

GLOBAL TRADE LAW SERIES

CISG EXCLUSION AND LEGAL EFFICIENCY

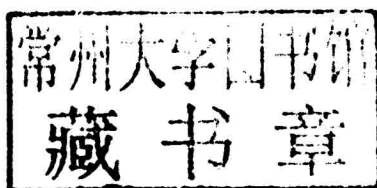
Lisa Spagnolo



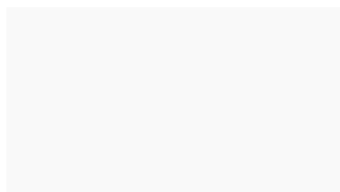
Wolters Kluwer
Law & Business

CISG Exclusion and Legal Efficiency

Lisa Spagnolo



Wolters Kluwer
Law & Business



Published by:
Kluwer Law International
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.kluwerlaw.com

Sold and distributed in North, Central and South America by:
Aspen Publishers, Inc.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@aspenpublishers.com

Sold and distributed in all other countries by:
Turpin Distribution Services Ltd
Stratton Business Park
Pegasus Drive, Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
Email: kluwerlaw@turpin-distribution.com

Printed on acid-free paper.

ISBN 978-90-411-5407-1

© 2014 Kluwer Law International BV, The Netherlands

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without written permission from the publisher.

Permission to use this content must be obtained from the copyright owner. Please apply to: Permissions Department, Wolters Kluwer Legal, 76 Ninth Avenue, 7th Floor, New York, NY 10011-5201, USA. Email: permissions@kluwerlaw.com

Printed and Bound by CPI Group (UK) Ltd, Croydon, CR0 4YY.

Global Trade Law Series

VOLUME 48

Series Editors

ROSS BUCKLEY

*CIFR King & Wood Mallesons Professor of International Finance and Regulation,
UNSW, Sydney, Australia.*

ANDREAS ZIEGLER

*Professor, Faculty of Law and Criminal Sciences, University of Lausanne,
Lausanne, Switzerland.*

Advisory Board

Kenneth W. Abbott, *Professor of Law and Global Studies, Arizona State University,
Tempe, Arizona.*

William Alford, *Professor of Law, Harvard Law School, Cambridge, Massachusetts.*

Bhupinder Chimni, *Professor of International Law, Jawaharlal Nehru University,
New Delhi.*

Bradly Condon, *Professor of Law, Instituto Tecnologico Autonomo de Mexico, Mexico
City.*

Thomas Cottier, *Professor and Director of the World Trade Institute, University of
Berne, Berne.*

Martin Davies, *Professor & Director, Maritime Law Center, Faculty of Law, Tulane
University, New Orleans.*

Xiang Gao, *Professor of Law, China University of Politics and Law, Beijing.*

Patricia Hansen, *Professor, Faculty of Law, University of Texas, Austin, Texas.*

Faizel Ismail, *Head, Delegation of South Africa to the WTO.*

Yong-Shik Lee, *Professor of Law, St John's University, New York.*

Petros C. Mavroidis, *Professor, Columbia University School of Law, New York,
and University of Neuchatel, Switzerland.*

Mitsuo Matsushita, *Professor of Law, Seikei University, Professor Emeritus, The
University of Tokyo, Japan.*

Armand de Mestral, *Professor of Law, McGill University, Montreal. Ernst-Ulrich Peters-
mann, Professor and Head of Law Department, European University Institute, Florence.*

Asif Qureshi, *Professor of International Economic Law, The University of Manchester,
Manchester.*

Aleka Sheppard, *Professor & Founding Director, London Shipping Law Centre,
University College, London.*

Jeff Waincymer, *Professor of International Trade Law, Faculty of Law, Monash
University, Melbourne.*

Jayashree Watal, *Counsellor, Intellectual Property Division, World Trade Organization,
Geneva.*

About the Author

Lisa Spagnolo is a member of the Law Faculty at Monash University, Melbourne, Australia. After graduating from Deakin University with first class honours and receiving the Supreme Court Prizes for best graduating student and honours paper, Lisa practised at Minter Ellison in litigation, banking and insolvency, later joining the faculty at Monash, lecturing in Land Law and Contracts, and was awarded her PhD in 2012, winning the Mollie Holman medal for the thesis.

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.

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

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

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.

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

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.

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 Waincymmer. 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.

Table of Contents

About the Author	v
Foreword	xiii
Preface	xv
Publication	xvii
Acknowledgements	xix
CHAPTER 1	
Introduction	1
§1.01 General	1
§1.02 Scope of This Work	3
§1.03 Future Research	4
CHAPTER 2	
Birth of the CISG: Its Applicability and Nature	7
§2.01 Introduction	7
§2.02 The Birth of the CISG	7
§2.03 How the CISG Becomes Applicable	10
[A] Both Parties from Contracting States; Article 1(1)(a)	10
[B] One Party from a Non-contracting State; Article 1(1)(b)	12
[1] Court in Article 95 Declaration Contracting State	12
[2] Court in Non-declaration Contracting State	14
[3] Court in Non-contracting State or Arbitral Tribunal	19
[C] Both Parties from a Non-contracting State	20
§2.04 The Environment of Party Autonomy and the CISG as Soft Law	21
§2.05 Conclusion	23

Table of Contents

CHAPTER 3

Economics and the CISG	25
§3.01 Introduction	25
§3.02 Efficiency of Law	25
§3.03 Original Economic Aims	29
§3.04 Economics beyond Original Aims	38
[A] <i>Ex Post</i> Costs	38
[B] Penalty Default Rules and Information Asymmetry	41
[C] Least-Cost Avoiders	43
[D] Positive Externalities	44
[E] Network Effects	44
§3.05 Conclusion	45

CHAPTER 4

The CISG and Efficiency: Substantive Advantages and Disadvantages	47
§4.01 Introduction	47
§4.02 General 'Efficiency' of Substantive Design Features	47
[A] Designed for International Sales – <i>Favor Contractus</i>	48
[B] Formation and Formalities	53
[C] The Need for Notice	57
[D] Timing of Acceptance ('Receipt' versus 'Postal' Rule)	58
[E] Warranties and Notice	59
[F] Type of Damages	63
[G] Foreseeability Rule	64
[H] Price Reduction	67
[I] Limited Scope of Coverage, Ambiguity and Uncertainty	67
[J] Preliminary Conclusion	78
§4.03 'Efficiency' of Substantive Content from Inter Se, Comparative and Transactional Perspectives	78
[A] Advantages and Disadvantages – Inter Se	78
[B] Efficiency: Relative to Competing Law	80
[1] 'In Writing' Requirement	81
[2] Parol Evidence Rule	82
[3] Foreseeability of Damages	83
[4] Measure of Damages	85
[5] Formation and Missing Terms	86
[6] Formation ('Last Shot' versus 'Knock Out' Rule)	88
[7] <i>Favor Contractus</i> and Notice	89
[8] Preservation	94
[9] Certainty	95
[10] Quality	95
[11] Preliminary Conclusion	96
[C] Advantages and Disadvantages: Transaction Type	97

§4.04	Costs of Opting Out of the CISG as a Default Rule?	97
§4.05	Conclusion	98
CHAPTER 5		
	The CISG and Efficiency: Non-substantive Advantages and Disadvantages	101
§5.01	Introduction	101
§5.02	Learning Effects and Network Effects in the Market for Law	102
	[A] Boilerplate	102
	[B] Choice of Law	105
	[C] Features of the CISG Relevant to Non-substantive Efficiency	106
§5.03	Micro-level Efficiency: Advantages and Disadvantages for Individual Parties	107
	[A] Information Costs	109
	[B] Negotiation and Drafting Costs	112
	[C] Market Access: Neutrality	115
	[D] Performance Costs	117
	[E] Choice of Law Rules and Legal/Forum Risk	118
	[F] Litigation Costs	122
	[G] Competitiveness	123
	[H] Preliminary Conclusion	124
§5.04	Macro-level Efficiency: Jurisdictional Advantages and Disadvantages	124
	[A] 'Hubs' and Comparative Legal Expertise	125
	[B] Ethical Considerations	128
	[C] Administration of Justice	128
	[D] Retaining Existing Comparative Advantage	129
	[E] Preliminary Conclusion	130
§5.05	Critics and Overview of Overall Efficiency	131
	[A] Sophisticated versus Unsophisticated Parties and Quality of the CISG	131
	[1] Unsophisticated Parties	131
	[2] Sophisticated Parties	138
	[3] The Classification of Sophisticated versus Unsophisticated	141
	[B] Majoritarian versus Non-majoritarian	143
§5.06	Conclusion	146
CHAPTER 6		
	Lawyer Opt-Out Rates and Reasons	149
§6.01	Introduction	149
§6.02	Rates of Exclusion	150
§6.03	Factors in Lawyer Choices of Law	152
	[A] Unfamiliarity	152
	[B] Learning (Information) Costs	155
	[1] Education Differential	156
	[2] Dispute Work Differential	158
	[3] Domestic Law Differential	164
	[4] Preliminary Conclusion	165

Table of Contents

[C]	Bargaining Strength	166
[D]	Substantive Concerns	168
[E]	Market Sector	173
§6.04	Conclusion	180
CHAPTER 7		
	Interdisciplinary Analysis of Lawyer Choices of Law	183
§7.01	Introduction	183
§7.02	Rationality and Exclusions	184
[A]	Path Dependence	185
[B]	Agency, Heuristics, Moral Hazard and Lemons	189
[C]	Polar Herds, Critical Mass and Game Theory	195
[1]	Group Polarization and the Norm of Automatic Opt-Outs	195
[2]	Game Theory and the Strategy of Automatic Opt-Outs	197
[D]	Iteration, Network Effects and External Shocks	203
[1]	Group Polarization: Environmental Change and New Norms	204
[2]	Game Theory: Altered Cost-Benefits and New Strategies	204
[E]	Internalization of Information Costs and Transparency	206
[F]	Institutionalization of Choice of Law	208
§7.03	Evidence of Changes since 2008	212
§7.04	Conclusion	218
CHAPTER 8		
	Interpretation in Light of Reasons for Exclusion and Efficiency	223
§8.01	Introduction	223
§8.02	Vicious Circle #1: Litigation Frequency, Education, Familiarity and Information Costs	224
§8.03	Vicious Circle #2: Certainty, Scope and Substantive Concerns	226
§8.04	Other Interpretive Areas	227
§8.05	Conclusion	227
CHAPTER 9		
	Precontractual Liability and the Efficiency Dilemma	229
§9.01	Introduction	229
§9.02	Normative Lessons Learned	229
§9.03	Interpretive Methodology, Legislative Compromise and Good Faith	231
[A]	Interpretive Method	231
[B]	Legislative Compromise	232
[C]	The Nature of Good Faith	235
[D]	Majority and Minority Doctrinal Positions	239
[1]	Minority Group One: By Internal Interpretive Methodology Alone	239
[2]	Minority Group Two: By Internal Interpretive Method but Acknowledging Scope	242

	[3] Majority Group Three: By the Interplay between CISG and Domestic Law	243
	[4] Majority Group Four: Historical and Comparative Absence Approaches	247
§9.04	The 'Efficiency Dilemma'	248
	[A] Formal versus Substantive Uniformity	249
	[B] Efficiency versus Fairness	251
	[C] Stability versus Evolution	254
	[D] Preliminary Conclusion	255
	[1] Presence of a Sales Contract	260
	[2] Absence of a Sales Contract	263
§9.05	Inside Out: Doctrinal Viability of Minority and Majority Positions	265
§9.06	Conclusion	269
CHAPTER 10		
	Exclusion by Conduct of Legal Proceedings	273
§10.01	Introduction	273
§10.02	The Problem, Traditional Solution and <i>Iura Novit Curia</i>	273
	[A] The Typical Situation	273
	[B] Normative Lessons Learned	275
	[C] The Traditional Solution	278
	[D] The Principle of <i>Iura Novit Curia</i>	279
	[E] Diversity of Approaches and Outcomes	280
	[F] Critique of Traditional Solution	284
§10.03	Is There a Duty to Apply the CISG if it Is Not Plead?	285
	[A] Courts in Contracting States	285
	[1] Obligation to Apply the CISG	285
	[2] Displacement of Domestic Procedural Rules	290
	[B] Courts in Non-contracting States	292
	[C] Arbitrations	294
	[D] Appeals	297
§10.04	Can the CISG Be Excluded by Failure to Plead It?	298
	[A] Exclusion within the Original Contract	300
	[B] Post-contractual Exclusion	303
	[C] Exclusion by Failure to Argue	304
§10.05	Proposed Solutions	310
	[A] <i>Simpliciter</i> Application Ex Officio	311
	[B] Dismissal of the claim	311
	[C] Intervention by Warning and Invitation	312
§10.06	Conclusion	314
CHAPTER 11		
	Conclusion	317

Table of Contents

Bibliography	321
Index	351