹¹¹ This will be particularly so if the tribunal awards relief not claimed or greater relief than claimed. Alternatively, the tribunal in applying novel legal points might be considered to have gone beyond its arbitral mandate.¹¹² However, such attacks are rarely upheld,¹¹³ so provided the arbitration agreement submits 'all disputes arising out of or in connection with the contract' to the tribunal, decisions based on the CISG are unlikely to be beyond the tribunal's mandate, even if impeachable for breach of due process.¹¹⁴

There are parallels to the issues that face courts.¹¹⁵ It may be true that, unlike court decisions, arbitral awards are not generally reviewable on questions of law,¹¹⁶ but both are vulnerable for failure to observe due process. The competing constraints under which a tribunal operates – its obligation to render a decision according to law

109. See, e.g., Bundesgericht [Federal Supreme Court], Switzerland, 4A_108/2009, 9 Jun. 2009. 28(3) ASA Bulletin 553 (2010) (inapplicable law not invoked but applied by tribunal); *Louis Dreyfus SAS v. Holding Tusculum BV*, Quebec Superior Court, Canada, 8 Dec. 2008 ('*Dreyfus v. Tusculum*') (annulling award imposing a remedy neither side had pleaded for failure of the right to be heard and *ultra petita*); Sophie Nappert, *Arbitral Activism* (2010), <http://demo.kluwerarbitration.com/arbitration/Newsletter.aspx?month=march2009> (commenting on *Dreyfus*); Beatrice Grob and Georg von Segesser *Iura Novit Curia – The Right to be Heard* (27 Aug. 2009), http://kluwerarbitrationblog.com/blog/2009/08/27/iura-novit-curia-the-right-to-be-heard-decision-of-the-swiss-federal-supreme-court-as-of-9-june-2009-4a_1082009/ (discussing Swiss Federal Supreme Court decision of 9 Jun. 2009).

110. Dimolitsa, above n. 102, at 429, 438; Isele, above n. 22, at 24; Kalniņa, above n. 94, at 101; ILA Final Report, above n. 24, at 21.

111. Model Law Art. 34(2)(a)(iii); New York Convention Art. V(I)(c); Born, above n. 95, at 2606-607; ILA Final Report, above n. 24, at 19; Cordero Moss, above n. 95, at 2; Kurkela, above n. 22, at 490; Kalniņa, above n. 94, at 90, 110.

112. Kurkela, above n. 22, at 297-98.

113. See, e.g., *Werfen Austria GmbH v. Polar Electro Europe BV*, Supreme Court, Finland, 2 Jul. 2007, translated at 3 Stockholm Int'l Arbitration Rev. 260 (2008) ('*Werfen case*'); Federal Supreme Court, Switzerland, 4A_220/2007, 21 Sep. 2007, 26(4) ASA Bulletin 742. Upholding this ground: *Systembolaget Aktiebolag v. V & S Vin & Sprit Aktiebolag*, Svea Court of Appeal, Stockholm, Sweden, T4548-08, 1 Dec. 2009 (translation by K. B. Vinge); *Dreyfus v. Tusculum*, above n. 110. See also Albert Jan van den Berg (ed), *ICCA Yearbook of Commercial Arbitration 2003* Vol 28, 656 (Deventer 2003); Born, above n. 95, at 2589, 2607-608; Lew et al, above n. 95, at 675 [25-38] to [25-39]; Nappert, above n. 103, at 286; Cordero Moss, above n. 95, at 3. For discussion of the *Werfen case*, see Nappert, above n. 103, at 286; Petra Kiurunen, *Finality of Arbitral Awards – Common Grounds?*, 3 Stockholm Int'l Arbitration Rev. 273, 277, 280 (2008).

114. See generally regarding applicable law, Cordero Moss, above n. 95, at 3-4.

115. See Isele, above n. 22, at 20-24.

116. Some jurisdictions still allow merits review: see Born, above n. 95, at 2646-47.

and its obligation to afford due process – ensure that ultimately, tribunals are faced with much the same dilemma. Essentially this boils down to a policy choice between:

- (i) a decision based on the wrong law and thus incorrect on its merits but with little chance of challenge (application of inapplicable but argued law);¹¹⁷
- (ii) a decision correct on the merits but which risks being overturned for procedural error (ex officio application of applicable but unargued law);¹¹⁸ or
- (iii) a decision both correct on its merits and with little chance of challenge (application of relevant law after affording an opportunity to either address it in argument or to agree to restrict the tribunal's discretion to apply that law).

Of course the preferable course is for the tribunal to suggest the parties agree openly on the procedural rules as a preliminary matter. The tribunal might propose a soft form *iura novit arbiter* rule with a broadly defined right to be heard and leave it to the parties to agree upon a more restrictive approach if they can.¹¹⁹

Thus although tribunals are not subject to the same obligation to apply the CISG as courts in Contracting States, nonetheless, it is submitted that the suggested approach to interpretation regarding exclusions in section §10.04 below and practical solutions proposed in §10.05 will hold relevance for arbitral tribunals as they seek to balance their own competing obligations.

[D] Appeals

A range of approaches is evident in appeals. The Slovak decisions mentioned earlier in which the lower court applied the wrong law were remitted by the appeal court back to the lower court for re-determination under the correct law.¹²⁰ In Germany, parties are not restricted upon appeal to non-CISG domestic law simply because this was the basis of argument in lower courts.¹²¹ Other systems might limit the scope of appeal to grounds already raised by parties, sometimes due to specific rules limiting the subject matter of the jurisdiction of the appeal court. Thus an appeal court might be constrained from applying a law overlooked at the trial stage. For example, in the *GPL*

117. Unlikely to provide grounds for refusal of enforceability, unless mandatory rules are overlooked: ILA Final Report, above n. 24, at 17, 22.

118. A rare example of the Swiss courts upholding breach of right to be heard for 'surprise' is Federal Supreme Court, 4A_400/2008, 9 Feb. 2009, (2009) 27(3) ASA Bulletin 501. Doubting this likely in Sweden: Martin Wallin and Katarina Mild, *Observations*, 1 Stockholm Int'l Arbitration Rev. 148, 149 (2007).

119. Gabrielle Kaufmann-Kohler, *The Arbitrator and the Law*, 21(4) *Arbitration Int'l* 631, 636 (2005); Nappert, above n. 103, at 287. See also, Dimolitsa, above n. 102, at 433; Kalniņa, above n. 94, at 103; ILA Final Report, above n. 24, at 16; Jeffrey Waincymer, *International Arbitration and the Duty to Know the Law*, 28 *J. Int'l Arbitration* 201, 227-8 (2011).

120. See above n. 50.

121. Court of Appeal (OLG) Rostock, Germany, 10 Oct. 2001, <http://cisgw3.law.pace.edu/cases/0111010g1.html>; Stefan Kröll, *Global Challenges of International Sales Law Conference*, 11-13 Nov. 2011, University of Florida, Gainesville, USA.

Treatment case in the US, the appeal court refused to hear CISG arguments.¹²² Similarly, in accordance with rules of appeal and pleading, counsel was refused permission to amend pleadings to incorporate CISG argument for the first time at the appeal stage in the Australian case of *Italian Imported Foods*.¹²³

Sometimes the grounds of appeal are matters of judicial discretion,¹²⁴ which itself might turn on whether new arguments would be 'futile'. Where this is so, it is submitted that preliminary CISG argument should always be permitted so as to gauge the extent of potential futility.¹²⁵

It could be argued that appeal rules fall within the more general proposition asserted earlier, and that they are procedural rules displaced by the CISG. I do not make this assertion. Instead, it is submitted that where rules of appeal allow for judicial discretion regarding new grounds, the matters raised above should be carefully taken into account in the exercise of that discretion to the fullest extent possible. A view inclined to allowing new argument will support the aims of the CISG and more closely align them with its application in practice. It will also encourage closer attention to it by counsel and therefore enhance familiarity with it in the jurisdiction concerned, with the attendant economic benefits discussed earlier.

§10.04 CAN THE CISG BE EXCLUDED BY FAILURE TO PLEAD IT?

Once it has been determined that the CISG is to be applied, then the remaining question is how the adjudicator should view the failure to plead the CISG and presentation of the case on the basis of inapplicable local sales laws. What is a court or tribunal to make of such conduct pursuant to the CISG? Can failure to plead the CISG amount to a waiver or tacit exclusion of it?

It was demonstrated above that presently, the answers to these questions in cases applying the CISG have been varied and unpredictable. This is clearly undesirable from the perspective of the lessons learned above, as it would tend to reduce litigation exposure of lawyers to the CISG (with associated societal benefits as discussed in Chapter 8) and would also tend to increase substantive concerns related to uncertainty. An approach that produces greater consistency is warranted from both an economic and qualitative perspective.

Since the contract is governed by the CISG, it is submitted that the adjudicator must look to its provisions alone to decide if such conduct amounts to an exclusion. It

122. *GPL Treatment*, above n. 9. Counsel was not permitted to alter pleadings and was held to have waived CISG argument since it was not raised until late in the trial: *GPL Treatment, ibid.*, Leeson J (dissenting, n. 8); Harry M. Flechtner, *Another CISG Case in the US Courts*, 15 J.L. & Com. 127, 129, n. 11 (1995).

123. *Italian Imported Foods*, above n. 8.

124. *GPL Treatment*, above n. 9; *Italian Imported Foods*, above n. 8; *Summit Chemicals Pty Ltd v. Vetrotex Espana SA*, Court of Appeal, Western Australia, 27 May 2004, <http://cisgw3.law.pace.edu/cases/040527a2.html>.

125. Unfortunately, this is not always appreciated in applications to amend pleadings.

is the CISG which controls the ‘choice of law rule’ when a CISG contract exists, not domestic procedural rules nor domestic waiver principles. Thus if parties wish to exercise that option during proceedings, they will need to comply with the CISG’s internal requirements before their autonomous choice is effective.

The ability of parties to choose to exclude its application is therefore controlled by Article 6 which deals with exclusion. This is so whether parties seek to exclude the CISG within the original contract or sometime thereafter.

Until Article 6 is enlivened, the CISG remains the governing law of the contract. Whilst there is minority opinion to the contrary which holds that the domestic law that would be applicable pursuant to private international law determines formation, the majority view is that any agreement to exclude must be formed pursuant to the formation provisions of the CISG, and will need to satisfy Article 6.¹²⁶ It seems incongruous to assert on the one hand that Article 6 ‘governs’ the question of exclusion from the CISG, but domestic law should ‘govern’ whether the agreement containing such an exclusion has been formed.¹²⁷ Such an approach would rob Article 6 of effect, remove the potential for uniformity in interpretation of exclusions, and run contrary to the nature of the CISG as applicable law. The CISG’s applicability from the outset is not subordinated to the

126. See, e.g., Court of Appeal (OLG) Oldenburg, Germany, 20 Dec. 2007, <http://cisgw3.law.pace.edu/cases/071220g1.html>; *Golden Valley Grape Juice and Wine, LLC v. Centrisys Corp.*, 2010 US Dist LEXIS 11884, US District Court (ED Cal), 22 Jan. 2010, <http://cisgw3.law.pace.edu/cases/100121u1.html> (‘Golden Valley case’); *Easom Automation Systems, Inc. v. Thyssenkrupp Fabco, Corp.*, 2007 WL 2875256, US District Court (ED Mich), 28 Sep. 2007, CISG-online 1601, <http://www.cisg-online.ch/cisg/urteile/1601.pdf>; Kantonsgericht St Gallen HG, Switzerland, 15 Jun. 2010, 2009/164, CISG-online Case No 2159 (translation P. Landolt, above n. 47); Ingeborg Schwenzer and Pascal Hachem, in *Schlechtriem & Schwenzer* 3rd edn, Art. 6, at 104, 105 (formation and interpretation of exclusion clauses subject to CISG rules); Martin Schmidt-Kessel, in *Schlechtriem & Schwenzer* 3rd edn, Art. 8, at 177 [61] (incorporation of choice of law clauses including exclusions of CISG within sphere of CISG formation provisions); Baile, above n. 66, at 302-304 (despite Art. 6 parties cannot completely contract out of the CISG, since ‘[o]nly after a court concludes that a contract has in fact been formed can a court give effect to a choice of law clause [selecting a] law other than the CISG’); Tribunale di Forlì, Italy, CISG-online Case No 2336, 26 Mar. 2009, §V (‘two-step’ process is avoided as the CISG prevails over private international law as a special and more limited law), <http://www.globalsaleslaw.org/content/api/cisg/urteile/2336.pdf>. *Contra* (minority view) Jack Graves, *CISG Article 6 and Issues of Rules*, 15 Vindobona J. Int’l Commercial L. & Arbitration 105, passim (2011) (domestic law on formation governs the issue, and application of CISG formation rules is ‘circular’); *Venter v. Ilona MY Ltd.*, Supreme Court of New South Wales, Australia, 24 Aug. 2012, [26], <http://cisgw3.law.pace.edu/cases/120824a2.html> (incorporation determined according to domestic law); Peter Schlechtriem, in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* Art. 6, 85-89 [7]-[10] (Oxford 2nd edn, 2005) (‘Schlechtriem & Schwenzer 2nd edn’) (private international law).

127. But see Graves, above n. 127, at 109 (Art. 6 governs exclusions, but exclusion clauses are separable and should interpreted according to applicable domestic law). See also Loukas Mistelis in Stefan Kröll, Loukas Mistelis and Pilar Perales Viscasillas (eds), *UN Convention on Contracts for the International Sale of Goods* Art. 6, 99, 102 [10] (Beck/Hart/Nomos 2011) (agreements to exclude should be treated as ‘stand-alone’ agreements).

will of the parties' unless that will amounts to an agreement to exclude in accordance with the CISG, since the CISG already applies pursuant to Article 1.¹²⁸

In other words, once in, the only way out is via the CISG's own rules.

[A] Exclusion within the Original Contract

Naturally, exclusion can occur at various stages of the contractual life-cycle. Much of this book contemplates exclusion at the *ex ante* contractual stage. Before considering interpretation of Article 6 CISG at the *ex post* litigation stage, it is useful to briefly examine the requirements for exclusion pursuant to Article 6 at the *ex ante* stage as a point of comparison.

Generally, courts and commentators have taken a rather restrictive approach to exclusion of the CISG within contractual clauses. The predominant view amongst scholars does not oppose implicit exclusion, but cautions against swift or hasty conclusions of an implicit exclusion within the contract.¹²⁹ At a minimum, a 'certain' or 'real' tangible intent is required for implicit exclusion to be effective, as opposed to a hypothetical or 'theoretical' intent.¹³⁰ While some cases have upheld implicit opt-outs,¹³¹ most courts and tribunals have been slow to infer exclusion where the contractual clause is unclear.¹³² Thus a reference to Incoterms has been held insufficient to demonstrate an intent to exclude the CISG.¹³³ A choice of national law

128. *Sté Ceramique Culinaire de France v. Sté Musgrave Ltd*, Supreme Court, France, 17 Dec. 1996, <http://cisgw3.law.pace.edu/cases/950926f1.html> (the CISG 'applies at the outset; its applicability is not subordinated to the will of the parties, express or tacit'). See also, Tribunale di Padova, 25 Feb. 2004, above n. 20 ('[f]urther, the silence in the pleadings on the matter of the applicability of the law at issue is immaterial because ... [the CISG] is applicable by operation of law').

129. Against implicit exclusion: Fritz Enderlein and Dietrich Maskow, *International Sales Law* Art. 6, 48-49 [1.2], [1.3] (Oceana 1992) ('Enderlein and Maskow'); Schlechtriem, in *Slechtriem & Schwenzler* 2nd edn, above n. 127, Art. 6, at 88-89 [12] (reluctance of legal writers to infer exclusion). In support of implicit exclusion: Michael Bridge, 'Choice of Law and the CISG' in Harry M. Fletcher, Ronald A. Brand and Mark S. Walter (eds), *Drafting Contracts under the CISG* 65, 77 (Oxford 2008), but see *ibid.*, 78 (parties bear the burden of making their intent plain); Honnold, above n. 9, Art. 6, at 108-110, n. 19 [77.1]; Bridge, above n. 18, at 945-46 [16.69].

130. Supreme Court, France, 17 Dec. 1996, above n. 129 (implied exclusion must be 'certain'); Honnold, above n. 9, Art. 6, at 107-108 [77] (requiring 'real' and not 'theoretical' intent, thus exclusions must be 'express' or 'clearly implied in fact'). See also Enderlein and Maskow, above n. 130, at Art. 6, 48; Franco Ferrari, *Specific Topics of the CISG in the Light of Judicial Application and Scholarly Writing*, 15 J.L. & Com.1, 88, n. 614 (1996); Ferrari, above n. 9, at 220.

131. See, e.g., *Olivaylle Pty Ltd v. Flottweg GmbH & Co KGAA (No 4)* (2009) 255 ALR 632, Federal Court of Australia, 20 May 2009, <http://cisgw3.law.pace.edu/cases/090520a2.html>; District Court (LG) München, Germany, 29 May 1995, <http://cisgw3.law.pace.edu/cases/950529g1.html>; Lower District Court (BG) Weinfeld, Switzerland, 23 Nov. 1998, <http://cisgw3.law.pace.edu/cases/981123s1.html>; Cour d'appel de Colmar, France, 26 Sep. 1995, <http://cisgw3.law.pace.edu/cases/950926f1.html> (criticized on appeal by the Supreme Court, 17 Dec. 1996, above n. 129).

132. See also Schlechtriem, in *Slechtriem & Schwenzler* 2nd edn, above n. 127, Art. 6, at 88-89 [12].

133. Supreme Court, Austria, 22 Oct. 2001, <http://cisgw3.law.pace.edu/cases/011022a3.html>.

excluding ULIS was held not to exclude the CISG.¹³⁴ A few cases have gone further still, denying even the possibility of implicit exclusion within the contract.¹³⁵ By contrast, a clause which provided for ‘exclusion of UNCITRAL law’ was upheld as manifesting an intent to exclude the CISG.¹³⁶

Frequently the issue arises when a choice of law clause selects the law of a Contracting State. The widely accepted view upheld by most courts and tribunals is that this will not exclude the CISG, since the CISG forms part of the law of the Contracting State.¹³⁷ Of particular interest is a long line of cases in the USA. These have likewise held that the CISG will not be excluded implicitly merely by a clause providing for a choice of the law of a Contracting State.¹³⁸ In only one recent US case has choice of the law of a province within a Contracting State been upheld as sufficient to exclude

134. District Court (LG) Düsseldorf, Germany, 11 Oct. 1995, <http://cisgw3.law.pace.edu/cases/951011g1.html>.

135. See District Court (LG) Landshut, 5 Apr. 1995, above n. 12, §II.1.a (‘[t]he parties can only exclude the application of the CISG by explicit agreement’); *Cybersphere Corp. v. United States*, 726 F Supp 1344, Federal Court of International Trade, USA, 24 Oct. 1989, n. 7, <http://cisgw3.law.pace.edu/cases/891024u1.html>; Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, Award 54/1999, 24 Jan. 2000, [1], <http://cisgw3.law.pace.edu/cases/000124r1.htm>.

136. *Olivaylle v. Flottweg*, above n. 132.

137. Supreme Court, France, 17 Dec. 1996, above n. 129 (‘[r]eferring only to the law of a Contracting State in a clause ... is not sufficient’); Supreme Court, Austria, 26 Jan. 2005, <http://cisgw3.law.pace.edu/cases/050126a3.html>; Supreme Court, Austria, 22 Oct. 2001, above n. 134; Supreme Court, Austria, 2 Apr. 2009, above n. 5; Supreme Court, Poland, 17 Oct. 2008, Maciej Zachariasiewicz, *Abstract*, <http://cisgw3.law.pace.edu/cases/081017p1.html>; ICC Award No. 7565/1994, above n. 33; Federal Supreme Court (BGH), Germany, 25 Nov. 1998, <http://cisgw3.law.pace.edu/cases/981125g1.html>; District Court, Zug, Switzerland, 11 Dec. 2003, <http://cisgw3.law.pace.edu/cases/031211s1.html>; Federal Supreme Court (BGH), Germany, 23 Jul. 1997, <http://cisgw3.law.pace.edu/cases/970723g1.html>; Appellate Court (OLG) Frankfurt, Germany, 30 Aug. 2000, <http://cisgw3.law.pace.edu/cases/000830g1.html>; Cour d’appel Paris, 6 Nov. 2001, <http://cisgw3.law.pace.edu/cases/011106f1.html>; District Court (LG) Kiel, Germany, 27 Jul. 2004, <http://cisgw3.law.pace.edu/cases/040727g1.html>. See also, *UNCITRAL Digest 2012*, above n. 18, Art. 6 [11]; Schlechtriem, in *Slechtriem & Schwenzer* 2nd edn, above n. 127, Art. 6, at 90 [14].

138. *Valero Marketing & Supply Co. v. Greeni Oy*, 373 F Supp 2d 475, Federal District Court New Jersey, USA, 15 Jun. 2005, <http://cisgw3.law.pace.edu/cases/050615u1.html>; *Ajax Tool Works, Inc. v. Can-Eng Manufacturing Ltd*, 2003 US Dist LEXIS 1306 (ND Ill), US District Court, 29 Jan. 2003, <http://cisgw3.law.pace.edu/cases/030129u1.html>; *American Mint LLC v. GOS-oftware, Inc.*, 2006 US Dist LEXIS 1569 (MD Pa), US District Court, 6 Jan. 2006, <http://cisgw3.law.pace.edu/cases/060106u1.html>; *Travelers Property Casualty Company of America v. Saint-Gobain Technical Fabrics Canada Ltd*, 2007 WL 313591, US District Court, Minnesota, 31 Jan. 2007, <http://cisgw3.law.pace.edu/cases/070131u1.html>; *Easom Automation case*, above n. 127; *Asante Technologies, Inc. v. PMC-Sierra, Inc.*, 164 F Supp 2d 1142, US District Court (ND Cal), 27 Jul. 2001, <http://cisgw3.law.pace.edu/cases/010727u1.html>; *St Paul Guardian Insurance Company v. Neuromed Medical Systems & Support, GmbH*, 2002 US Dist LEXIS 5096 (SD NY), 26 Mar. 2002, <http://cisgw3.law.pace.edu/cases/020326u1.html>; *BP International, Ltd v. Empresa Estatal Petroleos de Ecuador*, 332 F 3d 333, US Court of Appeals (5th Cir), 11 Jun. 2003, <http://cisgw3.law.pace.edu/cases/030611u1.html> (‘Where parties seek to apply a signatory’s domestic law in lieu of the CISG, they must affirmatively opt-out of the CISG’).

the CISG.¹³⁹ On the other hand, mention of a specific domestic statute or code is often, but not always, seen as denoting a choice of domestic non-uniform law.¹⁴⁰

In the context of exclusion under Article 6 within the original contract, the unmistakable impression is that, while implicit exclusion remains possible, an intent to exclude is not readily inferred. Regardless of whether the preference is an efficient one,¹⁴¹ it is fair to say that courts and tribunals in this context seem generally slow to reach the conclusion that parties intended to exclude at the *ex ante* stage.

Of course, each case turns on its particular facts, and the task of adjudicators is to balance competing inferences. At a positive level, this can be seen as a three step exercise conducted within the framework of Articles 6 and 8 CISG, whereby the adjudicator first considers an intent to exclude as the purported meaning of words used; second, considers any competing hypothesis for their meaning; and third, determines on balance which meaning is the most likely to have been intended, and reasonably understood by the other party.

What the cases demonstrate in the context of *ex ante* contractual clauses is that this balance generally tips in favour of non-exclusion where the facts do not support an inference of clear intent to exclude that is on balance more plausible than any competing alternatives. This is because the burden is on parties to make their choice of law plain enough that it would be reasonably understood as bearing the purpose of exclusion: Article 8(2) CISG.¹⁴² Selection of Incoterms concerns a narrow range of issues, and therefore cannot of itself objectively manifest a clear intent to exclude the

139. See *American Biophysics v. Dubois Marine Specialties*, Federal District Court Rhode Island, 411 F Supp 2d 61, USA, 30 Jan. 2006, <http://cisgw3.law.pace.edu/cases/060130u1.html>. This found exclusion by choice of the law of the state of Rhode Island, citing five earlier decisions for the (inaccurate) proposition the CISG applies when the 'contract does not contain a choice of law provision'. Yet these cases simply used 'imprecise descriptions, in dicta': William P. Johnson, *Understanding Exclusion of the CISG*, 59 Buff. L. Rev. 213, 243 (2011). In fact, *American Biophysics* stands alone in actually applying this incorrect proposition. Despite subsequent repetition as *dicta* in the *Golden Valley*, and *Easom* cases, both above n. 127, the CISG analysis in *Easom* was 'largely ultimately sound': Johnson, *ibid.*, at 245, and in *Golden Valley* parties agreed the CISG applied. Supporting the minority position: Mistelis, above n. 128, at Art. 6 105 [18] & 107 [23] (selection of law of a Contracting State province may indicate exclusion).

140. Supreme Court, Austria, 4 July 2007, <http://cisgw3.law.pace.edu/cases/070704a3.html> (reference to a particular law such as the Austrian Consumer Protection Act and the Austrian Commercial Code was an implied exclusion of the CISG)(overturning Appellate Court (OLG) Linz, Austria, 23 Jan. 2006 [2.3], <http://cisgw3.law.pace.edu/cases/060123a3.html>; Appellate Court (OLG) Oldenburg, 20 Dec. 2007, above n. 127; CIETAC Award, 24 Mar. 1998, CISG-online Case No 930. See also Court of Appeal (OLG) Stuttgart, 31 Mar. 2008, above n. 35 (words such as 'the provisions of the BGB are applicable' would indicate intent to exclude); *Asante Technologies v. PMC-Sierra*, above n. 139, 1150; *Delchi Carrier SpA v. Rotorex Corp.*, above n. 66, n. 1; *Doolim Corp. v. R Doll, LLC*, Federal District Court (SDNY), United States, 29 May 2009 [34], <http://cisgw3.law.pace.edu/cases/090529u1.html>. Contra Supreme Court, Hungary, 2007, Gfv.IX.30.372/2007/5, (applying CISG despite choice of Hungarian Civil Code on basis this was not tacit exclusion)(translation G. Bacher, 30 Oct. 2008, http://www.szecskay.hu/dynamic/Bacher_Application_of_CISG_in_HUNGARY.doc; District Court (LG) Landshut, 5 Apr. 1995, above n. 12, §II.1.a; Tribunale di Padova, 25 Feb. 2004, above n. 20; Appellate Court (OLG) Zweibrücken, Germany, 2 Feb. 2004, §3, <http://cisgw3.law.pace.edu/cases/040202g1.html>; Appellate Court (OLG) Hamm, 9 Jun. 1995, above n. 12.

141. Walt, above n. 15, at 345-46 (court preferences have not been based on economic grounds).

142. Bridge, above n. 130, at 78; Bridge, above n. 18, at 966-67 [16.110].

entire CISG rather than mere derogation of provisions relating to risk etc.¹⁴³ On the other hand, a reasonable person would understand a clause excluding UNCITRAL law to evince an intent to exclude something, and it is difficult to envisage an alternative hypothesis as to what might have been intended other than exclusion of the CISG.¹⁴⁴

At a normative level, there are good policy reasons for adjudicators to set the evidentiary bar at this level. It accords with the timbre of the Diplomatic Conference, where the concern was that uniform law would be rendered ineffective if courts were too quick to find exclusion.¹⁴⁵ The policy concern of governments to maximize uniformity in practice has therefore been realized by what might be termed a 'strict approach' to the burden of proof regarding inferences of exclusion at the contractual stage. Some cases have even recognized these policy implications in their reasoning.¹⁴⁶ Thus the norm now feeds back into the decision making process by way of Article 7 in the form of the guidance provided by the predominant view in cases and scholarship, although some scholars have stated the 'strict approach' to contractual exclusion has gone too far.¹⁴⁷

The question is whether this same 'strict approach' is appropriate for exclusions that occur after the contractual stage.

[B] Post-contractual Exclusion

Inexplicably, this stringent stance on *ex ante* implicit exclusion stands in stark contrast to the cases on implicit waiver of the CISG during litigation proceedings. As we have seen, some courts have allowed mere conduct of litigation to stand as a choice of law subsequent to conclusion of the contract.

The paradox is even more puzzling when one takes into account that in determining *ex ante* exclusion, whether or not a CISG contract even exists is still in question.¹⁴⁸ By contrast, *ex post* waivers or exclusions are already within the CISG's gravitational pull. Undoubtedly, determination of the efficacy of any purported post-contractual exclusion must be made pursuant to CISG rules. After all, a CISG contract already exists. Even the minority who advocate the use of conflict rules to test *ex ante*

143. See Supreme Court, Austria, 22 Oct. 2001, above n. 134.

144. See *Olivaylle v. Flottweg*, above n. 132, and above n. 137 and accompanying text.

145. The wording of Art. 6 was originally from Art. 3 ULIS, but the second sentence 'Such exclusion may be express or implied' was omitted 'lest the special reference ... might encourage courts to conclude, on insufficient grounds, that the [CISG] had been wholly excluded': UNCITRAL Secretariat, *Commentary*, UN Doc A/CONF.97/5 (14 Mar. 1979) Art. 5 [2], in Diplomatic Conference, Vienna, 10 Mar.-11 Apr. 1980, UN Doc A/CONF.97/19 14, 17. See also *Report of the Working Group*, 2nd sess, UN Doc A/CN.9/52 (7-18 Dec. 1970), in UNCITRAL Yearbook [1971] Vol II, UN Doc A/CN.9/SER.A/1971 50, 55 [45]; Honnold, *Documentary History*, above n. 72, at 61.

146. *Travelers Property case*, above n. 139 ('an affirmative opt-out requirement promotes uniformity and the observance of good faith in international trade, two principles that guide interpretation of the CISG'); *St Paul case*, above n. 139 (choice of Contracting State law did not exclude the CISG, and '[t]o hold otherwise would undermine the objectives of the [CISG]').

147. Schroeter, above n. 70, at text accompanying n. 56 (now stricter than 'under many private international law rules').

148. Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 127, Art. 6, at 89, 91 [12], [14].

exclusion clauses reject this stance in regard to post-contractual exclusions.¹⁴⁹ One might therefore think that, if contractual exclusions are construed strictly, then post-contractual exclusions should be construed just as stringently. Why then do courts consistently show great restraint regarding *ex ante* exclusion, yet frequently are ready to quickly accept *implicit or tacit* waiver as sufficient where a CISG contract already exists?

The absurdity of this proposition provides the key to its resolution. To recognize tacit waiver or implied post-contractual exclusion is to recognize a change to the governing law of the contract. Most legal systems allow such a modification for contracts governed by domestic law.¹⁵⁰ Essentially, in the present context, courts are endorsing exclusion by modification of a pre-existing CISG contract. It is submitted that this must be done by application of Articles 6, 14-24 and 29.

Yet the cases demonstrate that this approach is not consistently employed. Even amongst cases which purportedly apply these provisions, we find vastly divergent approaches.¹⁵¹ Moreover, it appears in many cases that the evidentiary bar is set far lower than it is at the *ex ante* contractual stage, and in some cases the court seems eager to conclude tacit waiver without careful consideration of the issue.

It is submitted that a better level of predictability can be fostered by greater consistency between interpretations of the applicable provisions, and by an appropriate assessment of inferences.

[C] Exclusion by Failure to Argue

It was contended above that failure to invoke the CISG in argument can only constitute an *ex post* implied agreement to exclude if it actually modifies the pre-existing CISG contract. Thus, in addition to Article 6, the conduct would need to satisfy Article 29 and Articles 14-24.¹⁵²

149. *Ibid.*, Art. 6, at 89, 91 [12], [14].

150. Whincop and Keyes, above n. 87, at 541. See also Art. 3(2) *Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations* [2008] OJ L 177/6 ('*Rome I Regulation*') Art. 3(2) ('[t]he parties may at any time agree to subject the contract to a law other than that which previously governed it' and moreover '[a]ny change in the law to be applied that is made after the conclusion of the contract shall not prejudice its formal validity under Article 11'); Ziegler, above n. 72, at 342, n. 30; Zajtay, above n. 90, at 9, §14-13.

151. See cases discussed above, nn 35-47 and accompanying text.

152. Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 127, Art. 6, at 91 [14]; Schwenger and Hachem, above n. 127, Art. 6, at 114, 116 [24], [28] (agreements to derogate by modification are 'only' subject to the CISG, not conflicts rules). Contracts modifying contracts falling within CISG are also subject to CISG formation provisions: Ulrich G. Schroeter, in *Slechtriem & Schwenger* 3rd edn, Art. 29, at 472, 473 [2], [4]; Peter Schlechtriem, *Uniform Sales Law* 63, §A5 (Manz 1986) ('*Uniform Sales Law 1986*'); Ferrari, above n. 77, at 61 ('contracts modifying an international sales contract fall under the CISG as well, since they directly affect the [parties'] rights and obligations'); Peter Schlechtriem and Petra Butler, *UN Law on International Sales* 87 [97] (Springer 2009); Pilar Perales Viscasillas, *Modification and Termination of the Contract*, 25 J. L. & Com. 167, 171 (2005-6); Henry Gabriel, *Contracts for the Sale of Goods* 22 (Oxford 2009)(provided not applied to their full extent). Alluding to

To achieve more coherent, uniform and hence more predictable outcomes, it is submitted there should be greater consistency in application of these provisions. It follows that what is needed is a realignment of the *ex ante* and *ex post* interpretations of Article 6. This would redress the anomaly of the ‘lax standard’ presently applied to post-contractual exclusions in the current context by comparison with the ‘strict approach’ applied to exclusions within the original contract. Likewise, there is a need to reconcile the restraint evident in modifications pursuant to Article 29 in more general settings with the tendency to eagerly jump to conclusions of tacit exclusion during proceedings. It is submitted that Article 29 should be consistently applied to all post-contractual modifications, including both performance and litigation phases.

Article 7(1) requires courts to interpret the CISG in a manner that promotes uniformity.¹⁵³ While a general principle of party autonomy underlies the CISG and Article 6 undoubtedly permits post-contractual exclusion, the divergence observed in the interpretation of Article 6 within litigation waiver cases (discussed above in section §10.02[E]) and between different contractual phases (see sections A and B above) demonstrates the need to develop a balanced and consistent approach as to *how* party autonomy may be legitimately exercised in the current context.

Unlike exclusion within the original contract, it is incontrovertible that CISG formation provisions apply to post-contractual exclusions.¹⁵⁴ While this means that parties can agree to exclude the CISG during litigation,¹⁵⁵ it is submitted that there must be appropriate evidence of a clear intent to exclude. An analysis of the provisions of the CISG, as well as certain pragmatic considerations discussed below, support the argument that the evidentiary balance should be set at a somewhat higher level than that displayed at present in many cases.

It follows from Article 14 CISG that *ex post* offers to exclude should exhibit an ‘intent to be bound’. It is submitted that it is improbable that an absence of argument on applicable law in litigation could constitute such an offer. Failure to mention the law sought to be excluded would arguably render most purported offers to modify hopelessly indefinite pursuant to Article 14 CISG.

Additionally, mere failure to object could only rarely amount to assent under Article 18 in this context. A defence which answers only those arguments raised by the claimant is a long way from what is generally understood as acceptance of a unilateral attempt to modify. In fact, generally speaking, under Article 29 CISG, failure to object

disagreement about the relevance of Arts 8, 14-24 in relation to Art. 29: Andrea Björklund, in Kröll et al (eds), above n. 128, Art. 29, 382, at 383 [5].

153. The need to promote uniformity in the CISG’s interpretation is described by Schlechtriem as a ‘maxim’: *Uniform Sales Law 1986*, above n. 153, at 38, §IVA.

154. Unlike exclusions within the original contract, about which there is still some disagreement: see above n. 127 and accompanying text. Compare also Schlechtriem, in *Slechtriem & Schwenzler* 2nd edn, above n. 127, Art. 6, at 89, 91 [12], [14] with Schlechtriem, *ibid.*, at 85-89 [7]-[10] and accompanying text.

155. Bridge, above n. 18, at 917, 922. Note that Bridge argues that where the forum would otherwise be obliged to apply the CISG, parties can post-contractually agree to apply non-CISG domestic law if, e.g., Art. 3(2) *1980 Rome Convention on the Law Applicable to Contractual Obligations*, 1980 OJ L 266, (‘*Rome Convention*’), applies (now Art. 3(2) *Rome I Regulation*, above n. 151); Ziegel, above n. 72, at 342, n. 30. See generally, Zajtay, above n. 90, at 9, §14-13.

to modification offers will be acceptance only in ‘very exceptional cases’,¹⁵⁶ since there is already a contractual balance of rights and obligations on foot.¹⁵⁷

Moreover, if the original contract contained a ‘no oral modification’ clause, the potential for tacit waiver by conduct of the case is further reduced, unless there has been reliance on the conduct: Article 29(2) CISG. The ‘mere fact that a party has not pursued his remedies against the other party should ... not constitute a sufficient reliance’ for the purposes of Article 29(2).¹⁵⁸ It must be doubted in formulating its response to claims a respondent has relied upon any absence of form.

A purported offer to modify must be understood as such by a reasonable person to be effective.¹⁵⁹ The intention to be bound must be tested objectively under Article 8(2), not ‘rashly’ assumed.¹⁶⁰ This is certainly so in the context of attempts to modify during the contractual performance phase, where caution has been urged in interpreting conduct as acceptance of offers to modify.¹⁶¹ Mere performance of the contract is normally not enough,¹⁶² and clear assent is required. Since in the current litigation context the parties are frequently unaware of the ‘right’¹⁶³ they supposedly relinquish, there will often be an objective absence of agreement to modify where the CISG is not raised in argument. As stated by one court:

in the presence of all requisites mentioned above [the CISG] is applicable by operation of law ... Neither can it be [sustained] that the silence of the parties

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156. Schroeter, above n. 153, Art. 29, at 476 [11]; Ulrich Magnus, ‘Incorporation of Standard Contract Terms under the CISG’ in Camilla B. Andersen and Ulrich G. Schroeter (eds) *Sharing International Commercial Law across National Boundaries* 303, 324 (Wildy Simmonds & Hill 2008); Perales Viscasillas, above n. 153, at 172; Schmidt-Kessel, above n. 127, Art. 8, at 172 [53]; *Macromex Srl v. Globex International Inc.*, American Arbitration Association Award, 23 Oct. 2007, <http://cisgw3.law.pace.edu/cases/071023a5.html> (aff’d 2008 WL 1752530 (SDNY); aff’d 330 Fed Appx 241, US Court of Appeal (2nd Cir), 26 May 2009) (‘failure to object to a unilateral attempt to modify a contract is not an agreement to modify a contract’); *Solae, LLC v. Hershey Canada, Inc.*, 557 F Supp 2d 452, US District Court Delaware, 9 May 2008, <http://cisgw3.law.pace.edu/cases/080509u1.html> (‘Nothing in the [CISG] suggests that the failure to object to a party’s unilateral attempt to alter materially the terms of an ... agreement is an ‘agreement’ within ... Article 29’).
157. Magnus, above n. 157, at 324; Schroeter, above n. 153, Art. 29, at 476 [11].
158. Schroeter, above n. 153, Art. 29, at 486 [37].
159. CISG Art. 8(2). Thus courts have rejected supposed offers to modify consisting of standard terms on reverse of invoices sent after conclusion of the contract: *Solae v. Hershey*, above n. 157; *Chateau des Charmes Wines Ltd v. Sabaté USA Inc.*, 328 F 3d 528, US Court of Appeals (9th Cir), 5 May 2003, <http://www.unilex.info/case.cfm?pid=1&do=case&id=899&step=FullText>. See also, *ibid.*, Art. 29, at 475, 476 [10], [11]; Schmidt-Kessel, above n. 127, Art. 8, at 173-74 [58].
160. Schwenzer and Hachem, above n. 127, Art. 6, at 113, 115 [21], [26]. Alluding to disagreement about relevance of Arts 8, 14-24 in relation to Art. 29: Björklund, in Kröll et al (eds), above n. 128, Art. 29, 382, at 383 [5].
161. Schroeter, above n. 153, Art. 29, at 476 [11] (urging ‘particularly careful assessment’ as to whether acceptance of an offer to modify has occurred).
162. Acts of performance are not acts of assent: CIETAC Arbitration Award, China, 23 May 2000, <http://cisgw3.law.pace.edu/cases/000523c1.html> (‘Partial performance of the Contract should not be deemed as a modification of the quantity of the goods under the Contract’); *Chateau des Charmes Wines v. Sabaté*, above n. 160 (payment of invoice containing new choice of forum clause); *Solae v. Hershey*, above n. 157.
163. Schroeter, above n. 153, Art. 29, at 485, n. 119 [33]; Schmidt-Kessel, above n. 127, Art. 8, at 164 [38].

constitutes an implied manifestation of the intent to exclude the application of [the CISG].¹⁶⁴

Several commentators agree that the ‘mere fact that the parties argue on the sole basis of a domestic law’¹⁶⁵ is anything but a clear indication of intent. Parties cannot intend to exclude the relevant law unless they are aware of its applicability.¹⁶⁶ Only then can parties ‘knowingly’ depart from the CISG by agreement.¹⁶⁷ Professor Schlechtriem perhaps stated this most clearly when he said:

[i]f the parties mistakenly ignore the applicability of the CISG and refer to provisions of domestic law in their pleadings or in the oral hearing in court, this cannot constitute an agreement to modify their contract. *Statements based on ignorance are not agreements, because they lack the necessary ‘intention to be bound’*; therefore they cannot alter the contents of a contract.¹⁶⁸

This line of reasoning works for both pleadings and oral argument. For pleadings, it is contended that it is not enough to view acceptance by both sides that domestic law applies as sufficient agreement to exclude in the absence of any reference to the CISG. Similarly, it is submitted that failure by counsel during argument to mention the CISG speaks of the likelihood it was simply overlooked. A belief that domestic law applies is not per se evidence of an agreement to exclude the CISG,¹⁶⁹ as echoed in better decisions on point.¹⁷⁰ Under these circumstances, it is argued that it would be

164. Tribunale di Padova, 25 Feb. 2004, above n. 20.

165. Ferrari, above n. 9, at 220 (this cannot ‘per se’ lead to the exclusion of the CISG’); Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 127, Art. 6, at 91 [14].

166. Ferrari, above n. 9, at 220; Court of Appeal (OLG) Rostock, Germany, 10 Oct. 2001, above n. 122; Tribunale di Vigevano, 12 Jul. 2000, above n. 12.

167. Schwenger and Hachem, above n. 127, Art. 6, at 113 [21] (‘conduct of the parties still needs to sufficiently indicate ... whether the parties knowingly departed from the otherwise applicable CISG’); Schmidt-Kessel, above n. 127, Art. 8, at 164 [38].

168. Schlechtriem, in *Slechtriem & Schwenger* 2nd edn, above n. 127, Art. 6, at 91 [14] (emphasis added).

169. Ferrari, above n. 9, at 220; Schwenger and Hachem, above n. 127, Art. 6, at 113 [21] (‘basing arguments on provisions of domestic sales law is simply a mistake on the part of the attorneys’, not evidence of intent to exclude); *ibid.*, Art. 6, at 90-91 [14].

170. See Court of Appeal (OLG) Stuttgart, 31 Mar. 2008, above n. 35 (failure to base allegations on the CISG does not imply post-contractual exclusion, since ‘[t]here is no mutual agreement of intent ... as this requires an express declaration of intent ... the application of the wrong provisions due to a legal misapprehension does not meet this requirement’); Tribunale di Padova, 25 Feb. 2004, above n. 20 (pleadings referring only to non-uniform domestic law cannot of themselves amount to an exclusion of the CISG, as an intent to exclude the CISG, ‘it must clearly show that [the parties] were aware of its applicability, and that they nonetheless insisted on referring only to the domestic rule’); Court of Appeal (OLG) Rostock, 10 Oct. 2001, above n. 122 (‘Merely referring to [the domestic provisions] is insufficient, because such reference might also be made because the parties think that that law was applicable anyway’); Court of Appeal (OLG) Hamm, 9 Jun. 1995, above n. 12; Tribunale di Forli, 16 Feb. 2009, above n. 35, at §4.3.3; District Court (LG) Landshut, 5 Apr. 1995, above n. 12, at §II.1.a (argument solely on the BGB ‘does not change anything’); District Court (LG) Bamberg, Germany, 23 Oct. 2006, <http://cisgw3.law.pace.edu/cases/061023g1.html>. See also, ICC Award No. 7565/1994, above n. 35; Tribunale di Vigevano, 12 Jul. 2000, above n. 12, at [5], [6]; Tribunale di Cuneo, 31 Jan. 1996, above n. 20 (although the latter two were based on the domestic procedural rule). See also Court of Appeal (OLG) Linz, Austria, 23 Jan. 2006, above n. 141 (failure to argue did not amount to exclusion, but overturned on appeal: Supreme Court, Austria, 4 Jul. 2007, above

erroneous for a court to infer an intent to exclude, without carefully considering the competing inference of ignorance or misapprehension.

With these points in mind, the disparate standards can be now realigned. General restraint is shown before other types of post-contractual modification are upheld under Article 29 CISG. Clear intent is required for inferences in relation to *ex ante* exclusion clauses in the original contract pursuant to Article 6 CISG. In view of the fact that exclusion by modification during litigation involves *both* Articles 6 and 29, it is proposed that the appropriate measure of intent should be no less stringent.

In setting the evidentiary standard for exclusion during proceedings, it is important to keep in mind the pragmatic consideration that, by contrast with the contractual stage, the evidentiary record is not static. At any time during proceedings, greater levels of proof are attainable upon enquiry by the adjudicator, simply by asking counsel.¹⁷¹ This means that provided the adjudicator raises the matter, whether before, during or after the hearings, the balance of inferences need not be hypothetical at all.

A court can be sure that parties clearly intend to modify their contract to exclude the CISG at the litigation stage if counsel present an express agreement by informed parties to that effect during proceedings. On the contrary, it is submitted that a court can only rarely infer with any confidence by mere reason of the way counsel conducts the case a clear intent to modify that satisfies both Articles 6 and 29. Adjudicators, in balancing inferences, must consider the alternative hypotheses: that counsel's conduct is, rather than demonstrative of tacit agreement by the parties, a product of counsel's own ignorance, misapprehension or simply convenience. Ignorance is not to be equated with intent. Thus the misapprehension of counsel or even stubborn refusal to argue the applicable law should never be accepted as manifesting an informed intent by the parties to exclude the CISG by modification of the contract.

Consistently with the predominant view under Article 6 on exclusions within the original contract, the adjudicator should exercise caution before jumping to the conclusion of exclusion by conduct in proceedings. In keeping with Article 29, adjudicators should be slow in accepting inferences that conduct of litigation amounts to an offer to modify and acceptance of that offer. Such inferences should of course be accepted when they are the *most* plausible explanation for counsel's conduct, but rejected when more plausible reasons, such as those suggested above, exist. This approach results in a standard of proof of similar rigour to that shown in cases dealing with *ex ante* exclusions, and the restraint apparent in relation to general modifications.

The balance suggested need not interfere with party autonomy. On the contrary, it is submitted that it mirrors the requirement for free choice to be 'clearly demonstrated' in other private international law contexts.¹⁷² It does no harm to the general

n. 141); District Court (LG) Saarbrücken, Germany, 2 Jul. 2002, above n. 39; Federal Supreme Court, Germany, 23 Jul. 1997, above n. 138, 3310 (relevant that 'the defendant had expressly adhered to application of the CISG during the oral court hearing in the second instance'); Supreme Court, Austria, 2 Apr. 2009, above n. 5 (exclusion of CISG upheld on basis of original choice of law, but also relevant was the conduct of the case at first instance).

171. See also Xiao and Long, above n. 10, at 77, 81-82.

172. *Hague Convention on the Law Applicable to Contracts for the International Sale of Goods*, 22 Dec. 1986, 24 ILM 1573, 1575 (1985) (not yet in force) Art. 7(1) ('[t]he parties' agreement on

principle of party autonomy to require a clear intent to alter the existing law of the contract, particularly when it is open to the parties to manifest that intent during proceedings. The current approach to waiver is anything but clear, and instead seems to facilitate confusion and avoidance of the applicable CISG by judicial fiat.

The suggested requirement of a clear intent does not rule out the possibility of implicit intent altogether, but acknowledges that it will rarely satisfy the relevant provisions of the CISG when applied in an integrated and coherent manner. Regardless of whether one agrees with strict tests for implied exclusion at the *ex ante* stage, confined to litigation waivers, this is a robust argument.¹⁷³ Adjudicators, above all, must be confident that, amongst the range of competing inferences, not only must an agreement to exclude the CISG be clearly capable of inference from counsel's conduct, but also that, on balance, such an inference is much more plausible than any other.

It might be contended that presumptions should not cloud the balance of proof, since we can never know in advance the probability that one conclusion rather than another is true. Professor Walt makes this point, albeit in relation to the strict *ex ante* exclusion test under Article 6.¹⁷⁴ However, the 'grave difficulty' faced by courts determining intent and waiver arguably makes it an 'error-prone' exercise, where setting the standard involves 'a tradeoff between different types of error'.¹⁷⁵ Thus it is useful to infuse the exercise with clear guidance drawn from empirical evidence relevant to the competing inferences. Doctrinal aspects aside, it is contended that evidence discussed in Chapter 6 does support the view that it is more likely than not that ignorance, misapprehension or convenience of counsel rather than an actual intent to exclude by the parties is behind the failure to mention the CISG in litigation. Further, it is submitted that a rigorous test for clear intent is supported by the economic indicators mentioned above in the case of litigation waiver.

The approach suggested puts forward a clear bright line. It is normally very costly for finders of fact to discover information regarding intent,¹⁷⁶ but raising the bar for the inference of exclusion by modification during litigation does not unduly affect evidentiary costs, particularly given the pragmatic possibility of intervention during proceedings. Indeed, it arguably reduces the evidentiary burden by requiring efficient behaviour from the parties to make a clear, timely and informed choice.¹⁷⁷

The standard suggested has the advantage of encouraging adjudicators to seek clarification, which would promote evidentiary efficiency. At the litigation stage, at the

this choice must be express or be clearly demonstrated'); *Rome Convention*, above n. 156 Art. 3(1) ('[t]he choice must be expressed or demonstrated with reasonable certainty'); *Rome I Regulation*, above n. 151, at Art. 3(1) ('[t]he choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case').

173. In a different context (*ex ante* implied exclusion) see: Bridge, above n. 18, at 945-46 [16.69] (Art. 6 supports party autonomy to establish penalty clauses, and describing the argument that parties must consciously exercise their autonomy under Art. 6 as a 'somewhat weak counter-argument').

174. Walt, above n. 15, at 349.

175. Charles J. Goetz and Robert E. Scott, *The Limits of Expanded Choice*, 73 Cal. L. Rev. 261, 276, 280 (1985) (albeit in context of waiver of implied terms at the performance phase).

176. Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts*, 99 Yale L.J. 87, 97 (1989).

177. See generally Whincop and Keyes, above n. 87, at 531.

time the waiver issue arises, the least-cost avoiders in terms of determining the intent to exclude by modification are indeed the parties themselves, given the potential for parties to ‘trump’ the evidentiary exercise by simply agreeing to exclude during proceedings.¹⁷⁸

Intervention would tend to also reduce the number of wasteful appeals on this point. Thus there are potential *ex post* efficiency gains for the parties themselves in terms of saved litigation costs.

Furthermore, as observed earlier (in Chapter 7, §7.02), a serious issue in the market for legal services is moral hazard in relation to the CISG. Mispriced legal services and the tendency for counsel to provide ‘average’ quality services may flow from information asymmetry regarding its applicability. The approach suggested here results in a reduction of moral hazard in terms of possible legal arguments forgone by failure to consider the CISG. It can be posited that moral hazard logically exists for at least one side where the CISG is waived during proceedings. If both sides are fully aware of the CISG and any differences in outcome under the CISG as opposed to domestic law, then one side will be disadvantaged by the waiver; and, if both sides are fully aware of the CISG and have concluded there are no differences in outcome, then there is no reason *not* to present the case on the basis of the CISG.¹⁷⁹ Indeed, given this, the likely reason for waiver in most cases is unfamiliarity and information costs. By definition, this means the decision to waive is likely to have been taken by at least one side in ignorance of differences in outcome for their client.

Importantly, the suggestion realigns the standards relating to inferences of intent to exclude at the contractual and post-contractual stages, so that the burden of proof is consistent at each stage. This brings improved coherence throughout the CISG and ensures it can be more easily understood and consistently applied, while still providing a clear avenue for true expression of party autonomy, if indeed parties really wish to exclude at the litigation stage.

§10.05 PROPOSED SOLUTIONS

It now falls to consider, if the above propositions are accepted, how in a practical sense courts should proceed once they realize the CISG applies.

For a court in a Contracting State, it is submitted that the CISG constitutes the entire picture. Essentially, the obligation to apply the CISG *ex officio* approximates the strict version of the *iura novit curia* principle. This means that, irrespective of its own domestic procedural inclination, the court must take a less than passive role. The only remaining question is how to implement it, given the availability of appeal for failure of due process. This calls for some flexibility in implementation, and leads us to three potential solutions for courts within Contracting States.

178. Goetz and Scott, above n. 176, at 281.

179. A point made eloquently by Schroeter, above n. 70, at text above n. 164.

[A] *Simpliciter Application Ex Officio*

Domestic systems that already follow the strict version of *iura novit curia* and have a narrowly defined right to be heard might simply apply the CISG. Where the right to be heard is limited to questions of fact in respect of domestic law, there is arguably no need for counsel to address the CISG before the court is entitled to apply it. Yet it is important to note that this result flows not from application of the domestic procedural rule, but from the CISG itself. Such courts would also need to ensure appropriate interpretation of Article 29 so that merely failing to plead is not instantly seen as tacit waiver. Rather than jump to such a conclusion, the court should carefully consider the competing inferences in the manner suggested in section §10.04 to determine whether counsel's conduct is a sufficient clear basis for an inference of intent to exclude, and whether such an inference is the most likely on balance.

What of jurisdictions which do not employ strict *iura novit curia*? It is not impossible to imagine application of the CISG even so. There have been cases where common law courts have applied the CISG despite a near (but not complete) absence of it from pleadings and/or argument. In the Australian *Roder Zelt* case,¹⁸⁰ nothing appeared in pleadings, and despite only a 'passing mention' in argument, the court applied the CISG at length. *Sua sponte* decisions might also occur in the US.

While possible to argue that all Contracting State courts should employ this solution on the basis of their obligation to apply the CISG, some will be uncomfortable with 'dusty' judges.¹⁸¹ There is also a need to reconcile the obligation to apply the CISG with broader definitions of the right to be heard, which may still underpin grounds of appeal. In these circumstances, less radical approaches might be more effective in practice, in order to reach similar ends by means that take account of differing conceptions of due process.

[B] *Dismissal of the claim*

This compromise achieves a correct but harsh result. It remains similar to the first solution in that, having formed the view that the CISG is applicable, the court gives it some effect. However, the type of effect given stops short of full application.

Where the CISG is not mentioned in argument, the case could be justifiably dismissed on the basis that any local procedural rules which might have constrained the court to apply the law argued by counsel are effectively displaced by the CISG. The judge would not go so far as to apply the substantive provisions of the CISG, but pursuant to the court's obligation to apply the CISG *ex officio*, would take judicial

180. *Roder Zelt - und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd*, (1995) 57 FCR 216, Federal Court of Australia, 28 Apr. 1995, <http://cisgw3.law.pace.edu/cases/950428a2.html>.

181. The reader will forgive my florid reference to the common law's discomfort with interventionist judges: *Yuill v. Yuill* [1945] P 15, 20 (UK), Court of Appeal, 30 Nov. 1944 (Lord Greene MR warning that the judge chooses to question the witness, the judge 'so to speak, descends into the arena and is liable to have his vision clouded by the dust of conflict').

notice of its existence and effect in displacing the law argued by counsel. Counsel has simply not made its case.

Of course, the fact that a valid case might have existed under the law that is applicable makes this result rather harsh. It may also offend more broadly defined rights to be heard. The result would certainly raise the alert that in future, counsel need to argue the applicable law, but the warning comes at a high cost to the individual party, for whom the adverse ruling may become *res judicata*.

[C] Intervention by Warning and Invitation

The final suggested compromise is that, upon realizing the CISG applies, counsel are warned that the CISG is the applicable law, and an indication is given that the court intends to apply it because it displaces domestic sales law. Ideally, the court should also explain to counsel that any local procedural rules that might otherwise constrain the court to the law argued by counsel are also displaced by the court's obligation to apply the CISG *ex officio*.¹⁸² The case might appropriately be adjourned to allow counsel time to prepare CISG based arguments.

After an appropriate warning, the following range of possibilities might eventuate:

- Counsel return and present argument on the CISG. The court can then apply it. This obviously presents no problems, since the court can both comply with its obligation and accord the right to be heard on the law.
- Counsel return and inform the court that an agreement has been reached that the CISG is not to apply. This also presents no problem, provided counsel have the informed consent of their clients. Express exclusion by agreement will invoke the operation of the CISG's modification rules pursuant to Article 29. Thus the court should make a formal ruling regarding the satisfaction of Articles 6 and 29 CISG in the manner indicated above (in section §10.04[C]).¹⁸³ The court is then relieved of its obligation, and accordingly justified in applying the law indicated by (now applicable) domestic procedural rules. It is submitted that the court should not propose that, unless counsel objects, conduct of the case alone will be treated as an implicit agreement to exclude.¹⁸⁴ That course would effectively subvert the application of Articles 6 and 29, and the weighing of competing inferences in accordance with the standard of proof proposed. Arguably, in making such a suggestion, the court would breach its obligation to apply the CISG *ex officio*. Instead, the court should give an appropriate warning to counsel, in order to encourage proper investigation of the rights and obligations arising from the applicable law, and if desired, formation of an *ex post* exclusion agreement with the informed consent of the clients.

182. Obviously in the case of arbitration, this will not apply. See discussion in §10.03[C] above.

183. The court should also consider the effect of any 'no oral modification' clauses.

184. Taking such an approach, see Court of Appeal (OLG) Köln, Germany, 28 May 2001, <http://cisgw3.law.pace.edu/cases/010528g1.html>.

- Counsel return and assert they do not need to argue the CISG, on the basis that local procedural rules preclude ex officio applications of law. It is at this point that the issue of displacement is critical. If the court has already explained that such domestic procedural rules have been displaced, then in performing its inherent obligation to properly apply and interpret the CISG, it would be justified in then dismissing the case. Moreover, unlike the dismissal discussed in section B above, a broad right to be heard will have been accorded.

It may seem incredible, but this actually occurred in an Australian case.¹⁸⁵ During its five hearings neither counsel nor the court recognized that the CISG applied. Only after the fifth hearing had finished did the court subsequently realize the CISG was relevant. Counsel for the plaintiff was properly invited to make further submissions on the applicable law. Incredibly, counsel declined, stating that it was unnecessary. Despite being an uncontested claim in which default judgment had already been ordered, counsel's stance ultimately cost the plaintiff the case. The court denied damages, saying the failure to address the CISG was 'fatal'.¹⁸⁶ Interestingly, this occurred in a country that does not overtly employ the *iura novit curia* principle.¹⁸⁷

- Alternatively, if counsel return and assert they do not need to argue the CISG, then rather than dismiss the case, provided the court has given adequate warning and opportunity, it could proceed to decide the case by application of the CISG ex officio. The ex officio power derives not from domestic procedural law of the forum, but rather from the CISG itself.¹⁸⁸ Again, the court should first make a formal ruling on Articles 6 and 29, taking care to apply the appropriate standard of proof in weighing conflicting inferences as suggested above, before applying the CISG. This solution will be available in most jurisdictions. Parties have been accorded an opportunity to be heard, yet chosen not to present argument on the applicable law. Clearly, the outcome would not result in a surprise application of law in a manner that could not be foreseen by parties, given the court's earlier warning. It is submitted, this approach is feasible even in common law courts, because it accords the broadest of opportunities to be heard.

Overall, the interventionist third solution (i.e., the solution in this section C) is a sound compromise. It is practical, acceptable, and has the advantage of complying with broad

185. *Perry Engineering v. Bernold*, above n. 48. See Bruno Zeller, *CISG Cases* (2004), <http://www.business.vu.edu.au/cisg/Cases.htm>. Something similar also occurred in Germany: see Court of Appeal (OLG) Rostock, 10 Oct. 2001, above n. 122 ('The parties have not made such a declaration even though they had been informed of its necessity by this Chamber. Merely referring to [domestic provisions] is insufficient, because such reference might also be made because the parties think that that law was applicable anyway').

186. *Perry Engineering v. Bernold*, above n. 48, at [16].

187. This stands in stark contrast to other Australian cases where the CISG's applicability is sometimes incorrectly bypassed on the basis of purely domestic interpretive principles: see, e.g., *Playcorp v. Taiyo Kogyo*, above n. 32; *AG Botswana case*, above n. 33; *Castel Electronics v. Toshiba*, above n. 33.

188. Contrary to the purported source in cases cited above n. 29.

conceptions of due process; parties cannot complain on appeal that they were denied the opportunity to be heard, nor were surprised by the application of the CISG. Importantly, this solution maintains that local procedural rules are displaced by the CISG, and in accordance with the interpretation of Articles 6 and 29 suggested above, rejects the application of domestic law despite the conduct of the case.

The third solution fulfils the obligation of a court in a Contracting State to apply the CISG. At a minimum, it ensures displacement to the extent necessary to preserve the CISG's integrity. At its maximum, it amounts to a form of *iura novit curia* which fits well with the CISG obligations and the due process sensibilities of most jurisdictions.

It was noted earlier that the solution to the procedural dilemma was more complex in arbitration than in litigation. Nonetheless, in some ways the solution is simpler too, since far more discretion is usually accorded to arbitral tribunals under arbitral laws and rules, and an appeal is generally not available on the merits. In the case of arbitration, unless the tribunal's mandate has been specifically restricted to exclude consideration of the CISG, or procedural rules which constrain the tribunal's discretion have been agreed by parties, it is submitted that the third approach (section C) is also suitable for arbitrators. While it cannot be said that an arbitral tribunal is under any *obligation* to apply the CISG in the same way as a court in a Contracting State, it will still be bound to decide according to law. In these cases, the interventionist third approach represents a safe solution. Thus it is proposed that arbitral tribunals adopting it will normally render an award impervious to challenge on the basis of *ultra petita*, failure of due process, or on grounds of bias.

Likewise, courts in non-contracting States that nonetheless conclude the CISG is applicable bear no *obligation* to apply the CISG, but may nonetheless find the third solution attractive and, in many instances, compatible with their own (applicable) procedural rules.

§10.06 CONCLUSION

This chapter seeks to apply some of the lessons from analyses in earlier chapters to a particular interpretive issue. The issue in this case was interaction between the CISG and domestic procedural rules of the forum relating to waiver in litigation, and the highly unpredictable outcomes in cases purporting to apply the CISG to resolve the issue of waiver in litigation.

It was submitted that the traditional view that the procedural rule of the forum is determinative is flawed where the applicable law is the CISG, and that courts in Contracting States in fact have a duty to apply the CISG to resolve the issue, such that domestic procedural rules and conceptions of waiver are displaced in favour of an obligation to apply the CISG ex officio if necessary, pursuant to a principle of *iura novit curia* arising from the CISG itself. It was contended that this meant that there was a semi-immutable quality to the default application of the CISG in waiver situations, such that courts in Contracting States are obliged to apply the CISG's own provisions to determine whether a post-contractual modification has been reached. It was argued that the inferences of misapprehension, ignorance and refusal should be pragmatically

weighed against the inference of clear intent to exclude by modification. Finally, it was submitted that a higher standard of proof relating to waiver in litigation accorded with a more coherent and internally consistent interpretation of the CISG's provisions across pre-contractual and post-contractual stages, and would lead to greater predictability in outcomes. It was further submitted that while arbitral tribunals and courts in non-contracting States do not have a similar obligation, where they have nevertheless determined the CISG is to be applied, they should adopt a similarly consistent approach to interpretation of its provisions.

It was submitted that provided courts and tribunals alert counsel to the applicability of the CISG and afford them an opportunity to either address it in argument or expressly agree to exclude it, they will conform to the broadest notions of due process and can render enforceable outcomes which apply the CISG as the governing law.

The interpretive approach suggested in this chapter in relation to waiver accords with the lessons learned from earlier analysis. It attempts to achieve greater internal consistency between the CISG's various provisions in order to improve the quality of clarity and internal coherence in the substantive content of the CISG, and greater predictability and uniformity of outcomes in all fora. Thus the interpretation addresses the matter of substantive concerns, including in particular, certainty and predictability in judicial application, which is an important issue for lawyers' *ex ante* choices of law.

It was demonstrated that the traditional solution of reliance on the forum's procedural law can be rejected on doctrinal grounds. Moreover, it is submitted that the requirement of *ex officio* application by courts within Contracting States is entirely consistent with the resolution of collective action problems referred to in Chapter 7. This is due to its implications for *ex ante* choices of law, *ex post* efficiencies for litigating parties, and for society more broadly. The approach favouring semi-immutability default application may increase litigation exposure rates, thereby addressing the matter of familiarity and information costs as an issue in lawyers' *ex ante* choices of law. Learning effects for the jurisdiction from litigation exposure may further affect *ex ante* choices through the same factors to the extent it influences choices by legal educators, as suggested in Chapter 8. As mentioned in Chapters 6 and 7, these issues have a broader effect on social welfare, in terms of the skill base of the jurisdiction's legal profession, the accumulation of case law, and efficient choices of law for transactions by lessening the effect of *status quo* bias. Societal benefits would also accrue from reductions in appeals. It is submitted that semi-immutability in litigation waiver is warranted in part because it helps reduce these externalities.

However, it is also submitted that semi-immutable default application also effectively protects the litigating parties from moral hazard. The approach suggested has the advantage of encouraging adjudicators to consider the competing inferences including misapprehension as the reasons for failure to argue the CISG and to seek clarification. Intervention would promote evidentiary efficiency, and encourage consideration of legal arguments which might otherwise be forgone due to *status quo bias* and moral hazard. It would also encourage recognition of CISG expertise and improve pricing of legal services. Thus there are potential *ex post* efficiency gains for the parties themselves in terms of reduction of moral hazard and saved litigation costs. Accordingly, it is submitted the approach suggested may be majoritarian in nature.

It may be argued that raising the standard of proof required for intent to exclude by modification increases the costs of contracting out, thus leading to ‘sticky’ default rules.¹⁸⁹ It is true that removal of the ability to ‘presume’ waiver pursuant to either domestic procedural practice or inadequate application of Article 6 might lead to some additional costs for individual litigants. Nonetheless, it can be countered that in the present context the ‘stickiness’ is minimal, given the bench’s ability to intervene and the parties’ ability to agree on exclusion during proceedings.

Alternatively, if the suggested approach is viewed as a penalty default rule, the internalizing by parties of the cost for counsel to inform them of its applicability, and of the advantages and disadvantages of reaching an agreement to exclude it at the litigation stage may still produce net gains *ex post*. This is due to the reduction in moral hazard and improved ability of parties to make an informed and therefore efficient decision to either exclude, or to take advantage of arguments available to them under the CISG. Effectively, it is submitted that the correction of the *status quo* bias is still worth the price, given the improved transparency or decreased information asymmetry to litigants.

More importantly, even if this were not so for the parties themselves, it is contended that the broader economic benefit by far justifies the imposition on individual litigants. Early intervention to clarify the issue maximizes positive learning effects, and may reduce the number of wasteful appeals by signalling to other counsel that they cannot continue to ignore the CISG in litigation, leading to societal benefits from more efficient use of judicial resources and improved skill levels and better pricing of legal services within the profession. Further, as submitted earlier, the impact on future *ex ante* choices, frequency of use, and network effects as a result of lower information costs from greater litigation exposure rates would enhance net societal welfare in the longer term.

189. See Walt, above n. 15, at 348 (strict interpretation of Art. 6 in *ex ante* exclusion where law of a Contracting State is chosen makes the CISG a default ‘sticky’, increasing exclusion costs). However, Walt acknowledges such presumptions might be justifiable on the basis of economic grounds: at 348.

CHAPTER 11

Conclusion

Ronald Coase once stated ‘[i]f we move from a regime of zero transaction costs to one of positive transaction costs, what becomes immediately clear is the crucial importance of the legal system’.¹

The CISG was created to improve the efficiency of international trade, but the exact means by which it was supposed to do so were not made clear. What appears in the Preamble and the legislative history is just a hint.² Since that time, global trade has grown enormously, as has our understanding of behavioural economics and law and economics. Thus in determining economic efficiency, we should not confine ourselves to the original non-specific aims of its creators, but look to the multifaceted ways in which it might achieve the broader aim of improving the efficiency of international trade.

The relevant question must ultimately be whether net exchange gains and social welfare are improved by the CISG, and perhaps also whether they might be improved further still by rectifying remaining deficiencies.

Other than as an idle academic pursuit, there would be little point in seeking to promote an inefficient default law. Therefore the first question asked in this book was whether the CISG is efficient, in the sense that it maximizes net exchange gains and maximizes social welfare. Whilst the CISG suffers from problems regarding the homeward trend in judicial application and uncertainty in relation to its interaction with some aspects of domestic law, it was noted that the design of the CISG is, on balance, an efficient one for many international sales transactions, and that it offers benefits related to neutrality, predictability, stability, and accessibility. It was determined that, contrary to the views of a number of critics of the CISG’s efficiency, upon a considered assessment of the advantages and disadvantages of its substantive and non-substantive qualities, the CISG is indeed an efficient default law, with the capacity

1. Ronald H. Coase, ‘The Institutional Structure of Production’, in R. H. Coase (ed), *Essays on Economics and Economists* 1, 11 (1994).
2. CISG Preamble.

to become more efficient still by the unlocking of network effects should the frequency of its use rise in the future.

Thus the CISG has the potential to improve efficiency in trade, but cannot fulfil its full economic potential if it is excluded in circumstances where it is the most efficient choice of law for the transaction. Given the link between the efficiency of the CISG and the frequency of its use, suboptimal exclusions could preclude optimal attainment of the CISG's aims. Therefore, the rate of exclusions by lawyers in various jurisdictions and the reasons given for opt-out preferences was reviewed carefully. It was noted that, particularly in higher exclusion jurisdictions, objectively legitimate substantive reasons are far less powerful influences upon lawyer decisions to exclude than familiarity and information costs, in the latter case, by using litigation exposure as a proxy for information costs. Analysis also demonstrated that the significance of objectively legitimate substantive concerns in exclusion decisions is inversely proportionate to exclusion rates. Consequently, they are of higher significance in jurisdictions with low exclusion rates, and of lower significance in jurisdictions with higher exclusion rates. Given the conclusion that the CISG is efficient, it was determined that many exclusions presently motivated by lack of familiarity and information costs are suboptimal in nature, and therefore lead to efficiency losses and decreases in social welfare.

The causes of suboptimal exclusions by lawyers were developed by reference to theories from the fields of economics and psychology. It was concluded that in some jurisdictions, suboptimal exclusions are caused by a number of problems in the decision making environment in which lawyers operate, including market distortions due to moral hazard, the 'lemon' problem, group behavioural dynamics, cognitive biases and heuristics, and institutional structures leading to risk-reward strategies that can perpetuate collective action problems. It was contended that all these aspects interfere with efficient choices of law. However, it was predicted that the global bargaining strength of pro-CISG China would gradually restructure payoffs, which will in time rectify collective action issues, cause increased transparency to reduce moral hazard and the 'lemon' problem, create learning effects through greater litigation exposure to decrease information costs, and result in new cognitive behavioural patterns so that satisficing behaviour will lead to more efficient choices in future. Thus it was anticipated that, although the capacity of the CISG to improve the efficiency of trade is not fully realized at present, in future suboptimal exclusions will decrease. Further empirical evidence was presented which appears to corroborate the beginning of this predicted process.

Further, as the CISG was determined to be efficient per se and efficient relative to competing choices of US and English law, it was determined that there is a normative justification for its promotion, in particular, for seeking to reduce exclusions in cases where they are not motivated by legitimate objective assessments regarding its relative suitability for the transaction. It was also contended that increased frequency of use would lead to network effects which would further enhance the CISG's relative value as a choice of law.

The final chapters undertook to infuse the underlying economic norms of the CISG into current doctrinal debates. It was suggested that, generally speaking, where two equally feasible doctrinal paths existed, the choice that best promotes the

efficiency of the CISG should be chosen. Scholars should promote such choices, and courts and tribunals should strive to implement them, either directly, or by reliance upon scholarly doctrine. The earlier analysis of aspects of the CISG's efficiency and reasons for suboptimal exclusions could therefore be useful in guiding the development of the CISG in a manner which furthers its original aims. This approach departs from the overwhelmingly doctrinal focus of CISG scholarship, and differs markedly from the work of critics of the economic effect of the CISG.

To demonstrate the manner in which economic norms could feedback into interpretation, two examples were developed. Each looked to increasing the attractiveness of the CISG as a choice of law, since its efficiency was earlier determined to be tied to the frequency of its use in practice, both by the unlocking of network effects (improving non-substantive efficiency) and by the resolution of collective action problems (decreasing suboptimal exclusions). Additionally, the suggestions also took into account the effect of more frequent application of the CISG in litigation (decreasing suboptimal exclusions by learning effects which would lower information costs and unfamiliarity) and improvements in the clarity and certainty of the CISG (decreasing exclusions motivated by substantive concerns by improving substantive efficiency).

The first example was precontractual liability. It was suggested that the CISG should not be interpreted to cover this issue within its scope, and recommendations were made regarding displacement of domestic precontractual relief. The tendency to apply internal interpretive methods to determine issues of scope was noted, and it was argued that this was not only doctrinally dubious, but also exacerbated the substantive problem of uncertainty as to scope or, more precisely, interaction with domestic law and judicial application. It was concluded, particularly in the context of precontractual liability, that geographic quantity of uniformity should be sacrificed for quality of uniformity, as a narrow scope of application with an easily ascertainable line of displacement of domestic actions would be the most likely to lower lawyer's substantive concerns, thereby reducing the frequency of exclusions. The predicted future increase in the relative significance of substantive concerns (*vis-à-vis* other factors) in opt-out decisions served to heighten this path as the policy choice most likely to serve the CISG's underlying economic ends.

The second example, of waiver by conduct during litigation, sought to demonstrate how one approach to the interpretation of exclusions under the CISG and the interaction between domestic law and the CISG was more likely to bring efficiency gains than the traditional approach advanced by scholars. Not only was the suggested solution doctrinally open, but it was determined that it would bring net economic benefits for litigant parties *ex post* by the reduction of moral hazard and improved transparency, and would maximize social welfare by clarifying the evidentiary burden and reducing appeals. Such an approach would bring societal benefits by improving accuracy of prices for legal services and encourage development of greater skills in the profession. Further, it was argued that positive learning effects from higher litigation exposure would follow, which, by virtue of its strong link with *ex ante* information costs and familiarity, would lower suboptimal exclusion within the jurisdiction concerned at the front end of the contractual process.

These examples suggest the CISG's efficiency can be improved by an interpretation sensitive to direct and indirect economic consequences. Notably, in one example, such sensitivity led to an argument in favour of restricting the CISG; in the other, for extending it. In any event, it is submitted that each suggested interpretation will not only improve efficiency, but will bring about qualitative legal improvements. As mentioned in Chapter 8, there are many other interpretive issues amenable to similar analysis.

Uniformity should never be an end in itself. It should be the means to an end. That end is the normative policy behind the CISG; improvement of the efficiency of global trade. Given that uniformity is not an end in itself, then an analysis of the economic effectiveness of uniform law is vital to answer the question as to whether we should care about its survival as a viable law in practice. Furthermore, an economic analysis which is alive to both obvious and subtle influences upon lawyer choices in the market for law provides the best guide to the development of that law in circumstances where there is more than one answer to a doctrinal question.

The reality of lawyer choice can therefore provide an important external discipline for interpretation of the CISG, not only in the examples examined here, but for other issues where there are competing interpretations. Lawyer choice drives frequency of exclusion, which in turn drives much of the CISG's existing and potential efficiency. Lessons learned from analysis of reasons for those choices can help provide normative guidance where doctrinal analysis comes to a dead end. This discipline can help keep expansions in check where they might hamper efficiency aims, or justify expansion if this approach will enhance the efficiency of the uniform law.

When linked to interpretation in an appropriate manner, the norms that led to the creation of the CISG can shape its future development in a manner that will facilitate its survival as a frequent choice amongst competing laws. In the Darwinian sense, it must adapt to changed conditions, so that it remains an efficient and viable choice into the future.

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