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LEGAL INFORMATIVE NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALES OF GOODS - CISG: TOOL OR TRAP? COMPARATIVE ANALYSIS FROM A PRACTITIONER PERSPECTIVE

Introduction - As commonly known, the 1980 UN Convention on contracts for the international sales of goods- CISG governs contracts for the international sales of goods between private businesses, excluding sales to consumers, sales of services, and sales of certain specified goods.

The CISG applies to contracts for the sale of goods if both parties are located in Contracting States, when private international law leads to the application of the law of a Contracting State, or by choice of the contractual parties themselves, regardless of whether they are located in a Contracting State. Pursuant to Article 6 of the CISG, parties are also free, by agreement, to derogate from or vary a CISG rule or exclude the applicability of the CISG entirely.

The contract must concern "predominantly" the sale of goods rather than services.[1] A contract for the sale of goods to be manufactured will fall within the scope of the CISG unless the buyer supplies a "substantial" part of the materials necessary for the manufacture of the goods to be produced.

Among other, the CISG does not apply to sales of stocks, shares, investment securities, negotiable instruments or money.

In addition to addressing the formation of the contract, which is concluded by offer and acceptance, the CISG deals with obligations of the parties to the contract.

For example, the seller's obligations include delivering the goods in accordance with the quality and quantity as specified in the contract as well as the time and place for delivery, and the buyer's obligations include payment, taking delivery of the goods, and examining the delivered goods.

Other significant provisions of the CISG cover topics including remedies for breach of the contract, the passing of risk in goods sold, damages, anticipatory breach of contract, and exemption from liability for failure to perform.

To Exclude or Not Exclude? - A quick look at the reported cases of the CISG indicates that the civil law countries have dealt with the CISG more frequently than common law countries.

In addition, it can also be observed that the common law Countries in general have not applied the CISG as consistently as civil law Countries. So, while in general European businesses have widely accepted the applicability of the CISG, many international sales contracts exclude the applicability of the CISG especially in North American Countries and/or in Countries having a common law or an anglo-saxon legal system.

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[1] This Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services.

The easiest comment heard in practice to the question on why opting out from the CISG is "because everyone else drop out".

A second look is necessary to try to understand the rationale of such a choice.

In Canada International mining offtake agreements, for example allow mining companies to market and sell the products eventually produced from their mines. They often expressly exclude the CISG.

It is quite common for mining offtake agreements to include a clause which reads, for example:
"This Agreement shall be governed by, and construed in accordance with the laws of the Province of Ontario and the federal laws of Canada. The application of 1980 United Nations Convention on Contracts for the International Sale of Goods is expressly excluded".

As generally pointed out, there are many reasons for the exclusion of the CISG in mining offtake agreements.

First, very few Canadian courts have recognized the applicability of the CISG or analyzed the effects of its application. There is still much uncertainty surrounding the interpretation of provisions of the CISG and their applicability, such as the way in which the CISG applies to certain forms of intellectual property.

Canadian entities may be reluctant to apply the CISG in mining offtake agreements due to this uncertainty, as well as the lack of guidance and commentary in Canadian jurisprudence.

Lawyers may also be unfamiliar with the terms of the CISG and aim to avoid the extra costs of "getting up to speed", which will either be borne by their clients or absorbed themselves. This may cause lawyers to favour domestic laws, to which they are more familiar, in transactions where the CISG would otherwise apply.

The parties involved in a transaction may also already have a well-established contractual relationship with one another under some set of domestic law rules, and therefore, might prefer to avoid implementing new rules under the CISG.

Companies may have also decided to opt out of the CISG early on in their operations, and continue to treat that decision as standard.

In certain transactions, the laws of the contracting parties may also be similar to each other. Therefore, it may make more sense for one of the parties to abide by the other's domestic laws throughout the transaction rather than apply the CISG, even if both parties are located in Contracting States.

In general, parties may also choose to opt out of the CISG due to the possibility of inconsistent interpretations by courts in different countries. Judges sometimes have difficulty interpreting certain provisions of the CISG and therefore rely on more familiar domestic legal concepts. Inconsistencies due to translation errors may also arise, since the CISG is written in multiple languages.

Based on my experience with US businesses, the situation is not different in the USA.

It comes as a great surprise to many American businesses and lawyers that the UN CISG – and not the UCC - may be the law applicable to a contract. Because the US has signed and ratified the CISG, its provisions qualify as American federal law, thereby pre-empting state law. Unless specifically excluded, the CISG – and not the UCC – is applicable to any contract that falls within its scope.

As commonly known, if the parties to a contract do not want the CISG to apply, the contract must contain an express exclusion. A simple clause, such as "this contract shall be governed by the law of the State of New York" will not suffice because, as explained above, the CISG is New York law. A specific reference such as the following is recommended:

The parties hereby agree that the United Nations Convention on Contracts for the International Sale of Goods will not apply to this contract.

The CISG does allow parties to opt out of some but not all of its provisions – as long as the specifics of the partial opt-out are clearly spelled out in the contract.

The CISG also generally allows the parties to opt in for contracts for services or for a combination of services and goods.

This option is rarely used in international sales transactions, as long as businesses tend to either accept or exclude entirely the application of the CISG.

Differences Between the CISG and the United States Uniform Commercial Code - UCC - There are some significant differences between the UCC (state law generally applicable to domestic contracts) and the CISG.

When the CISG applies, the parties may make incorrect assumptions concerning the existence of a contract between them.

Missing Terms - For example, under the CISG, a contract may fail for indefiniteness if neither the price nor a specific method for determining a price is specified whereas under the UCC this would not be the case. Where a court is called upon to supply the price under the CISG, the court will determine the price generally charged at time of conclusion, whereas under the UCC, the standard is the reasonable price at the time of delivery.

The CISG also provides that an otherwise revocable offer becomes irrevocable as soon as the offeree mails an acceptance, or if the offeree relies on it, thereby giving rise to a potential claim for full contractual damages rather than simply a reliance interest or other quasi-contractual or equitable remedy.

Revocability of Offers - Under the CISG, if the offer includes a date by which it may be accepted, the offer is deemed irrevocable until that date. Under the UCC, however, an offer is revocable until it is accepted unless the fairly stringent requirements for a "firm offer" – including separate written assurances- have been fulfilled.

Statute of Frauds - Unlike the UCC, the CISG does not require that the parties put their agreement in writing nor does it impose any other obligation as to form. Under the CISG, a contract may be proved by any means, including by witness testimony.

Businesses are therefore advised to pay particular attention to the keeping of records during negotiations in order to adequately protect themselves against a claim that a contract was formed under the CISG in the absence of a writing or that the terms of a contract are other than, or in addition to, those that appear in a written contract or exchange of writings.

Battle of the Forms - If there is not a perfect match between the offer and the acceptance – a situation which arises regularly where the buyer and the seller each use their own standard forms – the terms of the contract will be different under the CISG and the UCC.

The CISG uses the "mirror-image" rule: any difference between the terms of the offer and the acceptance will convert the acceptance into a counter-offer which, typically, will be accepted by performance of the contract. As a result, the "last shot" rule applies, i.e. it will be the terms of the acceptance/counteroffer that control whereas, under the UCC's "knock-out" rule, the terms of the contract would be only those to which both parties have agreed.

Buyers may, then, have a strong interest in opting out of the CISG in order to avoid having all of the seller's terms (including those appearing in the boilerplate clauses) apply to the purchase and sale.

Conclusion regarding the USA situation - There has been significantly more litigation concerning the UCC than the CISG in the United States.

The extensive case law interpreting the UCC may lead American businesses to feel that there is a greater degree of legal certainly under the UCC. In order to have the UCC apply, specific reference to, and exclusion of, the CISG must be make in all international contracts for the sale of goods.

The CISG in CHINA - It has been 25 years since the CISG came into effect in China. During these years, the CISG has been an important applicable law and business criterion universally accepted by law practitioners governing disputes over foreign-related contracts of sale.

Said that, China acceded to the CISG with reservations to Article 1(b) and Article 11 (contract not necessarily in written form) as permitted by Article 95 and Article 96. The latter reservation has just been withdrawn in 2013.

The former reservation that opts out of Article 1(b)[2] restricts to a large extent the application of CISG. It forms a situation in China where most cases of foreign-related contracts for the sale of goods are governed by the Contract Law of the People's Republic of China ('China Contract Law', or 'CCL'). Comparatively fewer numbers of cases are governed by CISG.

Given the dramatic increase of China's import-export trade, maintenance of this reservation has progressively revealed its adverse effect on the Chinese foreign-related commercial law system. Limitations on the application of CISG are also not beneficial to fairly settling disputes over international sale contracts.

The CISG in AUSTRALIA - I gathered some interesting information from Australian colleagues regarding the application of the CISG in their home Country.

Considering that the Australian States have adopted the CISG on April 1, 1989 only 22 cases were reported which is not an abundant use of the CISG. The routine exclusion of the CISG appears still to be prominent. As an example the Federal defence department in their supply contracts routinely excludes the CISG.

The real issue is that courts and counsels have not yet grasped the fundamental issues and advantages of the CISG. It is indeed a fact that recognition of laws emanating from conventions or soft laws like the UNIDROIT Principles is difficult if and I quote an Australian Professor - "nobody knows that it is there, [therefore] the new law has little capacity to shape behaviour."

This is certainly the case in Australia as the interpretation and application of the CISG exhibits a clear lack of applying the underlying principles of the CISG. Furthermore a recent research undertaken by Professor Lake[3] indicates the obvious. 9% of international and 55% of British respondents were unfamiliar with the UNIDROIT Principles . It can be assumed that the Australian response would have been the same.

It is argued that several "structural dogmas" inhibit a successful uptake of the CISG. The system of application and interpretation of international instruments is not compatible with a general common law approach of the application of precedents within a hierarchical system. Contract law in general is heard by state courts and on occasions federal courts, likewise in the US.

The High Court has not yet decided a case hence there is no binding precedent on the CISG which can guide all courts in Australia.

Also academic writing does not enjoy the same significance as in civil law countries and as a result guidance from these sources has not been consulted.

Conclusion - Determining whether to opt in or opt out of the CISG requires nuanced analysis, and it is no surprise that many manufacturers simply throw up their hands and opt out.

We urge you not to do that, but instead to examine the issue carefully so that you reach the right decision, not necessarily just the easy one.

Riccardo G. Cajola

[2] (1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:
(a) when the States are Contracting States; or
(b) when the rules of private international law lead to the application of the law of a Contracting State.

[3] Lake, S., An empirical Study of the UNIDROIT Principles – International and British Responses, Unif. L. Rev. 2011, 669,