

Contracting for the Purchase and Sale of Goods in a Risky Global Market

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Abstract: There is little doubt today's ISM members now work in a truly global market. As a result, simply understanding the laws of one's own state or nation is no longer enough. Rather, ISM members must know how to contract globally, and must understand the risks with doing so. This paper attempts to provide ISM members a practical discussion of global contracting with respect to the commercial sale and/or purchase of goods, including general overviews of the applicable laws that may govern domestic and international agreements, and a discussion of how international contractual relationships might differ from domestic counterparts. A solid understanding of this paper and its subject matter should provide readers the concepts, theories, and practical considerations necessary for drafting, interpreting, and negotiating on both a domestic and international level, with a particular focus upon risk identification and avoidance.

A. UNIFORM APPLICATIONS – THE UCC, CISG, AND/OR UNIDROIT:

What are the applicable uniform laws, conventions, and/or rules? Within the United States, the commercial sale or purchase of goods will generally be governed by some state-enacted version of Article 2 of the Uniform Commercial Code (UCC). Internationally, the transaction will frequently be governed by the United Nations Convention on Contracts for the International Sale of Goods (CISG). In many circumstances, the CISG will be further supplemented by the International Institute for the Unification of Private Law ("UNIDROIT").

When do these uniform laws, conventions, and/or applications apply? With the notable exception of transactions governed by the laws of Louisiana, some version of Article 2 of the UCC automatically applies to a commercial "sale of goods" within the United States and between residents of the United States. Conversely, the CISG will apply to an international "sale of goods" between parties, if residents of "contracting states" or nations to that convention. Notably, if only one party to the transaction resides within in a contracting jurisdiction, the CISG will not apply unless both contracting parties expressly agree. However, failure to expressly agree may result in the imposition of the national laws of one of the contracting parties, perhaps to the detriment of the other.

Is the CISG a "law"? The CISG applies only if parties agree to it, expressly or by implication. Moreover, contracting parties may expressly opt out of the provisions of the CISG through their contractual agreement. To ensure the opt-out is effective, the parties should clearly specify an alternate and mutually-agreeable choice of law.

⚠ CAUTION! Choice of Law Provisions: Even where the parties specifically, agree to the laws of a particular nation, or the UCC-enactment of a particular state, choice of law provisions within that nation or state could default to the CISG, if both parties are from "contracting states." Accordingly, it is vital that

contracting parties specifically exclude application of the CISG, if such is their intent.

B. SIMILARITIES BETWEEN THE UCC AND THE CISG: Both the UCC and CISG apply to the “sale of goods.” Neither applies to a mere services contract; however, either may apply to contracts providing for some mixture of services and goods. Additionally, goods may include equipment or inventory, but, as to the CISG, will not generally include goods bought by auction, shares of stock, investment securities or other intangibles, sales of ships or aircraft, or sales of electricity. Moreover, sales of consumer goods are not regulated by the CISG, but are regulated by the UCC.

Specific Similarities in Contract Interpretation: Contracts are often ambiguous in certain areas, and both the UCC and CISG provide similar methods of interpretation. To decipher ambiguities, both the UCC and CISG allow the use of course of dealing (or how parties have interacted through previous contracts); course of performance (or how parties have interacted throughout this contract); and usage of trade (or how other similar companies in the industry tend to act).

Specific Similarities in Warranties: Both the UCC and CISG also provide similar coverage for warranties, including, specifically implied warranties of merchantability (goods are fit for their ordinary purposes) and fitness for a particular purpose (goods match any purpose made known to seller, where buyer relied upon seller’s skill and judgment in choosing goods). These implied warranties may be found at sections 2-314 and 2-315 of the UCC and Article 35 of the CISG. Although the wording differs slightly between the UCC and CISG, both provide similar remedies for breach of warranties, including the right to “cover” (meaning to purchase alternative or replacement goods in case of a breach of contract), and consequential damages (loss suffered as a result of the breach, calculated in addition to the breach itself like lost profits).

Specific Similarities in Remedies: Under both the UCC and CISG, buyer’s rights will include delivery of conforming goods, and the right to receive the difference in the price paid versus the value of the goods received from seller. Under either, seller’s rights include forcing buyer to pay, take delivery, or perform its obligations, and recovery of lost profits.

⚠ **CAUTION! Damages Must be Foreseeable, But . . .:** The standard of “foreseeability” for damage recovery is far more relaxed under the CISG than under its UCC counterpart, allowing easier and greater recoveries for the non-breaching party. The CISG merely requires that the consequences of the breach be possible at the time of contract formation, whereas the UCC requires that the breaching party know, or have had reason to know, of the potential consequences. This creates a huge difference in potential liability for a breaching party under the CISG versus a breaching party under the UCC.

C. CRITICAL DIFFERENCES BETWEEN THE UCC AND CISG: While the UCC and CISG are similar in numerous respects, there are several differences between the CISG and UCC that create potential landmines for those unfamiliar with the CISG or international contracting, particularly regarding contract formation.

Differences in the Writing Requirement or, for the CISG, Lack Thereof:

Pursuant to section 201-1 of the UCC, a contract for the sale of goods for the price of \$500 or more is not generally enforceable *unless there is some writing* sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought. In stark contrast, Article 11 of the CISG provides that a contract of sale *need not be concluded in, or evidenced by, writing* and is not subject to any other requirement as to form. Under the CISG, the contract may be proved by any means, including witnesses. Stated simply, an oral conversation, by telephone or otherwise, is enough to create a contractual obligation under the CISG, and ISM members must be wary of such when negotiating with international counterparts from other signatory states.

△ **Electronic Contracts:** Under the UCC, “writing” requirements include any “intentional reductions to tangible form;” thus, electronic communications are enforceable. Electronic contracts are not specifically addressed under the CISG; however, given the possibility of oral contracts, it is difficult to believe electronic agreements would not be enforceable under the CISG.

Differences in Contract Formation – Offer and Acceptance: The UCC allows contracts to be formed even if the offer and acceptance do not exactly match. In fact, generally, only the price term is required to be included for there to be a valid contract. For all other provisions of the contract, the UCC provides “gap fillers,” or methods by which to interpret any differing terms or terms that are left out. Basically, if parties intend to contract, and there is some basis for a court to approximate a remedy, the contract will be legally enforceable under the UCC. All that is reasonably required by the UCC is a “definite and seasonable expression of acceptance or written confirmation.”

In contrast, the CISG follows a “mirror image” rule – the offer and acceptance must match in order to establish a contract. Any non-matching response to an offer operates as a rejection and becomes a counter-offer, creating many offer/counter-offer situations during which companies may negotiate, but during which there is no actual contract. Note that this applies only to “material terms,” including price, payment, quality and quantity of goods, delivery requirements, and liability issues. The CISG requires that both the quantity and the price terms be expressed; otherwise, no contract is formed.

Differences in Contract Formation – Timing: Once acceptance of an offer is placed in the mail, it becomes legally effective under the UCC, irrespective of whether the offeror has received the acceptance. The CISG has no such “Mailbox Rule.” Rather, acceptance only becomes effective when it reaches the offeror. Offers, rejections, and revocations also only become effective under the CISG upon reaching the appropriate recipient.

Differences in Contract Formation – Irrevocable or “Firm” Offers: Under the UCC, if an offer is irrevocable, it may only be held open for a maximum of three months. The CISG is far more flexible, and allows offers to be kept open as long as the parties desire – there is no maximum time limit. This open-ended timeframe can be dangerous if uncontrolled.

Differences in Available Remedies – Specific Performance: Specific performance is the right to require performance of the contract. Such is only allowed under section 2-711 of the UCC when other damages are inadequate. In contrast, the CISG, at Article 46, generally allows specific performance without pre-condition; however, courts are “not bound” to give specific performance unless the law of the forum state provides for specific performance in the given situation. Depending on circumstance, this may be an advantage or disadvantage to using the CISG.

Differences in Available Remedies – Penalty Causes: In many countries, penalty clauses are available to buyers, but not, as a general rule, under the UCC. The CISG is actually silent here, so applicable law will be the law that would apply if there were no CISG. This could potentially give rise to “surprise” penalties against sellers that do not expect or plan for this possible result.

Differences in Notices of Non-Performance: Both the UCC and CISG require buyer to give seller notice of non-conformities within a reasonable time after discovering same. This is to allow seller an opportunity to “cure” (make the goods conform). However, the CISG requires a much more specific notice than the UCC – the exact problems must be noted in detail. This has been strictly interpreted by a number of foreign jurisdictions, and failure here may leave an unwary buyer without a remedy.

Differences in Ownership: The CISG provides no guidance as to when title passes. Rather, the CISG defaults to national law. But, national systems can differ. Accordingly, it is best to include express provisions for passage of title in the contract.

D. SHOULD YOU AVOID THE CISG? If given a choice, many attorneys will advise their clients to avoid the CISG. Because it has not been litigated often in U.S. courts or elsewhere, there are, admittedly, ambiguous and unpredictable provisions which are open to interpretation. For example: are electronic contracts enforceable; what determines a fundamental breach; and what is the proper exchange-rate calculation? Rather than give a “one-size-fits-all” answer, we prefer that our clients consider, carefully, the differences between the UCC and the CISG; the party with whom our client is contracting; the cultural environment within which our client is contracting; and the specifics of the particular transaction. It may be that the CISG is preferable to some local national law what the other party would otherwise insist upon, or that our client would prefer the stronger or differing remedies that may be available under the CISG (as opposed to the UCC) in the event of the other party’s breach.

E. CHOICE OF LAW: The importance of an express choice of law cannot be overstated. For example, even a uniform law such as the UCC will have slight deviations from state to state that could yield unexpected surprises for the foreign party. For other uniform provisions, such as the CISG, certain items may simply not be addressed, such as passage of title, as mentioned above. In those situations, the CISG defaults to some national or local law by necessity.

Generally, and particularly within international transactions, parties will desire to use some neutral, fairly well-developed, law, such as those of New York or Sweden or Switzerland. Often, the parties may wish to avoid the laws of certain jurisdictions, such as France, China, Russia, or Mexico. To know if the law of a particular U.S. state, or a particular foreign jurisdiction, is available, we must first look at the contracting parties for sufficient jurisdictional contacts.

F. DISPUTE RESOLUTION: Choice of the dispute resolution method can be as important as choice of law, and may range from provisions escalating disputes to senior management, to provisions requiring formal mediation, to provisions requiring the use of some local court system, to provisions requiring the use of local or international arbitration. Obviously, escalation to senior management or use of mediation, prior to “formal” litigation or arbitration processes, tends to be the least expensive methods of dispute resolution. Moreover, the parties remain in control of these dispute resolution processes, and can often avoid outright adversarial confrontation in those nations where such is not generally considered culturally acceptable.

Local courts, meanwhile, may favor local businesses, and may not always be free from bias or improper influence. Even where such is not a concern, many local courts have long dockets and/or processes. However, use of such local courts may be the best (or only) choice for enforcing judgments.

Local arbitration in foreign jurisdictions may give rise to fewer concerns than would litigation in local courts. However, these are still frequently the subject of differing local rules/customs.

Meanwhile, issues with international arbitration can include difficulty obtaining emergency relief, and enforcing arbitration awards in jurisdictions other than where the award was made. The benefits with international arbitration should be speed, confidentiality, limited discovery, more knowledgeable fact-finders, and mature procedures if the proper entity is chosen.

CONCLUSION: The expansion of global contracting provides far more choices in terms of choice of law and choice of dispute resolution processes. At the same time, it provides more risks. The key is understanding the applicable laws that may govern your domestic and international agreements, and applying that understanding to your particular contractual relationship. Such is the only way to truly weigh, and, as appropriate, price your risks.