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INTERNATIONAL SALES LAW

Clayton P. Gillette

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Advanced Introduction to International Sales Law

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Preface

This volume provides an advanced introduction to the law of international sales as embodied in the United Nations Convention on Contracts for the International Sale of Goods (CISG). It is intended for those who have or who would like to obtain familiarity with the basic doctrines of the CISG, but who also desire some understanding of its theoretical underpinnings. Because this is an introductory text and is concerned with the theory underlying commercial law, it does not deal with all the provisions within the CISG or with all the nuances of those doctrines that are discussed. My hope is that it will provide an understanding of the most critical provisions and their principles for a more general audience, but also pave the way for more sophisticated inquiry into the subject. I have kept citations to cases and scholarly commentary to a minimum in order to provide a more readable and uninterrupted text. For those who are interested in more in-depth treatment of doctrine, as well as extensive discussion of some of the underlying theory, I have co-authored a more substantial treatise with Steven D. Walt, *The UN Convention on Contracts for the International Sale of Goods* (Cambridge University Press 2016).

The text considers the CISG through a particular methodological lens. It assumes that the primary objective of commercial law is to reduce transaction costs – costs related to the negotiation and implementation of contracts. If commercial law is to satisfy that objective, it should provide for the parties the legal doctrines and risk allocations that the parties otherwise would have negotiated for themselves. Throughout this text, the minimization of transaction costs serves as the basis of evaluation for the CISG. In more than 35 years of teaching commercial law, I have found an economic approach with a focus on transaction costs to be a powerful tool for explaining and justifying legal doctrines and judicial decisions. Taking that approach, however, does not mean that those who draft commercial law or those who decide commercial cases are intentionally following this reasoning. Rather, and perhaps more powerfully, an economic approach helps to explicate as well as evaluate commercial law. In effect, such an approach helps to make explicit, and thus easier to comprehend, what may be motivating the doctrines that constitute the body of commercial law. Moreover, being explicit in this manner often imputes content and precision to explanations and justifications for commercial doctrines that are often stated in more ambiguous terms, such as reasonableness and good faith.

I have had the good fortune to be able to discuss the content of this volume with friends and colleagues. Two deserve special mention. Franco Ferrari of the NYU School of Law read the entire text and saved me from embarrassing errors. Steven Walt of the University of Virginia School of Law has engaged me in constant conversation about commercial law for more than 20 years, and many of the lessons he has taught me appear herein. A generation of students deserve credit for their demanding inquiries into international sales law. As always, my greatest gratitude goes to my wife, Abby, for unending support and companionship throughout our first five decades together. Finally, I thank my dean, Trevor Morrison, and the Filomen D'Agostino and Max E. Greenberg Research Fund for financial support.

Contents

1 Why uniform international commercial law?

1.1 Introduction: the objectives of commercial law

This introductory volume considers the law and theory of international sales law, as embodied in the United Nations Convention on Contracts for the International Sale of Goods, known as the CISG. The CISG purports to unify the legal principles that govern commercial sales across national boundaries and cultures. It is the most successful treaty on commercial law ever created, at least if international adoption is the measure of success. As of this writing, 83 nations – called Contracting States – have agreed to be bound by the CISG. Prior efforts to create a body of international commercial law received far less approval. Indeed, the CISG may have effects even outside jurisdictions that have adopted it, because tribunals in those jurisdictions may apply conflict of law rules that select the law of a CISG jurisdiction in a particular litigation or arbitration.

Why has the CISG attracted so much support? It is tempting to identify its widespread adoption with a conclusion that the CISG has successfully satisfied the objectives that underlie commercial law. The legal rules that govern sales transactions play multiple functions. First, they provide rules of validation that inform the parties when they have entered a legally binding relationship, or contract. Second, they create interpretive rules that determine what is meant by the language that is used in the contract, and perhaps in the language of the rules themselves. Third, legal rules allocate the losses that arise from risks that might materialize during the operation of the contract; that is, they specify the performance obligations of each party and determine who bears the loss when a risk materializes that interferes with the expected performance. Finally, the legal rules indicate what remedies are available in the event that one of the parties fails to comply with its obligations under the contract or under the legal rules.

Commercial actors, however, presumably are not indifferent about the legal rules that are deployed to achieve these objectives. They would not want rules that simply pick from a hat among the various plausible risk allocations or contract formation rules that creative lawyers or commercial actors might devise. Rather, commercial actors who are involved in the purchase and sale of goods presumably prefer that the legal rules that the state provides reflect the same rules to which the actors would negotiate if the state were silent. Commercial actors wish to expend as few resources as possible negotiating contracts. They prefer to use their resources to produce and sell goods to, or obtain goods from, their trading partners. In short, commercial actors seek to reduce "transaction costs," that is, the costs related to the negotiation, drafting, and implementation of contracts. They can do that if the default rules supplied by the state – the rules that apply in the absence of some agreement to the contrary by commercial actors – simply correspond to the rules that the commercial actors otherwise would have supplied. In that manner, commercial parties need spend minimal time negotiating and writing contracts. They can simply adopt the background rules provided by the state as default rules.

The fact that the state supplies default rules implies that parties who wish to deviate from state-supplied legal rules in their individual transactions will be able to do so. State-supplied rules of commercial law, that is, are not mandatory.[1] After all, legal rules for commercial transactions are written with a broad array of commercial transactions in mind, and any given transaction may require a more highly tailored rule. But if the default rules of commercial law reflect the risk allocations that most commercial parties would prefer, then those parties who desire an alternative, and who must bargain for it, will constitute a minority of all commercial parties involved in any given situation governed by the default rule. The majority of commercial actors will be able to negotiate relatively brief contracts, knowing that any gaps they leave in their individual negotiations are completed by the state-supplied rules that pretty much reflect what the parties would have agreed to after more costly negotiations. Legal rules supplied by the state that do not reflect the terms to which parties generally would have agreed require the parties to incur additional transaction costs bargaining around

1 The underlying assumption of using default rules is that as long as parties to the transaction are not imposing substantial costs on third parties, and as long as one party is not acting in a manner that exploits some monopoly or other position that undermines arms-length bargains, commercial parties should be able to draft any contract they like.

the defaults.[2] In short, commercial parties want commercial law to do what the parties otherwise would have done for themselves.

One implication of the commercial desire to minimize expenditures on negotiating and drafting contracts is that commercial parties will desire default rules that minimize the costs related to risks that might arise during the performance of contracts. Thus, default rules that minimize transaction costs will have particular characteristics. They will tend to assign risks that might materialize during a commercial relationship to the party who is best positioned to avoid that risk from materializing or to deal with the risk if it does materialize. Assume, for example, that parties are engaged in a transaction that involves goods worth $1,000 and that there is a risk that the goods could be destroyed in transit from the seller to the buyer. Assume further that the seller could avoid this risk at a cost of $3, while the buyer could avoid the risk only at a cost of $4. This might be because the seller is a frequent shipper of the goods and has better information about risks and risk avoidance than the buyer. Presumably, both parties would prefer that the seller bear the risk of loss of the goods in transit. The seller will be indifferent as to whether it sells the goods for a total price of $1,000 with the risk of loss on the buyer or for a total price of $1,003 with the risk of loss on the seller. The buyer would prefer to pay $1,003 and place the risk of loss on the seller rather than pay a total price of $1,000 for the goods but have to spend an additional $4 to bear the risk of loss during transit. Thus, a legal rule that places the risk of loss on the seller in this instance would minimize the costs of negotiation and reflect what the parties would have done if they were required to negotiate. In this manner, commercial law reduces the transaction costs that parties must incur in order to reach binding agreements.

Transaction costs are similarly involved when parties face what we may think of as "contracting problems," that is, obstacles to trade that arise from each party's concern that the other party will fail to perform as expected unless constrained by some legally enforceable obligation. Often these obstacles reflect a concern that a trading partner will take advantage of a situation to obtain a greater part of the gains from trade

2 If the state-supplied rule is mandatory and cannot be bargained around by the parties, it may simply reflect an inefficient allocation of risk that raises the costs of the transaction in a way that the parties cannot avoid. Mandatory rules may be more appropriate where one party has insufficient information or capacity to bargain. Those concerns are typically raised in consumer transactions, which are excluded from coverage by the CISG, rather than in transactions that involve commercial actors.

than the parties initially intended. Contracting problems arise, for example, where parties face asymmetric information, the situation in which one party fears that its trading partner has superior knowledge about the goods to be traded and will be able to exploit that knowledge to the detriment of the relatively ignorant party. Alternatively, the contracting problem may take the form of a "hold-up" risk, in which one party fears that if it begins performance, the other party will be able to exploit that investment to extract a new, less favorable modification of the original bargain.

Contract law often plays the role of solving these contracting problems. Consider the problem of asymmetric information. If a buyer with inferior information is reluctant to trade for fear that the seller will provide goods of a lower quality than anticipated, and that the low quality will not be detectable at the time of delivery, the law could intervene with doctrines that reduce that fear. The law could impose a disclosure requirement, thus equalizing the knowledge of the parties. Alternatively, the law could make the party with superior information responsible for anything said about the goods, thus reducing the chance that the seller will say something that the buyer does not know is untrue. Or, the law could place the risk of product quality on the buyer and allow the buyer to take that into consideration in deciding what price to offer for the goods. If one of these solutions would reduce the overall costs of the transaction, then presumably all commercial parties would prefer it (that is, all but those who actively want to exploit their superior information). Presumably, even the seller would prefer this solution, since it would alleviate the buyer's concern about exploitation and make the buyer more willing to contract with the seller.

Does the CISG's widespread adoption indicate that it has generated legal rules that successfully address these issues of contract design? That is a question that is at the core of this text and that forms the basis for evaluating the legal rules embodied within the CISG. Throughout this text, therefore, we will not only explain the major legal rules embodied within the CISG; we will also assess them to determine whether they resolve contracting problems or otherwise minimize transaction costs for parties to international transactions.

1.2 The CISG as uniform commercial law

1.2.1 Development of the CISG

The CISG does not represent the first effort to create a body of uniform international sales law. Prior efforts led to promulgation of the Uniform Law for International Sales and the Uniform Law on the Formation of Contracts for International Sales in the early 1960s. Neither of these attracted much support, however, and virtually no support outside of Europe. The United Nations Commission on International Trade Law (UNCITRAL) decided to make an additional effort. It expanded the membership of those involved in the negotiation and drafting of a treaty to include representatives from a broad geographic, political, and cultural range of states. The result was agreement on the terms of CISG in 1980, and its entry into force in 1988 among the first ten nations to adopt it. Since that time, the CISG has generated substantial support, and the cases that interpret its provisions number in the thousands. The jurisdictions that have adopted it range from developed to developing nations and from those with longstanding capitalist economies to those that still retain remnants of planned economies. Among major trading nations, only India, South Africa, and the United Kingdom have yet to adopt the CISG.

The rationale behind uniform international sales law is easy to understand. To the extent that parties to an international transaction are familiar with their domestic law, but not with the law of other jurisdictions, they may prefer having their domestic law govern their transaction rather than foreign law. Since that preference will inevitably generate conflict between parties who come from different jurisdictions, uniform substantive law is viewed as a means of placing the parties in equipoise, as neither gets its choice of domestic law. One might think that any uniform body of law that governs international sales would have the effect of reducing transaction costs because it provides a single set of legal rules for all actors, regardless of their nationality or the underlying culture. In the absence of uniform international law, parties to international transactions who want to choose appropriate law for their transaction would have to be informed about the law of their trading partner's jurisdiction as well as their own law. Different jurisdictions may adopt different default rules, perhaps because the best solution to a commercial problem is contestable and multiple reasonable rules for resolving the issue exist, or perhaps because the legal culture of one jurisdiction has generated rules that vary from those with other legal cultures. Some civil law and common law countries, for example, have very different perspectives on issues such as the availability of a remedy, specific performance, or the conditions that warrant excuse from performance. In international sales transactions, therefore, transaction costs increase because neither party may be familiar with the default rules of the other party's jurisdiction (in addition to not necessarily being familiar with the conflict of laws rules that determine which law applies). Each party may prefer its own rules, if for no reason other than familiarity. In theory, therefore, uniform substantive law avoids transaction costs that might have to be incurred if each party to an international sales transaction desired that its domestic law applied. Uniform commercial law makes it unnecessary to learn a trading partner's domestic law, to determine whether it is a better fit for the specific transaction, and to negotiate for one's own domestic law if that is what is preferred. To the extent that the parties fail to choose governing law, uniform substantive law reduces uncertainty about the legal rules that affect their transaction.

Of course, achieving this goal requires that each party both be aware of and familiar with the uniform body of law that governs their contract. A party might want to compare that body of law with the alternative law of one of the party's jurisdictions. Thus, it is not clear that the costs of learning the relevant law are reduced, at least for parties who only occasionally enter international transactions and thus cannot amortize the costs of learning the relevant law over numerous transactions. Moreover, the CISG truly provides uniform law only if it receives uniform interpretation from the courts and tribunals that are asked to adjudicate its provisions. Thus, courts and arbitrators must also incur the costs of learning its provisions. Finally, uniform international sales law only achieves its objectives of reducing the costs of knowing applicable law if it is, in fact, uniform among the multiple jurisdictions that apply it. As we will see, the ability to achieve that goal is constrained both by the structure of the CISG itself and by practical issues involved in applying it.

1.2.2 The limits of uniform international sales law

Even if parties would prefer uniform law, the discussion above concerning the objectives of commercial law indicates that commercial actors will not simply care about having a discrete set of uniform rules that govern their transaction. They will also care about the substance of those rules. The success of the CISG, therefore, might be measured not simply in terms of whether states have adopted it. Success, instead, may be measured in terms of whether the legal rules and risk allocations incorporated into the CISG actually reflect the terms to which the commercial parties whose transactions are governed by it would otherwise have bargained. In short, the success of the CISG might be better judged in terms of whether it reduces transaction costs for the parties to whom it applies.

On this standard, the CISG deserves mixed reviews. Certainly, uniformity reduces transaction costs related to discovering and evaluating the relevant law of multiple different jurisdictions. But even on that score, the CISG is somewhat imperfect because uniformity in the form of widespread adoption of the CISG provides only a very incomplete measure of homogeneity in the law of international sales and in international sales transactions.

The first constraint on uniformity is that the CISG contains a strong rule of party autonomy or freedom of contract. Article 6 of the CISG permits parties to derogate from any of the legal principles that might otherwise apply. In effect, Article 6 provides that all of the rules set forth in the CISG are default rules that can be circumvented by agreement of the parties. As indicated above, this type of provision is perfectly appropriate, since legal rules are written for the general type of transaction, and parties should be free to adapt the risk allocating rules that govern their particular transaction if the general provisions do not offer an adequate fit to their circumstances. In short, making commercial rules mandatory rules rather than default rules would not necessarily reduce transaction costs. But one effect of embracing a rule of party autonomy is that the rules that apply to international sales contracts will not necessarily reflect the "uniform" rules set forth in the CISG.

Second, with respect to some legal principles, the CISG allows Contracting States to deviate from the rules set forth in the CISG, so that different Contracting States will have different versions of the CISG. For instance, Article 96 permits a Contracting State that has domestic law writing requirements for the formation of contracts to declare that parties located in its jurisdiction will not be bound by the provision in the CISG that eliminates such requirements. Article 95 permits a Contracting State to declare that it will not be bound by Article 1(1)(b), which determines the applicability of the CISG when fewer than all of the parties to the relevant contract have their places of business in a Contracting State. In addition, while Articles 46(1) and 62 permit the seller and buyer, respectively, to require specific performance of their contracts when the other party defaults, Article 28 subjects that right to the law of the forum in which the dispute is heard. Finally, as we will see in Chapter 2, the CISG does not purport to cover all aspects of an international sales transaction. Some issues, such as the validity of certain terms in an international sales contract, are specifically excluded from the CISG. The result is that such issues will be governed by the application of domestic law.

For the most part, these variations are not a consequence of commercial needs. Rather, they reflect political compromises that were struck in order to achieve consensus among those nations involved in drafting the CISG. But the very fact that the provisions serve political constituencies rather than commercial ones indicate that the subsequent rules will not only lack uniformity, but will also have objectives other than the reduction of transaction costs for the parties whose contracts are governed by the CISG.[3]

The third, perhaps more important constraint on uniformity, is that the CISG, like any statutory scheme, contains numerous provisions that require interpretation. Terms like "reasonable," "good faith," or "fundamental breach" require clarification in individual circumstances. The use of such vague terms is a function of two phenomena. Any statutory regime that purports to cover a broad set of transactions, ranging from one-time purchases of a truck to long-term supply contracts for the delivery of coal, cannot easily provide specific rules that will be appropriate for all relevant transactions. Thus, relatively imprecise terms are inevitable, and the specific nature of the obligation embodied in the rule will depend on the individual aspects of the transaction. A reasonable time for a seller to cure a defective delivery of lumber, for example, is likely to vary from the reasonable time for a seller to cure a defective delivery of tomatoes.

But some of the vagueness of the CISG is attributable to the same need for political compromise that allows Contracting States to opt out of various provisions. The CISG was drafted by diplomats and professors, not by commercial parties. It is a plausible conjecture that the objective of the drafters was to create a treaty that would be widely acceptable,

3 See Clayton P. Gillette and Robert E. Scott, The Political Economy of International Sales, 25 *Int'l. Rev. L. & Econ.* 446 (2005).