

Introductions to the CISG for the Practitioners

This paper formed the basis for remarks given by Albert Bloomsbury on Friday, September 23, 2011 at the Section's Seasonal Meeting in Panama

Introduction

The U.N. Convention on Contracts for the International Sale of Goods (the "CISG") is an important international treaty that governs contracts for the international sale of goods between businesses. The purpose of the CISG is to provide a modern, uniform and fair regime in this area. Thus, the CISG contributes significantly to introducing certainty in commercial exchanges and decreasing transaction costs. Over three decades it has gradually increased its influence. The United States is one of among 77 nations that have adopted the CISG.

The good news is that the practitioners have no reason to fear the CISG. The CISG is actually good for your practice and for your clients that trade internationally because it was created exactly for the benefit of the international sale of goods.

Although the CISG is now generally accepted, at the beginning, in the same way that people do not immediately accept a new technology, the business and legal communities were slow to embrace the new, more superior solution to cross-border sales. Twenty years ago, most of the practitioners in the U.S. and elsewhere in the world had reason to stay away from the new regime.

But now, times have changed and practitioners should embrace the CISG and use it to their advantage. During the last two decades, acceptance of the CISG has increased both in terms of the number of countries that have acceded to the Convention, and its real-life acceptance, exemplified by increased familiarity of the courts and arbitrators with the CISG as well as a corresponding increase in the volume of case law all over the world. These factors have changed the playing field in favor of the CISG. A critical mass has emerged.

A contract is an agreement of two or more parties, so the acceptance of a set of rules by more than a minimum percentage in the market dramatically changes the rules of the game. A small percentage of players in the market who insists on the use of the CISG can influence the silent majority, and that is especially the case because these determined minorities have the veto power against opting-out of the CISG (or no deal). We can draw similar examples in the acceptance of new technologies such as e-commerce and other telecommunication protocols. Those who refuse to follow the change of a tide will be left behind, in the similar way that those who refused to embrace e-mails and other information technologies lost their business. For attorneys, that means that ignoring the CISG factor in your client service would mean the risk of

economic loss to your client. The CISG, and failure to advise regarding the same, has now become one of the serious risk areas for a disciplinary action against an attorney.

Basics

Under the U.S. legal system, the CISG is a self-executing treaty. It is the law of the land under the federal Constitution's Supremacy Clause. Therefore, the CISG supersedes state law to the extent of CISG's subject matters, for instance the formation and termination of a contract, performance and damages. In other words, under the Supremacy Clause of the U.S. Constitution, the CISG is a part of New York law as much as any other federal law is a part of the overall law enforced in New York's courts. It is therefore important for the practitioner first to understand the threshold issues—when the CISG applies and supersedes state contract law, and to what degree.

Threshold issues when negotiating and drafting a contract, including the importance of forum choice

The practitioner must ask the questions as to who the parties to the prospective contract are and where the locations of the parties' businesses are with respect to that sale, and what is the subject matter of the contract.

In general, the CISG applies when two businesses of different CISG member countries enter into a contract to sell goods. In addition, the CISG also applies when an international sales contract is governed by the law of a country that is a member nation of the CISG under the private international law rule (or conflict of laws rule) of the forum. The latter, however, has a notable exception as the member states may make an Article 95 declaration not to apply this provision, and the United States is one of a few countries that has made that declaration. If a U.K. corporation that is conducting a business in France through a branch sells wine to a business buyer located in the United States as a part of the branch's business activities, the CISG applies because the place of business of both the seller and buyer are located within different CISG member countries (i.e. France and the U.S.) even though the seller is a resident of a non-CISG country (i.e. the U.K.). Note that the CISG's scope of application is determined based on the parties' "places of business," not residency, so that a practitioner must dig into the facts carefully and may have to do some research of case law because your client's or the other party's continuous business activities through an agent or other arrangement in a country outside the headquarter location may create a

“place of business” in such a country for purposes of the CISG.

If the contract pertains to the sale of securities, such as a negotiable instrument, or that of a ship or aircraft, or if the buyer is a consumer, it is not subject to the CISG. When the contract is predominantly about the construction of a structure for the buyer, the CISG does not apply even if the service provider ships its own materials overseas to finish the work.

A practitioner also must consider relevant peripheral issues that affect the application of the CISG such as the forum and governing law of the contract, which still applies to the matters not covered by the CISG, such as the property rights and provision of services.

Forum choice can significantly affect the outcome. Practitioners should be aware that, depending on how the designated court or arbitrator applies the CISG when one of the parties is a business of a non-CISG country, the choice of forum can significantly affect the outcome, and plan accordingly. For example, assume that a contract includes a London arbitration clause for a sale between Brazilian and Indian businesses and New York law is the applicable law under the private international law rule. The London arbitrator is arguably not bound by the U.S.’s Article 95 declaration, which limits the application of the CISG, but a question arises at the enforcement of an arbitral awards under the New York Convention in the U.S. The answer depends on whether or not the enforcing forum, a U.S. court, can laterally invoke the United States’ Article 95 declaration to deny the enforcement for manifest disregard of law under the U.S. domestic law, Federal Arbitration Act, despite the very limited basis of denial of enforcement under Article V of the New York Convention. This illustrates one of the most challenging issues that practitioners must think of. A more practical approach would be to choose the right forum and applicable law when an Article 95 declaration might cloud the picture.

There is an argument that parties may affirmatively choose the CISG as governing law, for instance by designating “New York law including the CISG” in their contract where at least one party’s place of business is in a non-CISG country. However, there remains uncertainty whether or not a U.S. court would actually honor this type of affirmative opt-in. Although an Article 95 declaration merely states that the United States is “not bound by” the provision that requires the CISG to apply to an international sale where the private international law rules lead to the use of the law of a CISG member state, some courts appear to view this language in a more restrictive manner.

A practitioner should anticipate these issues in advance and plan ahead to maximize their client’s objectives for clear, predictable results without incurring a risk

of the mess of prolonged international litigation on the threshold issues. Similar issues must be dealt with when a practitioner handles the situation where one of the parties is from a CISG country that made an Article 96 declaration so that that country requires the written form in the formation of a contract while the other party’s home country does not. This declaration also poses a practical issue in the age of e-commerce because the parties would be forced to take the traditional paper-and-ink method of formality to enter into a contract.

If the goods that are sold under a sales contract subject to the CISG are located in a third country, say for example in Kyrgyzstan as your U.S. client buys uranium ore sitting in Kyrgyzstan from a Russian business, the property right matter is arguably governed by the law of that third country and not by the CISG because the CISG does not cover such property rights.

If a sales contract under the CISG includes an after-care maintenance obligation of the seller, or the sale is subject to a security interest, those extra elements that are beyond the scope of the CISG will be governed by the applicable law of the contract. The practitioner must also become familiar with the U.S. federal case law on the U.S. Constitution’s Supremacy Clause and federal pre-emption matters in general to understand which state law provisions are likely to survive when the CISG governs the sale.

Litigating the CISG cases

If you are a litigator, you must watch carefully whether the CISG actually applies where the contract is silent about the CISG. Following are the issues that a litigant should pay attention to if the case is in the United States (some of these issues are also valid when the case is handled elsewhere):

- (i) If the contract assumes domestic law provisions but in fact the CISG applies, you must stitch together the rules of the CISG, the portion of the state law that survived the CISG’s pre-emption and the contract provisions themselves to determine how the contract should be interpreted. Certain merger provisions may not be applicable because the CISG spares the form requirement and there is no parole evidence rule or statute of frauds, so you might want to secure eyewitnesses to corroborate your client’s position.
- (ii) If you are defending, you may want to remove the case to the federal court, which is usually more familiar with the CISG, because any contract that is subject to the CISG involves a federal question under the U.S. Constitution’s Supremacy Clause and you may invoke the federal district court’s jurisdiction.

(iii) If you are dealing with an appellate case and if the lower court totally overlooked the CISG issues because neither party thought that the contract was subject to the CISG, you will have to do careful research on how to approach the issue under the particular jurisdiction's judicial administration rules. Technically, if a U.S. domestic court does not apply the CISG when it should, it's not only a violation of the Supremacy Clause of the Constitution but also of the U.S.' international obligation under public international law to faithfully observe the treaty provisions, and that problem vexed the U.S. Supreme Court in the *Medellin* case in 2008. So, in search of the ways to overcome the procedural challenges to help your client, the practitioner may want to think about every possible way to help the court to invoke an extraordinary measure and/or to take judicial notice to fix the serious breach of the United States' obligation under international law and constitutional violation.

(iv) Also, the practitioner must think carefully about whether a contract may have been accidentally formed under the CISG under a disputed fact pattern where only patchy written records exist. So, as a litigator, if you do not ask the right questions when your client comes to your office for the first time, you may make a huge mistake based on wrong assumptions. The four corners of the client's contract do not always reveal the whole picture, and your summary judgment motion for the plaintiff based on the paperwork may be denied with higher probability under the CISG. So you may have to budget for the discovery when you sign an engagement letter with your client.

Bottom line

The savvy practitioner should think about how to take advantage of the CISG because most of the provisions of the CISG are default rules that only apply where the parties do not address specific matters in the contract. Therefore to reach the desired result, he or she must understand the CISG's default rules and then decide how

they can be modified under party autonomy and through contract negotiations.

It must be pointed out that opting-out of the CISG itself is an option under party autonomy, but that can be done only when both the parties agree, so the opt-out itself can become a part of contract negotiations if both parties do not agree on this point. Second, to opt-out, the parties must insert specific language that the CISG will not apply. For instance the contract should say that the parties agree not to be governed by the CISG and instead governed by the laws of, for instance, the State of New York, without regard to the CISG. Simply putting the applicable law as New York law does not achieve the opt-out because technically speaking, the CISG forms a part of New York Law.

Also, from a practical perspective, returning to the earlier Kyrgyzstan example, opting-out may not be a wise decision because it can significantly increase uncertainty of the outcome. That is because the forum may not necessarily honor the parties' choice of law in the contract when parties opt-out of the CISG, and the forum may end up pointing to the law of an unfamiliar country like Kyrgyzstan, the location of the goods. And then, the forum may decide to use the CISG as adopted by Kyrgyzstan, negating the opting-out, or the domestic law of Kyrgyzstan without regard to the CISG, and in either case the result may be a total surprise to your client.

As compared to the "exotic" or "ancient" law, the CISG reflects modern international commerce and gives more predictability and reasonable results in the context of international sales. It has become better known by all the serious international economic players, including reputable practitioners of international law. Rather than spending energy thinking about how to opt-out of the CISG without a side effect, practitioners should be prepared to give a client advice as to which provisions of the CISG are likely to work for or against their objectives.

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