

DOES YOUR COMPANY KNOW WHAT LAW APPLIES TO ITS INTERNATIONAL SALES CONTRACTS?

Developing a Deeper Understanding of the U.N. Convention on Contracts for the International Sale of Goods

By Matthew Bradshaw

At a seminar earlier this year, I presented on legal issues that companies should consider when engaging in international business. At the outset of my presentation, I polled attendees to gauge their general familiarity of the United Nations Convention on Contracts for the International Sale of Goods (the “CISG”). Perhaps predictably, the vast majority of the attendees were unfamiliar with the CISG and only one attendee responded that he maintained a good working knowledge of the differences between the CISG and Article 2 of the Uniform Commercial Code (“UCC”).

What Is the CISG?

The CISG was adopted by the United Nations in 1980, formally ratified by eleven nations (including the United States) in 1986, and went into effect on January 1, 1988. The CISG represents an effort to establish a uniform international law relating to the purchase and sale of goods. A sale is deemed to be international when the parties to the underlying agreement reside in different “contracting states” (i.e., differing nations which have formally adopted the CISG). Currently, it is estimated that more than 80% of world trade flows between contracting states.

International treaties, such as the CISG, are the supreme law of the United States under the Supremacy Clause of the U.S. Constitution and will apply, in all cases, unless the parties expressly exclude or vary the CISG’s application. For example, a clause which reads, “This Agreement shall be governed by the laws of the State of Idaho,” would be insufficient to exclude or limit the application of the CISG to the contract in question. Rather, well-informed lawyers and business professionals will use much broader language such as the following:

“This Agreement shall be governed by the laws of the State of Idaho and Article 2 of the Uniform Commercial Code as enacted in the State of Idaho as amended from time to time. Pursuant to Article 6 of the United Nations Convention on Contracts for the International Sales of Goods (CISG), the parties expressly exclude application of the CISG in its entirety to this Agreement.”

The latter construction expressly excludes the CISG’s application, while the former construction did not. In perhaps the most famous (or infamous) case relating to this issue, a federal court held that the inclusion of a choice of law provision which simply states what law governs, without mentioning or excluding the application of the CISG, was insufficient to opt-out of application of the CISG. See *Eason Automation v. Thyssenkrupp Fabco., Corp.*, 2007 U.S. Dist. LEXIS 72641 (E.D. Mich. 2007). You should review the language of purchase orders, order acknowledgements, distribution agreements, supply agreements, sales agency agreements, and other international sales contracts to determine if your company’s contracts are currently unintentionally governed by the CISG.

How Does the CISG Differ from the UCC?

Depending on the facts and circumstances involved in your international business relationships, it may be worth a deeper review and analysis to determine whether, in some cases, the CISG’s application may be desirable. Two prevalent issues are summarized below.

“Battle of the Forms”

“Battle of the forms” is a term lawyers generally use to describe the scenario when two businesses are negotiating the terms of a contract and each party wants to contract on the basis of its own standard terms. The typical battle results when party A offers to buy goods from party B and includes in its offer its standard terms and conditions. In response, party B may purport to accept the underlying offer on the basis of party B’s standard terms and conditions. Interestingly, the determination of which party’s terms and conditions govern may largely depend on whether the CISG (generally pro-seller result) or the UCC (generally pro-buyer result) governs the transaction.

Best practices suggest you should invest in creating a standard agreement which you can use for similar transactions. Experienced legal counsel can prepare a standard form that will provide generally reasonable terms but subtly tilt the

scale on any material terms your business cannot live without. Where the economics and business leverage make sense, my recommendation is to prepare a form agreement for repeated use, rather than passively waiting for the other side to send you its standard form. I have witnessed this approach in numerous business relationships with good success and desirable outcomes. Further, if you are the seller, you might consider if application of some (or all) of the CISG's provisions would give you an advantage over the buyer in your international sales contracts.

Non-Conforming Goods

Perhaps because of the realities and expense of international trade, the rules relating to non-conforming goods are more flexible under the CISG than the UCC. The UCC requires a "perfect tender" to be made. That is, the buyer has the legal right to reject goods that fail in any aspect to conform to the contract. The CISG uses a "fundamental breach" standard. That is, the buyer may decline receipt of the product and void the underlying contract if the error constitutes a fundamental breach of the sales contract.

A simple hypothetical can further illustrate the difference between the two standards. Imagine you are a producer of carbon steel disks used in the manufacturer of a disk harrow farm implement. You produce these disks in a number of sizes and varieties to match the harrow into which they will be installed. Further, given the disk harrow market, your customers may ask that the outside casing and supporting supports around the disks be manufactured in a number of color schemes to match the ultimate color of the harrow into which they are to be installed. Perhaps a customer orders 500,000 red-cased disks of a certain size. However, due to a warehouse error, 500,000 of the green-cased disks matching the same dimensions are shipped to buyer. Under the UCC, there would be no question that the buyer can reject the goods as they were not the ordered color and failed the perfect tender standard. However, the inquiry is more difficult if analyzed under the CISG. Is the color of the harrow's outside casing material to the transaction? Perhaps. But, perhaps not. If the casing is wholly or mostly hidden from view once the disk harrow is completely assembled, then the nonconformance arguably is not "fundamental" and the disks must be accepted

by the buyer. Ignoring, of course any fundamental differences in "red" vs. "green" tractors and farm implements which may always be fundamental to the farmer.

The analysis would be easier if the size of the disks did not match the buyer's needed specifications and would not fit properly into the harrow. In that scenario, whether analyzed under the UCC or the CISG, the size of the disks would be fundamental and the buyer would have the right to reject the product.

So What Should I Do?

Whether your international relationships are well established or only beginning to develop, it is worth considering (or considering again) for the current contractual structure for your international sales relationships, and whether the choice of law provision in your contracts should be modified to exclude portions or the entirety of the CISG.

Still struggling to know where to start? Give us a call or drop us a note. We are available to help!

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